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Mr. Terence Stechysin
A/Senior Competition Law Officer
Competition Bureau
Place du Portage I
50 Victoria Street
Gatineau, Québec K1A 0C9

Dear Mr. Stechysin:

RE: Draft Information Bulletin on Merger Remedies in Canada

The National Competition Law Section of the Canadian Bar Association (the CBA Section) is pleased to provide its comments on the Competition Bureau's October 2005 draft *Information Bulletin on Merger Remedies in Canada* (the Draft Bulletin). The Draft Bulletin is intended to document the Bureau's approach to merger remedies and the drafters are to be commended. The CBA Section has only a few comments on specific aspects of the Draft Bulletin and generally endorses the Bureau's effort.

The Commissioner of Competition has said that the Bureau is also planning to undertake an analysis of impacts of mergers and whether the remedies required in specific cases had the desired effects.[1] The CBA Section welcomes this initiative, noting that similar studies in the United States and Europe have affected enforcement thinking and guidelines in those jurisdictions. It is important to have an empirical basis upon which to judge enforcement policy decisions.

There may be some merit in postponing the final version of the Draft Bulletin until the planned post-merger studies have been completed. Although the Draft Bulletin may reflect current enforcement practice, in some areas it appears to move Competition Bureau practice towards the adoption of other agencies' standards and to introduce policies that are new to Canada. The CBA Section recognises that incremental change based on experience is an important part of the Bureau's approach to the enforcement of the *Competition Act*. However, in the context of plans to develop an empirical basis upon which to measure the effectiveness of various merger remedies, it may be prudent to hold off settling enforcement approaches until those studies are completed.

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1 See "Competition Bureau Progress and Priorities", Speaking Notes for Sheridan Scott, Commissioner for Competition, Canadian Bar Association Annual Conference on Competition Law (November 3, 2005) at pp. 12-13.

500 - 865 Carling, Ottawa, **ONTARIO** Canada K1S 5S8
Tel/Tél. : (613) 237-2925 **Toll free/Sans frais :** 1-800-267-8860 **Fax/Télécop. :** (613) 237-0185
Home Page/Page d'accueil : www.cba.org **E-Mail/Courriel :** info@cba.org

Should the Bureau move forward and finalise the Bulletin, the CBA Section believes that several important aspects of the Draft Bulletin may benefit from further consideration. These include: "fix-it-first" remedies; short initial divestiture timeframes; and "crown jewel" provisions.[2]

Structural remedies

The Draft Bulletin clearly articulates the Bureau's preference for structural, rather than behavioural, solutions to problematic mergers. The CBA Section agrees that divestiture of a stand-alone functioning business will generally be the most effective remedy in a merger case and has no objection in principle to the use of fix-it-first remedies or, where that is not possible, reasonably short divestiture timeframes and even the potential use of crown jewel provisions. However, the CBA Section questions whether it is reasonable to expect, as the Draft Bulletin suggests, that fix-it-first divestitures will be common in Canada or that post-closing divestitures will regularly be on short timeframes with crown jewels. The CBA Section sees this as a shift in enforcement policy not necessarily supported by Canadian enforcement experience, or necessary for effective merger policy.[3]

Fix-it-first

Fix-it-first solutions involve pre-completion divestitures or agreements to effect divestitures concurrent with the completion of a merger. The CBA Section agrees that, conceptually, they are preferable to post-completion solutions for the reasons set out in the Draft Bulletin. However, there have been very few fix-it-first remedies in Canada, and the CBA Section does not believe that is likely to change in the future. Transaction complexities are such that, in the vast majority of cases, merger parties must focus on completion of the primary acquisition before implementing divestitures or other remedies. This is particularly so in public market transactions where it may be difficult or impossible to initiate divestiture discussions with third parties at an early date or complete a divestiture prior to closing.

Requiring fix-it-first solutions can also impose substantial costs on the merging parties. The need to find and receive approval for a buyer will usually delay closing the merger. This may delay the realization of merger efficiencies and increase transaction costs – or make the merger impossible to consummate. The additional delay creates greater risk that movements in the market may make share-for-share transactions unattractive or financing more expensive to obtain. Forcing the merging parties to sell assets before closing can give potential buyers tremendous leverage where the sale of the divested assets are holding up a much larger transaction and can significantly reduce the value of the divested assets for the parties.

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2 The CBA Section also notes the absence of a discussion about when dissolution may be sought, which is often an important issue from the vendor's perspective, and believes that consideration of this issue may be warranted. If the Bureau does have internal views on the circumstances in which dissolution would be sought, it would be helpful if they were incorporated into the draft.

3 The CBA Section also notes that remedies negotiations are case specific and that it would be difficult and undesirable to rigidly apply all aspects of the guidelines in all cases. Flexibility and recognition of particular circumstances are also important. Moreover, as noted later in greater detail, a dogmatic approach to implementing remedies can lead to undesirable results (e.g., in appropriate cases a well-organized, albeit lengthier, divestiture process that effectively creates a viable competitor should be preferred to a quick, but poorly executed, divestiture sale to a n ineffective buyer).

The CBA Section therefore believes that the Bureau should acknowledge that fix-it-first remedies, while desirable, will not be possible or expected in most cases and emphasize that it will not require fix-it first measures unless there is significant risk that a post-closing sale process will not succeed.

Short time periods

According to the Draft Bulletin, when it is not possible to fix-it-first, divestitures should ordinarily be completed within three to six months. If a divestiture has not been effected prior to the expiry of that initial time period, a trustee will ordinarily be appointed to complete the sale. While recognising that remedies should be implemented as expeditiously as possible, the CBA Section has a number of concerns about the very short initial time period.

As a preliminary matter, it would be helpful if the Bureau were to provide stakeholders with the data upon which it made its assessment that initial sales periods of three months would be commercially reasonable and periods in excess of six months would be problematic from a competition perspective. This might include any examples of Canadian cases in which divestiture periods in excess of six months resulted in material deterioration of assets such that the effectiveness of the divestiture was undermined. Such information would help stakeholders evaluate the reasonableness of the proposals in the Draft Bulletin.

In the absence of such data, the CBA Section notes that the three-month lower-end of proposed initial timeframe scale – and even six months – is unusually short relative to historic Canadian practice. It may well be an unreasonably short time in which to effect a divestiture at anything but a “fire sale” price. The Draft Bulletin states that “the Bureau has determined that 3-6 months is an appropriate initial sales period” “[b]ased on the Bureau’s past experience in Canada and the experience of competition authorities in other jurisdictions.”[4] However, the CBA Section believes that numerous effective divestitures have occurred in Canada following initial sales periods of longer than three to six months and that features of the Canadian marketplace may make historic practice more relevant than the experience of competition authorities in other jurisdictions.

Canadian markets are typically much thinner than US markets in terms of the number of strategic or even financial buyers. This makes it more difficult to find acceptable buyers in a short timeframe. Firms in the same industry, but not currently participants in the Canadian market, may take some additional time to evaluate the opportunity and make the strategic decision to enter. Sellers in industries subject to foreign investment limits in particular may find it difficult to locate domestic buyers in a short timeframe. Sellers who prefer to set up an auction process may find it difficult to complete the auction in three months. In general, the shorter timeframe will impose additional costs on merging parties to expedite the search process and likely result in some greater value reduction than would otherwise be the case with a longer sale period.

Unfortunately, the rigidity of the language in the Draft Bulletin[5] also appears to leave little room for flexibility in cases where a longer initial sales period may be warranted or necessary, as the CBA

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4 Information Bulletin on Merger Remedies in Canada, Competition Bureau, October 2005, p. 10, fn 11.

5 “The vendor will have a 3-6 month period to divest the asset package. This is considered sufficient time to identify and select suitable buyers and to complete due diligence. The Bureau may grant a short extension of this period in exceptional circumstances or where the vendor has signed a binding letter of intent with a prospective buyer and closing of the divestiture transaction is clearly imminent.” Ibid, p. 10, paragraph 31.

Section believes will sometimes or even often be the case. The CBA Section therefore recommends that, at minimum, the Draft Bulletin be modified to provide that "[t]he vendor will ordinarily have a period of not significantly more than six months to divest the asset package". This will provide clear guidance to stakeholders that six months is the norm but that longer periods may be acceptable in particular cases.[6]

Crown jewels

The CBA Section understands that the Bureau favours the addition or substitution of specified assets to the initial package of divestiture assets to increase the marketability of the divestiture if the initial package will not sell. While there may be circumstances in which the addition of assets proves necessary to make the divestiture package attractive, the CBA Section fears that the Bureau may intend to make the use of crown jewel provisions a standard feature of the merger remedy process.

From a competition policy perspective, crown jewels represent acceptance of either less-than-effective relief at the outset or a requirement to divest more than is necessary to remedy the competitive problem.[7] While, on occasion, crown jewel provisions may be necessary to ensure asset sales in cases where the attractiveness of the assets is particularly uncertain, this should be the only reason for their use, and they should be relatively rare.

Crown jewel provisions impose additional costs on the parties by creating uncertainty about whether the alternative assets will stay with the current owner or be divested. This puts on hold any integration plans the parties may have in relation to such assets, potentially delaying any efficiency gains that would flow from integration. It also puts in limbo the status of employees connected to those businesses or assets for an extended period of time, creating its own costs due to lost productivity and increased anxiety among employees about their future.

The use of crown jewel provisions may also impair the success of the original sale period if purchasers delay their interest in the hopes of ultimately acquiring the "crown jewels" at fire sale prices. This risk would be mitigated where the Bureau agrees to keep secret during the initial sale period the list of specific assets that would form the crown jewel package. However, the Draft Bulletin indicates that the fact that a crown jewel provision exists may not be kept confidential.[8] Where there is disclosure of crown jewel provisions, prospective purchasers may delay their interest in the hopes of picking up a more attractive package of assets at very attractive prices from a trustee sale. (In this context, the Draft Bulletin would benefit from a clear articulation of the criteria the Bureau would use when considering whether to keep crown jewel and other terms of a consent agreement confidential. Given that public disclosure is usually a matter of significant concern to merging parties, can be a source of contention

6 The current reference to "a short extension […] in exceptional circumstances" suggests only a limited willingness to extend a 3-6 month divestiture period rather than an acceptance of, for example, a nine-month period from the outset in an appropriate case.

7 Antitrust Division Policy Guide to Merger Remedies, US Department of Justice, October 2004, at p. 37.

8 Strategic buyers who are familiar with the assets of their competitors in any event may be able to determine with some precision the additional assets that would likely be available in a crown jewel sale.

when negotiating a consent agreement, and may materially affect the effectiveness of a divestiture, guidance would be welcome.[9])

The Bureau should also feel less need to have a backstop crown jewel divestiture where it undertakes more thorough market testing of the proposed divestiture asset package, as the Draft Bulletin suggests will be done in the future, since there will be less risk that it may have misjudged the viability of the original divesture package.

In light of these concerns, the CBA Section believes that the Bureau should emphasize in the Bulletin that any use of crown jewels terms would not be a standard condition of divestiture remedies and that they would be expected only in extraordinary cases where there is significant doubt as to the viability of the asset package.[10]

Conclusion

In any particular case, the Bureau should carefully consider the cumulative impact of the remedies conditions it requires, not only in terms of its objectives to have a viable and effective remedy but also in terms of the costs imposed on the parties and the economy. For instance, concerns about the viability of an asset package can be reduced by more extensive market testing of the asset package. The new policy articulated in the Draft Bulletin to generally prefer to have assets divested only from the target firm also reduces the risk that the assets may not work well together. However, this policy change means less flexibility for the parties and could result in lost efficiencies.

Shorter timeframes – although not commercially unreasonable ones – may be desirable in some cases, but it will be the rare case where both short timeframes and crown jewel provisions are required. Given the small size of Canadian markets and other constraints such as foreign ownership restrictions or the desire to have an auction process, fix-it-first remedies (or upfront buyers provisions) should be rarely required. The Bureau should be selective in the risk shifting provisions it employs in order to ensure that it can obtain its objectives without incurring unnecessary costs to the parties and the economy.

Yours truly,

(Original signed by Tamra Thomson on behalf of Madeleine Renaud)

Madeleine Renaud
Chair, National Competition Law Section

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9 The Draft Bulletin states that "the Bureau may agree to let certain provisions of a negotiated settlement requiring divestitures remain confidential" (emphasis added), and cites examples of the sorts of matters that could be confidential, but does not state when the Bureau would exercise its discretion.

10 The Draft Bulletin should also clarify that the crown jewel must normally be part of the relevant market in which there is a competition concern; it is inappropriate to use as a crown jewel an asset in an unrelated market merely to increase the appeal of the asset package to prospective buyers unless it is required to achieve a viable or effective competitor.