

Building Materials and Construction Industries

Merger Review Under the *Competition Act*
and *Investment Canada Act*



IN 2019, THE BUILDING
MATERIALS AND CONSTRUCTION
INDUSTRIES CONTRIBUTED
\$157-BILLION
IN ECONOMIC ACTIVITY

Representing

7.9%

of Canada's overall GDP.¹



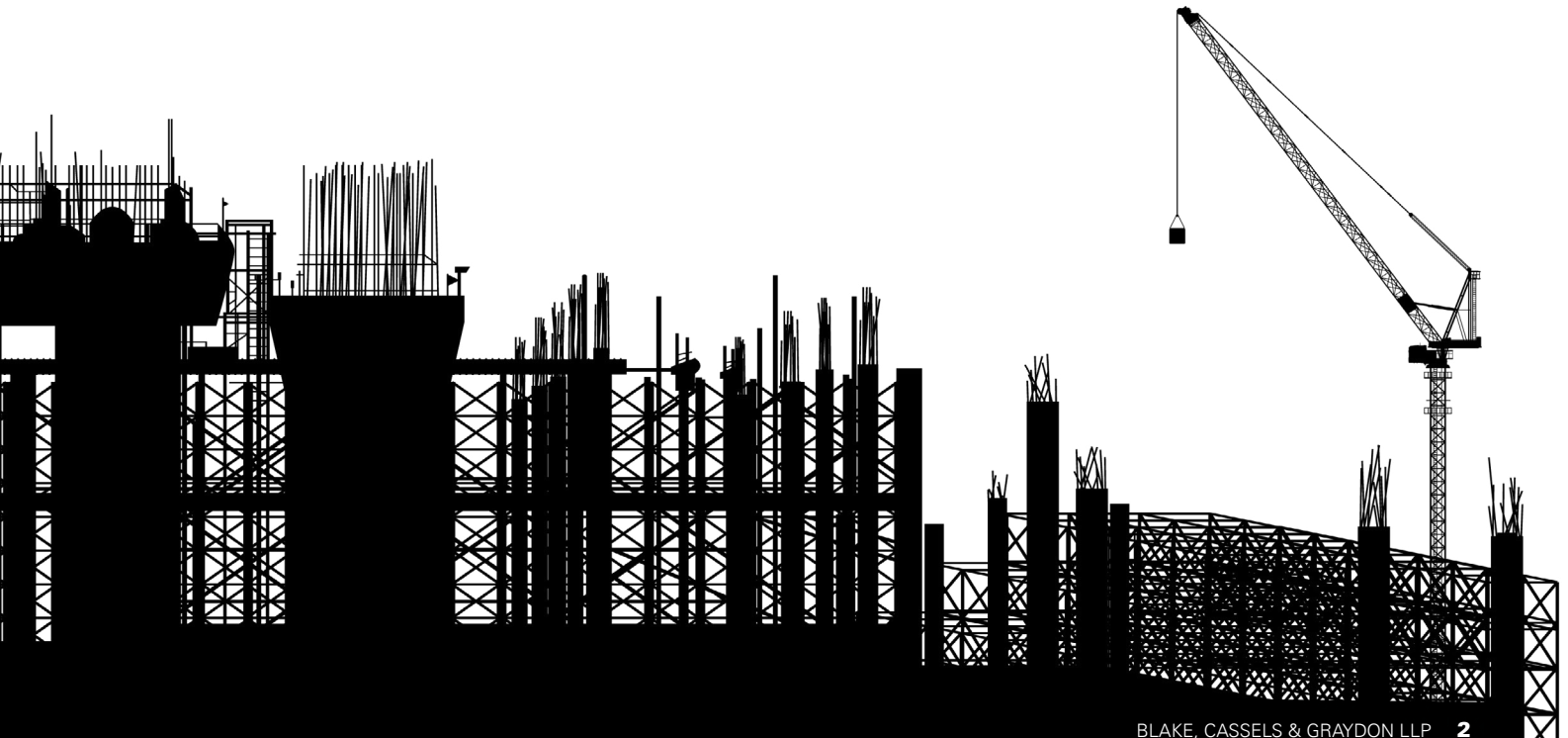
Combined with real estate, the building materials and construction industries contribute more to Canada's GDP than manufacturing, mining, and oil and gas extraction.²

The construction industry in Canada has experienced significant M&A activity during the past three years. In 2017, Bloomberg reported a then record number of transactions (94), with a total disclosed value of C\$10-billion. Deal flow increases continued in 2018 with 106 announced transactions with a total disclosed value of C\$13.2-billion, and 2019 continued to be a significant year for M&A activity with 117 announced transactions representing C\$14.1-billion in disclosed deal value. The majority of these deals (68 per cent) involved a cross-border element.

Over the last 10 years, cross-border M&A has originated principally from the U.S., but companies based in the U.K., Europe, Japan, Australia and China have been active as well.

Government agencies, including the Competition Bureau (Bureau) and the Investment Review Division (IRD) of Innovation, Science and Economic Development Canada (ISED) can have an impact on the business operations and transaction planning of building materials and construction companies in Canada. These types of companies operating in or planning to enter the Canadian market must be aware of, and fully comply with, applicable competition laws, whether bidding for a new project, merging with a competitor or engaging in its daily business operations.

The construction industry, like other industries, will continue to face financial pressures due to COVID-19, attributable to higher labour, health and safety costs, uncertainty around public projects, and increasing household debt.



Merger Notification Under the Competition Act and Investment Canada Act

Under the *Competition Act*, parties are required to notify the Bureau of a transaction if the parties to the transaction have assets or revenues in Canada greater than C\$400-million and the value of the assets or annual revenue of the target business in Canada is greater than C\$96-million.

Parties to a merger that exceed these notification thresholds must notify the Bureau and abide by a (minimum) 30-day waiting period before they can complete the merger. While some previous construction industry mergers did not require notification because they involved limited partnerships, the notification rules have changed such that assets and revenues from limited partnerships now count toward the threshold calculation. Accordingly, we anticipate that more construction industry mergers will be subject to *Competition Act* notification moving forward.

Parties to a joint venture transaction can benefit from exemptions to the notification requirements if they structure their transactions appropriately.

Recent changes to the *Investment Canada Act* have increased the monetary thresholds for review to C\$1.075-billion or more (other than for state-owned enterprise investors). This means that fewer foreign buyers will require approval in order to close their transactions. All transactions, no matter the size, can still be reviewed on national security grounds. As an example, CCCI's attempted acquisition of Aecon was blocked outright on national security grounds.

The rules concerning control acquisitions and monetary thresholds under the *Investment Canada Act* are complex. Certain construction industry transactions could require a pre-closing review application depending on how the target's construction projects are structured. For example, acquisitions through foreign corporations typically do not require pre-approval under the *Investment Canada Act*, whereas an acquisition of a Canadian corporation, limited partnership or joint venture could trigger a pre-closing application requirement because the liabilities on the balance sheet tend to be high, increasing the enterprise value of the target business above the financial threshold.



Market Definition in the Building Materials and Construction Industries

When reviewing a merger in the building materials and construction industries, the Bureau will typically attempt to define both the relevant product and geographic market where the merging parties compete. The relevant market comprises the smallest group of products and the smallest geographic area in which a hypothetical monopolist could profitably impose a small but significant non-transitory increase in price (called an SSNIP).³ The Bureau will also examine factors such as switching costs, relative prices, product end-use, past industry behaviour, transportation costs and shipping patterns.

The Bureau has not provided much in the way of guidance regarding how it defines product markets in the building materials and construction industries but has provided such guidance in related industries. For example, when reviewing the acquisition of Arcelor by Mittal, two steel companies, the Bureau defined the relevant product market narrowly and focused its review on coated cold-rolled steel after determining that the parties did not sufficiently overlap in their production of other forms of carbon steel.⁴

As building materials can be transported to end-users, the Bureau tends to define the relevant geographic market regionally or more broadly depending on the transportation costs of the products. In its review of Holcim's merger with Lafarge, the Bureau concluded that significant transportation costs and the requirement for local terminals meant that it viewed the geographic markets implicated in that merger as regional in size.⁵

As construction companies generally require a local presence to compete effectively for construction projects, the relevant geographic market for construction companies will likely be defined as local. For example, in its review of the amalgamation of Modular Space and Williams Scotsman, two modular unit lessors, the Bureau focused its analysis on the parties' overlapping local branch locations where the parties both had a significant presence.⁶



Efficiencies in the Context of Construction Mergers

In the face of higher costs for firms operating in the building materials and construction industries, mergers present an opportunity for firms to reduce costs, increase scale and share technology.

Under the *Competition Act*, a merger must be allowed to proceed where the efficiencies arising from the merger exceed the likely anti-competitive effects.

The efficiencies defence effectively functions as a cost-benefit analysis for mergers. On one side of the ledger are the gains in efficiency that will likely result from the transaction that will accrue to the Canadian economy and that would be lost if the Competition Tribunal issued an order to address the effect of the transaction on competition. On the other side of the ledger are the anti-competitive effects that will likely result from the merger, including the harm to society from reduced output (the "deadweight loss") and the negative effects (if any) of wealth transfers from consumers to the merging parties.

There is significant opportunity for efficiencies to emerge as a result of a merger, especially if existing players can combine operations. Efficiencies can result from both variable and fixed cost savings. Examples of possible efficiencies in the building materials and construction industries include the removal of duplication of corporate centre functions,⁷ streamlining customer support functions⁸ and consolidating plant/field operations.⁹



Document Discovery in Merger Review

Companies operating in the building materials and construction industries should ensure they have document management practices in place as the Bureau will examine parties' documents during their merger review, including for evidence of anti-competitive activity. The industry faces a particular risk profile due to frequent bidding for public contracts and market maturity and has been a major focus of the Bureau's criminal enforcement branch, particularly in the province of Quebec.¹⁰

The Bureau has actively investigated and prosecuted a number of Canadian construction companies and, over the last 10 years, has obtained many convictions of companies with fines in the millions of dollars. In addition, convicted companies can be prohibited (disbarred) from bidding on federal and even provincial government contracts for many years.

“Over the last 20 years, the Bureau has investigated more instances of alleged collusion in the Canadian construction industry than in any other industry in Canada.”

— Competition Bureau Submission to the OECD Global Forum on Competition Roundtable on Serial Offenders: A Discussion on Why Some Industries Seem Prone to Endemic Collusion



National Security Reviews for Foreign Investments

Investments in Canadian businesses with links to critical or strategic infrastructure will always be closely scrutinized by the Canadian government. Canada's *National Strategy for Critical Infrastructure* defines critical infrastructure to include processes, systems, facilities, technologies, networks, assets and services essential to the health, safety, security or economic well-being of Canadians and the effective functioning of government, referencing energy, utilities, transportation and government projects as specific critical sectors.¹¹

Foreign investors may want to consider submitting a notification to Canada's IRD before closing to allow the government the opportunity to vet the transaction on national security grounds. The government has up to 45 days to either initiate a national security review or notify the investor that the government may initiate a national security review. A national security review can take up to 200 days or potentially longer depending on the circumstances (extendible on consent). The government can prevent a transaction from closing, require undertakings from the foreign investor in relation to the investment or, if already implemented, require the foreign investor to divest themselves of their investment.



Key Takeaways

Recent revisions to notification rules have increased the number of construction and building materials industry transactions that are notifiable under the *Competition Act*, while increased threshold values have reduced the number of transactions reviewable under the *Investment Canada Act*.

Mergers between building materials or construction companies can often bring about significant efficiencies for the Canadian economy. Those efficiencies are counted in the *Competition Act* analysis.

Investors should be aware of foreign investment, including national security, review requirements and structure their deals appropriately to mitigate potential for pre-closing review applications and/or manage potential national security reviews.

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- 1 These figures were manually calculated using Statistics Canada data. See “Gross domestic product (GDP) at basic prices, by industry,” Table: 36-10-0434-01 (formerly, CANSIM 379-0031), Statistics Canada, online: <https://www150.statcan.gc.ca/t1/tbl1/en/tv.action?pid=3610043401>
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- 3 “Merger Enforcement Guidelines,” Competition Bureau of Canada (October 6, 2011) at 4.3, online: <http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/03420.html>
- 4 “Proposed Acquisition of Arcelor by Mittal,” Competition Bureau of Canada (October 2006), online: <http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/00550.html>
- 5 “Competition Bureau statement regarding the proposed acquisition by Holcim of Lafarge,” Competition Bureau of Canada (May 4, 2015), online: <http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/03920.html>
- 6 “Competition Bureau statement regarding the proposed amalgamation of Modular Space Corporation and Williams Scotsman International, Inc.,” Competition Bureau of Canada (June 23, 2016), online: <http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/04107.html>
- 7 Including corporate management, head office management activities, human resources, personnel and facilities, information systems and technology, purchasing, and marketing.
- 8 Including sales force and related management, customer service and administration, regulatory, and safety.
- 9 Including field sites, branches and plant operations, delivery and service fleets, and staff and inventory.
- 10 “Competition Bureau Submission to the OECD Global Forum on Competition Roundtable on Serial Offenders: A Discussion on Why Some Industries Seem Prone to Endemic Collusion,” Competition Bureau of Canada (October 30, 2015), online: <http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/03989.html>
- 11 “National Strategy for Critical Infrastructure,” Public Safety Canada, online: <https://www.publicsafety.gc.ca/cnt/rsrscs/pblctns/srtg-crtcl-nfrstrctr/index-en.aspx>

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