Joint ventures in Canada

Richard Elliott, Mark Katz, Christopher Margison
Davies Ward Phillips & Vineberg LLP

This chapter provides a brief overview of the treatment of joint ventures under Canada's Competition Act (the 'Act').[1]

The expression 'joint venture' lacks a consensus meaning in Canadian competition law and is often used to describe any of a wide variety of cooperative arrangements between firms, ranging from short-term, loose contractual alliances to more permanent and comprehensive structural integrations. The words 'joint venture' appear twice in the Act, in both cases in relation to a limited exemption to the merger review process.[2] However, for reasons touched on below, those statutory exemptions are of little practical relevance and do not connote the broader sense in which 'joint venture' is typically used in Canada. Therefore, for purposes of this chapter, the expression 'joint venture' will be more generically employed to encompass any form of inter-firm cooperative arrangement that falls shy of outright merger. Such arrangements are more commonly referred to in Canada as 'strategic alliances', an expression roughly akin to 'competitor collaborations' in the United States.

In 1995, the Canadian Competition Bureau (the Bureau)[3] published the 'Strategic Alliances Bulletin', which remains the Bureau's most extensive policy statement on its treatment of "inter-firm cooperative arrangements, be they called strategic alliances, joint ventures, or any other name".[4] The Strategic Alliances Bulletin acknowledges that most joint ventures do not raise competition concerns and that many produce pro-competitive benefits, such as technology transfers and cooperative research and development. Indeed, a stated goal of the Bulletin is to explain the potentially applicable provisions of the Act and avoid the 'chilling effect' of discouraging joint ventures that may be beneficial to the economy.

This chapter discusses the three main substantive provisions of the Act that are most potentially applicable to the analysis of joint ventures in Canada: the civil merger provisions, the criminal conspiracy provisions and the civil abuse of dominant position provisions. There are important differences between these provisions. For example, conspiracy is a criminal offence, involving criminal burdens of proof, mens rea considerations, substantial penalties and private rights of action. By contrast, mergers and abuse of dominance are civil matters, the enforcement of which is confined to actions by the commissioner of competition before the Competition Tribunal for remedial orders. There are also potentially significant divergences in the treatment of efficiencies: there is a statutory efficiency defence in merger review, whereas the Supreme Court has held that "counterbalancing efficiency gains to the public" are not relevant to the inquiry under the conspiracy provisions. Further, there may also be procedural considerations, notably that certain joint ventures, depending on their structure and size, may trigger pre-merger notification requirements.

Notwithstanding these differences, it is worth noting that the merger, conspiracy and abuse of dominance provisions all share the threshold prerequisite that a joint venture may only be condemned if it is likely to prevent or lessen competition substantially or unduly. Therefore, under any of these provisions, a joint venture should be permitted unless it can be shown that, among other things, in the absence of the venture, the joint venture parents would likely have competed with respect to matters within the scope of the venture and that they possess market power. Further, since the focus of the Bureau's competition concerns under the Act has been foremost on pricing and output effects, joint ventures that involve cooperation at the early stages of bringing a product to market, such as cooperative research or production, are less likely to attract scrutiny than ventures involving joint distribution or marketing.

Civil merger provisions

Unlike full mergers, most joint ventures are limited in scope, and often duration, such that the joint venture parents continue to function independently with respect to matters outside the scope of the venture. Nonetheless, a joint venture may entail sufficient integration and size that pre-merger notification and/or substantive review under the merger provisions of the Act may come into play.

Pre-merger notification

The pre-merger notification provisions in Part IX of the Act are triggered when certain types of transactions exceed the thresholds prescribed therein. In all cases, the parties to the transaction, together with their affiliates, must have (a) assets in Canada that exceed C$400 million in aggregate value, or (b) annual gross revenues from sales in, from or into Canada that exceed C$400 million in value.

In addition, Part IX applies only to five categories of transactions, where certain thresholds are exceeded (and no exemption applies). For an 'acquisition of assets', the value of the acquired assets in Canada of an operating business or the gross revenues generated by those assets must exceed C$50 million. For an 'acquisition of shares', the same thresholds apply as in the case of asset acquisitions; however, the acquirer must also end up owning voting equity in excess of 20 per cent if the acquiree is a public company and in excess of 35 per cent if the acquiree is a private company. In the case of the formation of a "combination of two or more persons ... otherwise than through a corporation," one or more of those persons must contribute from their operating businesses assets in Canada worth more than C$50 million, or those assets must generate gross revenues in excess of C$50 million. The other two categories of transactions relate to the acquisition of more than a 35 per cent interest in a non-corporate combination as described above and 'amalgamation'.

None of these categories specifically refers to 'joint ventures' or 'strategic alliances'. However, based on the use of the term 'combination' in other provisions of the Act, it appears that this concept is meant to cover joint ventures, at least to the extent that they are carried out other than through a corporation (eg, a partnership). 'Corporate' joint ventures, on the other hand, will be subject to the pre-merger notification provisions if they involve one of the other enumerated categories of transactions (eg, an asset or share acquisition) and the relevant thresholds are exceeded.

The Act contains a number of exemptions to the pre-merger notification requirements, one of which is section 112, which sets out a specific exemption for "combinations that are joint ventures". This exemption applies if: (i) the combination will be governed by a written agreement which imposes an obligation on at least one party to contribute assets and governs a continuing relationship between those parties, (ii) there will be no change in control over any party to the combination, and (iii) the agreement restricts the activities of the combination and provides for its orderly termination. Interestingly, section 112 is not limited on its face to unincorporated combinations, which has left open the argument that the exemption should apply to corporate joint ventures as well. However, the Bureau has issued guidelines stating its position that the section 112 exemption is restricted to unincorporated combinations and does not apply to joint ventures in corporate form. Overall, the exemption in section 112 is of limited practical significance because it is narrowly drawn and, even where it applies, the Bureau may still review a proposed combination from a substantive perspective, as discussed below.

Substantive merger review

If a joint venture constitutes a 'merger' within the meaning of the Act, the Bureau can, and likely would, review it under the merger provisions. 'Merger' is defined in section 91 as: "the acquisition or establishment, direct or indirect, by one or more persons, whether by purchase or lease of shares or assets, by amalgamation or by combination or otherwise, of control over or significant interest in the whole or a part of a business of a competitor, supplier or person."

Where a joint venture is subject to pre-merger notification, the Bureau will generally presume that the substantive definition of 'merger' is also met. However, even where notification is not required, the merger provisions may still apply, given the potentially broad concept of 'significant interest'. The Bureau's Merger Enforcement Guidelines (MEGs), revised in September 2004, interpret a "significant interest" in the whole or part of a business in terms of the "ability to materially influence the economic behaviour" of that business. Thus, where a joint venture involves the acquisition of a minority, non-controlling stake, important considerations in assessing whether the merger provisions may apply will include the amount of voting equity, board representation and the extent and duration of collaboration. Further, in the Strategic Alliances Bulletin, the Bureau indicates that "[g]enerally, the Bureau will examine alliances that involve the future acquisition of control as mergers, unless there is a basis for believing that the acquisition of control is a sham".[5]

Many joint ventures take the form of joint venture parents pooling their resources to produce or sell a common product or service. Often this will involve fully integrating a portion of their respective businesses. Even though the joint venture parents will continue to compete regarding matters outside the venture, the Bureau has generally taken the position that such joint ventures constitute mergers under section 91 with respect to the parts of the businesses being contributed to the joint venture. For example, in the late 1980s, Air Canada and Canadian Airlines, then the two largest airlines in Canada, formed a joint venture to combine their respective computer reservation systems into the Gemini system. The Bureau raised competition concerns, but ultimately accepted a consent order settlement under the merger provisions, thereby allowing the 'Gemini merger' to proceed, subject to certain safeguards which, among other things, were designed to prevent any anti-competitive spillover effects on competition in the airline industry, where the Gemini parents, Air Canada and Canadian Airlines, continued to compete.[6]

Where a joint venture meets the definition of a 'merger', the substantive test under section 92 of the Act is whether it is likely to result in a substantial prevention or lessening of competition. The MEGs address the conceptual framework for the analysis, which includes considerations such as relevant market definitions/shares, entry, possibility of unilateral or coordinated effects, business failure and exiting assets, and efficiencies. This framework is very similar to that employed under the US Merger Guidelines. For example, market definition is based on the same hypothetical monopolist paradigm.

There is relatively broader scope in Canada than many other jurisdictions, including the United States, to advance efficiency arguments. The 'efficiency exception' in section 96 of the Act provides that no remedy will be imposed against a merger where the merger is likely to produce efficiency gains that "will be greater than, and will offset, the effects of any prevention or lessening of competition" that will likely result from the merger. As a result of this provision, even a merger that leads to adverse effects on consumers may nonetheless be tolerated due to a broader societal trade-off of economic welfare considerations.[7] Given this greater scope to consider efficiency arguments, parties will generally prefer to have their joint ventures reviewed under the merger provisions of the Act (aside from consideration of the cost of a pre-merger notification filing, if required).[8]

The Act includes a specific exemption from merger review where the definition of 'joint venture' in section 95 is met. However, the section has several requirements that limit its practical significance. For example, the exemption only applies to joint ventures formed other than through a corporation. The venture must be for a specific project or programme of research and development, which would not likely otherwise occur in the absence of the venture. There can be no change in control over any party. An agreement must govern the continuing relationship between all parties and provide for termination of the venture upon completion of the project. Further, since section 95 may only exempt merger review, the joint venture could still be subject to scrutiny under other provisions of the Act, notably conspiracy or abuse of dominance.

Criminal conspiracy offence

A joint venture may potentially be reviewed under the criminal conspiracy provisions in section 45, which prohibits parties from entering into agreements which, among other things, prevent or lessen competition unduly.[9] Examples of agreements or arrangements to which section 45 may apply include those that fix, manipulate or manage prices; modify or eliminate rivalry for customers' business; limit or fix production quantities; allocate customers or territories; restrict or discourage new rivals from entering into the market; coordinate or otherwise manage the granting of trade credit; and implement group boycotts. Further, even where a joint venture pursues legitimate objectives, joint venture partners should be careful to limit information exchanges to what is reasonably necessary to carry out the joint venture activities.[10]

In order to obtain a conviction under the criminal conspiracy provisions, the Supreme Court of Canada has indicated that the following elements must be established beyond a reasonable doubt: (i) the existence of a conspiracy, combination, agreement or arrangement to which the accused was a party, (ii) that the conspiracy, combination, agreement or arrangement, if implemented, would likely prevent or lessen competition unduly, (iii) that the accused had the intention to enter into the agreement and had knowledge of the terms of that agreement, and (iv) that the accused was aware or ought reasonably to have been aware that the effect of the agreement would be to prevent or lessen competition unduly.[11] For joint ventures, the existence of an agreement and intent to enter into an agreement will usually be apparent such that much of the analysis will focus on whether competition is likely to be prevented or lessened unduly.

The Supreme Court has stated that it is the combination of market power and injurious behaviour that makes a lessening of competition undue: the greater the market power, the less injurious the behaviour need be, and vice versa. The assessment of market power is similar to that under other sections of the Act, including mergers and abuse of dominance, and involves considerations such as market definition and share, number and size of competitors, barriers to entry, geographical distribution of buyers and sellers, product differentiation, countervailing power and cross-elasticity of demand.

Regarding the assessment of how 'injurious' is the parties' behaviour, agreements that involve price fixing, restrictions on output or market sharing will be viewed as constituting clearly injurious behaviour. Further, agreements in respect of product quality, service, promotional activity or innovation may also be injurious where such considerations are an important determinant of competitive rivalry.

The Strategic Alliance Bulletin summarises the undueness requirement of section 45 for strategic alliances, including joint ventures, as follows: "...the Bureau will: (i) define the relevant product and geographic markets affected by the strategic alliance; (ii) determine whether the parties to the alliance possess market power in the defined relevant markets, or whether they are likely to obtain market power in these markets as a result of the alliance; (iii) assess what behaviour is specifically restricted or prescribed by the strategic alliance; and, (iv) determine if the alliance results in a combination of market power and behaviour injurious to competition which is serious or significant."

The Supreme Court has characterised section 45 as mandating a "partial rule of reason" inquiry. It is 'rule of reason' given that there is no per se violation. The rule of reason analysis is only 'partial' in that there is not full-blown consideration of efficiencies as may occur in the context of merger review. In particular, the Supreme Court has stated that "considerations such as private gains by the parties or counterbalancing efficiency gains to the public lie ... outside of the inquiry under [paragraph 45(1)(c)]. Competition is presumed by the Act to be in the public benefit."[12]

Concern about inadequate consideration of efficiencies, coupled with the fact that section 45 is a purely criminal provision, has led to criticism that section 45 may chill the development of legitimate joint ventures. As a result, over the last several years, the Bureau has assessed a series of alternative possible conspiracy provisions with a view to recommending a new provision that would, among other things, screen out legitimate strategic alliances.[13]

In addition to government enforcement under the conspiracy provisions, it should be noted that private parties may sue for damages resulting from "conduct that is contrary to" section 45.[14] Therefore, even if the Bureau chooses to review a joint venture under the civil provisions, notably mergers or abuse of dominance, the possibility of a private-damages action based on section 45 remains.

Exemptions and defences to the conspiracy provisions

The Act contains a number of qualified exemptions from the conspiracy provisions of the Act, including, for example, agreements or arrangements relating to the exchange of statistics or credit information, cooperation in research and development and defining product standards.[15] In general, these exemptions apply only if the agreement has no undue effect on competition in Canada with respect to prices, quantity or quality of production, markets or customers, or channels or methods of distribution.[16] In addition, subject to certain exceptions, a party cannot be convicted under the conspiracy provisions if an agreement relates only to the export of products from Canada.[17]

Section 86 of the Act provides a system for registering a 'specialisation agreement' with the Tribunal, which has the effect of exempting application of section 45. To be registered, the Tribunal must be satisfied that the specialisation agreement will produce efficiency gains that will be greater than, and will offset, any likely anti-competitive effects. Unfortunately, 'specialisation agreement' is narrowly defined as an agreement whereby each party agrees to discontinue producing an existing product. Thus, the section will not apply, for example, where parties contemplate a broader degree of collaboration or seek an agreement with regard to anticipated or future products. To date, there has been no application to the Tribunal to register a specialisation agreement.

Civil abuse of dominant position provisions

Joint ventures may also raise issues under the civil abuse of dominant position provisions in section 79 of the Act. The section provides for remedial orders in respect of situations where "one or more persons substantially or completely control, throughout Canada or any area thereof, a class or species of business" and they "have engaged in or are engaging in a practice of anti-competitive acts" with the result that competition is likely to be prevented or lessened substantially.

Initially, some commentators suggested that joint venture agreements falling shy of mergers should be reviewed only under the conspiracy provisions, not the abuse of dominance provisions. However, no such limitation appears on the face of section 79 and, given the fact that the Act contemplates that sections 45 and 79 could apply to the same conduct, it would appear that the better view is that section 79 can capture joint ventures.[18] Further, where a joint venture that is not a merger involves at least some operational efficiencies or pro-competitive justifications, civil review under the abuse of dominance provisions would seem a more appropriate enforcement vehicle than criminal prosecution for conspiracy.

One notable joint venture case under the abuse of dominant position provisions resulted in a consent order directed against the exclusionary rules of Interac, an electronic banking network owned by nine major Canadian financial institutions.[19] The case illustrates how the abuse of dominance provisions may be effective in addressing the barriers to entry created by a closed joint venture network.[20]

Conclusion

Potentially important substantive and procedural implications depend on whether joint ventures in Canada are reviewed under the merger, conspiracy or abuse of dominant position provisions of the Act. At the heart of the substantive differences between these provisions is the treatment of efficiencies. The merger provisions contain a statutory efficiency defence. By contrast, the conspiracy provisions contain no such defence and, furthermore, the Supreme Court has greatly circumscribed any potential role for efficiencies. The abuse of dominance provisions lie somewhere in between, having neither a statutory efficiency exemption, nor any jurisprudential limitation on the role of efficiencies comparable to that under the conspiracy provisions.

As discussed above, the perceived inadequacies of section 45 with respect to efficiencies have motivated calls for a civil 'strategic alliances' provision. Given the slowness and uncertainly of the legislative amendments process, the Bureau also sought, in late 2002, to revise its Strategic Alliances Bulletin with a view to further alleviating concerns about a chilling effect on legitimate joint ventures. The Bureau proposed either to clarify that joint ventures involving "meaningful, efficiency-enhancing integration" would be reviewed under the civil provisions or to "definitively set out the types of agreements that would be examined under section 45". These proposed changes to the Strategic Alliances Bulletin were never adopted. Moreover, it appears that the amendments process is on hold as well. The Bureau had said that it would release draft proposed amendments to section 45 in the autumn of 2005, but this was never done, possibly due to the intervention of a national election that was called around that time. The election resulted in a new Conservative minority government, which has made it clear that amendments to the Act are not amongst its legislative priorities. Accordingly, it remains to be seen what further steps, if any, the Bureau intends to take to deal with the enforcement challenge of trying to trace a line between legitimate pro-competitive joint ventures and those that may raise competition concerns.

Notes

1 RSC 1985, c C-34.

2 See sections 95 and 112 of the Act, id, where 'joint venture' appears in the margin headings.

3 The Bureau is Canada's antitrust agency. The commissioner of competition is the head of the Bureau and is the statutory official responsible for enforcement of the Act.

4 Director of Investigation and Research, Strategic Alliances Under the Competition Act (Ottawa: Supply and Services Canada, November 1995) at Part 1.

5 Id at Part 3.2.

6 *Director of Investigation and Research v Air Canada* (1989), 27 CPR (3d) 476 at 516-525 (Comp Trib). For a more recent example of a joint venture being reviewed as a merger, see *Commissioner of Competition v Saskatchewan Wheat Pool Inc and James Richardson International Limited, CT-2005-009* (Comp Trib). In this case, the Competition Bureau challenged a proposed joint venture between Saskatchewan Wheat Pool and James Richardson pursuant to which the parties would jointly operate their grain handling terminals in the port of Vancouver, but would continue to independently operate their respective terminals outside of Vancouver. The Bureau has alleged that the proposed joint venture would substantially lessen the competitive options available to non-integrated grain companies and to the Canadian Wheat Board, thus negatively impacting Canadian grain farmers. The Competition Tribunal is scheduled to commence its hearing of the Bureau's application in April 2007.

7 This occurred in *Canada (Commissioner of Competition) v Superior Propane Inc* (2002), 18 CPR (4th) 417 (Comp Trib), aff'd (2003), 23 CPR (4th) 316 (FCA).

8 On 18 March 2005 the Bureau announced the establishment of an advisory panel of experts to assess the role that efficiencies should play under the merger provisions of the Act. The panel's report was made public on 31 October 2005 (see www.competitionbureau.gc.ca/internet/index.cfm?itemID=1954&lg=e). The panel concluded that Canadian competition policy should continue to encourage efficiency gains and that efficiencies should be a regular and explicit consideration in the Act's merger review process. As to the Act's efficiencies 'defence', the panel stated that the current provision is not sufficiently clear and predictable but declined to suggest how this should be remedied, other than to say that – however the defence is ultimately re-structured – it should not be permitted in the case of a 'merger-to-monopoly'.

9 The Act also has more specific conspiracy provisions dealing with price maintenance (section 61) and bid rigging (section 47), which create per se offences. However, they are less relevant in most joint venture contexts, such that the discussion in this chapter will focus on the general conspiracy offence in section 45.

10 The Competition Bureau's sensitivities about possible anti-competitive information exchanges were evident in its recent resolution of a merger involving Quebecor Media Inc and Sogides Lteé, a publisher of French language trade books in the province of Quebec. The Bureau was not concerned that the acquisition itself would result in a substantial prevention or lessening of competition. However, during the course of its review, the Bureau learned that the president of Sogides (a Mr Lesperance) was the director of Renaud-Bray, a Quebec-based bookstore chain that competes against a Quebecor-owned bookstore chain. The Bureau obliged Mr Lesperance to resign his position and imposed other limitations to ensure that he would not be privy to any competitively sensitive information about the Renaud-Bray bookstore chain while in the employ of Quebecor. See Competition Bureau, Technical Backgrounder, 'Acquisition of Sogides Lteé by Quebecor Media Inc', www.competitionbureau.gc.ca/internet/index.cfm?itemID=2032&lg=e.

11 *R v Nova Scotia Pharmaceutical Society* (1992), 43 CPR (3d) 1 at 26, 36 and 38-39 (SCC).

12 Id at 31.

13 Sheridan Scott, commissioner of competition, 'Cartel Enforcement: International and Canadian Developments' (7 October 2004).

14 Supra note 1 at section 36.

15 Supra note 1 at section 45(3).

16 Id at section 45(4).

17 Id at sections 45(5) and (6).

18 Id at sections 45.1 and 79(7).

19 *Canada (Director of Investigation and Research) v Bank of Montreal et al* (1996), 68 CPR (3d) 527 (Comp Trib).

20 The Bureau also considered the potential application of the joint dominance concept during an inquiry into the exhibition and distribution of motion pictures in Canada. Competition Bureau Backgrounder, 'Inquiry into the Exhibition and Distribution of Motion Pictures in Canada' (12 December 2002).