Government of Canada approves airline merger following Competition Bureau objection

June 26, 2019

On June 16, 2019, the Government of Canada issued an Order in Council, approving the proposed merger transaction between Bradley Air Services Limited (doing business as First Air) and Canadian North Inc. (Canadian North), subject to a set of terms and conditions. This approval, required for closing and the first of its kind, followed an assessment in February by the Competition Bureau (the Bureau), Canada's antitrust enforcement agency, that the proposed merger would result in a substantial lessening of competition in passenger and cargo services on most of the parties' overlapping routes. It also signals the Government's willingness to balance competition-related concerns with other public interest factors when considering transportation-related mergers, and potentially, airline joint ventures.

The First Air-Canadian North merger

Announced on July 6, 2018, the proposed transaction contemplates a proposed merger between First Air and Canadian North, with the combined airline using new First Air livery (the Proposed Merger).[1] The two merging parties, First Air and Canadian North, are airlines that provide air passenger and cargo services in Northern Canada, including routes connecting points within Northern Canada, as well as routes connecting the North to Southern Canada. In announcing the Proposed Merger, the parties' parent companies pointed to anticipated benefits of the transaction, including service improvements, safety enhancements, sustainability and efficiencies, and contributions to regional economic development.[2]

Merger review under the *Canada Transportation Act*

The *Canada Transportation Act* (The CTA)[3] requires that all transactions subject to pre-merger notification to the Commissioner of Competition[4] that involve a "transportation undertaking", also submit a notification to the Minister of Transport (the Minister).[5] The term "transportation undertaking" is undefined in the CTA and has potentially broad application to, among other things, any business that transports third party goods and/or passengers across provincial or national borders by air, rail or road. Transactions that are subject to review under the CTA must receive either approval by the Minister (for a review concluded during the first phase of the review), or the Governor in Council (for a review that enters a second phase of the review). First phase approval by the Minister occurs if the Minister determines that the transaction does not raise "public interest" issues, while second phase approval must be provided by the Governor in Council (the federal cabinet) on the basis that it is satisfied that approval is in the "public interest."[6] Such approval under the CTA is in addition to the observation of the statutory 30-day waiting period under the *Competition Act*,[7] or any extension thereof, during which the parties are not permitted to close.

Following notification, the Minister has 42 days to determine whether or not the proposed transaction raises "public

interest" issues. The term "public interest" is undefined in the CTA. Draft Guidelines released by Transport Canada in 2008 indicate the concept includes economic (including impacts on users, communities, other transportation industry participants, Canada, and the parties), environmental, safety, security, and social impacts of the proposed transaction at issue.[8] If the Minister determines that no "public interest" issues are raised, that constitutes approval and the review is terminated. In those circumstances, where Ministerial approval is obtained during the initial 42-day period, the parties may close,[9] subject to any other outstanding closing conditions or regulatory approval processes. If the Minister determines that the transaction raises "public interest" issues, the transaction must proceed to second phase of the review, and the transaction can only close if the parties obtain approval by the Governor in Council.[10]

If a transaction proceeds to the second phase of the review, the Minister can direct the Canada Transportation Agency or another person to review the "public interest" issues raised by the transaction. Furthermore, the Bureau is required to issue a report to the Minister regarding its competitive assessment of the transaction.[11] The reports from the Canada Transportation Agency or other person appointed by the Minister are due within 150 days of appointment, while the Bureau's report is due within 150 days following initial notification to the Minister. The Minister can extend those reporting deadlines. [12]

Following receipt by the Minister, the Bureau's report must be made public. [13]

If approved by the Governor in Council under the CTA, the transaction is exempt from challenge by the Bureau under the merger review provisions of the *Competition Act*.[14] However, the Bureau has jurisdiction[15] to challenge non-compliance with any terms and conditions of the order, and the remedies available include a cessation of the contravention and a divestiture of assets.[16]

Competition Bureau's assessment of the First Air-Canadian North merger

The Bureau issued its report under the CTA to the Minister on February 25, 2019. In that report, the Bureau concluded that the Proposed Merger represented a "merger to monopoly", and was, "likely to result in a substantial lessening of competition with respect to the provision of passenger travel and cargo services on all overlapping origin-destination pairs … including on the Ottawa-Iqaluit route and the Trans-Arctic route, and within the Kitikmeot region, the Qikiqtaaluk region, and the Mackenzie Valley region." One exception to that conclusion was the Bureau's assessment that there would not be similar anti-competitive effects on the overlapping Edmonton-Yellowknife route because of competition from national carriers on that particular route.[17]

Among the Bureau's conclusions regarding anti-competitive effects on the overlapping routes, the Bureau predicted "reductions in passenger and cargo capacity, increases in price, and reductions in flight schedules." The Bureau also found that entry and expansion by competitors or potential competitors would be unlikely due to high barriers to entry, including weather, specialized equipment, regulatory requirements and high capital costs, among other factors.[18]

Approval of the Proposed Merger

The Government approved the Proposed Merger, notwithstanding the publicly stated concerns of the Bureau, pursuant to an Order in Council, dated June 16, 2019 (the Order).[19] The Order contains several terms and conditions applicable to the merged carrier that run between five and seven years from closing, including:

- Limitations on fare increases;

- Restriction of free baggage allocations for fare classes;
- Flight scheduling requirements;
- Capacity commitments;
- Minimum standards of service;
- Requirement to provide any new entrants access to cargo facilities;
- Commitments regarding employment;
- Commitment to establish an Inuit training and development program; and
- Compliance and reporting requirements.

Many of the commitments are subject to a non-public Confidential Implementation and Monitoring Agreement to be agreed to between the parties and the Minister, which the Order notes will, "contain precise and specific methodology for each term and condition, the nature of which is commercially sensitive and confidential."[20]

In announcing the approval, Transport Canada's press release noted that the Government's decision struck, "a balance between any public interest considerations and the need to have a more efficient and financially sustainable northern air carrier."[21] Indeed, approval of the Proposed Merger by the Government also reflects a clear balancing of concerns regarding anti-competitive effects, as expressed by the Bureau in its February report, with other "public interest" issues, such as employment opportunities in Canada's North, and Inuit training and development. In that regard, it should be noted that the Bureau's stated preferential remedy in context of mergers that result in anti-competitive effects is structural (such as a divestiture or prohibition), as opposed to stand-alone behavioural remedies.[22] The terms and conditions of the Order, on the other hand, contain only behavioural and quasi-structural remedies, such as the requirement to provide access to cargo facilities to any potential new entrants.

Conclusions

While the Proposed Merger is not the first transaction that required notification to the Minister since the mandatory Ministerial merger review process under the *Canada Transportation Act* was adopted in 2007,[23] it is the first to result in approval by the Governor in Council on the basis of the "public interest" in the second phase of the review. It is noteworthy that the Government's approval, subject to terms and conditions regarding pricing, scheduling and other issues, followed a report from the Bureau that concluded the transaction would result in a substantial lessening of competition on most of the parties' overlapping routes.

The Government's approval of the Proposed Merger, signalling potential flexibility in its approach in the reviews of airline mergers, also comes at an interesting point in time. While the mandatory review regime for mergers involving "transportation undertakings" that are notifiable under the *Competition Act* has been in place for more than a decade, Canada recently adopted a voluntary Ministerial review process for airline joint ventures – the relevant provisions coming into force in April 2019.[24] This process is consistent with the approach taken with airline joint ventures in other countries.[25] If approval is obtained under the voluntary review process on the basis of "public interest" considerations, a proposed airline joint venture can benefit from immunity from several provisions of the *Competition Act*.[26] In that regard, the Government's approval of the First Air-Canadian North merger may provide a reason for cautious optimism regarding its approach to the balancing of competition-related concerns and the public interest in assessments of mergers and, potentially, airline joint ventures going forward.

On the other hand, it should also be kept in mind, the concept of the "public interest" is broad, and because approval

by the Minister or Government is required for applicable mergers involving "transportation undertakings", the mandatory review process under the CTA has at least the potential to be used to block an undesirable or politically problematic transaction. While the Government used the approval process under the CTA as a shield in this matter, permitting a transaction that raised concerns regarding competitive impact, it can also be used as a sword. In this way, the CTA approval process has the potential for use in transportation-related transactions in a similar manner to the *Investment Canada Act*,[27] which the Government of Canada has employed in recent years to block several acquisitions of Canadian businesses by foreign investors.[28]

This Dentons Insight was authored by Adam S. Goodman, Partner in Dentons' Competition and Foreign Investment Review group.

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1. Press Release, “First Air and Canadian North join forces to better serve Pan-Arctic communities” (July 6, 2019), online: https://www.canadiannorth.com/about/news/0075979-first-air-and-canadian-north-join-forces-better-serve-pan-arctic-communities↩
2. *Ibid.*↩
3. *Canada Transportation Act, 1996*, S.C. 1996, c. 10, s. 53.1.↩
4. Proposed transactions that require pre-merger notification to the Commissioner of Competition and the Competition Bureau under the *Competition Act* must exceed two financial thresholds: (1) a CAD $96 million “size of transaction” threshold (in 2019; this threshold is adjusted annually); and (2) a CAD $400 million “size of parties” threshold. See Dentons Canada Insight, “Increase in Competition Act and Investment Canada Act thresholds for Canadian M&A transactions” (February 5, 2019), online: https://www.dentons.com/en/insights/alerts/2019/february/5/increase-in-competition-act-and-investment-canada-act.↩
5. Additionally, notifiable transactions that involve an “air transportation undertaking” must be notified to the Canada Transportation Agency to confirm the Canadian status of the resulting undertaking.↩
6. *Canada Transportation Act, 1996*, S.C. 1996, c. 10, s. 53.1(4) & 53.2(7)↩
7. *Competition Act*, R.S.C. 1985, c. C-34, s. 123.↩
8. Transport Canada, Draft Guidelines for Mergers and Acquisitions involving Transportation Undertakings (June 2008), online: https://www.tc.gc.ca/eng/policy/acg-acgb-mergers-guidelines-draft-3143.html↩
9. *Canada Transportation Act, 1996*, S.C. 1996, c. 10, s. 53.1(4).↩
10. *Canada Transportation Act, 1996*, S.C. 1996, c. 10, s. 53.2(1).↩
11. Pursuant to the legislation, the Commissioner of Competition, who heads the Bureau must report to the Minister.↩
12. *Canada Transportation Act, 1996*, S.C. 1996, c. 10, ss. 53.1(5), 53.1(6), 53.2(2).↩
13. *Canada Transportation Act, 1996*, S.C. 1996, c. 10, s. 53.2(3)↩
14. *Competition Act*, R.S.C. 1985, c. C-34, s. 94(c).↩
15. The Minister has similar jurisdiction to challenge parties’ non-compliance. *Canada Transportation Act, 1996*, S.C. 1996, c. 10, s. 53.4(1).↩
16. *Canada Transportation Act, 1996*, S.C. 1996, c. 10, s. 53.4(2).↩
17. Competition Bureau, Report to the Minister of Transport and the Parties to the Transaction Pursuant to Subsection 53.2(2) of the *Canada Transportation Act*: Proposed Merger of Bradley Air Services Limited, d.b.a. First Air, and Canadian North Inc. (February 25, 2019), online: https://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/04419.html↩
18. *Ibid.*↩
19. P.C. 2019-0805.↩
20. P.C. 2019-0805, s. 29.↩
21. Transport Canada, Press Release, Government of Canada Approves First Air and Canadian North merger (June 19, 2019), online: https://www.canada.ca/en/transport-canada/news/2019/06/government-of-canada-approves-first-air-and-canadian-north-merger.html.↩
22. “Standalone behavioural remedies are seldom accepted by the Bureau. It is difficult to design a behavioural remedy

that will adequately replicate the outcomes of a competitive market. Even if such a remedy can be designed in clear and workable terms, it is likely to be less effective and more difficult to enforce than a structural remedy. Moreover, any attempt to provide for a standalone behavioural remedy usually imposes an ongoing burden on the Bureau and market participants, including the merged entity, rather than providing a permanent solution to a competition problem." Competition Bureau, Information Bulletin on Merger Remedies in Canada (September 22, 2006), para. 49, online: https://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/02170.html.↩

23. In fact, during the week following the Order in Council approving the Proposed Merger, the Minister approved Onex Corporation's proposed $3.5 billion acquisition of WestJet Airlines Ltd. during the first phase of the CTA process. Westjet announced on June 24, 2019 that approval was received, "from the Minister of Transport (Canada) on the basis that the proposed acquisition of WestJet by Onex does not raise public interest issues as related to national transportation." Press Release, WestJet, "WestJet announces first regulatory approval in its proposed acquisition by Onex" (June 24, 2019). ↩
24. *Canada Transportation Act, 1996*, S.C. 1996, c. 10, s. 53.71 and ff.↩
25. "Australia, the European Union, Korea, Japan, Malaysia, New Zealand, Singapore and the United States are examples [of countries that] have processes that examine [airline joint ventures] from the perspectives of both competition and the public interest." *Regulations Respecting Fees for the Review of Arrangements Involving Transportation Undertakings Providing Air Services: SOR/2019-81*, Regulatory Impact Analysis Statement (March 26, 2019), Canada Gazette, Part II, Volume 153, Number 7.↩
26. *Competition Act*, R.S.C. 1985, c. C-34, ss. 45(6)(c), 47(3)(b), 90.1(9)(d), & 94(d).↩
27. *Investment Canada Act*, R.S.C. 1985, c.28 (1st Supp.).↩
28. For example, in 2008, the Minister of Industry declined to provide necessary approval under the *Investment Canada Act* (the "**ICA**") to US-based Alliant Techsystems' proposed $1.3 billion acquisition of the geospace division of MacDonald Dettwiler. In 2010, the Minister of Industry similarly refused to provide ICA approval to Australian investor BHP Billion regarding its $38 billion hostile takeover bid of Potash Corporation. Additionally, the Government has used the national security review provisions of the ICA to block several other foreign investments, including China Communications Construction Company International Holding Limited's proposed $1.5 billion acquisition of Canadian construction company, Aecon Group Inc. in 2018.↩

Your Key Contacts

Adam S. Goodman
Partner, Toronto
D +1 416 862 3416
adam.goodman@dentons.com

Sandy Walker
Partner, Toronto
D +1 416 863 4517
sandy.walker@dentons.com

Barry Zalmanowitz, Q.C.
Counsel, Edmonton
D +1 780 423 7344
barry.zalmanowitz@dentons.com

Simon Kupi
Senior Associate, Calgary
D +1 403 268 7178
simon.kupi@dentons.com