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M&A BuildingBlocks

The tricky bits: Dealing with bondholders, proxy advisory firms and approvals and more

The topics in this building block focus on considerations that relate primarily to external factors, which may affect the execution of an M&A transaction.

1 Dealing with public debt and convertible securities

It is quite common for Canadian public companies to raise capital thorough the issuance of convertible debentures. In the context of an acquisition, the acquiror will want to address how convertible debentures will be dealt with. As convertible debentures are governed by contract (an indenture) and not by statute, compliance with the terms of the indenture will be the first consideration. Generally, debentureholder consent is not required for an acquisition, however, typically neither the acquiror nor the issuer have the right to convert or force a sale of the debentures prior to or as part of the M&A transaction. As a result, the convertible debentures may survive completion of the M&A transaction and often require the target company to continue to comply with its continuous disclosure obligations. This can be particularly problematic for acquirors that are not already subject to continuous disclosure obligations. There are a few options for acquirors to consider when dealing with convertible debentures:

- **Amend the indenture to allow for early redemption of the debentures.** This will require debentureholder approval either through a consent solicitation or via a meeting of debentureholders. Note that often different approval thresholds apply depending on the route chosen.
- **Offer to purchase the debentures.** Unfortunately, it is often difficult to acquire all of the outstanding debentures successfully.
- **Defeasance.** This involves the payment into trust of the outstanding principal and all interest payable to maturity. In such circumstances, most of the covenants contained in the indenture, including on-going listing and reporting issuer covenants, will no longer apply.
- **Include the debentures in the plan of arrangement.** This would entail a separate acquisition of the debentures by the acquiror. Most often, completion of the acquisition of the target's equity is not conditional on acquisition of the debentures.
- **Credit support issuer exemption.** If the acquiror is a public U.S. or Canadian company, it may be able to leave the debentures outstanding and then satisfy any ongoing Canadian continuous reporting obligation of the target by filing the acquirors continuous disclosure documents on SEDAR. This would require meeting certain criteria under the credit support issuer exemption, under securities law.

2 Merger notification and foreign investment review

In an M&A context there are two Canadian regulatory approvals of broad application that must be considered in all M&A transactions:

- **Merger control.** The *Competition Act* (Canada) will require that an M&A transaction be reviewed in those circumstances where the value of the combined assets in Canada of both parties to the transaction exceeds CDN$400 million (the party size threshold) and where the value of the assets acquired from or owned by the target exceeds CDN$96 million (the transaction size threshold). M&A transactions that satisfy both of these tests will be subject to review by the Competition Bureau in a process that can take 45 days or longer depending on the complexity of the transaction. For transactions that are not expected to involve a substantial lessening or prevention of competition, application can be made for an Advanced Ruling Certificate (ARC) or a No Action Letter (NAL). An ARC and/or a NAL can be received within a 14-day period.
- **Foreign Investment Review.** An acquisition of control of a Canadian business will require notification and/or review under the *Investment Canada Act* in those situations where specific review thresholds have been exceeded. For acquisitions by acquirors from Trade Agreement countries (EU, US, Mexico, etc.) that threshold is an enterprise value of CDN$1.568 billion. For acquisitions by acquirors from WTO countries the threshold is CDN$1.045 billion. Lesser thresholds apply to acquisitions by state-owned enterprises (CDN$416 million) or where the acquisition is of a cultural business (CDN$5 million). When a transaction is reviewable, it can be expected that the review process will take approximately 75 days to complete. It is important to note that all acquisitions regardless of size by a non-Canadian can be subject to a national security review where the acquisition of a Canadian business could be injurious to Canadian national security. These reviews can extend as long as 200 days.

3 Concurrent financings

M&A transactions are often accompanied by a concurrent equity financing by the acquirer to help pay for the acquisition. In such circumstances, the buyer often wants to announce its financing at the same time as it announces the acquisition. The typical pricing rule for TSX-listed issuers is that financings are based on the market price – a 5 day VWAP prior to announcement and there is a presumption that the market price will reflect all material changes at the time of pricing. The TSX provides for an exception to its default-pricing rule provided the net proceeds of the financing do not significantly exceed the cash consideration of the acquisition and the financing does not provide for significant insider participation. In such circumstances, the TSX will permit pricing of a financing concurrent with the announcement of an M&A transaction if the acquisition would not have been approved by the board of directors *but for* the financing. Listed companies should keep this helpful exception in mind when completing an M&A transaction involving a concurrent equity financing.

4 ISS/Glass Lewis considerations

Institutional Shareholder Services (ISS) and Glass Lewis are proxy advisory services that provide advice to their clients, typically institutional investors, as to how to vote proxies on matters put to shareholders for consideration, including M&A transactions. ISS and Glass Lewis can have significant influence on the result of a vote and therefore M&A parties should be aware of their published positions and guidelines when undertaking and disclosing the terms of an M&A transaction. ISS and Glass Lewis have different views on matters of corporate governance and therefore it is important to consider each of their published guidelines. Each of the proxy advisory firms will review the M&A transaction as the information circular is distributed to shareholders and conduct an independent analysis of the transaction against their published guidelines. A report on the transaction, which will provide a vote for or against recommendation, can be expected to be issued by each firm approximately two weeks after the information circular is filed.

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