



Mergers & Acquisitions

in 52 jurisdictions worldwide

2007

Published by
GETTING THE DEAL THROUGH
in association with:

McMillan Binch Mendelsohn



Canada

Sean Farrell and Robert McDermott

McMillan Binch Mendelsohn LLP

1 Form

How may businesses combine?

A business combination may be structured as a takeover bid or a corporate transaction.

A takeover bid is the Canadian equivalent of a US tender offer. Under Canadian securities law, a takeover bid:

- must be made by way of a formal offer to all shareholders in prescribed form and may be commenced by way of an advertisement (typical in hostile bids) or by mailing the offer documents (typical in negotiated or friendly bids);
- must be open for acceptance for a period of at least 35 days; and
- must offer identical consideration to all shareholders, and may not, subject to certain exceptions, include a collateral arrangement which has the effect of providing one shareholder with consideration of greater value than that offered to other shareholders.

Corporate transactions typically take the form of a statutory amalgamation, plan of arrangement (which requires court approval before implementation) or other corporate reorganisation and require the approval of the target's shareholders.

2 Statutes and regulations

What are the main laws and regulations governing business combinations?

Business combinations are regulated under:

Corporate statutes

Canadian corporations may be incorporated under a federal, provincial or territorial statute. These statutes regulate ordinary and extraordinary corporate transactions. Extraordinary corporate transactions, which include statutory amalgamations and plans of arrangement, must be approved by a special resolution of shareholders (typically two-thirds of the votes cast). Shareholders generally have the right to dissent from extraordinary corporate transactions and demand payment for the 'fair value' of their shares (as determined by a court, if necessary). Canadian courts have broad remedial powers under Canadian corporate statutes to intervene in respect of transactions that are oppressive or unfairly prejudicial to or that unfairly disregard the interests of shareholders.

Securities laws

Securities regulation in Canada is the responsibility of the provincial and territorial governments. Each province and territory has its own legislation and securities regulatory authority that regulates, among other things, takeover bids. The provinces of

Ontario and Quebec have rules (including approval by a majority of the minority shareholders and independent valuation of the subject matter of the transaction) designed to ensure fair treatment of minority shareholders in connection with certain types of transactions involving controlling shareholders and 'related parties' (which include shareholders owning 10 per cent or more of the voting securities of a corporation).

Stock exchanges

The two principal stock exchanges in Canada are the Toronto Stock Exchange (TSX) (senior market) and the TSX Venture Exchange (junior market). These exchanges regulate selected aspects of business combinations.

A business combination may also involve approvals or filings under the Competition Act (Canada) (see question 4) and statutes regulating foreign ownership (see question 11).

3 Governing law

What law typically governs the transaction agreements?

In a negotiated transaction, the acquirer and the target will enter into a support or pre-acquisition agreement (in the case of a takeover bid) or a merger or combination agreement (in the case of a corporate transaction). These agreements typically provide representations and warranties and pre-closing covenants from the target to the acquirer, termination rights in favour of the target and deal protection measures (see question 10).

It is also common for the acquirer to enter into lock-up or support agreements with significant shareholders of the target, pursuant to which the shareholders agree to tender their shares to a takeover bid or provide voting support for a corporate transaction. These agreements may contain termination rights in favour of the shareholders (eg, if a 'superior proposal' is made by a third party or the transaction terms are changed without the consent of the shareholders).

These agreements are typically governed by Canadian law.

4 Filings and fees

Which governmental or stock exchange filings are necessary in connection with a business combination? Are there stamp taxes or other governmental fees in connection with completing a business combination?

The filings required in connection with a business combination depend on the structure of the transaction and the jurisdictions involved, but generally include the filing of a takeover bid circular, a directors circular and related materials with the securities regulatory authorities (in the case of a takeover bid) and a management information circular and related materials with the securities regulatory authorities and amendments to constating

documents with the corporate regulatory authorities (in the case of a corporate transaction). The filings made with the securities regulatory authorities are not subject to a review process. The fees payable in connection with these filings depend on the structure and size of the transaction and the federal and provincial jurisdictions involved.

Stock exchange listing approvals will be required where securities issued by the acquirer in consideration for the target's shares are to be listed on a Canadian stock exchange. Fees will vary based on the exchange and the number of securities to be listed.

If a business combination involves the acquisition of a Canadian business and the following thresholds are met, the business combination is a notifiable transaction under part IX of the Competition Act requiring prescribed pre-merger notification filings:

- the parties' (including affiliates) aggregate assets in Canada or annual gross revenues from sales in, from or into Canada exceed C\$400 million;
- the target's Canadian assets or annual gross revenues from sales in or from Canada generated by those assets exceed C\$50 million; and
- the acquirer will hold more than 20 per cent (35 per cent for a private company) of the voting shares, or more than 50 per cent of the voting shares if the acquirer already holds 20 per cent (35 per cent for a private company) of the voting shares.

A notifiable transaction cannot ordinarily close until the expiry of a waiting period of either 14 or 42 days following notification, unless the parties obtain an advance ruling certificate (ARC). The length of the waiting period depends on whether the parties submit short-form or long-form filings. Both parties have a notification obligation and special rules apply in hostile transactions that permit the commissioner of competition to require the target to submit a filing. A single fee of C\$50,000 is payable in all circumstances.

Whether or not a business combination is a notifiable transaction, the commissioner of competition may review a business combination under part VIII of the Competition Act to determine whether it raises any potential substantive competition concerns in Canada. Where a business combination raises concerns and the parties would like to obtain some comfort that the combination will not be challenged, it is customary to seek an ARC or 'no action' letter from the commissioner. The timing of the commissioner's substantive review under part VIII may or may not coincide with the applicable waiting periods.

Filings or approvals may also be required under the legislation regulating foreign ownership (see question 11).

There are no stamp taxes in Canada.

5 Information to be disclosed

What information needs to be made public in a business combination? Does this depend on what type of structure is used?

In a takeover bid, the acquirer is required to mail a takeover bid circular containing prescribed information, including: the terms of the offer, disclosure with respect to pre-offer share ownership and trading activities and whether the acquirer intends to initiate a second stage transaction as described in question 13, and any other information that would be material to shareholders. The directors of the target are required to prepare and mail to shareholders, within 15 days of the takeover bid, a directors circular containing prescribed information, including the board's recommendation as to whether shareholders should accept or reject the offer and the reasons for doing so, and, if the direc-

tors are unable to make a recommendation, the reason why. In a negotiated takeover bid, the takeover bid circular and the directors circular (containing a favourable recommendation) are often mailed together to shareholders.

In respect of a corporate transaction (which, as noted above, typically requires shareholder approval), the target is required to prepare and mail to shareholders a management information circular containing prescribed information, including the terms of the transaction and the negotiation and approval process, and any other information that would be material to shareholders.

Additional information must be provided in respect of business combinations involving 'related parties' of the target (see question 7) and in circumstances where securities of the acquirer will be issued in consideration for the target's shares.

6 Disclosure requirements for shareholders

What are the disclosure requirements for large shareholders in a company? Are the requirements affected if the company is a party to a business combination?

A person that acquires beneficial ownership of, or the power to exercise control or direction over, or securities convertible into, 10 per cent or more of a class of voting or equity securities of a Canadian public company is required to issue a press release and file a report containing prescribed information. A further press release and report is required upon the acquisition of each additional two per cent or if there is a change in any material fact contained in the report.

See also question 7.

7 Duties of directors and controlling shareholders

What duties do the directors or managers of a company owe to the company's shareholders, creditors and other stakeholders in connection with a business combination? Do controlling shareholders have similar duties?

Directors generally owe fiduciary duties of loyalty and care to the company. Canadian courts have interpreted this duty as meaning directors must act in the best interests of shareholders unless there is or may be nothing left for the shareholders (eg, upon an insolvency), in which case they have a duty of care to those who have a prior claim on the assets of the company (eg, the creditors). In recent years, there have been attempts to extend the duty of directors to a broader group of stakeholders (eg, employees and communities in which they are located). To date, these attempts have not had any tangible legal results, either in corporate statutes or before the courts. The fiduciary duties require the directors to act honestly and in good faith with a view to the best interests of the company, and to exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances. In respect of a business combination, directors are required to seek the best value reasonably available to shareholders. They are not required to conduct an auction (the so-called 'Revlon duty' in the US).

If the acquirer is a 'related party' of the target (eg, owns 10 per cent or more of the voting shares of the target) or the business combination has been negotiated with a related party which is acting together with the acquirer, and the target has a significant connection to the capital markets of Ontario or Quebec, the transaction will be subject to enhanced fairness rules which (subject to prescribed exceptions):

- require the preparation of a formal valuation of the target's shares by an independent and qualified valuer (the valuation must be summarised and a copy of the valuation report is typically included in the documents delivered to shareholders);

- require approval by a majority of the minority of disinterested shareholders; and
- recommend the use of a special committee of independent directors to carry out negotiations (if applicable) and provide that it is essential, in connection with the disclosure, valuation, review and approval process, that all shareholders be treated in a manner that is fair and that is perceived to be fair.

Shareholders, including controlling shareholders, do not generally owe fiduciary duties to other shareholders.

8 Approval and appraisal rights

What approval rights do shareholders have over business combinations? Do shareholders have appraisal or similar rights in business combinations?

Corporate transactions require the approval of the target's shareholders (typically, two-thirds of the votes cast). Also, majority of minority approval may be required in connection with corporate transactions involving related parties (see question 7). The shares acquired by the acquirer (in the case of a takeover bid) or held by shareholders entering into support agreements (in the case of a corporate transaction) may be included in the vote.

Shareholders typically have dissent rights and appraisal remedies in connection with business combination transactions (see question 13).

9 Hostile transactions

What are the special considerations for unsolicited (hostile) transactions?

Hostile takeover bids are less common in Canada than in other jurisdictions. This is due, in part, to the concentration of share ownership in Canada (over 25 per cent of the 300 largest Canadian public companies have a controlling shareholder and a larger number have a significant shareholder). Other factors which limit hostile takeover bids include:

- acquirer's lack of access to confidential information;
- the target's inability to use defensive tactics indefinitely and the resulting pressure to find an alternative transaction; and
- the target is not required to give the acquirer the opportunity to match or top an alternative transaction.

Shareholder rights plans (or 'poison pills'), which if triggered dilute an acquirer's voting rights and economic interest in the target, are the most common defensive tactic used in Canada. A poison pill will usually be triggered when an acquirer acquires or announces its intention to acquire a specified percentage (often 20 per cent) of the securities of the target, unless the acquirer does so pursuant to a 'permitted bid' (typically an offer to all shareholders that is open for acceptance for at least 60 days).

Canadian securities regulators will not permit a poison pill to be used to deny shareholders the opportunity to make their own decision with respect to a bid, and will terminate a poison pill if the target is unable to demonstrate that it is actively pursuing alternative transactions or if there seem to be no prospective alternative bids. The question is not 'whether' but 'when' the pill should go.

Other pre-emptive defensive tactics, such as 'shark repellents' are not popular and staggered boards are not common.

10 Break-up fees – frustration of additional bidders

What type of break-up fees are allowed? What are the limitations on a company's ability to protect deals from third-party bidders? Describe any 'financial assistance' restrictions and how they can affect business combinations.

The use of deal protection devices is not specifically regulated in Canada and has received limited judicial consideration. Subject to the duties described in question 7, a board of directors may agree to a variety of deal protection mechanisms in a negotiated business combination including break fees, no-shop clauses, matching rights, and asset and stock options. In the context of 'white knight' transactions, Canadian courts have acknowledged that deal protection mechanisms are appropriate where:

- they are required to induce a competing bid;
- the competing bid represents sufficiently better value for shareholders to justify their use; and
- they represent a reasonable commercial balance between their potential negative effect as auction inhibitors and their potential effect as auction stimulators.

Break-up fees are common in most negotiated business combinations in Canada. A break-up fee (sometimes referred to as a termination fee) is intended to compensate the acquirer with a cash payment in the event that the proposed transaction is terminated, in some cases because the shareholders of the target do not approve the transaction or because the target or the controlling shareholders of the target accept a superior proposal from a third party. Break-up fees are used primarily to attract an acquirer to make an offer, protect the acquirer from competing offers after its offer is made and compensate the acquirer for the costs of making an offer and foregone opportunities. Normally, the fee ranges from 2 per cent to 5 per cent of the value of the transaction. Recently, some of Canada's largest institutional shareholders publicly campaigned for shareholders to reject transactions with break-up fees that fell within this range. Some of these investors have established voting guidelines which stipulate that break fees should generally not exceed 2.5 per cent of the value of the transaction.

11 Governmental influence

Other than through relevant competition (antitrust) regulations, or in specific industries in which business combinations are regulated, can governmental agencies influence or restrict the completion of business combinations?

The acquisition by a non-Canadian of 'control' of a Canadian business with assets which exceed prescribed monetary thresholds is reviewable under the Investment Canada Act and subject to approval by the federal minister of industry or the minister of heritage (depending on the nature of the business of the Canadian company). Transactions below the applicable monetary thresholds are subject to a 'tick the box' notification process which may be made post-closing. If a transaction is reviewable, the acquirer may be prohibited from acquiring, or may be required to divest, the Canadian business if the relevant authorities are not satisfied that the acquisition is likely to be of net benefit to Canada.

Certain other Canadian statutes limit foreign ownership in specified industries (eg, financial services, broadcasting and telecommunications).

Update and trends

Continuing trends in Canadian M&A include: increased involvement by private equity funds, Chinese participation, large cross-border transactions, increased willingness to launch hostile and competing bids, increased institutional shareholder activism and growing recognition of national security interests in the context of M&A transactions.

There are currently no material proposals to change the regulatory or statutory framework governing business combinations.

12 Conditions permitted

What conditions to a tender offer, exchange offer or other form of business combination are allowed? In a cash acquisition, can the financing be conditional?

Generally, a business combination may be subject to any conditions, the only real restriction being market acceptance.

A takeover bid may not be conditional upon obtaining financing (arrangements to ensure the availability of funds to effect payment under a takeover bid must be made before the bid is launched and must be disclosed in the bid circular). In response to a recent case, the Ontario Securities Commission introduced a new financing rule (effective 3 January 2006) which provides that financing arrangements may be subject to conditions if, at the time the bid is commenced, the offeror reasonably believes that the likelihood that it will be unable to pay for the securities deposited under the bid solely due to a financing condition not being satisfied is remote. In practice, the conditions of any financing are typically structured to mirror the conditions of the takeover bid. Corporate transactions are not subject to the financing rules applicable to takeover bids (however, it is not uncommon for a target to require firm financing as a condition precedent to entering into a binding agreement with respect to a negotiated corporate transaction).

13 Minority squeeze-out

Can minority stockholders be squeezed out? If so, what steps must be taken and what is the time frame for the process?

If:

- 90 per cent or more of the outstanding shares are tendered to a takeover bid (excluding shares held by the acquirer on the date of the bid), the acquirer is generally entitled to exercise a statutory right of acquisition to squeeze-out any non-tendering shareholders by requiring them to elect to tender their shares for the bid consideration or to receive the 'fair value' of their shares; and
- less than 90 per cent of the outstanding shares are tendered to a takeover bid, the balance may be acquired through a second stage corporate transaction pursuant to which the acquirer is entitled to vote the shares acquired under the takeover bid (a minimum tender condition of two-thirds will generally be sufficient to ensure that the acquirer has sufficient votes to approve the corporate transaction).

The statutory right of acquisition may generally be implemented immediately. A second stage corporate transaction may generally be implemented within 30 to 60 days.

Shareholders typically have dissent and appraisal remedies in connection with the statutory right of acquisition and corpo-

rate transactions. The determination of fair value (if contested) is made by a court.

14 Cross-border transactions

How are cross-border transactions structured? Do specific laws and regulations apply to cross-border transactions?

Canada and the US are parties to a bilateral multi-jurisdictional disclosure system (MJDS), which generally facilitates the implementation of certain cross-border business combinations in compliance with home jurisdiction requirements. Under MJDS, a business combination involving a Canadian target with shareholders in both Canada and the US may be implemented using substantially Canadian documents and procedures if less than 40 per cent of the target's securities are held in the US. Also, if securities are being issued by the acquirer in consideration for the target's shares, the acquirer may use its home jurisdiction documents if the acquirer meets specified reporting history and market capitalisation thresholds.

Canada does not have similar arrangements with other countries and these transactions will typically be regulated under Canadian law to the extent that the target company is incorporated in Canada or a significant number of its shareholders are resident in Canada.

15 Waiting or notification periods

Other than competition laws, what are the relevant waiting or notification periods for completing business combinations?

Are companies in specific industries subject to additional regulations and statutes?

A takeover bid must remain open for at least 35 days from the commencement of the bid through advertisement or mailing of the offer documents.

If a corporate transaction involves a shareholders meeting, a record date will have to be fixed and a management information circular mailed to shareholders in advance of the meeting. Generally, the notice of the meeting and the record date for the meeting must be published at least 25 days before the record date; the record date must be at least 30 days before the meeting date and the information circular must be mailed to shareholders at least 24 days before the meeting date. These time periods may be compressed if the materials for the meeting are sent to all beneficial shareholders at least 21 days before the meeting date.

See also questions 4 and 11.

16 Tax issues

What are the basic tax issues involved in business combinations?

The basic tax issues to be considered include:

- shareholders of the target may realise capital gains or deemed dividends or may be entitled to tax deferrals in certain circumstances and not in others;
- for non-resident shareholders of the target, withholding tax and rollover eligibility may be important;
- for the acquirer, consideration should be given to the most effective way of financing the transaction where cash or debt is being used; and
- there can be significant tax issues associated with the acquisition of control of a Canadian corporation (eg, the loss of past tax losses).

In certain circumstances, a corporate transaction (in particular, a plan of arrangement) may offer more flexibility than a takeover bid in achieving certain tax objectives that may be attractive to the acquirer or the shareholders of the target.

17 Labour and employee benefits

What is the basic regulatory framework governing labour and employee benefits in a business combination?

In general, the continuing corporation or the acquirer will become the successor employer and will assume the associated liabilities.

18 Restructuring, bankruptcy or receivership

What are the special considerations for business combinations involving a target company that is in bankruptcy or receivership or engaged in a similar restructuring?

Insolvent companies are generally restructured pursuant to court sanctioned processes under the Companies' Creditors Arrangement Act or the Bankruptcy and Insolvency Act. Most major restructurings are carried out under the Companies' Creditors Arrangement Act as it affords more flexibility.

McMillan Binch Mendelsohn LLP

Contact: Sean Farrell

e-mail: sean.farrell@mcmbm.com

BCE Place, Suite 4400
Bay Wellington Tower, 181 Bay Street
Toronto, Ontario
Canada M5J 2T3

Tel: +1 416 865 7910
Fax: +1 416 865 7048