Competition Bureau Canada
Bureau de la concurrence Canada

Pre-Merger Notification Interpretation Guideline Number 14

Duplication Arising From Transactions Between Affiliates

Canada

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Enforcement guidelines

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Preface

This Interpretation Guideline is issued by the Commissioner of Competition ("Commissioner"), who is responsible for the administration and enforcement of the *Competition Act* ("Act"). The purpose of this Guideline is to assist parties and their counsel in interpreting and applying the provisions of the Act relating to notifiable transactions. This Guideline sets out the general approach taken by the Competition Bureau ("Bureau") and supersedes all previous statements made by the Commissioner or other Bureau officials relating to the content described herein. This Guideline is not intended to be a binding statement of how discretion will be exercised in a particular situation and should not be taken as such, nor is it intended to substitute for the advice of legal counsel to the parties, or to restate the law. Guidance regarding a specific proposed transaction may be requested from the Merger Notification Unit.[Footnote 1]

This Guideline addresses the treatment of duplicative assets and sales revenue arising from transactions between affiliates when determining whether a proposed transaction exceeds the party-size and transaction-size thresholds under sections 109 and 110 of the Act, respectively. Proper consideration and calculation of these assets and sales is important when evaluating whether a transaction is notifiable. It is particularly applicable in the context of inter-company transfers between a Canadian-based affiliate and one located in a different country.

1. Background

Section 114 of the Act places an obligation on parties to a proposed transaction that exceeds the party-size and transaction-size thresholds under sections 109 and 110 of the Act, respectively, to notify the Commissioner. The section 109 party-size threshold is measured by either the value of the parties' assets in Canada, or the gross revenues from sales in, from or into Canada. The section 110 transaction-size threshold is measured by either the value of the parties' assets in Canada, or the gross revenues from sales in or from Canada generated from those assets.

The *Notifiable Transactions Regulations* ("Regulations") provide that, in most cases, the value of the parties' assets and gross revenues from sales should be calculated using their most recent audited financial statements. Paragraph 3(a) of the Regulations requires that audited financial statements be prepared in accordance with the accounting principles normally used by that party (or its affiliates) and that are generally accepted for the type of business carried on by that party (or its affiliates). It is important to note that paragraph 3(b) of the Regulations also requires the use of working papers, and other records used to prepare audited financial statements, if reference to these documents is necessary to obtain the information required for determining the aggregate value of assets or the gross revenues from sales.

In addition, paragraph 4(1)(a) and subsection 5(2) of the Regulations provide that, in determining these amounts, any amount that represents duplication arising from transactions between affiliates[Footnote 2] "shall be deducted".

2. Policy

The purpose of deducting amounts that represent duplication is to eliminate double counting that may arise when combining amounts from the financial statements of affiliated entities. However, paragraph 4(1)(a) and subsection 5(2) of the Regulations do not permit deductions for all transactions between affiliates, even where such transactions would be eliminated on consolidation.

When determining whether the party-size and transaction-size thresholds in the Act are exceeded, subsection 5(2) of the Regulations allows a party to deduct revenue from the sale of a product only if it duplicates an equivalent amount of revenue from another sale of a product that is already included in the party-size or transaction-size calculation. Similarly, paragraph 4(1)(a) of the Regulations allows a party to deduct an amount from the aggregate value of assets only if it duplicates an equivalent amount that is already included in the party-size or transaction-size calculation. Such "duplication" may differ from the accounting duplication removed through the consolidation of financial statements, as the party-size and transaction-size notification thresholds require a sufficient nexus to Canada. More specifically, while the geographic origin and destination of sales, or the location of an asset, may not necessarily be important in most accounting exercises, these factors are essential when establishing the economic significance of the merging parties in Canada for the purposes of determining whether the notification thresholds have been exceeded.

In many cases, it will be apparent from the financial statements of the merging parties whether a notification is required without the need for a duplication analysis. For example, when assessing whether the party-size threshold is exceeded, if the total value of the assets in Canada and the gross revenues from sales in, from or into Canada of the merging parties, as stated in their consolidated financial statements, are below the threshold, it is not necessary to make any further adjustments based on the financial statements of the individual affiliates. Similarly, when determining whether the transaction-size threshold is exceeded, if the total value of the assets in Canada and the gross revenues from sales in or from Canada of the target company, as stated in its consolidated financial statements, are below the threshold, no further adjustments are required.

However, when the target of a proposed merger is a Canadian subsidiary of a foreign parent, duplication should not be assessed solely on the basis of consolidated financial statements. In such circumstances, when starting from the consolidated financial statements of a foreign parent, it may be necessary to add back certain inter-company transfers to determine whether the Canadian entity exceeds the transaction-size threshold. In such instances, particularly if there are multiple Canadian affiliates, the maximum potential transaction-size can be obtained by adding together the values stated in each affiliate’s (unconsolidated) financial statements, and then, if necessary, identifying and deducting inter-company transactions that represent duplication among those affiliates.

Examples

The examples below are hypothetical and are intended only to illustrate the Bureau's interpretation of this Guideline, as outlined above.

Example one

A and B are Canadian corporations and are subsidiaries of C, another Canadian corporation. Corporation A manufactures a widget and sells it to B for $100. Corporation A records gross revenue from sales of $100 in its audited financial statements from this transaction. Corporation B then sells the widget to a customer located in the United States for $150, and records gross revenue from sales of $150 in its audited financial statements from this transaction. As a result of these transactions, Corporation A has gross revenues from sales "in" Canada of $100, and B has gross revenues from sales "from" Canada of $150. If these amounts were added together, the total gross revenues from sales in or from Canada (or in, from or into Canada) of A, B and C arising from these transactions would be $250.

In determining the party-size under section 109 of the Act, $100 of these sales represents duplication arising from a transaction between A and B and a subsequent sale by B, and may be deducted. For the purpose of section 109, the gross revenues of A and its affiliates from these sales are $150.

Whether this $100 represents duplication for the purpose of determining the transaction-size depends on the nature of the proposed transaction. With regard to a proposed acquisition of C, $100 of the above sales represents duplication and may be deducted, such that for the purpose of section 110 of the Act, the gross revenues of C and corporations controlled by C arising from these sales are $150. With regard to a proposed acquisition of B, the revenues of A are irrelevant and, for the purpose of section 110, the gross revenues of B from these sales are $150. With regard to a proposed acquisition of A, the revenues of B are irrelevant and, for the purpose of section 110, the gross revenues of A generated from these sales are $100. In other words, in regard to a proposed acquisition of A, even though the $100 revenue results from a transaction between affiliates, it is not deducted because it is not duplicative of another amount included in the transaction-size calculation.

Example two

A is a Canadian corporation. Corporation A is wholly-owned by B, which is incorporated in the United States. Corporation B carries out its manufacturing activities through A, which is located in Canada. Corporation B is responsible for marketing and distributing the products and has a network of warehouses and sales offices throughout the United States. Corporation A manufactures a widget and sells it to B for $100. Corporation A records gross revenue from sales of $100 on its audited financial statements from this transaction. Corporation B then sells the widget to a customer located in Canada for $150, and records gross revenue from sales of $150 in its audited financial statements from this transaction. As a result of these transactions, A will have gross revenues from sales "from" Canada of $100, while B will have gross revenues from sales "into" Canada of $150. If these amounts were added together, the total gross revenues from sales "in, from or into" Canada of A and B would be $250.

In determining the party-size under section 109 of the Act, $100 of these sales represents duplication arising from a transaction between A and B and a subsequent sale by B, and may be deducted. For the purpose of section 109, the gross revenues of A and B from these sales (in, from or into Canada) are $150.

In determining the transaction-size, only sales in or from Canada generated from assets in Canada are included; as such, the sales by B into Canada are irrelevant. Accordingly, in a proposed acquisition of either A or B, for the purpose of section 110 of the Act, the gross revenues from these sales are $100.

Alternatively, if B sells the widget to a customer located in the United States for $150 (instead of Canada), Corporation A will have gross revenues from sales "from" Canada of $100, while B's revenues are not "in", "from" or "into" Canada. Accordingly, there is no issue of duplication that could affect the section 109 and 110 thresholds, and no amounts may be deducted from gross revenues from sales. As a result, the total gross revenues from sales for the purposes of determining whether or not the section 109 threshold has been met (i.e., gross revenues from sales "in, from or into" Canada) are $100. Likewise, the total gross revenues from sales for the purposes of determining whether or not the section 110 threshold has been met (i.e., gross revenues from sales "in or from" Canada generated from those assets "in" Canada) are also $100.

Example three

A is a Canadian corporation, while its subsidiary, B, is incorporated in the United States. Corporation A loans Corporation B $100 million. The loan is recorded on the financial statements of Corporation A as an asset, and is considered an asset in Canada. However, the loan is recorded as "cash" on the financial statements of Corporation B and would therefore be considered an asset in the United States. Since the loan is an asset in Canada for Corporation A, and the cash is an asset in the United States for Corporation B, there is no duplication.

If the cash was an asset in Canada because, in a different scenario, Corporation B was a Canadian corporation, there would be duplication and the amount of the loan could be deducted.

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Footnotes

Footnote 1

For further information, please refer to page 14 of the *Procedures Guide for Notifiable Transactions and Advance Ruling Certificates Under the Competition Act*.

Footnote 2

An affiliate is an affiliated corporation, partnership or sole proprietorship within the meaning of subsection 2(2) of the Act.