Competition

Law Group

COMPETITION LAW STRATEGY IN M&A DEALS

Merger review has evolved over the past decade and a half from a relatively obscure administrative process into a critical component of transactions involving competitors. Merging parties and other market participants are approaching these issues in an increasingly sophisticated and strategic manner, as can be seen from several recent M&A cases.

Negotiated Transactions

In private M&A deals, vendors and their advisors have refined auction processes to shift leverage away from any one potential purchaser in order to maximize value for the vendor. It is now commonplace for vendors to table a proposed agreement of purchase and sale containing provisions to ensure the transaction is cleared quickly:

- Vendor-friendly conditions precedent may require the purchaser to close after the expiry of statutory waiting periods rather than upon receipt of a no-action letter.

- Cooperation covenants are specifying purchaser obligations along with vendor monitoring / participation rights in greater detail.

- Purchasers are increasingly given tight deadlines to commence – and often complete - merger reviews.

- Significant break-up fees are frequently negotiated to protect the vendor against deterioration in the value of its business when a transaction fails to proceed because of regulatory impediments.

- Vendors now often attempt to get purchasers to agree in advance to remedy any competition law problems that may emerge by offering divestitures or other remedies up to some pre-agreed level (*i.e.*, so-called "hell or high water clauses").

Bidders in a well run auction will be judged in part on their regulatory (*Competition Act*, *Investment Canada Act*, *etc.*) risk profile and the steps they are prepared to take to manage it. Thus, while the foregoing items are all negotiable, bidders have a strong incentive to minimize derogations from such vendor proposals. The auction process also may move bidders' counsel into a bid-advocacy role, with the vendor then typically turning to its regulatory counsel to evaluate the suitors.

Financial bidders have an obvious advantage when compared with strategic bidders who are also significant competitors to the target business. An interesting recent example is Verizon Communication's 2004 sale of its Canadian "SuperPages" business to Bain Capital, a leading private equity house with no competing Canadian business, for approximately C$2 billion. It was reported that Verizon declined a significantly higher financial offer from the other main Canadian competitor, Yellow Pages Group (“**YPG**”) in order to be assured of an expeditious closing of the transaction prior to its year-end. Several months later, after business decisions had reduced competitive overlaps with YPG in eastern Canada, Bain was able to flip the SuperPages business to YPG for approximately C$2.55 billion in a transaction that received clearance without any major difficulty.

While competing bidders normally do not become competition law complainants while an auction is in progress, unsuccessful bidders are a potential source of challenges to negotiated transactions. A notable example is *Ultramar / Coastal Petroleum*, where MacEwen Petroleum (a customer of Coastal’s Ottawa wholesale petroleum products business) was outbid by Ultramar and then spearheaded complaints by independent gasoline marketers which resulted in the Competition Bureau negotiating a complex consent order settlement that was turned down by the Competition Tribunal. Absent MacEwen’s active involvement, the Bureau might not have insisted on a remedy, and the Competition Tribunal likely would not have found it to be inadequate.

UNSOLICITED TRANSACTIONS

Hostile or unsolicited takeover bids raise somewhat different bidder-acquiree dynamics. The offeror will face pressure to minimize uncertainty by avoiding heavy regulatory conditions precedent and long delays. Ideally, this will be supported by front-end loading of competition law analysis and as well as confidential advance contact with the Competition Bureau.

The target will be confronted with a fundamental strategic decision as to whether to invoke competition law arguments as part of a defence strategy. A high profile example is PeopleSoft Incorporated’s attempt to persuade competition law authorities in the U.S. and other jurisdictions to prohibit a take-over bid by Oracle Corporation. This led to a Phase II review in Europe and an injunction suit by the U.S. Department of Justice after the *Hart-Scott-Rodino* second request process was completed. However, the bid ultimately succeeded after Oracle was victorious in the protracted legal proceedings and no competing bidder emerged.

Members of a target’s board of directors or independent committee must exercise their fiduciary duties carefully when contemplating such a strategy. If successful, it can buy valuable time to obtain competing bids that offer shareholders an even higher premium and / or reduced regulatory risk. However, it may also eliminate or reduce the value of a bid that would have provided the highest value to shareholders. Thus, the safer course frequently will be to take a neutral posture on regulatory issues and leave any opposition to alternate bidders.

Competing bidders in a take-over contest will normally compare their regulatory prospects and this may factor into negotiations with the target as well as the offer disclosure documents sent to shareholders. There is no legal impediment to a bidder drawing competition concerns that would arise on an alternate bid to the attention of the Competition Bureau. Indeed, the Bureau welcomes (and often seeks) such interaction. However, it is clear that the Bureau’s role is to assess each transaction separately against the “substantial lessening or prevention of competition” standard in the *Competition Act*, rather than simply picking the transaction it regards as competitively preferable.

In the relatively rare case of two bids by significant competitors, the Bureau could conclude that both were problematic, neither were problematic, or one was problematic and the other was not. The Bureau considered such situations in the bidding for Riverside Forest Products and Microcell Communications in 2004:

- International Forest Products ("**Interfor**") was the white knight that emerged after an unsolicited bid for Riverside from Tolko Industries. The Interfor bid likely raised fewer competition issues, but Interfor was subsequently out-bid by a revised offer from Tolko, who was prepared to close and provide a "hold separate" commitment pending completion of the Bureau's review of the competitive effects of its combination. (The hold separate expired 30 days later, without Tolko and the Bureau agreeing on an appropriate resolution of the case: Tolko has since integrated its operations with Riverside).

- Rogers outbid TELUS to acquire Microcell. The Bureau ultimately cleared the deal after a thorough review and issued a background statement explaining its decision to allow a four-to-three consolidation in the wireless telephony market. However, the Bureau did not disclose anything about its assessment of the TELUS bid (which would also have led to a four-to-three consolidation) and TELUS did not indicate whether regulatory considerations were a factor in the decision not to counter Rogers's bid.

MARKETPLACE COMPLAINTS

Long and detailed merger reviews most frequently occur when the Bureau receives credible complaints from customers, competitors or other market participants (*e.g.*, suppliers, trade unions, *etc.*). However, recent court decisions in the U.S. (*F.T.C. v. Arch Coal* and *D.O.J. v. Oracle)* and in the E.U. (*AirTours, Schneider and Tetra Laval)* have emphasized that customer and competitor concerns cannot be accepted uncritically and that it is important to differentiate facts from opinions. The Competition Tribunal would very likely apply the same standard in adjudicating a contested merger proceeding in Canada. But the Bureau, in its initial investigation review process, will typically attach considerable significance to customer and competitor complaints (at least in the widely-held perception of Bureau practice to date).

Market participants are routinely contacted by Bureau staff to obtain or confirm factual information, and in the course of such interviews Bureau staff will solicit their views on the likely competitive effects of a transaction. However, it is now common practice for market participants with serious concerns to retain counsel (and possibly an expert economist) to make submissions pro-actively to the Bureau and to act as an information resource for Bureau staff as they proceed with the assessment of submissions from the merging parties. This process is somewhat less interactive than, for example, in Europe due to the Bureau's strict confidentiality rules and policies which minimize the Bureau's disclosure of information received from merging parties or complainants. Nevertheless, Bureau staff normally will give merging parties a general sense of issues raised by complainants to allow them a meaningful opportunity to respond.

A recent high profile example of the potential role played by competitors can be seen in Bell Canada's publicly announced opposition to the Manitoba Telecom Services Inc. ("**MTS**") bid for Allstream Inc. In addition to the *Competition Act* arguments, Bell sought injunctive relief based on certain commercial contracts between it and MTS. While the injunction application was denied, Bell and MTS eventually negotiated a large settlement which then rendered moot issues that the Competition Bureau had been examining very carefully.

Interested parties need not be competitors. The Bureau recently cleared the merger of West Fraser Timber and Weldwood of Canada under a consent agreement which required divestiture of certain assets. A third party – Burns Lake Native Development Corporation – claimed an economic interest in some of the divestiture assets and challenged the parties' divestiture arrangement in the Competition Tribunal. The case underscores the importance of considering complaint risks throughout the *Competition Act* process.

Implications for M&A Practice

In this environment of heightened sensitivity to and use of *Competition Act* merger considerations to challenge transactions, regulatory risk assessment should be a fundamental element of strategic decision-making for vendors, targets, bidders and other interested parties. In addition to assessing the *Competition Act* issues on the merits, it is vital for all parties to evaluate the risks that others will attempt to make strategic use of regulatory review processes and to consider the potential consequences of such actions. Parties who pay insufficient attention to the strategic use of the *Competition Act* review process do so at their peril.

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