Merger review in Canada

The Supreme Court has clarified merger review analysis

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On 22 January 2015, the Supreme Court of Canada (SCC) released its first decision in nearly 20 years regarding the Competition Act's merger provisions. Its decision in *Tervita Corp v Canada (Commissioner of Competition)* is important because (1) it sets out the proper analytical framework for determining whether a transaction substantially *prevents* competition, as opposed to substantially *lessens* competition; and (2) it clarifies the application of Canada's statutory "efficiencies defence" to otherwise anticompetitive mergers.

Background

Tervita, a waste-management services company in Western Canada, owned and operated the only two secure landfills for oil and gas hazardous waste in northeastern British Columbia when it acquired Complete Environmental in January 2011. A subsidiary of Complete Environmental owned the Babkirk site and a permit to operate a secure landfill for oil and gas waste at that site, although construction of a secure landfill at the site had not begun at the time of the merger.

The Tervita/Complete Environmental deal fell well below the premerger notification thresholds in the Competition Act (the Act) but was still challenged by the commissioner of competition (the Commissioner) on the basis that it was likely to prevent competition substantially in the market for the disposal of hazardous oil and gas waste at secure landfills in north-eastern British Columbia. The Commissioner said the transaction prevented the competitive entry of the Babkirk site that would have lowered tipping fees for producers of hazardous oil and gas waste.

Tervita argued that, without the merger, the vendors would have used the Babkirk property for a different service of treating hazardous waste (bioremediation) that would not compete meaningfully with Tervita. Accordingly, Tervita argued that the merger did not prevent competition but rather beneficially added capacity to the relevant market more quickly than might otherwise occur. Tervita also asserted that the transaction resulted in efficiencies that outweighed any anticompetitive effects and therefore that the Act's efficiencies defence applied.

Tribunal and FCA decisions

The matter was heard at first instance by the Competition Tribunal (the Tribunal). The Tribunal found a likely substantial prevention of competition in the relevant market, concluding that, in the absence of the merger, the vendors' non-competing bioremediation business would probably have failed and that, by the spring of 2013 at the latest (ie 27 months later), the Babkirk site would have commenced operating as a secure landfill in competition with Tervita.

On appeal by the merging parties, the Federal Court of Appeal (the FCA) agreed with the Tribunal, and clarified that the correct analysis requires determining whether the allegedly prevented entry or increased competition is likely to occur "within a reasonable period of time", which must be discernible although not precisely calibrated. The relevant time frame should generally be shorter than the time required for a new entrant to enter the market (for example, due to barriers).

Each of the Tribunal and the FCA rejected Tervita's argument that the efficiencies arising from the transaction would outweigh the anticompetitive effects, despite acknowledging that the Commissioner had failed to measure the quantifiable anticompetitive effects of the merger (for instance, deadweight loss). While the Tribunal was willing to consider these effects qualitatively, the FCA determined that to do so would raise fairness issues and lack the requisite objectivity. The FCA still found that merger-specific efficiencies in this case were "negligible" (ie less than the "yearly remuneration of a half-time junior employee") and therefore could not, on any reasonable analysis, offset the real but undetermined anticompetitive effects, including maintenance of Tervita's monopoly position.

The SCC's decision

Prevention of competition analysis

The SCC agreed with the Tribunal and the FCA that the merger was likely to prevent competition substantially. The SCC said that a prevention analysis (as with a lessening analysis) "requires looking to the 'but for' market condition to assess the competitive landscape that would probably exist if there was no merger".

In a prevention case, the analysis involves two steps. First, the firm or firms that the merger would prevent from independently entering the market must be identified. Typically, this would be one of the two merging parties but could also be a third party. Second, it must be determined whether, in the absence of the merger, the potential competitor would be likely to enter the market and, if so, whether such entry would decrease or constrain the market power of one or both of the merging parties.

The SCC further clarified the temporal scope of the analysis, finding that the time frame for entry by a potential competitor must be discernible and based on evidence of when the competition alleged to have been prevented is realistically expected to materialise. While the lead time normally required to enter the relevant market (for example, due to barriers to entry) may guide the temporal limits of the forward-looking analysis, that analysis becomes less reliable as the relevant time frame increases, and a longer lead time for entry cannot be used to look further into the future than the evidence supports.

Notably, the SCC also held that factual findings about the likelihood of entry in the absence of the merger must be based on evidence of decisions that the relevant company itself would make and not decisions that the Tribunal would make in the company's circumstances. Although the SCC held that the Tribunal does not have a licence to speculate, the SCC ultimately endorsed the Tribunal's assessment, which was based

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on a number of assumptions about how the market would unfold, including assumptions regarding the operation of the Babkirk landfill well into the future.

Assessment of efficiencies

Where a merger otherwise results in a substantial prevention or lessening of competition, the Act provides a defence if the gains in efficiency resulting from the merger are likely to be greater than, and offset, its anticompetitive effects. Until the SCC's decision, the Tribunal had given serious consideration to the efficiency defence in only one prior case, and significant questions remained about the correct approach to applying the defence.

A majority of the SCC (6-1) reversed the Tribunal and FCA decisions on the non-application of the efficiencies defence, and provided valuable guidance on the correct approach to assessing and balancing claimed efficiencies and anticompetitive effects. Consistent with prior Tribunal and FCA decisions, the SCC held that several methodologies may be used to determine whether the efficiency gains of a merger are likely to be greater than, and offset, competitive harm, and the Tribunal may choose the methodology appropriate to each case. For example, the Tribunal may determine in a given case whether gains to shareholders in a transaction are more or less important than losses suffered by consumers. In conducting its assessment, the Tribunal should consider all available quantitative and qualitative evidence.

The SCC held that the Commissioner has the burden of establishing the anticompetitive effects of the merger to be balanced against proven efficiencies. To ensure as objective an assessment as possible – and out of fairness to the merging parties who must make out the defence (and therefore know what level of efficiencies will outweigh the competitive harm) – the SCC held that any quantifiable anticompetitive effects claimed by the Commissioner must be quantified. Estimates are acceptable but must be grounded in evidence. Only anticompetitive effects that cannot be quantified (for instance, reductions in service or quality) can be assessed on a qualitative basis. Because of the emphasis on objectivity, the SCC noted that qualitative efficiencies and anticompetitive effects will, in most cases, be of lesser importance in the analysis.

In this case, the Commissioner did not provide the Tribunal with quantitative estimates of the merger's claimed anticompetitive effects. The SCC held that, in the absence of such evidence, the Tribunal and FCA should not have considered such effects qualitatively or otherwise given them any weight in the balancing exercise. Instead, the SCC assigned a zero weight to the quantifiable anticompetitive effects of the merger, and found the proved merger efficiencies, although negligible, were sufficient to outweigh and offset the lack of proved anticompetitive effects (the Commissioner also failed to prove qualitative anticompetitive effects). Importantly, the SCC held that proved efficiencies need not cross a significance threshold before they can be weighed in the balance. The defence will succeed if the efficiencies exceed and outweigh the competitive harm to any extent.

The SCC acknowledged that it may seem paradoxical to uphold the efficiencies defence in respect of an anticompetitive merger involving marginal efficiencies, particularly where the merger maintains a monopoly position. However, the SCC found that the Act allows for this result because of the distinct provisions dealing with substantial prevention or lessening of competition, on the one hand, and efficiencies, on the other. A quantification of anticompetitive effects is required only when the efficiencies defence is invoked because of the balancing exercise required to make out the defence.

Summary

The SCC's *Tervita* decision stands for three main propositions:

- In order to determine whether competition is likely to be prevented substantially by a merger, a forward-looking analysis is required of the "but for" landscape that would probably exist without the merger. This analysis is "inherently predictive" but must be based on evidence about what the parties themselves would have decided, rather than speculation.
- There is no threshold requirement that proven efficiencies are significant in order to be considered in the efficiencies analysis; the defence can succeed even in the case of marginal or very small efficiency gains.
- Although the efficiencies defence should be applied flexibly, the basis for assessment must be as objective as possible. As such, the Commissioner is obliged to quantify whatever anticompetitive effects are capable of being quantified. If the Commissioner fails to satisfy this burden of proof, he will probably lose the case.

Main implications for Canadian merger review

- The SCC's endorsement of the Tribunal's "substantial prevention" analysis confirms that merging parties should be alert to theories of competitive harm based on events that are not contemplated by the parties at the time of the merger. However, some comfort may be taken from the SCC's determination that the forward-looking assessment in merger cases must be based on evidence of decisions that companies themselves would make rather than speculation by the Tribunal.
- In light of the SCC's decision, merging parties may choose to invoke the efficiencies defence relatively more often in contentious cases, including in cases that may not be clearly motivated by efficiency gains, especially where it may be difficult for the Commissioner to quantify anticompetitive effects.
- The Commissioner's burden of delineating any quantifiable anticompetitive effects when confronted with an efficiencies argument may mean that he will seek information from merging parties about claimed or potential efficiencies earlier in the merger review process, even if efficiency gains are not asserted at that stage. This may lead to more burdensome merger reviews.

Another lesson

The *Tervita* case also offers an additional lesson, although not specifically tied to the SCC's judgment.

As noted, the transaction was well below the Act's merger notification thresholds (the approximate deal size was only CDN$6m). Nonetheless, the Commissioner was willing to bring an application to the Tribunal and expend significant resources on the matter. This underscores why it is so important for merging parties to assess even small transactions for competition law risk. The size of the transaction alone is not a conclusive indicator that a review/challenge is unlikely.