# Energy Industry

## Competition Law in Canada

Blakes

# Energy Industry and Competition Law in Canada

Canada's abundant energy resources have played a central role in our country's economic development and will continue to be extremely important to our prospects for growth and innovation in the future.

Competition law applies to all of the diverse participants in Canada's energy sector — from crude oil and natural gas to nuclear and renewable energy, and from pipelines transporting energy products to refinery complexes and retail gas stations — with a view to preserving the benefits of a competitive industry, often in parallel with sectoral regulators at the federal or provincial levels. In the wake of COVID-19 and uncertainty surrounding global supply levels, we expect to see higher levels of M&A activity, collaborations among competitors, and potentially even industry-wide initiatives as firms adapt to the new competitive environment.

# 5 Things You Need to Know About the Energy Industry and Competition Law in Canada

1. The energy industry is high profile for consumers, which has led to consumer-driven complaints about conduct and subsequent investigations by Canada's Competition Bureau under the *Competition Act* (particularly in the retail gas segment).

2. While Canada's Competition Bureau has recognized the generally high level of competition in some parts of the energy industry (such as upstream oil and gas), they also have a history of undertaking extensive investigations in parts of the energy industry where there are fewer players or evolving market dynamics that may impact competition.

3. Since Canada's merger control thresholds look to the value of the merging parties' assets and revenues to determine whether a transaction is notifiable (unlike the thresholds in the U.S. that focus on acquisition value), mergers involving companies with high turnover and low margins (common in the energy industry) can be unexpectedly notifiable in Canada despite a relatively low enterprise value of the target.

4. The energy industry is regulated by a complex federal and provincial regulatory regime that provides context for the application of Canada's competition laws and, in limited circumstances, may even override certain provisions in the *Competition Act*.

5. In investigating any subsegment of the energy industry, the Competition Bureau will employ its established framework for defining markets and will not accept generic arguments about the substitutability or competitiveness of different energy sources.

# 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 that are important for participants in Canada's energy industry, including criminal prohibitions against certain types of agreements among competitors, as well as civil provisions relating to mergers or business practices that are likely to prevent or lessen competition substantially. However, the Act also includes important provisions that recognize efficiency-enhancing behaviour.

The Act is administered and enforced by the Commissioner of Competition, an official who heads Canada's Competition Bureau (Bureau). The Act requires that mergers that exceed certain thresholds be reported to the Bureau for review. The Act also permits the Bureau to apply for court orders for the production of data and documents, the interview of company executives, and the search of premises.

However, the Bureau is not permitted to take action unilaterally in respect of competitive conduct that it believes contravenes the Act. Instead, the Bureau must present its concerns to a specialized court, the Competition Tribunal, or the Federal Court or provincial superior court (as the case may be), which will ultimately decide the issue. Alternatively, the Bureau may enter into settlements with private parties to resolve the Bureau's concerns.

# Merger Review

Canada's framework for merger review has similarities to other jurisdictions and includes the following important 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. Typically, large energy-industry mergers (i.e., those between established firms) exceed these thresholds.

Acquisitions of start-up companies are less likely to trigger a notification, although some energy-sector businesses may have a large asset value at a relatively early stage or book large topline revenues despite having a modest enterprise value that could trigger a notification.

In any event, the Bureau retains jurisdiction to review all mergers, including those that do not exceed the notification thresholds.

## Waiting Periods

The Bureau must be notified of mergers that exceed the financial thresholds in the Act. Closing is prohibited until 30 calendar days after the notification unless approval is received earlier.

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 often take between four to six months, or longer if remedies are required.

## Substantive Review

Regardless of whether a transaction meets the notification thresholds, the Bureau can assess whether a merger is likely to prevent or lessen competition substantially. This means whether 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 and the effects on innovation. Some key assessment factors the Bureau will consider include the parties' combined market shares, the degree of market concentration, barriers to entry/expansion (including the dynamics of innovation and research and development in the particular industry), demand-side considerations (including buyer power) and regulatory oversight that might constrain the merging 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 outweigh and offset the anticipated anti-competitive effects. 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.

## Resolution

Following its substantive review, the Bureau may issue a letter confirming it will take "no action" in respect of a merger (thereby, clearing the merger without a remedy). Alternatively, if the Bureau is concerned the merger is likely to prevent or lessen competition substantially, it may seek to negotiate changes to the merger (such as a divestiture or behavioural commitment) to address those concerns or apply to the Competition Tribunal for an order prohibiting all or part of the merger.

There are also numerous interim steps available to the Bureau, such as permitting merging parties to close transactions but mandating that particular businesses of concern be placed in a "hold separate" arrangement.

# Recent Trends in Merger Review

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

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

## Market Definition

The Bureau's general approach is to define the markets in which the parties compete for the purpose of assessing a merger's competitive effect. In certain energy industry segments where Bureau reviews are common, such as upstream oil and gas mergers, the Bureau typically will accept reasonable positions it has taken in previous deals without the parties needing to submit extensive new evidence.

In other energy-industry mergers, the Bureau has no preferred methodology for defining markets and will apply the "hypothetical monopolist" test. It will generally define product markets by reference to an energy product's or service's distinct end-use and will focus on identifying the set of products that are substitutes from a demand perspective.

From a geographic perspective, what matters is the ability and willingness of customers to switch their purchases of a particular energy product from suppliers in one location to suppliers in another. The Bureau will typically refer to its own precedents such as accepting a global market for upstream oil and gas, while likely concluding that the market is local for the sale of retail gasoline.

## Failing Firm Analysis

The significant decline in energy prices in March 2020, reflecting both an increase in global supply and a precipitous drop in demand stemming from the global pandemic, may lead to consolidation in the Canadian energy sector in the coming years. For mergers involving a firm that is bankrupt or insolvent, the Bureau's analysis can accommodate a transaction that would not be approved under ordinary circumstances.

However, the Bureau will apply a strict test to determine if the target is truly insolvent and if there was any competitively preferable alternative to the purchaser acquiring the failing firm's assets. Even if a target was only "flailing," as opposed to truly insolvent, the Bureau may take account of the diminished competitive role it would have played in the future.

## Efficiencies

Certain energy mergers may be appropriate cases for the application of the efficiency exemption under the Act. This exemption permits even an anti-competitive merger to proceed if the gains in efficiency outweigh and offset the anti-competitive effects. While this defence does not cover all synergies, it does take into account fixed-cost savings and variable cost savings, as well as dynamic efficiencies such as the optimal introduction of new products, the development of more efficient productive processes and the improvement of product quality and service.

Although there have not been many mergers that have been officially cleared on efficiencies grounds, this analysis may enable the parties to avoid a remedy or close a transaction in certain cases. A similar defence is not available in other major jurisdictions.

## Coordinating Processes

Given the number of global companies active in the Canadian energy industry, it is not uncommon for transactions in the sector to also require review by another merger control regime such as the U.S. In such cases, the Bureau will coordinate with agencies in these other jurisdictions and will often request that waivers be provided to those agencies to permit the exchange of the merging parties' confidential information.

The Bureau, together with U.S. antitrust agencies, 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.

# Non-Merger Business Practices

The Act contains numerous provisions regarding non-merger business practices that are relevant to energy industry participants, some of which are set out below.

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

It is a criminal offence to 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 any notice. These offences are punishable by significant fines and, for individuals, jail terms.

The Bureau has issued guidance explaining that it reserves use of the criminal offences for "naked restraints on competition," such as restrictions on competition not implemented in furtherance of a legitimate collaboration or joint venture. Private parties can also sue for violations of the criminal prohibitions for single (not treble) damages. These suits can be brought as class actions. Recent cases in Canada have significantly lowered the bar to class certification.

Within the energy industry, the retail gas sector has been a significant area of focus for the Bureau's criminal enforcement branch in recent years, with active monitoring and investigations having resulted in numerous price-fixing charges against individuals and companies.

## Civil Prohibitions on Abuse of Dominance

Business practices that constitute an abuse of dominance can be prohibited by the Competition Tribunal and may be subject to administrative monetary penalties (AMPs). A business practice may constitute an abuse of dominance where it is engaged in by a firm with market power, the purpose of the practice is anti-competitive (i.e., there is no overriding business justification for the practice) and the practice prevents or lessens competition substantially.

Unlike criminal matters, private parties cannot sue for damages for business practices that are alleged to be an abuse of dominance under the Act, but AMPs can be as high as C$15-million for a second contravention.

## Civil Prohibition on Illegal Agreements

Agreements among competitors or potential competitors that prevent or lessen competition substantially can be prohibited by the Competition Tribunal. No other sanction (such as a fine) is available for such agreements. The Bureau has issued guidance explaining it will use this provision to investigate agreements that do not rise to the level of "naked restraints on competition" but that, nevertheless, have an anti-competitive effect.

However, any agreement that results in efficiencies (including fixed-cost savings) that outweighs and offsets the anti-competitive effects cannot be prohibited. In addition, private parties cannot sue for damages under the Act in respect of agreements that are not alleged to be criminal in nature.

## Distribution Matters

The Act contains various provisions that address a company's ability to enter into agreements or engage in certain conduct (e.g., tied selling, exclusive dealing, resale price maintenance) with customers or suppliers. The only possible sanction is the practice being prohibited. In addition, such practices must have some level of anti-competitive effect in order to be prohibited. This means that it would be difficult for companies that do not have market power to be sanctioned for these types of "vertical restraint" practices. Private parties cannot sue for damages related to such conduct under the Act.

## Misleading Claims

The Act contains misleading advertising and deceptive marketing practice restrictions. In particular, the Act prohibits making a representation to the public that is false or misleading in a material respect, where the representation is made to promote a product or business interest. If the false or misleading representation is made knowingly or recklessly, then it may contravene the criminal provisions of the Act. Even if this is not the case, false or misleading representations may be subject to substantial AMPs.

These provisions would apply to not only customer-facing businesses in the energy sector such as retail gas stations, but also more general advertisements promoting an energy company's brand or project(s).

# Recent Trends in Enforcement

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

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

## Retail Gasoline Prices

The Bureau has initiated a number of inquiries and investigations in the energy industry related to the retail gasoline market. These inquiries have concerned alleged cartels and price-fixing with respect to retail gasoline pricing. Given the unique nature of the retail gasoline market (i.e., that retailers usually post their prices on large street-side signs), competing retailers frequently charge similar or identical prices, and similar gasoline prices or price changes do not necessarily indicate price-fixing conduct that would contravene the Act. As such, the detection of cartels in the retail gasoline industry is particularly time-consuming and labour intensive.

Despite this, the Bureau has prosecuted numerous individuals and companies for conspiring to fix the price of gasoline, including 33 individuals and eight companies that have pled or were found guilty with fines totalling over C$4-million in relation to a Quebec gasoline cartel case that has been ongoing for more than a decade.

The Bureau continues to make detecting and stopping cartels a top priority and remains focused on this sector. It recently released a Guide to Retail Gasoline Pricing in Canada, which provides an overview of the retail gasoline industry aimed at helping consumers recognize signs of possible price-fixing and distinguish them from signs of healthy competition.

## Energy Industry Software Challenge

In June 2019, the Bureau challenged a transaction between suppliers of software to oil and gas producers in Canada. Despite unaddressed concerns raised by the Bureau, Thoma Bravo, a U.S.-based private equity company, acquired Aucerna, a supplier of software to oil and gas companies, including the Value Navigator (Val Nav) software, in May 2019. One of Thoma Bravo's existing portfolio companies, Quorum Business Solutions, was also a supplier of software to oil and gas companies, including its MOSAIC Reserves Software.

During its review, the Bureau found that MOSAIC and Val Nav competed vigorously and were effectively the only two reserves software used by Canadian oil and gas firms, such that the Bureau was concerned the price and non-price benefits of competition between the merging parties would be lost. The Bureau and Thoma Bravo ultimately entered into a settlement agreement to address the Bureau's concerns that required Thoma Bravo to divest the MOSAIC business to a purchaser to be approved by the Commissioner.

In addition to its connection to the energy industry, the deal involved the digital economy, another of the Bureau's current enforcement priorities.

## Interface with Sectoral Regulation

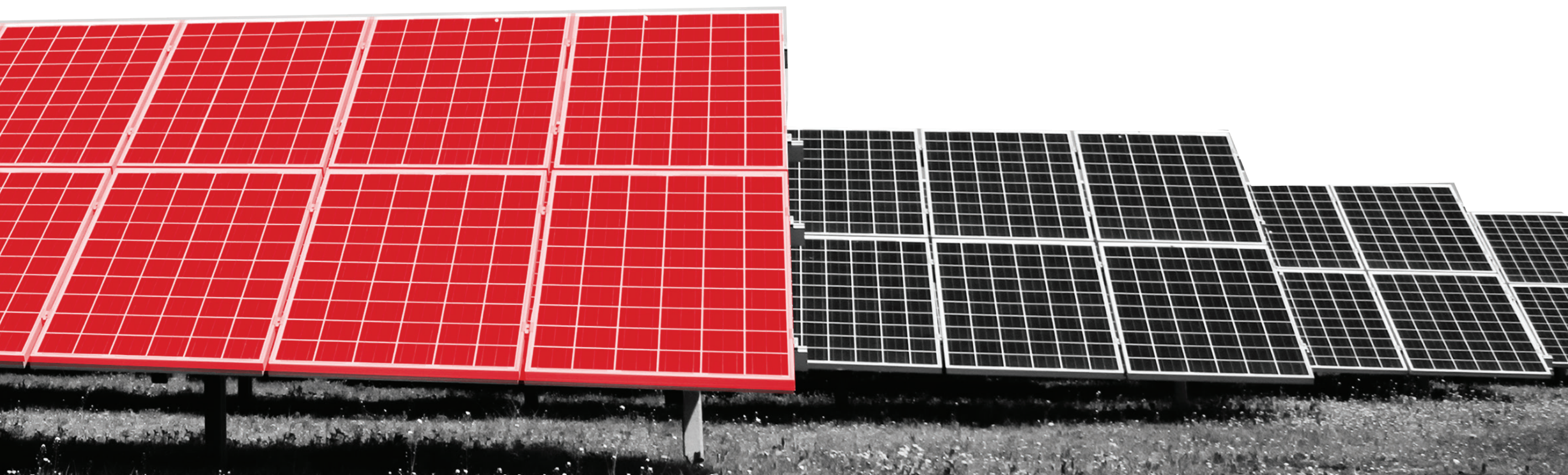
Several aspects of Canada's energy industry are regulated by either the federal National Energy Board (NEB) or provincial agencies such as the Alberta Energy and Utilities Board or Ontario Energy Board. Among other things, these regulatory bodies are statutorily authorized to set prices, through tariffs or otherwise, for certain energy services and utilities. The regulated conduct defence (RCD) may apply to exempt certain conduct that might otherwise be contrary to the criminal provisions of the Act when such conduct is permitted, authorized or mandated by another validly enacted federal or provincial law.

While the Bureau acknowledges the potential ability of the RCD to protect certain conduct, particularly in the context of active regulators such as the NEB where the government has clearly expressed its intention to regulate the subject matter in question (e.g., pipelines), it has also expressed an intention to continue to scrutinize regulated conduct that may offend the Act and use its discretion as to whether to pursue the matter.

Further, a recent decision of the Competition Tribunal in the Vancouver Airport Authority case limited the practical applicability of the RCD by finding that, as a matter of law, the RCD does not apply to the civilly reviewable conduct provisions of the Act. As such, it is important that participants in the energy industry be aware of potential competition issues that may arise in the course of their business, even if their conduct is authorized by regulations.

## Public Research

The Bureau occasionally undertakes a detailed review and analysis of the market and competitive dynamics in certain sectors of the energy industry. In 2014, this research included a joint Bureau/NEB report to ministers of natural resources and industry on propane market issues experienced during the winter of 2013-2014.



# Conclusion

Participants in the Canadian energy industry face myriad commercial, legal and regulatory challenges on a daily basis.

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 energy industry in Canada succeed.

Blakes

# CONTACTS

**Brian A. Facey**
Group Chair, Partner
brian.facey@blakes.com
416-863-4262

**Cathy Beagan Flood**
Partner
cathy.beaganflood@blakes.com
416-863-2269

**Cassandra Brown**
Partner
cassandra.brown@blakes.com
416-863-2295

**Iris Fischer**
Partner
iris.fischer@blakes.com
416-863-2408

**Anne Glover**
Partner
anne.glover@blakes.com
416-863-3266

**Nicole Henderson**
Partner
nicole.henderson@blakes.com
416-863-2399

**Randall Hofley**
Partner
randall.hofley@blakes.com
416-863-2387

**Navin Joneja**
Partner
navin.joneja@blakes.com
416-863-2352

**Robert E. Kwinter**
Partner
robert.kwinter@blakes.com
416-863-3283

**Andrea Laing**
Partner
andrea.laing@blakes.com
416-863-4159

**Kevin MacDonald**
Partner
kevin.macdonald@blakes.com
416-863-4023

**Wendy Mee**
Partner
wendy.mee@blakes.com
416-863-3161

**Julie Soloway**
Partner
julie.soloway@blakes.com
416-863-3327

**Micah Wood**
Partner
micah.wood@blakes.com
416-863-4164

**Psalm Cheung**
Associate
psalm.cheung@blakes.com
416-863-2239

**Emma Costante**
Associate
emma.costante@blakes.com
604-631-3332

**Chris Dickinson**
Associate
chris.dickinson@blakes.com
416-863-3254

**David Dueck**
Associate
david.dueck@blakes.com
416-863-2959

**Peter Flynn**
Associate
peter.flynn@blakes.com
416-863-3336

**Fraser Malcolm**
Associate
fraser.malcolm@blakes.com
416-863-4233

**Joe McGrade**
Associate
joe.mcgrade@blakes.com
416-863-4182

**Garth Murray**
Associate
garth.murray@blakes.com
416-863-2423

**Julia Potter**
Associate
julia.potter@blakes.com
416-863-4349

**Jim Robson**
Associate
jim.robson@blakes.com
416-863-2685

**Gillian Singer**
Associate
gillian.singer@blakes.com
416-863-2673

**Tori Skot**
Associate
tori.skot@blakes.com
416-863-2913

**Corinne Xu**
Associate
corinne.xu@blakes.com
416-863-3181

© 2020 Blake, Cassels & Graydon LLP | **blakes.com**