M&A Building Blocks

BASIC DEAL STRUCTURES

Acquisitions of public companies in Canada are implemented most often in one of two ways: by take-over bid or by plan of arrangement. Of these two, plans of arrangement are more common, for the reasons discussed on the following pages. Sales of assets, which are often used in the context of private company acquisitions, are seldom used in the public markets outside of distress situations, primarily because of the less favourable tax results realized by shareholders.

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Key Issues/Process Points

1 Take-Over Bids

A take-over bid is a direct offer by an acquiror to public shareholders[1] for their shares of the target company. It can be made with or without the cooperation of the target. The key features of a take-over bid are:

- It is made by way of circular sent to target shareholders (although the bid may be commenced by way of newspaper publication before actually sending the circular).
- The bid must be open for acceptance for a minimum 105 days, unless the target consents to a shorter period of not less than 35 days.
- The acquiror must have financing in place – the bid cannot be conditional on financing.
- The board of directors of the target must issue a directors' circular within 15 days of the bid recommending that shareholders either accept or reject the bid, or stating why a recommendation cannot be made.
- The bid may be conditional, including upon a minimum level of acceptance (which must be at least 50%).
- If a bid is accepted by at least 90% of shareholders, the legislation governing most corporations in Canada allows the acquiror to "squeeze-out" the remaining 10%; if less than 90% but more than 66 2/3% (depending on jurisdiction of incorporation) acceptance is achieved, it is usually possible to squeeze out the remaining shareholders by calling a shareholder meeting to approve the squeeze-out at which the acquiror is allowed to vote the shares acquired under the bid.

2 Plan of Arrangement

In contrast to a take-over, which is a direct offer to shareholders of a target, a plan of arrangement is a transaction agreed to by the acquiror and the target which must be approved by shareholders at a shareholder meeting. The acquisition of the target is achieved by including as one of the steps in the plan a transfer by shareholders of their shares to the acquiror. Key features of a plan of arrangement are:

- The plan can include any number and type of steps in order to implement the acquisition, including amalgamations, share and debt transfers, wind-ups and asset transfers.
- Plans of arrangement must be approved by shareholders (and any other relevant securityholders), at a meeting, usually by a 66 2/3% majority. A comprehensive proxy circular detailing the transaction is sent to shareholders for this purpose. The notice period for a meeting, in practical terms, is generally about 25 days.
- Plans of arrangement must also be approved by a court. This usually involves (i) an initial court application to obtain authorization to call the shareholder meeting and set procedures for the meeting, and (ii) once shareholder approval is received, a second court application for final approval to implement the arrangement. The court must find that the arrangement is "fair and reasonable".

3 Why choose one Structure over Another?

Most public company acquisitions are implemented by way of plan of arrangement. The reasons for this include:

- **Flexibility** - As noted above, a plan of arrangement can include many steps. This facilitates planning by allowing assets or subsidiaries of the target to be moved around, or other steps to be sequenced, to achieve a desirable business structure.
- **One step** - On closing, 100% of the target can be acquired. Invariably, a take-over will have less than 100% acceptance so a further squeeze-out is needed. A one-step acquisition can make it easier to put financing in place.
- **U.S. securities exemption** - If the acquiror is offering securities as all or part of the consideration for target shares, and there are target shareholders in the U.S., there is an exemption under U.S. securities laws for a plan of arrangement such that the shares do not have to be registered.

1 Sometimes holders of other securities can be involved, such as convertible debenture holders. For convenience, this bulletin will just refer to shareholders.

The chief disadvantage to using a plan of arrangement is the requirement to obtain court approval. For transactions which enjoy wide shareholder support with no strong opposition, this is generally not an issue because a court is unlikely to refuse approval unless a party comes forward and persuades it to do so. Where there is opposition however, the requirement for a court hearing with regard to fairness provides a ready-made platform for dissident shareholders to seek to stop a transaction, notwithstanding that it might have received the necessary shareholder approval. Even if the court eventually approves a transaction, the court process itself may add time and uncertainty to the transaction. There are a couple of recent examples of this happening where, although the arrangement was eventually approved, shareholders have used the fairness hearing to delay the transaction or extract concessions from the proponents.

One potentially overriding factor that can determine the choice between a plan of arrangement or take-over bid is whether the transaction is friendly or hostile. Since a plan of arrangement requires the target to call a shareholder meeting, and the target board of directors is unlikely to do so if it does not support entering into the transaction, a hostile acquiror often has no choice but to proceed by way of take-over bid.

4 Related Party Aspects

It is worth briefly noting that where a transaction involves related parties – for example, where the acquiror is already a significant shareholder or member of management of the target – then Multilateral Instrument 61-101– *Protection of Minority Security Holders in Special Transactions* may apply. MI 61-101 includes safeguards designed to ensure fairness where insiders are dealing with a public company. These safeguards could include, for example, a requirement for an independent valuation of securities being acquired from the public by an insider, approval by a majority of the shareholders other than the relevant insiders, and enhanced disclosure. Even if an acquisition is being carried out by a third party, and not an insider, certain requirements of MI 61-101 may still apply. A common example of this is where management is receiving some sort of additional compensation or continuing interest in the target. In that case, their votes may have to be excluded in determining whether the necessary shareholder approval had been received.

Conclusion

Each transaction has its own unique elements that affect the choice of acquisition structure. The factors described above, along with other factors such as tax, accounting, commercial and regulatory considerations, must be taken into account in determining the right method for any particular deal.

AUTHOR

Paul A.D. Mingay
T 416.367.6006
F 416.367.6749
pmingay@blg.com

KEY CONTACT

Frank Callaghan
National Group Head,
Corporate and Capital Markets
T 416.367.6014
F 416.367.6749
fcallaghan@blg.com

Calgary
Centennial Place, East Tower
1900, 520 – 3rd Ave S W, Calgary, AB, Canada T2P 0R3
T 403.232.9500 | F 403.266.1395

Montréal
1000 De La Gauchetière St W, Suite 900
Montréal, QC, Canada H3B 5H4
T 514.879.1212 | F 514.954.1905

Ottawa
World Exchange Plaza, 100 Queen St, Suite 1300
Ottawa, ON, Canada K1P 1J9
T 613.237.5160 | F 613.230.8842 (Legal)
F 613.787.3558 (IP) | ipinfo@blg.com (IP)

Toronto
Bay Adelaide Centre, East Tower
22 Adelaide Street West, Suite 3400, Toronto, ON, Canada, M5H 4E3
T 416.367.6000 | F 416.367.6749

Vancouver
1200 Waterfront Centre, 200 Burrard St, P.O. Box 48600
Vancouver, BC, Canada V7X 1T2
T 604.687.5744 | F 604.687.1415

blg.com/ma

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