

**JOINT COMMENTS OF THE AMERICAN BAR ASSOCIATION
SECTION OF ANTITRUST LAW AND SECTION OF INTERNATIONAL LAW
ON THE COMPETITION BUREAU (CANADA) DRAFT BULLETIN ON
EFFICIENCIES IN MERGER REVIEW***

October 7, 2008

The views stated in this submission are presented jointly on behalf of these Sections only. They have not been approved by the House of Delegates or the Board of Governors of the American Bar Association and therefore may not be construed as representing the policy of the American Bar Association.

Introduction

The Section of Antitrust Law and the Section of International Law (the Sections) of the American Bar Association (ABA) appreciate the opportunity to respond to the request for comments by the Competition Bureau (Bureau) in respect of the Bureau's *Draft Bulletin on Efficiencies in Merger Review* (the *Draft Efficiencies Bulletin*).

In providing comments to the Bureau in the past on various Canadian competition law issues, the Sections have sought to provide a helpful perspective based on the experience of antitrust and competition lawyers in the United States and internationally, while recognizing that there may be differences across jurisdictions due to economic, historical, and other factors. For example, the Sections previously submitted comments to the Bureau regarding the treatment of efficiencies in 2004, as part of the Sections' comments on the Bureau's Draft Merger Enforcement Guidelines.¹ The Sections offer the comments contained herein in the same spirit and with the same objective as with prior submissions. Even though differences exist between Canada and the United States (as well as with other jurisdictions) with respect to the treatment of efficiencies in merger review, the Sections believe the experience of the U.S. bar in dealing with the Federal Trade Commission (FTC) and the Department of Justice (Antitrust Division) (jointly referred to hereafter as the Agencies) on merger efficiencies may be informative to the Bureau.

In particular, the Bureau may find of interest the U.S. experience in assessing the impact of cognizable, merger-specific efficiencies on the likely competitive effects arising from a

* The members of the working group that drafted these comments are Margaret Sanderson, Margaret Ward, Richard Elliott, and Kevin Wright, with comments from Paul Crampton, Neil Campbell, and James Lowe.

¹ Joint Comments of the American Bar Association's Section of Antitrust Law and Section of International Law and Practice on Merger Enforcement Guidelines (Draft for Consultation March 2004) of the Competition Bureau of Canada.

transaction, since Canada and the United States share similar analytical frameworks for assessing whether transactions are likely to substantially lessen or prevent competition or produce anticompetitive effects. Whatever surplus standard is adopted to measure and evaluate the efficiencies generated by a merger,² expected cost savings and other synergies will have the same impact on competitive rivalry, prices, and other dimensions of competition.

Executive Summary

The Sections commend the Bureau for providing additional guidance to merging parties and their legal counsel regarding its approach to evaluating efficiencies under Section 96 of the *Competition Act*. While the *Draft Efficiencies Bulletin* limits its discussion of merger efficiencies to Section 96's formal trade-off analysis, which measures a merger's anticompetitive effects against the gains in efficiency it is likely to achieve, and has no direct analogue in the United States,³ the type of information used to assess claimed efficiencies by the Bureau under Section 96 is often comparable to that used in the United States to analyze a merger's competitive effects. The Sections acknowledge the fundamental differences between the analytical frameworks applied in Canada and the United States, but believe aspects of U.S. law and agency practice may be useful in the Bureau's consideration of the proper approach to this important issue.

The Sections also commend the Bureau for its receptivity to evaluating efficiency claims early on in the merger process and for indicating a willingness to undertake its own internal assessment of efficiency claims without necessarily bringing such claims to the Competition Tribunal (Tribunal) for adjudication. Early consideration of efficiencies can be an important component of determining the merger's likely competitive effects.⁴ As well, the Sections

² The Sections note that the U.S. standard is close to a consumer surplus standard, while the Canadian standard might best be described as a hybrid between total surplus and consumer surplus following the Competition Tribunal's redetermination decision in *Superior Propane*. Canada (Commissioner of Competition) v. Superior Propane Inc. (August 30, 2000), CT-1998/002 (Competition Tribunal), at ¶ 462.

³ While the Sections generally support convergence in merger review between the United States and its major trading partners, the Sections recognize that differences in approach mandated by statute must be respected.

⁴ Costs are an important factor in determining firms' pricing and output choices. As a result, savings in costs that are achieved by way of merger can alter rivalry depending on the magnitude and type of cost reductions. A failure to take such cost changes into account when considering a merger's impact on competition may lead to incorrect conclusions with respect to whether the transaction is likely to substantially lessen or prevent competition

commend the Bureau for continuing to consider reductions in fixed costs as part of its efficiency analysis.

With respect to the trade-off analysis itself, the *Draft Efficiencies Bulletin* provides a clear statement of the allocation of the burden of proof between the Commissioner and the merging parties. The Sections encourage the Bureau to disclose to the merging parties its assessment of anticompetitive effects and the remedial action that the Commissioner would seek before the Tribunal on a timely and detailed basis, so that the merging parties have sufficient information to assess whether they will be in a position to meet their burden of proving (a) the gains in efficiency are greater than and offset the anticompetitive effects and (b) the efficiencies would not likely be attained if an order under Section 92 were made.

The Sections note the *Draft Efficiencies Bulletin* indicates the balancing weights standard will be generally, but not exclusively, followed. Where the balancing weights standard is followed, the Sections believe it has the potential to become unworkable in practice, depending on how the Bureau will determine whether some part of the wealth transfer is considered an adverse effect of the merger or if the extent of pass-on is a component of the analysis. If the Bureau expects it will not follow the balancing weights standard in certain cases, the Sections encourage the Bureau to provide guidance on when and under what conditions it would not apply the balancing weights standard, and if not applied, what alternative trade-off approach would be applied.

In light of the importance that innovation plays in the economy, the Sections recommend that the Bureau provide additional guidance regarding how and to what extent the Bureau will credit dynamic efficiencies in its assessment of merger efficiencies and its analysis of a merger's likely competitive effects.

The Sections also encourage the Bureau to provide additional guidance regarding the circumstances under which it will treat forgone efficiencies as an anticompetitive effect or as a deduction from the parties' claimed efficiencies.

Finally, the Sections recommend that the Bureau provide clearer guidance regarding how it will assess whether efficiencies are likely to accrue to the Canadian economy, and to consider

discussing with the Agencies each jurisdiction's approach to cross-border efficiencies and anti-competitive effects.

Comments

The Bureau's current enforcement policy, based on its interpretation of existing legislation and jurisprudence, "take[s] into account substantiated efficiency gains in the consideration of whether the exception in Section 96 of the Act should be applied, rather than in the determination of whether a merger will likely result in a substantial lessening or prevention of competition under Section 92 of the Act."⁵ The Bureau thus segregates the assessment of a transaction's competitive effects from the efficiencies analysis, which differs from the more integrated analysis applied in the United States and the European Union, where efficiencies are taken into account in the assessment of whether a transaction is likely to substantially lessen, or significantly impede, competition.⁶

The Sections also believe that efficiencies are relevant to the analysis of the competitive effects of a merger in many circumstances, particularly where short-term reductions in average variable costs are substantial.⁷ This integrated analysis is the approach taken in the United States. Nonetheless, we are cognizant that the Bureau's "segregated" approach is based on the Bureau's interpretation of existing legislation and jurisprudence.

⁵ Draft Efficiencies Bulletin at 3. The Bureau's approach is informed by the Competition Tribunal's redetermination decision in *Superior Propane*, in which the Tribunal observed that Parliament intended that efficiencies are to be considered only under Section 96 and not under Section 92 of the Competition Act.

⁶ See, e.g., United States Department of Justice and Federal Trade Commission, COMMENTARY ON THE MERGER GUIDELINES, at 49 (March 2006); ICN Merger Working Group: Investigation and Analysis Subgroup, ICN Merger Guidelines Workbook, at 63 (2006); Ilene K. Gotts and Calvin S. Goldman, *The Role of Efficiencies in M&A Global Antitrust Review: Still in Flux?*, ANNUAL PROCEEDINGS OF THE FORDHAM CORPORATE LAW INSTITUTE, INTERNATIONAL ANTITRUST LAW AND POLICY (2003).

⁷ The Sections have previously commented that that "it may be clearer to consolidate the discussion of anticompetitive thresholds and effects into one part, and in the discussion of the efficiency exception to refer to that one part for the analysis of anticompetitive effects that will be needed in applying the efficiency exception." Joint Comments of the American Bar Association's Section of Antitrust Law and Section of International Law and Practice on Merger Enforcement Guidelines (Draft for Consultation March 2004) of the Competition Bureau of Canada.

1. Consideration of Cost Savings Early in the Merger Review Process

Notwithstanding this difference in approach, the Bureau encourages parties to address efficiencies claims “as early as possible in the merger review process.”⁸ The Bureau also states that, in appropriate cases, it will make its own internal assessment of whether efficiency gains that are likely to be brought about by a merger will offset the anticompetitive effects and will not necessarily resort to the Tribunal for adjudication of the issue.⁹ The Sections commend the Bureau for its willingness to evaluate efficiencies claims early in the merger review process and for its openness to assessing those claims without necessarily bringing a proceeding before the Tribunal.

In the United States, the Agencies regularly are presented with information relating to efficiencies and consider efficiencies in assessing the likely competitive effects of a merger. They typically do so from the start of the merger review period and take them into account in deciding whether to challenge a transaction. Notable transactions where efficiencies factored into the Agencies’ assessment include the historic 1982 decision in GM-Toyota joint venture, and more recent actions in Genzyme-Novazyme, Maytag-Whirlpool, XM-Sirius, and the SABMiller-Molson Coors joint venture.

- In GM-Toyota, the FTC, by a 3-2 Commission vote approved a production joint venture between the first and third largest automobile companies in the world, subject to certain restrictions.¹⁰ In allowing the joint venture to proceed, the FTC indicated the joint venture would allow for a greater number of small cars to be made available to American customers at lower cost than GM could achieve through any alternative available to it, and it would allow GM to learn more about efficient Japanese manufacturing and management techniques.¹¹
- The 2004 Genzyme-Novazyme merger combined the only two companies involved in the development of a treatment for Pompe disease, a rare condition that

⁸ Draft Efficiencies Bulletin at 1.

⁹ *Id.* at 7.

¹⁰ General Motors Corp., 103 F.T.C. 374 (1984).

¹¹ *Id.* at 386.

affects about 10,000 people annually.¹² The FTC declined to challenge the merger in part on the grounds that the sharing of knowledge between the two companies would accelerate the development of a successful therapy.

- When the Antitrust Division closed its 2006 investigation of Whirlpool's acquisition of Maytag, it cited in part the efficiencies Whirlpool would achieve, noting that "the parties provided detailed analyses supporting enough of these claimed efficiencies to indicate that Whirlpool is likely to achieve significantly more savings than Maytag could achieve if this transaction does not proceed. These efficiencies further reduce the likelihood that the transaction might harm consumer welfare."¹³
- In 2008 the Antitrust Division investigated but did not challenge the merger of satellite radio providers XM and Sirius. In closing its investigation the DOJ cited a number of factors for its decision, including the parties' claimed efficiencies. Even though the Antitrust Division did not accept all of the merging parties' claimed efficiencies due to lack of evidentiary support, it concluded that the parties would likely realize "significant variable and fixed cost savings through the merger." It cited the parties' ability to consolidate development, production and distribution efforts and the resulting cost savings and economies of scale. According to the Antitrust Division, "these efficiencies alone likely would be sufficient to undermine an inference of competitive harm."¹⁴
- In June 2008 the Antitrust Division closed its investigation of the Miller-Coors joint venture without seeking any remedial action notwithstanding high concentration levels among beer producers in the United States. At the time of announcing the combination of their U.S. and Puerto Rico operations, the parties claimed \$500 million of annual cost synergies arising from optimization of production over the

¹² Genzyme Corp. and Novazyme Pharmaceuticals, Inc. (2004), <http://www.ftc.gov/opa/2004/01/genzyme.htm>. The Commission decided to close the transaction by a 3-1-1 vote.

¹³ Department of Justice News Release, "Department of Justice Antitrust Division Statement on the Closing of its Investigation of Whirlpool's Acquisition of Maytag," March 29, 2006.

¹⁴ Department of Justice News Release, "Statement Of The Department Of Justice Antitrust Division On Its Decision To Close Its Investigation of XM Satellite Radio Holdings Inc.'s Merger With Sirius Satellite Radio Inc.," March 24, 2008.

existing brewery network, reduced shipping distances, economies of scale in brewery operations, and the elimination of duplication in corporate and marketing services.¹⁵ The parties also claimed the joint venture would provide them with greater flexibility and resources for brand-building initiatives and increased levels of innovation in taste, product attributes and packaging.¹⁶ In considering such efficiencies, the Antitrust Division noted there would be substantial reductions in variable costs of production and distribution that were likely to have a beneficial impact on price. Ultimately, the Antitrust Division concluded that “the joint venture is likely to produce substantial and credible savings that will significantly reduce the companies’ costs of producing and distributing beer.” It further noted that the claimed efficiencies “meet the Division’s criteria of being verifiable and specifically related to the transaction and include large reductions in variable costs of the type that are likely to have a beneficial effect on prices.”¹⁷ Unlike its closing statements in Whirlpool-Maytag and XM-Sirius, the Antitrust Division’s announcement regarding Miller-Coors does not discuss any factors in its competitive analysis other than efficiencies.

Although each agency decision is fact-specific, the type of information that the Bureau notes as useful to its consideration of efficiencies under Section 96 is very similar to information that merging parties regularly present to the Agencies when they consider efficiencies as part of an integrated analysis of competitive effects. Merging firms present detailed explanations of how cost savings will be realized, including evidence from internal company sources and external experts. Where applicable, information on efficiencies realized from prior transactions also is presented. Such information is very detailed, distinguishing between fixed and variable cost savings as well as one-time versus recurring savings and related implementation costs. It also may be incorporated directly into economic models of competitive interaction and merger simulation models that allow the impact of cost savings on pricing and competitive effects to be assessed.

¹⁵ SABMiller News Release, “SABMiller and Molson Coors to combine U.S. operations in joint venture,” October 9, 2007.

¹⁶ *Id.*

¹⁷ Department of Justice News Release, “Statement of the Department of Justice’s Antitrust Division On Its Decision To Close Its Investigation Of The Joint Venture Between SABMiller Plc And Molson Coors Brewing Company,” June 5, 2008.

Efficiencies may have different levels of importance depending on the economic model used to assess competitive effects. For example, savings in fixed costs may affect firms' pricing in cases where pricing is mediated by regulation that references the cost of providing a service or in bidding markets when fixed and variable costs are considered by firms when formulating a bid.¹⁸ The Sections commend the Bureau for continuing to consider reductions in fixed costs as part of its efficiency analysis and note that this is particularly appropriate in the context of a defense to a finding that the merger is likely to prevent or lessen competition substantially. The Sections note that it would be helpful if the Bureau confirmed that fixed cost savings generally will not be given less weight than variable cost savings, unless there is some fact-specific reason for according such lesser weight in the context of a particular case. The Sections previously have recommended that the *U.S. Horizontal Merger Guidelines* would be improved by addressing the Agencies' treatment of mergers that result in substantial reductions in fixed costs.¹⁹

2. Disclosure of Bureau Concerns Needed to Meet Parties' Burden

The Sections commend the Bureau for its clear statements on the burden of proof on the parties and the Commissioner under a Section 92 and 96 analysis. Because the parties bear the burden of proving that the gains in efficiency are likely to be greater than and offset a merger's anticompetitive effects and would not likely be attained if an order under Section 92 were made, the Sections suggest there is a need for disclosure as early as possible of the Bureau's preliminary assessment of anticompetitive effects and of the remedial action that the Commissioner would seek before the Tribunal, as soon as such assessment and determination have been made. In the Sections' experience in dealing with the Agencies, considerable information on the theory of competitive harm and on the economic modeling assumptions and conclusions can be provided without disclosing confidential information obtained from third parties.

¹⁸ See, e.g., Robert Rubinovitz, *New Thinking on the Role of Fixed Cost Savings in Merger Analysis*, THE ANTITRUST SOURCE, April 2008, available at <http://www.abanet.org/antitrust/at-source/08/04/Apr08-Rubinovitz4=21f.pdf>; David Painter, et al., *Importance of Fixed Cost Savings in Antitrust Efficiency Analyses*, Presentation at the Federal Trade Commission Bureau of Economics Merger Roundtable (Dec. 10, 2002), available at <http://www.ftc.gov/be/rt/presentationpanel4.pdf>.

¹⁹ Comments of the Section of Antitrust Law of American Bar Association in Response to the Antitrust Modernization Commission's Request for Public Comment Regarding the Appropriate Role of Efficiencies in Merger Enforcement, November 2005, available at <http://www.abanet.org/antitrust/at-comments/2005/11-05/roleofefficiencies.html>.

It would be extremely difficult for the parties to meet their burden if they do not have sufficient information regarding the key elements of the Bureau's findings of likely anticompetitive effects, such as the specific products or services of concern, the geographic region within which the merger's effects are being evaluated, whether price discrimination focuses the competitive concerns on specific customer segments, and the economic models of competitive interaction and competitive harm applied by the Bureau. Because the parties bear the burden of proving the efficiencies would not likely be attained if an order were made, the Sections suggest that the Bureau articulate the remedy that it would be seeking if the merger were to proceed. This allows the merging parties and the Bureau to consider which efficiencies are not relevant to the trade-off because they can be attained even if a remedy is imposed.

3. The Trade-Off Analysis

The *Draft Efficiencies Bulletin* indicates the Bureau will “generally follow” the balancing weights standard in conducting the trade-off analysis, but that “a different approach to weighing efficiency gains against the anticompetitive effects may be appropriate in a specific case.”²⁰ If the Bureau expects it will not follow the balancing weights standard in certain cases, the Sections encourage the Bureau to provide additional guidance regarding the circumstances in which it would not apply the balancing weights standard, and to identify the alternative approaches it would apply.

The *Draft Efficiencies Bulletin* does not clearly explain when and how a portion of the consumer wealth transfer would be considered part of the adverse competitive effects from the merger. The *Draft Efficiencies Bulletin* indicates only that a portion or all of the transfer will be included as part of the loss in surplus “if consumers of the relevant product(s) are worse off than producers.” The *Draft Efficiencies Bulletin* does not provide further guidance on critical issues such as (i) how much “worse off” consumers need to be in this regard; (ii) in which way they need to be “worse off”; (iii) how that assessment will be made; (iv) how the Bureau will assess any differences in “the use to which the product at issue is put, and whether that use tends to be one engaged in by relatively higher income groups”; (v) how to assess how much of the transfer

²⁰ Draft Efficiencies Bulletin at 4. Canada uses a net benefits methodology approach in assessing efficiencies while the United States utilizes a consumer welfare test.

should be counted; and (vi) how the Bureau will determine the relative weighting to be accorded to any portion of the transfer that is included in the trade-off analysis.

Where affected customers are businesses, the *Draft Efficiencies Bulletin* indicates the Bureau will consider the relative profitability of those businesses and their ability to pass on price increases. Comparing the profitability of the merging firms' customers (or, in cases where the relevant products are intermediate goods, the profitability of the customers of the merging firms' customers) with the profitability of the merging firms is likely to be extremely complex, assuming such data is even available. In practice, calculating the amount of likely pass-on by business customers of the merged entity to consumers is very complex and depends upon a numerous factors determining the underlying market demand and supply conditions at each stage of the distribution chain.

The Sections note the balancing weights standard has the potential to become unworkable in practice, depending on how the Bureau will determine whether some part of the wealth transfer is considered an adverse effect of the merger or if the extent of pass-on is a component of the analysis.

4. Dynamic Efficiencies

The Sections commend the Bureau for recognizing the importance of dynamic efficiencies in merger review; however, the *Draft Efficiencies Bulletin* provides little information on how the Bureau will address them. In light of the important role innovation plays in the economy, the Sections recommend the Bureau provide greater guidance on the experience that it has gained in assessing innovation and other non-price benefit claims in merger reviews. For example, there may be instances where a merger reduces competition in one product but provides the merging parties with greater incentives to create or improve another product, which may result in lower production costs (as a result of an innovation in production technology or an increase in demand for the parties' products as a result of product innovation), or a better quality product that consumers prefer. Such efficiencies, assuming that they are merger-specific and would not be obtained if a remedial order were made, may be quite significant where the new product, in effect, replaces the old product. Thus, the Bureau's trade-off analysis would involve balancing the welfare of those users who are able to switch to the new product against the welfare of legacy users. By providing guidance as to how these sometimes conflicting outcomes

in a merger will be analyzed by the Bureau, the merging parties may be better able to explain and quantify whether the efficiency benefits of the merger exceed its anticompetitive effects.

Similarly, transactions are often driven by the complementary nature of the merging firms' businesses and the ability to combine complementary and underutilized assets and specialized or unique expertise to position the merged firm to better serve customers with new or improved products at lower cost and sooner than could occur without the merger. The Sections encourage the Bureau to accord significant credit to transactions where such benefits can be reasonably demonstrated by the merging parties. Efficiencies created by combining complementary assets often promote dynamic efficiencies in the relevant market(s), by stimulating competitive activity with respect to innovation, product quality, and product diversity by others.

5. Forgone Efficiencies

The Bureau notes that efficiencies foregone as a result of the merger "generally . . . will be considered as [sic] an anticompetitive effect," but then goes on to note that in some cases it may be more appropriate to instead deduct forgone efficiencies from the parties' claimed efficiencies.²¹ The Sections observe that it seems inconsistent to consider forgone efficiencies at the stage of the assessment of competitive effects, but not to consider likely efficiencies at that stage. The Sections recommend that the Bureau provide more specific guidance on the circumstances under which it will count a forgone efficiency as either an anticompetitive effect or a deduction from the parties' claimed efficiencies.

6. Gains in Efficiency from Non-Canadian Sources

The *Draft Efficiencies Bulletin* states that "productive efficiency gains arising from the rationalization of the Parties' facilities located outside of Canada that do not accrue to the Canadian economy are not considered to be efficiency gains for the purposes of Section 96."^{22 23}

²¹ Draft Efficiencies Bulletin at 7.

²² Draft Efficiencies Bulletin at 6.

²³ The Agencies' Horizontal Merger Guidelines recognize that merger efficiencies sometimes are "not strictly in the relevant market, but so inextricably linked with it that a partial divestiture or other remedy could not feasibly eliminate the anticompetitive effect in the relevant market without sacrificing the efficiencies in the other market(s)." United States Department of Justice and Federal Trade Commission, HORIZONTAL MERGER

The Sections recognize that the analysis of cross-border transactions can be complex, involving different jurisdictional considerations, but note that care must be taken not to artificially limit efficiencies that are counted in the analysis to those involving assets located in Canada given that in a globalizing economy, off-shore efficiencies may accrue to the benefit of Canadian consumers. Because of these complexities, the Sections recommend that the Bureau undertake a more comprehensive consideration and provide clearer guidance regarding how it will assess whether efficiencies are likely to accrue to the Canadian economy. The Bureau does not currently provide any insight into how it will determine whether certain claimed efficiencies will accrue to the Canadian economy, other than to state that the issue is “whether the efficiency gains will accrue to the Canadian economy *rather than the ownership of the company* that will determine what should be counted as a ‘gain in efficiency’ for the purpose of section 96.”²⁴ (emphasis added) In addition, the Sections encourage the Bureau to examine this issue in more detail and to discuss with the Agencies each jurisdiction’s approach to cross-border efficiencies and anti-competitive effects.

Conclusion

The Sections welcome the Bureau’s initiative to provide additional and more transparent guidance regarding the analytical framework the Bureau applies when assessing efficiencies claims.

We appreciate the opportunity to comment and would be pleased to respond to any questions the Bureau may have, or to provide any additional information that may be of assistance to the Bureau.

GUIDELINES (jointly issued April 2, 1992 and revised April 8, 1997). In a 2006 Commentary on the Horizontal Merger Guidelines, the Agencies noted that in some cases, “inextricably linked out-of-market efficiencies . . . can cause the Agencies, in their discretion, not to challenge mergers that would be challenged absent the efficiencies.” United States Department of Justice and Federal Trade Commission, COMMENTARY ON THE MERGER GUIDELINES, at 57 (March 2006). The Agencies did not specify how they would treat efficiencies arising outside of the United States, and only noted that this situation can arise if a merger is likely to generate large procompetitive benefits in a large market and presents a small anticompetitive problem in another, smaller market.

²⁴ Draft Efficiencies Bulletin at 7.