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Canada Competition Bureau Wins Challenge to Non-Notifiable Merger

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Merger challenges are rare in Canada. The last contested merger case in Canada was in 2005. Typically, concerns about a prospective merger are resolved in negotiations between the Commissioner of Competition (the "Commissioner") and the acquiring party, with some form of partial divestiture the usual remedy required.

As such, it was a major development when the Commissioner applied to the Competition Tribunal (the "Tribunal") in January 2011 to prohibit the acquisition by CCS Corporation ("CCS") of the shares of Complete Environmental Inc. ("Complete") and its wholly-owned subsidiary Babkirk Land Services Inc. ("BLS"). The Tribunal is responsible for adjudicating merger applications under the *Competition Act* (the "Act").

CCS provides energy and environmental waste management services to upstream oil and gas producers in Western Canada. Among other things, CCS owns and operates the only two "secure" landfill sites in northeastern British Columbia capable of storing hazardous waste. Complete operated various businesses, but, most importantly, through BLS, owned land at a site in Babkirk, British Columbia along with a permit from the B.C. Ministry of the Environment to operate a secure landfill at that location.

CCS's proposed acquisition of Complete (the "Transaction") was not subject to pre-merger notification because it did not exceed the relevant thresholds set out in Part IX of the Act. However, the Commissioner's staff at the Competition Bureau (the "Bureau") investigated the matter, and the Commissioner advised the parties that she would challenge the transaction if they proceeded with their deal. Nonetheless, the parties decided to go ahead and close, based on a "hold separate" arrangement with the Commissioner whereby CCS agreed to maintain all approvals, registrations and other authorizations necessary to operate a landfill at the Babkirk site pending disposition by the Tribunal of the Commissioner's application to challenge the Transaction.

The Commissioner alleged in her application to the Tribunal that the Transaction was likely to prevent competition substantially by eliminating a poised entrant in the market for hazardous waste disposal services in northeastern British Columbia. In a decision announced on May 29, 2012 (with reasons made public on June 15, 2012), the Tribunal upheld the Commissioner's application and ordered that CCS divest the shares or assets of BLS on or before December 28, 2012, failing which a trustee is to effect a sale on or before March 31, 2013.

Apart from the fact that a merger challenge was brought at all, the *CCS* case is interesting from several perspectives:

- (a) Although the Commissioner has the authority to challenge transactions that are not subject to pre-merger notification under the Act, this authority has rarely been exercised.
- (b) The concern in most merger cases in Canada is that the transaction is likely to substantially *lessen* competition in a relevant market. It is less common for a case to focus on the alternative ground under Canadian law for prohibiting a merger, namely that it is likely to substantially *prevent* competition.
- (c) The Commissioner's principal request for relief was that the Transaction be dissolved, i.e., that the business be sold back to the vendors rather than divested by CCS.

Challenge to Non-Notifiable Transactions

Part IX of the 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 rare cases, sometimes beyond), the Bureau will review the proposed transaction to determine if it is likely to "substantially prevent or lessen competition" (the statutory test). If the Bureau reaches that conclusion, it may negotiate a resolution (the usual avenue) or apply to the Tribunal to prohibit or dissolve the transaction or to require specific divestitures.

The Part IX notification requirements and the substantive review process apply independently from each other, in the sense that a transaction may be subject to notification even if it clearly does not raise substantive issues, and may be reviewed and challenged even if it is not notifiable and has already closed (the Commissioner has one year following closing to bring an application).

As noted above, it is very unusual for the Commissioner to challenge transactions that are not subject to pre-merger notification under Part IX of the Act (and only slightly less rare to challenge transactions that are notifiable). Not surprisingly, in conducting their risk analysis, many merging parties have discounted the possibility of competition problems being raised by the Bureau in transactions that fall below the Part IX thresholds. This is particularly tempting in multi-jurisdictional transactions where it is sometimes difficult enough to deal with all of the countries in which notifications *have* to be made, let alone where notifications are *not* legally required.

The Commissioner's successful challenge to the CCS acquisition changes that dynamic. Indeed, the Commissioner had already stated on several occasions before the Tribunal's decision came out that she is determined to proceed against any transaction that the Bureau perceives to be anti-competitive, regardless of its size. The fact that the Bureau has now prevailed in the *CCS* case will no doubt embolden the Commissioner to proceed further down this path.

Substantial Prevention of Competition

Bureau concerns about mergers have typically related to the potential lessening of existing competition between the parties. In this case, however, 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. According to the Bureau, CCS was the only operator of secure landfills in northeastern British Columbia and the challenged transaction prevented the entry of a new competitor into the relevant market that would have lowered charges to producers of hazardous waste (known as “tipping fees”). Indeed, the Bureau alleged – based on CCS’s internal documents – that CCS sought to acquire the landfill with the express purpose of preventing such entry and averting a possible “price war”.

The Commissioner also argued that the expensive, lengthy and highly uncertain process for gaining the relevant approvals to operate a secure landfill meant that future entry by another competitor was not likely to be timely or effective in constraining an exercise of market power by CCS.

Since *CCS* is the first merger case in Canada to be based solely on a “prevention of competition” theory, the Tribunal began its discussion by setting out its analytical framework for determining whether a merger is likely to prevent competition substantially. According to the Tribunal, the issue is “whether a merger is more likely than not to maintain the ability of the merged entity to exercise greater market power than in the absence of the merger, acting alone or interdependently with one or more rivals”. Stated otherwise, the issue is whether the purchaser’s market power would have been challenged (and potentially diminished) “but for” the merger.

In this context, the Tribunal stated that it would focus on three questions:

1. what new competition would have emerged if the Transaction had not occurred;
2. what would have been the likely scale of that new competition; and
3. when would that new competition likely have emerged?

The Tribunal’s approach to “prevent” merger cases is very similar to the analytical framework it uses under the Act’s abuse of dominance provisions, which also focuses on whether the impugned conduct is being used to preserve the dominant party’s market position. Indeed, the Tribunal explicitly referred to case law under the abuse of dominance provisions which established the appropriateness of a “but for” analysis in that context.

As the Tribunal acknowledged, a “but for” analysis of this sort is necessarily “forward looking in nature”, which is also why CCS’s counsel cautioned the Tribunal at the hearing to beware of engaging in “unfounded speculation”. These concerns were well-placed because, in reaching its conclusion that the Transaction would prevent competition substantially, the Tribunal boldly embarked on an analysis that required it to make judgments on the vendors’ likely business decisions in the absence of the sale having taken place, even down to specific dates by when these decisions would have been made. Ultimately, the Tribunal concluded that, by the Spring of 2013 no less, the vendors would have been operating a fully competitive secure landfill at Babkirk, even though at the hearing the vendors asserted that it had not been part of their strategy to do so. Instead, the vendors said that, at most, they would have operated the landfill as an ancillary aspect of another part of their business but not in direct competition with CCS. While the Tribunal accepted the vendors’ intentions to operate an ancillary landfill, it concluded that such a strategy would have been unprofitable and surmised that the vendors would have switched tack after approximately one year. Accordingly, the Tribunal concluded that the Transaction should be prohibited because it prevented competition against CCS’s landfills from materializing.

Merger analysis always involves a measure of prognostication and predicting future market conditions. That said, the Tribunal's decision in *CCS* is striking for how far the Tribunal was willing to go in substituting its judgment for that of the parties on business matters outside its expertise.

Dissolution as a Remedy

In addition to naming the relevant corporate parties as respondents to her application, the Commissioner also named as respondents the five individual vendors from whom CCS acquired the shares in Complete. This was in aid of the Commissioner's preference that the Tribunal order dissolution of the merger, as opposed to divestiture of the business to an independent competitor. The Commissioner preferred dissolution as a remedy because she believed that the vendors would be highly motivated to recover their funds and thus would sell the landfill site more quickly than would CCS if ordered to divest.

The vendors challenged the Commissioner's proposed dissolution remedy in a motion for summary judgment prior to the hearing. They argued that divestiture would be the most effective and efficient remedy for any prevention of competition and that dissolution would be intrusive, overly broad and punitive given the hardship to the individual vendors. The Tribunal dismissed the vendors' motion as premature, preferring to weigh the factual evidence at the hearing before deciding on the relative merits of divestiture or dissolution as an appropriate remedy.

In the end, the Tribunal agreed with the vendors that the Commissioner's dissolution remedy was overbroad, intrusive and would not even necessarily lead to the establishment of a competitive secure landfill at Babkirk. The Tribunal held that a properly-structured divestiture order would be the more effective solution.

The Commissioner's position on dissolution in this case is hard to understand. As the Tribunal pointed out, divestiture orders in Canada can be, and are, structured to impose tight timelines on the sales process, including default to a trustee sale if the purchaser fails to secure divestiture on its own. In addition, the Commissioner typically maintains a measure of oversight by reserving the right to pre-approve the party acquiring the divested assets. Oddly, the Commissioner did not seek this right if dissolution were ordered.

So why did the Commissioner insist on dissolution as a remedy? Perhaps there is a clue in the Tribunal's comment that the Commissioner had warned the vendors that the Bureau would seek a dissolution order if they went ahead and sold the shares in Complete to CCS. Was pushing for dissolution simply a case of following through on this threat?

Of the various issues raised by the Tribunal's decision in *CCS*, the key practical take-away is that a purchaser whose proposed transaction does not exceed the Act's notification thresholds cannot automatically assume that the deal will float under the proverbial "radar screen" in Canada. As part of its necessary due diligence, a purchaser in this situation must consider the transaction's potential impact on competition in Canada. In particular, there must be an appraisal of whether other industry participants (especially customers) are likely to complain to the Commissioner and what the parties' internal documents say about the transaction's likely effects in Canada (which apparently was an issue with CCS's documents). In addition, special care may be required when deals fall below notification thresholds precisely because the target party remains in the start-up phase of operations or has yet to enter the market, as such transactions may raise questions about the potential for new or expanded competition to be prevented.

If potential issues are identified, purchasers must decide if the Bureau should be pro-actively engaged in order to "head off" the impact of potential complaints or if it is better to be reactive only. That decision, in turn, could have an impact on the type of closing conditions purchasers will require in their transaction agreements. For example, purchasers may want to condition closing on receipt of positive confirmation from the Bureau that it does not intend to bring an application to the Tribunal. This is typical for notifiable transactions but much less common where a notification is not required. On the other hand, vendors might resist this type of condition because they may not be keen to approach the Bureau when not statutorily mandated.

These decisions are not easy ones to make. One can never be certain if reaching out to the Bureau will only result in them investigating a merger that might otherwise have been ignored. However, if the *CCS* case really does signal the beginning of a trend, merging parties in non-notifiable transactions in Canada will now have to grapple with these issues much more often than before.

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