Supreme Court of Canada’s Tervita decision provides important guidance on Canada’s merger laws

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On January 22, 2015, the Supreme Court of Canada (SCC) released a ground-breaking decision in Tervita Corporation et al v Commissioner of Competition, 2015 SCC 3 (Tervita), that dismissed the Commissioner of Competition’s (Commissioner) long-standing application to block and obtain divestiture in the case of a merger in the waste industry.

The decision will be of considerable interest to merging parties and their advisors since the SCC has not considered the merger provisions of the Competition Act (Act) in the past decade. The SCC has provided welcome guidance on two important elements of substantive merger law. First, this was the first merger challenged by the Commissioner based solely on a likely prevention of future competition as distinct from a lessening of existing competition, and the decision establishes a framework for assessing the prospect of future competition. Second, the decision firmly endorses the availability of the efficiencies defence in section 96 of the Act, a unique feature of Canadian merger law that has been the subject of litigation and extensive debate. In Tervita, the SCC also provides some new (though not clear) guidance on the analytical framework to be used in weighing efficiencies against anti-competitive effects.

At the same time, the decision may increase the burden on merging parties in potentially important ways. In its guidance regarding the meaning of a substantial prevention of competition, the SCC has sent a signal to merging parties that they need to look into the future and consider prospective competition that might have occurred in the absence of the merger even if not imminent or planned. In addition, in endorsing the availability of the efficiencies defence, the SCC appeared to impose a significant burden on the Commissioner to quantify the anti-competitive effects of a merger once the merging parties had demonstrated the existence of even marginal efficiencies resulting from the merger. This burden will make it more difficult for the Commissioner to challenge mergers with even minimal efficiencies, and may lead the Commissioner to expand the scope of documents and information requested from merging parties during the course of a merger review.

BACKGROUND

In January 2011, the Commissioner filed an application with the Competition Tribunal (Tribunal)
challenging CCS Corporation’s (CCS) completed acquisition of Complete Environmental Inc. (Complete) (Tervita was formerly known as CCS). While this $6.1 million transaction was not subject to mandatory notification under the Act, the parties had advised the Competition Bureau of the merger on a voluntary basis prior to closing.

Tervita owns the only two hazardous waste landfills in northeast British Columbia. As a result of the transaction, Tervita acquired Complete’s interest in Babkirk Land Services Inc. (Babkirk), which held a permit to develop a new secure landfill site in northeast British Columbia. At the time of the proposed merger, Babkirk’s business plan was to operate a bioremediation facility on the site in question rather than a standalone hazardous waste landfill. However, the Commissioner’s application alleged that in the absence of the merger, Complete would have likely entered the market served by Tervita, and that, but for the merger, oil and gas companies in northeast British Columbia who must dispose of certain hazardous waste materials at a secure landfill would have enjoyed the competitive benefits that would have resulted from Complete’s entry.¹

In response, Tervita denied these allegations and also invoked the efficiencies defence, a unique feature of Canadian competition law. In short, section 96 of the Act provides that the Tribunal shall not make an order under the Act in respect of a merger that has been determined to substantially prevent or lessen competition if it finds that the efficiencies resulting from or likely to result from the merger offset its anti-competitive effects.

The Tribunal agreed with the Commissioner and found that the merger was likely to substantially prevent competition in the relevant market pursuant to section 92 of the Act. The Tribunal looked past Babkirk’s business plans which showed that it intended to operate a bioremediation site rather than compete with Tervita, and drew its own conclusion that the bioremediation business would likely have failed, following which Babkirk would have operated the site as a secure landfill in competition with Tervita, or would have sold the site to a third party who would have done so. The Tribunal also determined that the efficiency defence in section 96 of the Act did not save the merger because the efficiencies gained by the merger would not offset its anti-competitive effects. This finding was made despite the fact that the Commissioner did not put forward detailed evidence quantifying the likely anti-competitive effects of the merger. Tervita appealed the Tribunal decision to the Federal Court of Appeal (FCA).

The FCA upheld the Tribunal’s conclusion that the merger was likely to substantially prevent competition. The FCA determined that there must be a clear and discernible timeframe for market entry and that the burden of proving that the target was a poised entrant such that its acquisition substantially prevented competition rested solely with the Commissioner. However, the FCA validated the Tribunal’s approach of looking beyond the stated plans of the parties to assess how the market would have developed and unfolded in the absence of the merger.

The FCA disagreed with the Tribunal on the test to be applied in assessing and weighing the quantitative and qualitative efficiencies and anti-competitive effects of a merger and conducted a new analysis. Although the FCA was unable to objectively weigh the quantifiable efficiency gains against anti-competitive effects because the Commissioner had not quantified such anti-competitive effects, it nonetheless found that the gains in efficiencies resulting from the merger were “marginal to the point of being negligible” and could not reasonably have been considered to outweigh its anti-competitive effects. The FCA, therefore, dismissed the appeal and upheld the Tribunal’s divestiture order [Tervita Corporation v. Commissioner of Competition, 2013 FCA 28 (CanLII)].
SCC RULES ON SUBSTANTIAL PREVENTION OF COMPETITION

The SCC agreed with the FCA in validating the Tribunal’s use of discretion in assessing how the market would likely have developed and rejected Tervita’s argument that the Tribunal’s predictions should be based only on evidence from the merging parties’ assets, plans and business at the time of the merger (para. 69). The SCC cautioned that there is a timeframe after which predictions become merely speculative, but agreed with the Commissioner that the Tribunal did not speculate but simply made its finding that the merger would result in a substantial prevention of competition based on the evidence before it (para. 82).

SCC CLARIFIES THE APPLICATION OF THE EFFICIENCIES DEFENCE

In addressing the importance of the efficiencies defence, the SCC drew on the purpose clause of the Act in section 1.1, part of which provides that the Act is “to maintain and encourage competition in Canada in order to promote the efficiency and adaptability of the Canadian economy” (para. 2). The SCC noted that “[i]n the context of the relatively small Canadian economy, to which international trade is important, the efficiencies defence is Parliamentary recognition that, in some cases, consolidation is more beneficial than competition” (para. 87).

Consistent with the analysis of the Tribunal and the FCA, the SCC indicated that the efficiency defence requires “an analysis of whether the efficiency gains of the merger, which result from the integration of resources, outweigh the anti-competitive effects, which result from the decrease in or absence of competition in the relevant geographic and product market” (para. 90). In making this determination, the SCC affirmed that the Tribunal may choose between different possible methodologies for determining the efficiencies under section 96, including the “total surplus standard” and “balancing weights standard” (para. 91). In so doing, the SCC appears to have conspicuously avoided the ongoing debate that has haunted the application of the defence since its adoption by Parliament – namely, whether the Tribunal and the Courts are required to consider wealth transfer effects arising from an increase in market power, or only the modest effects on economic efficiency relating to the deadweight loss.

Regardless of the applicable test, the SCC held that the Commissioner has the clear burden to quantify the anti-competitive effects where such effects can be reasonably quantified, stating: The Commissioner’s burden is to quantify by estimation all quantifiable anti-competitive effects. Estimates are acceptable as the analysis is forward-looking and looks to anti-competitive effects that will or are likely to result from the merger. The Tribunal accepts estimates because calculations of anti-competitive effects for the purposes of s. 96 do not have the precision of history. However, to meet her burden, the Commissioner must ground the estimates in evidence that can be challenged and weighed. (para. 125)

In this case, the SCC held that the Commissioner had simply estimated certain price impacts and had not
prepared any estimate of the deadweight loss or other impacts. The Commissioner therefore failed to meet the burden under section 96.

The SCC disagreed with the FCA’s determination that a non-quantified quantifiable effect should be given an “undetermined” weight and instead held that the failure to quantify all quantifiable effects “is a failure to meet this legal burden and, as a result, the quantifiable anti-competitive effects should be fixed at zero. Quite simply, where the burden is not met, there are no proven quantifiable anti-competitive effects” (para. 128). As reflected in Karakatsanis J.’s dissent, the SCC’s analysis suggests that failure to quantify a quantifiable effect invalidates evidence that established there was a known anti-competitive effect of undetermined extent. Interestingly, while the SCC upheld the Tribunal’s use of discretion in determining how the market would unfold but for the acquisition, it denies the Tribunal such discretion in determining that the known, but undetermined, anticipative effects exceeded the “marginal to the point of being negligible” efficiency gains.

The SCC also held that efficiencies are not required to substantially outweigh the anti-competitive effects for section 96 to apply, and that if the Commissioner has failed to meet his onus, even a marginal showing of efficiency gains may redeem an anti-competitive merger. As Rothstein J. explains, “It is possible that, where proven quantitative efficiency gains exceed the proven quantitative anti-competitive effects to only a small degree, the Tribunal may still find that the s. 96 defence applies” (para. 151).

Since the SCC set the weight given to the unquantified quantifiable anti-competitive effects to be zero, any efficiency gains proven by the appellant outweighed the anti-competitive effects. Consequently, the SCC held that the efficiencies defence applied to allow the merger and dismissed the Commissioner’s application.

**PRACTICAL IMPLICATIONS FOR MERGING PARTIES**

- The case clearly demonstrates that non-notifiable transactions may attract aggressive challenges from the Bureau. The transaction value in this case was only $6 million.
- The SCC has endorsed the Commissioner’s ability to look beyond established business plans in assessing whether a merger is likely to prevent competition substantially. Merging parties will need to bear this in mind when assessing the risks of proceeding with a merger.
- The SCC has imposed a significant hurdle for the Commissioner to prove the quantifiable anti-competitive effects arising from a merger and to rebut an efficiencies defence once the merging parties have established even modest efficiencies. As a result, merging parties are advised to include expected efficiencies in competition analyses accompanying merger filings even where these are relatively small, and to present a detailed analysis of expected efficiencies in more complicated cases.
- The principles of the efficiency defence provided in the SCC’s judgment apply to mergers that are likely to lessen or prevent competition substantially caught by section 92 of the Act as well as agreements or arrangements between competitors that prevent or lessen competition substantially caught by section 90.1 of the Act.
- Merging parties in complex merger cases should expect to be asked to produce to the Commissioner documents and evidence to assist the Commissioner in quantifying anti-competitive effects.
- The SCC has not provided clear guidance on the test for weighing efficiencies against anti-competitive effects, and has left it open for future parties to argue balancing weights against total surplus standard.
- This was another enforcement loss for the Commissioner, and given the challenges in rebutting the
efficiencies defence, it is possible the Bureau may consider the possibility of legislative amendments.

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1 Significantly, the Commissioner originally sought dissolution of the transaction and, only in the alternative, a divestiture. However, in an interim decision, the Competition Tribunal found that the vendors failed to demonstrate that there is no genuine basis for the Commissioner to seek dissolution. See Osler’s Publication on the Tribunal’s Vendors Beware: Competition Tribunal Confirms Dissolution as a Potential Remedy to a Completed Merger.

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