Competition Bureau Canada | Bureau de la concurrence Canada

Report of the International Roundtable on Efficiencies

Summary of Consultations with International Competition Authorities

COMPETITION BUREAU

Legislative Affairs Division, Competition Policy Branch

Gatineau, Québec

April 29, 2005

INTRODUCTION

On September 24, 2004, the Competition Bureau launched a national consultation process on the role of efficiencies under the *Competition Act*. To facilitate discussions, the Bureau prepared a consultation paper that provides an assessment of the experience under section 96 (the efficiency defence in the review of mergers), the evolving economic context, the international environment and the relative merits of the various options. Stakeholders were invited to submit their written comments on the paper. They also had the opportunity to participate at roundtables held across Canada in January 2005.

The Competition Bureau also organised a meeting with various competition authorities around the world to obtain insights on the role of efficiencies in competition policy, specifically the practical issues relating to the consideration of efficiencies in their jurisdictions. Participants at the meeting included representatives from Australia, Canada, European Union, Mexico, the United Kingdom and the United States. Representatives from Ireland, Israel and Germany were unable to attend. This report is supplemented with written contributions from Germany, Japan, Norway, Sweden and South Africa.

The consultation process is complemented by the work of an advisory panel that is looking at the role of efficiencies in the Canadian economy of the 21st century.

This report is a summary of the discussion that took place during the meeting. It provides highlights of each participant's policies on efficiencies and their views on specific issues raised by representatives from the Competition Bureau.

A. TREATMENT OF EFFICIENCIES IN OTHER JURISDICTIONS

Participants were asked to provide a brief overview of their approach to efficiencies in the review of mergers. More specifically, participants were asked to address the following points:

- Whether their approach is set in legislation or guidelines;
- What is the policy reasons underlying their approach;
- What type of efficiencies are generally considered;
- Whether the approach requires that efficiencies bring benefits to consumers;
- What are the practical issues relating to evidentiary rules in their jurisdiction;
- What is the time frame for considering efficiencies;
- Under what circumstances are efficiencies allowed (merger to monopoly situation);
- Whether the competition authority has the authority to exercise a post-merger review; and
- What is the treatment of efficiencies in other types of agreements.

MEXICO

Legislation:	Federal Law of Economic Competition of 1993 (FLEC); Code of Regulations.
Enforcement and adjudicative authority:	Federal Competition Commission (FCC)

The prohibition of monopolies (any activity to concentrate the availability of goods) has been in effect in the Mexican Constitution since 1857. In the 90s, Mexico underwent a reform that would lead to privatization and market liberalization. As part of the reform, the government enacted the *Federal Law on Economic Competition* of 1993 that has, as its underlying purpose, economic efficiency.

Role of efficiencies in merger review

Efficiency is imbedded in various relative practices under the FLEC[2]. Section 18 of the FLEC and section 6 and 15 of the Code of Regulations address efficiency in cases of monopolization. Although these provisions offer some guidance on how to deal with efficiency claims, the Federal Competition Commission (FCC) formulates the treatment of efficiencies in draft merger guidelines.

The FCC has discretion to consider efficiency claims made by parties to a transaction. Efficiencies are considered as a pro-competitive effect of a transaction, in the overall analysis of the merger to determine whether the merger will reduce, impair or prevent competition. In order to be considered, it is required that efficiencies be passed-on to consumers.

The burden of proving efficiency claims falls on the claimants. In order to substantiate their claim, parties to the transaction must prove efficiencies with a reasonable degree of certainty and provide a quantified estimate to the FCC. The competition authority will usually consider efficiencies that may be realised within a 2-year timeframe.

Gains in efficiencies accepted by the FCC are (1) savings in resources which permit the merged parties, on a permanent basis, to produce the same quantity of the good at a lower cost, or a greater quantity, at the same cost; (2) efficiencies that lead to lower costs, if two or more goods or services are produced jointly rather than separately; (3) significant reduction of administrative costs; (4) transfer of production technology or market knowledge; and (5) lowering of production or marketing cost.

The FCC does not categorically reject a transaction that may create an agent with substantial market power. However, the FCC finds it unlikely that the creation of such an

[1] Efficiencies are not considered in the assessment of "absolute practices" (i.e. horizontal agreements) because they are considered *per se* illegal.

agent would increase the overall economic efficiency of the country. In recent years, there has been only one case where efficiency considerations made a difference in approving the proposed merger.

The FCC can sanction failures to notify mergers that meet notification requirements. The FCC can also take action against parties to a transaction that provided false or incorrect information. The FCC has one year to investigate non-notifiable mergers. The FCC will generally monitor the implementation of behavioural remedies. However, the authority does not have general post-merger auditing powers.

Role of efficiencies in non-merger situations

Section 6 of the Code of Regulations addresses efficiencies in cases of monopolization. If the claimant demonstrates that the efficiency gains derived from the relative practice positively affect the competitive process, the FCC has to consider these gains in evaluating whether the conduct is anticompetitive.

EUROPEAN UNION

Legislation:	EC Treaty (art. 81 and 82); Council Regulation (EC) No. 139/2004 of January 2004 on the control of concentrations between undertakings, O.J. L 24/1; Guidelines on the assessment of horizontal mergers, 2004/C 31/03
Enforcement and adjudicative authority:	European Commission, Directorate General Competition (EC)

Role of efficiencies in merger review

The European Union adopted a new Merger Regulation on May 1st, 2004. The Regulation does not specifically address the role of efficiencies in merger review. However, guidance is foreseen in Recital 29 of the Regulation and is to be found in the Commission's *Guidelines on the assessment of horizontal mergers*.

The EC will consider any substantiated claims of efficiency as part of the overall analysis of the merger to determine whether the merger will significantly impede effective competition in the common market. To the extent that the efficiencies may counteract the effects on competition – and in particular the harm to consumers – that the merger otherwise might have, those efficiencies may be taken into account as a factor pleading in favour of the merger being approved.

Most of the information relevant to the assessment of possible efficiencies is in the hands of claimants (the notifying parties). It is therefore for the claimants to provide the information in due time and to demonstrate the extent to which the gains in efficiency may counter the adverse effects of the merger on competition. They must also show that the efficiencies are likely to be realised.

In considering claims of efficiency, the EC will require the efficiencies to be verifiable and merger-specific. The guidelines also require the efficiencies to bring a net benefit to consumers. Various types of efficiencies may qualify for the competitive appraisal of a merger, such as cost savings that may give the parties to the transaction the ability to lower prices after the merger. Marginal cost savings are more likely to be relevant in that regard. The Guidelines indicate that efficiencies should be "timely" and that the later in time they are realised, the less likely they are to be considered as a countervailing factor.

Role of efficiencies in non-merger situations

Article 81 applies to agreements (horizontal or vertical), which prohibits competition. Article 81(3) provides an exception from the general prohibition of restrictive agreements for an agreement that "contributes to improving the production or distribution of goods or to promoting technical or economic progress”. Efficiencies can be taken into account in the assessment of that exception.

Article 82 prohibits abuse of dominance by firms. Article 82 does not provide for a defence or an exception. However, there is some scope for taking efficiency considerations into account. The EC is currently reviewing its policy on the application of Article 82. This review will also look at efficiency considerations.

<u>UNITED KINGDOM</u>

<u>Legislation:</u>	*Enterprise Act* (EA); Office of Fair Trading, *Mergers – Substantive Assessment Guidance*; *Merger References: Competition Commission Guidelines*
<u>Enforcement authority (Phase I):</u>	Office of Fair Trading (OFT)
<u>"Adjudicative" authority (Phase II):</u>	Competition Commission (CC)

The *Enterprise Act* came into force in June 2003. Although the EA substantially reformed the UK's competition legislation including replacing the public interest test with a competition test (substantial lessening of competition), it largely reflects the OFT's and the CC's approach when analyzing mergers under the *Fair Trading Act* and maintains consumer welfare as the underlying objective of competition policy in the UK. Both the OFT and the CC have limited experience with claims of efficiency in the review of mergers.

Role of efficiencies in merger review

Efficiencies in the review of mergers enjoy a multi-treatment in the UK as they can be considered at different stages of the review, by the Office of Fair Trading and by the Competition Commission.

Review by the OFT

The OFT determines whether a proposed merger should be referred to the Competition Commission for adjudication. The OFT has the duty to refer all mergers that it believes may result in a substantial lessening of competition. However, the OFT may exercise its discretion not to refer a merger to the Competition Commission if (1) the merger is insufficiently advanced to warrant a referral; (2) the markets involved are of insufficient importance to warrant a referral; or (3) the merger results in relevant customer benefits that outweigh both the substantial lessening of competition and any adverse effects of the lessening of competition that follow.

The EA permits the OFT to take efficiencies into account at two different points in the analytical framework. First, efficiencies may be included in the overall assessment of the merger (in applying the substantial lessening of competition test) if they have a positive effect on rivalry. Competition is viewed as a process of rivalry that induces firms to provide benefits to customers. Hence efficiencies that increase rivalry among the remaining firms in the market will benefit the UK economy.

Second, as noted earlier, in cases where the OFT determines that a merger may result in a substantial lessening of competition, the EA gives it the discretion to abstain from referring the merger to the CC. This exception is available in situations where a merger will generate sufficient customer benefits that outweigh the negative effects of the anticipated substantial lessening of competition. In order to be successful, parties to the transaction must show that sufficient residual incentives exist to induce the new entity to pass the benefits of the merger to customers. These benefits may include lower prices, higher quality or greater choice, and greater innovation. Overall, in order for the merger to be approved, it should net out customer benefits i.e. the parties must also show that the benefits will be sufficient to outweigh the competition detriments caused by the merger. The claimed customer benefits must accrue to customers of the merging firms but need not necessarily arise in the market(s) where the substantial lessening of competition concerns arise.

In general, exacting evidence in support of the claims of gains in efficiency will be required to satisfy the OFT. It will not accept mere promises about post-merger behaviour by the parties to the transaction. Claimants will be interviewed and internal documents in support of claims will be requested by the OFT. The OFT must believe that the claimed benefits will materialise within a reasonable period of time and must believe that they would be unlikely to arise without the merger. The OFT may also look at those customer benefits that can be realised on a longer term, depending on the specificities of the relevant market.

The OFT will typically look at marginal costs. However, it may also consider fixed costs depending on the context of each case. For example, the OFT indicated that in one case involving a merger between data collecting firms, savings in fixed costs were very important. It would not have been appropriate to bar consideration of fixed costs.

The OFT could decide not to refer a merger to the CC that would result in a monopoly if sufficient incentives to pass benefits to customers remain. However unlikely, the OFT would look for remaining competitive forces that may exert pressures on the new entity to pass benefits to customers.

Review by the Competition Commission

Similarly, the CC can look at efficiencies in two different stages of the analysis. The EA provides a general framework but is complemented by the CC's own guidelines. The CC has the responsibility to determine whether the merger will result in a substantial lessening of competition. It considers efficiencies as a factor included in the overall assessment of the merger, much like the OFT does.

Efficiencies can also be taken into account at the remedy stage if they bring customer benefits. The CC can tailor a remedy that will ensure that the anti-competitive effects of the merger are mitigated while at the same time maintain as much as possible the benefits to customers resulting from the merger. The types of efficiencies that could result in consumer benefits are narrowly defined. They have to be realized in a short time and it must be established that they could not be attained without the merger. So far, having found a substantial lessening of competition, the CC has not cleared a merger based on efficiencies.

Role of efficiencies in non-merger situations

The UK has harmonized its competition laws with those of the EC by the introduction under the *Competition Act 1998* of prohibitions of anti-competitive agreements and abuses of dominance. An area that is evolving is the role of efficiencies under Article 82 (abuse of dominance).

Market studies

Both the OFT and the CC can study the functioning of markets. The OFT carries out market studies and it may also refer markets for in-depth investigation by the CC if the OFT has reasons to believe that market features are leading to adverse effects on competition (AEC). If the CC finds that features of a market (structural or behavioural) have such an adverse effect on the market, it may impose remedies to address those effects. As in the case of mergers, the CC has the discretion to modify its remedies if it considers that the same features giving rise to an AEC also result in customer benefits. As in the case of mergers, the customer benefits take the form of lower prices, higher quality or greater choice and greater innovation and must have accrued or be unlikely to accrue without the market features concerned.

In addition, studies are carried out in the UK on the impact of the OFT or the CC's decisions on markets. For example, the OFT, the CC and the Department of Trade and Industry currently commissioned a study of recent mergers cleared by the CC and the impact they had on the markets http://www.oft.gov.uk/NR/rdonlyres/4E8F41F9-5D96-4CD4-8965-8DDA26A64DA8/0/oft767.pdf

UNITED STATES

Legislation:	*Clayton Act*; 1992 DOJ/FTC Horizontal Merger Guidelines (1997 revisions)
Enforcement authorities:	Department of Justice, Antitrust Division; Federal Trade Commission

Role of efficiencies in merger review

Pursuant to section 7 of the *Clayton Act*, any merger that may substantially lessen competition or tend to create a monopoly in any line of commerce or in any activity affecting commerce may be prohibited. The legislation is silent on the role efficiencies plays in that determination. However, guidance can be found in the 1992 DOJ/FTC Horizontal Merger Guidelines (1997 revisions). The Guidelines, which were promulgated by the enforcement agencies, describe the analytical framework and specific standards used by the agencies in analyzing mergers and other transactions. Although the Guidelines are statements of antitrust enforcement policy that do not have the force of law, U.S. courts frequently cite them in merger cases.

The authority analyzes efficiency claims when such claims are put forward by the parties to a transaction. It generally does not challenge a merger if *cognizable* efficiencies are of a character and magnitude such that the merger is not likely to be anticompetitive in any relevant market. In making this determination, the authority evaluates whether the claimed efficiencies are likely to be sufficient to reverse the merger's potential to harm consumers in the relevant market, for example by preventing increases in the price of the relevant product. The greater the potential adverse competitive effect of a merger, the greater must be the *cognizable* efficiencies in order for the authority to conclude that the transaction is not anti-competitive. In that context, extraordinarily great cognizable efficiencies would be necessary to prevent a merger to monopoly from being anti-competitive. When analyzing efficiencies the authority does not simply balance the raw magnitude of cognizable efficiencies generated by the merger with the likely anti-competitive effects of the transaction to determine whether the former outweighs the latter. Nor does it assess efficiency claims in isolation; rather, it evaluates such claims simultaneously with market definition, concentration, competitive effects, entry, and failing firm issues (the other Horizontal Guidelines factors).

Under the Guidelines, *cognizable* efficiencies are those that are merger-specific and verifiable, and that do not arise from anticompetitive reductions in output or service. Efficiencies are considered merger-specific if they are "likely to be accomplished with the proposed merger and unlikely to be accomplished in the absence of either the proposed merger or another means having comparable [or less] anticompetitive effects." Because efficiencies of any kind can be difficult to verify and quantify, "the merging firms must substantiate any claimed efficiencies so that the reviewing authority can verify by reasonable means the likelihood and magnitude of each asserted efficiency."

In evaluating efficiency claims the authority generally places more weight on documents generated by the parties in the ordinary course of business, such as board presentations and materials prepared for investors, than on studies prepared by the parties or their counsel specifically to support their claims. However, because such studies often specifically address the kinds of pro-competitive efficiencies that can reverse a merger's potential to harm consumers, the authority factors them into their analysis of the transaction. Regardless of the source, evidence offered to support efficiency claims must be based on more than mere speculation and promises about post-merger behaviour. Efficiencies that are predicted further into the future are likely to be less certain and more difficult to verify, and are therefore likely to be given less weight in the authority's analysis. The authorities also may discount in part efficiency claims that do not show a short-term effect on prices.

Although efficiencies are factored into the competitive assessment of a merger by the U.S. enforcement agencies, and increasingly by U.S. courts, no judicial decision has relied on efficiencies in rejecting a challenge to an otherwise illegal transaction.

Most mergers are reviewed before they are consummated pursuant to section 7A of the Clayton Act, also known as the Hart-Scott-Rodino (or "HSR") Act. However, the agencies are also empowered to investigate transactions post-consummation. This situation is most likely to arise within a few years following the closure of a transaction that was not reportable under the HSR Act, and hence may not have come to the attention of the agencies before consummation.

The FTC can also perform special studies of markets (known as "6(b) studies"). For example, a special study reviewing mergers approved by the authorities could be undertaken with this power. Although as with merger and non-merger investigations the FTC can compel private parties to submit information for its 6(b) studies, the FTC is sensitive to the burdens that compulsory production can place on market participants, and this power is therefore rarely used. When the FTC undertakes a 6(b) study it usually obtains sufficient information from public sources or voluntarily from market participants.

Role of efficiencies in non-merger situations

Under the conspiracy offence (section 1 of the *Sherman Act*), agreements are assessed under either the *per se* or the *rule of reason* standard. Agreements that are assessed under the *per se* standard, such as most horizontal price fixing and market allocation agreements, are conclusively presumed to be illegal without further examination. In contrast, *rule of reason* analysis requires an examination of the effects of the agreement on competition in the relevant market. Whether an agreement will generate efficiencies is sometimes important in choosing the appropriate standard of review, and in applying the rule of reason. *See, e.g., Broadcast Music, Inc. v. Columbia Broad. Sys., Inc.*, 441 U.S. 1 (1979).

Efficiencies can also be relevant in monopolization cases (section 2 of the *Sherman Act*), where they can provide a legitimate business justification for the challenged conduct. For example, the federal Court of Appeals for the District of Columbia Circuit addressed the relevance of efficiency claims in its recent *Microsoft* case, in which the company claimed that the conduct at issue benefited consumers. *See Massachusetts v. Microsoft Corp.*, 373 F.3d 1199 (D.C. Cir. 2004). As a general matter, however, section 2 analysis has focused more on whether there is any procompetitive justification for the conduct under scrutiny, rather than whether such benefits are sufficient to reverse any anticompetitive harm that the challenged conduct may cause.

AUSTRALIA

Legislation:	*Trade Practices Act, 1974*; Australian Competition and Consumer Commission Merger Guidelines (1999)
Enforcement authority:	Australian Competition and Consumer Commission
Adjudicative authority (authorization):	Competition Tribunal

Role of efficiencies in merger review

Two distinct processes may be applicable to mergers in Australia. The first one involves a merger review by the ACCC to assess whether a merger will substantially lessen competition in a substantial market in Australia. The second is an application for authorization to determine whether a potentially anti-competitive agreement or a practice (including a merger) may be permitted to proceed because it will result in sufficient public benefit.

Merger review under s. 50 of the *Trade Practices Act*

Over the last two decades, there have been significant changes in the legislation as it relates to mergers. In the 80s, a dominance test replaced a "substantial lessening of competition" test where only unilateral effects were considered. In the 90s, the legislation returned to the "substantial lessening of competition test".

Under the TPA, a corporation may not, directly or indirectly, acquire any assets that would have the effect of substantially lessening competition in a market. The ACCC adopts an integrated approach to merger review as it assesses various factors related to market characteristics to determine whether the merger is in breach of section 50. Although efficiencies can be considered as a factor, their consideration is most relevant in the public authorization process.

In essence, the extent to which any efficiency enhancing aspects of a merger may have a positive impact on competition in a market is relevant in the context of section 50.

Authorization process under ss. 88 and 90 of the *Trade Practices Act*

The authorization process applies to any transactions or practices – it is not specific to mergers. Parties to a transaction can apply for an authorization if they believe the merger will result in a significant benefit to the public. An authorization provides immunity to the claimants on public interest grounds and prevents the application of section 50 of the TPA. This process is a transparent and flexible means to consider matters not strictly related to competition policy, and to decide, on a case-by-case basis, whether a transaction or a practice is in the public interest.

An authorization is granted by the ACCC upon an application by a corporation. The Commission will conduct an analysis where detriments to competition are weighed against benefits of the transaction. There is not a preset list of relevant matters that must be examined in the context of the public benefit test; except that export enhancement, import replacement and matters that relate to international competitiveness must be regarded as public benefits in merger authorization. Applications will usually relate to gains in efficiency.

The ACCC will require strong evidence in support of the claims in efficiency. The efficiencies must be verifiable and cognizable. The ACCC will usually look at a 2 to 3-year span for the realisation of the efficiencies for which there is credible evidence. The ACCC will generally give more weight to quantitative efficiencies. The ACCC may deal with any concerns arising from the merger by way of undertakings by the merging parties. The Competition Tribunal can review the ACCC's determination of an application for authorization.

The ACCC is not ruling out the possibility for a merger to monopoly to be granted on public benefit grounds. However, it has not authorized such a merger so far.

The ACCC has extensive experience in considering efficiencies in the course of applications for authorization. The Competition Tribunal also provided guidance as to the most relevant issues to be considered. In a recent report (i.e. 2003 Dawson Report), a Committee recommended that all applications for authorization in a merger context be made directly to the Competition Tribunal, without prior review by the ACCC.

Role of efficiencies in non-merger situations

The authorization process applies to any transaction or practice with the exception of cases of misuse of market power (monopolization). Hence, subject to the exception, efficiency can play a role in any public interest review related to non-merger situations.

In cases of misuse of market power, efficiencies can nonetheless be relevant in the context of considering any proscribed purpose. Consideration may occur where the impugned conduct is supported by a legitimate business justification involving efficiency claims.

B. ISSUES RELATING TO EVIDENTIARY RULES IN THE PARTICIPANTS JURISDICTIONS

Participants were asked to address the practical issues relating to evidentiary rules in their jurisdiction, in particular whether the efficiencies were required to be verifiable, merger specific and likely to be attained. They were also invited to address the time frame in which the efficiencies are considered, the types of efficiencies usually considered by their authority and whether certain efficiencies had pre-determined weights.

Participants expressed a common view as to the challenge involved in considering efficiencies in the context of merger review. The types of efficiencies considered and their measurement have a direct consequence on the complexity of the exercise. However, participants also indicated that flexibility is key for assessing the efficiency gains resulting from a merger. There is not one seminal rule.

Participants indicated that the onus of proving the efficiency claims falls on the merging parties. Their competition authorities will require strong and well-argued evidence in support of the claims. They will not consider mere promises that efficiencies will be realized. Most participants indicated that merging parties' internal documentation in support of the claims is usually preferred to reports generated exclusively in support of their claims. They will look at statements made by the merging parties, including public statements, which would support their claims. Participants also specified that they would not consider reductions in output, variety or quality as "efficiency gains".

Participants discussed the types of efficiencies generally accepted in the assessment of the claims. The nature of the efficiencies will usually have a direct influence on the agencies' approach regarding the selected time period over which the anticipated efficiencies will likely be realised, the verifiability of the claims and the measurement of the gains.

Participants observed that efficiencies gains resulting from a merger should be achieved over a limited time period. The realization of efficiencies over a longer period of time will increase the difficulty to establish, with a certain degree of certainty, whether the efficiencies will in fact be achieved. Participants recognized that certain types of efficiencies would be easier to determine and verify. However, they will not bar other types of efficiencies from the assessment. They will instead weigh the evidence to determine which claims will be received. The competition authorities will also adjust the weight based on the quality of the evidence put forward by the merging firms.

For example, efficiency claims in relation to marginal cost savings will be provided more weight than that provided to fixed cost savings because of the likelihood that marginal cost savings will have direct short-term effects on price and will stimulate competition.

In order to appropriately consider efficiencies, they must be evaluated. This evaluation bears quantitative or qualitative aspects. Most participants indicated that their assessment usually involves a combination of both. Measurable efficiencies are usually easier to assess because they are realised on a short-term run and are more predictable. However, one participant contended, qualitative efficiency gains may also be important, especially in innovation markets where dynamic efficiencies are more likely to be present. The dynamic efficiencies usually take longer to be achieved and are not easily measurable. Participants indicated that it would be an error to require the quantification of qualitative efficiencies. If supporting evidence of the realization of these efficiencies is not as strong as desired, or the efficiencies will take a longer time period to be realized, these efficiencies could be discounted. Participants pointed out that assessing both qualitative and quantitative efficiencies would require an educated judgment.

One last point addressed by participants was the realization of efficiencies in several markets. Gains in efficiencies can vary from one market to the next or could have effects outside the relevant market. Some participants indicated that they do not necessarily engage in a balancing exercise to net out the benefits. However, the flexibility afforded by their guidelines allows for a case-by-case analysis. Their competition authorities would look at the complete picture and not be limited to a market-by-market analysis. They would look at remaining competition in the relevant market and the extent to which prices (or quality-adjusted prices) would remain stable or go down.

C. POST-MERGER REVIEWS AND MONITORING OF MERGER OUTCOMES

Participants were asked to address whether they had the authority to conduct post-merger reviews or audit to ensure that the projected efficiency gains claimed by the merging party are realized. They were also invited to comment on whether that authority would be useful and whether formal investigative powers would facilitate the review.

The consultation paper proposes an option called "merger outcomes". The option allows for a conditional approval of the efficiency exception subject to a post-merger assessment of whether efficiencies have been achieved. Although none of the participants have the authority to unwind mergers based on a failure to achieve the claimed efficiencies, they commented on this option.

Participants indicated that the constraints of post-merger reviews are mostly practical. For example, in cases where anticipated efficiencies are not realized as predicted and increases in price occur, it may be difficult to recreate a competitive environment after the merger has been consummated. It may also raise issues of fairness and legal uncertainty for parties that have consolidated their activities. It may also involve resource issues; as such reviews are very resource-intensive. Some participants indicated that post-merger reviews done for learning purposes, such as studying the effectiveness of merger remedies, are useful.

Participants also discussed the possibility of doing market inquiries. A few participants indicated that they have express authority to undertake such inquiries. They can also compel information by using formal production powers. Others indicated that they could study the functioning of markets either by themselves or by way of other governmental mechanisms. However, they cannot compel information from market participants. In general, participants indicated that they obtain information from market participants on a voluntary basis. One participant indicated that there are, however, risks involved in having formal powers available to do market inquiries. As an initial matter, such inquiries can impose significant costs on market participants. Also, a competition authority could find evidence of wrongdoing that may raise legal issues such as self-incrimination. Another participant indicated that this was not a major concern. A political programme could also motivate an inquiry. Implementing statutory safeguards could minimize these risks.

D. WHAT IS THE BEST APPROACH?

Participants were asked to provide their views on the different approaches proposed in the consultation paper.

Gains in efficiency can be considered under different approaches. First, it can be used as a defence after a determination that a merger is anti-competitive. This approach involves a trade-off between gains in efficiency and the anti-competitive effects of the merger. Recent case law in Canada also required the Competition Tribunal to consider some redistributive consequences of the trade-off exercise. The Tribunal must determine the socially adverse consequences of any associated wealth transfer in the trade-off exercise and set the appropriate weight to be attached to the portion of the transfer that is considered socially adverse. This is the option we called "*Status quo*".

Another approach used by many of the participants' competition authorities is considering efficiency gains as part of the overall competitive analysis of the merger. Efficiencies such as economies of scale and scope, transaction costs savings and R&D synergies are considered in the determination of whether a merger is likely to lessen competition, along with other criteria such as barriers to entry. Efficiency gains must be large enough to prevent the merger from lessening competition. Under such an approach, efficiency gains would not justify an anti-competitive merger.

One participant indicated that the fundamental problem with considering efficiencies as a defence is the balancing exercise, where the efficiency gains must outweigh the anti-competitive effects. In the context of a total welfare standard as interpreted by the Competition Tribunal, the balancing exercise is even more difficult. One participant indicated that unless the Competition Tribunal has provided a clear methodology for doing the trade-off exercise or for determining the various weights on the socially adverse consequences of the wealth transfer, merging parties would not be able to predict the outcome of their transaction where an efficiency argument can be made.

Under the *status quo* option, one participant indicated that there might be political ramifications associated with putting different weights on different types of consumers.

Some participants felt that the defence may move the focus away from the most important element: efficiencies. The defence may allow for considerations of issues not directly related to competition such as international competitiveness, industrial policy, import substitution, real value of exports and social aspects of a transaction. The trade-off exercise may easily become a debate about values, where it should be about what is the most efficient solution for the economy. That risk is increased if persons directly affected by the merger are allowed to intervene before the Competition Tribunal and make submissions as to the impact of the merger on them.

One participant felt that a defence imposes a higher burden of proof on parties to show the efficiencies.

Participants indicated that an integrated approach has worked for them. It provides a more efficient way to consider efficiencies. The competition authorities must only look at the efficiencies that are sufficient to address the lessening of competition. Efficiencies become part of a routine assessment.

On the flip side, one participant indicated that efficiencies are not a perfect fit in the competitive assessment. Their inclusion is complicated. A solution may be to adopt a view on efficiencies claims.

Participants supported efforts to increase convergence of merger review policies. However, one participant indicated that the *status quo* does not frequently generate frictions with the factorial approach adopted by other competition authorities because the efficiency argument is rarely raised in Canada.

E. SHOULD MERGERS TO MONOPOLY OR NEAR-MONOPOLY BE ALLOWED?

Participants were invited to comment on the suitability of allowing a merger to monopoly where significant efficiencies are generated by that merger.

Participants indicated that there are no express rules against merger to monopoly or near-monopoly in their jurisdiction. However, in practice, they indicated that it would be unlikely that a merger to monopoly would be allowed based on efficiencies. Participants would primarily focus on remaining or likely remaining competition. For example, in some concentrated sectors where you find a monopoly or near monopoly situation, foreign competitors or import pressures may exist and spur competition. No substantial lessening of competition would be found.

A participant noted that it is difficult to know where to draw the line between monopoly and non-monopoly situations in a legislative text. However, participants agreed that in markets where great market power exists, a greater magnitude of efficiencies should be required.

One participant indicated that putting extraneous considerations in merger review is not appropriate. For example, a “small market” argument, which would support high degrees of concentration, may not be the best way to promote the Canadian economy. In general, high concentration levels and lack of competition is a disservice to any economy on a long-term basis. That participant indicated that competitive markets or markets with rigorous competition are likely to generate the greatest efficiencies. On the other hand, a participant indicated that in the context of a small economy, international competitiveness becomes a relevant element that can be considered in the analysis.

F. SUPPLEMENTAL NOTE ON OTHER JURISDICTIONS

Other jurisdictions were invited to share their experience in dealing with efficiencies. Germany, Japan, Norway, Sweden and South Africa responded to the invitation. Some also provided their views on the various options presented in the consultation paper entitled *The Treatment of Efficiencies under the Competition Act*.

In Germany, efficiencies play a limited role in merger review. The Bundeskartellamt (Federal Cartel Agency) reviews mergers based on competition criteria. The Agency will prohibit a merger that is likely to create or strengthen a dominant position. However, a merger that is likely to generate benefits to the economy as a whole may be granted permission to proceed by the Federal Minister of Economics. This special authorization process is only used in exceptional cases based on non-competition grounds. In order to be authorized, a merger must bring benefits that will outweigh the restraints on competition. Efficiencies may be considered as a public benefit.

In Japan, efficiencies are considered as part of the analysis to determine whether the merger will substantially restrain competition. Efficiencies are addressed in the *Guidelines on the Application of the Antimonopoly Act to Reviewing Business Combination.*

In Norway, the purpose of the newly enacted *Competition Act* is to contribute to the efficient utilization of resources with a special consideration given to the interest of consumers. The Act is partly harmonized with the European Union's competition rules. The Norwegian Competition Authority considers efficiencies as part of the analysis of the merger (factor approach). This is a different approach from the previous legislation that suggested a defence approach with a total surplus standard. Under the current legislation, if a merger is likely to result in a price increase and efficiency gains, the authority will approve it if the merger increases the weighted sum of consumers' and producers' surplus, with more weight given to consumers' surplus. The authority also indicates that this balancing exercise is complex. In order to be considered, efficiencies must be considerable, likely to be achieved and be passed on to consumers.

With Canada, South Africa is the only other country with an explicit legislative efficiency defence. South Africa expressed views on the different options presented in the Consultation Paper and opined that the factor approach seems to best support the overall objectives of the Canadian *Competition Act*.

In Sweden, there exist no specific statement in the legislation or guidelines on the role of efficiencies in merger review. The Swedish authority has, therefore, limited experience of efficiencies when assessing mergers.