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Canadian Association of Broadcasters

L'Association canadienne des radiodiffuseurs

January 31, 2008

Via Epass

Mr. Robert A. Morin
Secretary General
Canadian Radio-television and
Telecommunications Commission
Ottawa, Ontario
K1A 0N2

Dear Mr. Morin:

Re: Broadcasting Public Notice CRTC 2007-139 (the "BPN"), *Call for comments on ways to streamline the determination of the allocation of the value of the transaction in changes in the effective control of a broadcasting undertaking*

1. The Canadian Association of Broadcasters (CAB) is the national voice of Canada's private broadcasters, representing the vast majority of Canadian programming services, including private radio and television stations, networks, specialty, pay and pay-per-view services. The goal of the CAB is to represent and advance the interests of Canada's private broadcasters in the social, cultural and economic fabric of the country.

2. The CAB is pleased to provide its comments regarding the Commission's call for comments on the development of a simplified methodology for allocating the calculated value of the transaction between those undertakings which must provide a tangible benefits package and those undertakings which are not so required.

3. In its Diversity of Voices Proceeding,[1] the Commission sought comments on how its benefits policy furthers the diversity of voices in the broadcasting system, and how changes to the policy might increase this diversity. In response, the CAB questioned the equitable application of the policy, given the changes in the marketplace, and the fact that this policy measure is not uniformly applied to all licensees in the system. The CAB acknowledges the Commission's determination in its recent *Diversity of Voices Regulatory Policy*[2]

[1] Broadcasting Notice of Public Hearing CRTC 2007-5, 13 April 2007
[2] Broadcasting Public Notice CRTC 2008-4, 15 January 2008

that the reasons for retaining the benefits test for programming undertakings set out in Public Notice 1996-69[3] – in which it amended its policy by removing the test for transfers of ownership or control of distribution undertakings – remain valid.

4. The CAB remains concerned that the continued application of the benefits test to programming undertakings is inequitable and has the effect of limiting the growth and competitiveness of these undertakings, particularly given that significant and effective competition exists in the programming sector. To the extent that the benefits test continues to apply to programming undertakings, however, the CAB supports the development of practices to make the process to determine and allocate benefits more effective, transparent, and streamlined, where possible.

Transparency of Approach

5. In this regard, before addressing the methodologies at issue in the Commission's call for comments, the CAB would like to advance some proposed overarching procedural guidelines. As stated in the call for comments, the valuation process has over time become increasingly complex and costly to prepare for the applicant, and time-consuming for the Commission to assess. The CAB considers that improvements not only in efficiencies, but also in fairness, could be achieved by making the valuation exercise more consistently transparent.

6. Parties should have a meaningful opportunity to know and understand the standard that needs to be met in processes before the Commission. The CAB advocates a more consistent and standardized level of notice and transparency in future proceedings. Notice provided either during the deficiencies process or in the Notice of Public Hearing can greatly assist parties in providing the specific information the Commission requires.

Case-by-Case Approach, subject to Guiding Principles

7. The transparency and clarity of expectations explained above can and must be balanced against the flexibility required in business valuations. As a fundamental proposition, the CAB considers that corporate transactions are complex dealings with unique circumstances that should continue to be assessed predominantly on a case-by-case basis. This approach may be taken within a framework of certain guiding principles, which the CAB submits as proposed best practices for the Commission in reviewing the valuation, and the allocation of the value of the transaction in changes in the effective control of a broadcasting undertaking.

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[3] *Call for Comments on a Proposed Approach for the Regulation of Broadcasting Distribution Undertakings*, 17 May 1996

8. The principles are grounded primarily in the use of the purchase price, negotiated on an arm's length basis, as the baseline value of the transaction and in adherence to Canadian Generally Accepted Accounting Principles (GAAP).

The value of the transaction should reflect the purchase price as negotiated between the purchaser and the vendor

9. In a corporate transaction, the amount actually paid by the purchaser, whatever form of the consideration, reflects the true, fair market value of the transaction arrived at by the parties on the basis of arm's length negotiations. The CICA Handbook defines fair value as the "amount of consideration that would be agreed upon in an arm's length transaction between knowledgeable willing parties who are under no compulsion to act."[4] This supports the idea that the fair value of the transaction in its entirety cannot be anything other than what was agreed to between the parties.

10. The enterprise value approach captures the economic stakeholders in the transaction, equity and long-term debt. The combination of the value of equity acquired and the assumption of long-term debt represents total enterprise value.

11. The process of determining the enterprise value is generally based on either an earnings multiple approach or a discounted cash flow approach. Either methodology is complex and takes into consideration many factors including: growth assumptions for revenues and expenses, cost of capital, capital expenditure requirements, economic and market conditions, competitive conditions, future commitments, prior transactions, taxes, synergies, maturity of the business, quality and rarity of assets, risk factors, shareholder control issues, and corporate status, among other things. The choice of the appropriate value measure varies from case to case and requires the application of judgment.

12. Given that valuation is invariably an exercise in estimation, it is often useful or necessary to adopt more than one methodology, to establish ranges of valuation. The selection of a single method may inappropriately restrict the exercise of considering and comparing ranges to address variabilities and best capture value.

13. Based on the above considerations, it is important that no single method of valuation be imposed, to allow for an appropriate level of flexibility to address the unique circumstances of each case.

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[4] Canadian Institute of Chartered Accountants, *CICA Handbook – Accounting, Volume 1* ISBN 0-88800-475-3 (Toronto: CICA, 2006) at section 1581. This is further supported by the International Financial Reporting Standards (IFRS), which Canada will adopt in 2011.

In assessing corporate transactions, the Commission should adhere to GAAP

14. GAAP is the standard framework of guidelines for financial accounting as established and maintained by the Canadian Accounting Standards Board and the Canadian Institute of Chartered Accountants (CICA). [5] Provincial securities regulators and federal and provincial corporate legislation all require the application of GAAP in the reporting of an enterprise's financial results. Given its broad based acceptance and usage, GAAP is the only appropriate framework for the Commission to follow.

15. Adherence to Canadian GAAP would provide consistency for parties involved in proceedings before the Commission and would ensure that financial accounting information used in such proceedings is consistent with general accounting practices throughout the country.

Allocation of Benefits

16. For the purpose of allocating benefits, the exercise of valuation should be as follows. First, the actual value based on the arm's length negotiations between the vendor and the purchaser, plus assumed debt and minus acquired cash – the total purchase price – should provide the starting point (the Baseline Value).

17. The Baseline Value will then be allocated, on a case-by-case basis in accordance with commonly accepted factors considered in valuation, among regulated and unregulated assets, at which point the allocation of 10% (for television undertakings) and 6% (for radio undertakings) of the regulated assets for benefits can be determined.

18. If an allocation is required, the allocation of the purchase price should be done with reference to a valuation. The Commission and the parties should be aware that liabilities as well as assets must be considered in allocating value between regulated and unregulated items. The Commission should also recognize that under GAAP the acquirer is required to allocate the purchase price to the assets acquired. This is not an arbitrary allocation but is based on sound methodology and is subject to audit verification.

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[5] These rules are used by accountants and in the preparation of financial statements, and are "accepted by the accounting profession as producing useful information about the financial condition of the person or enterprise that is the subject of the statements." See Peter W. Hogg, Joanne E. Magee, Jinyan Li, *Principles of Canadian Income Tax Law, 5th Edition* (Toronto: Thomson Carswell, 2005) at p.141; Canadian Institute of Chartered Accountants, *CICA Handbook – Accounting, Volume 1* ISBN 0-88800-475-3 (Toronto: CICA, 2006) at p. 1100.02; and Accounting Standards Board, *About AcSB – What are Accounting Standards?* <http://www.acsbcanada.org/index.cfm/ci_id/186/la_id/1.htm>.

Inclusions and Exclusions

19. Based on the above considerations, and given that parties to a transaction are committed to principles of fairness and transparency in financial dealings, the CAB has the following comments with regard to the matters highlighted in Section 10 of the BPN, as well as other elements considered by the Commission:

a) Cash and Working Capital

20. In general, it would be expected that acquired working capital (excluding cash) would be at a normal level for the operation and its value would be reflected in the purchase price paid and, accordingly, there should be no adjustment to the purchase price for working capital.

b) Debt and Other Long-term Liabilities

21. In the case of long-term debt, these amounts relate to the financing structures designed by the buyer and the seller. As previously discussed, long-term debt forms a portion of a company's enterprise value. In computing enterprise value, one would generally add the amount of debt assumed in the transaction and deduct the amount of cash acquired. The inclusion of debt should be based on the actual debt assumed not based on an amount determined by the Commission that does not reflect the terms of the purchase. Any cash flows associated with long-term liabilities other than debt have already been accounted for in the determination of the company's value, and should therefore not be added to the value again.

c) Operating Leases

22. Commitments under operating leases represent future cash outflows or expenses of the company. As such, they have already been considered in the determination of the company's value. Compliance with the Standards of the Canadian Institute of Chartered Business Valuators would consistently exclude operating leases from the overall valuation of the transaction. Canadian GAAP requires the disclosure of operating leases as companies are required to disclose the quantum and timing of all commitments which, for broadcasters, also commonly include programming purchase commitments. Operating leases do not represent financing arrangements; they are similar to program purchase agreements in that they are commitments to make future operating expenditures. The difference between a capital lease and an operating lease has been well researched and examined by accounting regulators and is well defined in accounting literature. The CAB strongly objects to its re-characterization by the Commission.

23. The provision of operating lease information by applicants to the Commission in the context of previous transaction valuations should not be taken as concession that this is an appropriate inclusion. Rather, it should be viewed as a sign that parties seeking approval of transactions will comply with the requirements of the

Commission, even when those requirements are contested. In that respect, the CAB notes that the inclusion of operating leases represents a relatively recent departure from past Commission practice. The CAB urges the Commission to reconsider this approach, which departs not only from its past practice, but also from compliance with GAAP's characterization of an operating lease as an agreement that results in expenses rather than an asset.

d) Other Assumed Commitments

24. Commitments reported in the notes to a company's financial statements represent amounts that will likely be payable in the future, but that do not meet the criteria of a liability for GAAP purposes, and are therefore not recognized in a company's balance sheet. These future or potential future outflows have been considered in calculating the company's value and should therefore not be added again.

e) Break-up Fees

25. As these fees are not paid to the seller, they do not represent a component of value. They are fees that are outside of the transaction.

f) Synergies

26. Synergies are already accounted for in the purchase price, therefore there should be no addition for them to the value of the transaction.

27. Where the Commission considers it necessary to review factors behind the purchase price, it should be recalled that by definition, synergies, if applicable, are shared between different segments of the business, precisely because, for example, the new entity may be cutting costs, or adding value, shared between them. Corporations often pay a premium price for the shares of an acquired company in order to reflect the benefit gained through synergies, and as such, this value is already incorporated into the total purchase price, as negotiated at arm's length between the parties. The CAB recommends that synergies be reviewed or "counted" only once in a transaction, that is, as they are reflected in the value negotiated by the parties to the transaction. If the Commission considers it necessary to review them in connection with separate segments of the businesses to be combined, they should be allocated between these different segments without overlap.

Debt used to finance transactions in which benefits are paid

28. The CAB further submits that if long-term debt is to be included in the valuation process – that is, as an element of enterprise value – the Commission should allow the flexibility to consider special circumstances such as acquisition debt. The benefits test should not be applied against debt that is incurred to finance acquisitions upon which benefits are already being paid. Where benefits are being

paid on previously acquired assets, the acquisition of these assets by another entity should not result in the layering on of additional benefits that would exceed the 10% and 6% requirements established by the Commission.

Independent valuation should not be required for every transaction

29. Independent valuation will not be an accurate representation of the knowledge of the parties at the time of negotiation, nor of their interests, and therefore will not necessarily reflect the total purchase price, as negotiated between the parties. The price negotiated is the best representative value of the transaction.

30. Independent valuation should therefore be seen as a further and additional point of reference or as a means to secure more detailed analysis in specific areas in instances of non-arm's length transactions, rather than as a first step. As corporations subject to significant securities, taxation, and broadcast legislation and regulations, parties to a transaction should be trusted to be in compliance with GAAP and CRTC regulations.

31. The CAB submits that the Commission should refrain from requesting an independent valuation, as it has done in some cases, unless there is some reason to expect one is necessary. Where such concern may arise, the Commission should first request clarification, and resort to requesting independent valuation only where it remains dissatisfied with the parties' response.

32. In the above cases, where the Commission requests an independent valuation, it should be used not to assess the "accuracy" of the Baseline Value, but rather for the purpose of allocating benefits as between television and radio, and as between the regulated and unregulated assets.

Conclusion

33. The CAB submits that flexibility is needed to achieve balance between compliance with regulations and independence in corporate decision-making. The allocation of value and the application of the benefits test as between regulated and unregulated assets, and further between television and radio, do not accurately reflect the organization of the modern-day broadcasting entity as a unified corporate undertaking with varied assets and interests. As these changes to the industry take place it is important that the Commission's processes and requirements remain flexible and adaptable.

34. The Commission has noted in its call for comments that its "value of the transaction" approach established in the 1998 Commercial Radio Policy and in the 1999 Television Policy has allowed it to use a case-by-case approach to reach its determinations. The Commission concluded its explanation of "concerns regarding

the allocation" in its call for comments with the statement: "The methodology that is chosen must, however, stand the test of reasonableness, be consistent and be the most appropriate under the circumstances". The CAB is strongly of the view that the first and last of these factors are the most important. The case-by-case approach to determining value that was recognized by the Commission a decade ago continues to be reasonable and appropriate under the circumstances. The guiding principles proposed by the CAB in its comments above will in addition serve to provide the consistency, and transparency, required by the Commission and by parties alike.

35. The CAB would be pleased to provide the Commission with further information on request.

Sincerely,

Original signed by:

Glenn O'Farrell
President and CEO

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