FAILING FIRM ANALYSIS IN CANADIAN MERGER REVIEW

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I. INTRODUCTION

With the recent global economic downturn, mergers across many industries have been promoted to meet a variety of public interest objectives. For example, the past nine months have witnessed an unprecedented wave of hastily arranged mergers in the financial services sector, particularly in the United States, amid calls to shore up and safeguard the integrity of the banking system. In other industries, public and private sector leaders have espoused the benefits of consolidation to address declining demand and excess capacity, with a view to improving the health of remaining companies. Job preservation has been front and centre in the pressure to restructure the automotive industry.

Whatever the motivation, a common thread underlying these mergers is that at least one of the parties is failing. Merger review under Canadian competition law, as in many other antitrust jurisdictions, has long recognized that whether a party to a merger is failing is a relevant consideration in the merger analysis. In the right circumstances, business failure may in itself constitute a complete justification for allowing a seemingly problematic merger to proceed. However, the circumstances where that has occurred have proven to be rare in Canada and the question has arisen as to whether Canada's merger review framework can adequately respond to the challenges presented by the current economic climate.

This paper examines the failing firm analysis in merger review under Canada's *Competition Act* (the "Act")[1] and, in particular, whether the approach of Canada's Competition Bureau (the "Bureau")[2] to failing firms is sufficient to meet the exigencies of merger review in an economic downturn. Part II sets out the Bureau's approach to mergers involving failing firms, as reflected in the Bureau's merger guidelines and the small number of failing firm cases. Part III draws some

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1 R.S.C. 1985, c. C-34.

2 The Bureau is the staff of the Commissioner of Competition ("Commissioner"), formerly the Director of Investigation and Research ("Director"), who is the official responsible for enforcing the Act. In this paper, the terms "Bureau", "Commissioner" and "Director" have the same meaning and the term "Bureau" will be employed in most cases.

observations from this limited experience to date with failing firm analysis. Part IV looks ahead and suggests some of the issues that may shape failing firm analysis in the future. Part V offers some brief concluding remarks.

II. Failing Firm Analysis under the *Competition Act*

The substantive test for merger review under the Act is whether the merger is likely to prevent or lessen competition substantially.[3] Section 93 of the Act enumerates a non-exhaustive list of factors that may be relevant in carrying out that competition assessment. Among these is paragraph 93(b), which considers "whether the business, or part of the business, of a party to the merger or proposed merger has failed or is likely to fail". The party facing the prospect of failure is typically the firm to be acquired.

There has been no consideration of paragraph 93(b) of the Act by the Competition Tribunal (the "Tribunal"). The issue was raised in the pleadings in the *Cast* case in 1996-97[4]; however, the matter was stayed prior to the hearing on the merits.[5] The case is discussed in section B below. It should also be noted that although not framed expressly in terms of paragraph 93(b) failing firm analysis, the Tribunal's decision in the *Gemini II* case in 1993 involved extensive consideration of whether Canadian Airlines was failing and whether there was any competitively preferable alternative to a merger with Air Canada.[6] As such, the case provides useful guidance on how the Tribunal may deal with those issues in the future.

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3 *Supra* note 1, s. 92.

4 *Canada (Director of Investigation and Research) v. Canadian Pacific*, Docket No. CT-1996-002(Comp. Trib.).

5 *See* Competition Bureau, Competition Bureau requests a stay of proceedings challenging the merger between Cast North America Inc. and C.P. Limited (Sept. 9, 1997), *available at* http://www.cb-bc.gc.ca/eic/site/cb-bc.nsf/eng/00681.html.

6 Canadian Airlines was facing imminent financial failure and its only alternative to being forced to merge with Air Canada (which would result in a single dominant Canadian air carrier) was an investment in Canadian Airlines by AMR Corporation, the parent of American Airlines and the Sabre computer reservation system. The Bureau brought an application under section 106 of the Act to vary an existing consent order regarding the merger of the computer reservation systems of Air Canada and Canadian Airlines to form the Gemini computer reservation system. The Gemini merger, in the changed market circumstances, was impeding the AMR transaction, which was predicated on Canadian Airlines transferring the hosting of its computer reservation system business to Sabre. The Tribunal ultimately agreed with the Bureau's position and dissolved the Gemini merger on the basis that it was, in the changed market circumstances, impeding a competitively preferable alternative to Canadian Airlines being forced to merge with Air Canada. See http://www.ct-tc.gc.ca/CMFiles/CT-1988-001_0800a_45PBT-4282004-6665.pdf and http://www.ct-tc.gc.ca/CMFiles/CT-1988-001_0873a_45QDY-4292004-3247.pdf.

A. Failing Firm under the *Merger Enforcement Guidelines*

Given the lack of Tribunal cases on paragraph 93(b), the Bureau's 2004 *Merger Enforcement Guidelines* (the "MEGs")[7] take on added importance in understanding how the Bureau is likely to treat claims of business failure in merger review. The MEGs build on, and refine, the approach to failing firm analysis as articulated in the Bureau's original 1991 *Merger Enforcement Guidelines* (the "1991 MEGs").[8]

There are two broad issues in the MEGs' failing firm framework under paragraph 93(b): (i) whether there is likely business failure and exit of assets from the relevant market; and (ii) whether there is any alternative to the merger that would likely lead to a materially higher level of competition. Where there is likely failure and exit of assets with no competitively preferable alternative, the merger can be permitted on the rationale that the loss of competition is not attributable to the merger – i.e., the merger is not preventing or lessening competition substantially.

1. Business Failure and Exiting Assets

The MEGs indicate that it is not business failure in itself that is critical, but rather whether such failure will result in the assets of the firm exiting the relevant market.[9] The determination of whether a firm is likely to fail serves to provide a tangible basis for assessing whether assets are likely to exit the market.

The Bureau considers a firm to be failing if: (1) it is insolvent or is likely to become insolvent; (2) it has initiated or is likely to initiate voluntary bankruptcy proceedings; or (3) it has been or is likely to be petitioned into bankruptcy or receivership.[10] The Bureau typically requires audited or independently prepared financial information from the firm (such as projected cash flows, credit information) to support its claims that it is failing or is likely to fail.

The MEGs also allow for the possibility of a "failing division" argument, in which case these same principles apply to assessing whether a division or subsidiary, rather than the overall enterprise, is failing.[11] Additional considerations, such as transfer pricing and intra-corporate cost allocations, are also relevant to evaluating whether a division or subsidiary is failing.

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[7] Competition Bureau, Merger Enforcement Guidelines (Sept. 1, 2004), *available at* http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/01245.html.

[8] Competition Bureau, Merger Enforcement Guidelines (Nov. 1991).

[9] *Supra* note 7, s. 9.2.

[10] *Supra* note 7, s. 9.3.

[11] *Supra* note 7, s. 9.5.

2. Alternatives to the Merger

Before concluding that a merger involving a failing firm or division is not likely to prevent or lessen competition substantially, the Bureau must be satisfied that there are no alternatives to the merger that would likely to result in a materially greater level of competition. The Bureau considers three possible alternatives: (a) acquisition by a competitively preferable purchaser; (b) retrenchment/restructuring; and (c) liquidation.

(a) Competitively Preferable Purchaser

The Bureau considers whether there is any competitively preferable third party that is willing to pay a price for the failing firm, net transaction costs, greater than the net proceeds that would be received in a liquidation. A purchaser is considered competitively preferable if an acquisition by it would be likely to result in a materially higher level of competition in a substantial part of the market.

The Bureau must be satisfied that a thorough search for a competitively preferable purchaser has been conducted. If not, the Bureau will require an independent third party (such as an investment dealer, trustee, or broker) to conduct such a search. The 1991 MEGs stated that a third party search would "ordinarily be required" and that a period not exceeding 60 days would ordinarily be sufficient.[12] The current (2004) MEGs have relaxed this criterion, requiring only that an adequate shop "has been conducted", with no presumption in favour of an independent third party search for buyers.[13]

(b) Retrenchment/Restructuring

The Bureau also considers whether the retrenchment or restructuring of the failing firm (e.g., restructuring with more focused or narrower operations) will lead to a materially greater level of competition than if the proposed merger proceeds. For example, withdrawing from selling certain products or from certain geographic areas may allow the firm to survive as a healthier competitor in other markets.

(c) Liquidation

The Bureau also considers whether liquidation of the failing firm will lead to a materially greater level of competition than if the proposed merger proceeds. The MEGs state that liquidation may facilitate entry or expansion in certain cases by enabling actual or potential competitors to compete for the failing firm's customers or assets to a greater degree than if it were acquired by the proposed acquiror.

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[12] *Supra* note 8, s. 4.4.

[13] *Supra* note 7, s. 9.3.

B. Failing Firm Cases

1. Wolverine/Noranda Metal (1988)

The acquisition of substantially all the assets of Noranda Metal Industries Ltd. by Wolverine Tube (Canada) Inc. in 1988 illustrates the application of failing firm analysis prior to the Bureau's first formal articulation of its failing firm policy framework in the 1991 MEGs.[14]

Wolverine and Noranda Metal were the only two Canadian manufacturers of seamless copper tubing. The Bureau had been advised by Noranda Metal that (i) Noranda Metal's tube mill operations were not a sustainable stand-alone business, (ii) there were no other interested purchasers of the assets and (iii) the only alternative to the merger was to liquidate the business, which would involve the cessation of operations at the tube mills. The Bureau's analysis revealed that liquidation would not likely facilitate future entry into the Canadian market. In November 1988, the Bureau announced that it would not oppose the transaction, but would be "monitoring market developments". The Bureau stated that "in these circumstances, it was apparent that the seamless copper tube industry in Canada would become a one-firm industry, whether or not the transaction proceeded".[15] The Bureau also noted that Wolverine would be able to realize significant efficiency gains as a result of the transaction.

The Bureau does not appear to have formally applied the failing firm requirements as subsequently articulated in the MEGs. Although Noranda Metal indicated that there were no alternative purchasers and that liquidation was not preferable, there is no public information that a formal shop was required by the Bureau or that an independent accountant was retained to verify Noranda Metal's claim.

It is noteworthy that almost three years after its decision not to challenge the merger, the Bureau commenced an inquiry into the merger following an application under section 9 of the Act by members of two unions who alleged that the acquisition had resulted in a substantial prevention or lessening of competition.[16] While section 9 obligated the Bureau to initiate an inquiry, it is interesting that the Bureau did not dispose of the inquiry based on the same failing firm considerations it had previously invoked. Rather, it indicated only that there had not been any substantial lessening of

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14 Director of Investigation and Research, *Annual Report of the Director of Investigation and Research for the Year Ended March 31, 1989* (Ottawa: Min. of Supp. and Svcs. Canada, 1989) at 14.

15 *Ibid*.

16 Director of Investigation and Research, *Annual Report of the Director of Investigation and Research for the Year Ended March 31, 1992* (Ottawa: Min. of Supp. and Svcs. Canada, 1992) at 11.

competition and that this was primarily due to an increase in imports from the United States providing effective competition to Wolverine.[17]

2. PWA/Wardair (1989)

In January 1989, PWA Corporation, the parent of Canadian Airlines, announced its intention to purchase Wardair, another scheduled domestic airline. In April 1989, following its review of the transaction, the Bureau concluded that, although the acquisition would significantly change the nature of competition in the market for domestic scheduled airline services, Wardair's serious financial difficulties indicated that Wardair would be likely to fail. As a result, the Bureau decided against challenging the transaction.[18]

The Bureau identified several adverse considerations in its competitive analysis of the merger. For example, the transaction would remove Wardair as a vigorous and effective competitor and result essentially in a duopoly in the domestic scheduled airline market. In addition, there were significant barriers to entry, such as regulatory restrictions on foreign carriers and slot constraints at Pearson airport in Toronto.

Notwithstanding these competition concerns, Wardair presented evidence that it was likely to fail in the absence of a merger, citing substantial operating losses which were expected to continue to occur. The Bureau retained an independent accounting firm and confirmed that operating losses were draining Wardair at an "alarming" rate and that the company would not be able to be forthcoming interest payments. In addition to verifying that Wardair was failing, the Bureau was also able to confirm that various scenarios alternative to an acquisition by PWA were not feasible:

- Wardair had been informed that they must seek alternative purchasers; however, while there had been some expressions of interest, no other firm offers to acquire the company were made.
- Liquidation was not viewed as a viable alternative. Under a liquidation scenario, most of the assets of Wardair (aircraft) would leave the Canadian market as there was already excess capacity and Wardair's fleet was not compatible with the fleets of other Canadian airlines.
- An accounting firm retained by the Bureau reviewed a number of retrenchment scenarios, but determined at all were either unattainable or unworkable in the circumstances present at the time.

As a result, the Bureau determined that the acquisition would not likely substantially lessen competition, given Wardair's position as a failing firm. Any change in the

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17 *Ibid*.

18 *See* Director of Investigation and Research, CCAC No. 189 10234 E 89-04, *Information Document on the Proposed Acquisition of Wardair Inc. by PWA Corporation* (Apr. 14, 1989).

nature of competition in the domestic airline industry could not be attributed to the transaction.

Overall, the PWA/Wardair case represents a good example of the Bureau's approach to failing firm analysis, even though, like *Wolverine/Noranda Metal*, it predated the Bureau's first formal articulation of its failing firm framework in the 1991 MEGs.

3. Cast (1996-97)

In late 1996, the Bureau challenged Canadian Pacific's ("CP") proposed acquisition of Cast North America ("Cast") before the Tribunal.[19] CP argued that Cast was a failing business within the meaning of paragraph 93(b) of the Act, but the Bureau contended that it was not failing or, alternatively, that sale to a third party, liquidation or retrenchment were preferable alternatives.

The Bureau argued that at least four potential purchasers were willing to purchase Cast at a net price above liquidation value and that these purchasers would have been competitively preferable to CP. Additionally, the Bureau claimed that the Royal Bank of Canada ("RBC"), Cast's financial advisor, had not performed a sufficient shop prior to Cast making a failing firm claim for a number of reasons, including: (1) RBC refused to allow access to all such information which is generally required by prospective purchasers; (2) RBC actively dissuaded Cast management from seeking alternative purchasers in the belief that RBC would receive a premium price from CP; and (3) RBC set a minimum price for the purchase of Cast in the amount of US$35 million.

The Bureau also submitted that liquidation of Cast was preferable to CP's acquisition because liquidation would facilitate entry into the market by new competitors or expansion by established competitors with the result of a materially higher level of competition. In particular, "Cast's liquidation would allow a new entrant or an established competitor to compete for Cast's customer base and assets that remained in the market, as well as make space available at the Port of Montreal."[20]

Finally, the Bureau argued that retrenchment was a preferable alternative to purchase by CP. The Bureau noted that Cast had begun to experience positive cash flows and that the prospect existed that it could successfully reorganize through bankruptcy or the *Company Creditors Arrangement Act*. Such a scenario would have been likely to result in a materially greater level of competition than if CP's acquisition was allowed to continue.

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19 *Supra* note 5, Notice of Application filed by the Director of Investigation and Research, para. 121.

20 *See ibid*., para. 126.

Ultimately, the proceeding was stayed and the Tribunal did not rule on the Bureau's failing firm claims.

4. Air Canada/Canadian Airlines (1999)

The Bureau's highest profile use of the failing firm analysis came in late 1999 when it permitted the acquisition of Canadian Airlines by Air Canada, notwithstanding that Air Canada would emerge as a single dominant Canadian airline, on the basis that Canadian Airlines was facing imminent failure and there was no competitively preferable alternative to the merger with Air Canada. The failing firm rationale was straightforward, as set out in the Bureau's decision not to oppose the transaction:

> . . . the key question under the merger provisions of the *Competition Act* is whether there is a competitively preferable alternative, under the existing regulatory framework, to the proposed transaction. In considering this question, due regard must be given both to Canadian's financial situation and to undertakings provided by Air Canada and the Offeror . . .
>
> The Bureau has concluded that Canadian is facing imminent insolvency, necessitating the need for urgent action. The Bureau also acknowledges that there is not likely to be a competitively preferable purchaser of Canadian in the absence of the proposed transaction. Given this situation, and on the basis of the Undertakings provided by Air Canada and the Offeror, the Bureau does not consider that there is a competitively preferable alternative to the proposed transaction. In other words, the proposed transaction with the Undertakings is preferable to the liquidation of Canadian.[21]

Notwithstanding this seemingly simple analysis, the case is notable in several respects that are important to understanding the context for the decision.

First, provisions of the Act were suspended for 90 days, from August 13, 1999 to November 11, 1999, by Cabinet, on recommendation of the Minister of Transport, to facilitate the pursuit of restructuring alternatives by Air Canada and Canadian Airlines. In the result, the merger review under the Act only lasted just over a month from the pre-merger filing in mid-November 1999 until the Bureau's decision on December 21, 1999 not to oppose the merger, subject to conditions.

Second, while it was an important part of the failing firm analysis to verify that Canadian Airlines was failing, the overriding premise for the government's decision to suspend the Act to allow restructuring talks was that Canadian Airlines was facing imminent financial difficulty.

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21 Letter from the Commissioner of Competition to Lawson A.W. Hunter (Dec. 21, 1999), "Proposed Acquisition by Air Canada and 853350 Alberta Ltd. (the "Offeror") of Canadian Airlines Corporation", *available at* http://strategis.ic.gc.ca/pics/ct/ac2199e.pdf.

Third, regarding competitively preferable alternatives, by the time the Bureau conducted its merger review, there had already been extensive canvassing of the competitive alternatives to the merger, including during the three months that the Act had been suspended. However, it is also important to bear in mind that concurrent with suspension of the Act, the Bureau put forward various policy recommendations to the Minister of Transport to increase foreign ownership in airlines in Canada or otherwise liberalize airline competition in Canada.[22] Had all, or even some, of those recommendations been adopted, then the landscape for assessing competitive alternatives (notably the attractiveness of transactions with foreign airlines) could have shifted significantly. It is for that reason that the Bureau's decision not to oppose the transaction referred to the lack of competitively preferable alternative "under the existing regulatory framework".

Fourth, unlike other merger reviews by the Bureau, Air Canada's acquisition of Canadian Airlines was approved by the Minister of Transport under (subsequently enacted) provisions of the *Canada Transportation Act* ("CTA"), not by the Bureau under the Competition Act.[23] In fact, it was this transaction that gave rise to the current public interest merger review process under the CTA. That process initially applied only to airlines, but was expanded in 2007 to cover mergers in the transport sector generally.[24] The Air Canada/Canadian Airlines transaction remains the only merger to be subjected (albeit retroactively) to a public interest review under the CTA. The Minister approved the transaction subject to the undertakings negotiated by the Bureau, as well as commitments provided directly to the Minister relating to employment and service to remote communities. Thus, notwithstanding that Air Canada's acquisition of Canadian Airlines satisfied the Bureau's failing firm test under competition principles, the transaction was allowed in any event under the broader public interest standard employed by the Minister of Transport.

5. More Recent Cases

Since the Bureau's decision to not oppose Air Canada's acquisition of Canadian Airlines in December 1999, there have been no mergers allowed (at least not publicly) by the Bureau on failing firm grounds. That is not to say that the financial state of companies or industries has not been a relevant consideration in merger review. For example, in allowing Rogers' acquisition of Microcell in 2005, the Bureau referred to Microcell's poor financial position, including its recent filing under the *Company Creditor's Arrangement Act*, in concluding that Microcell was unlikely to be a

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22 The Bureau's policy recommendations to the Transport Minister included potentially raising the foreign ownership limits from 25% to 49%, allowing "indirect cabotage", and allowing foreign ownership of "Canada only" airlines. *See* Letter from Konrad von Finckenstein to David Collenette (Oct. 22, 1999), *available at* http://strategis.ic.gc.ca/pics/ct/coll-e.pdf.

23 *Supra* note 21.

24 *An Act to amend the Canada Transportation Act and the Railway Safety Act*, S.C. 2007, c. 19.

significant "maverick" in a coordinated effects context.[25] Also, in the Bureau's 2007 decision to not oppose the Abitibi/Bowater merger (notwithstanding the Bureau having raised objections to Abitibi's prior acquisition of Donahue in 2001), the Bureau noted that "the industry is experiencing declining demand".[26]

III. Some Observations Regarding Failing Firm Analysis to Date

Although there has been limited experience with failing firm cases, the ensuing discussion offers a few observations on some of the issues that have arisen in practice regarding failing firm analysis.

A. Factor versus Defence

There has been some question regarding whether imminent business failure should be treated as a "factor" or a "defence" in Canadian merger review. The issue is arguably one of semantics, as discussed below; nonetheless, characterizing failing firm as a factor may understate its full significance in merger analysis.

Under the Act, the prospect of business failure is referred to as a factor, not a defence, in assessing whether a merger is likely to substantially lessen competition. Similarly, the MEGs characterize the failing firm consideration as a factor, not a defence: "Probable business failure does not provide a defence for a merger that is likely to prevent or lessen competition substantially".[27] The rationale is that any loss of competition cannot be attributed to the merger where imminent failure would likely result in the firm's assets leaving the relevant market in any event.

However, because establishing the elements of the failing firm "factor" is in itself a sufficient basis to allow the merger, business failure functions in practice largely like a defence. The MEGs implicitly recognize this by dedicating a distinct section of the guidelines (Part 9), separate from the discussion of other section 93 factors, to the failing firm analysis.

Whether the failing firm analysis is a "defence" depends on whether "defence" is understood to mean a defence to an anticompetitive merger (in which case it is not a defence) or a defence to an *otherwise* anticompetitive merger (in which case it is a defence). For example, the efficiency defence (as it is sometimes called) in Canadian merger law creates a defence that may permit an anticompetitive merger – i.e, the

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25 Competition Bureau, Technical Backgrounder – Acquisition of Microcell Telecommunications Inc. by Rogers Wireless Communications Inc. (2005), *available at* http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/00257.html.

26 Competition Bureau, Technical Backgrounder – Merger between Abitibi-Consolidated Inc. and Bowater Incorporated (2007), *available at* http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/02508.html.

27 *Supra* note 7, s. 9.1.

merger may be allowed even though it will likely lessen competition substantially and lead to higher prices (as the Tribunal concluded in the *Superior Propane* case[28]). Conversely, the efficiency "defence" in U.S. antitrust merger review more typically refers to a situation where efficiencies result in there not being an anticompetitive merger – in other words, a merger that would otherwise be anticompetitive is not because of efficiencies. Similarly, the failing firm factor in Canada is a defence to an otherwise anticompetitive merger – where there is likely business failure resulting in exit of assets and no competitively preferable alternative, then the reduction in competition cannot be attributed to the merger.

Semantics aside, whether one labels the failing firm analysis as a defence or merely a decisive factor, the important point is that where the elements of the failing firm analysis are present, that constitutes in itself a complete justification for allowing a merger.

B. Business Failure versus Exiting Assets

The Act refers to whether a business is likely to fail and does not mention whether assets are likely to exit the market. Determining the likelihood of business failure is also important under the MEGs; however, the MEGs indicate that it is not failure in itself, but rather the resulting exit of assets that is critical:

> the loss of the actual or future competitive influence of a failing firm is not attributed to the merger if imminent failure is probable and, in the absence of a merger, the assets of the firm are likely to exit the relevant market.[29]

Business failure, the statutory factor, is both over and under inclusive of exiting assets, the economic consideration. It is over-inclusive, as the Bureau has suggested, insofar as it captures situations where firms may fail, but their assets may not leave the market. However, it is submitted that business failure is unlikely in most cases to be associated with a significant amount of productive assets remaining in the market.

Conversely, business failure is under-inclusive of exiting assets in that firms and their assets could exit a market even where they are not failing, such as where assets are relatively mobile and better returns on the assets are available elsewhere. The original (1991) MEGs explicitly recognize this possibility:

> The underlying rationale of section 93(b) is equally applicable to situations where a firm wishes to exit a market for reasons other than failure, such as unsatisfactory profits, or a desire by a diversified firm to focus its efforts elsewhere. In short the anticompetitive effects attributed to the merger, where

28 *Canada (Commissioner of Competition) v. Superior Propane Inc.* (2000), 7 C.P.R. (4th) 385 (Comp. Trib.).

29 *Supra* note 7, s. 9.

> there are no likely alternatives that would result in a maintaining a materially higher level of competition in the relevant market than if the merger proceeded. Accordingly, likely failure is not a necessary condition that must exist.[30]

Those 1991 MEGs nonetheless also recognize that as business failure becomes less likely, it generally becomes more difficult to establish that there is no competitively preferable alternative.

By contrast to the 1991 MEGs, the current MEGs contain no discussion of a pure exiting assets scenario for reasons unrelated to business failure. As such, the current MEGs do not expressly recognize, or rule out, the possibility of allowing a merger on the basis of an exiting assets argument where there is no likely business failure.

Since business failure may not be required in certain cases to demonstrate that assets would likely exit a market in the absence of a merger, it follows that where a business is only "flailing", but not quite failing, that similarly does not preclude arguing that the assets would likely exit the market absent the merger.

C. Assessing Alternative Purchasers

The Bureau's approach to assessing alternative purchasers has become more pragmatic, as reflected in the evolution from the 1991 MEGs to the current MEGs. The 1991 MEGs set out a relatively onerous framework for establishing that there is no competitively preferable purchaser, stating that "searches for alternative buyers will ordinarily be required to be conducted by an independent third party" and contemplating a search timeframe of up to 60 days. The 1991 MEGs do recognize that an independent search may not be required where the Bureau "is satisfied that a thorough search has already been undertaken, or where the involvement of such a third party would likely cause significant harm to the exiting firm". Nonetheless, the norm contemplated is a search by an independent third party.

The current MEGs relax the presumption in favour of a search by an independent third party and require such a shop only "[i]f the Bureau is not satisfied that a thorough search for a competitively preferable purchaser has been conducted". This is a welcome shift and is consistent with the reality that while a business may be headed toward financial failure, it is usually already concurrently assessing alternative options, including other purchasers. Therefore, by the time that a company has determined that it is failing, it will often have extensively explored many alternatives, such as other purchasers, retrenchment or even liquidation, as was the case in Air Canada's acquisition of Canadian Airlines.

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30 *Supra* note 8, s. 4.4.1.

D. Do Non-Competition Considerations Matter?

The U.S. Supreme Court first recognized a failing firm justification for allowing a merger in *International Shoe*, where the court described the rationale as follows:

> In light of the case thus disclosed of a corporation with resources so depleted and the prospect of rehabilitation so remote that it faced the grave probability of business failure with resulting loss to its stockholders and injury to the communities where its plants were operated, we hold that the purchase of its capital stock by a competitor (there being no other prospective purchaser), not with a purpose to lessen competition, but to facilitate the accumulated business of the purchaser and with the effect of mitigating seriously injurious consequences otherwise probable, is not in contemplation of law prejudicial to the public interest and does not substantially lessen competition or restrain commerce within the intent of the Clayton Act.[31]

The failing firm analysis has been subsequently recognized in legislative history and other cases in the United States. However, the exact status of non-competition considerations, such as harm to the community, is unclear, since many failing firm cases can be understood merely on the basis that the merger is not the cause of the lessening of competition. Nonetheless, at least some of the judical commentary acknowledges that broader public interest considerations may be relevant.[32]

In Canada, the MEGs state that "the impact that a firm's exit can have in terms of matters other than competition are generally beyond the scope of the assessment contemplated by paragraph 93(b)". The wording "generally beyond the scope" arguably leaves the door open to non-competition considerations; however, in practice the Bureau has stuck to doing what it does best: competition analysis. That is not surprising, given the economic orientation of the MEGs and the fact that even without paragraph 93(b), the substantive test under the merger provisions relates to the impact on competition. Moreover, while the Bureau specializes in competition analysis, it is probably not the best forum for weighing non-competition considerations.

Although it is apparent that the Bureau itself pays little regard to non-competition considerations, such as job loss,[33] in carrying out its merger assessments, it would be an oversimplification to suggest that such broader public interest considerations are not relevant to how merger review has evolved at the Bureau. It is noteworthy that much, if not most, of the experience with failing firm analysis in Canada has involved the airline industry. Moreover, in the one airline merger where competition and

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31 *International Shoe Co. v. Federal Trade Commission* (1930), 280 U.S. 291 at 302-03 (U.S.S.C.).

32 See, e.g., *US Steel Corp.* (1968), 74 FTC 1270 at 1288.

33 Job loss may even be viewed positively by the Bureau, such as in terms of efficiencies.

broader public interest concerns mattered most (and potentially diverged), the Minister of Transport was sufficiently concerned that the Bureau's approach to failing firm analysis would not adequately consider broader public interest considerations, particularly job loss, that the Act and CTA were amended to allow for the Minister to override the competition analysis to effect broader public interest goals.

E. Liquidation

Even where there is no competitively preferable purchaser or viable restructuring option, the MEGs will still deny a failing firm argument if "liquidation of the firm is likely to result in a materially higher level of competition in a substantial part of the market than if the merger in question proceeds".

Yet, liquidation is different in important respects from the alternatives of either a competitively preferable purchaser or restructuring. Whereas an alternative purchaser or restructuring means that the failing firm will survive in some form, liquidation entails the death of the firm and its operations. Such tangible harm must be measured against the speculative gains to competition sought to be achieved by forcing liquidation. This may explain why the U.S. failing firm doctrine focuses only on two alternatives: the prospect for successful reorganization and the possibility of an alternative purchaser.[34] It remains to be seen whether the Bureau would oppose a merger involving a failing firm where the only viable alternative to the merger was liquidation.

IV. Looking Ahead

A. Will the Bureau Be More Tolerant of Failing Firm Mergers?

The current economic climate has put pressure on competition agencies to consider whether their approach to reviewing mergers involving failing firms can adequately respond to market realities while maintaining the integrity of sound antitrust enforcement.

Jurisdictions outside Canada have not taken a uniform approach to this issue, although calls for a more flexible approach appear to outweigh desires to stick with a rigid application of competition laws. For example, the UK's Office of Fair Trading[35] and

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34 *Citizen Publishing Co. v. United States*, 394 U.S. 131 at 136-138 (1969).

35 For example, the head of the Office of Fair Trading recently gave a speech in which he warned against the wholesale abandonment of competition principles in dealing with the economic downturn but also acknowledged that authorities will have to exercise some pragmatism in recognizing when other policy interests may override competition concerns. John Fingleton, "Competition Policy in Troubled Times" (Speech at the Charles River Associates Conference, Brussels, Jan. 20, 2009), *available at* http://www.oft.gov.uk/shared_oft/speeches/2009/spe0109.pdf. These statements followed on

some American politicians[36] and antitrust experts[37] have called for a more flexible approach to failing firm claims in the current economic climate. On the other hand, although the European Commission has demanded an active role for itself in merger review and with respect to the review of state aid proposals, Commissioner for Competition Policy Neelie Kroes has stated that the Commission is committed to applying existing rules in the economic downturn, albeit while acknowledging the need to act quickly in response to emergency rescue measures.[38]

In Canada, the Bureau has signalled a clear intent to stick to competition principles in evaluating mergers in the current environment. In a recent speech, the Interim Commissioner noted that in the prevailing economic environment:

> we anticipate more mergers involving firms with claims of financial distress, which may or may not satisfy the conditions associated with a legitimate failing firm defence. Here, we must be clear, timely and decisive. However, at the very time we seek to deliver on those imperatives, we expect some in the competition community will urge the Bureau to somehow 'lighten' antitrust scrutiny in this time of

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the heels of the UK government's quick approval of the merger between Lloyds TSB and HBOS as being in the public interest, despite the OFT's concerns. *See* Decision by Lord Mandelson, the Secretary of State for Business, not to refer to the Competition Commission the merger between Lloyds TSB Group plc and HBOS plc under Section 45 of the Enterprise Act 2002 (Oct. 31, 2008), *available at* http://www.berr.gov.uk/files/file48745.pdf. *See also* Lloyds TSB's HBOS deal is cleared, BBC News, Oct. 31, 2008, *available at* http://news.bbc.co.uk/2/hi/business/7702809.stm.

36 Nancy Pelosi, the Speaker of the House of Representatives, has called for the Department of Justice's Antitrust Division to consider the economic challenges and competition from other media facing local newspapers when looking at mergers in that industry. Peter Scott, "Pelosi Calls for Newspaper Leeway", Global Competition Review (Mar. 17, 2009), *available at* http://www.globalcompetitionreview.com/news/article/13086.

37 For instance, one expert has called for a "failing economy defence" that would allow otherwise anti-competitive mergers to go ahead where the most important consideration is to protect jobs and other companies in the supply chain. Global Competition Review, "ABA Debates Antitrust in a Downturn" (Mar. 27, 2009), *available at* http://www.globalcompetitionreview.com/news/article/13147.

38 *See, e.g.*, Neelie Kroes, European Commissioner for Competition Policy, "The role of state aid in tackling the financial & economic crisis" (Introductory remarks at press conference, Brussels, Belgium, Dec. 8, 2008), http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/08/683&format=HTML&aged=0&language=EN&guiLanguage=en; Neelie Kroes, European Commissioner for Competition Policy, "Dealing with the current financial crisis" (Speech to the Economic and Monetary Affairs Committee, European Parliament, Brussels, Belgium, Oct. 6, 2008), http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/08/498&format=HTML&aged=0&language=EN&guiLanguage=en.

> economic crisis, abandoning principled application of the standards in our Act.
>
> This is an important message I would like to leave with you. From my perspective, there is only one starting point. Canada's *Competition Act* is, with certain limited exceptions, a law of general application, capable of accommodating both ordinary and extraordinary market conditions. Accordingly, just as the *Competition Act* applies during times of prosperity to prevent conduct that deprives markets of the innovation, efficiency and productivity that would otherwise be fostered, it is of equal, or greater, importance during times of economic hardship.
>
> I assure you that there will be responsiveness; there will be flexibility; and there will be creativity and hard work to help Canadian businesses and consumers weather these conditions and rebound. But 'competition lite' is no option; we would be abandoning Canadians just when the long-term health of our economy most depends on us.[39]

Thus, it is likely that the Bureau's requirements for justifying a merger on failing firm grounds will remain essentially intact. That said, in the current economic environment there may be more mergers that meet those requirements.

B. Closing into Hold Separate Arrangements

While it is unlikely that the substance of the Bureau's failing firm analysis will change in any significant way, one procedural mechanism to address the time pressures surrounding the analysis would be to allow the transaction to close into a "hold separate" arrangement pending completion of the merger analysis. Hold separates have received attention in merger review generally in recent years, although they may be particularly appropriate in the failing firm context – since they may provide a means for an immediate infusion of capital to avoid failure, while still preserving remedy options. For example, the Bureau could allow for the closing of the transaction into a trust arrangement (as is common in mergers requiring CRTC approval) pending completion of its review.[40]

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39 Melanie Aitken, Interim Commissioner of Competition, Notes for an Address to the Northwinds Professional Institute 2009 Competition Law and Policy Forum (Feb. 12, 2009), *available at* http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/02994.html.

40 *See* Canadian Radio-television and Telecommunications Commission, Public Notice CRTC 1999-196, "Policy regarding use of trust arrangements" (Dec. 10, 1999), *available at* http://www.crtc.gc.ca/eng/archive/1999/PB99-196.htm. Trust arrangements have been used, for example, in CanWest's acquisition of Alliance Atlantis. *See* Canadian Radio-television and Telecommunications Commission, Broadcasting Decision CRTC 2007-429 (Dec. 20, 2007), *available at* http://www.crtc.gc.ca/eng/archive/2007/db2007-429.htm.

The Bureau has traditionally been reluctant to allow parties to close a transaction where the Bureau has identified competition issues and has not completed its review. Ultimately, the issue is whether closing removes the ability of the Tribunal to subsequently remedy any potential harm to competition. The Tribunal has signalled that irreparable harm from the closing should not necessarily be presumed to the extent the Bureau has done in the past.[41] Moreover, in a failing firm context, the harm of not allowing the closing may be more obvious and severe than the more speculative concern about loss of remedial options where the closing is allowed into a hold separate arrangement.

C. Second Request Implications

A related timing consideration going forward will be how the Bureau's new authority to issue "second requests" in merger review will impact failing firm analysis. The Bureau now has up to 30 days following a pre-merger filing to issue a second request, which triggers a new waiting period that expires 30 days following compliance with that request. This system is modelled closely on the U.S. HSR process, which suggests that the time period from the pre-merger filing to expiration of the waiting period will typically be several months. That will be too long where a party is truly failing. Recall that in Air Canada's acquisition of Canadian Airlines, the entire review occurred in a little over one month.

Thus, in a failing firm scenario, the Bureau should consider more expeditious options than a second request to verify the likelihood of failure and lack of competitively preferable alternatives. Moreover, a second request would typically seek extensive information regarding market structure, shares, barriers, etc. – information that may not be necessary where the requirements of the failing firm analysis can be established.

V. CONCLUSION

To date, the Canadian experience with failing firm analysis in merger review has been limited. The few cases where the Bureau has expressly addressed failing firm arguments have largely followed the criteria set out in the MEGs. Recent pronouncements from the Bureau signal that it will continue to adhere to those principles in the current economic downturn.

While one should not expect any significant relaxation of the Bureau's requirements for establishing a failing firm argument, the prevailing economic climate may increase the number of transactions that satisfy those requirements. In addition, while substantive changes in the Bureau's approach are unlikely, it is hoped that there may

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41 *Commissioner of Competition v. Labatt Brewing Company Ltd.* (2007), Docket No. CT-2007-003 (Comp. Trib.).

nonetheless be opportunities for greater procedural flexibility, such as allowing transactions to close into hold separate arrangements where appropriate, that can help address the challenges of reviewing mergers involving failing firms in Canada.