Transcontinental: Competition Bureau uses Consent Agreement to Test Failing Firm Analysis

By Charles Tingley

A position statement issued by the Competition Bureau ("**Bureau**") in respect of a recent acquisition of community newspapers includes interesting clues about how the Bureau might approach future claims by merging parties about the financial health and viability of takeover targets. That approach could create uncertainty for purchasers and vendors about when and how the Bureau will test claims about the financial distress of takeover targets and the absence of competitively preferable purchasers.

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Specifically, the Bureau has used a consent agreement divestiture process to test the parties' claims that a number of newspapers were likely to fail and therefore should not be considered to be effective competitors for the purposes of a competitive effects analysis. While this approach appears to have suited the parties in this case, if applied more broadly, it could in other circumstances second-guess efforts by merger targets to conduct comprehensive auction processes to demonstrate the absence of competitively preferable purchasers, and may be impractical from a timing perspective if failure is imminent.

The Bureau's Merger Enforcement Guidelines

Section 93 of the *Competition Act* (the "**Act**") provides that, in determining whether a merger is likely to prevent or lessen competition substantially, the Bureau and ultimately the Competition Tribunal may have regard to whether a business or part of a business of a party to a proposed merger has failed or is likely to fail. Proof of probable exit from the relevant market means that the loss of competitive influence of the failing firm post-merger cannot be attributed to the merger itself. In the absence of causation, the merger is not anti-competitive and no remedy may be obtained.

According to the Bureau's Merger Enforcement Guidelines, the Bureau takes a two-step approach to considering claims by merging parties about likely business failure.[1] First, the Bureau will assess the extent to which a business is likely to fail by reference to various financial metrics. For a claim of business failure to be made out, this assessment must indicate that the business in question is likely to become insolvent, initiate voluntary bankruptcy proceedings or be petitioned into bankruptcy or receivership.

Second, where actual or likely business failure is established, the Bureau will consider whether alternatives to the proposed merger would likely result in a materially greater level of competition than if the proposed

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[1] See Competition Bureau, *Merger Enforcement Guidelines* (October 2011), section 13, available at: http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/03741.html.

transaction proceeds. In this step, the Bureau asks whether:

- ***A competitively preferable third party purchaser exists that could acquire the business at a net price above liquidation value:*** where such a third party purchaser exists, the Bureau will generally assume that, but for the proposed merger, the failing business will either continue in the market or merge with the competitively preferable purchaser. The Bureau must be satisfied that a thorough search for such a competitively preferable purchaser has been conducted before it will accept the failing firm rationale as grounds not to challenge a proposed transaction.

- ***The merger target could survive as a meaningful competitor by retrenching or restructuring:*** if this is possible, for example by withdrawing from the sale of certain products or from certain areas, and is likely to result in a materially greater level of competition than if the proposed merger proceeds, the Bureau will not accept the failing firm rationale.

- ***Liquidation of the failing firm is competitively preferable to the proposed merger:*** even if there are no competitively preferable purchasers identified, and retrenchment or restructuring of the firm is not feasible or likely, the Bureau will assess whether liquidation of the firm may nonetheless lead to materially greater competition than if the proposed merger proceeds, for example by facilitating entry into a market or allowing actual or potential competitors to better compete for the firm's customers or assets.

Transcontinental's Proposed Acquisition of Community Newspapers

The Bureau announced on May 28, 2014 that it had entered into a consent agreement with Transcontinental Inc. ("**Transcontinental**") requiring the sale of 34 local community newspapers in order to address the Bureau's concerns about Transcontinental's proposed acquisition from Quebecor Media Inc. ("**Quebecor**") of 74 community newspapers in the province of Quebec, together with certain associated regional offices and pre-press hubs.[2] The Bureau's position statement summarizing its analysis of the proposed acquisition explained that the Bureau conducted a failing firm analysis in light of evidence and claims by the parties that many of their newspapers faced serious financial difficulties in recent years, consistent with the general decline of the print industry in Canada and globally.

The Bureau's review focused on potential anti-competitive effects arising from the acquisition in the markets for (i) the door-to-door distribution of third party community newspapers and flyers and (ii) the sale of advertising in community newspapers.

Door-to-door distribution

The parties had competed head to head in the door-to-door distribution of community newspapers and flyers since Quebecor entered that business in 2009 to compete against Transcontinental's established distribution network. However, Quebecor shut down its distribution network in January 2014, shortly after the parties agreed to and announced the proposed merger in December 2013.

The Bureau concluded that the parties were the only viable distribution options for national retailers and certain independent newspapers given the particular geographic coverage these customers require. The Bureau further determined that barriers to entry into flyer and newspaper distribution are significant, despite few physical assets being required, given the importance of reputation and the need to maintain minimum customer volumes to cover high fixed costs of contracting with distribution personnel.

The Bureau's investigation confirmed Quebecor's claims that its distribution network was in financial distress, and the Bureau concluded that, even in the absence of the proposed newspaper acquisitions, Quebecor's network was unlikely to be re-deployed competitively whether through acquisition by a third party (due to the network's financial state and the barriers noted above, even if the newspapers were offered for sale together with the network) or liquidation (due to the limited assets available for sale). Consequently, the Bureau concluded that any lessening of competition arising from Quebecor's exit from newspaper and flyer distribution

[2] The Bureau's press release and position statement are available on its website at: http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/03741.html.

was not attributable to Transcontinental's proposed acquisition of newspapers and related assets. As discussed below, the Bureau was apparently less confident about reaching the same conclusion about the parties' financially distressed newspapers.

Sale of advertising in community newspapers

The Bureau's Analysis: For the purposes of the proposed acquisition, the Bureau treated community newspaper advertising as a market unto itself and found that the parties were each other's closest competitors for the sale of such advertising in those areas in which they each owned community newspapers. Indeed, in many such areas, there were no competing community newspapers. Although not stated explicitly, the Bureau apparently concluded that, unless a failing firm analysis demonstrates that the assets to be acquired would exit the market in any event, the proposed acquisition would substantially lessen or prevent competition for the sale of community newspaper advertising (and potentially the quality of content to readers)[3] in the overlapping markets.

With respect to its failing firm analysis, the Bureau concluded, after careful review of the parties' financial statements and with the assistance of an accounting firm, that at least one of the parties' newspapers was in financial distress in the "vast majority" of overlap markets. However, rather than setting out its analysis of whether the distressed newspapers were likely to continue competing in the relevant market if the proposed acquisition did not proceed, as it did for Quebecor's distribution network, the Bureau's position statement indicates that the trustee sale process provided for in the consent divestiture agreement would determine this issue by way of a real-life experiment:

> "In light of the financial distress of many of the newspapers to be offered for sale and the ongoing transformation of the community newspaper industry, the Bureau is satisfied that the sale process will market-test the potential economic viability of the divested newspapers, test the existence of a competitively preferable alternative to the Proposed Transaction, and provide for the opportunity for the implementation of any available remedy in all local markets in which the Parties' community newspapers compete against each other."

The Consent Agreement: According to the consent divestiture process, 34 of the parties' community newspapers will be offered for sale at no minimum price and subject to Bureau approval of prospective buyers.[4] Further recognizing the distressed nature of the newspapers being offered for sale, the consent agreement provides that Transcontinental will supply to any potential purchaser distribution services for a period of up to three years and printing services for a period of up to one year, in each case on terms substantially similar to the *status quo*.

Consistent with the Bureau's use of the divestiture process as a surrogate for a failing firm analysis, the consent agreement uniquely provides that Transcontinental may retain any newspapers proposed to be divested if (i) the sale process does not yield an acceptable buyer for the assets within the trustee sale period (i.e., 60 days subject to extension in certain circumstances, which is significantly shorter than the sale period applicable in many consent agreements) and (ii) the Commissioner confirms that the sale process was fair and there is no likely interested, viable and acceptable purchaser that can acquire the assets in a timely manner.

The consent agreement further provides that the Commissioner's assessment under item (ii) above must: take into account the views of the divestiture trustee; consider and give due weight to Transcontinental's prior submissions on the financial distress of the newspapers to be divested; assess the current losses being incurred by those newspapers; and consider Transcontinental's compliance with the consent agreement.[5]

While parties to consent agreements have, in some cases, ultimately retained divestiture assets following failed sales processes in the past, this may be the first case in which a consent agreement explicitly provides for the retention of divestiture assets. This makes sense in the context of a failing firm analysis because a lack of purchasers under appropriate sale conditions would confirm that any lessening or prevention of competition

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[3] Although clearly not the focus of its review, the Bureau confirmed that it considered the potential for the proposed merger to impact the quality of content offered to readers, noting that similar analyses have been undertaken by foreign competition agencies in media mergers. The Bureau did not describe its analysis or conclusions in this regard, noting that the remedy in the consent agreement would address any potential concerns about a lessening of competition for readers.

[4] The consent agreement between Transcontinental and the Commissioner of Competition is available on the Tribunal's website at: http://www.ct-tc.gc.ca/CasesAffaires/CasesDetails-eng.asp?CaseID=370.

[5] See paragraph 31 of the consent agreement.

would arise regardless of the proposed acquisition. Nevertheless, this represents a departure from some past Bureau positions to the effect that once a party has agreed to divestitures, it might even have to pay a purchaser to complete them.[6]

Implications

In Canada, it is novel to use a consent agreement to test claims by merging parties about the failure and likely exit of businesses that are the subject of a proposed merger. Normally, failing firm analysis would be conducted during the Bureau's review, and if that analysis indicated to the Bureau that the relevant assets would likely remain in the market, then it could seek to persuade the Competition Tribunal that a likely counterfactual exists in which the level of competition would be materially greater than if the merger proceeds.

By contrast, there may be a certain administrative convenience to using a consent agreement divestiture process to "shop" the relevant assets and test whether viable alternatives exist to a proposed merger. Among other things, such an approach might avoid significant resource and financial costs associated with fully investigating and potentially litigating failing firm claims. It might also reduce concerns about false negative or positive outcomes because the failing firm analysis is allowed to play out in the market. Indeed, it is admittedly challenging for the Bureau to confidently assess, within tight timeframes, the types of counterfactuals considered in a failing firm analysis, which can involve a heightened degree of speculation as compared to status-quo type alternatives to a merger.

That said, it is not at all clear that the consent agreement reached in the Transcontinental/Quebecor case will become a template for resolving future merger investigations that feature failing firm arguments. A number of factors could make such an approach impractical or unlikely. These include:

- ***the urgency of the financial situation:*** in this case, Transcontinental was apparently willing to maintain the assets for the duration of the sale process, but in other cases there may not be the luxury of time to conduct an auction by way of consent agreement.

- ***whether a "shop" has already been conducted:*** it seems that a formal "shop" of the distressed newspapers may not have been conducted prior to the Bureau's review in this case, and the fact of the consent agreement indicates that the Bureau could not be satisfied that willing buyers did not exist. However, despite the sense of certainty that a trustee sale process might provide in this regard, it would be hoped that in future cases the Bureau would not lightly second-guess a good faith shop process conducted by a vendor prior to a proposed merger. If such a process has occurred, then a further natural experiment by means of a consent divestiture agreement is unnecessary.

- ***other specific facts and complexities of each case:*** a host of other factors could complicate the analysis or make a consent divestiture agreement unsuitable in a particular failing firm situation. For instance, the focus on a third party sale in the Transcontinental consent agreement implies that the Bureau was satisfied that the distressed newspapers would not continue to be operated by the parties themselves (e.g., through a restructuring) if the merger did not proceed. If this was not the case, then the Bureau would presumably seek to block the acquisition without the need of further market testing.

In this case, however, clearly all parties were ultimately amenable to verifying the failing firm claims through a consent divestiture process. It will be interesting to see the outcome of that process and whether the Bureau experiments in the future with variants to this approach in difficult cases requiring assessment of claims of likely failure and exit of relevant assets.

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[6] See Speaking Notes for Sheridan Scott, Commissioner of Competition, "The Canadian Competition Bureau's Approach to Merger Remedies", Trade Practices Workshop, Law Council of Australia, Business Law Section, Queensland, Australia (August 10-12, 2007) at note 20. The Transcontinental consent agreement specifically provides that a divestiture is not to take place at a negative price. See paragraph 5(b)(ii).