

MCMILLAN BINCH LLP

The Efficiency Defence and Canadian Welfare

by **Ryan Morris**

June 16, 2003

THE EFFICIENCY DEFENCE AND CANADIAN WELFARE

I: INTRODUCTION

Surprisingly, international considerations have largely been ignored by commentators and the courts when discussing how efficiencies ought to be measured in merger review. However, mergers inevitably take place in a global economy. The existence of foreign shareholders, foreign consumers, and trade agreements greatly affect what Parliament can and ought to set as the standard for measuring efficiencies. It also affects how courts ought to interpret the legislation. In Canada, following the *Superior Propane* decisions¹ and the introduction of Bill C-249, *An Act to Amend the Competition Act*², the timing is ripe for Parliament to consider the international aspects of merger review and legislate a standard that maximizes Canadian welfare.

In Canada, the debate as to how efficiencies ought to be measured has largely been between the consumer welfare and total surplus standards.³ Part II is designed to give the reader background information relevant to the debate. Part II outlines the efficiencies defence in Canadian competition law and then frames the debate between the different standards that can be applied.

Part III examines the debate between the standards absent international considerations. Part III introduces the concept of a bright-line consumer welfare standard, holding that the consumer welfare standard cannot be applied on a case-by-case basis under current legislation. It concludes that while the bright-line consumer welfare standard, under certain conditions, could be the standard that maximizes Canadian welfare, the total surplus standard is currently the preferred model.

Part IV expands the debate and introduces the concept of a domestic welfare standard. The domestic welfare standard modifies the total surplus standard to account for international considerations and ensures Canadian welfare is maximized. Part IV assumes that the total surplus standard maximizes Canadian welfare absent international considerations. However, the domestic welfare standard can modify the consumer welfare standard as well.

Part V outlines arguments against using the domestic welfare standard and concludes that the standard could not be applied directly. Part VI however, explains how the domestic welfare standard can be used to determine which standard as between the total surplus standard or the bright-line consumer welfare standard maximizes Canadian welfare.

II: BACKGROUND

The Efficiencies Defence and the Debate between Standards

In Canada, as in other developed nations, mergers are reviewed with the goal of preventing certain harms that can arise with market power. The *Competition Act*⁴ (hereinafter the “Act”) gives the power to an administrative body, the Competition Tribunal, to prevent or disallow a merger that “prevents or lessens, or is likely to prevent or lesson, competition substantially.”⁵

However, unlike in other developed nations, the Act explicitly recognizes an efficiency defence in merger review.⁶ A merger that is expected to result in anti-competitive effects will nevertheless be allowed if the anticipated anti-competitive effects are outweighed by expected efficiencies arising from the merger.

While section 92 allows the Tribunal to prevent or disallow a merger that has anti-competitive effects, subsection 96(1) states:

The Tribunal shall not make an order under section 92 if it finds that the merger or proposed merger in respect of which the application is made has brought about or is likely to bring about gains in efficiency that will be greater than, and will offset, the effects of any prevention or lessening of competition that will result or is likely to result from the merger or proposed merger and that the gains in efficiency would not likely be attained if the order were made.⁷

Therefore even a merger that has anticipated anti-competitive effects will be allowed if the anticipated efficiencies from the merger, provided they are not achievable absent the merger, outweigh the anti-competitive effects. This is an explicit recognition by Parliament that competition is not an end in and of itself. Competition can be seen as valued, not for its own sake, but because it likely brings about positive economic and social benefits. Parliament makes clear through subsection 96(1) that competition ought not to be promoted when it threatens the very benefits competition policy seeks to protect. As the subsection seeks to promote economic welfare, Canada is seen worldwide as having the most economically advanced competition policy.⁸

While it is certain that under Canadian merger review, efficiencies are to be weighed against any anti-competitive effects, it is uncertain how this calculation should be performed.⁹ The uncertainty lies in the wording of subsection 96(1), that the efficiencies must be weighed against the “effects” of any prevention or lessening of competition.

The Effects of an Anti-Competitive Merger with Efficiencies

The effects of an anti-competitive merger with efficiencies, which are at the centre of the debate between the consumer welfare and total surplus standards, are illustrated in Figure 1.¹⁰ Where a merger is anticipated to result in a price increase and reduction of costs,

there will be three effects. The first effect is a result of the price rising from the pre-merger price of P^1 to the post-merger price of P^2 . This will cause certain consumers to be driven out of the market as demand decreases from Q^1 to Q^2 . This results in a loss, referred to as the deadweight loss, and is represented in Figure 1 by the area L.¹¹

The second effect is a result of a reduction in costs, from the pre-merger level of P^1 to the post-merger level of C. This will result in an efficiency gain and is represented in Figure 1 by the area E.¹² The third effect is a result of the consumers remaining in the market being forced to pay an increased price for the product. This has the effect of transferring the consumer surplus they had before the merger to the producer; this amount is represented in Figure 1 by the area T.

The Debate Defined

Both the consumer welfare standard and the total surplus standard weigh the efficiencies, area E, in favour of the merger and the deadweight loss, area L, against the merger. The difference in the standards is the treatment they accord the wealth transfer, area T.¹³ The consumer welfare standard weighs the transfer, or some portion thereof, against the merger. The total surplus standard does not weigh any of the transfer against the merger.

III: RESOLVING THE DEBATE ABSENT INTERNATIONAL CONSIDERATIONS

As the *Superior Propane I* decisions demonstrate, section 96 is ambiguous as to which standard is to apply in weighing the anti-competitive effects.¹⁴ Whereas the Tribunal stated that Parliament, if it had so intended, would have stated clearly that the wealth transfer is

to be considered, the Federal Court states that Parliament, if it had so intended, would have stated clearly that the wealth transfer *is not* to be considered.

The ambiguity of Parliamentary intent is resolved somewhat by subsection 96(3). Subsection 96(3) provides that “the Tribunal shall not find that a merger or proposed merger has brought about or is likely to bring about gains in efficiency by reason only of a redistribution of income between two or more persons.”¹⁵ As the Federal Court in *Superior Propane I* points out, the absence of a provision similar to subsection 96(3) with respect to the “effects” side of the balance, suggests that Parliament intended for the redistribution of income to be considered on the “effects” side.¹⁶

Further, the Tribunal’s contention that nothing in the Act allows for consideration of distributional goals in merger review is wrong.¹⁷ The reference in section 1.1 of the Act, that one of the purposes and objectives of the Act is “to provide consumers with competitive prices,” can be seen as a direct invitation from Parliament to consider distributional effects in merger review.¹⁸

However, if the wealth transfer is neutral, its consideration will have no effect on merger analysis, as distributional goals will be irrelevant. In such a case there will be no difference between the consumer welfare and total surplus standards. The argument that the wealth transfer is neutral is based on the fact that, in the end, shareholders are also consumers. Thus, any wealth distribution is simply “a robbing of Peter...to pay Paul.”¹⁹ If wealth is distributed between different consumers, it cannot be determined *a priori* which set of consumers is wealthier than the other.²⁰ Therefore the contention is that the wealth distribution should always be considered neutral.

However, the wealth distribution will not always be neutral. A regressive wealth distribution can occur during anti-competitive mergers because wealth can be transferred from lower income consumers to higher income shareholders. As an additional dollar seemingly improves the welfare of a lower income individual more than an additional dollar would improve the welfare of a higher income individual, a regressive wealth distribution decreases social welfare. Section 96 can account for this loss in social welfare by weighing a portion of the wealth transfer as an anti-competitive effect.

Thus, the preceding analysis suggests that Parliament's intent was to have the consumer welfare standard operate in section 96. However, this suggestion comes from the implication of subsection 96(3) and is by no means stated explicitly in the Act. Thus, if this interpretation of Parliament's intent would lead to absurd results then there is reason to suppose Parliament had a different intention.

The interpretation that Parliament intended the consumer welfare standard to apply to section 96 would be absurd if it failed to best achieve the objective of the Act. Being a piece of Canadian legislation passed by members of Parliament elected by Canadians, it would seem that the broad-based objective of the Act is to enhance Canadian welfare. It would be absurd to suppose, without explicit direction from the Act, that Parliament would choose competition legislation that did not maximize Canadian welfare. Thus, where there are two possible interpretations of the Act, both enhancing Canadian welfare, the one that enhances Canadian welfare the most is to be the preferred interpretation.

Thus, the disagreement between the use of the total surplus standard and the consumer welfare standard would seem to be a disagreement over which standard maximizes

Canadian welfare. Canadian welfare can be defined for present purposes as the combination of social and economic welfare. The total surplus model suggests that maximizing Canadian welfare is best achieved by maximizing economic welfare. The consumer welfare model suggests that Canadian welfare is maximized only when merger review also accounts for social welfare.

Advocates of the total surplus standard do not necessarily have to disagree with the proposition that regressive wealth distributions decrease social welfare. It is possible that the decreased welfare that results from a regressive wealth distribution is more effectively handled by other government tools that are better equipped at redistributing wealth such as a tax act.²¹ Having the total surplus standard maximize economic welfare, as another government tool redistributes wealth, may maximize Canadian welfare. Thus, under the total surplus standard, a regressive wealth transfer can be deemed to be neutral, not because it is neutral, but because deeming it neutral maximizes Canadian welfare.²²

Thus, if Parliament could effectively account for any regressive wealth distribution, the total surplus standard would be the standard that maximizes Canadian welfare. Under the total surplus standard, wealth would be maximized and any loss of social welfare would be corrected by redistributing wealth through other means, resulting in no loss of net welfare.

However, Parliament's capability and desire to effectively correct for the regressive wealth distribution can be questioned on numerous grounds. One, Parliament may choose not to redistribute wealth from the regressive wealth distribution; raising taxes would be much more politically unpopular than putting in a merger review system that prohibits a few, or

even several wealth enhancing mergers.²³ While the redistribution is part of a larger scheme, it may be the case that the redistribution of wealth is already inadequate and using the total surplus standard in merger review would compound the problem and further reduce Canadian welfare.²⁴ Two, rather than refusing to act, Parliament may lack the knowledge that a regressive distribution is occurring during mergers.²⁵ Three, the redistribution will inevitably be imperfect and will thus result in at least some reduced welfare. Four, although redistribution systems are already in place, there may be additional costs that would directly reduce welfare.

To the extent that there are faults with wealth redistribution, there will be a loss of social welfare equal to some portion of the loss of social welfare from the regressive wealth distribution. This loss of social welfare can be thought of as a redistribution cost that results from the total surplus standard. As the consumer welfare standard avoids the need to redistribute wealth, the redistribution costs do not occur under the consumer welfare standard. Thus, assuming redistribution costs and a world of perfect knowledge, the consumer welfare standard would maximize Canadian welfare. The consumer welfare model would weigh that portion of the wealth transfer against the merger such that it maximizes the combination of social and economic welfare.

Problems with the Consumer Welfare Standard

The first obvious problem with the consumer welfare standard is that this is not a world of perfect knowledge. It would be impossible to know the exact magnitude of any regressive wealth transfer. However, the wealth redistribution process that is involved with the total surplus standard would also be faced with this problem. Thus, the loss in social welfare from this constraint is the same under both standards.

A more serious problem is that in deciding which portion of the wealth transfer to weigh against the merger, the consumer welfare standard demands a comparison be made between social and economic welfare. It would require comparing an inherently quantifiable economic welfare against an inherently unquantifiable social policy that is involved with social welfare. Deciding who, between two sets of consumers, is more deserving seems to be within the ability of the implementing authorities²⁶ as it would simply require evidence on which group is on the whole wealthier than the other group. However, it would seem out of the implementing authorities realm to judge *how much* one group is more deserving than the other.²⁷

Further, problems suggest that the application of the consumer welfare standard leads to absurd results. Mathewson and Winter state:

If redistributive effects were consistently accounted for, a merger that was unacceptable when wealthy Canadian families closely held the merging firms would suddenly become acceptable if a teachers' pension fund bought the shares. The incentives for share ownership by wealthy and less wealthy individuals would then be affected, the impact of merger policy on these share incentives would become an issue for concern, and merger analysis could become hopelessly complex.²⁸

Mathewson and Winter are correct that the transferability of corporate ownership provides a problem for the application of the consumer welfare standard on a case by case basis.²⁹ In addition to the oddity of having the fate of a merger be uncertain from one day to the next, the transferability of corporate ownership would undermine the consumer welfare standard. Wealthy shareholders faced with a potential wealth enhancing merger could sell their shares, pre-merger, to lower income individuals or a pension fund. As the shares are worth more in the hands of the buyers, the parties will have incentive to trade the shares at a price ranging from the pre-merger price to the expected post-merger price. Therefore, at least some of the wealth from

the merger, which will include some of the wealth transfer, will be paid to higher income shareholders in any event.

The problem associated with the transfer of corporate ownership could perhaps be resolved with appropriate timing rules. A timing rule, that allows the court to examine the identity of the shareholders at a point some time before the merger, may avoid the incentive to trade.³⁰ Under this rule, perhaps a court would only be allowed to exercise its discretion to use the timing rule if it appeared that trading was done with the intent of undermining merger policy. This would largely avoid turning down legitimate wealth enhancing mergers where trading occurred for reasons other than undermining merger policy.

Regardless of whether the problem with the transferability of corporate ownership can be resolved, the application of the consumer welfare standard on a case by case basis would still lead to absurd results. As explained by Mathewson and Winter:

...carrying the welfare-weights approach to its full conclusion means that mergers such as the IntraWest acquisition of Whistler Mountain...could be accepted in spite of the prediction of negative cost efficiencies and a positive deadweight loss because the merger produced a favourable redistribution of wealth from very wealthy consumers (on average) to less wealthy shareholders...Sections 92 and 96 of the Act do not provide for decisions involving both a lessening of competition and negative efficiencies.³¹

The conclusion that they draw from this example, that the consumer welfare model is not fully consistent with the Act, is correct as to the application of the consumer welfare model on a case by case basis. However, the consumer welfare model could be applied, not on a case by case basis, but as a bright-line standard applied to all mergers.

A Bright-Line Consumer Welfare Standard

Under the bright-line consumer welfare standard, a fixed percentage of each wealth transfer is weighed against the merger and the same percentage is used in all merger reviews.³² A bright-line consumer welfare standard may be welfare enhancing because, despite exceptions such as the IntraWest and Whistler Mountain example, it is almost certain that on average shareholders are wealthier than consumers.

As a bright-line test, the consumer welfare standard would be both over and under-inclusive. It would be over-inclusive in that it may prevent some mergers where the wealth differential is less than average (including cases involving a beneficial distribution), that if applied on a case by case basis it would otherwise allow. It would be under-inclusive in that it may allow some mergers where the wealth differential is greater than average, that if applied on a case by case basis it would otherwise prohibit.

While a bright-line test may not be ideal because of its over and under-inclusive nature, the test avoids the potential problems of the case by case model of corporate transferability and the IntraWest type scenario. Also, the bright-line standard addresses the Tribunal's concern in *Superior Propane I* for predictability as the Tribunal's criticism in that regard was leveled at the case by case consumer welfare standard.

A bright-line consumer welfare standard would be preferable to the total surplus standard where the loss of welfare caused by using the bright-line consumer welfare model, caused by its over and under-inclusive nature, is less than the loss of welfare caused by redistribution costs caused by using the total surplus standard. This scenario would seem at least possible given the redistribution costs discussed earlier.

The Tribunal in *Superior Propane I* claimed that weighing the transfer against the merger would effectively read section 96 out of the Act. However, if the bright-line standard would enhance Canadian welfare relative to the total surplus standard, than the Tribunal's claim is suspect and immaterial.³³ It is suspect because the fixed percentage may be very small. The portion of the wealth transfer accounted for under the bright-line standard would be based on the wealth difference between all shareholders and all consumers. When social welfare and economic welfare are compared and balanced, it may be only a small portion of the wealth transfer that is weighed against the merger. If such is the case, only slightly more efficiency gains would be required to be shown under the consumer welfare standard than the total surplus standard and section 96 would be given effect.

The claim that section 96 would be effectively read out is also immaterial. If section 96 is essentially read out of the Act, it is read out of the Act because to do so enhances Canadian welfare. As mentioned before, unless the Act states explicitly otherwise, Parliament must be ascribed that intent which maximizes Canadian welfare. Here, Parliament can be ascribed the intent of legislating the provision to address the situation where a merger comes under review that *does* satisfy the consumer welfare standard, however unlikely that merger will exist and however many other mergers that would have passed the total surplus standard are prohibited.

Of course, use of a bright-line consumer welfare standard is dependent on the availability of information that can show how much wealthier, if at all, shareholders are compared to consumers. More importantly, even if this information were available, setting the percentage of the wealth transfer to weigh against the merger would still require comparing

social and economic welfare. As previously suggested this comparison would seem to be best performed by Parliament.

Therefore, absent legislative intervention, the total surplus standard would seem to be the preferable model to be used by the Bureau, Tribunal, and Courts, as it avoids the need to compare social and economic welfare. However, comparing and balancing economic and social welfare is well within Parliament's capabilities and duties. Thus, as this part demonstrates, under certain conditions, Parliament may want to set out a bright-line consumer welfare model to be applied in merger review.

IV: INTERNATIONAL CONSIDERATIONS AND THE DOMESTIC WELFARE STANDARD

The preceding analysis has examined the debate between the consumer welfare standard and the total surplus standard absent international considerations. Unfortunately, legal scholars and economists have largely ignored international considerations in merger review.³⁴ However, as previously mentioned, Canadian merger policy should have as its aim the maximization of *Canadian* welfare.

In addition to it being inherent in a piece of Canadian legislation, section 1.1 of the Act makes clear that the purpose of the Act is to promote Canadian welfare.³⁵ Section 1.1 states:

The purpose of this Act is to maintain and encourage competition *in Canada* in order to promote the efficiency and adaptability of the *Canadian* economy, in order to expand opportunities for *Canadian* participation in world markets while at the same time recognizing the role of foreign competition *in Canada*, in order to ensure that small and medium-sized enterprises have an equitable opportunity to participate in the *Canadian* economy and in order to provide consumers with competitive prices and product choices.³⁶ (Emphasis added)

Therefore, the standard to be used in the efficiency defence should be that which maximizes Canadian welfare. Thus, regard must be had for

- i) the foreign ownership content of the merging parties, and
 - ii) the effect the merger will have on “foreign” consumers.
- i) *Foreign Ownership*

One of the main propositions behind the total surplus standard is that the wealth transfer from consumers to producers is neutral, or as suggested before, ought to be deemed neutral. However, this neutrality can be questioned when taking into account foreign ownership.

In *Hillsdown*, Reed J. stated:

Another question respecting the alleged neutrality of the wealth transfer is: if the dominant firm which charges supra-competitive prices is foreign-owned so that all the wealth transfer leaves the country, should the transfer be considered neutral?³⁷

A wealth transfer from Canadian consumers to foreign shareholders cannot be considered neutral. Consider an anti-competitive merger with efficiencies, where the merging corporations are both foreign-owned and all their consumers are Canadian. When the firms merge, the increased profits resulting from the merger will be largely realized outside Canada.³⁸ The increased profits result from the efficiency gains plus the transfer of wealth. The wealth transfer portion of the gain, as opposed to the efficiency portion of the gain, will happen at the expense of Canadian consumers.

The wealth transfer resulting in the above scenario cannot be considered neutral under current Canadian competition policy. As made clear above, the purpose of the Act is to promote Canadian welfare. Quite obviously, decreasing Canadian consumer welfare while enhancing foreign shareholder welfare decreases Canadian welfare. Therefore, a wealth transfer

from Canadian consumers to foreign shareholders cannot be considered neutral. This type of wealth transfer will occur in all mergers involving corporations with at least some foreign ownership that result in at least some Canadian consumers paying increased prices.

Further, efficiencies experienced by the foreign shareholders cannot be given weight in favour of a merger as it does not improve Canadian welfare. It is true that section 96 states that it is the “gains in efficiency” that need to be considered and does not explicitly state that consideration can only be given for the efficiencies achieved for the benefit of Canadian welfare. However, section 96 must be read in the context of the purpose of the Act, which is to protect and benefit Canadian welfare. Thus, the efficiencies in section 96 must refer only to those efficiencies that accrue to the benefit of Canadian welfare.

Foreign ownership thus militates against the use of the total surplus standard in Canadian merger review in two ways. First, the wealth transfer from Canadian consumers to foreign shareholders reduces Canadian welfare and should weigh against allowing the merger. This is opposed to the total surplus standard, which considers all wealth transfers to be neutral. Second, efficiencies experienced by foreign shareholders do not represent an enhancement of Canadian welfare and should therefore not be given any weight as a reason for allowing the merger. This is opposed to the total surplus standard as well as the consumer welfare standard, which both advocate weighing total efficiencies in favour of allowing the merger.

It is important to note that when accounting for foreign ownership concerns, consideration must be given for the foreign ownership content of each merging party.³⁹ When Reed J. asks in *Hillsdown* whether the “dominant firm” is foreign-owned, she seems to imply that the only concern should be with the foreign ownership content of the merged entity. That is

because the efficiencies and increased profits will be realized by the merged entity. However, this intuition is incorrect when it is realized that share prices reflect the net present value of the expected future cash flows of the firm. As the expected profits from the merger will be divided in some way between the acquiring and target shareholders, consideration must be given to the foreign ownership content of each group of shareholders.⁴⁰

For reasons described above, a merger policy that ignores foreign ownership considerations could lead to a decrease in Canadian welfare. It follows that Parliament needs to consider foreign ownership when passing Canadian competition legislation. Likewise, the Bureau, Tribunal and courts must consider foreign ownership when administering and interpreting the Act.

The potential problem with foreign ownership should not be underestimated. One commentator notes that “between 1986 and 1992, 64.4 percent of the 5,847 mergers publicly reported in Canada included a foreign-owned or foreign-controlled acquiring company.”⁴¹ The problem with foreign ownership and the efficiency defence is exacerbated in a country such as Canada that is heavily dependent on foreign investment.⁴² Thus, the effect of foreign ownership on Canadian welfare in merger review is potentially very large.⁴³

ii) Foreign Consumers

Unlike foreign ownership, consideration of foreign consumers can enhance Canadian welfare. Foreign consumers refer to the consumers that are outside Canada and for simplicity can be considered the merging parties export sales. Assuming the existence of at least some Canadian shareholders, a merger that results in increased prices on exports will result in a wealth transfer from foreign consumers to Canadian shareholders.

This wealth transfer, as is the case with the transfer described to foreign ownership, is not neutral to Canadian welfare. However, unlike with foreign ownership, this wealth transfer enhances Canadian welfare and should therefore be weighed in favour of the merger. Further, any deadweight loss that is attributed to foreign consumers being forced out of the market should not weigh against the merger, as this loss does not affect Canadian welfare.

Thus, foreign consumer considerations militate against the use of both the total surplus standard and the consumer welfare standard in two ways. First, the wealth transfer from foreign consumers to Canadian shareholders enhances Canadian welfare and should weigh in favour of allowing the merger. This is opposed to the total surplus standard, which considers all wealth transfers to be neutral, and the consumer welfare standard that would weigh the transfer against the merger. Second, the portion of the deadweight loss attributable to foreign consumers does not decrease Canadian welfare and should not weigh against allowing the merger. This is opposed to the total surplus and consumer welfare standards, which takes into account the deadweight loss from the total number of consumers forced out of the market.

Unlike with foreign ownership, which militated against the total surplus and consumer welfare standards because they could *allow* mergers that decrease Canadian welfare, foreign consumer considerations militate against the standards because they could *prohibit* mergers that enhance Canadian welfare.

The Domestic Welfare Standard

The total surplus standard can be adapted to take into account domestic welfare concerns. Such a domestic welfare standard would weigh the benefits accruing to Canadian welfare as a result of the merger against the deadweight loss experienced by Canadian

consumers. As this domestic welfare standard is simply an adaptation of the total surplus standard, it can also be applied to adapt the consumer welfare standard. Thus, the consumer welfare standard that entails accounting for a regressive wealth distribution, would be further adapted by weighing a portion of the transfer of wealth from Canadian consumers to Canadian shareholders against the merger; all other aspects of the wealth transfer are already taken into account in a domestic welfare standard. However, for present purposes the wealth transfer between Canadian consumers and Canadian shareholders is deemed to be neutral.

Under an adapted total surplus standard, the domestic welfare standard would approve a merger that satisfies the equation:

$$D(E+XT) > (1-X)L^{44}$$

Where **D** represents the percentage of domestic ownership of the merging entities;
E is the efficiencies from the merger;
X represents the percentage of profits achieved through exports;⁴⁵
T is the wealth transfer from consumers to the shareholders as a result of the price increase; and
L represents the deadweight loss.

The positive benefits that accrue to the Canadian economy can be represented algebraically as $D(E+XT)$. The gains accruing to the Canadian economy is the proportion of efficiencies that is realized by domestic shareholders (DE) plus the wealth transfer that accrues to Canadian shareholders at the expense of foreign consumers (DXT). Combining these two figures results in the equation $D(E+XT)$.

On the other side of the equation, the anti-competitive effects that are experienced in Canada can be represented algebraically as $(1-X)L$. In the total surplus standard, the efficiency gains are measured against the deadweight loss (L). However, under the domestic welfare standard, the deadweight loss needs to be discounted because the Canadian economy need not be

concerned with foreign consumers forced out of the market. The proportion of the deadweight loss (L) that the Canadian economy should be concerned about is the percentage of domestic consumers (1-X) forced out of the market.

Direct Evidence that Parliament Legislated a Domestic Welfare Standard

In addition to the inherent intent to enhance Canadian welfare, the Act seems to explicitly favour somewhat of a domestic welfare standard. Subsection 96(2) states:

In considering whether a merger or proposed merger is likely to bring about gains in efficiency described in subsection (1), the Tribunal shall consider whether such gains will result in

- (a) a significant increase in the real value of exports; or
- (b) a significant substitution of domestic products for imported products.⁴⁶

In subsection 96(2)(a) it is unclear what is meant by the term “real value of exports.” Real value, in an economic sense, usually means a nominal dollar figure is discounted to take into account inflation. This makes sense in merger review because inflation would increase the nominal value of exports whether or not the merger was allowed to proceed.

It would appear from the definition of “real value” that any increase in the value of exports includes that increase which is a result of a rise in price. Therefore, subsection 96(2)(a) seems like a requirement from Parliament to treat the wealth transfer from foreign consumers to Canadian shareholders as a factor to be weighed in favour of a merger. As the wealth transfer is not a true efficiency gain, subsection 96(2)(a) appears to deem this wealth transfer an efficiency gain for the purpose of subsection 96(1).

However, subsection 96(2)(a) must be read with subsection 96(3), which states:

For the purposes of this section, the Tribunal shall not find that a merger or proposed merger has brought about or is likely to bring about gains in efficiency by reason only of a redistribution of income between two or more persons.⁴⁷

Subsection 96(3) can be read as stating that any wealth transfer from consumers to shareholders cannot be added to the efficiency side of the equation in subsection 96(1). This reading of subsection 96(3) would have the curious effect of rendering subsection 96(2)(a) meaningless, or at best a clarification provision. Any efficiency gains from export sales should already be considered in the application of subsection 96(1), absent subsection 96(2)(c) considerations.

To give subsection 96(2)(a) substance, subsection 96(3) can be read with concentration on the words “by reason only”. Under this interpretation, a redistribution of income cannot be taken into account as a deemed efficiency under subsection 96(2), until there are at least some true efficiency gains under subsection 96(1). This interpretation of subsection 96(3) is also curious; there would seem to be no reason why subsection 96(3) should ever apply to subsection 96(2)(a). If the wealth transfer in 96(2)(a) was considered a positive, it is unclear why it would not count towards the merger regardless of *any* showing of efficiencies.

The Bureau seemingly adopted the first interpretation of subsection 96(3) above, which renders subsection 96(2)(a) meaningless. Section 5.6 of the MEG’s stated in regards to subsection 96(2) that

the words ‘described in section (1)’ make it clear that section 96(2) does not operate to expand the class of efficiency gains that may be considered in the trade-off analysis. Accordingly, this provision is simply considered to draw attention to the fact that, in calculating the merged entity’s total output for the purpose of arriving at the sum of unit and other savings brought about by the

merger, the output that will likely displace imports, and any increased output that is sold abroad, must be taken into account.⁴⁸

Also, as will be demonstrated later, international agreements also support Bureau's reading of subsection 96(3). Thus, as the Bureau interpreted the Act, no consideration was to be given to the wealth transfer from foreign consumers to Canadian shareholders. Also, consideration did not seem to be given to the identity of the shareholders, as to whether or not they are Canadian.⁴⁹

The Domestic Welfare Standard and the Bureau's Total Surplus Standard Compared

The Bureau at one time supported the total surplus standard. Section 5.1 of the MEG's stated that in subsection 96(1) "anti-competitive effects refer to the part of the total loss incurred by buyers and sellers in Canada that is not merely a transfer from one party to another, but represents a loss to the economy as a whole, attributable to the diversion of resources to lower valued uses."⁵⁰ For greater certainty section 5.5 stated:

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. The efficiency gains described above are balanced against the latter effect, i.e., the deadweight loss to the Canadian economy.⁵¹

The MEG's noted that the redistribution is neutral because "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."⁵² Thus the Bureau, to the extent it followed its own guidelines, clearly supported the total surplus standard. However, due to case law and a change of position by the Commissioner, the MEG's and the Bureau no longer support the total surplus standard. The Bureau's web site simply states that section 5 of the MEG's no longer applies and that the "Bureau will apply the principles set out in the decision of the Federal Court of Appeal

in the *Commissioner of Competition v. Superior Propane Inc. and ICG Propane Inc* 2001 FCA 104.”⁵³

The Bureau’s total surplus standard (hereinafter the Bureau’s standard) took into account, at least partially, domestic welfare. Section 5.5 of the MEG’s stated that the efficiency gains from the merger were to be weighed against “the deadweight loss to the *Canadian* economy”⁵⁴(emphasis added). Thus, the total surplus standard was altered somewhat by limiting the deadweight loss to that portion that occurred in Canada. Thus it appears that the *Competition Act* was interpreted as espousing, at least partially, a domestic welfare standard.

Thus under the Bureau’s standard, the question was whether total efficiencies are greater than the deadweight loss to the Canadian economy.⁵⁵ However, under the domestic welfare standard the question that should be asked is whether the benefits to the Canadian economy are greater than the deadweight loss to the Canadian economy. The respective equations for the two standards under which a merger will be approved can be represented by the following equations:

$$\begin{array}{ll} \text{Bureau’s Standard} \rightarrow & E > (1-X)L \\ \text{Domestic Welfare Standard} \rightarrow & D(E+XT) > (1-X)L \end{array}$$

As one side of the equation is identical, the repercussions of using the Bureau’s standard over the domestic welfare standard can be illustrated by comparing the relative size of “E” to “D(E+XT)”. If the merging firms are completely domestically owned and there are no foreign consumers, then there is no issue as the equations produce the same result. However, to the extent that domestic ownership decreases, the Bureau’s standard risks allowing mergers that the domestic welfare standard would prohibit. Further, to the extent that exports exist, the

Bureau's standard risks prohibiting mergers that the domestic welfare standard would approve. Either allowing or prohibiting a merger under the Bureau's standard where the conclusion would be different under the domestic welfare standard will necessarily decrease Canadian welfare.⁵⁶

The Domestic Welfare Standard and the Worldwide Total Surplus Standard Compared

A worldwide total surplus standard (hereinafter "the worldwide standard") seems to be favoured by individuals, particularly economists, who would like to see the maximization of the combination of global consumer and producer surplus.⁵⁷ Under the worldwide standard a merger is approved if it satisfies the equation $E > L$. When comparing this equation to the domestic welfare equation, it is clear that the same merger proposal may be subject to different fates depending on which standard is applied. This follows from the discussion above that highlighted foreign ownership and foreign consumer concerns.

The relative effect of foreign ownership and foreign consumption on Canadian welfare under the two standards can be demonstrated by examining the effect of four extreme assumptions:

1. No Foreign Consumption
2. No Domestic Consumption
3. No Domestic Ownership
4. No Foreign Ownership

1. No Foreign Consumption

Assuming no exports, the equation for determining whether the merger will be allowed under the domestic welfare standard would be $DE > L$. As exports are an irrelevant consideration under the worldwide standard, the determining equation under that standard remains $E > L$. Thus assuming that there is at least some foreign ownership, the merging parties must show greater efficiencies under the domestic welfare standard in order for the merger to be

approved. The worldwide standard overestimates the benefits to the Canadian economy by the percentage amount of foreign ownership.

2. No Domestic Consumption

Assuming no domestic consumption, the domestic welfare equation becomes $D(E+T) > 0$. This results from the fact that all of the deadweight loss occurs outside Canada. Thus, as long as there is some domestic ownership, the merging parties will have to show greater efficiencies under the worldwide standard in order to have the merger approved.

3. No Domestic Ownership

Assuming that the merging parties are completely foreign owned, the domestic welfare equation becomes $0 > (1-X)L$. This results from the fact that all the efficiencies are realized outside Canada. Thus, the worldwide standard is the only standard which makes such a merger possible.⁵⁸

4. No Foreign Ownership

Assuming that the merging parties are completely domestic owned, the domestic welfare equation becomes $(E+XT) > (1-X)L$. Thus, as long as there is some foreign consumers, the merging parties will have to show greater efficiencies under the worldwide standard in order to have the merger approved.

Only where the merging firms are completely domestically owned and there are no foreign consumers, will it be the case that the worldwide standard equation and the domestic welfare standard equation are identical. This will be a rare circumstance as merging firms under review will almost inevitably involve a mixture of foreign ownership and foreign sales content. When the equations do differ, as will almost certainly be the case, there is the risk that one

standard would allow a merger while the other would not. As mentioned before, either approving or prohibiting a merger where the conclusion would be different under the domestic welfare standard will necessarily decrease Canadian welfare.

The Domestic Welfare Standard and the Tribunal's Domestic Welfare Standard Compared

The Tribunal in *Superior Propane II* supported a slightly different version of the domestic welfare standard (hereinafter “the Tribunal’s standard”). The Tribunal stated that “efficiency gains and deadweight loss (i.e. losses in efficiency) in foreign markets resulting from an anti-competitive merger in Canada are to be excluded in the application of section 96.”⁵⁹ However, the Tribunal did not suggest that the wealth transfer from foreign consumers to Canadian shareholders should be weighed in favour of the merger. Instead the Tribunal stated that the wealth transfer from “foreign consumers should be excluded in the section 96 analysis.”⁶⁰ The Tribunal’s standard can be compared to the domestic welfare standard as follows:

$$\begin{array}{ll} \text{Tribunal's Standard} \rightarrow & DE > (1-X)L^{61} \\ \text{Domestic Welfare Standard} \rightarrow & D(E+XT) > (1-X)L \end{array}$$

As one side of the equation is identical, the repercussions of using the Tribunal’s standard over the domestic welfare standard can be illustrated by comparing the relative size of “DE” to “D(E+XT)”. If there are no foreign consumers or no domestic ownership, then there is no issue as the equations produce the same result. However, to the extent that there are exports and some domestic ownership, the Tribunal’s standard risks prohibiting mergers that the domestic welfare standard would allow; prohibiting such mergers will necessarily decrease Canadian welfare.

V: AGAINST A DIRECT DOMESTIC WELFARE STANDARD

There would seem to be three main arguments against the use of the domestic welfare standard. One, the domestic welfare standard, because of retaliatory measures from other nations, would actually reduce Canadian welfare. This result would be quite the opposite of the standard's intent. Two, the transferability of corporate control somewhat undermines the application of the domestic welfare standard. Three, the domestic welfare standard violates the North American Free Trade Agreement ("NAFTA").

The first argument is questionable. The second argument is reason for concern that may or may not be able to be addressed. The third argument negates the direct application of the domestic welfare standard.

i) The Claim that a Domestic Welfare Standard would Reduce Canadian Welfare

The domestic welfare standard is built on the pretense that the purpose of Canadian competition policy is to enhance Canadian welfare and that use of the domestic welfare standard would in fact enhance Canadian welfare. However, international trade considerations may lead to the conclusion that use of the domestic welfare standard would be detrimental to Canadian welfare.

For example, export cartels may be seen as domestically welfare enhancing as monopoly profits are extracted from foreign consumers. However, nations would not be able to promote the domestic use of export cartels without risking foreign nations themselves promoting them. As these retaliatory measures may reduce domestic welfare, all nations may be better off by entering into an agreement prohibiting export cartels.

Likewise, a similar argument can be made against a domestic welfare standard in Canadian merger review. While a domestic welfare standard may enhance Canadian welfare in the short-term, it would invite retaliatory measures from other nations that, as with export cartels, will leave all nations in a worse state.⁶²

However, the comparison between export cartels and merger policy is misleading. Export cartels, by definition, do not directly affect domestic interests. However, merger policy often is addressed to achieve domestic social and industrial policy goals such as consumer protection, the protection of small business, and preventing political corruption from large firms.⁶³ These policy goals are present whether or not the merger has international ramifications.

It would seem that Canadian competition policy uses the efficiency defence because of a genuine belief that efficiencies are beneficial to the economy and ought to be allowed in some circumstances even when a merger has anti-competitive effects. Likewise, it would seem that U.S. competition policy is largely a consumer protection measure and efficiencies are not to be given the same weight. Neither policy seems developed with an eye towards international mergers, but both apply with international mergers because the domestic concerns that gave birth to the policy still apply. As such, each nation should respect the other's sovereignty to structure its economy as it chooses.⁶⁴

Examining the U.S. position, it seems that efficiencies will not save an otherwise prohibited merger unless the efficiencies are so great that the merger is guaranteed not to result in a price increase.⁶⁵ This is known as the price standard and is obviously quite different from the total surplus standard. Under the price standard, a merger may be prevented that would be allowed under the total surplus standard.⁶⁶ Thus, Canada would allow a merger that benefits U.S.

shareholders, but the United States would prohibit a merger that benefits Canadian shareholders. Further, Canada would allow a merger that would hurt U.S. consumers, but the U.S. would prohibit a merger that hurt Canadian consumers. However, since the merger in question is efficiency enhancing, the loss to Canadian shareholders is greater than the savings to Canadian consumers.⁶⁷

Thus, the adoption of a domestic welfare standard would not result in a “downward spiral or beggar-thy-neighbour dynamic” because its adoption would simply complete the downward spiral, not start it.⁶⁸ While it may be argued that this would encourage the U.S. to adopt a domestic welfare price standard, it is not clear that this is possible. Under the price standard, presumably the efficiencies are so great that it is in the company’s best interest to charge a price no higher than the pre-merger price. It is unclear how considerations of foreign ownership and consumption change anything.⁶⁹

The U.S presumably instituted the price standard “for what were conceived to be good domestic reasons.”⁷⁰ That the standard is different from what Canada has chosen, provides no basis for complaint.⁷¹ However, that Canada has no right to demand the U.S. adopt the total surplus standard, does not mean that Canada cannot adjust its policy in response to the U.S. position. To hold otherwise, would be to call for Canada to adopt a non-welfare-maximizing standard without any reciprocation.

Before it was mentioned that all nations might be better off by entering into an agreement to prohibit export cartels. Likewise, it also may be true that all nations would be better off if they entered into an agreement to apply the total surplus standard in merger review on a worldwide basis. Merger review would consist of weighing worldwide efficiencies against the

deadweight loss experienced worldwide. Under this scheme, Canadian courts would at times approve mergers which provide a net benefit to foreign interests and net detriment to domestic interests and at other times approve mergers that provide a net benefit to domestic interests and a net detriment to foreign interests. Likewise, foreign courts would at times approve mergers which provide a net benefit to Canadian interests and net detriment to foreign interest and at other times approve mergers that provide a net detriment to Canadian interests and a net benefit to foreign interests. On average, each nation may be better off than without the agreement. However, entering into such an agreement is unlikely, given the different policy goals of each nation.⁷² In the absence of such an agreement, Canada should not adopt a policy which benefits foreign interests at the expense of domestic interests.

ii) *The Transferability of Corporate Ownership Undermines the Domestic Welfare Standard*

The transferability of corporate ownership somewhat undermines the application of the domestic welfare standard on a case by case basis for much the same reason as it presents a problem for applying the consumer welfare standard on a case by case basis.

Adapting the *Winter and Mathewson* argument discussed previously: If foreign ownership concerns were consistently accounted for, a merger that was unacceptable when it involved foreign-owned firms may suddenly become acceptable if all the shares were bought out by Canadian investors. The incentives for share ownership by foreign investors and domestic investors would then be affected, the impact of merger policy on these incentives would become an issue for concern, and merger analysis could become hopelessly complex.⁷³

The transferability of corporate ownership would undermine the domestic welfare standard somewhat by transferring at least some of the wealth from mergers to foreign

shareholders. Take, for example, a merger that would be accepted under the total surplus standard but rejected under the domestic welfare standard because of foreign ownership content. The shares would be worth more in the hands of domestic shareholders, as then the firms will be allowed to merge and realize increased profits. As was the case discussed previously between the acquiring shareholders and the target shareholders, the foreign and domestic investors will have incentive to trade their shares for a price ranging from the current price to the expected post-merger price.

Thus, the domestic welfare standard may not be able to prevent reduction of Canadian welfare in any event. After the shares are traded, the money in acquiring the shares has already been spent by Canadian investors. Canadian investors will have paid a premium on the pre-merger price as the investor has assumed the merger will be approved post-trade. If the merger is now rejected, Canadian investors will lose the premium they paid for the shares. Thus, the domestic welfare standard would allow the merger because from that point in time the merger enhances Canadian welfare.

Of course the gains may be so great, or the negotiated price may be such that Canadian welfare is enhanced regardless. Also, the problem might be addressed by getting rid of the incentive to change the nationality of ownership. Perhaps, as was suggested when this problem emerged with the consumer welfare standard, the problem could be alleviated with the appropriate timing rule. In any event, implementation of the domestic welfare standard would require consideration of the transferability of corporate ownership.

iii) *The Domestic Welfare Standard violates NAFTA*

The domestic welfare standard cannot be used in merger review without violating NAFTA.⁷⁴ NAFTA prohibits discrimination against a company on the basis of foreign ownership. Article 1102 of the agreement, entitled National Treatment states:

1. Each Party shall accord to investors of another Party treatment no less favorable than that it accords, in like circumstances, to its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.
2. Each Party shall accord to investments of investors of another Party treatment no less favorable than that it accords, in like circumstances, to investments of its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.⁷⁵

Prohibiting a merger based on foreign ownership content would be in direct contravention of Article 1102, as it would prohibit a foreign investor from engaging in an acquisition that it would approve in like circumstances to a domestic investor. Thus, the domestic welfare standard could only be applied directly if Canada wished to violate NAFTA.

It must be presumed that Parliament does not wish to violate NAFTA. Therefore, it would be wrong for the Bureau to directly apply the domestic welfare standard on a case by case basis. As stated in *Driedger on the Construction of Statutes*:

[T]he legislature is presumed to comply with the obligations owed by Canada as a signatory of international instruments and more generally as a member of the international community. In choosing among possible interpretations, therefore, the courts avoid interpretations that would put Canada in breach of any of its international obligations.⁷⁶

However, as noted above, the Tribunal in *Superior Propane II* supported a version of the domestic welfare standard. In supporting its version of the domestic welfare standard, the Tribunal stated that the standard “may or may not be discriminatory under Canada’s international

obligations, but the Act is not. In the Tribunal's understanding, those obligations require 'national treatment' in the application of Canadian laws."⁷⁷ Unfortunately the Federal Court in *Superior Propane II* did not address this issue. It must be assumed that had the issue been raised, the Tribunal's standard would not have withstood judicial scrutiny.⁷⁸

VI: USING THE DOMESTIC WELFARE STANDARD INDIRECTLY

The transferability for corporate control raises some concerns for the domestic welfare standard, though as mentioned previously, it could perhaps be addressed with the appropriate timing rules. In any event, the non-discriminatory clause in NAFTA represents certain death for the direct application of the domestic welfare standard. However, while the domestic welfare standard may not be able to be applied directly, it can be used to determine which of the other standards should be applied in merger review.

The Bureau's Standard versus The Consumer Welfare Standard

Recall the comparison between the Bureau's standard and the domestic welfare standard. If $D(E+XT)$ is greater than E , then the domestic welfare standard ought to be applied as using the Bureau's standard in this case will risk prohibiting a merger that increases Canadian welfare. On the other hand, if $D(E+XT)$ is less than E , then the domestic welfare standard ought to be applied as using the Bureau's standard will increase the risk of allowing a merger that reduces Canadian welfare. These concepts can be applied in choosing which standard as between the consumer welfare and Bureau's standard maximizes Canadian welfare, given the constraint of not being able to apply the domestic welfare standard directly.

i) *Where a Consumer Welfare Standard is Preferable*

Taking all contested mergers together, if $D(E+XT)$ is on average less than E , the Bureau's standard risks reducing Canadian welfare by allowing too many mergers. As previously mentioned, a consumer welfare standard operates by weighing a portion of the wealth transfer against the merger, making it more difficult to attain merger approval. Thus, the risk of allowing too many mergers would be reduced if the consumer welfare standard is applied.⁷⁹

To account for domestic welfare concerns, the weight applied to the wealth transfer would aim to approximate the value of the domestic welfare standard by accounting for average foreign ownership content and consumption. As such, the Bureau would adopt a consumer welfare standard such that mergers would be approved if $E > (1-X)L + PT$, where P is a fixed percentage applicable to all mergers.

The consumer welfare standard is used, not because it is believed that the wealth transfer is anti-competitive, but to take into account domestic welfare concerns. As to avoid direct discriminatory practices, this estimation is not applied to each individual merger, but to all mergers. The aforementioned NAFTA provision forces a bright-line rule to be made; there is no option to apply the domestic welfare standard on a case by case basis.

As with the previous bright-line rule discussed, this standard would be both over and under-inclusive. It will approve mergers that reduce Canadian welfare because it will either underestimate the foreign ownership of the merging firms, overestimate the impact of their foreign consumers, or both. Likewise, it will prevent mergers that enhance Canadian welfare because it will either overestimate the merging firms foreign ownership, underestimate the impact of their foreign consumers, or both.

The determination of whether a bright-line test should apply should be determined by the following question: Will Canadian welfare be enhanced more by applying the Bureau's standard or the bright-line domestic welfare standard? As the goal should be to maximize Canadian welfare, the standard that more closely approximates this goal should apply.

If applying the consumer welfare standard maximizes Canadian welfare, it would seem open to Parliament to adopt it and for the Bureau to implement it. However, Parliament need not directly legislate the consumer welfare model for it to be implemented. As mentioned before, Parliament must be taken to legislate with the intent on maximizing Canadian welfare. As such, using the domestic welfare rationale, the Bureau, Tribunal and court can assume that Parliament favours the consumer welfare standard as it maximizes Canadian welfare. Unlike applying the consumer welfare standard to address regressive distributions, applying the consumer welfare standard to address the domestic welfare concern, does not require the implementing authorities to balance social policy goals.

Also, the consumer welfare standard would be open for adoption because as the test will apply to all firms regardless of foreign ownership, the policy is at least on its face non-discriminatory. Though the impetus behind the policy would be discriminatory, nations should be able to choose domestic policy that takes into account fully the implications for foreign trade and investment.⁸⁰

Further, to the extent that the policy is attacked as being a form of disguised discrimination,⁸¹ Parliament can defend its decision based on the rationale for the consumer welfare standard of protecting against regressive wealth distributions.⁸²

ii) *Where the Bureau's Standard is Preferable*

However, it may be the case, that taking all contested mergers together, $D(E+XT)$ is on average greater than E . In such a circumstance, using the Bureau's standard risks prohibiting mergers that would enhance Canadian welfare. However, the alternative consumer welfare standard would be an even worse alternative as it prevents more mergers than the total surplus standard.

To apply the bright-line domestic welfare standard here, would require either an addition on the efficiencies side of the equation or a subtraction on the deadweight loss side of the equation. Unlike the previous bright-line standard that mimicked the consumer welfare model, it is unclear how such a new bright-lined test could be camouflaged as to disguise the discriminatory impetus behind the legislation and implementation. Thus the Bureau's standard would seem to be the preferable test where $D(E+XT)$ is on average greater than E .

The Worldwide Standard versus The Consumer Welfare Standard

As was done with the Bureau's standard, the same comparison can be done with the worldwide standard. Recall the respective equations for the worldwide standard and the domestic welfare standard under which a merger will be approved:

$$\begin{aligned} \text{Worldwide Standard} &\rightarrow E > L \\ \text{Domestic Welfare Standard} &\rightarrow D(E+XT) > (1-X)L \end{aligned}$$

To better compare the efficiency gains required to approve a merger under either standard, it is necessary to divide both sides of the domestic surplus standard by $(1-X)$. Since the combined percentage of foreign profits and domestic profits is 1, $(1-X)$ is equivalent to the

percentage of national profits which can be represented by N . Therefore the domestic welfare standard equation for approvable mergers can be rewritten as $(D/N)(E+XT) > L$.

With one side of each standard identical, the previous comparison of the consumer surplus and the Bureau's standard can be duplicated with respect to the worldwide and consumer welfare standards. Thus, if $(D/N)(E+XT)$ is on average less than E , then there may be reason to prefer the consumer welfare standard as using the worldwide standard in this circumstance risks allowing a merger that reduces Canadian welfare. However, if $(D/N)(E+XT)$ is greater than E , then the worldwide standard is the preferable standard as it enhances Canadian welfare more than the consumer welfare model.

The Tribunal's Standard versus The Consumer Welfare Standard

Recall the comparison between the Tribunal's standard and the domestic welfare standard. If $D(E+XT)$ is greater than DE , then the domestic welfare standard ought to be applied as using the Tribunal's standard in this case will risk prohibiting a merger that improves Canadian welfare. Note that $D(E+XT)$ will be at least as great as DE , and if there are any exports and some domestic ownership, greater.

Thus, while the Tribunal's standard risks prohibiting mergers that would enhance Canadian welfare, the consumer welfare standard would be an even worse alternative as it would prevent more mergers. However, because of NAFTA concerns as expressed above, it is unlikely that the Tribunal's standard would withstand judicial scrutiny.

The Worldwide Standard versus The Bureau's Standard

If it is determined that the worldwide standard and the Bureau's standard are preferable to the consumer welfare standard, domestic welfare concerns suggest the Bureau's

standard is to be preferred. As the predominant risk with either standard is prohibiting mergers that enhance Canadian welfare, the Bureau's standard reduces this risk as compared to the Worldwide standard. As the Bureau's standard only accounts for the deadweight loss experienced by Canadian consumers, there is less risk that its use will reject mergers that would enhance Canadian welfare.

VIII: CONCLUSION

The *Superior Propane* decisions and the tabling of Bill C-249, bring to the forefront the debate between the total surplus standard and the consumer welfare standard in merger review. This paper has sought to define how the recognition of Parliament's goal to maximize Canadian welfare can shine light on this debate.

The total surplus standard is strongly supported in the economic community. Absent international considerations and wealth redistribution costs, the total surplus standard maximizes welfare and ought to be adopted in merger review. However, because of the existence of redistribution costs, it is possible that under certain conditions it is the consumer welfare standard that maximizes welfare.

However, the consumer welfare standard could not be applied on a case by case basis as it leads to perhaps insurmountable difficulties and absurd results. It also ought not to be applied on a case by case basis, as it would require a balancing of social and economic policy that is beyond the expertise of the implementing authorities.

However, a bright-line consumer welfare standard that weighs a fixed portion of the wealth transfer against a merger is feasible as it avoids the difficulties and absurdities of the

case by case standard and can be implemented by Parliament. A bright-line consumer welfare standard would be preferable to the total surplus standard if the loss of welfare caused by using the bright-line consumer welfare model is less than the loss of welfare caused by redistribution costs caused by using the total surplus standard.

Therefore, adopting a consumer welfare standard to account for regressive wealth distributions in merger review cannot be disregarded as a feasible standard. Further, regardless of the outcome of the debate concerning regressive wealth distributions, international considerations may suggest a consumer welfare standard is preferable.

Canadian merger policy should have as its aim the maximization of Canadian welfare. The domestic welfare standard could hypothetically be applied in merger review to achieve this result. However, the domestic welfare standard cannot be applied directly, particularly because it would violate NAFTA.

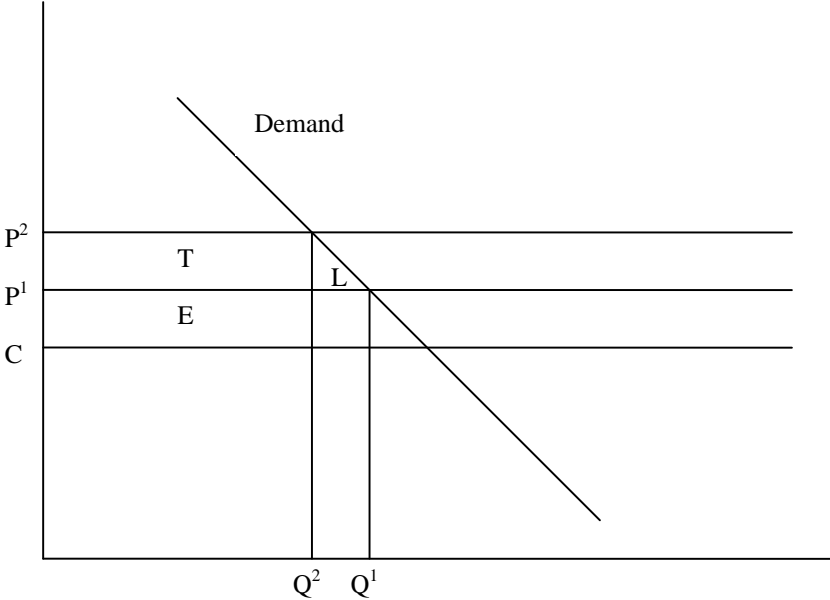
The domestic welfare standard can be used to determine which standard as between the total surplus standard and the consumer welfare standard maximizes Canadian welfare. The consumer welfare standard, applied as a bright-line domestic welfare standard, would be preferable to the total surplus standard if the loss of Canadian welfare caused by the bright-line standard is less than the loss of Canadian welfare under the total surplus standard. As applying the consumer welfare standard to address domestic welfare concerns does not require the implementing authorities to balance social policy goals, the Bureau, Tribunal, or court could apply a bright-line consumer welfare standard.

The domestic welfare standard can also be applied to a consumer welfare standard that is used on the basis of regressive distribution concerns. Foreign ownership and consumption

considerations would dictate whether more or less of the wealth transfer ought to be weighed against the merger. Interestingly it may be that while regressive distribution concerns favour the consumer welfare standard, high domestic ownership and high foreign consumption might dictate that the total surplus standard would be preferable.

Finally, maximizing Canadian welfare does not necessarily imply using the domestic welfare standard. The total surplus standard is highly favoured by economists for good reason. The total surplus standard applied worldwide, such that merger policy strives to maximize the combination of global consumer and producer surplus, provides a net positive benefit across all affected parties.⁸³ There is therefore good reason to enter into an international agreement to uphold the total surplus standard.⁸⁴ However, economists are not politicians; there is no reason why Canada should uphold legislation which benefits foreign interests at the stake of Canadian welfare if the foreign countries do not do the same.

Figure 1: The Williamson Trade-off Model



* Ryan L. Morris is with McMillan Binch LLP in Toronto, Canada.

¹ *Canada (Commissioner of Competition) v. Superior Propane Inc.*, [2003] FCA 53 (F.C.A.) aff'g *Canada (Commissioner of Competition) v. Superior Propane Inc.* (2000), 18 C.P.R. (4th) 417 (Competition Tribunal) (collectively "Superior Propane II") redetermining *Canada (Commissioner of Competition) v. Superior Propane Inc.* [2000] C.C.T.D. No. 15 rev'd *Canada (Commissioner of Competition) v. Superior Propane Inc.* [2001] F.C.J. No. 455 (collectively "Superior Propane I").

² Bill C-249, *An Act to Amend the Competition Act*, 1st Session, 37th Parliament, 2001, cl. 1. This Bill attempts to introduce the price standard into Canadian merger review.

³ The consumer welfare standard in this paper refers to any standard that weighs the transfer of wealth, or any portion thereof, from consumers to shareholders as a result of an anti-competitive merger against the merger.

⁴ *Competition Act*, R.S.C., 1985, c. C-34.

⁵ *Ibid.*, s. 92.

⁶ Margaret Sanderson, "Efficiency Analysis in Canadian Merger Cases" (1997), 65 *Antitrust L.J.* 623 at 623.

⁷ *Competition Act*, supra note 4, s. 96(1).

⁸ Michael Trebilcock and Ralph Winter, "The State of Efficiencies in Canadian Merger Policy" (Winter 1999), 19 *Canadian Competition Record* No. 4:106 at 106. Milos Baruticiski and Brian A. Facey, "Comment and Analysis: The Superior Propane Case" (Fall 2000), 20 *Canadian Competition Record* No. 2:36 at 36.

⁹ See Mark A. Warner, "Efficiencies and Merger Review in Canada, the European Community, and the United States: Implications for Convergence and Harmonization" (1994), 26 *Vanderbilt Journal of Transnational Law* VI:1059 at 1069:

If efficiencies are too difficult or expensive to identify, quantify, and verify ex ante on a case by case basis, then the choice between a competitive effects and tradeoff analysis may be moot.

This paper assumes that a case by case efficiency analysis is feasible, however it is recognized that this assumption is questionable. See Richard Posner, *Antitrust Law*, 2nd Ed. (University of Chicago Press, 2001), at 133; Robert Bork, *The Antitrust Paradox: A Policy at War with Itself* (New York: Basic Books, 1978) at 124-128; Alan A. Fisher and Robert H. Lande, "Efficiency Considerations in Merger Enforcement." 71 *Cal. L. Rev.* 1582. However as Paul Crampton points out "Parliament must have had some basis to be more optimistic." See Paul Crampton, "The Efficiency Exception for Mergers: An Assessment of Early Signals from the Competition Tribunal" (1993), 21 *Can. Bus. L. J.* 371 at 382.

The Tribunal itself in *Superior Propane I* raises the feasibility question as the Tribunal could not agree on the size of the probable efficiencies (For an account of the general failure of mergers to achieve efficiencies see Walter Adams and James W. Brock, "Antitrust and Efficiency: A Comment" (1987), 62 *N.Y.U.L.R.* 1116). Also, the Tribunal failed to take into account pre-existing market power and thus underestimated the required efficiencies under a s. 96 tradeoff. The Tribunal overestimated the claimed cost savings. See Frank Mathewson and Ralph Winter, "The Analysis of Efficiencies in Superior Propane: Correct Criterion Incorrectly Applied." (Fall 2000), 20 *Canadian Competition Record* No.2:88.

A case by case efficiency analysis may be more attractive if merger approval was made conditional on achieving certain results, though this solution may not be practical. Also, problems with case specific efficiency analysis can be largely addressed by assigning the efficiencies proper weight, restricting measurement to a limited class of efficiencies, and/or assigning an appropriate burden of proof. See Sanderson, supra note 6 at 634-639; Donald G. McFetridge, "Prospects for the Efficiency Defence" (1996), 26 *Can. Bus. L. J.* 321 at 334-335, 352-354; Dennis A. Yao and Thomas N. Dahdough "Information Problems in Merger Decision Making and their Impact on Development of an Efficiencies Defence" (1993), 62 *Antitrust L. J.* 23.

¹⁰ This figure is an adaptation of the Williamson trade-off model. Williamson, "Economies as an Antitrust Defence: The Welfare Tradeoffs" (1968), 58 *Am. Econ. Rev.* 18.

¹¹ It is a loss because consumers are driven out of the market even though they are willing to pay a greater price for the product than it costs the firm to supply it.

¹² For simplicity, it is assumed that the parties were in perfect competition pre-merger.

¹³ A portion of the wealth transfer can also be considered a loss as the incentive of monopoly profits may induce excessive rent-seeking behaviour. See Posner, supra note 9 at 13-14. This loss, as with the deadweight loss, should be considered by any efficiency trade-off standard. Thus for the purposes of this paper, this loss can be considered part of the deadweight loss.

¹⁴ See *Mathewson and Winter*, supra note 9 at 89.

¹⁵ *Competition Act*, supra note 4 at s. 96(3).

¹⁶ *Superior Propane I* (Federal Court), supra note 1 at para. 103; For a contrary argument see P.S. Crampton, *Mergers and the Competition Act* (Toronto: Carswell, 1990) at 522:

It would be somewhat unfair to deny merging parties the benefit of efficiency gains that represent mere distributions of income between two or more persons [subsection 96(3)] while at the same time counting ‘effects’ that are mere redistributions against them on the other side of the scales.

This argument is effectively rebutted in *McFetridge*, supra note 9 at 351:

While it may or may not be unfair, it is not inconsistent. Redistributive gains are not efficiency gains and they are not eligible for the efficiency defence under s. 96. The fact that redistributive gains are not efficiency gains does not imply they cannot be part of the anti-competitive effects.

¹⁷ See *Superior Propane I* (Tribunal), supra note 1 at para. 426.

¹⁸ This is also supported by Paul Crampton, a supporter of the total surplus standard. See *Crampton*, supra note 16 at 523: “there is nothing in the Act or elsewhere which suggests that wealth transfers were intended to be virtually ignored in situations where the efficiency and competitive prices objectives conflict with one another.”

¹⁹ *Ibid.* at 521.

²⁰ *Ibid.* at 522.

²¹ See *Trebilcock and Winter*, supra note 8 at 111-112. See also B. Dunlop, D. McQueen and M. Trebilcock, *Canadian Competition Policy* (1987) at 66.

²² *Crampton*, supra note 16 at 522.

²³ The later government action would probably anger only a minute fraction of people in the Country’s largest business locations.

²⁴ This seems like a realistic situation as it is at least conceivable, if not probable, that wealthier citizens have, through either campaign financing or higher voter turnout, a disproportional effect on who gets elected.

²⁵ Perhaps they buy into the total surplus jargon that the wealth transfer *is* neutral, not recognizing that it is only being *deemed* neutral.

²⁶ Implementing authorities refers to the Bureau, Tribunal and judiciary.

²⁷ See *Trebilcock and Winter*, supra note 8 at 112 where the authors state “The...position that [the Bureau] will decide which wealth transfers are acceptable and which are not risks incorporating into the merger review process greater politics and lobbying by special interest groups.” See also *Dunlop, McQueen and Trebilcock*, supra note 21 at 66.

²⁸ *Mathewson and Winter*, supra note 9 at 90.

²⁹ Consumer welfare standard on a case by case basis refers to the balancing-weights standard advocated by the Commissioner in *Superior Propane I* as opposed to a bright-line consumer welfare standard that weighs a fixed proportion of the wealth transfer against the merger in every case.

³⁰ There would still be some incentive to trade as there is always the potential that in the long run a merger possibility would present itself. However, the point here is that the incentive could be drastically reduced to perhaps almost nothing.

³¹ *Mathewson and Winter*, supra note 9 at 90.

³² It is interesting to note that the Commissioner has previously rejected using predetermined weights for the wealth transfer. See *Superior Propane I* (Tribunal), supra note 1 at para. 420.

³³ See *Superior Propane I* (Tribunal), supra note 1 at para. 434. For support of the Tribunal’s interpretation in this regard see *Crampton*, supra note 16 at 523-525. See also Jason L. Gudofsky and Patrick Gay, “Long Live the Merger Enforcement Guidelines? A Review of the Superior Propane Decision” (Fall 2000), 20 Canadian Competition Record No. 2:46 at 72-73.

³⁴ The impact of foreign ownership on section 96 has been previously questioned but not answered. See *Gudofsky and Gay*, *Ibid.* at 77.

Professor Stephen Ross recognized that foreign ownership weighs against the adoption of a total surplus standard. See Stephen F. Ross, “Afterword - Did the Canadian Parliament Really Permit Mergers that Exploit Canadian Consumers So The World Can Be More Efficient?” (1997), *Antitrust L.J.* 641. However, Ross only accounts for foreign ownership in his analysis and fails to consider the domestic benefits of transferring wealth from foreign consumers to domestic shareholders.

Other articles blatantly ignore the issue. See *Crampton*, supra note 9 at 393. Crampton specifically responds to Reed J's question regarding a merger involving a life-saving drug but ignores the second question immediately following regarding foreign ownership.

³⁵ See *Ross*, Ibid. at 643.

³⁶ *Competition Act*, supra note 4 at s. 1.1.

³⁷ *Canada (Director of Investigation and Research) v. Hillsdown Holdings (Canada) Ltd.*, (1992), 41 C.P.R. (3d) 289 at para. 96-97 ("Hillsdown"); In *Hillsdown*, Reed J. found that there was unlikely to be a substantial lessening of competition and therefore she did not find it necessary to answer this question.

³⁸ Some of the profits will be realized in Canada as the Canadian government will tax the corporation for its business operation as well as the foreign shareholders through withholding tax. As the government will receive increased taxes, a large enough efficiency gain may still make it within the Canadian economy's best interest to allow the merger. However, the efficiency gain must be much higher than when Canadian residents receive the benefits of the efficiency gains. The taxes from the increased efficiencies would have to be high enough to compensate for the wealth transfer from Canadian consumers to have the wealth transfer remain neutral.

³⁹ Regard must also be given to the fact that as prices increase, foreign producers will find it profitable to increase their supply, which will represent additional wealth leaving the Canadian economy. See *Crampton*, supra note 16 at 532.

⁴⁰ When two firms merge, it is almost always the case where one firm offers the other firm's shareholders a choice or combination of shares in the new entity or money. Thus two sets of shareholders should be considered, the acquiring shareholders which belong to the corporation which is making the offer, and the target shareholders which belong to the corporation accepting the offer.

Expected increased profits from a merger will be divided in some way between target and acquiring shareholders. For example, assume pre-merger that each firm has an equal number of shares and each share is worth \$10. If the acquiring firm can raise its shares to \$25 by acquiring the target firm costlessly, that is without paying any money for the shares, then the acquiring firm has an incentive to acquire the shares of the target company for an amount between \$10-\$15. At \$10, the acquiring firm would raise its stock price to \$15; at \$15, the stock price would remain at \$10. As the target shareholders have an incentive to sell their shares for any price \$10 or greater, the target company should come to an agreement to sell shares to the acquiring corporation for a price between \$10-\$15. It can be seen that the expected gains from the merger of \$5 will be divided in some way between the acquiring and target shareholders.

⁴¹ *Warner*, supra note 9 at 1091.

⁴² One commentator states that "except for tiny Luxembourg, no other developed nation in the world has an economy so dominated and controlled by foreign interests." See Mel Hurtig, "The Canadian Economy is Being Sold Out" (January 21, 2000), accessed on the Flipside web site on November 14, 2001 at <http://www.flipside.org/vol3/jan00/00ja21b.htm>.

⁴³ About 40 per cent of the top 500 corporations in Canada are foreign-controlled. See Mel Hurtig, "How Much of Canada do we Really Want to Sell?" (February 5, 1998), *Globe and Mail*, accessed on November 14, 2001 at <http://www.monetary-reform.on.ca/archives/5h.shtml>

⁴⁴ Likewise, the merger would not be allowed if $D(E+XT) \leq (1-X)L$.

⁴⁵ It is assumed, for simplicity, that profit margins from exports and domestic sales are identical. It is also assumed that the wealth transfer applies proportionally to both domestic and foreign consumers. These assumptions are not realistic as it may cost more to serve foreign consumers and different competitive pressures may limit the wealth transfer from one group of consumers more than the other. While it is assumed that these complications can be built into the simple model, the simple model will suffice to show the importance of a domestic welfare standard.

⁴⁶ *Competition Act*, supra note 4 at s. 96(2).

⁴⁷ Ibid. at s. 96(3).

⁴⁸ Director of Investigation and Research, *Competition Act, Merger Enforcement Guidelines* at s.5.6. The Merger Enforcement Guidelines (the "MEG's") sets forth a general approach that is taken by the Competition Bureau towards merger review. The MEG's can be accessed at the Competition Bureau's web site at <http://strategis.ic.gc.ca/SSG/ct01026e.html> as of June 13, 2003.

⁴⁹ *McFetridge*, supra note 9 at 329.

⁵⁰ *MEG's*, supra note 48 at s. 5.1.

⁵¹ Ibid., s. 5.5.

⁵² Ibid., footnote 57 in s. 5.5.

⁵³ Ibid., accessed at <http://strategis.ic.gc.ca/SSG/ct01281e.html> on June 13, 2003.

⁵⁴ *MEG's*, supra note 48 at s. 5.5

⁵⁵ After *Superior Propane*, the total surplus standard is no longer applied. As mentioned previously, the domestic welfare standard can be adapted to take into account the transfer of wealth from Canadian consumers to Canadian shareholders, and that all other wealth transfers are already built into the model. Thus, for simplicity, the two standards can be compared absent general wealth transfer effects.

⁵⁶ This is subject to retaliatory measures from other nations that will be discussed later.

⁵⁷ Michael J. Trebilcock and Robert House, *The Regulation of International Trade*, 2nd ed. (New York: Routledge, 1999) at 474. See also, Eleanor Fox and Janusz Ordovery, "The Harmonization of Competition and Trade Law" (1995), 19 *World Competition* 5 at 16

⁵⁸ There is an anomaly here, as when there is no domestic ownership and no domestic consumers the domestic welfare equation becomes $0 > 0$, implying that the merger would not be allowed even though the Canadian economy would be indifferent to it. Three responses. One, this result is extremely unlikely. Two, in the event that it did happen, a court could use discretion and apply a standard that benefits the foreign economy, since Canada is indifferent. Three, to this point we have been avoiding tax consequences. However, in this situation, the merger will most certainly be approved because the firms must anticipate that profits will be increased. Thus allowing the merger will allow the Canadian government to receive more taxes and thus enhance Canadian welfare.

⁵⁹ *Superior Propane II*, supra note 1 at para. 196.

⁶⁰ *Ibid.*, at para. 198.

⁶¹ This equation represents an adaptation of the total surplus standard based on the Tribunal's dicta. In the second *Superior Propane* decision, the Tribunal, as directed by the Federal Court did not adopt a total surplus standard. However, to keep the analysis consistent, an adapted version of the total surplus standard is used here. As previously mentioned, the transfer of wealth can be added to the domestic welfare standard if that is deemed to maximize Canadian welfare.

⁶² *Fox and Ordovery*, supra note 57 at 15.

⁶³ See *Ibid.* at 28: "The decision to allow or disallow a merger affects the structure of a nation's economy."

⁶⁴ *Ibid.* at 28.

⁶⁵ See also *Ibid.* at 27: "Neither the United States nor the European Community have an explicit efficiencies defence or set-off that could sanction mergers that enhance market power, as Canada does."

⁶⁶ It is assumed for the purpose of this illustration that the standards are applied on a worldwide scale.

⁶⁷ This assumes that the proportion of Canadian consumers and Canadian shareholders is the same. This seems to be a reasonable assumption. Given the smallness of the Canadian market to that of the States, one would think that Canada would account for only a small portion of U.S. profits, and would also only account for a small portion of their corporate ownership.

⁶⁸ See *Trebilcock and House*, supra note 57 at 475 and 479. Reference here is to Trebilcock and House's claim that discriminating between mergers based on domestic welfare is myopic in the long run.

⁶⁹ Also, this concern of a further downward spiral is no longer a concern when the domestic welfare standard is applied to develop another standard that is applied non-discriminatorily. See below.

⁷⁰ *Trebilcock and House*, supra note 57 at 479.

⁷¹ *Ibid.*

⁷² *Fox and Ordovery*, supra note 57 at 29.

⁷³ This is not Mathewson and Winter's argument but a direct adaptation of their argument against the balancing weight standard. See *Mathewson and Winter*, supra note 9 at 90.

⁷⁴ See *Ross*, supra note 34 at 644. While Ross does not commit to stating that a domestic welfare standard would in fact violate NAFTA, he suggests that NAFTA would most likely be violated.

⁷⁵ Accessed at <http://www.nafta-sec-alena.org/english/nafta/chap-111.htm> on June 13, 2003.

⁷⁶ Ruth Sullivan, *Driedger on the Construction of Statutes* (Toronto: Butterworths, 1994) at 330; see *Zingre v. R.* (1981), 127 D.L.R. (3d) 223 (S.C.C.).

⁷⁷ *Superior Propane II* (Tribunal), supra note 1 at para. 197.

⁷⁸ See footnote 76.

⁷⁹ See *McFetridge*, supra note 9 at 356 where the author suggests that this may have been what was motivating the court in *Hillsdown*:

...the definition by the Tribunal of the effect of a substantial lessening of competition to include domestic consumer surplus redistribution as a result of the exercise of market power may reflect an attempt to develop a decision rule that prevents large transfers of surplus from Canadian consumers to foreign

shareholders. The Tribunal may have concluded that, given the extent of foreign ownership in the Canadian economy, the gain from having a decision rule that protects domestic consumer surplus in cases involving mergers between foreign-owned firms exceeds the loss resulting from prohibiting some total surplus-increasing mergers between domestically owned firms.

⁸⁰ *Trebilcock and House*, supra note 57 at 479 states:

Countries which have chosen unilaterally to adopt more assertive domestic antitrust policies...have presumably done so for what were conceived to be good domestic reasons, *taking fully into account the implications for foreign trade and investment*. (Emphasis added)

⁸¹ *Ibid.* at 478.

⁸² To the extent that this “camouflages” the true reasons for the legislation, so be it. For the view that this camouflaging is a problem, see *Fox and Ordovery*, supra note 57 at 17.

⁸³ Subject to redistribution costs.

⁸⁴ Now seems the perfect time to enter into negotiations as several countries seem to be examining how they measure efficiencies. See Ann-Brit Everett and Thomas W. Ross, “The Treatment of Efficiencies in Merger Review: An International Comparison” November 22, 2002 accessed on the Bureau’s web site on June 13, 2003 at <http://strategis.ic.gc.ca/SSG/ct02516e.html>.