
Adam F. Fanaki Competition Law Moot

Official problem of the 2021 Adam F. Fanaki Competition Law Moot

Reference: *The Commissioner of Competition v Poodle Inc.*

IN THE MATTER OF an Application by the Commissioner of Competition for an order pursuant to section 92 of the *Competition Act*, RSC 1985, c C-34, as amended;

BETWEEN

The Commissioner of Competition
(Applicant)

and

Poodle Inc.
(Respondent)

REASONS FOR ORDER DATED OCTOBER 15, 2020

I. Executive summary

A. Overview

[1] The Commissioner of Competition (the "**Commissioner**") has filed an application pursuant to section 92 of the Competition Act, R.S.C. 1985, c. C-34, as amended (the "**Act**"), seeking a dissolution order to remedy the substantial lessening or prevention of competition ("**SLPC**") that she alleges is likely to occur as a result of Poodle Inc.'s ("**Poodle**") completed acquisition of Trowel.it Inc. ("**Trowel.it**").

[2] Poodle is one of the largest diversified technology companies in the world. It offers a wide variety of search, e-commerce, web hosting and computing services, including Poodle Search, Poodle Maps, Poodle Marketplace and Poodle Web Hosting, as well as a social networking and media platform, Poodle Pups. Poodle also licenses a number of web services and technologies to software developers as part of its Poodle Toolkit product suite.

[3] Trowel.it is a Canadian start-up that develops social networking technologies designed to appeal to home gardeners. For example, Trowel.it allows users to make their lawns available as community gardens, sell their produce and earn incentives when purchasing new gardening equipment. Trowel.it's users access its features through "plug-ins" or "applets" developed for social networking platforms such as Poodle Pups and Frenchton.com, a similar platform offered by Poodle rival Frenchton.com, Inc. ("**Frenchton**").

[4] Prior to its acquisition by Poodle, Trowel.it had been working to expand its appeal with non-gardeners and, at the same time, develop a broader suite of social networking features (such as the ability to share messages and photos) through the development of an ambitious program described internally as "Project Papillon". According to the Commissioner, if completed successfully, Project Papillon would have allowed Trowel.it to offer a full-featured standalone social network, while continuing to make its innovative hobbyist features available as plug-ins to other platforms in accordance with its "open garden" approach.

[5] In the months leading up to the Commissioner's application, lockdown measures adopted in response to the global corgid-19 pandemic generated an unprecedented interest in home gardening by freshly minted amateur gardeners, which has in turn significantly expanded Trowel.it's user base. In late March of 2020, Trowel.it initiated a sale process, hoping to exit before its users returned to work and, it predicted, lost interest in gardening and other hobbies. Trowel.it received a number of bids. Poodle's bid was strongest, but it did not approach the valuation that Trowel.it's co-founders had anticipated. Believing that the pandemic would

continue, Trowel.it decided to discontinue the sale process and wait for a more advantageous time to sell their business.

[6] In response to Trowel.it's rejection, Poodle took certain steps designed to persuade Trowel.it to accept Poodle's offer, including by reducing Trowel.it's revenues, increasing its costs and withholding technologies that were necessary to implement Project Papillon. As a result of these tactics, Trowel.it decided in desperation to accept Poodle's offer. As the transaction was not subject to mandatory pre-merger notification under the Act, Poodle and Trowel.it completed their merger on June 1, 2020 without notifying the Commissioner in advance.

B. The Commissioner's Application and Poodle's Response

[7] The Commissioner's application alleges that Poodle's acquisition of Trowel.it is likely to result in a SLPC in the market for social media and social networking services. In the Commissioner's submission, absent the merger, Project Papillon would have brought Trowel.it into direct competition with Poodle Pups.

[8] Poodle disagrees that its acquisition of Trowel.it is likely to result in a SLPC. In its submission, the Commissioner's allegations are highly speculative, and are based on wild guesses about the likely success of Project Papillon and the future growth of Trowel.it's business. The Commissioner and Poodle disagree vigorously about the degree of "speculation" that the Tribunal may engage in when undertaking a forward-looking analysis about the likely outcomes of speculative, future events, particularly in the dynamic technology and social media industry.

[9] Poodle also argues that, even ignoring the speculative nature of the Commissioner's concerns, Project Papillon was doomed to fail. Poodle argues that Trowel.it could never have completed Project Papillon on its own because it would have required access to Poodle technology that Poodle would not have made available, absent an acquisition. The Commissioner responds that these arguments amount to "hostage-taking" and "gamesmanship" that would subvert the Tribunal process and undermine the aims of the Act.

[10] Finally, Poodle argues that even if the Tribunal accepts the Commissioner's submissions with respect to the alleged effects of the transaction, the merger should nevertheless be permitted because Trowel.it is a failing firm, even though both parties agree that there were alternatives to the acquisition (such as being acquired by another bidder or restructuring) that may have been competitively preferable. Poodle submits that the Tribunal should not consider whether there may have been competitively preferable alternatives, since to do so is excessively speculative; the Commissioner responds that, on the contrary, the Tribunal is required to consider such evidence in order to give effect to paragraph 93(b) of the Act, and if Poodle fails to demonstrate that there

were no competitively preferable alternatives, then the “failing firm defence” has not been made out and failing firm arguments must be ignored. In any event, the Commissioner argues, Poodle should not be permitted to avail itself of this defence because its own predatory and abusive conduct was the proximate cause of Trowel.it’s likely failure.

[11] There is no dispute as to remedy.

C. The Tribunal’s findings

[12] With regard to the alleged anticompetitive effects of the merger, the Tribunal finds that the Commissioner’s concerns with respect to the likely horizontal effects of the merger are too speculative to justify intervention under section 92 of the Act. It is not open to the Tribunal to adjust its evidentiary standards when hearing applications involving high technology or in light of the corgid-19 pandemic; if it were, the Tribunal would decline to do so.

[13] In case the Tribunal has erred in concluding that the Commissioner has not discharged her burden to demonstrate that the impugned transaction is likely to substantially lessen or prevent competition, the Tribunal has also considered Poodle’s arguments that Project Papillon could never have succeeded in bringing Trowel.it into competition with Poodle (either because Poodle would not have licensed the necessary technology to Trowel.it, or because Trowel.it would not have pursued the project in order to avoid creating antitrust issues for its eventual sale to Poodle). The Tribunal agrees with the Commissioner. If such arguments were to be afforded any weight, the Tribunal’s process would be vulnerable to hostage-taking and gamesmanship and the aims of the Act would be undermined.

[14] Similarly, although it need not do so in light of its other conclusions, the Tribunal has considered the parties’ submissions regarding failing firm arguments and the correct interpretation of paragraph 93(b) of the Act. With respect to the applicable test, the Tribunal finds that it is not entitled to consider potential alternatives to the transaction as part of its analysis. Nor is it Poodle’s burden to adduce evidence establishing a positive “failing firm defence”: instead, failing firm arguments are part of the SLPC analysis and weighed against other relevant considerations, such as the likelihood of entry and the existence or absence of barriers to entry, as part of that inquiry. Finally, the Tribunal finds that the Commissioner’s submission that Poodle is effectively “estopped” from raising failing firm arguments is without merit.

[15] As a result of these findings, the Commissioner’s application for a dissolution order in respect of the completed acquisition of Trowel.it by Poodle is denied.

II. The Parties

A. The Commissioner

[16] The Commissioner is the public official appointed by the Governor in Council under section 7 of the Act to be responsible for the administration and enforcement of the Act.

B. Poodle

[17] Poodle is a technology company with activities that touch virtually every corner of the digital world. From relatively humble beginnings as a search engine, Poodle has grown to offer numerous search products, a leading e-commerce platform and several other services that would, if offered by independent firms, easily represent some of the largest companies in the world. Poodle is the subject of constant antitrust scrutiny around the world, but its products are undeniably widely used and of significant interest to advertisers.

[18] For the purposes of this decision, it is important for the Tribunal to further consider and describe four specific Poodle offerings:

a. *Poodle Web Hosting* comprises a suite of network architecture solutions that Poodle offers to third parties using its own server infrastructure in exchange for a fee. Poodle estimates that as much as 30% of all Internet traffic, including both web pages and mobile applications, involves Poodle Web Hosting in some way.

b. *Poodle Toolkit* is an enormous library of proprietary software solutions that Poodle customers can use when developing their own software. Poodle Toolkit contains highly sophisticated algorithms, methods and tools that are, in practice, too complicated for most developers to replicate by working from scratch. Access to Poodle Toolkit is thus a *sine qua non* for many small developers when creating software.

c. *Poodle Pups* is a social network that enables users to connect with friends and share content, play games and transfer money. Poodle Pups has almost three billion unique monthly active users.

d. *Poodle AdWoofs* is an advertising platform developed by Poodle that allows advertisers to bid to display brief advertisements and other messages to web users. AdWoofs can place ads on Poodle Search results and on third-party sites, with the third party earning a small fee for each ad impression.

[19] Poodle acquires an average of 20 companies of all sizes every year; Trowel.it is the latest.

C. Trowel.it

[20] Trowel.it was, until its acquisition, a small but rapidly growing start-up founded in Waterloo, Ontario in 2017 by Suresh Khan, a self-described “serial founder” who has previously started and sold three other companies. Prior to its acquisition by Poodle, Trowel.it had just 26 employees and approximately 30 million users. Approximately 40% of the interests of Trowel.it were held by Mr. Khan, with the balance held by four different venture capital firms that had contributed to its growth in different “funding rounds”.

[21] Trowel.it offers a suite of gardening-focused social services designed to integrate with social networks, including Poodle Pups, that enable users to take advantage of Trowel.it’s unique features while using other platforms. Trowel.it’s features are all designed to appeal to hobbyist gardeners. For example, Trowel.it allows users to make their lawns available as community gardens, sell their produce and earn incentives when purchasing new gardening equipment from Trowel.it’s partner retailers. Similarly, a Poodle user searching for nearby organic groceries may be presented with advertisements for local Trowel.it gardeners offering the produce they need, while Trowel.it users can purchase tools and supplies through Poodle’s e-commerce partnerships and exchange loyalty points they earn by using Trowel.it for premium gardening content hosted on the Poodle platform.

[22] Trowel.it users access these services by logging into the third-party platform, navigating to the Trowel.it “add-in” and granting permission for their information to be shared between the two services; they can then use Trowel.it features within the integrated platform. Trowel.it has deliberately pursued an “open garden” approach to its dealings with third-party platforms, maximizing its compatibility with as many third parties as possible and rebuffing numerous proposals to make its features exclusively available to one platform. Trowel.it’s revenue comes primarily through Poodle’s AdWoofs program, with Trowel.it earning a small fee when its users view AdWoofs advertisements placed on Trowel.it (whether through Poodle Pups or another platform).

[23] A central focus of Trowel.it’s growth plan was a series of initiatives collectively codenamed Project Papillon. Project Papillon had two main goals. First, Trowel.it would develop core social networking functionality and a standalone platform, so that users desiring seamless and early-access Trowel.it features could access them directly through an entirely new social networking platform rather than through Poodle Pups, Frenchton.com or any other portal. Second, and concurrently, Trowel.it would continue to develop innovative functionality for both gardeners and other hobbyists, such as home bakers, carpenters and artists. These new features would be offered through the newly developed Trowel.it platform first but would the be rolled out to other

platforms as quickly as possible in accordance with the “open garden” principle. Both the standalone platform and the contemplated new features would leverage Poodle Toolkit technology extensively to rapidly develop and scale these exciting new features.

III. Factual background

[24] Prior to 2020, Trowel.it was a small three-year old technology start-up catering to a relatively niche community of Canadian hobbyist gardeners. While it was growing at a reasonable pace, its popularity exploded in 2020 when a global pandemic led to a significant increase in amateur green thumbs.

[25] In March 2020, the World Health Organization declared that the corgid-19 respiratory illness caused by a rapidly spreading novel corgivirus was a pandemic. Governments around the world took steps to slow the spread of the disease by imposing lockdowns and other measures.

[26] As a result of these measures, millions of people were forced to find ways to pass the time while confined at home. Due in part to the timing of the pandemic in the northern hemisphere, many turned to gardening. Many of these new gardeners discovered Trowel.it and found its unique features highly useful. As a result, Trowel.it was widely discussed in the popular press and experienced unprecedented user growth.

[27] Mr. Khan and his investors determined that the interest generated by the pandemic represented an ideal opportunity to exit the social gardening technology space. In June 2020, Trowel.it initiated a sale process.

[28] Trowel.it received four bids. Two of these were from competing social gardening technology providers (namely, Diatomaceous Earth Industries, Inc. and Secateur Corporation); the former was only prepared to offer its own shares as consideration and the latter – perhaps somewhat ironically – abandoned its bid relatively early in the sale process due to perceived antitrust risk. The third and fourth bids were from Frenchton and Poodle; Poodle’s offer was approximately twice as generous as Frenchton’s, but still significantly less than Mr. Khan felt the company was worth. Accordingly, Trowel.it discontinued the sale process and continued to pursue Project Papillon, its greenfield organic growth ambition.

[29] Poodle was enraged that Trowel.it had spurned its acquisition offer. Shortly after, Poodle adopted a strategy designed to weaken Trowel.it and make it more amenable to Poodle’s offer. Specifically, Poodle (a) changed its AdWoofs policies to be far more restrictive on “competitive social network technologies”, resulting in significant, short-term reductions in Trowel.it’s revenues; (b) increased certain pricing tiers for its Poodle Web Services computing services business,

increasing Trowel.it's costs; and (c) revoked Trowel.it's access to certain core Poodle Toolkit services that Trowel.it had been using to develop the Project Papillon program.

[30] As a result of these measures, Trowel.it found itself in acute financial and strategic distress. From the perspective of Mr. Khan and his venture capital partners, Trowel.it faced: (a) reduced AdWoofs revenues and had no obvious alternative source of short-term revenue; (b) rising costs due to increased usership from the corgid-19 pandemic (disproportionate to the increased revenues from increased usership); and (c) no clear path to profitable growth in the absence of a viable way to develop Project Papillon. Trowel.it had a short-term liquidity crisis and a long-term strategic crisis. Moreover, its venture capital investors had no appetite to engender hostility from Poodle, given their relationships with Poodle (as a serial acquirer of start-ups). In desperation and facing significant investor pressure, Trowel.it agreed to be acquired by Poodle.

[31] The transaction was not subject to mandatory notification under the Act and was completed on September 19, 2020. After closing, the transaction was reported in the trade press and came to the attention of the Merger Intelligence and Notification Unit of the Competition Bureau. The Commissioner commenced an investigation and ultimately brought the present application to the Tribunal.

IV. Contested issues and positions of the parties

[32] The parties submit – and the Tribunal agrees – that the dispute over this application can be reduced to four key issues:

a. For acquisitions in the highly dynamic technology industry (where future outcomes and growth prospects are uncertain), or in light of the uncertainty caused by the global pandemic, is the Tribunal entitled to adjust its standard for whether a transaction is "likely to prevent competition substantially"? Should it do so here?

b. Should the Tribunal's analysis of the alternatives to this transaction take into account potentially self-serving evidence as to the likely actions which the respondents themselves would have taken in the absence of the merger?

c. Is the Tribunal entitled to consider evidence as to the applicability of section 93(b) of the Act (*i.e.*, evidence that a firm may be "likely to fail") in the absence of evidence about alternatives to the transaction?

d. Is a purchaser "estopped" from raising failing firm arguments if its own conduct was the proximate cause of the target's likely failure?

[33] The parties have agreed that the only appropriate remedy – should a remedy be required – would be to prevent the transaction entirely, requiring Trowel.it to seek another acquirer or, if necessary, allowing it to fail. Thus, the resolution of these four issues will be sufficient to determine the outcome of this application.

A. Speculation and the Commissioner's burden under section 92

[34] The Commissioner's application alleges that Poodle's acquisition of Trowel.it is likely to result in an SLPC in the market for social media and social networking services. More specifically, the Commissioner submits that Poodle's acquisition of Trowel.it will result in a substantial prevention of competition in the market for social media and social networking services because, absent the merger, Trowel.it was likely to have pursued Project Papillon and developed its own social networking platform that would have competed directly with Poodle Pups. Because it removes this potential future competition, the transaction meets the standard for Tribunal intervention in section 92 of the Act.

[35] The Commissioner submits that, once complete, Project Papillon would have benefitted from a "virtuous cycle" of user growth, including as a result of continuing interest in various hobbies due to the continuing effects of corgid-19. In support of these claims, the Commissioner has adduced a variety of evidence regarding the likely appeal of Project Papillon's contemplated new features, Mr. Khan's and Trowel.it's track record in launching successful companies and Poodle's own initial user growth trajectory. The Commissioner also made voluminous submissions regarding previous Poodle acquisitions, including several companies that have experienced significant growth as part of the Poodle organization (and, the Commissioner alleges, would have competed vigorously against Poodle had it not acquired them at a nascent stage). The Commissioner has also presented evidence regarding the likely duration of corgid-19 lockdown measures and the increasing popularity of various hobbies.

[36] Notwithstanding this evidence, the Commissioner acknowledges that her projections about the outcome of Project Papillon and the ongoing effects of corgid-19 are necessarily somewhat speculative. She even conceded, during questioning by Poodle, that the evidence available may not meet the threshold that the Tribunal would historically have required before finding that a merger would be likely to result in an SLPC. However, she encourages the Tribunal to "err on the side of caution", since the costs of failing to prevent a "killer acquisition" are high, and the Commissioner cannot reasonably be expected to provide certain evidence in light of the challenges of fast-moving technology markets and a global pandemic.

[37] The Commissioner recognizes the language of section 92 of the Act, which empowers the Tribunal to make an order only where it "finds that a merger or proposed merger prevents or

lessens, or is likely to prevent or lessen, competition substantially". Instead, she argues that the Tribunal is entitled – and indeed obligated – to interpret the word "likely" in a purposive manner that achieves the objectives of the Act. She argues that the Tribunal can and should "read down" the required degree of likelihood where a stricter interpretation may have perverse outcomes and frustrate effective enforcement.

[38] The Commissioner emphasizes that certain inherent features of the technology industry make it impossible for her and her staff to meet an evidentiary burden that was developed for use in less dynamic industries. Specifically, she submits, the fact that customers face virtually no switching costs and can costlessly use multiple platforms means that a nascent competitor with compelling features can attract millions or hundreds of millions of users in a matter of months. She cites a number of recent examples of successful new entrants such as SnoopChat and DigDog. The Commissioner argues that competition policy is not served by permitting incumbent behemoths like Poodle to acquire potential competitors in the cradle. She submits that she will be powerless to prevent such acquisitions if the Act requires her to "scry the future". As the Commissioner's counsel put it, "if I could do that, I'd be an investor and not an enforcer."

[39] The same logic applies, the Commissioner argues, to periods of time that are characterized by extreme uncertainty, such as the present pandemic. She submits that, when the world becomes highly unpredictable, the enforcer's burden to persuade the adjudicator that her concerns are more than speculative becomes, in practice, a bar against all enforcement action. Any predictions are necessarily speculative under such conditions.

[40] Given these considerations, the Commissioner argues that the Tribunal must adopt a flexible and purposive approach to its interpretation of the word "likely" in section 92, and should interpret the Commissioner's burden as being lower – and satisfied – in the particular circumstances of this case.

[41] Poodle objects to the Commissioner's suggestion that the Tribunal should relax the burden for technology acquisitions, during a pandemic or in any other case. In the first place, Poodle argues, the Tribunal has no discretion to interpret the word "likely" in any manner other than its plain meaning, in accordance with the usual principles of statutory interpretation. Nor is it appropriate, in Poodle's submission, for the Tribunal to interpret any part of the Act in different ways depending on the industry or time period at issue in a particular case. Poodle argues that such an approach would undermine the efficacy and fairness of the Tribunal and undermine the public's confidence in its application of the law.

B. Evidentiary burden in the "but for" analysis

[42] When assessing whether a merger is likely to substantially prevent or lessen competition, the Tribunal must first consider the "but for" scenario (*i.e.*, what level of competition would have prevailed in the absence of the transaction). In this regard, Poodle argues that the "but for" scenario postulated by the Commissioner (*i.e.*, robust competition between Poodle and Trowel.it in the social networking market) could never have arisen, because it is inconsistent with the actions that Poodle and Trowel.it would actually have taken in the absence of the merger.

[43] In the first place, Poodle submits, it would never have licensed its technology to a competitor that it genuinely perceived as threatening. As a result, Project Papillon – which explicitly contemplated the use of Poodle Toolkit and could not have been achieved without it – was doomed to fail even in the absence of the merger. Poodle argues that it should not be "hoisted on its own petard" by having its own products "used against it" when acquiring firms whose competitiveness is premised on the use of such products.

[44] Poodle also argues that Trowel.it had always intended to be acquired in the relatively near term, ideally by Poodle itself. Emails between Mr. Khan and Trowel.it's venture capital investors refer to a Poodle acquisition as "the Holy Grail" and "the golden bone". Documents even suggest (albeit ambiguously) that Trowel.it deliberately worked to develop social technology in order to ensure it would be within Poodle's "kill zone" (a modern coinage used to refer to a strategy of acquiring any start-up operating within close conceptual proximity to a large incumbent's businesses). Poodle submits that Trowel.it would never have become a *bona fide* competitor, since doing so would create regulatory risk that could jeopardize its eventual acquisition by Poodle (which was Trowel.it's eventual goal). Instead, Trowel.it was in fact more like an affiliated developer or "farm team" that would sooner or later be brought into the Poodle organization without ever becoming a serious competitive threat.

[45] The Commissioner rejects these arguments for legal and policy reasons. She says that these arguments depend on actions the respondents themselves have taken or might take to alter the "but for" scenario. Such actions must be ignored in order to prevent the potential "gaming" of the Tribunal by sophisticated parties. If the Tribunal allows these arguments to affect its assessment of the "but for" world, the Commissioner argues, it will effectively grant *carte blanche* for Poodle to acquire any potential competitor that planned to rely on its indispensable Poodle Toolkit.

[46] The Commissioner argues that, if the Tribunal determines this application on the basis of a "but for" world that assumes Poodle's future refusal to license Poodle Toolkit to potential competitors, it will have acquiesced and vindicated a "deliberate campaign of hostage-taking and anticompetitive behaviour". Such a standard will allow future acquirers to acknowledge that they

plan to prey on potential competitors and then, having been permitted to acquire the same potential competitors instead, never have the need do so. Thus, as a rule, the Tribunal should not entertain arguments about a "but for" world premised on an acquirer's ability to stymie, exclude or prey upon a potential target absent a merger.

[47] The Commissioner's submissions about Trowel.it's ambition to be acquired are similar. Almost any firm is willing to be acquired at some price, and the most anticompetitive acquirers are often willing to pay the highest prices. If the ambition to be acquired is taken into account when assessing the "but for" world, almost any acquisition could be justified. Moreover, the Commissioner argues, such a principle would be self-reinforcing: if a firm *wants* to be acquired, then *of course* the firm would have taken steps to facilitate this acquisition. The Commissioner urges the Tribunal to adopt a clear, general principle: evidence that a target would have resisted competition with a prospective acquirer in order to avoid competition law issues with its eventual acquisition must be ignored and must not inform the "but for" world.

[48] For its part, Poodle responds that these "principles" would create an unacceptable level of uncertainty and are inconsistent with applicable law. Poodle submits that the Tribunal's task is to dispassionately and objectively assess what *was likely to have happened* in the absence of the merger and then compare the likely competitive effects of the merger to this "but for" world. The Tribunal cannot, according to Poodle, "engage in moralistic and policy-driven game theory to try to vindicate a baseless perception that big companies are bad."

C. Relevance of competitive alternatives for failing firm arguments

[49] Even if the Tribunal accepts the Commissioner's submissions with respect to the alleged effects of the transaction, Poodle argues that the merger should nevertheless be permitted because Trowel.it is a failing firm. The Commissioner does not dispute that Trowel.it was likely to fail in the absence of an acquisition. However, the Commissioner argues that Trowel.it's dire financial position should not prevent the Tribunal from making an order under section 92, because Poodle has not met the test articulated in the Bureau's *Merger Enforcement Guidelines* (among other places). This test requires not only that a target is likely to fail, but also that there are no competitively preferable alternatives to the merger, including alternative acquirers or liquidation.

[50] Poodle responds that the test articulated in the Bureau's guidance is not law, is inappropriately strict and goes far beyond what Parliament could have intended in drafting section 93(b) of the Act. Poodle encourages the Tribunal to apply a much more lenient and fact-specific test, particularly in light of the effects of the corgid-19 pandemic. In any event, Poodle submits that the failing firm "defence" is not an affirmative defence at all, but rather it is just permissive statutory language providing that the Tribunal *may* 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", with no stipulation that the Tribunal must consider competitively preferable alternatives or, indeed, any reference to competitively preferable alternatives whatsoever.

D. Failing firm "Estoppel"

[51] Finally, the Commissioner argues that, as a matter of policy, the Tribunal should not permit Poodle to raise failing firm arguments at all, because Poodle's own predatory and exclusionary behaviour is the proximate cause of Trowel.it's failure. The Commissioner submits that permitting this merger based on failing firm considerations would be perverse and would incent other dominant firms to deliberately force acquisition targets into failure to avoid the application of section 92.

[52] Poodle responds that, to the contrary, any allegedly predatory conduct is a matter for the Commissioner to address through an application to the Tribunal under section 79 (or another section). What would be truly perverse, Poodle says, would be for the Commissioner to suggest that her own decision not to pursue a dominance case now renders failing firm arguments unavailable in the merger context.

V. Tribunal's analysis

[53] This application raises numerous challenging and topical issues. The Tribunal has carefully considered the parties' arguments with respect to the nature of competition and regulation in the extremely dynamic technology industry and in the midst of an unprecedented public health crisis.

[54] The Tribunal is asked to decide a fundamental question: how must competition law be enforced in dynamic and challenging contexts, subject to profound uncertainty. The corgid-19 pandemic has caused significant turmoil across many industries and has led to fundamental questions about the future of work and competition. The high-tech industry, however – which was dynamic at the best of times – has largely benefitted from increased usership through the pandemic, leading to increased valuations and revenues.

[55] This application also raises difficult questions about how mergers should be judged when the respondents themselves can place a "thumb on the scale" by acting or threatening to act in ways that are not consistent with fair and rational competitive decision-making and thereby altering the likely competitive outcome absent the merger.

[56] Finally, the application also provides the Tribunal with a highly timely opportunity to provide guidance on the so-called "failing firm defence" – which is, in fact, not a defence at all.

[57] Bearing these weighty considerations in mind, the Tribunal has carefully considered the parties' submissions, the relevant jurisprudence and the evidence available to it. The Tribunal has concluded as follows:

a. The Commissioner's burden *cannot* be adjusted in response to uncertainty associated with particular industries or historical periods, and must be consistent. As such, this merger *will not* result in a likely SLPC by eliminating future competition between Trowel.it and Poodle.

b. An acquirer's intent to behave anticompetitively cannot validly form part of the "but for" analysis in merger review. Poodle's prospective intention to withhold Poodle Pups from Trowel.it must be ignored when assessing what would have happened in the absence of this merger. Similarly, Poodle's arguments that Trowel.it would have declined to compete in order to preserve its ability to be acquired are circular and unpersuasive.

c. The Tribunal *is* entitled to consider failing firm arguments even if no evidence regarding competitively preferable alternatives has been offered. Trowel.it's troubled financial state pre-merger is an important fact that must be considered in assessing whether the merger is anticompetitive.

d. There is no basis for a principle of effective "estoppel", whereby an acquirer cannot say that a target was "failing" if the acquirer itself put the target in this failing position. Once again, Trowel.it's likely failure must be considered by the Tribunal in assessing whether this merger meets the test set out in section 92.

[58] The Tribunal's reasoning with respect to each of these issues is summarized below.

A. Speculation and the Commissioner's burden

[59] As a general principle, the Tribunal agrees that it is entitled and required to interpret the Act purposively in order to give effect to Parliament's competition policy. Moreover, the Tribunal recognizes that it may often be difficult for the Commissioner to establish, on a balance of probabilities, that the acquisition of a nascent competitor is likely to substantially lessen or prevent competition – or indeed to establish that any outcome is "likely" – in an environment characterized by extreme global uncertainty.

[60] However, the Tribunal has no discretion to "read down" the word "likely" in some cases and not in others. The meaning of the word "likely", for purposes of section 92, is well-established by case law. No previous Commissioner has suggested that the meaning should differ from one case to another, despite some cases involving very dynamic industries and some highly uncertain

situations. The Tribunal itself has interpreted the word “likely” many times, and is bound by a large body of jurisprudence. In particular, the Supreme Court of Canada has noted that:

> There is only one civil standard of proof: proof on a balance of probabilities. This means that in order for s. 92 of the Act to be engaged, the Tribunal must be of the view that it is more likely than not that the merger will result in a substantial prevention of competition. Mere possibilities are insufficient to meet this standard. And, as will be discussed, as events are projected further into the future, the risk of unreliability increases such that at some point the evidence will only be considered speculative. (*Tervita* at para 66, citations omitted.)

[61] The Tribunal is also persuaded by Poodle’s submissions about the need for a predictable and fair process that is not subject to the constant and erratic movement of goalposts. To give effect to the Commissioner’s submissions in the present application would further reduce the certainty and predictability of Canada’s merger control framework and impose a chilling effect on economic activity. Respondents have the right to make a reasonable and informed prediction of the case they will need to meet in merger proceedings, without having to wonder whether the Tribunal may find that their industry is too dynamic, or that the state of the world too uncertain, to hold the Commissioner to the historic standard.

[62] The Tribunal therefore concludes that the Commissioner’s burden in this case will not be adjusted. The Commissioner has conceded that – while a lower standard might have yielded a different conclusion – the historical “likeliness” standard does not support a conclusion that Trowel.it was likely to have competed vigorously against Poodle in the absence of the merger. The Tribunal agrees.

B. Evidentiary burden in the “but for” analysis

[63] The Tribunal must assess the effects of a merger by means of a counterfactual or “but for” analysis that asks “whether the merger will give the merged entity the ability to prevent or lessen competition substantially compared to the pre-merger benchmark or ‘but for’ world” (*Tervita* at para 51). The Supreme Court’s *Tervita* decision describes the necessary analytical steps. First, the Tribunal must identify the potential competitor (Trowel.it). Then, the Tribunal must examine the “but for” market condition with respect to the likelihood of entry, considering “any factor that in the opinion of the Tribunal could influence entry upon which evidence has been adduced … includ[ing] the plans and assets of that merging party, current and expected market conditions, and other factors listed in s. 93 of the Act”, and the likelihood that such entry will have a substantial effect on the market (*ibid* at paras 61-79).

[64] Poodle has argued that the likelihood of future competition between Poodle’s social network (Poodle Pups) and a new social network developed by Trowel.it is *de minimis*. Its key evidence for this argument is: (*i*) its claim that it would have prevented Trowel.it from accessing Poodle

Toolkit in order to prevent Trowel.it from competing and (*ii*) Trowel.it's strategic goal of being acquired, which would have caused Trowel.it to avoid competition with Poodle in order to avoid creating regulatory obstacles to its eventual acquisition.

[65] The Tribunal is persuaded that, as a matter of fact, Poodle would indeed have withheld Poodle Toolkit from Trowel.it (or otherwise made it unduly difficult or costly for Trowel.it to access necessary Poodle Toolkit features), and also that Trowel.it would have been unlikely to vigorously pursue Project Papillon and thus jeopardize its own acquisition plans.

[66] The question, then, is whether this is the end of the analysis. Poodle submits that it is: *Tervita* asks the Tribunal to determine whether competitive entry is likely on the basis of the available evidence, and the Tribunal has concluded that it is not. Based on the four corners of the Act and the relevant jurisprudence, the prevention inquiry would normally stop there.

[67] However, the Commissioner submits that the Tribunal should ignore Poodle's arguments. The Commissioner urges the Tribunal to adopt a principle that arguments relying on (*i*) threats of the respondent's own exclusionary conduct or (*ii*) the target's potentially self-serving evidence that it will choose not to compete for reasons having nothing to do with competitive decision-making should not form part of the "but for" analysis.

[68] The Tribunal recognizes the Commissioner's profound concern regarding the precedent that could be established if Poodle's arguments were to be given weight. In a world where behemoths like Poodle control key inputs that are indispensable to competition, they must not be allowed to subvert the merger control process merely by threatening to withhold such inputs or otherwise exclude new competition. If the "but for" world is one in which Poodle is willing to take any steps necessary to prevent any potential competition, there will be no way to stop the company from acquiring almost any potential competitor in which it might take an interest. Such an outcome cannot be consistent with the aims of the Act.

[69] Similarly, the Tribunal cannot cogently accept a target's evidence that it would have refrained from future competition against a purchaser merely to ensure that section 92 does not apply to their merger. The Tribunal's task is to determine whether section 92 applies, and this conclusion will be the predicate for Trowel.it's future competitive decisions *vis-à-vis* Poodle (not the other way around). If the Tribunal determines that Poodle *cannot* acquire Trowel.it, then Trowel.it may decide to become more independent and compete more vigorously against Poodle (to earn more revenue, or to increase its potential value to another acquirer). The Act cannot operate to pre-empt this future decisionmaking by taking the current transaction as a "given". Such circular reasoning is rejected.

[70] In light of these considerations, the Tribunal finds that it is permissible and appropriate to disregard potentially self-serving respondent evidence within the two narrow categories described above when conducting the "but for" analysis, and (recognizing that it is not in fact necessary in light of its finding as to the Commissioner's burden above) does so in this case.

C. Relevance of competitive alternatives for failing firm arguments

[71] In considering the parties' submissions on section 93(b) of the Act, it should be noted that while parties commonly refer colloquially to a failing firm "defence" – presumably because such arguments are generally raised as part of a defensive strategy in dialogue with the Bureau – in reality there is no such defence as a matter of Canadian law.

[72] Unlike the efficiencies "defence", which applies *after* an SLPC has been found to prevent the Tribunal from making an order, failing firm arguments play a role as one factor to be considered in the SLPC inquiry itself. Once an SLPC has been found, failing firm arguments have no further relevance. The real question for the Tribunal to answer under this heading, then, is *how* it should give effect to the inclusion of paragraph 93(b) in the list of factors to which the Tribunal may have regard as part of its SLPC inquiry. Specifically: is the target firm's potential failure relevant to the Tribunal's analysis only inasmuch as there are no competitively preferable alternatives, or should the Tribunal consider the likelihood that the target firm will fail as an independent factor, and if so under which circumstances?

[73] Before proceeding to the Tribunal's conclusions about the application of section 93(b), it is important to restate two factual conclusions that are not disputed between the parties. First, the Tribunal agrees that Trowel.it was likely to fail (*i.e.*, become insolvent) if this merger did not proceed, for the reasons outlined above. Second, the Tribunal agrees that – if Trowel.it were to have failed – there are potential alternative outcomes that are more procompetitive than Trowel.it's acquisition by Poodle. For example, if Trowel.it failed and could not be acquired by Poodle, it might have been acquired by another bidder or it might have taken restructuring steps to preserve itself.

[74] However, after careful consideration, the Tribunal finds that neither the text of the Act nor any legally binding precedent compels it to consider "competitively preferable alternatives" to the merger (or, by logical extension, to disregard evidence regarding a firm's likely failure where the respondent has not demonstrated that no such alternatives were available). Instead, paragraph 93(b) requires the Tribunal to consider the target's likely failure independently of the existence of any competitive alternatives.

[75] In an application under section 92 of the Act, the Tribunal's task is to consider the competitive consequences of the transaction before it. The Tribunal cannot engage in speculation about alternative transactions or alternative outcomes that may flow from its decision to block or permit a particular merger. The Tribunal cannot pick and choose the acquirer or outcome it likes best; alternative transactions and outcomes have their own nuances, subtleties and uncertainties. The Tribunal has no evidence to assess their relative likelihood nor their relative merits. The Tribunal must only consider whether, in the absence of the transaction before it, the target firm was likely to fail. In this case, the Tribunal concludes that it was.

D. Failing firm "Estoppel"

[76] Finally, the Commissioner submits that Poodle should not be permitted to raise failing firm arguments because its own exclusionary conduct was the proximate cause of Trowel.it's failure. The Tribunal disagrees. If the Commissioner believes that a party's conduct may be abusive, it is incumbent on her to bring the matter to the Tribunal's attention through the proper channel.

[77] As a practical matter, the present application neither alleges a violation of the "abuse of dominance" provision in section 79 of the Act, nor does it contain sufficient evidence to enable the Tribunal to reach a conclusion under this provision. While Poodle's conduct toward Trowel.it does raise *prima facie* concerns of potentially predatory or abusive behaviour, this application is not correct opportunity to evaluate such concerns.

[78] Moreover, it must be observed that the Act does not provide the Tribunal with the authority to order the dissolution of a merger – or to abridge a party's right to advance arguments in a merger proceeding – in response to allegedly abusive historical conduct.

[79] The Tribunal is sympathetic to the Commissioner's concerns. In particular, it acknowledges that resource constraints may make it impossible for the Commissioner to pursue every instance of abusive or exclusionary conduct, and that establishing as a general rule that such conduct will cause prejudice to a party's right to raise certain arguments in a subsequent matter before the Tribunal could, in theory, help to disincentivize such behaviour. However, this argument works in reverse, as such a policy could just as easily have a chilling effect on legitimate – if somewhat sharp – competitive conduct.

[80] On balance, the Tribunal is of the view that the best way to prevent abusive behaviour is through the abuse provisions of the Act. It is open to Parliament to narrow the application of section 93(b) if it does not wish for certain types of behaviour to be considered in the Tribunal's analysis.

VI. Order

[81] For these reasons, the Commissioner's application is dismissed.

DATED at Ottawa, this 15th day of October 2020.

SIGNED on behalf of the Tribunal by the Panel Members.