DENTONS

Going private in Canada

From start to finish, Dentons provides comprehensive guidance on every step essential to successfully going private in Canada.

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The Securities & Corporate Finance team at Dentons Canada has extensive knowledge of, and experience in, the Canadian capital markets. From our offices across the country, we regularly advise issuers, registrants, security holders, and others on a broad range of Canadian securities law matters, including the transaction types described in this guide.

Please contact any of our office leads to discuss how we can assist in guiding you through the intricacies of Canadian securities laws.

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What is a going-private transaction?

There are several methods for a Canadian public company to become a private company and de-list its securities from the public market trading systems. This is commonly known as the process of "going-private." In the process, public share ownership is eliminated, and the share ownership is consolidated to a limited number of shareholders. The shares of the company are subsequently de-listed from the public market.

This guide discusses the paths to going private in Canada.

Why go private?

Usually, a public company will consider reverting to private or limited shareholdings when management or other significant shareholders of the company want to buy out the public shareholders, which is referred to as a management buy-out, or a third party wants to purchase the target public company, with or without management support. Going-private transactions are sometimes referred to as leveraged buy-outs, as a common method of acquisition involves using debt to finance the purchase of public company shares.

The following are common reasons why a going-private transaction would be considered:

- To enable greater business and operational efficiencies or allow for greater flexibility when operating the business of the company;
- To extend the operational horizon and business planning metrics of the business and avoid short-term focus on quarterly reporting metrics;
- To eliminate or significantly reduce the costs associated with being a public company, including those expenses associated with financial reporting and other continuous disclosure requirements, regulatory compliance, investor relations, or other professional service fees;
- To provide an exit strategy for the existing shareholders;
- To permit the transfer of the business to controlling shareholders;
- To allow for significant business reorganization without the requirement to obtain diffuse shareholder approvals;
- To avoid being a target for purchase by opportunistic buyers;
- To access and obtain different or additional financial support or operational expertise and expert knowledge from sponsors of the going-private transaction; and
- For a buyer or sponsor of the going-private transaction, to permit the purchase of a desired company or business at opportune pricing because of depressed share trading values.

Key considerations for sponsors or targets

To assess whether a going-private transaction would be desirable, a thorough assessment should be made regarding the likelihood that the transaction will be successful. This will depend, in part, on the type of transaction that is being pursued, the level of shareholder approval that will be necessary and the possibility of not reaching the necessary threshold of approval, and the ability of the acquiror to obtain the necessary financing to acquire the public company shares in a process that is transparent and could invite competing offers.

In general, a company that is a candidate for a going-private transaction will need to be a solid company amongst its peers and industry area, have strong management capabilities, and good business metrics, including a client base, positive cash flow or margins. Generally, a public company will be considered an attractive target when its share price is trading below the company's inherent value due to market conditions that are separate from the value of the company itself. Sometimes, a concentration of shareholdings in a limited group of shareholders will also enhance the attractiveness of a public company to acquirors.

If the party that proposes the going-private transaction is an insider of the company, a related party, or someone considered to be acting in concert with or jointly with an insider of the target company, then a formal valuation will be required unless an exemption applies.

Furthermore, a plan of arrangement approved by a Canadian court will sometimes be required to complete the proposed transaction. Under a plan of arrangement, a judge will be asked to consider the fairness of the transaction to the shareholders and possibly other stakeholders. Therefore, anyone proposing a going-private transaction must have a thorough understanding of the interests of the various shareholders and stakeholders of the company. The court process will permit shareholders and other stakeholders an opportunity to present their views at the hearing to approve the transaction.

Advantages

Reduce continuous disclosure obligations

Public companies have significant ongoing reporting obligations under securities laws to which private companies are not subject. Quarterly and annual financial reports, news releases, annual proxy circulars, and offering documents, among other things, all require attention and financial resources that might otherwise be dedicated to growing the business. Directors and officers bear ultimate responsibility for the company's continuous disclosure and have to disclose their security holdings in the company.

Meetings with accounting, legal and other advisers and investors result in additional ongoing costs and demands on management. Stock exchange rules are an added layer of regulation and associated cost, though in some respects, the exchange rules and securities laws operate in tandem.

Strengthen founders' control

A company's founders will typically have their ownership diluted when the company conducts a financing upon going public and/or in future financings. This, combined with the fact that outsiders can build up a position in the company's securities through the company's securities offerings or via acquisitions of outstanding securities in the market, can lead to the founders' loss of control over the company.

A public company is also subject to the risk of unsolicited take-over bids and contests for board control (e.g., via a proxy battle). Such events put founders' control at risk in ways not applicable to a private company.

Tighten privacy

Public companies are required to disclose all material or significant facts relating to the company and its securities, both in its initial disclosure document and on an ongoing basis. This can lead to unwelcome insight into its business from its competitors and others.

Reduce litigation risk

Public companies and their directors and officers, among others, are subject to greater litigation risks as compared to private companies. Securities laws allow investors to sue the company and key individuals in the event of a misrepresentation (or an omission to state a material fact) in an offering document or in continuous disclosure, such as a news release, including by way of class action.

Disadvantages

Restricted access to financing

Being public, by definition, involves tapping the public markets for cash. Post initial public offering, all subsequent financings, though subject to extensive regulation, can be larger and sometimes quicker than securities offerings or bank loans by private companies. This stems from a public company's ability to issue free-trading securities in a short time frame, access to a broader base of potential investors, and an existing disclosure record on which such investors or lenders can rely. Further, a public company may have greater flexibility to conduct debt financing than a private company, but much will depend on the strength of the company's balance sheet.

Less liquidity for security holders

The ability to sell shares into the public market applies both to the company itself, as described above, and to its security holders. The benefits of enhanced liquidity (i.e., the securities are much more easily saleable) exists because there is an active market of buyers and sellers. Once a company goes private, this liquidity is restricted for the remaining shareholders. The value of compensating employees and others with stock options or other equity-based incentives is also decreased as a result of going-private due to the lack of a market to liquidate such securities.

Acquisition challenges

A public company interested in acquiring other companies or assets may be better positioned to do so due to the currency-like features of its treasury securities. Because a public company can issue its shares or other securities as payment to acquire the securities or assets of other companies, acquisitions may be facilitated more readily by a public company. While this is also possible for private companies, it may involve more significant valuation and liquidity challenges.

Loss of exposure and prestige

Going public generates publicity that the company can use to enhance its business prospects by selling its products or services and attracting employees. In addition, certain aspects of goodwill created through being a public company could be lost among suppliers, clients, and customers.

Who is involved?

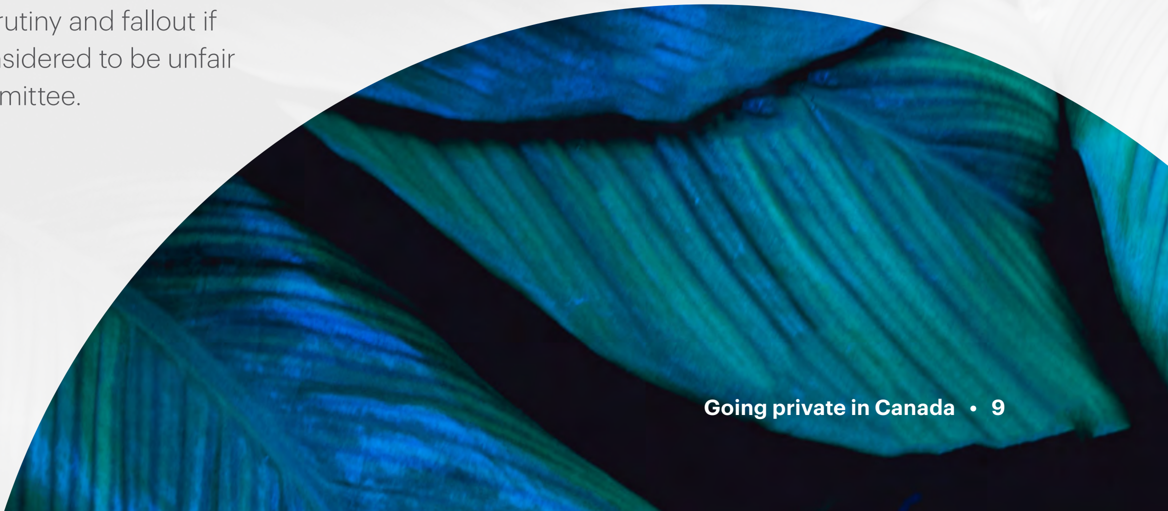
The key players in a company's going-private process include its management, directors, legal counsel, auditors, one or more investment dealers, and a transfer agent. Large shareholders who may be selling their shares may also be involved as either the acquirors themselves or as necessary participants to obtain the required support for approval of the going-private transaction. A court hearing will occur in some circumstances in which a judge will preside to determine the fairness of the proposed transaction to shareholders and other stakeholders.

Transaction process

Public vs. private process

Sometimes an offeror may discreetly raise the possibility of a going-private transaction, subject to advice from their financial advisor and getting an indication of what level of support there would be with significant shareholders or the target company's independent committee. A private process may be considered to minimize employee departures, reduce the prospect of organizational disruption, and prevent the introduction of hostile or competing bidders into the process. An offeror may also want to avoid the scrutiny and fallout if the proposed offer is considered to be unfair by the independent committee.

An offeror may instead announce its intention to take a public company private before attempting to gain the support of the independent committee. Reasons for a public offer include the intention to signal unwillingness to move higher on price and to prevent long, drawn-out negotiations. In most cases, the public announcement of an intent to take a public company private occurs when the offeror does not expect or is not willing to pay a premium but still wants the shareholders to consider the offer because of other benefits, such as a change of management or operational synergies.



How to go private?

When a significant shareholder is attempting to implement the going-private transaction, there are issues surrounding conflicts of interest. Knowledge about the target's business may provide an advantage to those already more involved in the business than an outside entity. Predictably, there are significant securities and corporate law issues that apply to going-private transactions. There are many obligations, rules, and restrictions on the various parties involved in a going-private transaction designed to prevent minority shareholders from being treated unfairly. In general, an independent valuation, full disclosure to existing shareholders, and the majority of the minority shareholder approval are required unless certain exemptions apply.

Selecting a going-private transaction structure

In some cases, an offeror wants to transact a going-private transaction in a single step and, as a result, may look to have a shareholders' meeting to approve a plan of arrangement which requires judicial sanction to implement an amalgamation, for example. Another route is by way of take-over bid with a follow-up transaction to acquire any untendered shares as needed.

Plan of arrangement

Under a plan of arrangement, a court must approve the process first by approving the materials which will be sent to shareholders to consider the proposed transaction, and second through a follow-up hearing to determine that the transaction is fair, substantively and procedurally, to shareholders and other stakeholders, as applicable.

Amalgamation

A shareholders' meeting is required to approve the amalgamation of the target company, typically with a subsidiary of the offeror. Upon amalgamation, target company shareholders will receive, in exchange for their common shares, redeemable preferred shares in the amalgamated company. Such shares will be immediately redeemed for cash, and the offeror receives all of the voting shares of the newly amalgamated company.

Under corporate law, the amalgamation must be approved by holders of two-thirds of the shares of the target company represented at the meeting, in person, or by proxy. Under securities law, the amalgamation must be approved by a majority of the minority shareholders.

Take-over bid

In a take-over bid, the offeror will offer to acquire all of the outstanding shares of the target company. Where there is a high acceptance rate, the offeror can acquire the balance of the outstanding shares under a compulsory acquisition. In all such cases, the offeror must first acquire not less than 90% of the shares it does not already own to utilize this procedure. If a majority of the minority shares are acquired under the take-over bid, the offeror can then utilize a squeeze-out as a second-step transaction. Shares purchased from the minority under a take-over bid can be voted in favour of the second-step transaction.

How long will it take?

In any going-private transaction, the parties will need to have the time and commitment to engage in what can be a lengthy and involved process. Generally, the transaction can be completed within 60 to 90 days, but it may take longer to complete in particular circumstances.

Process

1. An independent committee of the board of directors is appointed by the target company.
2. An independent financial advisory company is retained by the independent committee.
3. Financial commitments and arrangements are negotiated by the offeror.
4. The independent committee of the target company and the offeror negotiate to determine the pricing and terms of the going-private transaction and all related agreements.
5. The valuation report is completed, and/or a fairness opinion is prepared, as necessary.
6. The board of directors of the target company (or the independent committee thereof) agrees to support the transaction and passes a resolution to approve.
7. A public announcement is made to provide the details of the going-private transaction.
8. All necessary documents are prepared for the shareholders' meeting or take-over bid.
9. The shareholders' meeting is held, or the take-over bid expires and closes.

Key documents involved in a going-private transaction

Confidentiality agreement

A key agreement between the offeror and the target company is a confidentiality agreement that details how the offeror will be able to review due diligence materials related to the target company.

Lock-up agreements

Typically, a voting or lock-up agreement is entered into with directors, officers, and material shareholders of the target whereby they agree to support the going-private transaction by voting their shares in favour of the transaction at a shareholders' meeting or to tender their shares to the take-over bid. Some lock-up agreements will require such actions; others will permit the shareholders to consider better offers and withdraw their shares in the event of a superior offer.

Definitive going-private agreement

All going-private transactions require a form of acquisition agreement under which the consideration, conditions, representations and warranties, indemnifications of parties, and other material terms of the agreement will be set out.

Directors' duties with regard to going-private transactions

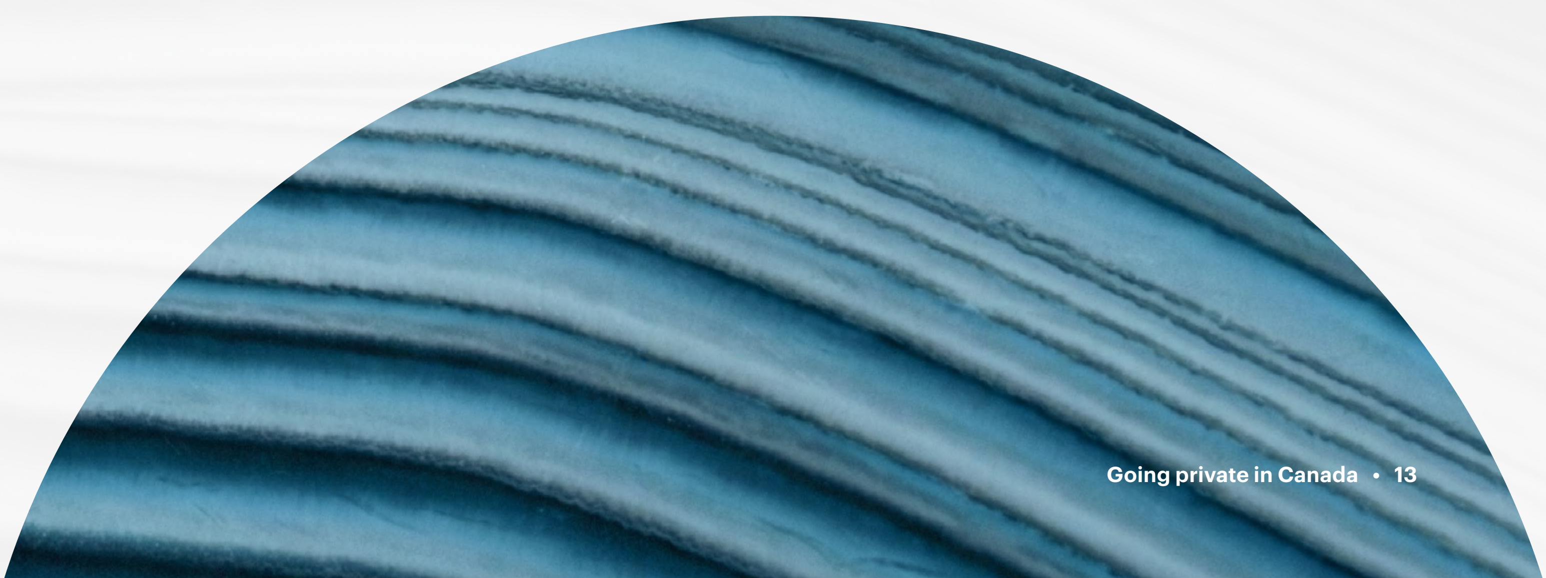
Under Canadian law, directors are required to act honestly and in good faith with a view to the best interests of the corporation and to exercise the care, diligence, and skill that a reasonably prudent person would exercise in comparable circumstances. These duties apply to all deliberations of the board of directors and any committee of the board. The requirement that directors act in the best interests of the corporation means that when making decisions regarding the corporation, directors must consider the interests of all affected stakeholders (including shareholders, employees, creditors, consumers, governments and the environment). In addition to their fiduciary duty, directors also have a duty of care, meaning they must take reasonable care in reaching decisions on behalf of the corporation. Because this standard of care applies to all deliberations of a board of directors or a committee of the board, a director must inform themselves of the issues relevant to the decisions they are making and take enough time to reasonably consider them. In a going-private transaction, the directors of the target need to determine whether the transaction is fair and in the best interests of the company. Where there is a conflict of interest, a director must declare the conflict and abstain from voting.

Independent committee, valuation, and fairness opinion

In general, no matter what structure is proposed for a going-private transaction, an independent committee of directors will usually be created to oversee the process and provide their approval. In some cases, the independent committee will appoint an independent financial advisor and help prepare and review a valuation report or fairness opinion, if required. Any director who is a member of management or who has a conflict of interest is precluded from being a member of the committee. Typically, this committee will make its recommendation to the board of directors once its review is complete, and it may retain outside counsel to provide advice separately from the target company's counsel. The formal valuation is prepared by a qualified valuation firm under the auspices of the independent committee's instruction and overview. It is also common practice to obtain a fairness opinion for a going-private transaction from the financial advisor.

Dissent rights

Corporate laws usually grant rights of dissent for transactions, including plans of arrangement, amalgamations, or the sale of all or substantially all of the target company's properties. In most cases, an offeror will include a condition limiting the percentage of dissenting votes for the transaction to proceed. If the transaction is approved by the required votes, then a dissenting shareholder only has the right to be paid fair value for their shares.



Other regulatory considerations

Investment Canada Act

Where an offeror that is a "non-Canadian" controlled by a "trade agreement investor" member country (i.e., the US) proposes to acquire control of a target company and the "enterprise value" of the target company exceeds CA$1.711 billion, approval by the relevant Minister may be necessary as a condition of closing the going-private transaction. For offerors that are "world trade organization" country members, this enterprise value threshold falls to CA$1.141 billion. For offerors that are "state owned enterprises" the review threshold is a book value of the assets of the target of CA$454 million. If subject to review, the offeror may not close the transaction until the Minister under the *Investment Canada Act* has approved the transaction.

Competition Act

Depending on the size of a going-private transaction, the offeror and the target company may be required to make a pre-merger notification under the *Competition Act*. This will generally be required where the target is not already a subsidiary of the offeror, the combined assets in Canada or combined gross revenues from sales in, from, and into Canada of the offeror and the target company together with their affiliates exceed CA$400 million and the assets in Canada or revenues of the target company's business in and from Canada exceed CA$93 million. If subject to notification, the offeror and the target company must file a notification and not complete the transaction until the expiry of a waiting period unless the parties receive a waiver to the notification provisions.

Post-closing

Regulatory and securities laws

The target company must apply to delist its shares from the relevant exchange and apply to cease to be a reporting issuer under Canadian securities laws. The delisting application will typically be approved. Provided there are fewer than 15 security holders in each of the jurisdictions of Canada and fewer than 51 security holders in total worldwide post-transaction and the shares are delisted, the resulting company will cease to be a reporting issuer.

Post-closing agreements

Following closing, new agreements are generally entered with the remaining shareholders, including unanimous shareholder agreements. Non-competition agreements, employment agreements, and compensation plan agreements will typically be signed with the resulting officers and directors of the resulting company.

Conclusion

Canada's capital market features a variety of methods for taking a public company private as described in this guide. The Securities & Corporate Finance group at Dentons Canada has broad experience in this area. We know that working with numerous independent firms across multiple jurisdictions to handle transactions and legal matters can be onerous, time-consuming, and increase risk. Dentons can act as your single point of contact with ease, ensuring consistency and quality control across each jurisdiction. Dentons is the world's largest law firm, with 12,000+ lawyers and professionals, in 200+ locations spanning 80+ countries. Supplemented by our Nextlaw Referral Network, our geographic reach is unparalleled.

We welcome the opportunity to discuss any points touched on in this guide and how they might make sense for your business.

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