


Mergers And Acquisitions In Canada

Section 3: *Competition Act, Merger
Notification and Review*



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Competition Act – Merger Notification and Review

Introduction

Canada's competition (or antitrust) law is found in the *Competition Act*⁴⁵ (the "Act"), a federal statute generally applicable to all industries throughout Canada. There are no provincial statutes of general application that provide for merger notification or review for the purpose of a competitive impact assessment.

Parties proposing mergers and acquisitions, or similar types of transactions, must consider two issues:

1. Is the transaction one that is subject to notification obligations before it can be completed?
2. Is the transaction one that will attract close review and a challenge by the Canadian Competition Bureau (the "Bureau")?

The Act contains merger notification provisions analogous to those in the U.S. *Hart-Scott-Rodino Antitrust Improvements Act of 1976*.⁴⁶ Substantive merger review and challenge provisions are similar to the standard found in section 7 of the *Clayton Act*.⁴⁷

Overview

Administration and Enforcement

In Canada, the Commissioner of Competition (the "Commissioner") is the head of the Bureau and administers and enforces the Act. The Commissioner's responsibilities are analogous to those of the U.S. agencies: the Federal Trade Commission and the U.S. Department of Justice. In this chapter, references to the Bureau and the Commissioner are synonymous.

The Commissioner conducts investigations and initiates proceedings either in the courts or before the Competition Tribunal (the "Tribunal"), which is composed of lay and judicial members. Merger notification filings are made to the Commissioner, and proceedings to block or dissolve a merger are brought by the Commissioner to the Tribunal.

Parties to certain types of transactions that exceed prescribed financial thresholds are obliged to notify the Commissioner of the transaction before it is completed, pay a \$50,000 filing fee and wait until the waiting period (30 days, but if the Commissioner delivers a supplemental information request within that time, then 30 days after the requested information is supplied) expires before they may complete the transaction. The purpose of the merger notification provisions is to provide the Commissioner with information about economically significant transactions. The Bureau can then determine whether a transaction should be challenged under the merger provisions of the Act on the basis that it would result in a substantial lessening or prevention of competition in any market.

45 (R.S., 1985, c. C-34).

46 15 U.S.C s.18.

47 15 U.S.C s.12 et seq.

Notification

Notification Thresholds

The two notification thresholds, both of which must be exceeded in order to trigger the notification obligation, are:

1. size of parties test:
 - a. the parties to the transaction, together with their affiliates in aggregate, have assets in Canada or annual gross revenues from sales in, from, or into Canada over \$400 million; and
2. size of transaction test:
 - a. in the case of an acquisition of assets, the aggregate value of the assets in Canada, or the gross revenues from sales in or from Canada generated from those acquired assets, exceed \$73 million⁴⁸;
 - b. in the case of an acquisition of shares, the aggregate value of the assets of the corporation being acquired, or the gross revenue from sales in or from Canada generated from those assets, is above \$73 million, and the person or persons acquiring the shares, together with their affiliates, would own more than 20% of the voting shares in the case of a public corporation, or 35% in the case of a private corporation. Where the acquiring party, together with its affiliates, already owns more than 20% of the voting shares of a public corporation, or more than 35% of a private corporation, then notification is required only where the proposed acquisition would result in the acquiring party, together with its affiliates, owning more than 50% of the corporation;
 - c. in the case of an amalgamation, the value of the assets in Canada of at least two of the amalgamating corporations together with its affiliates or the gross revenues from sales in or from Canada generated from those assets, is over \$73 million;
 - d. in the case of a combination of two or more persons to carry on a business otherwise than through a corporation (e.g. formation of a partnership or joint venture), the aggregate value of the assets in Canada that are the subject matter of the combination, or the gross revenues from sales in or from Canada generated from those assets, is over \$73 million;
 - e. in the case of an acquisition of an interest in an existing combination that carries on an operating business otherwise than through a corporation (e.g. an acquisition of interests in a partnership or joint venture), the aggregate value of the assets in Canada that are the subject matter of the combination, or the gross revenues from sales in or from Canada generated from those assets, would be over \$73 million, and where, as a result of the acquisition of the interest, the person or persons acquiring the interest, together with their affiliates, would hold an aggregate interest in the combination of over 35%, or, if they already have more than a 35% interest, would have more than a 50% interest.

Generally, the asset values or gross revenues from sales are determined by reference to the most recently completed year-end audited financial statement book values. However, these may be subject to adjustment if there are material post year-end changes. There are regulations that specify how asset values or revenues are to be calculated. In close cases, a more detailed analysis should be conducted to determine whether the transaction exceeds the thresholds and is subject to notification. The rules for determining whether a

48 The size of the transaction threshold is indexed and changes annually.

transaction is notifiable are technical and, in some instances, determining whether a transaction is notifiable can be complex.

Notification Procedure, Waiting and Review Periods

If both the size of parties and the size of transaction thresholds are exceeded, the parties to the proposed transaction are required, before completing it, to file a notification together with the required information. The required information to be supplied is set out in the *Notifiable Transactions Regulations*.⁴⁹

Filing of the prescribed information triggers a 30-day waiting period before the transaction can close. If the Commissioner delivers a supplemental information request within the 30 days requiring specified further information, then the waiting period is extended until 30 days after the supplemental request is satisfied.

The information gathering process can be onerous, especially if a supplemental request is delivered. The basic prescribed information requirements include: detailed information about the parties, their product lines, their suppliers and customers, future business plans, and copies of all reports or analyses prepared or received by senior officers for the purpose of analyzing the transaction. The information that may be required by a supplemental information request is not prescribed and will be determined by the Bureau on a case-specific basis. The Bureau will take into account the potential competition issues engaged by the transaction, as reflected in the prescribed information supplied, and the Bureau's preliminary internal analysis. In either event, the waiting period begins on the day on which the required information is received by the Commissioner.

The Commissioner's review of a transaction that raises significant concerns about anti-competitive effects may take longer than the statutory waiting period. Although parties to the transaction are not prohibited from closing after the expiry of that waiting period, absent an interim injunction from the Tribunal on the application of the Commissioner, they face the risk that the Commissioner will then bring proceedings before the Tribunal for a merger remedies order that may retroactively impact the closed deal.

Even if a transaction does not exceed the notification thresholds, it may still be reviewed and challenged in proceedings before the Tribunal under the substantive merger provisions of the Act within one-year period following substantial completion.

Typically, in appropriate cases, parties who file notifications with the Bureau also ask for a form of clearance (either an advance ruling certificate or a "no-action letter," which are discussed below).

Clearances and Timing

In addition to, or in lieu of, a prescribed notification, parties may apply for an advance ruling certificate which, if issued by the Commissioner, precludes a challenge to the transaction, provided that the information submitted by the parties, upon which the issuance of the certificate was based, is substantially accurate. Where only a request for an advance ruling certificate is made, the parties will typically, in the alternative, request from the Commissioner a "no-action" letter and a statutory waiver of the obligation to notify and supply the prescribed filing information.

49 SOR/87-348.

If the Commissioner is not entirely comfortable with the competitive effects of a transaction, rather than an advance ruling certificate, a no-action letter will be issued indicating that the Commissioner does not, at that time, have grounds to challenge the transaction under the merger provisions. A no-action letter provides the parties with sufficient comfort and will typically satisfy the competition-related closing condition in the merger agreement, although such transactions can technically be challenged for a year after closing.

The Commissioner may, in cases where the Bureau has not completed its assessment and does not have sufficient concerns to apply for an interim injunction, issue a “close at your own risk” letter. At the time of negotiating purchase and sale agreements, parties should consider what type of condition under the Act best suits their needs and risk tolerances.

The Bureau has also published service standards for the review of transactions and the preparation of advance ruling certificates. The maximum turnaround times are 14 days for a non-complex transaction and 45 days for a complex transaction unless a supplementary information request has been issued, in which case the period is 30 days from the time that the supplementary information has been provided to the Bureau. Generally, the categorization of the degree of complexity depends on the nature of the industry, the extent to which the transaction raises issues of competitive effects, and the number of geographic and product markets that must be examined. It is to be expected that transactions which have generated a supplemental information request or “second request” from the Bureau will fall under the complex service standard. The Bureau’s service standards are generally, but not invariably, met.

Exemptions from Pre-Notification

A transaction is not notifiable if it falls within specified exemptions. Transactions between corporations which are all affiliates are exempt. A transaction with respect to which an advance ruling certificate has been issued is also exempt. In addition, the following are exempted from notification obligations:

1. acquisitions of real property, or goods in the ordinary course of business which do not amount to substantially all of the assets of a business, or an operating segment of a business;⁵⁰
2. acquisitions of voting shares or an interest in a combination solely for the purposes of underwriting;
3. acquisitions of voting shares, or an interest in a combination, or assets that result from a gift or inheritance;
4. acquisitions of collateral or receivables, or an acquisition resulting from a foreclosure or default, or forming part of a debt workout made by a creditor;
5. acquisitions of certain Canadian resource properties where the buyer intends to carry out exploration or development activities;
6. asset securitization transactions; and
7. joint ventures that meet certain criteria.

Substantive Merger Review under the Act

A merger can be challenged by the Commissioner in proceedings before the Tribunal on the grounds that the merger, or proposed merger, prevents or lessens, or is likely to prevent or lessen, competition substantially in any market. Section 91 of the Act contains a definition of “merger” which is very broad and includes:

50 Referred to as the “paper clip” exemption, this deals with the acquisition of supplies, equipment and realty for use in the ordinary course of business.

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, customer or other person.

Most mergers which are reviewed under the Act fall within the typical types of merger and acquisition (M&A) transactions, but the definition is broad enough to capture various types of strategic alliances, joint ventures and other cooperative agreements.

The Tribunal may prohibit a proposed merger, or order full or partial divestiture or dissolution of a completed merger. The Act lists factors that the Tribunal may consider in determining competitive impact, which include:

1. the extent of foreign competition;
2. whether the business of one of the parties has failed or is likely to fail;
3. the extent to which acceptable substitutes to the products of the merging parties are or are likely to become available;
4. any barriers to entry into a market (including tariff and non-tariff barriers to international trade, interprovincial barriers to trade and regulatory controls over entry) and the effect of the merger on such barriers; and
5. the extent to which there will be effective competition remaining after the merger and the likelihood that the merger may result in the removal of a vigorous and effective competitor.

The Act also prohibits the Tribunal from finding that a merger prevents or lessens, or is likely to prevent or lessen, competition substantially based solely on evidence of concentration or market share.

A unique feature of the Act is that it provides for an efficiencies defence which prohibits the Tribunal from issuing a remedial order, if the merging parties can demonstrate that there would be efficiency gains from the merger that would be greater than, and would offset the effects of, any prevention or lessening of competition likely to result from the merger. The efficiency defence has been the subject of extensive litigation and is discussed in more detail below.

Merger Assessment by the Commissioner

Few mergers are contested in proceedings before the Tribunal. Challenge proceedings are similar to complex commercial litigation with oral and documentary discovery, expense, delay and uncertainty, making most transactions commercially unattractive. As such, a decision by the Commissioner to challenge a transaction in proceedings before the Tribunal is usually enough to cause the parties to either abandon it, or enter into negotiations with the Commissioner to make modifications to address anti-competitive effects, which may then become the subject of a consent agreement to be entered as an order of the Tribunal.

Merger Enforcement Guidelines

The Commissioner's approach to assessing a merger and determining whether to issue a form of clearance (either an advance ruling certificate or a no-action letter) or to challenge it, is set out in the general Merger

Enforcement Guidelines (“MEGs”).⁵¹ The Bureau has also issued specific merger enforcement guidelines applicable to certain industries, such as banks, and has consulted on similar guidelines issued by Transport Canada in respect of mergers in the federal transportation sector, which require separate statutory approval under the *Canada Transportation Act*⁵² and notification under both that statute and the Act. As this example illustrates, it is important to remember that mergers in certain sectors invoke specific guidelines and statutory regimes apart from the Act, and require additional approvals of other federal authorities.

The general MEGs are not binding on the Tribunal or the Commissioner, but they provide assistance in understanding the approach the Commissioner takes when examining and assessing proposed mergers. They are similar to the guidelines issued by the U.S. Department of Justice and the Federal Trade Commission.

Substantial Lessening of Competition

The fundamental principle in the MEGs is that a merger will likely prevent or lessen competition substantially when the parties to the merger are more likely to be in a position to exercise a materially greater degree of market power in a substantial part of the market for two years or more, than if the merger did not proceed. Market power can be exercised unilaterally or interdependently.

Market Definition

The first stage of a merger analysis is to define the relevant market for the purpose of a competitive impact assessment. The MEGs use a hypothetical monopolist test similar to the U.S. Merger Guidelines. A relevant market is defined as the smallest group of products, including at least one product of the merging parties, and the smallest geographic area in which a sole profit-maximizing seller (a “hypothetical monopolist”) would impose and sustain a significant and non-transitory price increase, above levels that would likely exist in the absence of the merger. Generally, the MEGs consider a 5% increase to be significant and a one-year period to be non-transitory.

The consideration of potential competition from new entrants or expansion by smaller firms within the market is considered at a later stage.

Although the hypothetical monopolist approach for defining a relevant market is highly conceptual, in most cases, a preliminary examination is based on more practical considerations. These include functional substitutability, who the merging parties or their customers consider to be competitors, and information contained in prospectuses, financial reports, securities filings, offering memoranda and other similar sources. If data is available and market definition is complex, expert economists may be consulted to assist the parties in defining the market, calculating market shares and concentration, and applying the hypothetical monopolist model.

Safe Harbours

Once a market is defined both in terms of geographical boundaries and product or service, the Bureau, as a starting point, will measure the impact that the merger will likely have on market share and concentration. Generally, where the post-merger market share of the merged entity would be less than 35%, the Commissioner will not likely challenge the merger on the basis of concern related to unilateral exercise of market power.

51 The Bureau is in the course of updating the MEGs and in June 2011 issued for consultation a draft revision.
52 (S.C. 1996, c.10)

A merger will not likely be challenged on the basis of concerns relating to the coordinated exercise of market power where, after the merger, the market share accounted for by the four largest firms would be less than 65% or the post-merger market share of the merged firm would be less than 10%. These thresholds are often referred to as “safe harbours” that distinguish between mergers that will not be reviewed closely and will likely receive a clearance, from those that will receive a more detailed analysis of competitive effects.

Where a proposed merger is outside the safe harbours, the Bureau will look at other criteria, the most important being barriers to entry. The consideration of barriers to entry includes tariff and non-tariff barriers to international trade, regulation, intellectual property issues and the extent to which entry involves incurring significant sunk costs.

While transactions that fall below the notifiable thresholds are reviewable under the substantive merger provisions, their relatively low economic significance will be a factor in determining whether the Commissioner will choose to spend the Bureau’s limited resources to challenge the transaction. In addition, relatively low asset values may imply low barriers to entry.

Vertical Mergers

A merger of firms that have a customer/supplier relationship is called a “vertical merger” and may raise concerns when it increases barriers to entry, facilitates coordinated behaviour, or forecloses competitors from access to inputs or distribution channels. While issues arising from vertical mergers are far less common than with horizontal mergers, the parties should be prepared to consider whether there are any vertical issues and address them in their notification submissions to the Bureau.

Efficiencies

Canadian competition law differs from U.S. antitrust law in that the Act expressly provides for an efficiency defense. This prohibits the Tribunal from issuing a remedial order if the parties can establish that the efficiency gains from the merger would be greater than, and would offset the prevention or lessening of, competition that would result from it.

The issues of the types of efficiencies that can be counted and the appropriate welfare standard that should be used to measure anti-competitive effects were recently the subject of lengthy litigation in *Commissioner of Competition v. Superior Propane*.⁵³ Initially, the Tribunal applied a total surplus standard and found that the efficiency defense prevailed, because the gains in efficiency that would result from the merger of the two largest propane distribution companies in Canada would exceed the dead weight loss (total welfare loss) that would result from the combination of the price increase and the decrease in output that would likely follow the merger. The Tribunal decided that income transfers from consumers to producers should be treated as neutral for the purposes of the consideration of the efficiencies defense.

On appeal, the Federal Court of Appeal decided that the Tribunal had not applied the correct test and that it should have given consideration to the impact of the transfer of wealth from consumers to producers. It sent the case back to the Tribunal for re-determination. The Tribunal reassessed the impact in accordance with the directions from the Court of Appeal, but still concluded that the efficiencies outweighed the effects of the lessening of competition.

53 [2003] 3 F.C. 529 (F.C.A.).

The MEGs set out the Bureau's approach to considering an efficiencies justification to an otherwise anti-competitive merger. The Bureau has also published a Bulletin on efficiencies in merger reviews.

While mergers that are cleared on the basis of the efficiencies defense alone will not be that common, in preparing a submission to the Commissioner to obtain an advance ruling certificate or a no-action letter, efficiencies are relevant and should be addressed if they are an important business motivation for the transaction.

Conclusion

Parties proposing M&A transactions involving Canadian businesses must address the following:

1. Is the transaction notifiable under the Act?
2. Will the transaction attract a close review from the Bureau and risk a challenge under the substantive merger provisions?
3. Does the transaction involve a business sector which may entail additional merger issues and review, as well as the input of regulators other than the Bureau?

Generally, in the case of a horizontal merger (where businesses of merging parties overlap, in a competitive sense, in products and territory), some analysis must be done to assess the risks and to develop a strategy for notification, requesting clearances, sorting timing issues and addressing the potential concerns of the Bureau. While the Commissioner is the only party that can bring proceedings under the substantive merger provisions, there are provisions for third parties to ask for intervenor status. Often what motivates the Bureau to closely review and challenge a transaction are concerns by customers, suppliers or other levels of government. Concerns of customers are the most influential. Concerns by competitors are also considered, but are scrutinized to ensure that the basis of the complaint is relevant to a true competitive impact assessment and not motivated by ulterior strategic objectives.

Filings of notifications under the Act, as well as information and submissions provided to the Bureau, are confidential. However, in the merger review process, the Bureau typically contacts market participants, and the parties' customers and suppliers, to solicit their views on competitive impacts of the merger. The Bureau is sensitive about disclosing non-public information without the merging parties' consent. Careful consideration of this issue is required up front in situations of sensitive mergers.

While the focus of the Bureau's assessment is the impact on competition in Canada, in cases of multi-jurisdictional transactions, one can expect that the competition authorities in the jurisdictions affected will cooperate with each other. Parties and their lawyers should ensure that concerns in each affected jurisdiction are addressed and that submissions made to the agencies in all jurisdictions are consistent.

Merger law in Canada can give rise to difficult issues relating to competitive impact and the necessity of pre-notification. The Competition Group at Fraser Milner Casgrain LLP is experienced in complex domestic and international mergers, and can provide practical advice and assistance to facilitate expeditious completion of merger transactions.



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