# Chemicals Industry

## and Competition Law in Canada

Blakes

# The chemicals industry, from manufacturing to distribution and retail, is a critical part of the Canadian economy,

producing products used throughout the value chain in a wide variety of industries as inputs for other production processes and as end products. Many features of the chemicals industry can raise unique competition law issues.

# 5 Things You Need to Know

1. Canada's *Competition Act* applies to the chemicals industry in Canada, including mergers and other business practices that impact competition in Canada.

2. Canada's Competition Bureau, which administers and enforces the *Competition Act*, has reviewed over 60 mergers in the chemicals industry since 2012 and entered into consent agreements requiring divestitures for at least five of these mergers.

3. Higher fixed costs of production at many chemical facilities can create incentives to operate plants at high utilization rates, which makes capacity utilization an important consideration.

4. The ability to ship products significant distances can impact how broadly or narrowly competition authorities consider a geographic market. Since chemical products are often sold globally to recover the fixed costs of production, remedies in one jurisdiction may also solve or mitigate competition concerns in other jurisdictions.

5. The significant efficiencies that can be generated by mergers in the chemicals industry may lead to the clearance of mergers in Canada that may face significant obstacles in other jurisdictions.

# Competition Law Enforcement Framework

Like many developed economies, Canada has a competition law of general application called the *Competition Act* (Act). The purpose of the Act is, among other things, to "maintain and encourage competition in Canada in order to promote the efficiency and adaptability of the Canadian economy … and in order to provide consumers with competitive prices and product choices."

The Act contains numerous provisions potentially relevant to participants in Canada's chemicals industry, including civil provisions relating to mergers and abuse of dominance and criminal prohibitions against certain types of agreements among competitors (cartels). The Act is administered and enforced by the Commissioner of Competition (Commissioner), the head of Canada's Competition Bureau (Bureau). The Act requires that mergers exceeding certain thresholds be reported to the Bureau for review. The Act also permits the Bureau to apply for court orders to produce data and documents, interview company executives and search property. However, the Bureau is not permitted to take action in respect of competitive conduct administratively or unilaterally. Instead, the Bureau must present its concerns to a specialized court, the Competition Tribunal (Tribunal) or a criminal court (as the case may be), which will ultimately decide the issue. Alternatively, the Bureau or the PPSC may enter into settlements that resolve the Bureau's concerns.

# Merger Review

Canada's framework for merger review has similarities to other jurisdictions but also contains the following unique elements:

## Notification Thresholds

The Act establishes various thresholds that, if exceeded, require that merging parties notify the Bureau of their transaction. The financial thresholds test the book value of the merging parties' assets and revenues in Canada. Mergers in the chemicals industry will often exceed these thresholds given that many chemicals companies have large operations to take advantage of economies of scale. Moreover, the Bureau retains jurisdiction to review all mergers, including those that do not exceed the notification thresholds and are increasingly monitoring and taking action with respect to non-notifiable mergers.

## Waiting Periods

The Bureau must be notified of mergers that exceed these financial thresholds, prior to closing. Closing is prohibited until 30 calendar days after the notification. In addition, the Bureau can extend this waiting period by issuing a supplementary information request (SIR), which is similar to a second request under the United States *Hart-Scott-Rodino Act*. The issuance of an SIR extends the waiting period until 30 calendar days after the merging parties have submitted information responsive to the requests in the SIR. Reviews of mergers where SIRs are issued can take between four to six months or longer if remedies are required.

## Substantive Review

Regardless of whether the transaction meets the notification thresholds, the Bureau will assess whether a merger is likely to prevent or lessen competition substantially. This occurs only where a merger is likely to create, maintain or enhance the ability of the merged entity, unilaterally or in coordination with other firms, to exercise market power. Among other things, the Bureau will consider the likely price effects of a merger, as well as impacts on product quality. Other key assessment factors the Bureau will consider include the parties' combined market shares, the degree of market concentration, barriers to entry/expansion, demand-side considerations (including buyer power) and regulatory oversight that will constrain any exercise of market power by the merged parties.

## Efficiencies

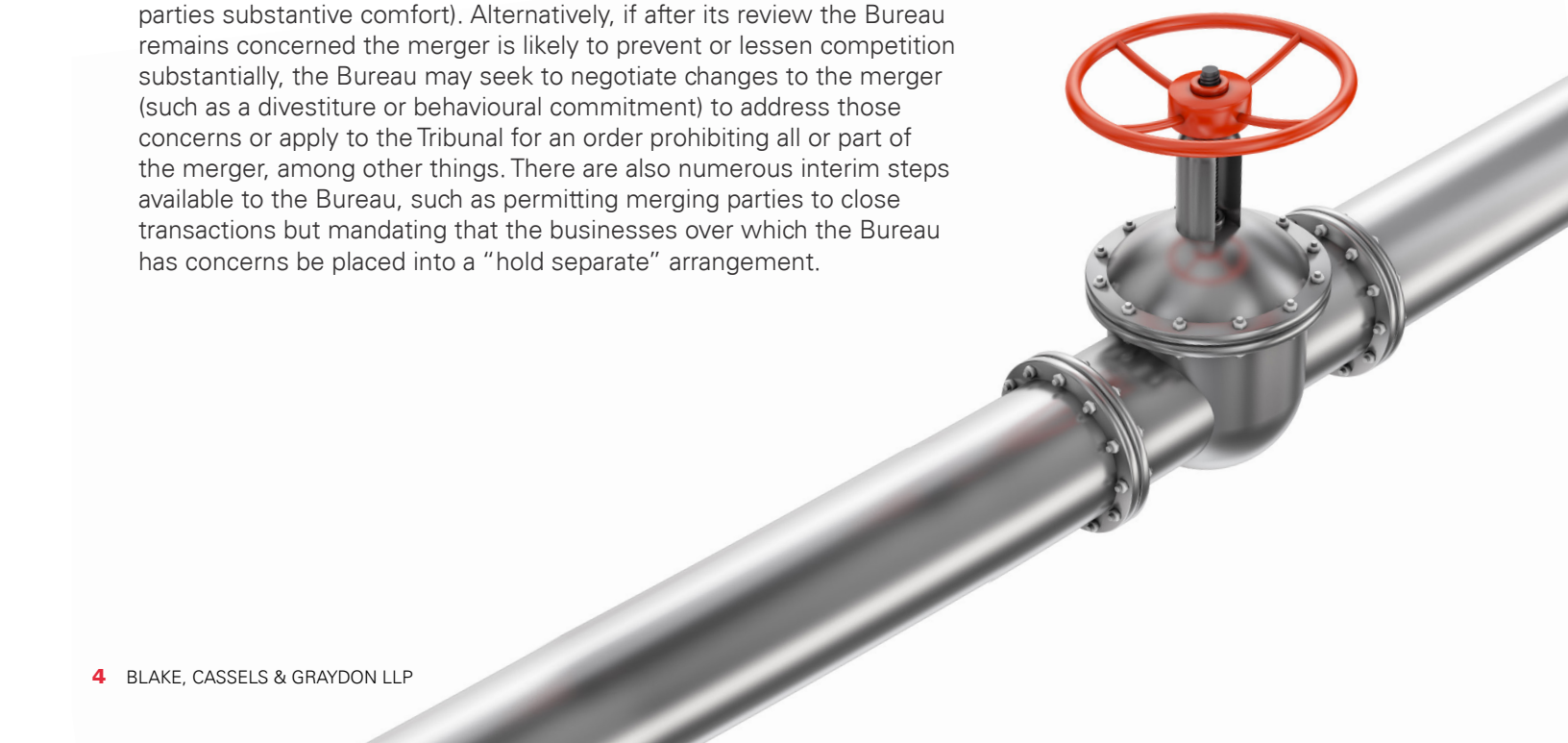
The Act includes an express efficiencies defence that enables even mergers that are likely to prevent or lessen competition substantially to proceed so long as the efficiency gains from the mergers offset the anticipated anticompetitive effects (including effects on low income consumers in certain circumstances). This defence takes account of fixed-cost savings and dynamic efficiencies, not just variable cost savings. This defence may result in mergers being cleared in Canada with no remedies, or only limited remedies, as compared to other jurisdictions where no similar defence exists.

Mergers involving chemical manufacturers may include significant efficiency gains arising from production optimization, freight and logistics optimization, and corporate overhead savings. Moreover, many sales of chemical products are business-to-business and not business-to-consumer, making it unlikely that wealth transfers from low-income consumers to shareholders will count against merging parties under the efficiencies trade-off analysis.

The Canadian Competition Bureau cleared a merger in the chemicals industry in 2016 based on the significant efficiencies generated by the merger. In reviewing this transaction, the Bureau considered efficiencies arising from freight optimization and the elimination of overhead costs and duplicate corporate services. Although the Bureau found that the merger would result in a substantial lessening of competition, it also concluded that these efficiencies outweighed any potential anti-competitive effects. This was the first time that the Bureau has ever publicly cleared a merger solely on efficiencies, and Blakes represented the purchaser in connection with the Canadian competition review of this transaction.

## Resolution

Following its substantive review, the Bureau may issue a letter confirming it will take "no action" in respect of a merger (which gives the parties substantive comfort). Alternatively, if after its review the Bureau remains concerned the merger is likely to prevent or lessen competition substantially, the Bureau may seek to negotiate changes to the merger (such as a divestiture or behavioural commitment) to address those concerns or apply to the Tribunal for an order prohibiting all or part of the merger, among other things. There are also numerous interim steps available to the Bureau, such as permitting merging parties to close transactions but mandating that the businesses over which the Bureau has concerns be placed into a "hold separate" arrangement.



# Recent Trends in Merger Review

Mergers in the chemicals industry have been an area of active enforcement for the Bureau, and the Bureau is expected to continue to apply close scrutiny to chemicals-industry mergers in the future.

Recent trends in chemicals-industry merger review in Canada include the following:

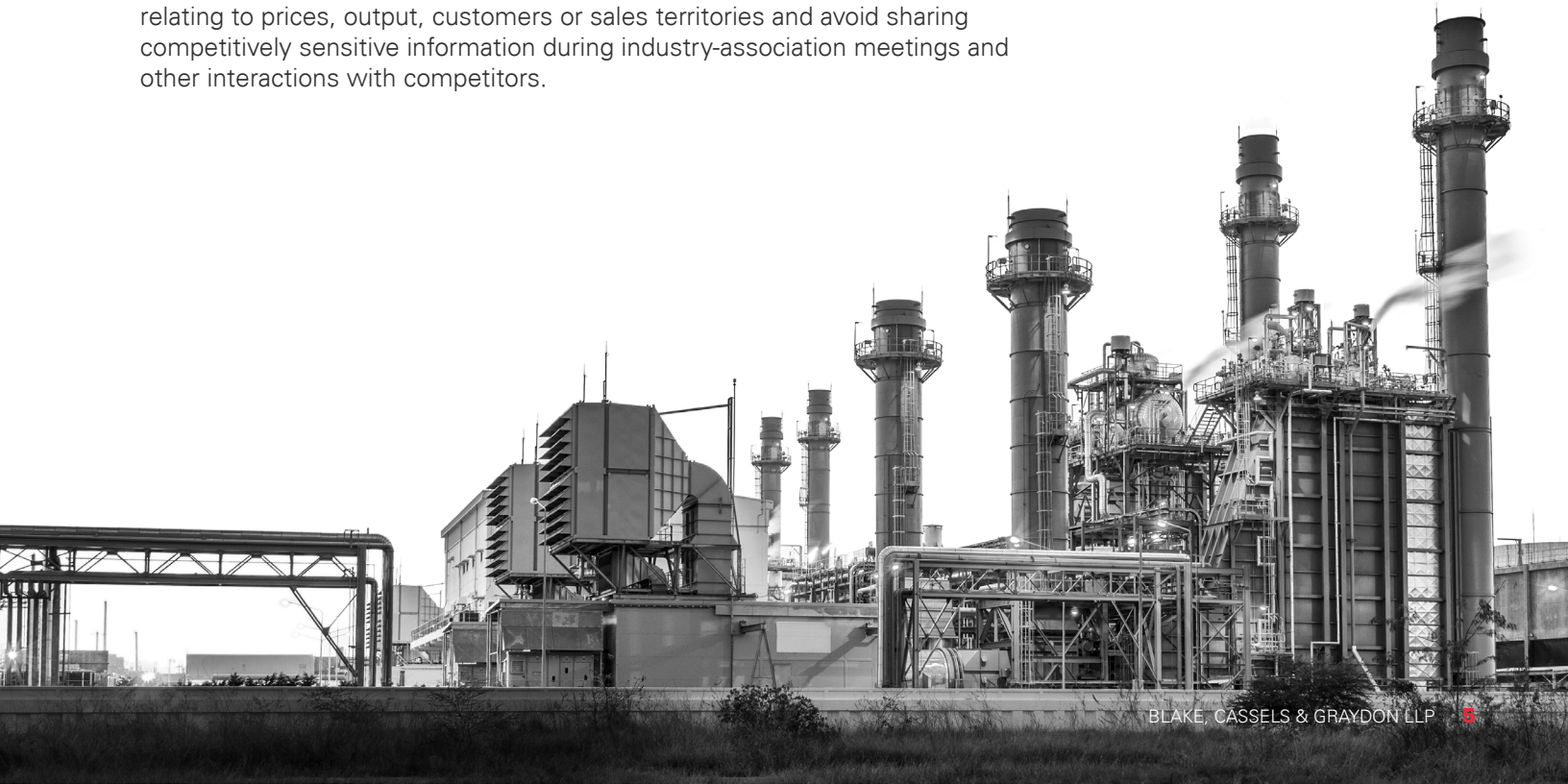
## Market Definition

The competitive analysis in chemical mergers is often highly dependent on the definition of the relevant markets in which the merging parties compete. The Bureau's general approach is to define markets for the purpose of assessing a merger's competitive effect by identifying the set of products that are substitutes from a demand perspective.

Product markets in chemical mergers are often easier to define than geographic markets. As a result, determining geographic markets is critical to assessing potential overlaps between merging parties and their competitors. Key evidence considered in this regard includes sales data and the content of parties' internal documents.

## Concerns About Industry Consolidation and Coordination

When reviewing mergers, the Bureau considers the potential for the merger to result in both unilateral and coordinated effects. Coordinated-effects concerns are further heightened whenever there is a history of past coordination between competitors in an industry. Parties should, therefore, be very careful to avoid entering into any agreements or arrangements with competitors relating to prices, output, customers or sales territories and avoid sharing competitively sensitive information during industry-association meetings and other interactions with competitors.



## Coordinating Processes and Remedies Across Jurisdictions

Chemicals-industry mergers reviewed under the Act often involve global companies with significant assets or sales in Canada. These mergers are typically also subject to review in other jurisdictions, including the United States and the European Union. This requires coordination by competition lawyers to ensure that submissions made in one jurisdiction are consistent with the submissions made in other jurisdictions.

In such cases, the Bureau will coordinate with agencies in these other jurisdictions and may request that waivers be provided to those agencies to permit the exchange of the merging parties' confidential information (the Bureau takes the position that it does not require a waiver under Canadian law). In addition, the Bureau has issued guidance outlining best practices on cooperation in cross-border merger investigations that calls for, among other things, coordination on timing and outcome of cross-border mergers reviewed by these agencies.

Remedies offered in order to solve competition concerns in one jurisdiction (such as the divesture of manufacturing facilities) may also mitigate concerns in other jurisdictions because chemical companies frequently market their products in multiple jurisdictions in order to recover the high fixed costs of production. This often results in parties proposing the same remedies in Canada that they propose to other agencies. Where such remedies satisfy the agencies, the Bureau has taken different approaches. In some cases, it has required a consent agreement that is substantively identical to remedies imposed upon the merging parties in other jurisdictions. In other cases, it has simply concluded its review, noting that remedies imposed upon the parties in other jurisdictions are sufficient to address its concerns. The approach the Bureau takes when remedies are coordinated across jurisdictions depends on the facts of the case, such as whether assets to be divested are located in Canada or when enforcement of the remedy necessitates the formalities of a consent agreement.

## Document Management and Privilege

The Bureau often looks to the merging parties' internal documents to learn how the parties view competitive dynamics in the chemicals industry. Internal documents can be a critical piece of evidence used in assessing the competitive impact of mergers. Competition compliance training is a simple and effective way to limit the creation of documents that may be misunderstood or inaccurate.

Documents prepared for or by legal counsel in the course of regulatory due diligence and preparation of regulatory filings are privileged. In order to avoid an inadvertent waiver of privilege, policies should be put in place to facilitate the quick and accurate identification of privileged documents, including marking all documents prepared for or by legal counsel as "PRIVILEGED & CONFIDENTIAL."

# Non-Merger Business Practices

The Act contains numerous provisions regarding non-merger business practices that are potentially relevant to chemicals industry participants. These include:

## Criminal Offences for Price-Fixing and Bid-Rigging

It is a criminal offence to, among other things, enter into an agreement with a competitor or potential competitor with respect to price, customers, output or capacity, or to submit a bid (or refrain from submitting a bid) in response to a call for tender that was arrived at through an agreement with another person without providing notice of such agreement. These offences are punishable by significant fines and, for individuals, jail terms. Private parties can also sue for damages for violations of the criminal prohibitions and these suits can be brought as class actions. Recent cases in Canada have significantly lowered the bar to class certification and damages sought are on the increase.

## Civil Prohibitions on Abuse of Dominance

Business practices that constitute an abuse of dominance can be prohibited by the Tribunal and may be subject to an administrative monetary penalty. Abuse of dominance occurs where a firm with market power engages in conduct which excludes or otherwise harms a competitior absent a legitimate business justification for the practice and the practice prevents or lessens competition substantially.

## Civil Prohibition on Illegal Agreements

Agreements among competitors or potential competitors that prevent or lessen competition substantially can be prohibited by the Tribunal. No other sanction (such as a fine) is available for such agreements. The Bureau has issued guidance explaining that it will use this provision to investigate agreements that do not rise to the level of the "naked constraints" targeted by the criminal agencies but which nevertheless have an anti-competitive effect. However, any agreement that results in efficiencies (including fixed-cost savings) that outweigh and offset the anti-competitive effects cannot be prohibited.

## Distribution Matters

The The Act contains various provisions that permit the prohibition of different business practices relating to the distribution of products where those practices have different levels of anti-competitive effects. While private parties can seek the same orders, with leave of the Tribunal, there are no sanctions (such as a fine) for these distribution practices and private parties cannot sue for damages for those practices under the Act.

In the chemicals industry, manufacturers often enter into agreements with distributors who transport and sell their products to customers. Provisions in the Act relating to resale price maintenance, exclusive dealing or market restrictions may apply to certain clauses in distribution agreements if they are likely to lead to adverse effects on competition.

# Recent Trends in Enforcement

Practices in the chemicals industry have been an area of periodic attention from the Bureau, with a focus on ensuring that Canadians obtain the benefits of competition and innovation that come from this sector.

Recent trends in enforcement in the chemicals industry in Canada include:

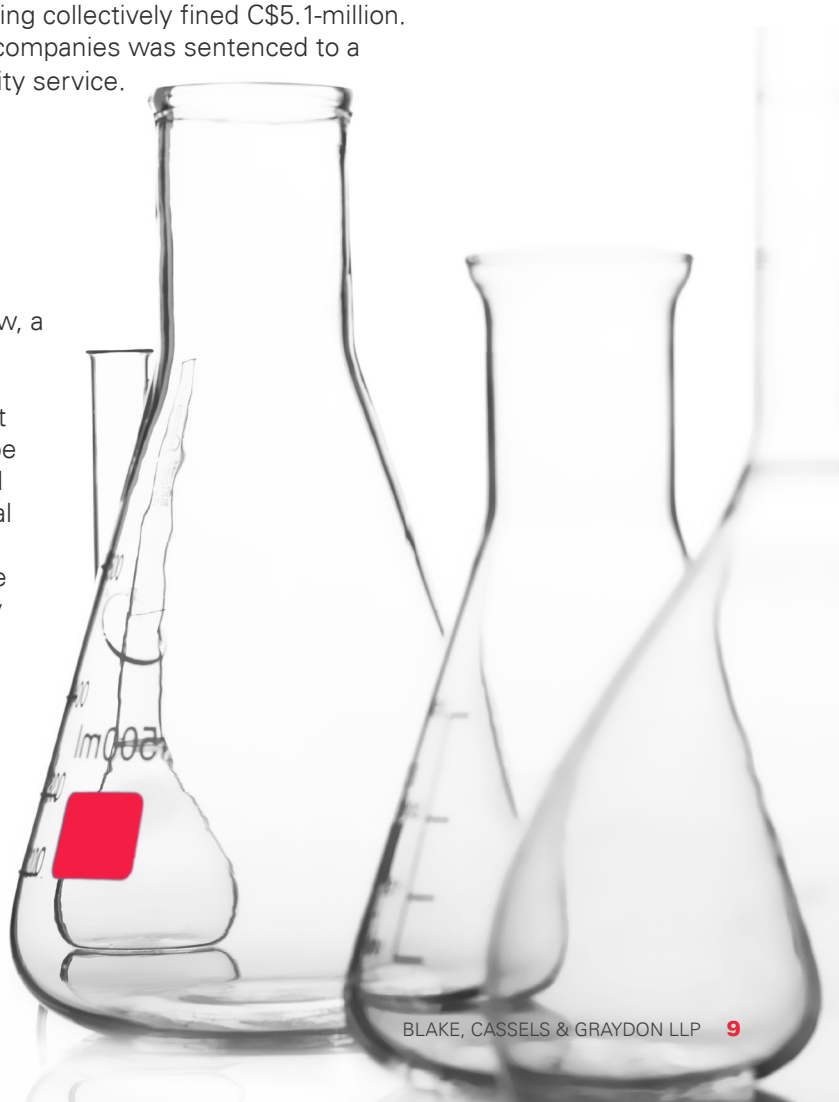
## Cartel Enforcement

Chemical companies have faced investigations and fines for alleged criminal activity in Canada and around the world. Penalties for price-fixing and bid-rigging can be significant and potentially result in fines and/or prison sentences. For example:

- Chemical company was fined C$2.5-million after pleading guilty to criminal charges for conspiring with competitors to fix the price of hydrogen peroxide sold in Canada.
- The Bureau fined a chemical company C$3.3-million for participating in two international price-fixing cartels in the rubber-chemicals market.
- International conspiracies regarding choline chloride, monochloroacetic acid and monochloroacetate resulted in four companies being collectively fined C$5.1-million. In addition, a former vice-president of one of the companies was sentenced to a nine-month prison term and 50 hours of community service.

## Importance of a Compliance Program

The Bureau will now take into account the presence of a corporate compliance program when making a recommendation to the Public Prosecution Service of Canada regarding a criminal matter. In the Bureau's view, a compliance program must be credible and effective. A compliance program is considered credible if, at minimum, it demonstrates the company's commitment to conducting business in conformity with the Act. To be effective, a compliance program needs to motivate and inform all those acting for the company about their legal duties, the need for compliance with internal policies and procedures, the potential costs of contravening the acts and the harm to the Canadian economy caused by contraventions of the acts.



# Conclusion

Participants in the chemicals industry in Canada face myriad commercial legal and regulatory challenges daily. Part of this environment is Canada's *Competition Act*, a law of general application whose operation should be considered whenever strategic decisions are made.

Careful planning and management can help minimize the burden associated with compliance with Canada's *Competition Act* and help participants in the chemicals industry in Canada succeed.

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