Canada: Merger remedies

The Competition Bureau is evaluating responses to its draft bulletin

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On 19 October 2005, the Canadian Competition Bureau (the Bureau) issued in draft an information bulletin (the Draft Bulletin) describing its approach to designing and implementing merger remedies under the Canadian Competition Act (the Act). According to a press release issued with the Draft Bulletin, interested parties were given until 20 January 2006 to comment, following which time the Bureau would consider the feedback provided and publish a final document.

Although the Draft Bulletin is generally consistent with the Bureau's past public statements concerning merger remedies, it reflects the Bureau's clear intention to circumscribe in its favour the process involved in implementing such remedies. This is undoubtedly the result of perceived failures to implement effective or timely remedies in previous merger cases.

The legislative context

Section 92 of the Act authorises the Commissioner of Competition (the Commissioner), who heads the Bureau, to challenge merger transactions that are likely to "prevent or lessen competition substantially" in a relevant market. Applications to challenge mergers are brought by the Commissioner before the Competition Tribunal (the Tribunal), a hybrid administrative body comprised of both judges and non-judicial members. The Tribunal may issue orders preventing a merger from being consummated, dissolving the merger or imposing a remedy requiring the disposition of specific assets or shares. With the consent of the parties, the Tribunal may also issue orders requiring that "any other action" be taken in respect of a merger by the person against whom the order is directed.

The Commissioner has only rarely exercised the authority to challenge merger transactions before the Tribunal. In the approximately 19 years since the Act's merger provisions were enacted, only four mergers have been the subject of contested applications. To the extent that issues are raised by a merger, they are generally resolved through some form of negotiated settlement between the Commissioner and the merging parties.

The Supreme Court of Canada has held that the standard against which a merger remedy is to be judged is whether the remedy will "restore competition to the point at which it can no longer be said to be substantially less than it was before the merger". In other words, the remedy only needs to eliminate the "substantial lessening or prevention of competition" caused by the merger in that market. The court has also said that a merger remedy should be the least intrusive way of achieving the desired effect. But if the only choice is between a remedy that goes further than necessary and one that does not go far enough even to reach the acceptable level, then the former is preferable.

The Draft Bulletin

The purpose of the Draft Bulletin is to set out the "essential elements" that the Bureau will take into account in "all cases where remedial action is required". While the remedy in any given situation will depend upon the specific facts of that case, the Bureau will insist in all instances that the remedy's terms are sufficiently clear and well-designed to ensure timely implementation, with minimal or no future monitoring or enforcement by the Bureau or the Tribunal. Remedies must also be designed to "promote competition, not competitors".

The key points of the Draft Bulletin are summarised below.

Negotiation rather than litigation

The Draft Bulletin reaffirms the Bureau's clear preference for negotiating merger remedies without resort to litigation. The Draft Bulletin states that proceeding by way of settlement is less costly, more expeditious and allows a wider range of remedies to be considered.

By virtue of amendments to the Act in 2002, most merger settlements in Canada are now concluded in the form of a consent agreement that is registered with the Tribunal. The new consent agreement procedure does not require prior approval from the Tribunal. Rather, upon registration, a consent agreement is deemed to have the same force and effect as if it were an order of the Tribunal.

Structural versus behavioural remedies

The Draft Bulletin reiterates past statements by the Bureau that it will normally insist upon structural remedies (ie divestitures of assets or businesses) over behavioural remedies. According to the Draft Bulletin, structural remedies are simpler, more effective, less costly to administer and more readily enforceable than behavioural remedies. For these reasons, the Bureau will consider standalone behavioural remedies only where no viable structural remedy is available.

Nonetheless, the Draft Bulletin leaves open the possibility of accepting what it calls "quasi-structural" remedies in lieu of divestitures where such remedies have a significant structural impact by reducing or eliminating barriers to entry, offering access to necessary infrastructure or key technology, or otherwise facilitating new entry or expansion. Examples include licensing intellectual property, granting non-discriminatory access rights to networks and supporting the removal or reduction of tariffs. The Bureau will only accept these types of quasi-structural remedies if they adequately address the competitive harm arising from the merger (eg eliminate significant entry barriers) and do not create any anticompetitive effects of their own.

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For the most part, though, the Draft Bulletin states that the Bureau is inclined to accept behavioural remedies only where they support a "core structural remedy" – for example by assisting the buyer of the divested assets to become a more effective competitor more quickly or by imposing additional behavioural restraints on the acquiring party post-merger. Examples include short-term supply agreements, technical assistance, waiver of restrictive contract terms and codes of conduct.

The divestiture process

Given the Bureau's clear preference for structural remedies, most of the Draft Bulletin is dedicated to describing the Bureau's requirements in negotiating such remedies.

According to the Draft Bulletin, the Bureau will agree to a negotiated divestiture remedy only if it meets the following minimum criteria: (1) the assets elected for divestiture must be viable and sufficient to eliminate the substantial lessening of competition; (2) the divestiture must occur in a timely manner; and (3) the buyer of the assets must be independent of the merged entity and have the ability, incentives and intention to compete effectively in the relevant market(s).

The Bureau will also not normally agree to permit closing to take place before a remedy is agreed upon – for instance, pending completion of its investigation.

■ **The divestiture package.** The Bureau may accept either "full" divestitures of entire operating businesses or "partial" divestitures of discrete assets like manufacturing facilities, retail locations, individual product lines or intellectual property. However, the Bureau will apply greater scrutiny to partial divestitures since the competitiveness of discrete business components is more speculative.

Whether a divestiture is full or partial, the Bureau prefers a clean sweep of assets from one of the merging parties – usually the target – in order to reduce uncertainty and asset integration issues and to limit the ability of the acquiring party to obtain confidential information about the assets to be divested. In addition, the Bureau may require the divestiture of assets outside the relevant market, particularly where economies of scale or scope are important or when assets in the relevant market do not constitute a standalone business.

Prior to agreeing to an asset package, the Bureau also may conduct confidential market testing to determine whether the assets to be divested will be saleable, viable and effective in eliminating the competitive harm arising from the merger. This could involve seeking information from competitors, customers, suppliers and industry experts.

In order to ensure the viability of the divestiture package, the Bureau will normally require the acquiring party to "hold separate" the assets or businesses that are the subject of the remedy pending implementation of the divestiture. In such cases, the Bureau will also normally require that an independent "hold separate manager" be appointed to operate the assets until the sale is complete. Only in very limited circumstances will the Bureau settle for a mere maintenance obligation in respect of the relevant divestiture assets, ie directing the acquiring party to maintain the competitive viability of the divestiture assets without the benefit of a hold separate arrangement. Vendors also will be expected to provide all reasonable and ordinary commercial representations and warranties to the buyer as part of any divestiture package.

■ **Timely implementation.** The Draft Bulletin places much emphasis on quick implementation of merger remedies. For example, the Bulletin sets out the Bureau's preference for fix-it-first solutions, which involve divestiture of relevant assets to an approved buyer prior to or upon completion of the merger. In the Bureau's view, this is the optimal approach because it avoids issues regarding the marketability of a divestiture package, prevents material devaluation of the relevant assets and preserves or restores competition in the relevant market as quickly as possible.

The same concern about ensuring early implementation underscores the Bureau's approach to post-merger divestiture remedies. These remedies ordinarily provide for a fixed period of time in which the vendor can market the divestiture package on the best terms it can negotiate with potential buyers. Where a sale is not effected in the initial period, an independent trustee will be appointed to complete the sale.

One requirement the Bureau says it will now impose in this regard is to give vendors only three to six months in which to divest the asset package before a trustee will be appointed to take over the process. This period is shorter than the initial sale periods in past merger settlements which have typically varied between six months and one year. According to the Draft Bulletin, the Bureau may grant a short extension of the initial sale period in "exceptional circumstances" or where there is a binding letter of intent and closing of the divestiture transaction is "clearly imminent". The trustee sale period will also normally be three to six months, depending on the circumstances.

The Draft Bulletin states that the Bureau also will not agree to any settlement that imposes restrictions on the price at which the trustee may sell the designated assets, regardless of how those restrictions may be expressed (eg, "fair market value", "going concern", "liquidation price", "fire sale", etc).

In addition, the Bureau may require crown-jewel provisions that would allow specified assets to be added to or substituted for the initial divestiture package to make the sale more appealing to buyers during the trustee sale period. According to the Draft Bulletin, crown-jewel provisions are not intended to be punitive but rather to encourage vendors to implement the initial divestiture package quickly and to ensure a viable alternative remedy if the initial package is not saleable. The Draft Bulletin provides little guidance about when the Bureau will require crown jewels except to say that the Bureau is more likely to use crown-jewel provisions to support the effective implementation of partial divestitures.

■ **Suitable buyers.** The Draft Bulletin states that the Bureau will not approve a proposed buyer unless it has both the means and incentive to preserve or restore competition. In particular, the Bureau will insist that: (1) sale of the assets to the buyer must not itself harm competition; (2) the buyer must be at arm's length from the vendor; and (3) following divestiture, the assets must be used by the buyer to compete in the relevant market (as judged in part on the buyer's business plan).

Thus, while the universe of acceptable buyers generally includes new and existing market participants, the latter may not be appropriate where the Bureau's concerns about the merger relate to co-ordinated behaviour among existing firms in the market. The Bulletin also notes that in the case of partial divestitures, where the assets lack an established infrastructure, the Bureau may require the vendor to identify the buyer for pre-approval even before agreeing to register a consent divestiture agreement.

Confidentiality

As a concession to vendors, the Draft Bulletin notes that the Bureau may agree to keep some of the key terms of a consent divestiture agreement confidential during the sale period – for example, the length of the initial sale period, the specific assets that form part of a crown jewel package (but not the existence of such a package) and the fact that the sale is not subject to a minimum price. However, given the Bureau's clearly articulated position on these very issues in the Draft Bulletin, it would appear that the promise of confidentiality may have only a marginal impact on preserving the bargaining position of vendors during the initial sale period. In any event, the Bulletin makes clear that all terms of a consent agreement will be made public if and when the trustee sale period begins.

International mergers

The Draft Bulletin contains a separate section discussing the Bureau's approach to remedying the anticompetitive effects in Canada resulting from international mergers. When a merger leads to similar anticompetitive effects in Canada and other jurisdictions, the Bureau will co-ordinate with other competition authorities on remedies. Co-ordination may involve ongoing communication as developments arise in particular jurisdictions, participation in joint discussions with merging parties and the creation of parallel remedies to ensure consistency across jurisdictions.

According to the Draft Bulletin, co-operation on remedies will be helpful where a single buyer, trustee or monitor is required for a North American or global divestiture. In addition, and consistent with past Bureau practice, the Draft Bulletin notes that the Bureau may determine in appropriate cases that action beyond that taken by foreign jurisdictions is not required. (For example, the Bureau recently determined that divestitures required by the US and European competition authorities with respect to Procter & Gamble's acquisition of Gillette adequately resolved concerns in Canada.)

On the other hand, the Bureau is more likely to formalise its own remedies in Canada when the merger raises Canada-specific issues, the assets to be divested are in Canada or remedial action in Canada is critical to enforcing the terms of the settlement.

Conclusion

There are few surprises in the Draft Bulletin. For example, it is very similar in content to the European Commission's notice on merger remedies. With certain exceptions, the Draft Bulletin is also consistent with the approach taken by the US antitrust authorities to merger remedies. (One point of distinction relates to crown jewels. The Bureau, like the Federal Trade Commission, favours using crown-jewel provisions in appropriate cases; the antitrust division of the US Department of Justice does not.)

That said, there is a particularly Canadian backdrop to the Bureau's approach as set out in the Draft Bulletin. For example, the emphasis on timely implementation is, in part at least, a reflection of the Bureau's experience in several recent cases where the acquiring party, having entered into a settlement, subsequently sought to rescind its agreement to divest by arguing changed circumstances (see *CLI* 26 July 2005 for a description of one of these cases). From the Bureau's perspective, the shorter the sale period, the less opportunity for a party to evade its obligation to divest by arguing that circumstances have changed.

Similarly, the Bureau's stated preference for fix-it-first solutions is likely a reaction to a number of high profile cases in the last several years where negotiated structural remedies were not implemented because no buyers could be found for the divestiture package. In the result, the assets reverted to the acquiring party notwithstanding that – at least on the Bureau's analysis – this resulted in a substantial lessening of competition. In at least two of these cases, there was also an issue about the price at which the trustee would be entitled to sell the assets in question in the event that a buyer was found. Although there is no evidence that sales were prevented or discouraged because of this issue, another lesson apparently learned by the Bureau, as reflected in the Draft Bulletin, is that there can be no restrictions placed on the price at which the trustee may arrange a sale.

One of the concerns about the Draft Bulletin, however, is that it may go further than is necessary to address some of these issues. For example, the proposed three to six month period for vendors to market a divestiture package before losing control of the process is shorter than past practice in Canada. It also compares unfavourably to the European experience, where a recent study by the Commission indicates that the average divestiture deadlines for remedies imposed under the ECMR was 7.6 months, while the average actual timeframe to implement a divestiture was 6.2 months. The European study also notes that imposing too short a divestiture period can actually operate against a successful sale by, for example, reducing the time available for a potential purchaser to conduct necessary due diligence and to negotiate an adequate agreement.

Another broader concern is that the Bureau will come to treat its Bulletin as setting out immutable rules to be followed in all cases. For example, the Bureau apparently plans to include a "template consent agreement" with the final version of the Draft Bulletin when it is released. This template would reflect the "standard guiding principles" to be applied by the Bureau in dealing with merger remedies. The question is whether such a template would merely be a point of reference in remedy negotiations going forward, or whether merging parties would effectively be expected to adopt the template in every case.

It is obviously to be hoped that the Bureau will continue to demonstrate sufficient flexibility in dealing with merger remedies, notwithstanding the existence of its standard guiding principles and templates. Both policy considerations and practical realities dictate that in dealing with merger remedies, as with most other aspects of competition law, the Bureau should not be rigid or dogmatic in its approach.

References

The Draft Bulletin and the Bureau's press release are available at *http://www.competitionbureau.gc.ca/internet/index.cfm?itemID=1983&lg=e.*