Merger Review under the Canada Transportation Act – The Interplay with Competition Act Review

Mark Katz and Jim Dinning

Originally published in The Pipeline
Spring 2022 | Volume 1, Number 1
(a publication of the Antitrust Law Section of the American Bar Association)

Merger Review under the Canada Transportation Act – The Interplay with Competition Act Review

Mark Katz and Jim Dinning – *Davies Ward Phillips & Vineberg LLP*

In addition to review under the Canadian Competition Act ("**Competition Act**") by the Competition Bureau ("**Bureau**"), merger transactions in certain sectors in Canada are also potentially subject to separate review by the regulatory authorities with responsibility for those sectors.

The transportation sector is one such area where there is a parallel merger review process to that under the Competition Act. Pursuant to this regime, which is set out in the Canada Transportation Act ("**CTA**"), Canada's federal Minister of Transport (the "**Minister**") may also review a transaction that "involves a transportation undertaking" to determine if it is contrary to the "public interest as it relates to national transportation". Where such a review is conducted, the Bureau is assigned a supporting advisory role, with the ultimate decision on the transaction being made by the Canadian federal Cabinet, known as the "Governor-in-Council" ("**GIC**").

Although only a very few transactions have been subjected to this dual review process, experience so far indicates that the Minister and the GIC will not hesitate to overrule the Bureau and permit transactions to proceed which the Bureau views as anti-competitive.

We now discuss the CTA merger review regime and its interplay with merger review under the Competition Act in more detail.

1. Process and Procedure

In 2007, the CTA was amended to provide for a "public interest" review of merger transactions involving a transportation undertaking. The CTA had contained a special review process prior to 2007, but it was limited to transactions involving airline mergers. This latter process had been enacted in 2000, in the wake of Air Canada's proposed acquisition of the other major domestic airline at the time, Canadian Airlines. The effect of the 2007 amendments was to extend the potential application of the CTA's review process to any merger involving a transportation undertaking that met the relevant criteria.

(i) Scope and Application

Section 53.1 of the CTA provides that every person who is required to file a pre-merger notification pursuant to the Competition Act with respect to a proposed transaction that involves a transportation undertaking must at the same time give notice of the transaction to the Minister. Where an "air transportation undertaking" is involved, notice must also be provided to the Canada Transportation Agency (the "**Agency**"), so that the Agency can assess whether the specific rules relating to limits on foreign ownership have been met.

As a preliminary point of jurisdiction, therefore, the CTA merger review process only applies to transactions that are notifiable under the Competition Act, i.e., those transactions that exceed the pre-merger notification thresholds set out in Part IX of the Competition Act. Although the Bureau has the authority to also review transactions that are not notifiable, that broad jurisdiction does not extend to the Ministerial review under the CTA.

One of the questions that has arisen in this regard is how to treat transactions that are technically subject to pre-merger notification under the Competition Act but where parties do not file a notification because they are seeking a form of clearance that potentially waives this requirement (i.e., an "advance ruling certificate" or a "no action letter" with express waiver). The argument is that since section 53.1 only applies to transactions where pre-merger notification is required, it

should not capture transactions where this requirement is ultimately waived. We are not aware of this question having been formally resolved, but it seems that a routine practice has evolved in applicable circumstances where parties will still file materials with the Minister but make the alternative argument that section 53.1 does not apply, which the Minister will then ignore as a matter of routine as well.

A more difficult threshold issue of jurisdiction is what the CTA means when it says that the transaction must "involve a transportation undertaking". Constitutionally, this phrase is understood to apply to transactions involving transportation undertakings that clearly fall within federal jurisdiction, such as inter-provincial or cross-border railways, airlines, pipelines, power lines or trucking and shipping firms; by the same token, transportation undertakings which operate wholly within a province are not covered (except for limited exceptions largely involving railways). Otherwise, however, no guidance has been provided for the meaning of this phrase. For example, it is still not clear as a matter of law if the review process applies where only the acquirer, and not the target, carries on a transportation undertaking; where the transportation component is merely ancillary to the main non-transportation business of a party or the parties; where the business provides important services to a federal undertaking but does not itself transport goods or people across provincial or international borders (e.g., freight-forwarding, terminals/ports or parts manufacturing); or where the "transportation" undertaking in question is not otherwise within the Minister's purview :(e.g., pipelines or power lines).

(ii) Notice to the Minister

If a transaction is caught by the CTA process, the first step is to provide notice of the transaction to the Minister at the same time as the Bureau is notified. There is no prescribed form for this notice, but there is a requirement to submit (a) the same information required under the Competition Act's pre-merger notification rules (e.g., information regarding the transaction, the parties, their relevant affiliates, as well as top supplier and customer information and transaction planning documents), and (b) any information with respect to the public interest as it relates to national transportation that would be relevant to the Minister's assessment of the transaction. In practice, parties will typically submit whatever materials have been filed with the Bureau and prepare a letter submission setting out why the proposed transaction is not contrary to the public interest ("public interest submission").

In the latter regard, section 5 of the CTA provides some guidance as to what considerations may be relevant in assessing the public interest as it relates to national transportation. This section sets out the "National Transportation Policy" underlying the CTA, which is based on the principle that "a competitive, economic and efficient national transportation system that meets the highest practicable safety and security standards and contributes to a sustainable environment and makes the best use of all modes of transportation at the lowest total cost is essential to serve the needs of its users, advance the well-being of Canadians and enable competitiveness and economic growth in both urban and rural areas throughout Canada." Section 5 also states that the objectives of the Policy are likely to be achieved when, among other things:

(a) competition and market forces, both within and among the various modes of transportation, are the prime agents in providing viable and effective transportation services;

(b) regulation and strategic public intervention are used to achieve economic, safety, security, environmental or social outcomes that cannot be achieved satisfactorily by competition and market forces and do not unduly favour, or reduce the inherent advantages of, any particular mode of transportation; and

(c) governments and the private sector work together for an integrated transportation system.

Draft guidelines issued in 2008 under the CTA offer more detail on the factors that may be considered in determining whether a transaction raises public interest issues as it relates to national transportation. Although these guidelines were never finalized, they are a helpful indication of the types of public interest considerations that should be addressed in the public interest submission to the Minister, as applicable. These factors include economic, social, environmental, safety and security considerations, such as the potential effects of the transaction on:

(d) prices and the levels of and access to services and facilities;

(e) the development and viability of local communities, including the impact on labour and employment;

(f) intermodal connections and supply to other transportation undertakings;

(g) trade gateways and corridors;

(h) innovation, technology and R&D;

(i) the financial viability of the target;

(j) congestion and pollution;

(k) workplace safety;

(l) vulnerable groups, such as low income workers and the disabled; and

(m) national security related issues, such as the ability to use the national transportation system to respond to threats or the ability of Canada to protect its national sovereignty.

In addition to addressing relevant public interest considerations, the draft guidelines also suggest including the following in the public interest submission to the Minister:

(n) a narrative description of the proposed transaction including the objectives of the transaction;

(o) a description of the transportation undertaking(s) involved in the transaction and the objectives of the transaction with respect to the transportation undertaking(s);

(p) a description of proposed changes to the business or strategic plans, if any, in respect of any transportation undertakings involved in the transaction;

(q) identification of major stakeholders who may be interested in the transaction (shippers, passengers, customers, suppliers, other levels of government, the general public, etc.);

(r) a description of any consultation which has taken place with affected stakeholders prior to notification; and

(s) identification of any other government approvals required to complete the transaction including foreign approvals, actions taken to seek such approvals, and status of such actions.

There is no fee for making the CTA filing and all information submitted to the Minister is treated as confidential consistent with section 51 of the CTA. Failure to file the notice required by section 53.1 is a criminal offence that is potentially punishable by a fine not exceeding $50,000.

(iii) The Review Process

Initial Screening

Once a notice is filed, the Minister's officials at Transport Canada will perform a preliminary assessment of the information received for completeness. If required, the Minister may ask for additional information to be provided at this stage.

The Minister has 42 days after notice is provided to determine if the proposed transaction raises public interest issues. If it does not, the Minister will send a letter confirming that there will be no further review under the CTA, and the matter ends there. It should be noted that this 42 day initial screening period means that the CTA process may still be ongoing even after the Bureau has provided its clearance. For example, unless extended, the statutory waiting period under the Competition Act is 30 days from the date that the parties' Part IX notifications are certified as complete; moreover, if the Bureau has designated a transaction as "non-complex", it may complete its review and provide clearance within 14 days of the filing of the parties' materials.

On the other hand, if the Minister determines that public interest issues are raised, the Minister may direct the Agency (or any other person appointed under the Department of Transport Act) to examine those issues, and the transaction cannot be completed unless and until the GIC approves it. Failure to abide by this prohibition is a criminal offence, punishable by imprisonment for a term not exceeding five years or to a fine not exceeding $10,000,000, or to both.

The Minister will also inform the Bureau that a public interest review has been initiated, as the Bureau's review process will be subsumed by the CTA review, as discussed in more detail below.

Public Interest Review

Once the public interest review has been commenced, the Agency (or the other appointed person conducting the review) shall report to the Minister with the results of its public interest assessment review within 150 days or within any longer period that the Minister may allow. The Bureau is also obliged to provide its own report to the Minister, as well as to the parties to the transaction, within 150 days after having been notified of the transaction or within any longer period that the Minister may allow. The Bureau's report is made public after its receipt by the Minister.

With both reports in hand, the Minister will then consult with the Bureau regarding any overlap between the concerns it may have expressed in its report and those contained in the public interest assessment report . The Minister will also consult with the parties to the transaction regarding any concerns that have been raised, and will give the parties the opportunity to offer solutions for these concerns, including proposed revisions to the transaction.

Assuming the parties are willing to offer up measures to address the concerns raised, the Minister will consult with the Bureau about their adequacy, following which the Minister will make a recommendation to the GIC in respect of the proposed transaction.

If the GIC is satisfied that it is in the public interest to approve the proposed transaction, taking into account any revisions to it proposed by the parties and any measures they are prepared to undertake, the GIC may, on the recommendation of the Minister, approve the transaction and specify any terms and conditions that the GIC considers appropriate.

2. Decisions

Although the CTA merger review process has been in place for almost 15 years, only two cases have gone to full review in that time. In both of those cases, the Minister and the GIC ultimately allowed the proposed merger transaction to proceed even though the Bureau had recommended blocking the transaction because of anticipated anticompetitive effects.

(i) Proposed Merger of First Air and Canadian North

The parties, each of which provided air passenger and cargo services in Northern Canada, announced their proposed transaction in July 2018. The Minister subsequently initiated a full public interest review under the CTA.

As required, the Bureau published its report in February 2019, with the conclusion that the proposed transaction would likely substantially prevent or lessen competition for passenger travel and cargo services on certain routes in Canada's North, leading to reductions in passenger and cargo capacity, increases in price, and reductions in flight schedules. On each of these routes, the Bureau concluded that (a) the parties were the only competitors such that the transaction would result in a merger to monopoly, and (b) barriers to entry or expansion were high, including unpredictable weather, requirements for specialized equipment, regulatory requirements, access to feed traffic, and capital costs associated with acquiring or leasing aircraft as well as securing infrastructure such as hangars, cargo handling facilities, and other equipment.

Notwithstanding these findings by the Bureau, the GIC approved the transaction, on the Minister's recommendation, in June 2019. The Minister decided, and the GIC agreed, that the proposed transaction was in the public interest because it would create a more efficient and financially sustainable air carrier in the North. The GIC's approval was subject to various conditions, including restrictions on price increases and reductions to schedules, mandatory access to facilities and equipment for new airlines entering the market, and a commitment to increasing Inuit representation across the merged entity's operations.

(ii) Proposed Merger of Air Canada and Air Transat

Air Canada is the largest provider of scheduled passenger service in Canada, with headquarters in Montreal and hubs in Toronto, Montreal, and Vancouver. Air Canada also develops, markets, and distributes vacation packages through its tour operator business, Air Canada Vacations. Air Transat is an airline and vertically integrated travel company headquartered

in Montreal, with principal bases in Montreal, Toronto, and Vancouver.

The Parties announced their proposed transaction in June 2019 and filed their materials in July 2019. In August 2019, the Minister determined that the proposed transaction raised public interest issues relating to national transportation and triggered a formal public interest review, as required by the CTA. Given the complexity of the transaction, the Minister granted several extensions to his officials at Transport Canada and to the Bureau to complete their respective reports.

The Bureau issued its report on the proposed transaction in March 2020, concluding that the merger should not be allowed to proceed because it was likely to substantially prevent or lessen competition on numerous routes where the parties competed. The report noted that the Bureau's analysis was based entirely on pre-COVID-19 data and that it did not purport to assess the impact of the pandemic on the airline industry. Transport Canada issued its own "public interest assessment" in May 2020, which also expressed concerns about the transaction. The Minister then asked the parties to address these concerns, which they did by changing aspects of the proposed transaction and also by proposing detailed remedial measures that they would be willing to adopt.

The Bureau rejected the adequacy of the proposed remedies, largely because they were behavioural rather than structural in nature, and maintained its objection to the proposed transaction. However, the Minister and the GIC overruled the Bureau and decided to approve the merger on public interest grounds in February 2021, based on commitments by the parties to, among other things, maintain Air Transat's head office and brand in Quebec; encourage other airlines to take up former Air Transat routes to Europe; ensure that aircraft maintenance contracts remain in Canada (prioritizing Quebec); launch new routes within five years; and commit 1,500 employees to the merged-company's new travel business.

The impact of the pandemic on Air Transat and the airline industry was a major factor in the Minister's decision. In particular, the Minister noted the financial challenges faced by Air Transat because of the pandemic, including the need to raise significant funds to continue operating and compensate for ongoing losses. The Minister concluded that it could not be assumed that Air Transat would survive as an independent competitor absent the transaction , and therefore allowing the proposed transaction to proceed would benefit competition by ensuring a "clear and stable future" for Air Transat, providing operating efficiencies to the wider Canadian air transportation system, and maintaining employment in the sector.

In reaching the conclusion that Air Transat's financial viability was endangered by the pandemic, the Minister echoed the "failing firm" factor under Canadian competition law, which provides that the merger analysis of a transaction should consider "whether the business or a part of the business of a party to the merger, or proposed merger, has failed or is likely to fail". The Bureau has historically taken a strict approach to failing firm arguments (although it had approved Air Canada's takeover of Canadian Airlines in 2000 on this basis), and confirmed in several statements that it would not be relaxing its attitude because of the impact of COVID-19. It is somewhat ironic, therefore, that the Minister was prepared to incorporate failing firm- - related considerations into his analysis, while the Bureau remained unwilling to alter its approach to merger review even in the face of a global pandemic.

As a postscript, Air Canada and Air Transat eventually terminated their proposed transaction in April 2021 due to the low likelihood that the transaction would be approved by the European Commission.

3. Conclusions

Full CTA merger reviews are obviously a rare occurrence. However, one may argue that the system has been a policy success, notwithstanding that it has only been invoked a very few times. The CTA merger review process was adopted based on the perception that the fate of certain types of merger transactions should not be judged on competition law considerations alone and that the broader public interest ought to factor in as well. The two decisions issued to date, in which the Bureau's competition law analyses were effectively overruled, demonstrate that the subordination of pure competition law is necessary in certain circumstances. The fact that this has been done on only two occasions in 15 years also shows that politicians have been appropriately circumspect in exercising their public policy override.

The other point to note is that while CTA merger reviews can be quite lengthy (the Air Canada/Air Transat review took 18 months to conclude), merging parties may stand a better

chance of getting difficult transactions cleared based on public interest considerations than if they faced Bureau scrutiny alone. That may be an important point to recall as the pressure grows to generally incorporate more public interest considerations into the review of mergers, such as the impact on labour. Proponents of this path may believe that they would be arming authorities with yet another way to inhibit certain mergers; but as the CTA experience demonstrates, the impact could be the exact opposite.