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Canadian Competition Tribunal Orders Divestiture in Waste Merger: Some Lessons Learned

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I. INTRODUCTION

The Canadian Competition Tribunal (the "Tribunal") has issued its first decision in a fully contested application under the merger provisions of the *Competition Act* (the "Act") in over a decade. On May 29, 2012, further to an application by the Commissioner of Competition (the "Commissioner") challenging the acquisition (the "Merger") by CCS Corporation ("CCS") of Complete Environmental Inc. ("Complete"), the owner of a landfill site in northeastern British Columbia known as Babkirk, the Tribunal ordered CCS to divest Complete.[2]

The Commissioner's application raised a number of legal issues, including the threshold and analysis for establishing that a merger has *prevented* future competition, as opposed to lessening existing competition in the marketplace. Importantly, the case also demonstrates the Commissioner's willingness to challenge mergers that are not subject to notification under the Act and that have already been completed. Finally, the case also confirms the Commissioner's readiness to seek the dissolution of a merger as an alternative to divestiture (even though the Tribunal did not grant dissolution in this particular instance). Accordingly, the potential for a post-closing challenge by the Commissioner should be of significance to all parties to a transaction, including vendors, where the transaction may have anticompetitive effects.

II. BACKGROUND

CCS provides energy and environmental waste management services to upstream oil and gas producers in Western Canada. It owned and operated the only two secure landfills for hazardous waste in northeastern British Columbia when it acquired Complete in January 2011. Among its assets, Complete owned land at the Babkirk site and a permit from the B.C. Ministry of the Environment to operate a secure landfill there, although at the time of the acquisition Complete had not begun building a secure landfill at the site.

The Merger fell well below the mandatory pre-merger notification thresholds in Part IX of the Act. However, CCS communicated with the Competition Bureau (the "Bureau") prior to completing the transaction. The Commissioner raised concerns with CCS prior to closing, but no resolution was reached. In an unusual step, the Commissioner then agreed not to object to CCS completing the acquisition, subject to an undertaking from CCS to preserve and maintain all approvals necessary for the operation of a secure landfill at the Babkirk site pending

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[2] *Commissioner of Competition v. CCS Corporation, Complete Environmental Inc., Babkirk Land Services Inc., Karen Louise Baker, Ronald John Baker, Kenneth Scott Watson, Randy John Wolsey, and Thomas Craig Wolsey, available at*: http://www.ct-tc.gc.ca/CasesAffaires/CasesDetails-eng.asp?CaseID=336. The case is on appeal at the Federal Court of Appeal under the name *Tervita Corporation et al. v. Commissioner of Competition et al.*

determination of the Commissioner's challenge to the acquisition. The Commissioner filed an application challenging the merger two weeks after it closed.

In the application, the Commissioner alleged that CCS's acquisition of the Babkirk landfill site would likely result in a substantial prevention of competition in the market for "the disposal of hazardous waste produced largely at oil and gas facilities in northeastern British Columbia." According to the Bureau, the challenged transaction was preventing the entry of a "poised competitor" into the relevant market that would have lowered tipping fees for producers of hazardous waste. Significantly, the Bureau alleged that—based on what it claimed was revealed in CCS's internal documents—CCS sought to acquire the landfill site with the express purpose of preventing such entry and averting a possible "price war."

In addition to naming the relevant corporate parties as respondents, the Commissioner also named as respondents the five individual vendors from whom CCS acquired the shares in Complete. This was in aid of the Commissioner's preference that the Tribunal order dissolution of the merger (i.e., undoing the sale back to the vendors), as opposed to divestiture of the business to an independent competitor. The vendors challenged the Commissioner's chosen remedy in a motion for summary judgment. They argued that divestiture would be the most effective and efficient remedy for any prevention of competition and that dissolution would be intrusive, overly broad, and punitive given, among other things, the merger's transfer of control over significant assets unrelated to the Babkirk landfill site and the Commissioner's agreement not to require any undertaking to preserve those unrelated assets. The Tribunal dismissed the vendors' motion as premature, preferring to weigh the factual evidence at trial before deciding on the relative merits of divestiture or dissolution as an appropriate remedy.

III. THE TRIBUNAL'S DECISION

A. Substantial Prevention of Competition

The Tribunal found a likely substantial prevention of competition in a small market for the disposal of hazardous waste by oil and gas companies in a relatively small area within North East British Columbia. In essence, the Tribunal accepted the Commissioner's argument that in acquiring Complete, CCS removed its only potential competitor in that market.

While the Tribunal acknowledged Complete's business plan to use the Babkirk property for a different use (bioremediation of hazardous waste) that did not compete closely with the product supplied by CCS, the Tribunal was willing to second guess that plan and determine that the vendors likely would have failed in the bioremediation business after approximately one year, following which they would have operated the site as a full service secure landfill for hazardous waste. In particular, by the spring of 2013 (i.e., a little more than two years after the challenged January 2011 merger), the vendors likely would have then operated a secure landfill for hazardous waste or have sold the Babkirk property to someone who would have done so. (The Tribunal determined that, by the time of the hearing, subsequent events led another firm in the secure landfill business to be a likely purchaser of the Babkirk property.)

Given that, pre-Merger, CCS was the only operator of secure landfills for the disposal of hazardous waste in the relevant market, the Tribunal considered even a small impact on competition resulting from new competition from the Babkirk property to be "substantial." The Tribunal clarified that the assessment of whether a merger is likely to prevent competition substantially for the purposes of the merger provisions of the Competition Act focuses on whether the new entry or increased competition that would be prevented by the merger would be sufficiently timely and occur on a sufficient scale to result in a material reduction in prices (or a material increase in non-price competition) relative to prevailing levels in a significant part of the relevant market for a period of approximately two years. The Tribunal rejected CCS's arguments that barriers to entry into the full service secure landfill business were low, finding that it would take a new entrant at least 30 months to enter.

B. Efficiencies

CCS argued that the Commissioner had failed to meet the burden of quantifying the anticompetitive effects of the merger so that any relevant efficiencies established by CCS would invoke the application of the efficiencies defense in section 96 of the Act. In rejecting the efficiencies defense, the Tribunal essentially concluded that the Merger would have preserved a monopoly, resulting in various quantifiable and qualitative anticompetitive effects that were not offset by the efficiency gains. In particular, the Tribunal found that most of the claimed efficiencies were not merger-specific—i.e., they would still be achieved irrespective of whether a remedy was ordered.

C. Remedy

The Commissioner had requested an order dissolving the Merger or, alternatively, requiring CCS to divest itself of the relevant business to a purchaser approved by the Commissioner. The respondents, and particularly the vendors, were strongly opposed to dissolution.

The Tribunal ordered divestiture. In declining to order dissolution, the Tribunal was concerned that dissolution may not lead to a prompt sale and a timely opening of the Babkirk facility as a secure landfill. The Commissioner argued that the vendors would be forced to re-sell the Babkirk site quickly because, given their current financial situations, they would be highly motivated to recover their funds from the sale as quickly as possible. The Tribunal questioned this analysis, pointing out that CCS had indemnified the vendors against all claims arising from the Bureau investigation and the Commissioner had no right of approval over a new sale by the vendors, as would exist in respect of a sale by CCS pursuant to a Tribunal divestiture order. In addition, the Tribunal noted that dissolution was overbroad since it would involve other businesses of Complete that were not part of the relevant secure landfill market.

IV. OBSERVATIONS

Overall, much of the decision is sound. Notwithstanding that the Tribunal took the opportunity to expound on a number of jurisprudential points, the crux of the decision is straightforward. The case is very similar the Bureau's last (and only fully successful) merger challenge, which also involved a landfill site. The Bureau advanced similar arguments and used the same key expert in both cases.

The following are a few noteworthy aspects of the CCS decision.

A. Abuse of Dominance Focus

While this was a merger case, it is apparent that the Tribunal viewed this as much as a case about a monopolist engaging in conduct to preserve its monopoly. There was even a threshold question of whether this case was properly regarded as a merger, given the nascent state of the "business" being acquired by CCS, although ultimately the Tribunal concluded that the transaction was a "merger."

More fundamentally, the Tribunal made several references to abuse of dominance type analysis. Notably, the Tribunal's "but for" analysis at the heart of the "substantial prevention of competition" discussion refers to two abuse of dominance cases—*Canada Pipe*[3] and *Tele-Direct*.[4] In particular, the Tribunal quoted *Tele-Direct* for the proposition that where there is a high degree of pre-existing market power, small impacts on competition will be considered "substantial."

B. Minimal Reference to the Merger Enforcement Guidelines

This is the only contested merger case since the Bureau published both the 2004 and 2011 versions of the Merger Enforcement Guidelines ("MEGs").[5] Both publications were issued following extensive public consultation and with some profile. Indeed, the MEGs are widely regarded as among the most developed guidelines published by the Bureau. It is perhaps surprising therefore that there are only three references in the entire CCS decision to the MEGs (and one of those is based on the *Propane*[6] case). This contrasts markedly with prior merger decisions, such as the *Propane* case, where the MEGs were cited extensively. That is not to suggest that the Tribunal disagreed here with the MEGs. The scant references are supportive of the MEGs. Nonetheless, it raises the question of how much emphasis to put on the MEGs in future submissions to the Bureau or before the Tribunal.

For example, a key issue debated in the context of the development of the 2011 MEGs (and, more so, the 2010 US Horizontal Merger Guidelines) was the extent to which competitive effects may be directly measured, without necessarily having recourse to market definition. While the market definition analysis in the CCS decision appears relatively straightforward, it is noted that the Tribunal actually appears to put significant weight on a "natural experiment" (the effect on prices in Alberta of entry of a competitor to CCS) that provided direct evidence of market power/effects:

> the "natural experiment" that occurred when SES opened its facility in Willesden Green Alberta, and CCS subsequently reduced its Tipping Fees to seven of its significant customers, strongly suggests that CCS' pricing behaviour is primarily determined by reference to the location of competing suppliers of Secure Landfill services, rather than by competition with suppliers of bioremediations services.

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[3] *Commissioner of Competition v. Canada Pipe Company Ltd.*, 2006 FCA 233.

[4] *Director of Investigation and Research v. Tele-Direct (Publications) Inc.* (1997), 73 C.P.R. (3d) 1.

[5] The current 2011 MEGs are *available at*: http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/vwapj/cb-meg-2011-e.pdf/$FILE/cb-meg-2011-e.pdf. The predecessor 2004 MEGs are *available at*: http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/01245.html.

[6] *Commissioner of Competition v. Superior Propane*, 2000 Comp. Trib. 15, 7 C.P.R. (4th) 385 (Comp. Trib.); rev'd 2001 FCA 104, [2001] 3 F.C. 185, leave to appeal to SCC refused, 28593 (September 13, 2001); *Commissioner of Competition v. Superior Propane Inc.*, 2002 Comp. Trib. 16, 18 C.P.R. (4th) 417, aff'd 2003 FCA 53, [2003] 3 F.C. 529.

C. Efficiencies

The discussion of efficiencies is practically sound in its outcome in this case, but confusing insofar as it purports to provide guidance going forward. Also, it is doubtful that a "prevention" case provides the best blueprint for assessing efficiencies.

On the positive front, the Tribunal clarifies that the wealth transfer from consumers to producers will be neutral in most cases, meaning that the complex "balancing weights" approach from *Propane* will usually be avoided. In addition, the Tribunal provides a number of useful screens to filter out efficiencies that do not count, such as where efficiencies would likely emerge irrespective of the remedial order.

However, the Tribunal also offers some comments on efficiencies that may raise more questions than answers. For example, the Tribunal refers to the need to provide estimates of both market elasticity as well as own-price elasticity of demand for the merged entity. However, the basic premise for market definition is that usually it is only market, not firm-specific own-price, elasticity that can be meaningfully estimated. (Recall that the "naïve" trade-off model used in some s.96 discussions avoids this real world complication by assuming merger to monopoly such that the demand elasticities for the merged firm and the market are one and the same. Similarly, this complication was avoided in this case given that the Tribunal found the merger to be preserving a monopoly.) A merged firm's own price elasticity may be more difficult to estimate in situations other than merger to monopoly.

The overriding tone of the efficiencies discussion is skewed by the recognition that the CCS merger "will maintain a monopolistic structure.” This seems to create a willingness to count (or implicitly recognize) all kinds of anticompetitive "effects,” without any clear sense of how their magnitude is measured or how this approach would play out in a case where efficiencies are more significant. For example, there is acknowledgement that dynamic efficiencies "can have a major impact on the trade-off assessment,” but no practical guidance on how they will be factored into the analysis.

More generally, the redactions and absence of numbers in the CCS decision make the efficiencies analysis difficult to follow (contrast this to the *Propane* case, where many amounts in the trade-off calculation were set out). For example, the single most important determinant of deadweight loss here is pre-existing market power, particularly given that the Tribunal considers CCS to have a monopoly. However, the discussion of "areas under the demand curve" and a "right triangle" are confusing and give no actual insight into how pre-existing market power was assessed in this case.

V. SIX PRACTICAL LESSONS

Despite the small size of the CCS/Complete transaction, some of the broad principles that emerge from the Tribunal's decision may have significant implications for merger review in the future. In particular, merging parties may be less inclined to rely on certain considerations that have traditionally provided comfort (e.g., small size, lack of customer concern, evidence of parties' plans). Here are six key take-aways from the Tribunal's decision:

A. Size Does Not Matter

This case makes it abundantly clear that the Commissioner is prepared to challenge mergers of any size, no matter how small. This is consistent with a trend in the United States to challenge mergers (often completed) that are below notification thresholds.

Indeed, the Merger was far below notification thresholds under the Act (which include that the target must have more than $77 million in assets in Canada or revenues from such assets). The transaction in this case was valued at only $6.1 million, plus repayment of certain outstanding loans. Moreover, CCS ascribed only 60 percent of the overall purchase price to the Babkirk site.

B. It May Not Matter That the Merging Parties Have Never Competed

This case signals that even where there is no existing competition between merging parties, the Commissioner may still challenge a merger purely based on the more speculative concern of loss of potential future competition.

Notably, this is the first pure prevention of competition merger case challenged by the Commissioner. Some prior merger cases have had a prevention component; however, it has usually not been material to the outcome. For example, in the *Seaspan*[7] case, there was a significant prevention allegation, but the case was ultimately settled with the remedy focussing on existing competitive overlap. The *Propane* case included a prevention aspect in Atlantic Canada, but the case was decided based on the competition analysis (including efficiency considerations) relating to the rest of Canada.

C. Lack of Customer Concern May Not Matter

The Tribunal acknowledged the lack of customer concern in this case, but held that the absence of such concern did not preclude that there could be adverse consequences to competition or "a very real and credible threat of future rivalry."

The lack of focus on customer complaints is no doubt partly a function of this being a "prevention" case and customers never having experienced Complete as a competitor in the marketplace. That said, the Tribunal's almost complete disregard for the apparent lack of customer complaints is somewhat troubling. Bureau merger reviews (including as contemplated in the MEGs) have traditionally given important weight to customer views. Similarly, competition counsel have often relied on anticipated expectations of customer reactions as an important consideration in assessing whether the Bureau is likely to oppose a merger.

The prospect of challenging a merger where customers are not complaining raises legitimate questions about how far the Bureau should substitute its views for the views of those most directly affected.

D. The Business Plans of Merging Parties May Not Matter

Interestingly, the Tribunal accepted the vendors' claim that they had no intention of operating a secure landfill in competition with CCS.

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[7] *Director of Investigation and Research v. Dennis Washington* (1996), *available at*: http://www.ct-tc.gc.ca/CasesAffaires/CasesDetails-eng.asp?CaseID=192.

Nonetheless, the Tribunal accepted the Bureau's position that the vendors' planned business model (bioremediation, with landfill as "incidental") would fail, and then the vendors would either operate the Babkirk site as a full secure landfill or sell it to someone who would.

This willingness to substitute the judgment of the Bureau and Tribunal for that of the vendors calls into question the more normal process of focussing on evidence of parties' intents (such as internal documents) as important components of the competition analysis.

E. Vendors in Completed Mergers are Not Out of the Woods

While the Tribunal appropriately declined to grant dissolution in this case, one would hope as a practical matter that dissolution will always be viewed as only a last resort. However, the Tribunal could have been much more definitive in issuing a stronger statement to that effect, such as based on the Supreme Court's decision in *Southam*[8] that held that a remedy under the Act need not re-create the pre-merger competitive landscape, but should only go as far as necessary to eliminate the "substantiality" of the alleged lessening or prevention of competition. The ultimate awarding of partial costs of the vendors against the Commissioner in this case is helpful, but is unlikely to be a significant deterrent on the Commissioner seeking dissolution and keeping vendors in the proceedings.

At a minimum, vendors in completed mergers that are challenged should expect that they will be made parties to the litigation (unless they can escape jurisdiction based on no connection to Canada). As noted above, the vendors' attempt in this case to be let out of the proceedings at a preliminary stage was unsuccessful.

F. Efficiencies Analysis May Lead to Increased Informational Requirements

Although the Tribunal took the opportunity to expound on the efficiencies defense, the many redactions and the lack of actual figures or indications how various anticompetitive effects were taken into account limit the practical guidance on how to assess efficiencies claims. What appears clearer from the decision is that efficiencies will rarely justify a merger that creates or preserves a monopoly.

The Tribunal indicates that both the Commissioner and the merging parties will have to present a substantial amount of evidence to assess efficiencies claims. One practical consequence is that this may lead the Bureau to request considerable amounts of efficiency-related documents in supplementary (or voluntary) information requests. This may prove unfortunate and unnecessary in many cases, given that efficiencies have rarely been relevant in the Bureau's decision of whether to challenge a merger.

[8] *Canada (Director of Investigation and Research) v. Southam Inc.,* [1997] 1 S.C.R. 748.