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Background

On February 1, 2007, Labatt Brewing Company Limited announced its intention to buy all of the outstanding units of Lakeport Brewing Income Fund and thereby acquire the operations of Lakeport Brewing Limited Partnership. Labatt is the second largest brewer in Canada. Lakeport beer is marketed as a lower-priced alternative to other brands of beer.

On February 12, 2007, Labatt and Lakeport filed a "long-form" notification with the Competition Bureau pursuant to the Competition Act's pre-merger notification provisions. The filing of a long-form notification triggers a 42-day waiting period during which the parties to the merger are prohibited from implementing their transaction. Under Canada's merger control system, however, expiry of the 42-day statutory waiting period does not represent substantive clearance. Instead, the Bureau's substantive review runs on a separate and parallel track that is governed by different (and non-binding) timeframes (called "service standard periods"). For example, the Bureau normally takes longer than the 42-day waiting period to review transactions that raise significant competition issues.

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(Bureau guidelines state that such a merger may take up to five months to review, with no guarantee that it may not be longer.)

In this instance, the 42-day waiting period triggered by the parties' long-form filing was set to expire on March 26, 2007. The Bureau advised the parties that it would not complete its review by that date because it believed the transaction raised potentially significant issues (e.g., the Bureau characterized Lakeport as a "maverick" in the market whose removal might prevent or lessen competition substantially). Labatt nevertheless proposed to close the Lakeport acquisition shortly after the expiry of the waiting period. However, Labatt also offered to implement a "hold separate" arrangement that would delay integration of the Lakeport business for 30 days to allow the Bureau more time to complete its review. The Bureau declined to accept this proposal and, on March 22, 2007, filed an application with the Competition Tribunal for a temporary injunction under section 100.

The Tribunal's Decision

In order to obtain relief under section 100, the Bureau must demonstrate that:

(i) it is "on inquiry" (i.e., formally investigating the competitive effects of the proposed transaction);

(ii) it requires more time to complete its review of the transaction; and

(iii) its failure to prevent a party to the merger from taking "an action" (e.g., closing the transaction) would "substantially impair the ability of the Tribunal to remedy the effect of the proposed merger on competition … because the action would be difficult to reverse."

The central issue before the Tribunal was whether allowing the transaction to close would "impair" the Tribunal's ability to remedy the effect on competition post-merger if the Labatt/Lakeport transaction were successfully challenged.

The Bureau argued that, because the Act provides the Tribunal with fewer remedies where a merger has already been completed, permitting the acquisition to close would impair the Tribunal's ability to order an appropriate post-merger remedy. The Bureau also argued that, once a merger has been closed, it is often difficult to achieve an effective remedy after the acquired assets have been integrated into the operations of the acquirer. Labatt and Lakeport responded that there was no evidence to demonstrate that the merger would impair the Tribunal's ability to order dissolution or divestiture, especially given that they had offered to comply with a hold separate arrangement of the type that the Tribunal had endorsed in the past.

Justice Phelan of the Tribunal held that the relevant question to be answered under section 100 was whether allowing the transaction to close would substantially impair the Tribunal's ability to order a post-merger remedy that would "restore competition to the point at which it can no longer be said to be substantially less than it was before the merger." He concluded that the Bureau had failed to adduce sufficient evidence to demonstrate that the Tribunal's remedial authority would be impaired and dismissed the Bureau's application. Significantly, Justice Phelan did not consider it necessary to order that a hold separate arrangement be put in place. Indeed, he held that the Tribunal lacked the jurisdiction to impose a hold separate arrangement under section 100.

As a result, Labatt was permitted to close its acquisition without any restraint on its ability to integrate the two businesses, which it proceeded to do on March 29, 2007.

The Appeal

The Bureau appealed the Tribunal's decision to the Federal Court of Appeal ("FCA" or "the Court"). It argued that Justice Phelan had misinterpreted section 100 by imposing too high an evidentiary burden in order to obtain relief. Essentially, the Bureau claimed that the granting of an interim injunction under section 100 should be virtually automatic unless the merging parties can show that the Bureau's application constitutes an abuse of process.

The Court rejected the Bureau's argument in a decision released on January 22, 2008, stating that "[w]e do not agree that Parliament intended the role of the Tribunal to be so limited." The Court held that Justice Phelan had formulated the applicable legal test correctly, and was reasonable in concluding that the Bureau had not satisfied this test. The Court also elaborated on the types of evidence that would be relevant on a section 100 application to establish the need for an interim order (e.g., an understanding of the nature of the potential lessening of competition allegedly caused by the merger); the kinds of remedies the Bureau might seek; and the potential effectiveness of these remedies with and without an interim order in place.

Implications

When section 100 was amended in 1999, the prevailing view was that the threshold for relief was relatively low. In particular, it was thought that the prospect of post-merger integration ("scrambling the eggs") would be sufficient in most cases for the

Tribunal to hold that the failure to issue an interim injunction would substantially impair its remedial authority. The FCA's decision confirms that this view was incorrect and that the threshold for relief under section 100 is higher than the Bureau would prefer, and indeed more onerous than many in the Canadian competition bar had thought.

In theory, this represents an improvement in the relative bargaining position of merging parties with respect to the Bureau's. In practice, the impact of the decision should not be overstated:

- In the large majority of cases, the Bureau is able to complete its review in a timely fashion. (According to the Bureau, it completes 90 percent of its merger reviews within 10 days of receiving a completed notification filing.) Therefore, the issue in the *Labatt* case arises only in a handful of instances at most.
- It is still rare for the acquiring party to close a transaction knowing that it faces the potential risk of a challenge within three years of closing and the prospect of forced divestitures within a short time frame at fire-sale prices. Labatt had its own particular reasons for pressing to close the Lakeport acquisition in this instance, even in the absence of Bureau clearance; it had apparently lost out on a prior acquisition opportunity because of the time it took the Bureau to complete its review and was not inclined to repeat the experience. That set of circumstances is unlikely to be duplicated often, if at all.
- Where international transactions are concerned, the Canadian part of the merger review is rarely a critical "gating" item, particularly if there are serious issues to be resolved. In those instances, the U.S. and EC reviews usually extend well

beyond the Bureau's review, and closing will not take place in any event until those authorities are on side.

- In cases that raise particularly serious issues, the Bureau may be prepared to proceed straight to a substantive merger challenge, even within the 42-day waiting period, and seek an injunction to prevent closing pursuant to the usual criteria (i.e., determination of a serious issue to be tried, irreparable harm if the injunction is not issued, and balance of convenience).

It also must be recognized that the FCA's decision has not rendered section 100 a "dead letter". It is still open to the Bureau to obtain a temporary injunction provided that it leads the necessary evidence, which it is now more likely to do since its onus of proof has been clarified. Indeed, less than a week after the *Labatt* decision was released, the Bureau applied for a section 100 order in another merger involving scrap metal processors. Although much of the supporting materials were redacted, it is evident from what is on the public record that the Bureau took the FCA's decision to heart and directly addressed the issue of whether allowing the transaction to proceed would impair the effectiveness of the remedies it might subsequently ask the Tribunal to grant.

One possible result of the *Labatt* decision is that the Bureau may now be more willing to entertain the notion of interim hold separate agreements pending completion of its substantive review. The Bureau has publicly stated in the past that it would not normally agree to allow parties to close on the basis of an interim hold separate agreement (and, of course, it rejected that option in *Labatt*). However, this position may soften in light of what is now a tougher burden to obtain a section 100 injunction. As a

possible signal of things to come, the Bureau eventually agreed to an interim hold separate arrangement in the scrap metal processor merger, thus obviating the need to proceed with the section 100 application (although the acquiree was apparently in financial difficulty).

Of course, another possibility is that the Bureau could try to erase any negative consequences stemming from its defeat by seeking amendments to the Act that would either:

(i) give it substantially more time to review transactions; or

(ii) alter the evidentiary threshold under section 100 to make it easier to secure injunctive relief.

The Bureau has responded to other litigation setbacks in the past by proposing legislative amendments and could do so again. Should that happen, the *Labatt* case may turn out to be nothing more than a Pyrrhic victory for merging parties in Canada.