CANADIAN COMPETITION RECORD

THE FIRST SECTION

ONE STEP FORWARD, TWO STEPS BACK – *SUPERIOR PROPANE*, BILL C-249 AND THE FUTURE OF EFFICIENCIES IN CANADIAN MERGER REVIEW

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Even before the Federal Court of Appeal[2] had dismissed the Commissioner of Competition's second appeal in the *Superior Propane*[3] matter, legislation had been tabled in Ottawa[4] that, if passed, would effectively repeal the efficiency defence in section 96 of the *Competition Act*.[5] While few initially would have given Bill C-249 much chance of becoming law, the Court's refusal to overturn the Competition Tribunal's redetermination decision,[6] and the Commissioner's subsequent decision to forgo a further appeal in favour of a "legislative solution", make it very likely that section 96 ultimately will be amended or repealed. The result will be that efficiencies in Canadian merger review will be reduced to a "factor" that may be considered by the Tribunal in assessing the anticompetitive effects of a merger, while consumer protection – rather than economic efficiency – will become the focus of the Canadian merger review process. This change will represent a step backwards in Canadian competition policy – a step that should not be taken without a thorough and informed policy debate.

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Throughout most of the twentieth century, policy makers in Canada and elsewhere struggled with the role that competition law should play in helping to shape their economies. While on the whole, competition policy in Canada before 1970 appears to have been directed towards economic ends, other considerations also likely played some role.[7]

The authors of the 1969 *Interim Report on Competition Policy* [8] recognized two economic ends that could be distinguished – the first being concerned with the distribution of income, and the second with the allocation of real resources in the economy. The authors concluded that the main objective of Canadian competition policy should be that of obtaining the most efficient possible performance from our economy:

> Essentially, we are advocating the adoption of a single objective for competition policy: the improvement of economic efficiency and the avoidance of economic waste, with a view to enhancing the well-being of Canadians...
>
> This concentration on one objective is not meant to imply any necessary disparagement of other objectives, such as a more equitable distribution of economic power, which have been entertained for competition policy in the past. It is simply that we believe:

> (1) that a competition policy concentrated on the efficiency objective is likely to be applied more consistently and effectively; and
>
> (2) that there exist more comprehensive and faster working instruments...for accomplishing the deliberate redistribution of income and the diffusion of economic power...[9]

A debate on the form and substance of the amendments necessary to strengthen and modernize Canada's competition law ensued in the years after the *Interim Report* was published.[10] It was not until 1986, after extensive federal government consultation with business and consumer groups, organized labour, legal experts, provincial governments and other interested parties, that the *Competition Act* was enacted, providing Canadians with "an effective and up-to-date competition law – something that was long overdue".[11] Among other important changes, the *Competition Act* clearly established the role of economic efficiency in competition policy in Canada.[12]

With respect to the merger provisions of the *Competition Act*, the *Guide* that accompanied Bill C-91 noted that:

> [t]he existing merger provision is considered to be unsuitable for the Canadian economy, which is small and open. Canadian firms often have to compete with larger foreign rivals both at home and abroad. In these circumstances, they should not be prevented from obtaining economies of scale which improve their competitive position. An effective merger law must weigh the advantages of economic efficiency against the disadvantages of a lessening of competition.[13]

In these circumstances, the new merger provisions included an "efficiency defence" – even where a proposed merger was likely to result in a substantial lessening of competition, the Competition Tribunal could not make an order in respect of the transaction where it was likely to bring about gains in efficiency that would be greater than and would offset its anticompetitive effects.

Until the *Superior Propane* case,[14] few Canadian commentators – particularly those familiar with the 1986 amendments – questioned the desirability of balancing the expected benefits to the Canadian economy of efficiency enhancing mergers against the disadvantages of lessening competition.[15] The only question that arose from time to time was the precise nature of the "balancing" test. And, for the most part, even this did not seem to be in doubt.[16]

* * *

Initiatives currently underway in Ottawa would significantly undermine the economic principles reflected in the *Competition Act*, in general, and in the merger provisions of the *Competition Act*, in particular. Bill C-249, a private member's bill that is currently before the Senate, would amend section 96 of the *Competition Act* to provide that efficiencies would only be relevant in Canadian merger review where the efficiency benefits of the merger would be passed on to consumers. Unfortunately, these initiatives appear to be driven by political considerations and ignore the important economic considerations that led to enactment of the *Competition Act* in the first place.

Even the Commissioner tends to discuss the proposed changes – which he supports – in political rather than economic terms. In recent remarks to the House of Commons Standing Committee on Industry, Science and Technology,[17] the Commissioner stated:

> [I]t is timely that we are discussing efficiencies today because the [Competition] Bureau has decided that it will not appeal the Federal Court of Appeal's latest decision in the Propane case... After extensive litigation, it is clear that further litigation would not have clarified the efficiency defence. Only a legislative solution is workable.
>
> It is not my intention to go into the details of the Propane case. However, I will say that the outcome is unacceptable from a political perspective...[18] [emphasis added]

In the Commissioner's view, the outcome of *Superior Propane* is unacceptable for two reasons. First, it would permit an otherwise anticompetitive merger to survive if it generated sufficient efficiencies, even if it resulted in "substantial harm" to consumers[19] – in other words, if any group of consumers faced the prospect of higher prices after the merger. The Commissioner used the example of rural households in the Yukon to reinforce his point.

The Commissioner's second objection is that the Tribunal's and the Court's interpretation of section 96 would "condone the creation of monopolies", a "perverse result" in the Commissioner's view.[20]

Both objections are problematic.

The first is essentially a consumer protection argument that reflects a preoccupation with the income transfer between consumers and producers – whoever they may be – likely to result from an otherwise anticompetitive merger. But, as noted above, more than 30 years ago, the Economic Council of Canada rejected this concern as the appropriate focus of Canadian competition policy.[21]

Furthermore, in the case of *Superior Propane*, the consumer protection concern is largely unsupported by the facts. As the Tribunal concluded during the *Superior Propane* redetermination decision, approximately 90 percent of the customers of the merged entity would be other businesses, not "household consumers".[22] In the Tribunal's view, the evidence before it tended to support the conclusion that the "socially adverse redistributive effects" of the merger would be limited effects on low-income households, "but... the number of such households appears to be small".[23]

The Commissioner's second objection was soundly rejected by both the Tribunal and the Court, because not only does it lack a credible economic rationale, but it is also inconsistent with the express provisions of the *Competition Act*. As the Tribunal noted in the redetermination decision:

> [I]n terms of the section 96 inquiry, the finding of a monopoly according to any particular definition thereof is irrelevant. If the creation of a so-called monopoly is not *per se* sufficient to justify a conclusion of substantial lessening or prevention of competition under section 92 of the Act, then its creating cannot be a bar to the application of section 96.[24]

On appeal, the Court stated:

> Monopoly, however it might be defined... is a description of a market condition, not the effect of that market condition. If monopoly is to be taken into account for the purposes of subsection 96(1), it is the effects of the monopoly that must be considered, not the existence of monopoly *per se*.[25]

The Commissioner also appears to be of the view that Canadian merger law is out of date and does not reflect the economic realities of the twenty-first century. He stated to the Committee:

> When the Act was amended in 1986, Parliament was seized with the [Macdonald Commission Report] which, among other things, noted the urgency of opening up Canada's markets, and freeing up Canadian industry to compete internationally... We see this particularly in Section 96 of the Act which not only cites efficiencies, but emphasizes in 96(2) the importance of gains in exports and import substitution.
>
> Canada's economy has changed significantly since 1986, due to globalization[,] the FTA and NAFTA. Today's economy is knowledge driven and dynamic. We have a vastly different perspective on the importance of competition as the driving force behind development.
>
> But we have a law that has not changed, and which is leading to results inconsistent with the new reality.[26]

But this objection is also problematic.

It is quite simply not the case that Canada's economy today is "fundamentally different" from the Canadian economy at the time the *Competition Act* was enacted. While much has changed since 1986, Canada remains a relatively small economy with a dependence on international trade.[27] Or, as then Minister of Consumer and Corporate Affairs, Michel Côté, put it in 1986, "Canada is, first and foremost, a trading nation."[28]

In 1986, the dollar value of Canadian exports as a percentage of our gross domestic product was approximately 27.5 percent, approximately four times that of the United States. By 2000, the percentage had risen to approximately 46 percent.[29] This suggests that, if anything, Canada is even more a "trading nation" today than it was at the time the *Competition Act* was enacted.[30]

It is also unlikely that we have a "vastly different" perspective today "on the importance of competition as the driving force behind development" than we did in 1986. On the contrary, the importance of competition as "a driving force behind development" was itself a driving force in the enactment of the *Competition Act*. As the Guide that accompanied Bill C-91 stated on page 1:

> Competition is not an end in itself but is the most effective stimulus to efficiency, productivity, and Canadian industrial growth.[31]

* * *

As was the case in 1969 and in 1986, Canada's unique economic circumstances strongly suggest that Canada should have, and should continue to have, a unique competition policy – one that carefully balances the competing economic interests set out in section 1.1 of the *Competition Act*. Particularly in the area of merger review, to simply adopt the competition policy of another jurisdiction, such as the United States – with its focus on consumer protection – would be to ignore both the realities of the Canadian economy and important differences between the Canadian economy and the economies of our major trading partners – to the detriment of all Canadians.

Yet this is precisely what Bill C-249 would do. If enacted, the Bill would effectively repeal the section 96 efficiency defence and place consumer interests squarely ahead of economic efficiency in Canadian merger review. While this should be troubling to those familiar with the debate leading up to the enactment of the *Competition Act*,[32] what is more troubling is that a single merger decision appears to be behind the proposed change.

Superior Propane is the only merger case in more than 15 years that has turned on the section 96 efficiency defence. In the view of many who have studied the decisions, the case was lost not on the interpretation of section 96 adopted by the Tribunal and the Court, but on the insufficiency of the evidence put forward on behalf of the Commissioner in opposing the merger.[33] Yet the Commissioner insists that the outcome of the case is unacceptable and that the only workable solution is a legislative amendment – an amendment that, by refocusing the section 92 enquiry on vaguely defined consumer interests, will undermine both the important economic principles reflected in the *Competition Act*, and the consensus within the Canadian business and legal communities that emerged in the debate leading up to its enactment.

Legislative changes that represent a major shift in competition policy should not be based on the outcome of a single merger decision, particularly one as tortured as *Superior Propane*. Rather, they should be preceded by a thorough policy debate. One can therefore only hope that Bill C-249 dies on the order paper, and that any future proposed changes to the Canadian merger review regime, including section 96, receive the thoughtful consideration they deserve – for the benefit of all Canadians.

Notes

1 Jay Holsten is Chair of the Antitrust and Competition Law Group at Torys LLP.
2 Hereinafter, the "Court".
3 2003 FCA 53 (hereinafter, the "Appeal Judgement").
4 Bill C-249, *An Act to amend the Competition Act* (hereinafter, "Bill C-249").
5 R.S.C. 1985, C-34, as amended.
6 [2002] C.C.T.D. No. 10.
7 These included a desire to diffuse economic power, sympathy for the plight of entrepreneurs and small businesses, suspicion of big business, and concerns with the fairness of competitive behaviour. See Economic Council of Canada, *Interim Report on Competition Policy* (1969) (hereinafter, the "*Interim Report*"), at 6.
8 *Supra*.
9 *Interim Report*, *supra*, at 19.
10 *Competition Law Amendments, A Guide* (1985), Minister of Supply and Services Canada (hereinafter, the "*Guide*"), at 2.
11 Speech by Federal Consumer and Corporate Affairs Minister Michel Cote, *Consumer Minister tables new competition law proposals*, December 17, 1985, NR-80-30 (hereinafter, the "Cote Speech").
12 *Guide*, at 4. "[This important consideration is] recognized at the outset in the purpose clause of the legislation"
13 *Guide*, at 16.
14 2000 Comp. Trib. 16; 2001 FCA 104; [2002] C.C.T.D. No. 10 (the "redetermination decision"); 2003 FCA 53.
15 While some U.S. commentators have questioned whether the Canadian efficiency defence was appropriate (see, for example, S. Ross, *Afterword-Did the Canadian Parliament Really Permit Mergers that Exploit Consumers So That The World Can Be More Efficient?*, Antitrust Law Journal, vol. 65, Issue 1, Fall 1996), their criticisms appear to reflect a U.S. perspective on merger review and its focus on consumer protection — which, as noted below, was rejected by the Economics Council of Canada as the appropriate focus of Canadian competition policy more than 30 years ago.
16 Until the *Superior Propane* case, the Commissioner's *Merger Enforcement Guidelines* adopted the total surplus standard as the section 96 test.

[17] Hereinafter, the "Committee".

[18] Speaking Notes for Konrad von Finckenstein, Commissioner of Competition, Bill C-249 *An Act to amend the Competition Act*, Standing Committee on Industry, Science and Technology, March 31, 2003. Readers should note that this is the text of the Commissioner's remarks to the Committee as posted on the Competition Bureau website as at April 4, 2003. The version of the Commissioner's remarks currently posted on the Competition Bureau website indicates that the Commissioner stated, "However, I will say that the outcome is unacceptable from a policy view point for two reasons..." [emphasis added].

[19] *Supra.*

[20] *Supra.*

[21] An important conclusion of the *Interim Report* was that there exist more comprehensive and faster working instruments than competition policy for accomplishing the deliberate redistribution of income.

[22] Redetermination decision at para. 262.

[23] Redetermination decision at para. 267.

[24] Redetermination decision at para. 280.

[25] Appeal Judgment at para. 49.

[26] *Supra.*

[27] See footnote 29 below.

[28] Cote Speech at 3.

[29] Source: UN Statistical Yearbooks, 1986 and 2000.

[30] It is also worth noting that, while the absolute dollar value of Canadian exports has increased significantly since the 1980s, the nature of Canadian exports (i.e., our export product mix) has remained fairly constant.

[31] *Guide*, at 1.

[32] It does not appear to be of concern to the Commissioner, who recently advised the Committee that:

> Bill C-249 in its present form ... [is] consistent with the treatment of the efficiencies in other jurisdictions. This is particularly important in a multi-jurisdictional context because divergence in merger review can adversely affect the ability of firms to compete internationally. In the U.S., competition policy serves the interest of consumers. Therefore, claims of efficiencies may only be taken into account if they do not result in higher prices to consumers. In the U.K., a new law that will come into force shortly will allow the office of fair trading to take into account clear and quantifiable claims of efficiencies only in mergers where the consumer will benefit from lower prices, greater innovation and greater choice. These two countries consider efficiencies as part of the lessening of competition test which would also be the case in Canada with the proposed changes to Bill C-249.

[33] See, for example, M. Sanderson, "Competition Tribunal's Redetermination Decision in *Superior Propane*: Continued Lessons on the Value of the Total Surplus Standard" (2002) 21:1 Can. Comp. Rec. 1; F. Mathewson & R. Winter, "The Analysis of Efficiencies in *Superior Propane*: Correct Criterion Incorrectly Applied" (2000) 20:2 Can. Comp. Rec. 88.

CANADIAN MERGER POLICY FOLLOWING *SUPERIOR PROPANE*

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Introduction

Superior Propane[1] dealt head-on with the most vexing issue in Canadian merger policy. When should a merger that both raises prices to consumers and lowers costs to suppliers be allowed? When are efficiencies so large that they "are greater than and offset" a substantial lessening of competition, as required by the efficiency defence for anticompetitive mergers in section 96 of the *Competition Act*? At issue is the very purpose of Canadian merger law. Should the law maximize the total flow of benefits from a merger, maximize the benefits for consumers only, adopt some compromise between these objectives or encompass all elements listed in the purpose clause of the Act?

The four decisions in *Superior Propane* hinge on the interpretation of section 96. In its original decision, the Competition Tribunal adopted without qualification the total surplus or total benefits standard for mergers in its interpretation of the section, and allowed the merger between Superior Propane and ICG Propane. The Federal Court of Appeal then rejected the unqualified reliance on the total surplus standard and remanded the case back to the Tribunal. However, it allowed the Tribunal a great deal of flexibility in the weight that must be attached to factors other than the impact on total surplus. In the redetermination, the Tribunal again approved the merger. The Tribunal's reasons in the original and the redetermination decisions indicate, we will argue, that the current law on efficiencies in mergers is both clear and close to the total surplus standard: pending any changes in the *Competition Act*, the Tribunal's rulings on future mergers will be the same as under the total surplus criterion unless the redistribution of income away from consumers (to shareholders) substantially impacts consumers of low income. Finally, the Federal Court of Appeal upheld the redetermination decision on the basis that the requirements of its first decision had been met.

A debate on the role of merger efficiencies in the law and the purpose of Canadian merger policy took place outside the hearing rooms and courts as well, and was especially active in this journal.[2] The completion of *Superior Propane* presents a natural time for an assessment of the law and the policy debate. Proposed statutory reform of the *Competition Act*, some of which is in direct response to *Superior Propane*, makes this assessment vital.

In the normative debate on the efficiency defence, three views have been especially prominent in print and at conferences. One is that the total surplus standard, whereby the impacts of a merger on consumer and producer benefits from a market are treated equally, is the only valid standard for merger analysis. The total surplus standard was explicitly endorsed by the Competition Bureau in its *Merger Enforcement Guidelines* in 1991, and the departure of Canadian competition policy from the total surplus standard, as a result of the first Court of Appeal decision in *Superior Propane*, is in this view a negative development. The second view is that competition

policy is entirely about protecting competition, for the benefit of consumers, and the Tribunal decision in *Superior Propane* to accept a merger that in its own judgment substantially lessens competition is a negative development. Accordingly, the efficiency defence should be rewritten so that consumer interests are never compromised for the benefit of a profit-enhancing merger. Finally, a view expressed in conferences and the competition policy community at large is that the meaning of section 96 is now so uncertain that the law would be better without it. Statutory reform is essential if merger efficiencies are going to be a coherent part of a merger case.

We take issue with all three views. We argue below that the redetermination decision in *Superior Propane*, under the constraints of the first ruling by the Federal Court of Appeal, is well reasoned and leaves us with a legal merger standard that is coherent, appropriate, and as predictable as one could reasonably hope for. In converging to a correct and implementable interpretation of section 96, the common law has worked. The proposed statutory amendment to the efficiency defence now well on its way to becoming law is misguided and potentially dangerous.

The Appropriate Standard for Balancing Efficiencies and Lessening of Competition in Merger Policy

Utilitarian Approaches

Any consistent rule for when a government should intervene to prevent or remedy a merger must depend upon the effect of the intervention on the welfare of market participants, i.e. on the benefits of intervention to consumers and the costs of the intervention to producers. And, from the perspective of law and economics, a coherent rule must depend only on these costs and benefits.

The approach that demands that government policy be assessed according to its impact on the welfare of market participants is referred to as "utilitarianism" in social philosophy and much of economics.[3] Utilitarianism is the starting point of welfare economics. A rule for intervention that is not utilitarian is bound to lead to decisions in some circumstances that make all parties affected by the intervention worse off, or at least harm some without benefiting others. We adopt a utilitarian approach to our discussion of which standard should be adopted for balancing merger efficiencies and a lessening of competition. We also discuss the problems that arise with some prominent standards or rules that violate utilitarianism.

Any utilitarian rule depends on the impact of a merger on two types of market benefits.[4] Benefits to producers from exchange in a market are measured as profits.[5] Benefits to consumers are measured as consumer surplus. If a consumer gets to purchase a product for $5 that she values at $7 then she has gained $2 in consumer surplus. The sum of all consumer surplus in a market measures the total benefit of the market to consumers, and if prices increase because of a merger then the resulting loss in consumer surplus is the cost to consumers of the merger.

The utilitarian contenders in the debate about appropriate merger standards are the (1) total surplus standard; (2) the price standard; and (3) a "weighted surplus" approach. In the total surplus standard, the gains to consumers and the losses to producers from any intervention by the Tribunal, e.g. blocking the merger, are weighted equally in measuring the net benefit of such intervention. Intervention is justified only if total surplus would decrease as

a result of the merger. Under the price standard, intervention is justified whenever the price to consumers would rise with the merger.[6] In other words, under the price standard gains to consumers from intervention are given a weight of 1 and the costs to suppliers of the intervention are given a weight of 0. Intervention is justified under this standard if it helps consumers, regardless of the costs of the intervention to producers. In the weighted surplus approach, one supposes that the Tribunal chooses relative weights that should be attached to consumer surplus and producer surplus[7], and based on these weights determines if the weighted sum of surplus increases or decreases with the merger. Alternatively, as Professor Townley recommended very influentially during the first *Superior Propane* hearing, the Tribunal calculates from the evidence the minimum weight on consumer surplus that would be necessary to reject the merger, and then decides whether the weight that it should attach to consumer surplus in evaluating the merger exceeds the minimum weight so calculated. (As a matter of terminology, this is referred to in the case as a "balancing weights approach", which is a way of implementing the weighted surplus standard.) Professor Townley's balancing weights approach is a very appealing method of implementing the weighted surplus standard because it allows the Tribunal to make a decision without having to establish a precise value for the relative weights of consumers and producers, thus potentially reducing the difficulty of their decision and allowing them to avoid unnecessary commitment to a very specific set of weights.

We note that as a technical matter, only the relative weights matter; weights of (.5, .5) and (1,1) implement the same rule and weights of (1.6, 1) (.61, .39), for example, also implement the same standard.[8] We adopt the convention under which weights sum to one. If the Tribunal always chooses equal weights such as (.5, .5) on consumer and producer surplus in the weighted surplus approach, the approach becomes equivalent to the total surplus standard; if the Tribunal always chooses weights of (1,0), the approach would reduce to the price standard. In this sense, the weighted surplus approach is more general than the other two standards discussed.

Theoretical Basis for the Total Surplus Approach

We consider the theoretical basis for each of these approaches. Two main theoretical arguments have been advanced in favour of the total surplus approach. First, where the total surplus increases with a merger, it is possible to redistribute wealth in order to make all parties better off if the merger is allowed. As pointed out repeatedly (and correctly) in the Canadian merger policy debate, the possibility that redistribution of gains post-merger could make all parties better off is not a reason for adopting the criterion where the redistribution would not actually take place. The first argument for the total surplus standard is incorrect. The second argument offered for the total surplus approach is that a choice of weights different than (.5,.5) on consumer surplus and producer surplus involves a value judgment that the Tribunal is not in a position to make. Or, more crudely, commentators argue that the Tribunal or the Bureau is not in a position to say that a dollar accruing to consumers is more or less valuable than a dollar accruing to shareholders. This argument is also incorrect, because even the choice of equal weights involves a value judgment.[9] In a policy decision in which some people are made worse off and some are made better off, a value judgment cannot be avoided.

Theoretical Basis for the Price Standard

The price standard, which as mentioned is logically equivalent to selecting the most extreme set of weights, 1 on consumer surplus and 0 on producer surplus, lacks any theoretical support. The extreme value judgment inherent in this standard is that the government (the Tribunal) should intervene by blocking a merger if there are any benefits to consumers from such intervention, whatever the costs to producers. This value judgment is not only *ad hoc*, it finds few parallels in other government policy decisions. Democratic governments rarely take policy decisions without attaching some weight to the potential costs of the alternatives among which they are choosing, even if these costs are borne by less than half the voting population.

Stephen Ross[10] offers the following argument in favour of the price standard. The majority of citizens identify themselves as consumers rather than shareholders. Therefore the price standard, which follows only consumer interests, yields results consistent with improving the welfare of the majority of Canadians. Finally, the Canadian government, as a parliamentary democracy, should and will invoke any policies that have the support of the majority of the voting population.

This argument relies on an extremely simplistic notion of a democracy. The Canadian government does not evaluate policy decisions on the basis of how 51% of voters would vote on the decisions. Nor should it. The magnitude of the losses to 49% of the population from a policy decision is not irrelevant. When a rational voter evaluates a governmental party in an election, she balances the gains that she is likely to experience from the election of the party with the losses – assessing both the number and size of gains and losses. Magnitudes of losses are critical and deserve weight. When it formulates public policies that – as a package – attract the highest number of voters, a political party must consider the magnitude of losses to any policy, rather than dismissing the losses as borne by 49% or less of the population. In other words, the majority decision rule that we use for the choice of government in democratic elections does not translate into a majority decision rule for each policy decision undertaken by the government. This principle is obvious and well established in political theory.[11]

Theoretical Basis for the Welfare Weights Approach

Thus, neither the total surplus nor the price standard can be solidly grounded in theory, prior to considering the practical aspects of implementation. The welfare weights approach, however, has a basis in theory. Suppose that the Tribunal can infer from general economic and social evidence the penalty or gain that Canadian society attaches to a particular redistribution between two groups (again, setting aside for now any practical difficulties with this inference). As Professor Townley's evidence indicates, and as the Tribunal astutely recognized in the redetermination decision, the basis for different weights must lie in the difference in the wealth levels of shareholders and consumers. Nothing in the labels "consumer" and "shareholder" inherently justifies different weights in a weighted surplus approach. A redistribution of wealth among citizens should be reflected in a policy decision to the extent that it distributes wealth between groups of different wealth levels. Nothing in the fact that some citizens are shareholders, directly or through their pensions or mutual funds, renders their welfare less important at the margin than the welfare of consumers. In cases where shareholders are wealthier, however, there is a basis for attaching higher weight to the change in wealth accruing to consumers.

What is the basis for differential weights? Either of two perspectives can justify the attachment of higher weights to the marginal dollar accruing to less wealthy individuals. First, simply the observation that the Canadian tax and social insurance system as a whole redistributes income from more wealthy to less wealthy citizens, at the cost of some loss in efficiency, tells us that Canadians attach positive social value to greater equality in wealth. The marginal social value to a dollar flowing to poor individuals is apparently greater than to wealthy individuals. This social value must be recognized, in theory, through higher welfare weights to wealth flows to or from less wealthy citizens. This is the *ex post* perspective.

A frequent response to this reasoning from total surplus advocates is that other policy instruments such as taxation and welfare payments are more efficient for wealth redistribution than merger decisions. The difficulty of redistributing wealth through merger prohibitions has some practical currency, but – keeping the analysis at a theoretical level for now – the argument that tax and welfare redistribution are sufficient instruments for redistribution and should therefore displace merger law completely from this role is wrong. As a matter of reality, the tax system is not used to redistribute gains from mergers. An individual consumer's income taxes are not affected by losses or gains from a merger. Higher prices paid as a result of a merger are not tax deductible and the incidence of high prices on some consumers is thus not offset by the tax system. A merger will generally affect the distribution of wealth in ways that may be socially detrimental, and these effects will in fact not be corrected by taxes, however superior the tax system is as an instrument for redistribution.[12]

The second perspective to justify the inclusion of welfare weights, as functions of the wealth levels of consumers and shareholders, is the *ex ante* perspective. Economists often approach a policy design problem like the task of designing an optimal merger standard by taking a long run perspective, asking how a representative citizen would design a merger standard prior to any knowledge about which mergers were going to affect her and whether she was going to be a consumer or a shareholder. This is similar to the modern social contract approach adopted by political philosophers, most notably John Rawls, in thinking about distributive justice.[13] Rawls approached the problem of how wealth should be distributed among individuals in a society by asking how any individual would choose to allocate wealth among individuals if she were "behind a veil of ignorance", not knowing which position she occupied in the society.[14]

An individual, behind such a veil of ignorance, would assign probabilities to being on either side of any transfer of wealth, and would consider as well the range and distribution of possible wealth levels that she might have in the future when any particular merger was being assessed. In the absence of separate insurance markets to protect consumers from losses due to transfers, she would look to create institutions or rules that would protect her from suffering losses when she has lower income, even if this means she must pay a price in situations in which she has higher income (This is referred to as risk aversion.) In other words, she would design a welfare weights merger standard that attached higher weight to whichever group, consumers or shareholders, had lower wealth. This would reflect her anticipation of higher marginal utility of wealth in states with low wealth. (A dollar in future states where she is poor is "worth more" than when she is wealthy.) Merger policy, in short, would substitute partially for the obvious absence of, or incompleteness in, markets for insurance against the risk of high prices. Merger policy would become part of the network of social insurance schemes.

Either the *ex post* or *ex ante* perspectives can justify, in theory, the use of merger policy as an instrument, not just to increase the efficiency of the Canadian economy, but to redistribute income as well. But what is the justifiable *extent* of wealth redistribution to be achieved via merger policy? An *ex ante* approach to this question would attempt to estimate the degree of risk aversion of the typical Canadian citizen as well as the efficient role of merger policy as one of the available instruments of social insurance. It would be practicably impossible to arrive at a sensible answer to the question via this approach. An *ex post* approach to the question is to identify the extent of income redistribution that is revealed in social choices regarding income redistribution. This approach is more helpful.

The Price Standard is not more Judicable

As a final comment on general, utilitarian approaches to the issue of a merger standard, we note that the price standard has found some support on practical or judicability grounds. The propane merger involved a nearly homogenous, single product industry, allowing potentially accurate quantification of consumer and producer surplus figures. In an industry with many differentiated products, however, the exercise would not be nearly so tractable or transparent. The estimation error for these surplus calculations could be large and lead to major transactions costs in disputes and hearings. Hence, the price standard may be easier to "referee" both before and after a merger.

We disagree with this position on two grounds. First, the accurate estimation of price effects requires essentially the same information – demand and cost parameters – as the estimation of changes in surplus. Marginal cost and the elasticity of demand for the range of products must be estimated in both cases. Disputes and potential errors will not be reduced by moving to a price standard. Second, it is important to remember that the burden of proof in the efficiency defence falls on the respondents. In a case where the information is weak and uncertain, adjudication under a price standard will not lessen the risk of section 96 leading to an incorrect decision, since then the efficiency defence is unlikely to be successful even under a total surplus or weighted surplus test. Thus, the price standard neither makes the evidentiary task easier nor leads necessarily to a lower chance of error.

Utilitarian Reasoning in Superior Propane

In the redetermination decision in *Superior Propane*, the Tribunal looked to the progressivity of the Canadian tax code for guidance in determining the relative value that Canadians attach to income flowing to citizens of different wealth or income levels. This is an insightful part of the decision. The Tribunal cites R. Boadway & H. Kitchen, who found that the tax system overall implements taxes that are roughly proportional to income.[15] As these authors and the Tribunal noted, however, the combination of taxes, social insurance and fiscal expenditures do reveal progressivity, i.e. an inclination to redistribute wealth to the poor. But social insurance such as welfare payments, and fiscal expenditures such as public housing, represent transfers to the poor, rather than transfers from, say, the wealthiest half of Canadians to the least wealthy half of Canadians. There is no evidence to justify substantial redistribution except to the extent that parties detrimentally affected by the merger are genuinely poor, as opposed to simply less wealthy than those who gain from the merger. As the Tribunal stated at paragraph 113 of the redetermination decision in *Superior Propane*, "Having regard to the combined system of taxes and public

expenditures in Canada, there appears to be a basis for attaching a greater weight to the income groups that could be described as poor or needy than to shareholders assuming they are neither." [emphasis added]

Redistribution of Income only to "Poor or Needy" Consumers

This is the Tribunal's key concession in the redetermination decision to the Court of Appeal's ruling that it must look beyond total surplus in interpreting section 96. We agree with the statement. However, government intervention in mergers should not be relied upon more strongly to implement a redistribution of income than the policy instruments designed specifically for that purpose. While the Tribunal stated (at 112) that it would expect to have evidence on the issue and additional research is clearly needed, the indication is that redistribution is mainly to income groups that could be described as poor or needy. The choice of the lowest quintile of consumers (as opposed to the lowest quartile or the lowest decile) as "poor or needy" is arbitrary. But the choice is convenient given the form of Statistics Canada data on consumer expenditure and the arbitrariness in the definition of the size of the group can be offset by, or rather transferred to, the choice of welfare weight to be attached to this group.

The effect of the statement is to justify welfare weights that are higher than the weight on profits only for those consumers who are "poor or needy". If we identify these as falling within the lowest quintile of the income distribution then only consumers from this lowest quintile would warrant the higher welfare weight. Suppose, for example, that we are considering a merger in a market in which consumption is independent of income. Then the set of consumers would be drawn from the entire income distribution and 20% of the consumers in the market would warrant a high welfare weight. What should the weight be? This is the biggest source of ambiguity or uncertainty in the entire normative exercise. The weight should reflect the higher marginal social value of income to the poor, but should also be tempered by the practical difficulties and inaccuracies in using merger policy as an instrument for wealth redistribution. Even if the weight on income to poor consumers were 50% greater than that on other consumers and producers, the weight on consumer surplus as a whole would be only 10% greater than that on producers. Equivalently, the weights on consumer surplus and profit, instead of being (.5, .5) as in the total surplus approach, would be (.52, .48).

These weights are based on an assumption that demand is independent of income or, in economic terminology, that the income elasticity of demand is 0. On average across products, however, the income elasticity of demand is approximately equal to 1.[16] For a typical product, therefore, expenditure rises with income and the poorest 20% of Canadians account for much less than 20% of the quantity purchased. For example, in 1996, the lowest income quintile of consumers accounted for only 6.7% of the total expenditure on all goods.[17] Thus, if the lowest quintile is to receive a weight of 50% higher than other market participants, the resulting weights on consumer surplus and profits in the weighted surplus approach are, for the average good, (.508, .492) instead of the equal weights corresponding to the total surplus measure. Even if the welfare weight on the poorest consumers is twice that on other consumers, then the implied weights are (.516, .484). For a typical case, in other words, the Tribunal's reasons in the redetermination decision – reasons that we have argued are supported by analysis and evidence – lead to a change in the second or third decimal point to the weights applied to consumer and

producer surplus, within the class of weighted surplus rules. While these weights follow from the Tribunal's reasons (combined with an assumption of a weight on the surplus of -poor consumers 50% greater than that on other consumers and producers) the Tribunal itself did not carry through these calculations to the conclusions that we reached. It did not need to. Under the balancing weights approach, the Tribunal need only decide whether or not the weight on consumer surplus necessary to lead to a rejection of the merger is too high. But our calculations indicate that the balancing weights approach to implementing the weighted surplus standard would lead to the acceptance of virtually as many typical mergers – that is mergers in markets with average income elasticities of demand – as the total surplus rule. Readers familiar with the wide range of approximations, estimation errors and rough guesses involved in evidence in merger cases will agree that a change in the second or third decimal place of the weights will have a trivial impact.

The application of this approach to the *Superior Propane* case specifically, rather than a typical product, introduces an additional factor. As the Tribunal noted, only 10% of the buyers of propane are consumers. 90% are businesses. Lacking any evidence on the distributional impact of the price increases resulting from the increased prices to businesses, the Tribunal assigned the business buyers a weight equal to that on shareholders.[18] Suppose that we incorporate, in our calculations above, this fact and the fact that the lowest quintile of consumers purchase approximately 13% of propane.[19] Then, adopting our illustrative assumption that the appropriate welfare weight on poor consumers is 50% greater than that on the other participants, the resulting welfare weights on consumer surplus and producer surplus are (.502, .498). While the Tribunal did not state their assumption as to the appropriate weight to attach to the income of poor consumers – the benefit of the balancing weights approach is that it did not need such an explicit assumption – even if the Tribunal's extra weight on poor consumers' income was double ours, the practical departure of the redetermination decision from a total surplus ruling was tiny. And, as we have argued, this ruling has a solid basis in economic analysis and the available evidence on the extent of income redistribution in Canada.

At the risk of overkill, we must mention an additional factor which, if incorporated, would render welfare weights even closer to (.5, .5). Even setting aside (as we have) the merger impact on labour and shareholders of competing firms, there is a third group affected by a merger: Canadian taxpayers at large. Any profits accruing to corporations do not flow directly to shareholders but are split between shareholders and government tax receipts. Each dollar of taxes received from corporations reduces the need to raise taxes from other taxpayers. And the effect is important: corporate tax rates average 38% in Canada, and profit is taxed again when it is distributed as dividends before it can be spent by shareholders. Roughly speaking, therefore, taxpayers share the before tax profit equally with shareholders. Taxpayers as a group deserve at least the weight attached to consumers as a group (at least for a product with an income elasticity of 1), since one alternative available to the government is to distribute the tax receipts among individuals of varying wealth. The effect is that in *Superior Propane* and in general, incorporating the flow of tax revenue renders any set of weights even more egalitarian.

Tribunal Discretion in Determining Welfare Weights

The discussion of the appropriate welfare weights to this point has omitted a practical consideration. We have assumed that the Tribunal knows or can assess the social value of income accruing to consumers of different wealth. However, commentators on all sides of the debate have argued – most strongly the Tribunal itself and those concerned with uncertainty of merger policy – that it is dangerous and inappropriate to place the Tribunal in the position of assessing in each merger the relative social value of each dollar of benefits accruing to shareholders versus the dollar of benefits accruing to consumers. The discretion of the Tribunal in deciding upon relative values, or relative weights within a general standard, should be minimized.

The upshot of this practical concern, it may be argued, is that the welfare weights should be set to some objective, default values for most cases or almost all cases, and should deviate from these values only when the justification for doing so is very compelling. Prominent antitrust experts, such as Richard Posner, argue strongly for "bright line rules".[20] Taking into account the Boadway-Kitchen results as summarized by the Tribunal, the issue in choosing weights is the fraction of consumers who are genuinely poor or needy (as opposed to simply less wealthy than the average shareholder). Our analysis above indicates that for a typical case, conditioning upon a relative welfare weight 50% higher for the poorest quintile of the population, welfare weights on consumer surplus and profit would be approximately (.508, .492). Even if the deviation of this set of weights from (.5, .5) is wrong for a particular case by a factor of 10, the possibility of error in using (.5, .5) instead of the correct number is likely to be small. It may well be argued that the adoption of an inflexible standard of (.5, .5) is optimal on three grounds: (1) creating greater certainty in the law; (2) minimizing Tribunal discretion; and (3) reducing the costs of hearings.

This argument has some currency. Certainly the equal weights are a much closer approximation to the "exact" weights for typical cases than the weights of (1,0) implicit in the price standard. The original decision of the Tribunal is consistent with this argument. We believe, however, that some allowance must be made for the possible merger cases in which the vast majority of consumers are poor and in which the gain in total surplus is small. These are cases in which the total surplus rule would possibly be reversed by redistribution concerns. Indeed, this is the law after the first Court of Appeal decision that factors such as wealth redistribution must at least be considered; and in our opinion this is appropriate. The benefits of this flexibility lie simply in the possibility that the wrong decision would be made under the total surplus rule. There are examples of mergers with small positive effects on total surplus and a large detrimental impact on the distribution of wealth that would overwhelm the efficiency effects. A merger between slum landlords that would lead to a small increase in total surplus, but which would raise prices by capturing a very large share of low-cost housing in a city, is one example. The overwhelming consensus among Canadians "behind a Rawlsian veil of ignorance", we suggest, is that a merger such as this one would not be desirable; a small gain in the total wealth at the expense of a transfer from poor tenants to wealthy landlords would not be in the public interest. The procedure that we support (and which we will argue is the law including the redetermination decision in *Superior Propane*) is the following: the burden of proof for demonstrating a section 92 substantial lessening of competition would fall (as it currently does) on the Commissioner; the burden for demonstrating an increase in total surplus would fall on the parties to

the merger; and the burden of demonstrating a seriously detrimental wealth redistribution would then fall on the Commissioner.

Potential Costs of Adding Flexibility are Small

The three potential costs of adding flexibility to the total surplus rule are small. First, while the weight to be applied to the loss in surplus by poor consumers is not precise and as a result some uncertainty is added to the law, the additional vagueness in the merger standard that we have described would not add significant uncertainty. All prospective parties can do the calculations that we have outlined above and it is clear that of those mergers that would pass under the total surplus test, the proportion that would be rejected by a weighted surplus test is small. For practical purposes, firms and lawyers can assume that the total surplus rule continues to hold except in rare cases. Moreover, whether 1% or 10% of those mergers that do pass the total surplus test would then be turned back on distributional issues, is a small matter relative to other sources of uncertainty in the outcome of merger cases. Finally, if the degree of uncertainty were – in contrast to our opinion – considered serious, the Competition Bureau could amend its *Merger Enforcement Guidelines* to specify the types of mergers where the impact on wealth distribution would be challenged. Merger policy in practice has succeeded in overcoming the serious uncertainty caused by vagueness in the meaning of the term "substantially" in section 92; merger policy could also overcome the very small uncertainty associated with vagueness regarding the importance of the redistribution of wealth in *Superior Propane*. There is, as we discuss in the conclusion to this article, no legitimate reason to avoid detrimental wealth redistribution at all costs by jumping to the weights of (1,0) that are implicit in the price standard.

With regard to the concerns expressed by some practitioners that tremendous uncertainty has been introduced into Canadian merger law by *Superior Propane* – even to the extent that section 96 is useless – we suggest that the opposite is true. Before *Superior Propane*, the Tribunal had expressed skepticism of the total surplus measure (in Madame Justice Reed's now famous *obiter* in *Hillsdown*) and the Competition Bureau and Commissioner had wavered, adopting positions along the entire spectrum of views on the interpretation of section 96 and withdrawing the relevant section of the *Merger Enforcement Guidelines*. Now, it is not too far off the mark to suggest that in the redetermination decision the Tribunal nailed the interpretation down to the second or third decimal place.

Regarding the second cost to the flexibility in the redetermination decision, the introduction of discretion over wealth distribution to the Tribunal, it is clear from the above calculations that this discretion is minimal, if not in every possible case then in the vast majority of cases. And under Professor Townley's balancing weights approach, the Tribunal need not be pinned down to a specific set of weights in each case. We also have some sympathy with the Court of Appeal's statement that government administrative bodies in general, if not quasi-judicial bodies, are called upon to make the tradeoff between income flows accruing to different social groups. (In fact, an economic literature exists that estimates the welfare weights revealed in decisions by administrative or regulatory agencies, for agencies that take hundreds of decisions; we refer the reader to Stan Wong's *The Foundations of Paul Samuelson's Revealed Preference Theory*[21] for a superb treatment of revealed preference

theory.) The discretion invested in the Tribunal by the first Court of Appeal decision, as clear from our discussion of the redetermination decision, is very small compared to the discretion that must be exercised by other agencies.

Finally, the third cost to the flexibility in the redetermination decision, the administrative cost of introducing another dimension along which merger cases can be fought, is very small. The Commissioner, in deciding among cases and among arguments within cases under the law of *Superior Propane*, may be able to obtain evidence on expenditures on relevant products from Statistics Canada. We suggest that the set of cases where the Commissioner will identify a likely argument for serious redistributive effects will be small, and the cost of doing so averaged across all merger cases will be insignificant.

Non-utilitarian Approaches to Interpreting Section 96

A host of non-utilitarian arguments have been offered to justify various merger standards. Several of these were adopted by the Commissioner in the redetermination hearing. To the surprise of many observers as well as the Tribunal, the Commissioner abandoned the balancing weights approach (i.e. the welfare weights standard) that he had adopted in the first hearing through his expert, Dr. Townley; the Court of Appeal had commented favourably upon the balancing weights approach, stating that it would be consistent with its ruling.

Three examples of non-utilitarian approaches to the interpretation of section 96 are particularly prominent. All were adopted at different times by the Commissioner in arguing against the Superior – ICG merger in the redetermination hearing. The first is the statement that efficiencies can never offset the anticompetitive impact of a merger to monopoly because monopolies are antithetical to competition. The second is inherent in the "free competition" legal doctrine, that Canadian consumers have the right to the benefits of competition. The third is the rule that is (in some commentators' interpretation) suggested by the *obiter* in *Hillsdown*: the gain in profits from efficiencies (a positive effect of a merger) should offset the sum of negative effects, which include not only the "deadweight loss" in consumer surplus but also the transfer of surplus to producers. While it is not obvious, the *Hillsdown* standard violates utilitarianism, as we discuss below.

Before commenting on these approaches, we remind the reader that we are assessing the approaches as a matter of policy, rather than as a matter of law. Sometimes bad policy is correct as a matter of law. We will not share our view on whether this is true with section 96, since our areas of expertise are economics and policy, not law. We therefore abstain from purely legal, non-utilitarian approaches to statute interpretation, such as inferring Parliamentary intent from the text of debates on the bills within Parliament. But it is important to note that utilitarianism is of course often used in arguments over statutory interpretation under the assumption that the right law must be what Parliament intended (such as in the question, "Could the Canadian Parliament Really Permit Mergers that Exploit Consumers So the World Can be More Efficient?")[22] or under the assumption that courts and the Tribunal should simply interpret a statutory law in the manner that makes the best policy. While we are adopting a purely normative approach, assessing merger standards or rules purely as policy, the discussion is therefore relevant for the issues of legal interpretation as well.

Merger to Monopoly

The argument that efficiencies cannot defend a merger to monopoly was both adopted by the Commissioner in the *Superior Propane* redetermination and espoused by him in recent speeches. But a merger to monopoly with significant efficiencies can benefit all market participants, and therefore if one accepts the (utilitarian) premise that what matters is the impact of a law on the welfare of individuals affected, the blanket dismissal of section 96 in merger to monopoly cases is wrong. A pure "monopolist" in the common interpretation of a firm without competitors, as the Tribunal notes[23], is a hypothetical construct. In competition policy, however, one uses a definition of a market that is more precise than the general use of the term. This is the hypothetical monopolist definition.[24] Under this definition, as typically applied, any merger that – without its associated efficiencies – would result in a price increase of more than 5% is a merger to monopoly.[25] This is true even if the cost efficiencies would in fact lead prices to fall with the merger. It is important to note in addition that the position that any merger to monopoly should be prohibited or remedied by the Tribunal is inconsistent with section 92(2), which states that market share evidence (an example of which is a post-merger market share of 100%) is insufficient to allow a remedy under section 92.

"Free Competition" Doctrine

Our assessment of the old "free competition" doctrine is similar. Adoption of either of these positions in law would take competition policy to a position where competition is an end, rather than a means, and where protection of competitors becomes a goal. This is a position now abandoned completely in U.S. law. The position and the doctrine are not just neutral but hostile to efficiencies, but could result from acceptance of either of the argument that merger to monopoly should be prohibited or the "free competition" doctrine, in place of evidence on the impact of mergers on the parties affected.

The *Hillsdown* Standard

In the *Hillsdown* standard, different components of profit receive different weights: the profit that results from merger-related efficiencies receives a weight of 1 and the profit that results from a transfer from consumers receives a weight of 0. It is possible that the *Hillsdown* standard when applied to each of two mergers, A and B, could accept A and reject B, even though B is better for both firms and consumers. Consider as an example mergers A and B described by Table 1.

Merger	DWL	Transfer	Efficiencies	Hillsdown Net Effect	Impact on Consumers	Impact on Profits
A	16	79	98	+3	–95	177
B	8	86	92	–2	–94	178

Table 1: Effects of Two Hypothetical Mergers

In this example, the *Hillsdown* net effect of merger A is efficiencies minus the sum of deadweight loss ("DWL") and the transfer, which equals 3; the impact on consumer surplus is the negative sum of deadweight loss and the transfer, or -95; the impact on profits is the sum of the transfer and efficiencies, or 177. Similarly for B. The *Hillsdown* test would accept merger A, but reject merger B, even though for all parties affected B is the better merger.

The point of the example is not that the Tribunal is ever in the position of choosing between two mergers (although it is possible that the *Hillsdown* test could be applied to prospective remedies in a particular merger, with the same effect). The argument is that a sensible merger rule should be consistent with what economists refer to as the "Pareto ordering": if a merger A yields outcomes at least as good for all parties as another merger B and strictly better for some, then the rule should never accept B but reject A.

All of the non-utilitarian tests discussed above violate this principle of consistency with the Pareto ordering. The utilitarian tests that we discussed, the welfare weights standard and special cases of this standard such as the total surplus test, satisfy the consistency principle. This is not surprising, because the Pareto ordering or the Pareto principle is the essential ingredient of utilitarianism. Revealed preference theory[26] can be used to show that any test, defined for all possible mergers, that is consistent with the Pareto principle can be expressed as a weighted surplus rule (or generalizations of the rule to nonlinear aggregation of the surplus of parties affected by the merger). If one believes in the Pareto principle, one believes in a weighted surplus rule of some sort, or its generalization. Anything else should be tossed out.

In the previous section of this article, we were highly supportive of the Tribunal's utilitarian reasoning in the redetermination decision. Unfortunately, the Tribunal also justifies its decision with resort to a second line of reasoning: a non-utilitarian *Hillsdown*-type approach. The Tribunal generalizes the *Hillsdown* standard by suggesting that a smaller weight could be attached to the transfer from consumers to producers in summing up the negative and positive consequences of the merger. The Tribunal considers the weight that would have to be attached to the transfer in order to render negative the net effect of the merger (redetermination decision, at 370-371). In our view, neither the *Hillsdown* standard (which was originally raised as a possible approach, not as a ruling, by Madame Justice Reed) nor the Tribunal's generalization has any foundation. The standard has served only to confuse an area of competition law and policy that is already complicated enough.

Conclusion

An irony of *Superior Propane* is that the entire debate over the central and fundamental issue, the standard for assessing a merger, arose only because of a simple miscalculation of deadweight loss by an expert testifying on behalf of the Commissioner. As previous articles on the case have discussed, the Commissioner would have likely won the case under any standard but for this error.[27] An attempt by the Commissioner to correct the error in final argument was naturally excluded from consideration by the Tribunal as an attempt to introduce new evidence, but the Tribunal indicated that its decision may well have been different had the correction been introduced properly.

In our view, however, the error allowed a decision that should be regarded as a valuable and well-reasoned clarification of the standard to be adopted in Canadian merger law. Bad cases can make good law. We have established four propositions in this article. First, uncertainty in the meaning of section 96 is much less, not greater, after *Superior Propane*. The standard that the Tribunal would attach to balancing efficiencies and anticompetitive effects of a merger was highly unpredictable before the *Superior Propane* cases, but following the redetermination decision, upheld under appeal, the standard is surprisingly precise for most cases. The main line of reasoning in the redetermination decision provides, we argue, a clear and implementable method for arriving at the impact of wealth redistribution. Second, *Superior Propane* leaves us with a rule that is in practice very close to the total surplus rule. While exceptions exist in theory and must be allowed for because of the first Court of Appeal decision, and should be allowed for as a matter of policy, these exceptions are likely to be rare. This is not surprising given the great flexibility that the appellate court decision provided for the Tribunal in remanding the matter back to it. Third, the Tribunal's main line of reasoning in the redetermination decision is solidly grounded in economic analysis. The secondary, non-utilitarian line of reasoning should be abandoned. Finally, various other non-utilitarian arguments for interpreting section 96 also lack foundation and, especially in the case of the *Hillsdown* standard, add only inconsistencies and confusion to discussions of Canadian merger policy.

A second effect of the evidentiary error in *Superior Propane* and the resulting decisions, however, is the misconception that after the case and without statutory amendment of the *Competition Act*, we will see mergers to monopoly everywhere. This is wrong. Mergers to monopoly will almost always fail to pass even the total surplus standard, as the merger between Superior Propane and ICG Propane would likely have had the test been calculated correctly.

This brings us to the proposed amendments of section 96 currently under consideration in a private member's bill, C-249. The most recent version of the bill proposes replacing the section with the following:

> **96(1)** In determining for the purpose of section 92, whether or not a merger or proposed merger prevents or lessens, or is likely to prevent or lessen, competition substantially, the Tribunal shall, together with the factors that may be considered by the Tribunal under section 93, have regard to whether the merger or proposed merger has brought about or is likely to bring about gains in efficiency <u>that will</u>

> provide benefits to consumers, including competitive prices or product choices, that would not likely be attained in the absence of the merger or proposed merger. [emphasis added]

This amendment, which may become law by the end of this year, is not a clarification of section 96. It is a complete change of direction in the clear and well-founded law on merger efficiencies under *Superior Propane*. Under our interpretation, the change would likely implement a price standard.[28] In fact, the test may be even more stringent than a price standard since the amendment could be interpreted as restricting consideration of beneficial price effects to *competitive* prices, because of the phrase "including competitive prices or product choices". Mergers that reduced prices but left them above competitive levels would be indefensible on efficiency grounds in this stronger interpretation. Whether the stronger interpretation holds is a matter of substantial uncertainty, however.

As we have discussed in this article, there is no justification for adopting a price standard. This standard places zero weight on the costs of intervention by the Tribunal that are borne by shareholders, and full weight on the benefits of intervention that accrue to consumers, independent of the wealth levels of consumers or shareholders. The weight of 0 on shareholders' wealth has no foundation in either *ex ante* or *ex post* analysis of net benefits to Canadians, and places merger law in a position of redistributing wealth to a much greater extent than is achieved by tax and welfare policies – instruments designed specifically for the purpose of wealth distribution. A test even more stringent than a price standard would obviously be even worse.

The amendment may appear to bring Canada to the U.S. test for aggregating efficiency and competitive effects of mergers. It is even more restrictive and less progressive than the U.S. law not just because it is arguably stronger than the U.S. price standard but because the amendment would integrate into a statute a standard that is at least as strong as the U.S. common law. The statute-based competition law in Canada is less flexible than U.S. law, in which the central antitrust acts are only several paragraphs long and the details are entirely in common law interpretation of the statutes. While efficiencies have never been the primary reason for the failure in the U.S. of a government challenge to a horizontal merger in court, there is at least the indication of a trend in the lower courts to recognize efficiencies as a defence.[29] The prosecutorial authorities in the U.S., the Department of Justice and the Federal Trade Commission, exercise more flexibility in considering efficiencies in merger cases than would likely be the case in Canada under a rigid and detailed statutory amendment.

In short, the forthcoming amendment to section 96 is a misguided and dangerous change to a section that had finally been given a clear and solidly reasoned interpretation by the Tribunal.

Notes

[1] *Canada (Commissioner of Competition)* v. *Superior Propane Inc.*, 2000 Comp. Trib. 16 ("original decision"); [2001] 3 FCA 185 ("first Court of Appeal decision"); [2002] C.C.T.D. No. 10 ("redetermination"); 2003 FCA 53 ("second Court of Appeal decision"). The Commissioner decided not to appeal the second Court of Appeal decision. See "Bill C-249 An Act to amend the *Competition Act*" (Speaking Notes for Konrad von Finckenstein, Commissioner of Competition for an appearance before the House of Commons Standing Committee on Industry, Science and Technology, 31 March 2003).

[2] See, e.g., M. Sanderson, "Competition Tribunal's Redetermination Decision in *Superior Propane*: Continued Lessons on the Value

of the Total Surplus Standard" (2002) 21:1 Can. Comp. Rec. 1; F. Mathewson & R. Winter, "The Analysis of Efficiencies in *Superior Propane*: Correct Criterion Incorrectly Applied" (2000) 20:2 Can. Comp. Rec. 88; R.J. Holsten, "*The Commissioner of Competition* v. *Superior Propane* – The Tribunal Strikes Back" (2002) 21:1 Can. Comp. Rec. 26; R.W. Lusk, "Balancing Competition and Efficiencies – An Impossible Dream" (2002) 21:1 Can. Comp. Rec. 33; D.G. McFetridge, "Efficiencies Standards: Take Your Pick" (2002) 21:1 Can. Comp. Rec. 45; M. Barutciski & B.A. Facey, "*Superior Propane*: An Overview of the First Efficiency Case" (2000) 20:2 Can. Comp. Rec. 36; J.L. Gudofsky & P. Gay, "Long Live the *Merger Enforcement Guidelines*? A Review of the *Superior Propane* Decision" (2000) 20:2 Can. Comp. Rec. 46; M. Trebilcock & R.A. Winter, "The State of Efficiencies in Canadian Merger Policy" (1999-2000) 19:4 Can. Comp. Rec. 106; D. Tadmor, "Comments on the *Superior Propane* Case" (2001-2002) 20:4 Can. Comp. Rec. 77; J.S. Tyhurst, "The *Superior Propane* Decision: Common Sense Overcomes Geometry, or How the Federal Court of Appeal Squared the Triangle" (2001) 20:3 Can. Comp. Rec. 8; S.F. Ross, "The Political Economy of the Efficiency Defence" (2002-2003) 21:2 Can. Comp. Rec. 89; P.G.C. Townley, "Efficiency Standards: They Also Serve Who Only Sit and Weigh(t)" (2002-2003) 21:2 Can. Comp. Rec. 115; R. Ware, "Is Competition Economics 'Beyond the Ken of Judges'? The Federal Court of Appeal Ruling in *Superior Propane*" (2001) 20:3 Can. Comp. Rec. 1; R. Ware, "Efficiencies and the Propane Case" (2000) 3 International Antitrust Bulletin 3.

[3] This terminology is consistent with general, non-technical discussions in philosophy and economics. The classic references to utilitarianism are J. Bentham (1973, originally published in 1789), "Principles of morals and legislation" in *The Utilitarians* (Anchor, Garden City) 5-398; J.S. Mill (1969, originally published in 1861), "Utilitarianism," in S. Hollander, *Collected Works of John Stuart Mill*, Vol. X (University of Toronto Press, Toronto) 203-259; and H. Sidgwick (1966, originally published in 1907), *The Methods of Ethics* (Dover, New York). We caution the reader, however, that social choice theorists now refer to the principle that government policy or the social good should be assessed exclusively with regard to its impact on the welfare of individuals as welfarism. Utilitarianism refers in this literature to the special case in which the social good is measured as the sum of individual utility (A. Sen, *Collective Choice and Social Welfare* (San Francisco: Holden-Day, 1970)). We adopt what we believe is more familiar, if less precise, terminology.

[4] To keep things simple, we focus exclusively on the impact of the merger on consumers and shareholders of the merging firms.

[5] More precisely, producer surplus includes both profits and "rents". See M. Sanderson & R. Winter, "Profits versus Rents in Antitrust Analysis" (2002) 70:2 Antitrust Law Journal 485.

[6] The Tribunal refers to this as the "modified price standard". We adopt the standard usage.

[7] Equivalently, the Tribunal chooses relative weights to be attached to the changes in these two surplus values.

[8] This statement follows from the fact that $.61 \times \triangle CS + .39 \times \triangle PS > 0$ whenever $1.6 \times \triangle CS + 1 \times \triangle PS > 0$. (Here "$\triangle$" means "change in".)

[9] This point, and the general impossibility of avoiding value judgments, has been made most forcefully by Townley, *supra* note 2 at 119.

> The text of Part 5 of the 1991 *Merger Enforcement Guidelines* effectively assumed away equity issues: 'Where a merger results in a price increase, it brings about both a neutral redistribution effect and a negative resource allocation effect on the sum of producer and consumer surplus (total surplus) within Canada' [emphasis added by Townley]. However, the accompanying footnote 57 reads: 'When a dollar is transferred from a buyer to a seller, it cannot be determined *a priori* who is more deserving, or in whose hands it has a greater value.'
>
> Whereas the footnote is true but hollow – if we know nothing, then we know nothing – the text is inane. If it is impossible to determine how the parties affected by a merger value dollars – their marginal utilities of income (or wealth) – then, obviously, it is impossible to determine that they value them identically. If there is not enough information to say they are different, there is not enough to say they are the same. A priori, there is no basis for concluding that the redistribution is neutral or is not neutral. That this 'conclusion' of neutrality is used to justify the total surplus standard is quite bizarre.

[10] Ross, *supra* note 2.

[11] Stephen Ross colours his analytical framework with rhetoric, referring to advocates of the total surplus standard as "anti-consumer" (at 94). We suggest that a rule that attaches equal weight to consumers' total welfare and shareholders' total welfare, rather than putting all the weight on the former, is egalitarian, not "anti-consumer".

[12] A comeback by some theoretical economists to this argument, in turn, will be that if the income tax system has already achieved within limits the socially optimal or appropriate wealth distribution then the marginal value of a dollar to any citizen is equal. This justifies equal weights in summing up the welfare effects of individual wealth levels, such as those attributable to a merger, that are small relative to individuals' total wealth levels. In other words, the total surplus criterion is approximately justified. This argument, stated formally, is the Atkinson and Stiglitz Theorem (A. Atkinson & J.E Stiglitz, "The Design of Tax Structure: Direct versus Indirect Taxation," (1976) Journal of Public Economics 6 which provides conditions under which all redistribution of wealth should be implemented through the

income tax system rather than through commodity taxes (or, by extension, through subsidies to consumers via market-specific policies that distort efficiency). The Atkinson-Stiglitz theorem, however, is violated for a myriad of reasons (R. Boadway & P. Pestieau, "Indirect Taxation and Redistribution: The Scope of the Atkinson-Stiglitz Theorem," Working Paper, Queen's University Department of Economics, 2002) and would be violated if one incorporated mergers into a theory of redistribution.

[13] J. Rawls, *A Theory of Justice* (Cambridge, Mass.: Harvard University Press, 1971). Rawls' Theory of Justice resurrected the social contract theory of Locke and Rousseau and is regarded as one of the most important works in philosophy in the second half of the 20th century.

[14] Rawls set out as well a second postulate which, in contrast to the first, is not adopted by economists. This is the assumption that the individual is "infinitely risk averse" in the sense that she would choose, from behind the veil of ignorance, a distribution of wealth that maximized the welfare of the least well-off member of society.

[15] R. Boadway & H. Kitchen, *Canadian Tax Policy*, 3rd ed. (Canadian Tax Foundation, 1999).

[16] The average income elasticity across products, weighted by expenditures, differs from 1 only because of a higher marginal propensity to save among wealthier individuals.

[17] This is calculated from the data in Table 1 in the expert affidavit of Dr. Peter Townley in *Superior Propane*. We note that, as Dr. Townley indicated, there are limitations on these data.

[18] We caution, however, that one cannot conclude that this distributional impact is neutral because the buyers are businesses. The impact will fall mainly on the buyers from these businesses, assuming that the elasticities of supply in these secondary markets (markets such as agricultural markets) are high.

[19] The figure of 13% is calculated from Table 2 of Dr. Townley's evidence (for the year 1996), and is based only on expenditures for bottled propane, because of data limitations.

[20] R.A. Posner, *Antitrust Law* 2nd ed. (Chicago: University of Chicago Press, 2001).

[21] S. Wong, *The Foundations of Paul Samuelson's Revealed Preference Theory* (London: Routledge & Kegan Paul, 1978).

[22] (1997) 65 Antitrust Law Journal 641.

[23] *Superior Propane* redetermination decision at 268.

[24] Conceptually, a relevant market for merger analysis under the Act is defined in terms of the smallest group of products and smallest geographic area in relation to which sellers, if acting as a single firm (a 'hypothetical monopolist') that was the only seller of those products in that area, could profitably impose and sustain a significant and nontransitory price increase above levels that would likely exist in the absence of the merger...In most contexts, the Bureau considers a 5 percent increase to be significant, and a one year period to be nontransitory. *Merger Enforcement Guidelines*, s. 3.1.

[25] This statement follows from the fact that if prices would go up with the merger by 5%, then the products sold by the merging firms constitute a market under the hypothetical monopolist test. Possible efficiencies are not considered in market definition under the hypothetical monopolist test.

[26] Wong, *supra* note 20.

[27] See Sanderson, *supra* note 2 and Mathewson & Winter, *supra* note 2.

[28] In a price standard, it is understood that changes in prices are adjusted for changes in quality or in product choice.

[29] J. Baker, "Horizontal Merger Analysis Grows Up: A Review of Chapter 5 of Richard Posner's *Antitrust Law*" (January 2002) The Antitrust Source 2.