Restaurant Industry: Competition Law in Canada

Meeting the challenges of increasing competition, changing business conditions and heightened customer expectations requires legal counsel with in-depth industry knowledge and experience across many legal disciplines. We make sure we understand our client's business objectives and concerns in order to craft the best solution.

Blakes Means Business

About Blakes

As one of Canada's top business law firms, Blake, Cassels & Graydon LLP (Blakes) provides exceptional legal services to leading businesses in Canada and around the world. We focus on building long-term relationships with clients. We do this by providing unparalleled client service and the highest standard of legal advice, always informed by the business context.

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Introduction

Canada's restaurant industry is going through a period of substantial uncertainty and disruption following COVID-19 and related lockdown measures. Against this backdrop, industry participants may seek to achieve greater scale and cost efficiency through collaboration or consolidation in order to combat declining revenues and shifting consumer behaviour.

The restaurant industry has historically not been the subject of considerable scrutiny from Canada's Competition Bureau, nor enforcement under the *Competition Act* (Act), due in large part to the high number of competitors and industry fragmentation.

As the sector continues to face consolidation pressures, it is important for industry participants to be aware of, and effectively navigate, Canada's competition law and foreign investment regimes.

Things You Need To Know

Things You Need to Know About the Restaurant Industry and Competition and Foreign Investment Law in Canada

1. The Competition Bureau has yet to challenge or require remedies relating to a restaurant transaction in Canada.

2. Competition Bureau has recognized that certain competitor collaborations may be required to address challenges particular to COVID-19.

3. Recent guidance from the Competition Bureau confirms that agreements relating to wages and not poaching employees are not subject to the Act's criminal conspiracy provisions but may be reviewed as a civil matter to assess whether they are likely to harm competition.

4. Canada's foreign investment regime has required foreign buyers of Canadian restaurant businesses to agree to standard undertakings regarding the Canadian business.

Competition Law Enforcement Framework

Like many developed economies, Canada has a competition law of general application called the *Competition Act*. The Act's purpose 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 relevant to participants in Canada's restaurant industry, including civil provisions relating to mergers, abuse of dominance, and the accuracy of advertising and other representations, as well as criminal prohibitions against certain types of agreements among competitors (i.e., cartels) and bid-rigging.

The Act is administered and enforced by the Commissioner of Competition (Commissioner), the head of Canada's Competition Bureau (Bureau). It requires that mergers that exceed certain financial thresholds be reported to the Bureau for review — all reported and unreported mergers can be reviewed up to one year following closing. The Act also permits the Bureau to apply for court orders to produce data and documents, interview company executives and search property. However, the Bureau is not permitted to act unilaterally. Instead, the Bureau may bring administrative proceedings to a specialized court, the Competition Tribunal (Tribunal), or refer criminal matters to the Public Prosecution Service of Canada (PPSC) for potential prosecution. Alternatively, the Bureau or PPSC may enter into settlements that resolve the Bureau's concerns.

Merger Review

Canada's framework for merger review has similarities to other jurisdictions but also contains the following unique 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 (including domestic sales, exports and imports). The Bureau retains jurisdiction to review all mergers, including those that do not exceed the notification thresholds and are increasingly monitoring and investigating non-notifiable mergers.

Waiting Periods

Where the notification thresholds are exceeded, closing is prohibited until 30 calendar days after the notification. In addition, the Bureau can extend this waiting period by issuing a supplementary information request (SIR). The issuance of an SIR extends the waiting period until 30 calendar days after the merging parties have submitted complete responses to the SIR.

Typical reviews of non-complex transactions will take two weeks or less. Reviews of more complex transactions may take between four and six weeks (if the Bureau does not issue an SIR) or between four and six months (if the Bureau does issue an SIR).

Substantive Review

Regardless of whether the transaction meets the notification thresholds, the Bureau reviews mergers to assess whether they are likely to "prevent or lessen competition substantially." This occurs only where 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, typically in the guise of increased prices or detrimental impacts on product quality, variety, service and similar factors. Key assessment factors the Bureau will consider include the parties' combined market shares, the degree of market concentration, barriers to entry and expansion, and demand-side considerations (including buyer power) that will constrain any exercise of market power by the merged 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 offset the anticipated anti-competitive effects (including effects on low-income consumers in certain circumstances). 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 (which gives the parties substantive comfort). Alternatively, if after its review the Bureau remains concerned the merger is likely to prevent or lessen competition substantially, the Bureau may seek to negotiate changes to the merger (such as a divestiture or behavioural commitment) to address those concerns or apply to the Tribunal for an order prohibiting all or part of the merger, among other things. There are also numerous interim steps available to the Bureau, such as permitting merging parties to close transactions but mandating that the businesses over which the Bureau has concerns be placed into a "hold separate" arrangement.

Recent Trends in Merger Review

No Substantive Merger Reviews or Remedies in Restaurant Sector to Date

Historically, the Bureau has not taken action against, or required remedies in, any transactions in the restaurant industry. This is due largely to the fragmentation of the industry, the high number of competitors in the sector, and the relatively low barriers to entry in the industry.

The most recent high-profile merger in the restaurant industry was the acquisition of Tim Hortons by Burger King in 2014, backed by Brazilian private equity firm 3G Capital. The deal resulted in a combination of the two restaurant giants for a purchase price of over US$ 11-billion. The Bureau cleared the transaction with no remedies required on October 28, 2014, two months after it was announced. The Bureau's press release on the clearance cited "the existence of a large number of competitors and the low barriers to entry in the fast-food industry" as the key reasons for its decision.

As trends of consolidation continue in the industry and participants' market shares climb closer to the Bureau's "safe harbour" threshold of 35 per cent, future mergers in this sector may draw increased attention from the Bureau.

Non-Merger Business Practices

Non-Merger Business Practices

The Act contains numerous provisions regarding non-merger business practices that are potentially relevant to restaurant industry participants. These include:

(i) Criminal Offences for Price-Fixing and Bid-Rigging

It is a criminal offence to, among other things, enter into an agreement with a competitor or potential competitor to fix or control price (e.g., to agree on menu pricing), fix or control output (e.g., to agree on seating capacity); or to allocate customers, markets, sales or territories (e.g., to agree on territories in which a restaurant chain will not operate or to agree that certain customer groups will only be served by one of the companies). It is also a criminal offence 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 providing notice of such agreement.

These offences are punishable by significant fines and also, for individuals, jail terms. Private parties can also sue for damages for violations of the criminal prohibitions, typically brought as class actions. Recent cases in Canada have significantly lowered the bar to class certification, and the damages sought are increasing.

(ii) Civil Prohibitions on Abuse of Dominance

Business practices that constitute an abuse of dominance can be prohibited by the Tribunal and may be subject to an administrative monetary penalty and other remedies. Abuse of dominance occurs when a firm with market power engages in conduct that excludes or otherwise harms a competitor (absent a legitimate business justification for the practice) and the practice prevents or lessens competition substantially. However, private parties cannot sue for damages for business practices that are alleged to be an abuse of dominance under the Act.

(iii) Civil Competitor Collaborations

Agreements among competitors or potential competitors that prevent or lessen competition substantially can be prohibited by the Tribunal. No other sanction (such as a fine) is available for such agreements. The Bureau has explained that it will use this provision to investigate agreements that do not rise to the level of "naked constraints," but that, nevertheless, have an anti-competitive effect, including agreements with competitors relating to suppliers or employees. However, any agreement that results in efficiencies (including fixed-cost savings) that outweigh and offset the anti-competitive effects cannot be prohibited.

(iv) Misleading Claims

The Act contains criminal and non-criminal misleading advertising and deceptive-marketing practice restrictions. In particular, the Act prohibits making any representation to the public for the purpose of promoting a product or business interest that is false or misleading in a material respect. If the false or misleading representation is made knowingly or recklessly, then it may constitute a criminal offence, be subject to prosecution, and subject to private class actions.

Recent Trends In Enforcement

No-Poach Litigation in Canada

Discussions regarding "no-poach" clauses in agreements between competitors and in franchise agreements (which prevent franchise managers from hiring employees from other franchisees within the same brand) has begun to make its way to Canada. However, the Canadian framework is different from that in the United States, such that these agreements do not potentially violate the Act's criminal conspiracy provisions.

The Bureau issued guidance in November 2020, noting that buy-side agreements to not hire employees away from competitors (no-poach agreements), or agreements that set wages at a specific lower level or range (wage-fixing agreements) fall outside the scope of the criminal conspiracy provisions of the Act. However, the Bureau may assess buy-side agreements under the civil competitor collaborations provisions of the Act, provided that the agreement would likely prevent or lessen competition substantially. If the Bureau believes the agreement is likely to have that effect, it may apply to the Tribunal for an order to prevent enforcement of that element of the agreement.

Competitor Collaborations Relating to COVID-19

Collaborations between competitors may be needed on an urgent basis to address issues arising from COVID-19. In this regard, the Bureau issued a statement indicating it will generally refrain from exercising scrutiny in circumstances where there is a clear imperative for short-term collaboration to ensure the supply of products and services that are critical to Canadians in response to COVID-19, provided that any such collaboration is done in good faith and does not go any further than needed to address the COVID-related issues. The Bureau is also willing to provide an informal assessment of any proposed collaboration where parties believe that greater comfort is needed from the Bureau, which may be time-limited as necessary to respond to the COVID-19 crisis. This policy would apply to companies in the restaurant industry who may need to collaborate with competitors, for example, with respect to supply chain management, to ensure the continuity of food supply to Canadians.

More generally, competitor collaborations can usually be structured to manage risk under the Act. Such collaborations can be an important way for parties to enhance innovation efforts or achieve cost savings and other efficiencies absent a full-blown merger. When engaging in any such collaboration, effective management of communications between competitors, with the assistance of competition law counsel, can substantially reduce (and likely eliminate) the risk of criminal or civil contravention of the Act.

Foreign Investment Regime

All acquisitions of Canadian businesses by non-Canadian investors are subject to the foreign investment regime set out under the *Investment Canada Act* (ICA). This applies to restaurant businesses that can be acquired by non-Canadians.

Direct acquisitions can be subject to foreign investment review if certain thresholds are met. The base threshold is C$5-million. However, this threshold is subject to broad exceptions and grows to C$1.043- billion for World Trade Organization (WTO) investors and C$1.565 -billion for specific trade agreement investors (which currently covers over 40 countries, including the United States, Mexico, the U.K. and all countries in the EU). The WTO and trade agreement thresholds are subject to annual adjustment.

A reviewable transaction may not be completed unless the investment has been reviewed and approved as of "net benefit to Canada." The non-Canadian proposing the investment must make an application to Investment Canada setting out particulars of the proposed transaction. There is then an initial waiting period of up to 45 days, with a possible further extension of 30 days.

Typically, acquirors will agree to certain undertakings as part of an ICA review, which may include undertakings to keep management or head offices in Canada, as well as the maintenance or expansion of employment or investment levels in Canada. The Burger King acquisition of Tim Hortons was subject to an ICA review, and Burger King committed to maintaining employment levels at Tim Hortons in Canada, establishing the joint head office in Oakville, Ontario, and listing on the TSX, among other commitments.

Conclusion

Participants in the restaurant industry should be aware of the competition and foreign investment regimes in Canada that may impact future consolidations and ongoing activity in the industry. Careful planning and management can help minimize the burden associated with compliance with these regimes and allow for successful growth during this period of transition.

Key Contacts

Blakes competition, antitrust & foreign investment is frequently retained by major domestic and international companies and by international and domestic law firms to provide strategic counsel and representation in merger reviews, cartel investigations, abuse of dominance cases, distribution practices cases, advertising matters and other competition-related matters.

Blakes is also a leading firm withrespect to securing approvals for non-Canadian purchasers under Canada's foreign investment laws.

Competition Regional Firm of The Year – Americas
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Competition Law Firm of The Year
— Benchmark Canada Awards 2018

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