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Canadian Commissioner of Competition Challenges Acquisition of Specialized Software Business

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The Commissioner of Competition recently filed a notice of application with the Canadian Competition Tribunal challenging the acquisition of a Canadian software company that closed on May 13, 2019. The Commissioner claims that the acquisition has resulted in a merger to monopoly for the development, service and supply of business critical reserve reporting and valuation software (reserves software) for medium and large oil and gas producers (producers) in Canada by combining under common private equity ownership the two principal software firms serving this alleged market.

The Commissioner's application is notable for a number of reasons, including the following:

- It is the first contested merger challenge filed with the Tribunal since the Commissioner sought to block the proposed acquisition of Office Depot Inc. by Staples Inc. in December 2015 and aligns with the new Commissioner's recently stated intention to make aggressive use of the enforcement tools available under the *Competition Act* (see Davies' bulletin on the Commissioner's enforcement plans).
- The application relates to a relatively small transaction (and market) that appears not to have been subject to mandatory pre-merger notification in Canada. (While prior Commissioners have challenged a number of small market non-notifiable mergers in the past, the new Commissioner recently announced the creation of a Merger Intelligence Unit dedicated to monitoring for unreported mergers that may raise competition issues in Canada.)
- The filing of the Commissioner's application within approximately four months of the announcement of the challenged acquisition and within one month of the closing may demonstrate the speed with which the Commissioner can move to intervene; however, it is unclear when the Commissioner became aware of the matter and, according to materials posted to the Tribunal's website, the Commissioner has apparently not filed an application for interim relief (e.g., for a hold separate and preservation arrangement) or requested an expedited hearing on the merits of the challenge at this time.
- The alleged market concerns software platforms, which aligns with the Commissioner's stated focus on digital markets and innovation, and this is the first contested merger case in Canada to focus squarely on the technology sector.

The Commissioner's Allegations

According to the Commissioner's notice of application, the acquisition by U.S. private equity firm Thoma Bravo, LLC, of 3ES Innovation Inc., carrying on business as Aucerna, is likely to result in a substantial lessening of competition in the market for reserves software for producers in Canada with wells of varying characteristics. In particular, the Commissioner alleges that the transaction brings under common control Aucerna and Thoma Bravo's wholly owned subsidiary, Quorum Business Solutions, Inc. (Quorum), the two principal suppliers of reserves software to producers in Canada. The Commissioner further alleges that Aucerna's Value Navigator product (ValNav) and Quorum's Entero MOSAIC product each constitute approximately 50% of reserves software sales to producers in Canada, making the transaction an effective merger to monopoly.

According to the Commissioner, MOSAIC and ValNav were built and developed in Canada for the Canadian market, and other international reserves software competitors, such as Schlumberger's Merak PEEP and Halliburton's ARIES products, are not sufficiently

adapted to the needs of Canadian producers. In this regard, the Commissioner highlights in his notice of application the unique features of reserves software required by producers in Canada, including tailored information needed to

- make payments to federal, provincial and territorial governments in respect of taxes, royalties and other payment obligations, including under benefit agreements with Canada's Indigenous groups, based on formulas that are unique to Canada; and
- report proved and probable reserves in accordance with distinct standards of disclosure for oil and gas activities – established by Canadian Securities Administrators and enforced by provincial and territorial securities regulators – for those producers whose stock is traded on a Canadian public exchange.

The Commissioner alleges that the transaction is likely to result in increased prices or lower quality of services and reduced innovation and product quality enhancement through decreased incentives to invest in research and development. The Commissioner claims that these results flow from

- the absence of remaining foreign or other competition to MOSAIC and ValNav by other reserves software providers, suppliers of general business and oil and gas software, or third party consultants (who also use MOSAIC and ValNav);
- high barriers to entry into the supply of reserves software in Canada, including the time and cost of accounting for features specific to the Canadian regulatory landscape, the small size (tens of millions of dollars) of the Canadian market, and limited customer switching; and
- the removal of vigorous competition between MOSAIC and ValNav on price, service and particularly innovation.

Although it appears that MOSAIC's and ValNav's customers are likely mostly composed of sophisticated oil and gas companies, the Commissioner presumably concluded that such customers do not have sufficient countervailing power to avoid the alleged anticompetitive effects, for example by encouraging new entry.

The Commissioner also states in his notice of application that Thoma Bravo has not identified any efficiencies resulting from the acquisition. However, this does not preclude Thoma Bravo from asserting efficiencies claims before the Tribunal and potentially seeking to rely on the "efficiencies defence" available under Canadian law. Under this defence, the Tribunal may not order a remedy if the efficiencies that are likely to result from the merger are greater than and offset its likely anticompetitive effects. It is unclear from the Commissioner's pleadings whether Thoma Bravo intends to integrate Quorum and Aucerna, including their MOSAIC and ValNav platforms, a factor that could be relevant to the potential application of the efficiencies defence. Indeed, this may not be the case, as the Commissioner refers only to MOSAIC and ValNav coming under "common control," and states that Thoma Bravo will "control the strategic decisions relating to MOSAIC and ValNav and has the ability and incentive to eliminate the competitive rivalry that previously existed between the suppliers of MOSAIC and ValNav." In addition, in its media release announcing the transaction in February 2019, Thoma Bravo noted that it would support Aucerna's continued growth, both organically and through acquisitions.

The Commissioner has asked the Tribunal to require Thoma Bravo to dispose of all of its interests in one of its two reserve software businesses or, alternatively, to dispose of such assets or shares as may be required to remedy the alleged substantial lessening of competition resulting from the transaction.

Thoma Bravo has 45 days to respond to the Commissioner's application and such response may provide further context regarding the Commissioner's review and challenge of the transaction. In addition, it remains to be seen whether the Commissioner will request that the matter proceed under an expedited Tribunal process introduced earlier this year that is designed to bring matters for hearing within approximately five or six months of the filing of a notice of application, a significantly shorter period than has been the case historically.

Implications

The Commissioner's challenge in this case may be the first evidence of his promise to actively monitor and take enforcement action in respect of mergers that are not subject to pre-merger notification in Canada. It also highlights the need for parties to evaluate whether a proposed transaction may have anticompetitive effects, even in small or niche markets in Canada, regardless of whether the transaction

is subject to mandatory pre-merger notification. When potential competition issues are identified in non-notifiable transactions, parties may still choose to voluntarily seek clearance from the Commissioner, or be prepared to address, or possibly contest before the Tribunal, any issues that the Commissioner may raise before or within one year of the closing. In any event, where competition issues may arise, parties should be aware of the potential costs of responding to a *Competition Act* investigation and/or a challenge before the Tribunal.

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