July 30, 2001

Collette Sicard
Administrative Officer
Merger Notification Unit
Competition Bureau
Place du Portage
19th Floor, 50 Victoria Street
Hull QC K1A 0C9

Dear Ms. Sicard

Re: Draft Interpretation Guideline No. 3 relating To Paragraph 111(a); Exemptions for Acquisitions in the Ordinary Course of Business

Introduction

The National Competition Law Section (the Section) of the Canadian Bar Association welcomes the opportunity to comment on Draft Interpretation Guideline No. 3 (Draft Guideline), which was issued May 18, 2001.

We appreciate the Competition Bureau's efforts in preparing the Draft Guideline. In general, the Bureau's practice of issuing interpretative guidelines increases transparency and predictability of the Bureau's interpretation and application of the *Competition Act*.[1] We encourage the Bureau to continue the practice of developing and issuing interpretation guidelines.

Policy

We agree with the Bureau's approach of setting out the underlying policy at the beginning of the Draft Guideline. This will assist counsel in applying the Draft Guideline to the particular facts of a proposed transaction. Unfortunately, the section entitled "Policy" launches immediately into the methodology of interpretation. Instead, it should start with a paragraph which clearly describes the policy.

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1 In this letter, all references to sections, subsections and paragraphs are to the *Competition Act*.

This policy statement should relate to the overall purpose of section 110 (where the pre-merger notification requirements are set out). Most of the subsections of section 110 relate to the proposed acquisition of an interest in an *entire* business. For example, a person that acquires shares of a corporation thereby acquires an interest in the entire operating business of that corporation. Subsection 110(2), relating to asset acquisitions, is the only subsection that could involve the acquisition of an interest in something less than the vendor's entire business.

Subsection 110(2) applies to the acquisition of assets of an operating business, whether such assets themselves constitute all or substantially all of the assets of the vendor's business. In our view, the policy underlying paragraph 111(a) is to limit the application of subsection 110(2) to the acquisition of assets that form all or substantially all of the vendor's business (or an operating segment of its business). This would therefore exclude from pre-merger notification the acquisition of assets (no matter what their size) that do not form all or substantially all of the vendor's business (or of an operating segment), where they are acquired in the ordinary course of the purchaser's business.[2]

The meaning and intent of the last paragraph under the "Policy" section is unclear. It reads:

> In a proposed transaction that includes an acquisition of real property or goods that is exempt under paragraph 111(a) of the *Act*, the acquisition of any other assets in that transaction may be subject to notification under section 114 of the *Act* as if the assets were being acquired in a separate transaction.

When parties are calculating the value of assets in applying the $35 million "size of transaction" threshold, the above paragraph may be misinterpreted as allowing them to "carve out" the value of certain assets, if acquired on their own, that would be exempt pursuant to paragraph 111(a). In our view, if a single transaction occurs, then the value of *all* assets must be taken into account in determining whether notification is required.

Two Step Approach to Interpretation

A two-step approach to interpreting paragraph 111(a) is appropriate, as there are clearly two thresholds that need to be satisfied for the exemption to apply.

Step One: Hold All or Substantially All of the Assets of a Business

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[2] Paragraph 111(a) therefore also has the effect of requiring notification of an "out of the ordinary course of business" acquisition of significant assets (that may not constitute all or substantially all of the assets of the vendor's business). This would be an exception to the overall policy.

Paragraph 111(a) exempts pre-merger notification if, among other things:

> …the persons who propose to acquire the assets would not, as a result of the acquisition, hold all or substantially all of the assets of a business or of an operating segment of a business;

In Step One, the two fundamental interpretation issues relate to: (1) when "all or substantially all" of the assets of a business (or operating segment of a business) are acquired and (2) the application and interpretation of the terms "business" and "operating segment of a business".

On the second issue, the Draft Guideline provides that:

> [i]n considering whether a group of assets constitutes an operating business or an operating segment, the manner in which the vendor organizes or defines the group of assets is not determinative and, in many cases, will not be relevant.

As indicated above, we believe that the primary purpose of paragraph 111(a) is to exempt asset transactions where the *vendor* does not dispose of all or substantially all its business (or an operating segment of its business). The manner in which the vendor "organizes or defines its group of assets" (to use the words of the Draft Guideline) is therefore critical to a determination of the "business" or "operating segment of a business" in question.

Many individual assets, taken in the abstract, could be said to comprise all or substantially all of the assets of a theoretical "business". However, we submit that the reference to business in paragraph 111(a) *can only be to the actual business of the vendor*. If the vendor can continue to carry on its business (or the business of the affected operating segment) after the disposition of assets, it is unlikely that any significant competition concerns will arise (particularly if the acquisition was in the ordinary course of the purchaser's business). Presumably, a vendor can only continue to carry on the business if it has *not* disposed of all or substantially all of the assets. The discussion below on Examples 1 and 2 of the Draft Guideline illustrates this issue.

As the determination of the relevant "business" focuses on the vendor, it is therefore not appropriate to look to whether the "purchaser could reasonably be expected to carry on an operating business" with the assets in question, as suggested in the Draft Guideline

We agree that both quantitative and qualitative considerations should be taken into account in determining what constitutes an operating business or operating segment. Industry Canada's *Interpretation Note No. 2 – Part of a Business Capable of Being Carried on as a Separate Business* and *Interpretation Note No. 3 – All or Substantially All of the Assets,*[3] in respect of the

[3] Available at http://investcan.ic.gc.ca/en_doc_i.htm#separate and http://investcan.ic.gc.ca/en_doc_i.htm#all, respectively.

Investment Canada Act, provide a useful basis for applying quantitative and qualitative considerations to such a determination. These guidelines are consistent with jurisprudence that looks to qualitative as well as quantitative aspects of a transaction to determine when all or substantially of the assets of a business have been acquired.[4]

Consistent with this approach, the word "may" should be added to the examples given in the Draft Guideline such that it reads:

> Examples of an operating business or an operating segment **may** include, but are not limited to, a regional division, a company branch, retail store or factory.

We question why the Draft Guideline needs to provide guidance on the meaning of "hold". An acquisition of assets under subsection 110(2) requires that beneficial ownership be acquired by another party. The other party would then clearly "hold" the assets in question. If a subsidiary is the "beneficial" owner of an asset, then the parent of the subsidiary cannot also be the beneficial owner of that asset (unless they are co-owners).

We endorse the Draft Guideline's conclusion that the term "business" in paragraph 111(a) should be interpreted to mean "operating business", as that term is defined in section 108.

Step Two: Acquisitions in the Ordinary Course of Business

The Bureau's interpretation of this phrase should be consistent with case law and should reflect its plain meaning.

At the beginning of Step Two, the Draft Guideline notes that: "an acquisition of real property or goods is in the ordinary course of business if the acquisition is a routine business transaction". We agree with this statement. However, we emphasize that the "ordinary course" test should focus on routine transactions in the context of the purchaser's business, not on transactions which "firms … in general" carry out, as provided in the Draft Guideline. This is consistent with paragraph 111(a), which refers to "an acquisition…in the ordinary course" rather than a "sale" or "disposition". Moreover, the word "routine" should not be not confined to transactions that are repetitive or frequent. It should include single or infrequent transactions, depending on the particular business and circumstances.

The Draft Guideline suggests that the interpretation of "ordinary course of business" in paragraph 111(a) be limited to acquisitions of assets that do not transfer production capacity

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[4] See *85956 Holdings Ltd.*, [1986] 2 W.W.R. 754 (Sask. CA); *Martin v. F.P. Bourgault Industries Air Seaters Divisions Ltd.* (1987), 45 D.L.R. (4th) 296 (Sask. C.A.); *Lindzen v. International Sterling Holdings Inc. et al.* (1989), 45 B.L.R. 57 (BCSC). See also the U.S. case of *Gimbel v. Signal Companies* 316 A. 2d 619 (1974).

between firms in the same line of business. We do not agree. We acknowledge that in the vast majority of cases, it is unlikely that a transaction that transfers a significant amount of production capacity is routine. However, there are businesses that routinely acquire assets that “transfer production capacity”. Such transactions clearly meet the “ordinary course of business” threshold. Where these transactions do not involve acquiring “all or substantially all” of the assets of the vendor’s business or operating segment of the business (in other words, where the vendor can continue to carry on its business), notification should not be required. In the extremely unusual case where a competition concern might arise, the Bureau can avail itself of the substantive merger provisions in section 92.

Similarly, the age or condition[5] of the acquired asset should not be a determinative factor as to whether a transaction is in the ordinary course. If the purchaser acquires “used” assets, this may well be in the ordinary course. The Draft Guideline also suggests that ordinary course transactions only include purchases of new real property or of “used” real estate which has been held by a lessee under a financial lease from the time it was new. We do not agree. When a person is in the business of acquiring, developing and selling real property, any real property that person acquires is akin to “inventory” for other businesses and is in the ordinary course.[6] We do agree that, as a general proposition, the acquisition of current supplies is a transaction in the ordinary course. Such acquisitions, by definition, must occur (or are likely to occur) on a routine basis.

Part IX is principally a set of procedural rules that should allow merging parties to easily determine whether they are caught by the “pre-notification net”. The Draft Guideline, as noted in the preceding paragraphs, attempts to insert a substantive competition law analysis into paragraph 111(a). This cannot be supported as a matter of statutory interpretation and is undesirable from a policy perspective. The application of the “ordinary course of business” test should be consistent with the plain and accepted application of that concept in Canadian law. There is plenty of jurisprudence that merging parties may reference to determine whether an acquisition is in the ordinary course. The thrust of the case law is consistent with the Bureau’s suggestion that transactions in the ordinary course are those that are “routine”. In determining whether a transaction is done in the ordinary course, courts will look to see if it is “done according to the usual practice of a particular kind of business”[7] or is a “usual , or regular type of

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5 In other words, whether the asset is new or used.

6 If the acquired property is an operating business or operating segment of a business, obviously paragraph 111(a) will not apply by virtue of the test in Step One of the Draft Guideline. The determination of whether or not the property is an operating business or operating segment will depend on the quantitative and qualitative factors at issue in a particular case.

7 *Canadian Pittsburgh Industries Ltd. v. Bank of Nova* Scotia (1962), 5 C.B.R. (N.S.) 266 at 281(B.C.S.C.). See also *Glenko Enterprises Ltd. v. Ernie Keller Contractors Ltd.*

transaction".[8] One case has noted that "the transaction must fall into place as part of the undistinguished common flow of the company's business".[9]

Black's Law Dictionary's definition of "ordinary course of business" reflects the concept of a purchase made as part of the "regular" business of a company.[10] The Canadian Institute of Chartered Accountants *Handbook* defines normal business activities as follows:

> Factors to consider when determining whether the business activities of an entity are normal include: type and scope of operations, characteristics of the industry, operating policies, nature of products and services and the environment in which the entity operates. Transactions and events, regardless of size, resulting from normal business activities would not result in extraordinary items.[11]

The Supreme Court of Canada has stated that there is no comprehensive definition for "ordinary course of business" and therefore each case should take into account the circumstances involved to determine if a specific transaction occurred in the ordinary course of business:

> It is not wise to attempt to give a comprehensive definition of the term "ordinary course of business" for all transactions. Rather, it is best to consider the circumstances of each case and to take into account the type of business carried on between the debtor and creditor…[12]

Each case must be decided on the basis of its own circumstances. As noted above, the Draft Guideline attempts to interpret the concept of "ordinary course of business" to apply only if there is not a transfer of productive capacity between firms in the same line or lines of business. This strains the ordinary meaning of the phrase and is contrary to its normal usage. We are concerned,

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(1994), 17 C.L.R. (2d) 273 (Man. Q.B.).

8 *Fairline Boats Ltd. v. Leger* (1980), 1 P.P.S.A.C. 218 at 222 (Ont. H.C.).

9 *Re Bradford Roofing Industries Pty. Ltd.* (1966), 84 W.N. (Pt.1), [1966] 1 N.S.W.R. 674 at 276, apprv'd by *Bastion Management Ltd.v. Canada* [1995] 2 C.T.C. 252 (Fed C.A.)

10 (5th ed.) (St. Paul, Minn.: West, 1979) at p. 989.

11 Canadian Institute of Chartered Accountants, *Handbook (Accounting)*, vol. 1 (Toronto: CICA, 1999), recommendation 3480.

12 *Re Pacific Mobile Corporation*, [1985] 1 S.C.R. 290 at 291*, affirming* (1982) 44 C.B.R. (N.S.) 190 (Que. C.A.). Although this decision was based upon the term "ordinary course of business" for the *Bankruptcy Act*, it has also been used in other decisions, for example in *Societe d'Investissement Desjardins v. M.N.R.* (1991), 91 D.T.C. 393 (T.C.C.) where the above Supreme Court of Canada quote was used in interpreting the *Income Tax Act*.

therefore, that the definition will not be applied and that merging parties will instead simply use their own.

The Examples

The foregoing discussion, if adopted, may change some of the conclusions in the examples set out in the Draft Guideline.

The examples provide insufficient information to guide readers in determining whether their transaction is in the ordinary course. For instance, in Example 1, the reader would need to know how the vendor organized its business in order to determine whether a store can be operated on a stand-alone basis (in other words, whether it is an operating segment of a business).

We agree with the conclusion in Example 2 on the basis of the premise that the office building to be sold constitutes an operating business. This implies that A has structured its operations so that each building is managed as a separate business. If, however, A managed the several buildings as one business, the sale of only one building would, in our view, pass the first test.

Another issue that arises regularly and is related to Example 2 is the acquisition of an undivided co-ownership interest in a bundle of rights and assets that likely amount to an operating business or an operating segment of an operating business (such as an office tower or a retail complex). To the extent that an office tower or retail complex is an operating business or an operating segment of an operating business, does the acquisition of an undivided interest amount to an acquisition of assets of an operating business (within the meaning of subsection 110(2))? Depending on the operational and structural arrangements, we believe that such an acquisition may be the acquisition of an interest in a combination within the meaning of subsection 110(6). However, to the extent that it is the acquisition of "assets", at what level would such an acquisition amount to "all or substantially all" of the assets of an operating business or segment thereof? To address this question, it would be necessary to consider the quantitative and qualitative factors identified in the case law. Nonetheless, the Bureau could indicate that an acquisition of an undivided interest below a certain threshold percentage would not be considered as an acquisition of all or substantially all of the assets of an operating business.

In Example 3, the acquisition of the 12 fibreoptic strands may or may not be in the ordinary course of B's business. Further information would be required to make such a determination. Whether such strands transfer productive assets or are new or used should not determine whether the acquisition is in the ordinary course of business.

Depending on the circumstances, Example 4 could be exempt from pre-merger notification. If A, the railroad company, routinely purchases locomotive engines, then such purchases may be "in the ordinary course of business". To say that routine purchases are not in the ordinary course of business would strain the plain and ordinary meaning of that term.

We agree with Example 5.

We agree with Example 6 except for the statement that the analysis turns on the fact that the acquisition of these assets does not transfer productive capacity between firms in the same line of business.

Conclusion

We trust that you will find the foregoing helpful. If you have any questions or comments, please do not hesitate to contact Anthony Baldanza, Chair of the Section's Mergers Committee.

Yours truly

Stanley Wong
Chair, National Competition
Law Section