Brewing up a storm

Canada's Competition Bureau loses – twice

*by **Mark Katz****

January 2008 was not a great month for Canada's Competition Bureau (the Bureau). It suffered two stinging setbacks in decisions issued by the Federal Court of Canada, both relating to the Bureau's review of Labatt's acquisition of another Canadian beer company, Lakeport Brewing.

In the first decision, the Federal Court of Appeal (FCA) upheld a March 2007 ruling of the Competition Tribunal (the Tribunal) denying the Bureau's application for an interim injunction prohibiting Labatt from acquiring Lakeport, pending completion of the Bureau's review process. In a second decision, a judge of the Federal Court Trial Division set aside a production order obtained by the Bureau against Labatt and Lakeport, on the grounds that the Bureau had not provided adequate disclosure in its application materials.

The FCA's interim injunction decision

▌**Background**. Labatt announced its intention to acquire Lakeport on 1 February 2007. On 12 February 2007, Labatt filed a "long form" notification with the Bureau pursuant to the Competition Act's pre-merger notification provisions. This triggered a 42-day statutory waiting period within which Labatt's acquisition of Lakeport could not be completed.

Under Canada's merger control regime, expiry of the statutory waiting period does not necessarily entail substantive clearance as well. Instead, the Bureau's substantive review process runs on a separate and parallel track that is governed by different – and non-binding – timeframes, called "service standard periods". For example, the Bureau normally takes longer than the 42-day statutory waiting period to review transactions that raise significant competition issues. Indeed, Bureau guidelines state that such a transaction may take up to five months to review, although it could be even longer than that.

In this instance, the Bureau advised Labatt that it would not complete its review by the date on which the 42-day waiting period was set to expire (26 March 2007). The Bureau indicated that it had substantive concerns about the proposed transaction relating to the elimination of Lakeport as a low-pricing alternative to other brewers. Labatt responded that it intended to close the transaction shortly after the waiting period's expiry, but that it was prepared to enter into a "hold-separate" arrangement that would delay integration of the businesses to allow the Bureau more time to complete its review. The Bureau declined to accept this proposal and applied to the Competition Tribunal for a temporary injunction under section 100 of the Competition Act.

The key issue before the Tribunal was whether allowing the transaction to proceed would impede the Tribunal's ability to subsequently order relief in the event that the Bureau decided to proceed against the merger post-closing (the Bureau has the power to challenge a merger up to three years following closing). Mr Justice Phelan of the Tribunal held that the Bureau did not address this issue sufficiently in its evidence and thus had not met its burden on the application. In the result, Labatt was entitled to close its transaction without any limitations, which it did on 29 March 2007.

▌**The appeal**. The Bureau appealed the Tribunal's decision to the FCA. It argued that Mr Justice Phelan had misinterpreted section 100 by imposing too high an evidentiary burden in order to obtain relief. Essentially, the Bureau claimed that the granting of an interim injunction under section 100 should be virtually automatic unless the merging parties can show that the Bureau's application constitutes an abuse of process.

The FCA rejected the Bureau's argument in a decision released on 22 January 2008, stating that "[we] do not agree that parliament intended the role of the Tribunal to be so limited". The FCA held that Mr Justice Phelan had formulated the applicable legal test correctly, and was reasonable in concluding that the Bureau had not satisfied this test. The FCA also elaborated on the types of evidence that would be relevant on a section 100 application to establish the need for an interim order – for example, an understanding of the nature of the potential lessening of competition allegedly caused by the merger; the kinds of remedies the Bureau might seek; and the potential effectiveness of these remedies with and without an interim order in place.

▌**Implications**. The FCA decision confirms that the threshold for relief under section 100 is higher than the Bureau would prefer, and indeed more onerous than many at the Canadian competition bar had thought. In theory, this represents an improvement in the relative bargaining position of merging parties vis á vis the Bureau. In practice, the impact of the decision should not be overstated, though:

(1) In most cases, the Bureau is able to complete its review in a timely fashion. (According to the Bureau, it completes 90% of its merger reviews within 10 days of receiving a completed notification filing.) Therefore, the issue in the *Labatt* case arises only in a handful of instances, at most.

(2) Labatt had its own reasons for pressing to close the Lakeport acquisition even in the absence of Bureau clearance. It had apparently lost out on a prior acquisition opportunity because of the time it took the Bureau to complete its review and was not inclined to repeat the experience. Those circumstances are unlikely to be duplicated.

(3) It will still be a rare acquiring party that is willing to close a transaction knowing that it faces the potential risk of a challenge within three years of closing and the prospect of forced divestitures within a short timeframe at fire-sale prices.

(4) Where international transactions are concerned, the Canadian part of the competition review is rarely a critical "gating" item, particularly if there are serious issues to be resolved. In those instances, the US and EU reviews usually

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extend well beyond the Bureau's review, and closing will not take place in any event until those authorities are on side.

The FCA's decision does not mean that section 100 is now defunct. The Bureau can still obtain a temporary injunction provided that it leads the necessary evidence, which it is now more likely to do since its onus of proof has been clarified. Indeed, less than a week after the FCA's decision was released, the Bureau applied for a section 100 order in another merger involving scrap metal processors. Although much of the supporting materials were redacted, it is evident from what is on the public record that the Bureau took the FCA's decision to heart and directly addressed the issue of why allowing the transaction to proceed would impair the effectiveness of the remedies it might subsequently ask the Tribunal to grant.

One possible result of the FCA decision is that the Bureau may now be more willing to entertain the notion of interim hold-separate agreements pending completion of its substantive review. The Bureau has previously stated that it would not normally agree to allow parties to close on the basis of an interim hold-separate agreement. However, this position may soften in light of what is now a tougher burden to obtain a section 100 injunction. As a possible sign of things to come, the Bureau eventually agreed to an interim hold-separate arrangement in the scrap metal merger referred to above, thus obviating the need to proceed with the section 100 application (although the acquiree was apparently in financial difficulty).

The section 11 decision

▌**Harsh criticism of the Bureau**. When Labatt pressed ahead with its acquisition of Lakeport on 29 March 2007, matters did not end there. The Bureau continued to review the transaction and, in November 2007, obtained a series of ex parte orders under section 11 of the Competition Act requiring Labatt, Lakeport and other industry participants to produce extensive documentation and other information for the Bureau's investigation. Labatt then applied to set aside the orders granted against itself and Lakeport. On 28 January 2008, Madam Justice Mactavish of the Federal Court Trial Division upheld Labatt's motion and set aside the orders, without prejudice to the Bureau's right to bring a fresh application.

Strongly rebuking the Bureau, Madam Justice Mactavish ruled that it had failed in its obligation to make full and frank disclosure of all material facts in its ex parte applications for the section 11 orders. In particular, the Bureau had not adequately disclosed the extent to which it already possessed a "voluminous and profound" amount of information regarding the Canadian beer industry, including information secured as a result of previous orders obtained against Labatt and Lakeport. Using terms rarely heard in the genteel world of Canadian competition law, the judge characterised the Bureau's application materials as "misleading", "inaccurate", "incomplete" and "disingenuous", and said that she would not have issued the section 11 orders had proper disclosure been made.

The Bureau subsequently tried to defend the propriety of its disclosure practices once Madam Justice Mactavish's decision was made public, but the very strong language employed in the ruling caused the minister of industry to take the unusual step of publicly expressing his disappointment with the Bureau and his intention to investigate what had happened. On 15 February 2008, the minister announced that he had appointed a (so far unidentified) "third party reviewer" to lead an independent probe into the process for obtaining section 11 orders. The reviewer will have three months to report to the minister, including any recommendations for change.

▌**Implications**. An examination of the section 11 order process is welcome. Labatt is not the only party to have been treated unfairly by this process. Practitioners have long complained about the extraordinary costs that clients must incur in responding to these orders, which can require the production of massive amounts of documents and information going back many years. The burden is particularly onerous for non-parties, who are equally obliged to produce information even though they are not directly involved in the transaction.

For example, in a merger investigation in early 2007, the Bureau obtained 34 production orders against various third parties. The Bureau subsequently withdrew these orders, having reached an accommodation with the merging parties. In the meantime, however, the third parties subjected to the orders had expended significant time and resources in an effort to comply – all for nothing, in the end.

The biggest problem with the section 11 application process is its ex parte nature. No-one is disputing that the Bureau needs industry information to conduct its merger reviews. But section 11 orders are often unfocused and overly broad, largely because they are drafted by Bureau officers and government lawyers who are lacking in industry expertise.

It is also not apparent that most situations in which section 11 orders are sought are so urgent that applications without notice are required. That is why organisations such as the Canadian Bar Association have recommended that the Bureau be required to give prior notice of section 11 applications except where it can be demonstrated that this would impair the integrity of an investigation. Indeed, taking the concept a step further, it would be even more helpful to require the Bureau to consult with parties before proceeding to court for an order, unless that would somehow prejudice the investigation.

One possibility is that scrutiny of the section 11 process, at least in the merger context, will lead to a broader review of Canada's merger control system. There are several interests that must be balanced here: the merging parties' interest in timely and certain decision-making; the Bureau's interest in obtaining relevant information; and the interest of the subjects of section 11 orders (whether the merging parties or third parties) in fairness and due process. It may require changes to Canada's merger control system to reconcile all of these interests.

One idea might be to scrap the current dichotomy referred to above between the statutory notification waiting periods and the Bureau's non-binding substantive review "service standard periods" in favour of a uniform system of first and second stage reviews with definitive triggering and end points. This could offer parties greater certainty as to timing but be structured so that the Bureau is also given a reasonable opportunity to conduct its reviews, particularly for complex cases. In that way, the Bureau could not use undue time pressures as justification for maintaining an ex parte process for obtaining section 11 orders. An added advantage is that a change of this nature would bring the Canadian system into closer conformity with that of most other jurisdictions.