PERSPECTIVE

Canadian Competition Bureau's Recent Enforcement Action and Plans to Revise Guidelines May Signal More Expansive Merger Reviews

March 9, 2011

A recent Competition Bureau challenge to a completed merger below the compulsory notification thresholds and an announced intention to amend certain aspects of the Bureau's Merger Enforcement Guidelines may signal more expansive merger reviews by the Bureau. In particular, the Bureau appears to be reviewing more transactions below the compulsory notification thresholds, and may, in its merger reviews, be focusing more on (i) whether the merger may create anti-competitive buying power, (ii) potential vertical foreclosure of competitors who are also suppliers or customers of a merger party, and (iii) minority interests and interlocking directorates. The Bureau also appears to be poised to follow recent amendments to the U.S. merger guidelines and de-emphasize the role of market definition in establishing anti-competitive effects of a merger. Finally, the Bureau's recent merger challenge serves as a reminder that the Bureau considers not only whether a merger lessens existing competition between the parties, but also whether it is likely to prevent future competition from developing.

Below, we discuss the Bureau's application to the Competition Tribunal for dissolution of the January 2011 acquisition of Complete Environmental Inc. by CCS Corporation, and the Bureau's February 25, 2011 announcement that it will revise its Merger Enforcement Guidelines later this year.

Merger Review Under the *Competition Act*

Part IX of the *Competition Act* requires the parties to a merger transaction to submit a notification filing when certain financial and voting interest thresholds are exceeded. The filing of a notification triggers a "waiting period" within which the parties are prohibited from closing their transaction.

During that waiting period and, in relatively rare cases, sometimes beyond, the Commissioner of Competition and her staff at the Competition Bureau will review the proposed transaction to determine whether it is likely to "prevent or lessen competition substantially". If the Commissioner reaches that conclusion, she may apply to the Competition Tribunal to prohibit or dissolve the transaction or to require specific divestitures. Typically, though, the Commissioner and the parties are able to negotiate a resolution, which will then be filed with the Tribunal in the form of a consent agreement. The last contested merger challenge was brought in 2005.

The Part IX notification requirements and the substantive review process apply independently in the sense that a transaction may be subject to notification even if it clearly does not raise substantive issues. Conversely, a transaction may be reviewed and challenged even if it is not notifiable and has already closed. The Commissioner has one year following closing to seek a divestiture or dissolution order from the Tribunal.

Challenge to Completed Merger in B.C. Waste Disposal Industry

Although the Commissioner has the authority to challenge non-notifiable transactions, this authority has rarely been exercised. However, in a case involving the acquisition of a landfill site in British Columbia, the Commissioner has taken the step of not only challenging a merger transaction, but challenging one that had already closed, and was non-notifiable as well.

The transaction at issue is the January 2011 acquisition by CCS Corporation ("CCS") of Complete Environmental Inc. ("Complete"), the owner of a landfill site in northeastern British Columbia known as Babkirk. The transaction apparently fell below the Part IX thresholds. However, it also appears that CCS voluntarily communicated with the Bureau prior to completing the transaction.

Most Bureau concerns about a merger relate to a lessening of existing competition between the parties. However, in this case the Bureau's review led it to conclude that CCS's acquisition of the Babkirk landfill site would likely result in a substantial *prevention* of competition in the market for "the disposal of hazardous waste produced largely at oil and gas facilities in northeastern British Columbia". In February 2010, Complete obtained a permit to operate a secure landfill for hazardous waste at the Babkirk site, although, at the time of the Commissioner's challenge, Complete had not yet started building a secure landfill at that site. According to the Bureau, CCS is the only operator of secure landfills in that area and the challenged transaction is preventing the entry of a poised competitor into the relevant market that would have lowered tipping fees for producers of hazardous waste. Indeed, the Bureau alleges – based on what it claims is revealed in CCS's internal documents – that CCS sought to acquire the landfill site with the express purpose of preventing such entry and averting a possible "price war".

The Commissioner brought her concerns to CCS's attention prior to closing, but no resolution was reached. In a somewhat unusual step, the Commissioner then agreed not to object to CCS completing the acquisition, subject to a written undertaking from CCS to preserve and maintain all approvals necessary for the operation of a secure landfill at the Babkirk site pending determination of the Commissioner's challenge to the acquisition. The fact that Complete did not yet have an operating business at the Babkirk site was likely critical to the Commissioner's position.

The Commissioner is seeking dissolution of the merger and has named all the vendors (in addition to CCS and Complete) as parties to her application. Accordingly, the potential for a post-closing challenge by the Commissioner is of interest to all parties to a transaction.

It may be noted that U.S. antitrust authorities have also recently challenged completed and non-reportable merger transactions. In the last two years, U.S. antitrust authorities have challenged at least a dozen non-reportable transactions following closing. In one instance, the transaction had been approved by a bankruptcy court. In another, the value of the entire deal was no more than $5 million – well below the applicable U.S. threshold.

Amendments to Merger Guidelines

On February 25, 2011, the Commissioner announced that the Bureau will undertake "moderate" revisions to the Bureau's 2004 Merger Enforcement Guidelines. The announcement identified the following specific areas that will be revised to better reflect current Bureau practice and economic and legal thinking.

Buying Power. Typically, when the Bureau has concerns in relation to a merger, they involve a finding that the merger is likely to result in higher prices to customers, or a reduction in the quality or variety of products produced by the parties. On occasion, however, the Bureau may identify concerns about the merger's "upstream" effect on purchases by the merged entity. The Commissioner's announcement states that the Merger Guidelines will be revised to provide additional guidance on these upstream issues in accordance with prior Bureau submissions to the Organisation for Economic Co-Operation and Development ("OECD"). Those OECD submissions state that buying power is anti-competitive where a firm is able to suppress the price that it pays for a product to the point that the overall quantity of the purchased product produced or supplied in the relevant market is reduced below production levels that would otherwise prevail. The Bureau would not be concerned about buying power that enables a purchaser to negotiate lower prices that do not diminish overall supply of the product. Examples of enforcement action by the Bureau prompted by buying power concerns include consent resolutions negotiated in the context of a merger of forestry companies that accounted for a large share of timber purchases in certain local markets, and a merger of retail bookstores that accounted for a large share of book purchases from Canadian publishers.

Minority Interests and Interlocking Directors. Again, the Bureau has indicated that revisions to its Merger Guidelines in relation to minority interests and interlocking directors will build on its previous OECD submissions. In those submissions, the Bureau pointed out that it will review minority interests or interlocking directorships only if they are either ancillary to a merger transaction or themselves constitute an ability to materially influence the economic behaviour of the business of a competitor. Acquisitions of as little as a 20 percent interest in a public company or 35 percent in a private company can trigger compulsory notification requirements, and the Bureau regularly reviews acquisitions of minority interests in that context. Interlocking directorships, however, do not in themselves trigger any notification requirement in Canada. (Unlike U.S. antitrust law, Canadian competition legislation does not expressly address or prohibit interlocking directors or officers between competitors.) In a few instances, the Bureau has examined and sought the elimination of interlocking directorships between competitors that came to light in a review of a full merger between two other competitors. However, the Bureau's OECD submission indicates that, in the Bureau's view, it is possible that an interlocking directorship itself could independently trigger a Bureau review. In this context, the Bureau would assess the relevant director's ability to materially influence the economic behaviour of the business and his or her access to confidential information relating to a relevant market.

*Market Definition***.** The Commissioner's announcement states that revisions to the Merger Guidelines will clarify that merger review does not necessarily start with defining a relevant product and geographic market (i.e., by identifying close substitutes that customers would switch to in the event of a certain range of hypothetical price increases). Rather, merger review may be based on other evidence of competitive effects, with the goal of determining whether a merger creates or enhances market power. This comment, and the apparently intended changes, appear to be inspired by the 2010 revisions to the merger guidelines of the U.S. antitrust agencies. The 2010 U.S. guidelines adopted a more flexible approach to assessing likely anti-competitive effects with a reduced emphasis on the need to assess market definition, market shares and market concentration in all cases. For example, the U.S. guidelines now state that, in some cases, where sufficient information is available, the U.S. agencies may be able to assess the degree to which a price increase by one merging party would divert sales of its products to those of the other merging party, such that a post-merger price increase above competitive levels would be profitable. In this case, the U.S. guidelines assert, identifying the price effects of a merger need not rely on the traditional market definition analysis. (It remains to be seen, however, whether U.S. courts – or the Canadian Competition Tribunal - will follow this approach.)

Vertical Foreclosure. The Commissioner has indicated that the revisions to its Merger Guidelines will provide more accurate guidance on how the Bureau assesses vertical issues, focusing on foreclosure effects. The current Guidelines include a brief discussion of circumstances in which a "vertical merger" between a supplier and a customer may raise concerns where the elimination of an independent upstream source of supply (or downstream distribution outlet) leaves (for other competitors) only a small amount of unintegrated capacity at either of the stages or sectors of the industry at which one of the merging parties competes. Alternatively, the current Guidelines indicate that a merger that creates or increases a high degree of vertical integration between an upstream market and a downstream retail market can facilitate coordinated behaviour by firms in the upstream market by making it easier to monitor the prices charged by rivals at the upstream level. To date, the Bureau has not challenged a transaction principally because of vertical foreclosure concerns. However, we have observed of late increased examination by Bureau staff of potential "vertical" issues that can risk delaying the Bureau's review if not addressed pro-actively or expeditiously.

Other Changes. The Commissioner's announcement also said that the revisions to the Bureau's Merger Guidelines will provide more guidance on the Bureau's current economic thinking with regard to assessment of both unilateral and coordinated effects of a merger, and that the revisions will incorporate a previously released bulletin discussing the efficiencies defence in the merger provisions of the *Competition Act*.

The Commissioner stated that the Bureau intends to publish revised draft Merger Enforcement Guidelines during the second quarter of 2011 and to seek public feedback on the revisions prior to publishing final guidelines in the fall.

Implications

The CCS challenge underscores the need for all parties to consider possible Bureau challenges to mergers below the notification threshold. In some cases, it may be advisable to proactively contact the Bureau to head off possible investigations. In others, the parties may consider themselves to be in a better position to address any issues following closing.

Whether or not a merger is notifiable, the above-noted developments serve as a reminder of several potential issues (prevention of future competition, buying power, interlocking directors, and vertical foreclosure) that, while not typical bases for Bureau concern, can lead to challenge or delay if not proactively identified and addressed as they are clearly on the Bureau's assessment checklist.

If you have any questions regarding the foregoing, please contact George Addy (416.863.5588), John Bodrug (416.863.5576), Adam Fanaki (416.863.5564), Mark Katz (416.863.5578) or Richard Elliott (416.863.5506) in our Toronto office or Hillel Rosen (514.841.6443) in our Montréal office.