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# ANTITRUST MERGER CONTROL IN CANADA: TIPS FOR PRIVATE EQUITY INVESTORS

*Posted on November 21, 2019*

**Categories:** Insights, Publications

Since 2009, antitrust merger control in Canada has followed a process very similar to the *US Hart-Scott-Rodino* (*HSR*) regime. Transactions exceeding certain financial and shareholding thresholds must be notified to the Canadian Competition Bureau (CCB) and cannot close during a suspensory waiting period.

Asset acquisitions, and shareholding acquisitions of 20% or more (for publicly-traded companies) and 35% or more (for private companies), that exceed both of the following thresholds require notification in Canada:

- ***Target-Size Threshold*:** The target must have assets in Canada, or generate gross revenues from sales in or from Canada, that exceed C$96 million. Please note that this threshold is adjusted annually; C$96 million is the figure for 2019.
- ***Parties-Size Threshold***: The parties to the transaction, taken together with all of their affiliates, must collectively have assets in Canada, or collectively generate gross revenues from sales in, from, or into Canada, that exceed C$400 million. (This threshold is not adjusted annually.)

Antitrust review is a critical aspect — in some instances, the critical aspect — of successfully completing transactions. With this background in mind, we offer below 8 tips for private equity (PE) investors in Canada.

**1. Do You Have Portfolio Compan(ies) In The Same Sector?**

We appreciate that pre-closing confidentiality is of paramount importance for PE transactions. However, when pursuing new targets — whether intended as bolt-on to an existing portfolio company, or to be run independently — in sectors in which the fund is already active, assistance from your existing portfolio company(ies) may be extremely valuable. Consider the following:

- **Pre-signing Competitive Assessment.** Management of your existing portfolio company is ideally-placed to provide insight and analysis of the pre-transaction competitive conditions in the sector, which may be crucial to understanding the regulatory risk to the proposed new acquisition. They can suggest arguments to be made to the CCB (antitrust regulator), and discuss potential remedy options (if necessary), including fix-it-first or upfront remedies. Their views on the complexity of potential overlaps

between the target and the existing portfolio company will also inform your estimations of the antitrust review timeline and its impact on the overall transaction timetable. Even a high-level "no names" discussion with existing portfolio company management may provide valuable inputs for your pre-signing competitive assessment.

- **Assistance With Merger Notification Filing.** The merger notification filing required under Part IX of Canada's *Competition Act* demands substantially more information than the equivalent filing required under the *HSR* regime in the United States. This includes detailed information about customers and suppliers for any "*principal category of products*" for which there is an overlap with the target. Typically this information must be obtained directly from the PE fund's existing portfolio company(ies) in the sector.
- **Answering Ongoing Questions From The CCB**. As its review progresses, the CCB will typically ask questions or issue Requests for Information to the merging parties. Failure to respond to such requests in a timely way may lead to a "pausing" of the CCB's service standard timeline for completing its review. Again, given its familiarity with the sector, information responsive to these requests will typically come from the existing portfolio company(ies) in the relevant sector.

Do not underestimate the "goodwill" value of engaging with your existing portfolio company in a meaningful way for acquisitions intended to be accretive but not bolt-on. As noted above, management's views, participation and assistance can make a material contribution to obtaining a swift and successful merger clearance. For non-bolt-on transactions that the existing portfolio company may view as "competitive" with its own operations, keeping management engaged and incentivized to provide a high level of cooperation may prove a delicate exercise.

**2. Expect Challenging Minority Shareholding Questions From The CCB**

Over the last 2-3 years, the CCB has taken an increasing interest in the potential anti-competitive effects of minority shareholdings. It now routinely asks PE funds to identify:

i. All of their affiliates;
ii. Any 10% or greater direct or indirect shareholders of the fund; and
iii. Any 10% or greater direct or indirect downstream shareholdings of the fund.

For the fund and for each of the entities/individuals identified above, the CCB will then require information concerning any 10% or greater interest held by these entities/individuals in any entity that has a horizontal overlap (*i.e.*, that provides competing products or services) or vertical overlap (*i.e.*, that serves as a supplier to or customer of) the target's operations. If there are minority investments in such overlapping companies, the CCB will typically request customer and/or supplier information, or additional information, from those entities.

Answering such questions can be challenging. Often, a PE fund minority shareholder may not have sufficient rights to compel the portfolio company (or the majority shareholder) to provide such information, and may not have sufficient access to obtain the information directly itself. Delays in responding to such questions may again lead to a "pausing" of the CCB's service standard.

Consequently, PE investors should identify any such minority shareholding interests prior to notifying the transaction, and consider — once confidentiality concerns permit — making contact with any overlapping minority investment portfolio companies. With early identification, the lines of communication can be made ready so that answers to minority shareholding questions can be quickly obtained during the review period.

### 3. Recent Changes To The Definition Of "Affiliates" Will Capture More Transactions

As noted at the outset of this bulletin, the *Parties-Size Threshold* asks whether all parties to a transaction, together with their affiliates, have assets in Canada or revenues from sales in/from/into Canada that exceed C$400 million. Historically, the definition of "*affiliate*" under the Competition Act was applied more narrowly to partnerships and trusts than to corporations, resulting in many portfolio companies of PE funds not being considered "*affiliates*" for the purposes of calculating the *Parties-Size Threshold*. Many transactions escaped mandatory notification on this basis.

However, in 2018, amendments to the *Competition Act* took effect aimed at equalizing the affiliation treatment as between partnerships, trusts and corporations and thereby closing a perceived notification loophole. As a result of these amendments, majority-controlled portfolio companies within the same PE fund will now almost certainly be considered to be "*affiliates*" of each other. The value of the assets and revenues of those affiliated portfolio companies will need to be considered in determining if the *Parties-Size Threshold* is exceeded.

### 4. Whether Acquired Assets Are "*In Canada*" Is Broadly Interpreted

Both the *Target-Size Threshold* and the *Parties-Size Threshold* involve an assessment of the value of assets "*in Canada*". That analysis can become nuanced and complex when dealing with intangible assets such as intellectual property and goodwill, and financial assets. Mobile tangible assets, such as inventory, ships, aircraft, rolling stock, or vehicle fleets can also raise issues.

The CCB has published detailed guidance on assessing whether assets are "*located in Canada*", including the following observations:

i. Immovable tangible assets (*e.g.*, land or buildings) are "*located in Canada*" if their permanent address is in Canada.
ii. Mobile tangible assets (*e.g.*, inventory, vehicles) of a Canadian entity are presumed to be located in Canada unless it can be shown that the assets were located outside of Canada for the entire relevant

fiscal period.

iii. Mobile tangible assets of non-Canadian entities will be considered to reside in Canada if, at any point during the relevant fiscal period, those assets were located in Canada.

iv. Intangible assets (*e.g.*, patents, trademarks, copyrights) and financial assets (*e.g.*, promissory notes) are considered to be located in Canada if they have rights or privileges conferred pursuant to a Canadian statute. For example, a Canadian-registered patent is a Canadian asset, but a US-registered patent is not. Where there are a group of these assets on a balance sheet that include both Canadian and non-Canadian assets, the owner must determine the proportion of the value of those assets that is attributable to Canada.

v. Private and contractual intangible assets, goodwill, and financial assets are considered to be Canadian assets if they are shown on the balance sheet of a Canadian entity.

If securities of other entities are reflected on a company's balance sheet, those securities will be considered to be located in Canada if the entity was formed under Canadian law and will be considered to be located outside of Canada if the entity was formed outside of Canada.

**5. Caution Is Advised When Creating Records Analyzing A Potential Transaction**

Canadian merger notification filings must include certain records analyzing the impact of a proposed transaction, using criteria modelled on the *HSR* "4(c)" document production requirement in the United States. In particular, a party must provide:

i. All studies, surveys, analyses and reports,
ii. that were prepared or received by an officer or director of the party,
iii. for the purpose of evaluating or analyzing the proposed transaction,
iv. with respect to market shares, competition, competitors, markets, potential for sales growth or expansion into new products or geographic regions.

It is prudent to exercise caution when preparing such analytical documents, and to refrain from commenting on issues with particular significance to antitrust review — such as the scope or definition of product or geographic markets, either party's market share, or barriers to entry. Similarly, colourful or pejorative statements about the combined companies' size or strength (*e.g.*, it will "*dominate*" or "*control*" the market), or its ability to increase prices or eliminate maverick rivals, are best avoided.

This advice applies equally — indeed, typically with even greater importance — to PE funds exiting an investment, particularly in the preparation of CIMs or similar documents intended to market a portfolio company to prospective buyers.

### 6. Below-Threshold Deals Are Still Reviewable — And Sometimes Should Be Notified

Unlike many other jurisdictions, the CCB can — and does — review below-threshold transactions. It can review any transaction within one year of the deal closing. According to its own statistics, the CCB reviewed 18 non-notifiable deals in its 2018 fiscal year, and 20 such deals in its 2019 fiscal year.

Recently, the CCB announced the creation of a team within its renamed Merger Intelligence and Notification Unit (MINU) that is dedicated to finding problematic below-thresholds deals. In September 2019, the CCB announced *"a broader focus on active intelligence gathering on non-notifiable merger transactions that may raise competition concerns"* in order to *"identify transactions that are otherwise not brought to [its] attention."*

Such transactions may attract the CCB's attention in various ways — through news releases, media coverage, customer concerns, or strategic complaints from competitors (including unsuccessful bidders). Where a transaction raises substantive antitrust issues, and is likely to come to the CCB's attention, it may be strategically preferable to proactively notify the CCB of the deal and address the issues head-on through advocacy, rather than taking the risk that the CCB finds and challenges the transaction at a later date. That is a particular concern in public markets transactions and/or in multinational deals with multiple condition precedent clearance jurisdictions, where an unexpected challenge from the CCB could jeopardize the essential closing timetable. Worse still, the CCB could challenge such a transaction post-closing, potentially leaving the buyer with no means — *e.g.*, a purchase price reduction, or funds held in escrow pending the outcome of the litigation — to mitigate its litigation risk.

For transactions meeting this profile, we recommend that you contact us for a frank discussion of the potential merits of proactive notification.

### 7. Merger Remedies May Limit Future Acquisition Opportunities

As is well-known, problematic transactions often result in remedies imposed by antitrust regulators. Most PE funds are familiar with the standard structural (*e.g.*, full or partial divestiture) and behavioural (*e.g.*, licensing, supply obligations, information firewalls, etc.) antitrust remedies. In Canada, divestitures typically also include a commitment not to reacquire the divested assets for a period of ten years.

Perhaps less well-known is a more recently-adopted remedy, by which the CCB also requires (as a condition of any remedial consent agreement) that a buyer notify any below-threshold acquisitions in the same sector for a defined period. Most commonly, this period has been set at two years, although there have been instances of commitments to notify for up to ten years.

This requirement can complicate completion of subsequent roll-up transactions, and inevitably introduces greater regulatory risk and delay as the CCB analyzes each subsequent transaction.

## 8. Identify Early The End-Game With Roll-up Transactions

It is not unusual for PE funds to be a catalyst for industry consolidation. After its initial investment in an industry sector, a fund may enter into subsequent roll-up transactions to enhance its market presence and perhaps gain efficiencies.

But with each transaction, the fund's share of the relevant market increases. And as the market becomes more concentrated, the antitrust risk for future transactions grows.

A well-advised fund will keep its eye on the end-game to ensure the most important and valuable targets are acquired early-on, to minimize risk to later acquisitions.

For more than three decades, McMillan LLP has been recognized nationally and internationally as a leader in competition/antitrust law. Our team has advised PE funds on hundreds of notifiable acquisitions and sales in Canada, including in some of the most complex industry consolidation transactions involving private equity buyers.

by Casey Halladay, John Clifford and Joshua Chad

**A Cautionary Note**

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.

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