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Supreme Court of Canada Allows Challenged Merger to Proceed on Efficiency Grounds

Authors: John Bodrug, Charles Tingley, Jim Dinning and George N. Addy

On January 22, 2015, the Supreme Court of Canada (SCC) reversed a decision of the Federal Court of Appeal (FCA) that had dismissed an appeal from an order of the Competition Tribunal (Tribunal) requiring Tervita Corporation[1] to divest the Babkirk hazardous waste landfill site following its acquisition of Complete Environmental Inc.

The SCC agreed with the Tribunal and the FCA that the merger was likely to prevent competition substantially because, in the absence of the merger, the Babkirk site would likely have emerged as Tervita's only competitor in the relevant market within 27 months. However, a majority of the SCC found that the efficiencies defence to otherwise anti-competitive mergers applied on the evidence available to the Tribunal. Since the Commissioner of Competition had failed in her burden of quantifying the anti-competitive effects of the merger, the SCC determined that proven efficiency gains resulting from the merger (even though minimal) were greater than, and offset, any proven anti-competitive effects.

The case is the first fully contested proceeding under the merger provisions of the *Competition Act* in over a decade, and the SCC's decision is the first from that Court to consider the substantive merger provisions of the Act in nearly 20 years.

The SCC provided important guidance on the correct approach to merger review in cases involving alleged prevention of future competition and the invocation of the efficiencies defence. The SCC's decision has a number of significant implications:

- To determine whether a merger gives rise to a substantial prevention of competition, the Tribunal must conduct a forward-looking analysis of the "but for" landscape that would likely exist in the absence of the merger, especially regarding what the parties to the merger would likely have done in the absence of the challenged merger. This analysis is "inherently predictive" but must be based on evidence rather than speculation.
- The efficiencies defence should be applied flexibly but as objectively as possible such that quantifiable anti-competitive effects must be quantified by the Commissioner to weigh in the analysis; and competitive harm will be considered qualitatively only if it cannot be quantitatively estimated.
- There is no threshold significance requirement for proven efficiencies to be considered in the efficiencies analysis; the defence can succeed even in the case of marginal or very small efficiency gains – for example, despite a finding that the merger is likely to prevent competition substantially, if the Commissioner fails in her burden to establish quantitative or qualitative anti-competitive effects, as occurred here, such effects must be given a zero value for the purposes of balancing against proven efficiencies, however negligible those may be.

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 from the B.C. Ministry of the Environment to operate a secure landfill for oil and gas waste at that site; however, at the time of Tervita's acquisition, Complete Environmental had not begun building a secure landfill at the site.

The Tervita/Complete Environmental transaction fell well below the pre-merger notification thresholds in the Act, but was nevertheless challenged by the Commissioner on the basis that it was likely to result in a substantial prevention of competition in the market for "the disposal of hazardous waste produced largely at oil and gas facilities in northeastern British Columbia". According to the Commissioner, the transaction prevented the entry of a "poised competitor" into the relevant market that would have lowered tipping fees for producers of hazardous waste.

Tervita argued that the merger did not prevent competition because, absent the sale to Tervita, the vendors planned to and would have used the Babkirk property for a different service of treating hazardous waste (bioremediation) that would not compete meaningfully with Tervita. Therefore, Tervita argued that the merger was pro-competitive because it added capacity to the relevant market more quickly than might otherwise occur. Additionally, Tervita asserted that the transaction gave rise to efficiencies that it claimed outweighed any anti-competitive effects of the merger and therefore that the Act's efficiencies defence applied.

Tribunal and FCA Decisions

The Tribunal found a likely substantial prevention of competition in the relevant market. Although agreeing with Tervita that the merger would not remove an existing or poised competitor at the time of the merger, the Tribunal determined that it was reasonable to conclude that, absent the merger, Complete Environmental's non-competing bioremediation business would likely have failed and that, by the spring of 2013 at the latest, Complete Environmental would have commenced operating a secure landfill in competition with Tervita or sold its business to someone else who would have done the same. The FCA upheld the Tribunal's analysis, finding that an assessment is required to determine whether the alleged new entry or increased competition that is prevented by the merger is likely to occur "within a reasonable period of time". The FCA clarified that a reasonable period of time must be discernible although needn't be precisely calibrated, and that the time frame for the emergence of the prevented competition should generally be a shorter period of time than that required for a new entrant to enter the market.

The Tribunal also rejected Tervita's argument that the efficiencies arising from the transaction would outweigh the anti-competitive effects. Due to a number of identified legal errors in the Tribunal's assessment of the efficiencies defence, the FCA conducted its own analysis. However, the FCA arrived at the same conclusion, finding that any merger-specific efficiencies were "negligible" (amounting to less than the "yearly remuneration of a half-time junior employee") and therefore could not reasonably offset or compensate for the anti-competitive effects, which included the preservation of a pre-existing monopoly, even though the Commissioner had not quantified those effects.

The SCC's Decision

Prevention of Competition Analysis

The SCC upheld the decisions of the Tribunal and FCA that the merger was likely to result in a significant prevention of competition. In so doing, the SCC clarified the permissible scope for a forward-looking analysis of whether future competition is likely to be prevented substantially by a merger.

Framework for Analysis

The SCC confirmed that a prevention analysis (as with a lessening analysis) "requires looking to the 'but for' market condition to assess the competitive landscape that would likely 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. This would typically be one of the two merging parties, although the SCC noted that a merger could also prevent a third party from entering a market. Second, the Tribunal must determine whether, absent the merger, the potential competitor would be likely to enter the market and, if so, whether the effect of that entry on the market would likely be substantial in the sense of decreasing or constraining the market power of one or both of the merging parties.

Time Frame for Assessment

Consistent with the views of the Tribunal and FCA, the SCC held that the time frame for entry by a potential competitor need not be a "precisely calibrated determination". It must, however, be discernible and based on evidence of when the competition alleged to have been prevented is realistically expected to materialize. Further, while the lead time normally required to enter the relevant market (e.g., due to barriers to entry) may guide the time frame in which the Tribunal may conduct its forward-looking analysis, that analysis will become less reliable as the relevant time frame increases, making it more difficult to establish that the entry alleged to be prevented is "likely" to occur. In addition, a longer lead time for entry cannot be used to look further into the future than the evidence supports. On the SCC's analysis, the relevant time frame for reliable prediction could well vary from one industry to another. For instance, the time frame for predictability may be shorter in a dynamic technology market relative to a landfill market, in which longer lead times may be required to obtain necessary permits.

Notably, the SCC also held that factual findings about whether a company would have been likely to enter in the absence of the merger must be based on evidence of decisions the 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 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 that the Tribunal may not make an order if the gains in efficiency resulting from the merger are likely to be greater than, and offset, its anti-competitive effects. The Tribunal has given serious consideration to the efficiency defence in only one prior case. Due to the limited jurisprudence, there remains significant debate over the appropriate standard to be applied in measuring and weighing the efficiencies arising from a transaction. A majority of the SCC reversed the Tribunal and FCA decisions on the non-application of the efficiencies defence. In holding that the defence applied on the evidence available to the Tribunal, the SCC provided valuable guidance on the approach to assessing and balancing claimed efficiencies and anti-competitive effects where the efficiencies defence is invoked.

Methodology for Assessing Efficiencies

Consistent with prior Tribunal and FCA decisions, the SCC held that several methodologies may be used to determine whether efficiency gains of a merger are likely to be greater than, and offset, competitive harm, and the Tribunal has the flexibility to choose the methodology appropriate to the circumstances of each case. For example, the Tribunal may use its discretion to 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 Balancing Test

The SCC held that the Commissioner has the burden of establishing the anti-competitive effects of the merger to be balanced against proven efficiencies. In keeping with the goal of ensuring as objective an assessment as possible, and out of fairness to the merging parties that must make out the defence (and therefore must know what level of efficiencies are required to outweigh the competitive harm), the SCC held that any quantifiable anti-competitive effects claimed by the Commissioner must be quantified. While estimates of such effects are acceptable, they must be grounded in evidence that can be challenged and weighed. If such quantifiable effects are not quantified, they cannot be considered qualitatively and will be given no weight. Only anti-competitive effects that cannot be quantified (e.g., reductions in service or quality) can be assessed on a qualitative basis. The SCC noted that, because of the appropriate emphasis on objectivity, qualitative efficiencies and anti-competitive effects will, in most cases, be of lesser importance in the analysis.

In the present case, the Commissioner did not provide the Tribunal with quantitative estimates of the merger's claimed anti-competitive effects. The SCC held that, in the absence of such evidence, the Tribunal and the FCA should not have considered such effects qualitatively or otherwise given them any weight in the balancing exercise. Consequently, the SCC assigned a zero weight to the quantifiable anti-competitive effects of the merger (no valid qualitative anti-competitive effects were proven), and the merger-specific efficiencies established by the merging parties, though negligible, were nonetheless sufficient to outweigh and offset the lack of proven anti-competitive effects.

In this regard, the SCC held that proven efficiencies need not cross a significance threshold before they can be weighed in the balance. All that is required for the defence to succeed is that the efficiencies are greater than and outweigh the competitive harm to any extent.

While the SCC acknowledged that it may seem paradoxical to uphold the efficiencies defence in respect of an anti-competitive merger involving relatively marginal efficiencies, particularly where the merger maintains a monopoly position, the Court found that the statutory scheme allows for this result because of the distinct analyses for dealing with substantial prevention of competition (section 92) and efficiencies (section 96). A quantification of the former is required only under section 96 because of the need to carry out the balancing exercise required by that section.

Implications

The SCC's decision is likely to have significant implications for parties to mergers subject to review under the Act. For example:

- Merging parties may take some comfort from the SCC's determination that the forward-looking assessment called for in prevention cases must be based on evidence of decisions that companies themselves would make rather than speculation by the Tribunal. However, the SCC's endorsement of the Tribunal's analysis in this case, which made relatively far-reaching findings about the likely failure of the vendors' bioremediation business and future operation of a competing landfill, confirms that merging parties should be alert to theories of competitive harm involving scenarios other than those planned or contemplated by the parties at the time of the merger.
- Given the Commissioner's burden of quantifying any quantifiable anti-competitive effects when confronted with an efficiencies argument, and the time and cost potentially required to develop such evidence, the Commissioner may be more likely to seek information from merging parties about claimed or potential efficiencies earlier in the merger review process, even if parties do not positively assert significant efficiency gains at that stage. Indeed, following the SCC's decision, the Commissioner issued a statement that the Competition Bureau will consider any changes to its information-gathering practices that may be required in light of the decision. Even though relatively few merging parties rely on the efficiencies defence, this decision may lead to a more burdensome merger review process for many transactions.
- 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 anti-competitive effects.

The SCC's reasons for judgment are available here.

[1] Formerly known as CCS Corporation.

Key Contacts: John Bodrug, Charles Tingley and Jim Dinning