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COMPETITION LAW ENFORCEMENT IN CANADA DURING THE ECONOMIC CRISIS

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Introduction

Given the turmoil in Canadian politics with the minority Conservative Government almost being toppled by a coalition party at the end of 2008, the inauguration in the United States of what is expected to be a more activist administration in antitrust enforcement, the recent resignation of Sheridan Scott, the head of the Canadian Competition Bureau, and the enactment of significant changes to the *Competition Act*, all in the midst of what is now often referred to as "the deepest economic recession since the Great Depression," these are very challenging times for competition law enforcement in Canada.

It could be argued that the current economic crisis requires more flexible or permissible competition enforcement as antitrust concerns should not prevent industry consolidation that is required to ensure financial stability, even where such consolidation provides merging parties with market power. Foreign authorities have taken extraordinary measures in recent months to ensure the quick completion of several high-profile transactions in the financial services industry, including Lloyds/HBOS, Wells Fargo/Wachovia and JP Morgan Chase/Washington Mutual. Thus, the downturn in the world economy could push the Bureau to be more flexible in the timing and substantive standards applied to merger review in Canada in order to facilitate market stability. However, the new interim Commissioner, along with the more activist approach to antitrust enforcement promised by the Obama administration and the far reaching amendments to the *Competition Act* recently implemented by the Canadian Federal Government signal quite the opposite: tougher competition enforcement may be on the horizon for Canada.

It remains to be seen whether economic forces will outweigh legislative developments and lead to a more "soft pedal" approach to competition enforcement in Canada, or whether the new Bureau leadership will follow Obama's lead and bring more cases against alleged abuses of dominance, conspiracies and anti-competitive mergers. Regardless of which one of these forces triumphs over the other, one thing is certain: the confluence of these factors will certainly lead to change, change for the authorities enforcing competition laws and change for the companies and individuals subject to them.

The purpose of this paper is to explore the impact of the global credit crunch and economic downturn on the administration and enforcement of Canadian competition laws. Specifically, this paper will discuss the recent changes in the antitrust enforcement teams and governments in Canada and the U.S., the changing players in mergers and acquisitions due to the lack of credit

opportunities, the effect of failing firms and shot gun marriages on merger review processes and the increased incentives for coordination among competitors in times of recession. This analysis will provide insight into the nature of the issues and challenges that will arise for the administration and enforcement of the *Competition Act* as a result of the current economic crisis.

Changing Enforcement Teams

The Canadian Competition Bureau is looking for a new leader. Sheridan Scott, Commissioner of Competition at the Bureau, recently resigned from her position at the Bureau to head to private practice. Melanie Aitken, Senior Deputy Commissioner, has been appointed Interim Commissioner of Competition while the government conducts a search for Ms. Scott's replacement. Ms. Aitken, formerly the head of the Bureau's mergers division, has been involved in several highly contested mergers, both during her tenure at the Bureau and in private practice, including the recent Labatt/Lakeport merger, and the highly litigated Superior Propane merger. Many expect Ms. Aitken's appointment to lead to more action by the federal regulator and stricter application of merger laws in Canada.

Given the degree of cooperation and comity between the Canadian Competition Bureau and foreign antitrust enforcement agencies, especially the U.S. Department of Justice and Federal Trade Commission, the likelihood of stiffer merger review in Canada is bolstered by the more activist approach to antitrust enforcement expected under the new Obama administration. Before the full onset of the credit crisis, Obama's campaign severely criticised the Bush administration's antitrust enforcement[1] and promised to "reinvigorate merger enforcement and take effective action against mergers that are likely to harm consumers."[2] Despite the dire economic situation facing the U.S., recent nominations to the Obama antitrust enforcement team signal that Obama intends to follow through on his promises of stiffer merger review standards and more cases against dominant companies that use market power to raise prices.

The Obama administration's appointment for Antitrust Chief of the Department of Justice, Christine Varney, and Jon Leibowitz, the appointment to head the Federal Trade Commission, are both known to favour aggressive enforcement and mark a change from the Bush administration, which pursued numerous price fixing cases, but challenged few mergers and rarely brought cases against alleged monopoly conduct.[3] Ms. Varney, previously a partner at Hogan & Hartson, helped persuade Justice officials to launch the successful antitrust case against Microsoft Corporation, and more recently urged a U.S. review of Google's proposed advertising deal with Yahoo! Inc. which was abandoned last year to avoid federal antitrust challenge. Mr. Leibowitz, previously a Federal Trade Commission member, has been an advocate of the agency's tough stand against alleged "pay for delay" tactics of pharmaceutical firms and generic drug makers.

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Changing Governments

Although less publicized than in the U.S. election, Canada recently elected a minority Conservative government that also included, as part of its platform, several promises to change competition laws. Prime Minister Stephen Harper announced that his government would introduce a package of amendments designed to "strengthen" Canada's competition laws, "to protect Canadians from anti-competitive practices and from other abuses" and to position Canada to compete in the global economy by "fostering open markets." The proposed amendments reflected the government's view that the enforcement provisions in the *Competition Act* are "no longer significant enough to effectively deter anti-competitive behaviour."

Indeed, in the recent Budget Implementation Bill tabled before Parliament on February 6, 2009 (the "Budget Bill") and implemented on March 12, 2009, the Federal Government has made good on its campaign promises and has enacted significant amendments to the *Competition Act*. Of greatest significance are the following:

- repeal of the existing conspiracy provisions and the creation of a *per se* criminal offence to address hardcore cartels and a civil provision to deal with other types of agreements between competitors that have anti-competitive effects;
- repeal of the price discrimination, promotional allowance, and predatory pricing provisions;
- replacing the existing criminal price maintenance provision with a new civil provision to address price maintenance conduct that has an anti-competitive effect on competition;
- authorizing the Tribunal to order administrative monetary penalties for violations of the abuse of dominance provisions;
- increasing potential fines and imprisonment terms for various violations, including conspiracies, obstruction, false and misleading representations, and failure to comply with a prohibition;
- introducing a U.S. style second-request type merger review process;
- increasing the "size of transaction" threshold for merger notifications to CDN $70 million (up from CDN $50 million);
- decreasing the Commissioner's time period to challenge a merger to one year (currently three years); and
- various other changes, including changes to bid-rigging and misleading advertising.

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Changing Players

The current credit shortage is expected to favour strategic buyers with strong balance sheets and sovereign wealth funds, loosely defined as state-owned investment funds, with greater access to financing over traditional financial buyers, such as private-equity funds. As the global liquidity crisis has obliterated easy access to capital to fund acquisitions, private equity investors and other financial purchasers have seen their access to credit drastically diminished, making it more difficult for these types of investors to apply the degree of leverage they require to achieve their targeted return. However, wealthy strategic purchasers who are able to realize significant efficiencies from a particular transaction, or sovereign wealth funds ("SWFs") who can fund the transaction out of cash flow off their own balance sheets, or with their own securities, are likely to be more active in the current market.

Strategic buyers often include competitors of the target who are disposed to certain acquisitions due to their ability to realize significant business synergies or efficiencies through the transaction. Strategic mergers are, therefore, more likely to invoke the efficiency defence provided in the *Competition Act*. The efficiency defence allows anticompetitive mergers to proceed where they are likely to generate gains in efficiency that "will be greater than, and will offset the effects of any prevention or lessening of competition." The inevitable consolidation in certain industries, such as the automobile industry, will likely lead buyers to invoke the defence, giving rise to significant competition issues, including the appropriate standard upon which to measure such efficiency gains.

Although the recent financial turmoil has affected the returns of SWFs, declining equity values in North America make acquisition opportunities difficult to pass up, especially as many SWFs have a mandate to invest internationally. Moreover, unlike private equity firms, many SWFs are able to take a long-term view of their investments and are more capable of riding out the current business cycle. SWFs, seeking to become more active in investing in Canada, while unlikely to raise competition concerns, will have to mitigate political concerns under Canadian foreign investment laws.

Changing Timelines

The current credit crunch and economic downturn are expected to raise new challenges and have significant implications on merger review. Foreign antitrust enforcement authorities have demonstrated flexibility in both the timing and substantive standards applied to the review of mergers in the financial industry.[4] With global financial markets in turmoil, foreign governments have been resorting to exceptional measures in an attempt to reinvigorate struggling financial institutions.

A particularly controversial example was the radical intervention of the UK government to facilitate the acquisition by Lloyds TSB plc of the distressed HBOS plc, creating the UK's largest

bank and mortgage provider. The UK Office of Fair Trading (the "OFT") had investigated the merger and concluded that the merger was likely to result in a substantial lessening of competition in various banking services, such as current accounts. However, the UK government introduced a "public interest consideration" relating to financial stability to allow the transaction to proceed without being blocked by the OFT. The public interest consideration allowed the UK Secretary of State to trump the competition concerns expressed by the OFT and to allow the merger to proceed in the interest of financial stability.

Canada's *Competition Act* provides a similar public interest exemption for mergers in the financial services and transportation industries. In respect of financial services, section 94 of the *Competition Act* provides that the Competition Tribunal shall not make an order preventing a merger under the *Bank Act*, the *Cooperative Credit Associations Act*, the *Insurance Companies Act*, or the *Trust and Loan Companies Act*, where the Minister of Finance has certified to the Commissioner of Competition that the merger is in the public interest.[5] While it does not fit squarely into any of the criteria, it seems likely that ensuring the stability of Canada's financial sector, or economy, would be in the "public interest." Moreover, the Bureau's 2003 *Merger Enforcement Guidelines as Applied to a Bank Merger* (the "Canadian Bank Merger Guidelines") indicate that where a merger in the financial services industry involves a firm in financial difficulty, this may be a circumstance where the Minister could use the override authority set out in section 94 of the *Competition Act* to allow a merger that the Bureau would otherwise challenge.[6]

Another competition law tool that may prove useful in the present context is the "failing firm" doctrine. Section 93 of the *Competition Act* provides that where the target of a merger "has failed or is likely to fail" (i.e. will exit the market due to financial difficulties, even in the absence of the merger), any reduction in competition as a result of the failing firm's acquisition will not be attributed to the merger. The Bureau's *Merger Enforcement Guidelines* provide that a firm is failing where: (a) it is insolvent or likely to be insolvent; (b) it has initiated voluntary bankruptcy proceedings or is likely to initiate voluntary bankruptcy proceedings; or (c) it has or is likely to be petitioned into bankruptcy or receivership. The Bureau also requires that the target conduct a formal search for a competitively preferable purchaser. In addition, the Bureau will give consideration to whether the restructuring of the failing firm would be a more pro-competitive alternative than allowing the proposed merger to proceed.

The failing firm criteria are quite onerous and, to date, competition authorities, including the Bureau, have applied the defence strictly when allowing mergers that would otherwise be prohibited. However, it is possible that the Bureau, when faced with significant time pressures to clear a transaction, could consider the economic crisis and relax its requirements. The Bureau faced a failing firm transaction in 1999 when confronted with the possible failure of one of Canada's two national airlines. In this case, the Bureau allowed Air Canada to acquire the distressed Canadian Airlines unopposed, subject to numerous undertakings. It did so on the basis that Canadian was facing imminent insolvency that necessitated urgent action and

the Commissioner of Competition decided that the merger, with undertakings, was more pro-competitive than a liquidation of Canadian through bankruptcy proceedings.[7] The Bureau took the position that where a competitor would otherwise fail (and no alternative purchaser exists), no lessening of competition is occasioned by the merger, even where the result is less competition after the merger than before.

Of note, the Canadian Bank Merger Guidelines state that even for "failing firm" transactions, the Bureau generally requires six weeks to determine whether the target is likely to fail. Thus, when a rescue package has to be put together very quickly, the waiting periods required under the competition laws in Canada and abroad could seriously hamper rescue acquisitions. The European Commission has indicated that, where necessary, it will, on a case by case basis, waive its usual standstill obligation to merger parties so that "rescue mergers can be completed before a clearance decision is issued." In the Bradford & Bingley case, the European Commission was quick to grant a derogation from the suspensory effect of its waiting period rules to permit Santager, the winning bidder, to close the deal immediately. Similarly, the U.S. Department of Justice has afforded expedited and largely unburdened review of several mergers and acquisitions between commercial banks and investment banks, some of which appeared to involve direct horizontal combinations (e.g. Wells Fargo/Wachovia and JP MorganChase/Washington Mutual) that would have been likely to attract extensive reviews and possible remedies in more stable and positive economic times.[8]

The speed at which transactions involving distressed financial institutions require clearance may lead the Bureau to address consolidation concerns via post-closing merger review. Pursuant to section 97 of the *Competition Act*, the Bureau has the right to challenge a transaction up to one year following its substantial completion (reduced from three years in the recently enacted legislation). While this power has rarely, if ever, been exercised, the dire economic circumstances could persuade the Bureau to rely on this option as a matter of expediency rather than preventing a merger from closing.[9] Alternatively, the Bureau could also address its concerns under the abuse of dominance provisions of the *Competition Act*. Indeed, there is precedent for such action by the Bureau. While the Air Canada/Canadian merger was allowed to proceed, the Bureau brought an abuse of dominance case against Air Canada for predatory pricing less than a year after the transaction's closing.

Changing Incentives

Despite, or perhaps in light of, the global financial crisis, cartel enforcement will continue to be the primary enforcement priority of the Bureau and many competition authorities around the globe. In difficult economic times, the temptation for competitors to enter into illegal agreements to fix prices or allocate markets is almost irresistible. Indeed, "[a] historical review of economic downturns provides powerful testimony that the major global cartels, ranging from lysine and citric acid to vitamins and graphite electrodes, had their origins at moments of economic stress

when executives sought the easy – and illegal – solution to their economic woes."[10] Statistics would tell us that competitors in several industries will try to stabilize market conditions through coordinated conduct during this unprecedented global economic downturn. "Economic difficulties may, however, make it more difficult for antitrust authorities to obtain the types of dramatic fines that have become common in recent years, and may lead antitrust agencies to look for other methods of deterrence, such as jail sentences or other individual sanctions."[11]

Conclusion

While the initial effects of the economic downturn have been felt in the financial services sector, the current credit crisis has far wider implications for the world economy and competition law enforcement in Canada. Continued recessionary pressures are likely to lead to consolidation in many sectors in North America including the automotive, construction, and manufacturing industries. As a result, the Bureau is likely to be faced with several mergers presenting challenging competition issues, as well as a strong commercial imperative to get the deal done quickly. While the Bureau has historically resisted relaxing its timing and substantive standards in the review of acquisitions involving failing firms – unless their exit from the market was certain and imminent – the depth and severity of this recession may force the Bureau to adopt a more flexible stance, as we have seen with several foreign competition authorities.

In addition, the Bureau will be faced with the challenge of finding new leadership, enforcing a significantly amended *Competition Act*, and living up to promises made by governments on both sides of the border for increased antitrust enforcement. We expect the Bureau to maintain a watchful approach where consolidation does occur, especially given the increased incentives for collusion in the current economic climate. We may also see the Bureau conduct retrospective reviews of transactions in an effort to balance market stability and ensure that parties do not abuse their market power. As stated above, it remains to be seen how the changing economic and political landscape will impact competition law enforcement in Canada.

Notes

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[1] See Barack Obama, "Statement of President-elect Barack Obama for the American Antitrust Institute", (2007) found at http://www.antirustinstitute.org/archives/files/aai-%20Prediential%20campaing%20-%Obama%209-07_092720071759.pdf.

[2] See Barack Obama, "Barack Obama and Joe Biden's Plan: Technology" (2008), found at http://origin.barackobama.com/issues/technology.

[3] John R. Wilke, "Varney Emerges as Likely Antitrust Pick" Wall Street Journal, January 22, 2009, found at http://online.wsj.com/article/SB123265154794706989.html.

[4] Rod Carlton, Andrew Renshar, Andrea von Bonin, Paul Yde & Martin McElwee, "United Kingdom: Antitrust in the Downturn" Freshfields Bruckhaus Deringer, December 5, 2008, found at http://www.mondap.com/article.

asp?articleid=71116&print=1.

[5] In a 2003 statement, the Federal government set out five criteria that the Minister would consider in assessing the "public interest": (1) access to financial services by Canadian consumers; (2) continued access to sufficient choice by Canadian consumers; (3) impact of the merger upon international competitiveness and long-term growth prospects for the merging parties; (4) contribution of the merger to the "deepening and the broadening" of Canadian capital markets; and (5) transition of employees displaced by the merger.

[6] Government of Canada, Competition Bureau, *The Merger Enforcement Guidelines as Applied to a Bank Merger*, January 2003, at 36, found at http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/01253.html.

[7] See Competition Bureau Press Release, "Competition Bureau Announces It Will Not Oppose Acquisition of Canadian Airlines" Ottawa, December 21, 1999 found at http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/emg/00619.html.

[8] *Supra* note 5.

[9] Jonathan M. Rich & Thomas G. Sciven, "Bank Consolidation Caused by the Financial Crisis: How Should the Antitrust Division Review "Shotgun Marriages"?", The Antitrust Source, December 2008, found at www.antitrustsource.com; The United States Antitrust Division has a similar power, called a "pocket decree," which permits a transaction to close immediately, but, within limits, permits the Antitrust Division to file a consent decree and require a divestiture at a later date if it concludes that a remedy is necessary.

[10] Donald C. Klawiter, "Cartel Enforcement Today: The Perils of The Economic Downturn" September 2008, Global Competition Policy, found at www.globalcompetitionpolicy.org.

[11] George Addy, Anita Banicevic & Mark Katz, "Antitrust Legislation and Policy in a Global Economic Crisis – A Canadian Perspective" Global Competition Policy, December 2008 found at www.globalcompetitionpolicy.org.