Fraser Milner Casgrain LLP

LEGAL GUIDE

Mergers And Acquisitions In Canada

Section 1: Overview of Canadian Securities Legislation

FMC LAW

Click below to download the full guide

DOWNLOAD NOW

Mergers and Acquisitions in Canada

Fraser Milner Casgrain LLP

LEGAL GUIDE

Forward

This publication has been prepared to provide a general overview of the principal securities, tax, competition, foreign investment, labour relations, employment and pensions considerations that would be applicable in the acquisition of a Canadian business. Most of the material contained in this publication focuses on federal, British Columbia, Alberta, Ontario and Quebec legislation. The material is not meant to be an exhaustive analysis of the law and should not be relied on with respect to any particular transaction or other proceeding. Persons considering the acquisition of a business in Canada should obtain professional advice from any of the offices of Fraser Milner Casgrain LLP.

Table of Contents

Introduction

This guide is intended to outline the principal legal considerations pertinent to the acquisition of a Canadian business. The information is based on the assumption that the reader is a non-resident of Canada. With few exceptions, the same considerations apply where all of the parties are based in Canada.

This guide addresses a myriad of mergers and acquisitions issues, including:

1. securities law requirements;
2. tax considerations;
3. competition (antitrust) law requirements;
4. foreign investment requirements under the *Investment Canada Act*;
5. labour relations and employment considerations; and
6. pensions and benefits.

The contents and comments contained in this guide are for general information purposes only. This guide is not intended as a substitute for specific legal advice and should not be relied upon with respect to any particular transaction or circumstance. The information is provided as of the date set out below, and thus the reader is cautioned that changes or developments in the law, or its interpretation, may have occurred since that time.

If you are interested in buying or selling a Canadian business, Fraser Milner Casgrain LLP would be pleased to assist with your transaction. As a full-service business law firm with offices in all of Canada's major business centres, an in-depth understanding of each of Canada's leading industries and a pragmatic approach dedicated to timely client service, we are uniquely positioned to provide the legal and business advice you need to make your transaction a success.

September 2011

Overview of Canadian Securities Legislation

Introduction

The acquisition of a public company is a complex matter which requires knowledge of corporate and securities law, tax law and competition (antitrust) law. The issues are even more challenging when the buyer, the target company and their respective shareholders, are residents of different countries. This discussion provides an overview of Canadian corporate and securities law applicable to mergers and acquisitions, and highlights certain considerations and issues faced by a non-Canadian entity considering a share acquisition of a Canadian public company. For the purpose of this discussion, it has been assumed that the buyer owns less than 10% of the outstanding shares of the Canadian target company and that the target is a "foreign private issuer" under U.S. securities laws.

Overview of Canadian Securities Legislation

Although securities regulations in Canada and many other countries, including the U.S., are based on similar principles, there are certain key distinctions. The first is that there is no federal securities legislation in Canada. Securities regulation is solely a matter of provincial or territorial jurisdiction, and is governed by the securities legislation of each of the 10 provinces and three territories of Canada. However, with respect to take-over bids, the laws of the Canadian jurisdictions are virtually identical. All of the jurisdictions, with the exception of Ontario, have adopted Multilateral Instrument 62-104 – *Take-over Bids and Issuer Bids* ("MI 62-104"), which governs the securities law aspects of take-over bids. Ontario's legislation[1] has some differences in form, but is the same in substance as MI 62-104.

A second key distinction between Canadian securities legislation and the legislation of other countries, such as the U.S., is that Canadian securities legislation is not based on a "registration system". In Canada, a distribution of securities may only be made:

1. pursuant to a prospectus which has been filed with and receipted (accepted) by the securities regulatory bodies in the provinces and territories in which the securities will be issued;
2. pursuant to an exemption from the prospectus requirement in such jurisdictions; or
3. pursuant to a discretionary order granted by the applicable securities commission.

The definition of "distribution" includes an issuance of previously unissued securities of an issuer, a trade of securities held by a control person, and a first trade in securities previously acquired pursuant to a prospectus exemption, unless certain conditions are met. These conditions may include a four-month hold period on securities acquired under a prospectus exemption, depending on which exemption was used. In addition to permitting a distribution, the receipt of a prospectus will also trigger continuous reporting obligations for the issuer under the securities legislation of the provinces and territories in which the prospectus was filed.

1 Part XX of Ontario's *Securities Act*, R.S.O 1990, Chapter 5.5, ("OSA"); and Ontario Securities Commission Rule 62-504 – *Take-Over Bids and Issuer Bids* ("Ont. Rule 62-504").

Take-Over Bids

Share acquisitions of Canadian public companies are usually structured as either a take-over bid or a court-approved plan of arrangement (which may involve an amalgamation, capital reorganization or share exchange).

A "take-over bid" is generally defined in securities law as an offer to acquire voting or equity securities of an issuer that is made to one or more persons, any of whom is in the legislating jurisdiction, if the securities subject to the offer, together with the securities held by the offeror, constitute in the aggregate 20% or more of the outstanding securities of that class at the date of the offer.[2]

In Canada, the term "take-over bid" refers to an offer made directly to the shareholders of the target, whether the offeror is offering cash, securities or a combination of both to the target shareholders (although sometimes a take-over bid that offers shares as consideration is referred to as a "share exchange take-over bid"). This differs from the terminology in the U.S. which generally refers to cash take-over bids as "tender offers," and take-over bids in which shares are offered as consideration as "share exchange offers." For the purpose of this discussion, a take-over bid refers to a take-over bid made by way of a take-over bid circular, not a bid which is exempt from the take-over bid rules.

In the U.S., the Office of Mergers and Acquisitions of the Securities and Exchange Commission (the "SEC") reviews each tender offer for compliance with the rules. When securities are offered, the applicable industry group of the Division of Corporate Finance reviews the registration statement for the offered securities. In Canada, no securities commission is statutorily required to review a take-over bid circular prior to its mailing or upon its filing with the appropriate securities commission, regardless of the consideration offered.[3] As a result, there is no significant timing difference in Canada between the mailing of a take-over bid where cash is offered and one in which shares are offered. In addition, the period of time between the announcement of the transaction and the mailing of the take-over bid circular, particularly in the context of a hostile take-over bid, can be very short (i.e. within one or two days of receipt of the security holders list, which usually takes 10 days to obtain).

Advantages and Disadvantages

A take-over bid has certain advantages over a plan of arrangement and is generally the only alternative where the offer is unsolicited. The overall time frame to complete a take-over bid is shorter (35 days versus 60-plus days), although this shorter time frame may not be of significant assistance to the offeror if filings under the *Competition Act*[4] (Canada) are required. A take-over bid is usually less costly than a plan of arrangement (unless the offeror is an insider of the target, which may require an independent valuation).

On the other hand, a take-over bid also has certain disadvantages. The first is the risk that less than 90% of the outstanding shares are tendered to the bid. If the offeror is able to acquire 90% or more of the outstanding shares of the target (other than shares held by the offeror at the commencement of the bid), then the balance of the shares may be acquired through a statutory compulsory acquisition process often referred to as a "squeeze-out" transaction. However, if the offeror is only successful in acquiring between $66^{2/3}$% and

2 MI 62-104, s. 1.1; OSA, ss. 89(1).

3 In practice, the staff of some securities commissions may review filed take-over bid circulars to ensure material compliance with the procedural and disclosure rules.

4 R.S., 1985, c. C-34.

90% of the outstanding shares, then a second-stage transaction, such as a plan of arrangement or amalgamation, would need to be completed in order to obtain the balance of the shares of the target company.

The take-over bid rules are more restrictive than the requirements related to a plan of arrangement. They restrict the conferring of collateral benefits on security holders, which may become problematic where the offeror wants to enter into collateral agreements with senior management who are also shareholders. The take-over bid rules also strictly control purchases of the shares which are subject to the bid, prior to, during and after the bid. Due diligence is generally more difficult in a take-over bid, particularly in a hostile bid where the offeror will be limited to the public record. However, even in a friendly bid, representations and warranties are generally not provided by the target. Finally, where more than a nominal number of beneficial holders of securities reside in Quebec, the take-over bid circular must be translated into French, whereas a management proxy circular in respect of a plan of arrangement or amalgamation generally does not.

Commencing a Take-Over Bid

A take-over bid may be commenced by publishing an advertisement in the newspaper (in which case the date of the take-over bid is deemed to be the date of publication) or by sending the circular to the shareholders of the offeree company (in which case the date of the take-over bid is deemed to be the date of mailing). In either case, the bid must be open for at least 35 full days from the date of the bid.

Acquisitions Outside of the Bid

Pre-Bid Purchases

For various reasons, it may be advantageous for an offeror to secretly acquire shares of the target prior to the commencement of the bid. This practice is referred to as acquiring a "toe-hold" position. Securities legislation generally requires that, if the offeror acquires beneficial ownership of securities of the class that is subject to the bid within 90 days immediately preceding the offeror's bid, then the bid must meet certain criteria. Specifically, the bid's terms must be at least as favourable as the most favourable terms of any of those prior transactions, both in terms of the consideration offered and the percentage of the sellers' securities of the class for which the offer is made. If the highest consideration in the prior transactions was not solely in the form of cash, the consideration in the bid must be in the same form as that highest consideration or at least its cash equivalent.

However, the foregoing pre-bid integration rules do not apply to trades effected in the normal course on a published market, so long as:

1. no broker acting for the purchaser or seller performs services beyond the customary brokerage function, or receives more than reasonable fees or commissions;
2. the purchaser, or any person or company acting for the purchaser, does not solicit or arrange for the solicitation of offers to sell securities of the class subject to the bid; and
3. the seller or any person or company acting for the seller does not solicit or arrange for the solicitation of offers to buy securities of the class subject to the bid.[5]

5 MI 62-104, s. 2.6; OSA, s. 93.2; and Ont. Rule 62-504, ss. 2.3(1).

Trades that are matched in the "upstairs" market and completed through the facilities of a recognized stock exchange, do not meet the requirement of "normal course" purchases under the pre-bid integration rules.

The pre-bid integration rules do not apply to an acquisition of securities from the issuer of the securities, whether the securities previously had been unissued or acquired by the issuer.[6]

No public disclosure of pre-bid purchases is required under Canadian law unless the total number of securities of any class (including securities convertible into that class of securities) held by the buyer, and any person acting jointly or in concert with the buyer, constitutes 10% or more of the outstanding securities of that class.[7] However, where the class of securities of the Canadian target issuer is registered under the U.S. *Securities Exchange Act of 1934*, the buyer will be required to report its acquisitions to the SEC within 10 days of acquiring more than 5% of the outstanding securities of that class.

Purchases During the Bid

From the day of the announcement of the offeror's intention to make a formal take-over bid until the expiry of the bid, the offeror is prohibited from acquiring (or agreeing to acquire) beneficial ownership of securities of the target class, or securities convertible into securities of that class, other than under the bid itself,[8] unless certain conditions are met. These conditions include, among others:

1. the intention to make such purchases is stated in the take-over bid circular, or, if the intention changes after the date of the bid, that intention is stated in a news release issued and filed with the securities regulators at least one business day prior to the purchases;
2. the number of securities acquired outside of the bid does not exceed 5% of the outstanding securities of the target class as at the date of the bid;
3. the purchases are normal course, non-pre-arranged transactions on a published market; and
4. the offeror issues and files a press release containing prescribed information after the close of business on each day securities are purchased.[9]

The prohibition against acquisitions outside of the take-over bid does not apply to an agreement between a security holder and the offeror to the effect that the security holder will tender its securities to the take-over bid.[10]

Insider Trading

The insider trading provisions of securities legislation prohibit any person or company in a special relationship with a reporting issuer, from purchasing or selling securities of the reporting issuer with the knowledge of a material fact or material change with respect to the reporting issuer that has not been generally disclosed.[11]

A person or company in a special relationship with a reporting issuer includes an insider, affiliate or associate of a person or company that is proposing:

6 MI 62-104, ss. 2.4(2); OSA, ss. 93.2(3); and Ont. Rule 62-504, ss. 2.3(2).
7 MI 62-104, ss. 5.2(1); OSA, ss. 102.1(1); and Ont. Rule 62-504, s. 7.1.
8 MI 62-104, ss. 2.2(1); and OSA, ss. 93.1(1).
9 MI 62-104, ss. 2.2(3); OSA, ss. 93.1(5); and Ont. Rule 62-504, ss. 2.1(1).
10 MI 62-104, ss. 2.2(2); OSA, ss. 93.1(5); and Ont. Rule 62-504, ss. 2.1(2).
11 OSA, ss. 76(1); ASA, ss. 207(1); BCSA, ss. 86(1); and QSA, ss. 187 and 188.

1. to make a take-over bid for the securities of the reporting issuer; or
2. to become a party to a reorganization, amalgamation, merger or arrangement, or similar business combination with the reporting issuer, or to acquire a substantial portion of its property.[12]

Although it is difficult to precisely determine when a take-over bid is "proposed," as a result of the above, it is generally recommended that no purchases of shares in the target be made by the officers or directors of the offeror from the time a take-over bid is being considered.

In Quebec, there is a real issue as to whether an offeror may acquire a toe-hold without making use of insider information. Given the desire of the AMF to maintain a certain degree of harmony with the legislative framework of the other provinces, it will generally not intervene if the parties have no significant connection to Quebec. If the parties have a significant connection to Quebec, it is recommended that the proposed acquisition of securities be first discussed with the AMF.

Request for List of Security Holders

Securities law requires that the take-over bid circular be sent to all holders of the class of securities subject to the bid, as well as all holders of securities that are convertible into securities of the class which are subject to the bid (e.g. options). In order to accomplish this, it is necessary for the offeror to obtain a list of security holders of the target. The *Canada Business Corporations Act* ("CBCA"),[13] and Alberta's *Business Corporations Act* ("ABCA"),[14] require a corporation to provide such lists within 10 days after receipt of an affidavit[15] or statutory declaration,[16] respectively, containing the prescribed information. An offeror may be able to obtain the shareholders list in less time if the corporation is governed by British Columbia's *Business Corporations Act* ("BCBCA"),[17] since such statute states the list is to be furnished "promptly,"[18] or if the corporation was incorporated under Ontario's *Business Corporations Act* ("OBCA"),[19] which states that the list must be produced "as soon as is practicable."[20]

The delivery of this request will sometimes be the first notice to the target of the proposed bid. The courts have stated that the form of the affidavit or statutory declaration must be in strict compliance with the applicable legislation in order to be effective.[21] Accordingly, the contents of the affidavit or statutory declaration will be carefully reviewed by the target, and its counsel, to ensure compliance. If found to be defective, the affidavit or statutory declaration must be redelivered and the deadline to deliver the lists will start over.

More aggressive bidders have attempted to obtain the lists pursuant to the provisions of corporate law, which permit any person to examine the securities register upon payment of a reasonable fee and to make copies of those records.[22] The issue is whether option holders are covered by this provision. In at least one case,

12 OSA, s. 76(3); ASA, ss. 9(a); BCSA, ss. 86(3); and QSA, s. 189.
13 R.S., 1985, c. C-44.
14 R.S.A. 2000, c. B-9.
15 CBCA, ss. 21(3).
16 ABCA, ss. 23(5).
17 [SBC 2002] Chapter 57.
18 BCBCA, ss. 49(4).
19 R.S.O. 1990, Chapter B.16.
20 OBCA, ss. 146(2).
21 *Dylex Ltd. v. Mark's Work Wearhouse Ltd.* (1997), 38 B.L.R. (2d) 52 Alta. (Q.B.).
22 ABCA, ss. 23(4); CBCA, ss. 21(1); BCBCA, s. 46; and OBCA, s. 145. Under the CBCA (ss. 21(1.1)), and the BCBCA (s. 47), a person requesting such a list must provide an affidavit in the prescribed form.

an Alberta court has permitted the inspection of the records of the target, including the name and address of each holder of options, warrants, rights and securities convertible into common shares of the target.[23]

If there is no corporate statute that requires the target to provide a list of security holders to the bidder, as in the case where the target is an income trust, an offeror is still entitled to the list under securities legislation,[24] which, under this circumstance, substantially adopts the requirements of the CBCA.

Prohibition Against Collateral Agreements

As a general rule, an offeror in a take-over bid, and the offeror's joint actors, must not enter into an agreement or understanding that would have the effect of providing a security holder of the target with consideration of greater value than that offered to the other holders of the same class of securities (a "collateral benefit").[25] However, there are exceptions for benefits that are received by security holders solely in connection with their services as an employee, director or consultant of the target or of the successor to the business of the target, if certain conditions set out in the legislation are met.[26] It may also be possible to obtain from the securities regulators a discretionary exemption from the collateral benefit prohibition on the basis that the benefit would be conferred for reasons other than to increase the value of the consideration paid for securities acquired in the take-over bid.[27]

Defensive Tactics

Inadequate Disclosure and Misrepresentation

Once an unsolicited bid has commenced, the target will often engage in a series of defensive tactics to try to give its board of directors more time to adequately pursue all available alternatives. These tactics include a review of all actions taken by the bidder to ensure compliance with applicable law, such as compliance with the pre-bid integration rules. In addition, the target's corporate counsel will review the take-over bid circular for compliance with the disclosure requirements. Where the disclosure is found to be materially deficient, the target may make an application to the local securities regulatory authority to have the take-over bid cease traded. The commissions have entertained many applications based on allegations of non-compliance. Upon review of such decisions, it is clear that the deficiencies in the circular must be material. This position was clearly stated in *Re Standard Broadcasting Corp.* (1985), 8 OSCB 3672 at 3676-77:

> As to the allegations of inadequate disclosure that were made and did surface at several points during the course of the hearing, none were, in our respectful opinion, material in the sense that the disclosure asked for would have been necessary to allow an investor to make an informed investment decision. We stress this last point, as it is often the case that allegations of non-disclosure or inadequate disclosure, are made during the course of a take-over bid. There is a difference between perfect

23 See the order of the Court of Queen's Bench of Alberta dated May 25, 1999, in *Samson Canada Ltd. v. Highridge Exploration Ltd.* (unreported), Action Number 9901-07172 1999, in which the Court ordered compliance with ss. 21(4) of the ABCA, permitting the inspection of records of the target, including the name and address of each holder of options, warrants, rights and securities convertible into common shares of the target or any predecessor. No reasons for the decision were provided.

24 MI 62-104, s. 3.4; and OSA, s. 99.1.

25 MI 62-104, s. 2.24; and OSA, ss. 97.1(i).

26 MI 62-104, s. 2.25; OSA, ss. 97.1(2); and Ont. Rule 62-504, s.4.1.

27 MI 62-104, s. 6.2; and OSA, ss. 104(2)(a).

> disclosure (which no two opposing counsel likely would ever agree upon), acceptable disclosure and material non-disclosure or material misleading disclosure. In a case between these parties that was argued in the Supreme Court of Ontario before Madame Justice McKinlay after this Commission had denied relief, Madame Justice McKinlay noted that the appropriate standard of materiality is that set out in the judgment of the United States Supreme Court in *TSC Industries, Inc. et al v. Northway Inc.*, 426 U.S. 438, 96 5. Ct. 2126 (1976), which standard was approved by Montgomery, J. in *Royalty Trustco Ltd. et al. v. Campeau Corp. et al.* (1980), 31 O.R. (2d) 75 at 101 and by the Ontario Court of Appeal in *Sparling et al. v. Royal Trustco Ltd. et al.* (1984), 45 O.R. (2d) 484 at 490. That standard is:
>
>> "…an omitted fact is material if there is substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote…[or in deciding whether the tender his shares in the case of a take-over bid]…"
>
> No[t] one of the allegations of non-disclosure or inadequate disclosure met that standard of materiality. Although the *TSC Industries* standard of materiality often has been quoted and is well understood, it is frequently lost sight of when an allegation of non-disclosure is made before the Commission The fact that counsel for an applicant would have worded a matter differently, or would have made fuller disclosure, or would have placed emphasis on a different aspect of a matter, does not amount to non-disclosure unless there is a showing of materiality.

Even if the disclosure is found to be materially deficient, the securities commissions appear reluctant to cease trade an offer if the non-disclosure has been rectified through some other means. The most common means is through the directors' circular. The board of directors of the target is required to send to all shareholders a directors' circular within 15 days of the date of the bid. The statutory requirements of such circular impose upon the directors a statutory duty to rectify any deficiencies or material non-disclosure in a take-over bid circular. Accordingly, the commissions often take the position that any deficiencies in the take-over bid have been rectified by the directors' circular. An example of this can be found in *In the Matter of Rolland Inc. and Cascades Inc.* (1987), 10 OSCB 1629 at 1636:

> It must be noted, however, that Mr. Rolland's decision not to tender and the necessary result that the 90% acceptance condition, unless waived, could not be met, were forcefully and prominently stated in the Rolland directors' circular and, so stated and communicated, must be taken to be brought home to offerees. For that reason, and in all the circumstances of this case, we do not believe that Cascades' failure to disclose material information in its take-over bid circular should, by itself, lead us to make the requested cease trade order.

This position was also supported in *Canfor Corporation and Slocan Forest Products Ltd.* (1995), 18 OSCB 475 at 481-2, where the OSC stated:

> We have some doubt as to whether the correction of serious disclosure deficiencies in a take-over bid circular by appropriate disclosure in the directors' circular would in all circumstances suffice to remedy the situation. However, in this case the Slocan directors did make appropriate disclosure in their circulars of the matters which we have found should have been, but were not, disclosed in the Canfor offering documents, and the deficiencies in the latter were, in our view, while material, not so significant as to demand and order correcting them in the circumstances. In addition, the directors of Slocan disclosed the omitted information in sufficient time to allow the Slocan shareholders to make a reasoned decision as to the desirability of accepting the Canfor bid.

Poison Pills

Many Canadian public companies have adopted a shareholder rights plan ("SRP") or "poison pill." If the target has an SRP, the offeror will need to carefully review it.

The normal stated purposes of an SRP in Canada are to ensure that all shareholders are treated equally and to provide a period longer than 35 days for the board of the target to develop an alternative to maximize shareholder value. An SRP must be approved by a majority of the shareholders within six months of its adoption by the board of directors or the SRP is terminated.[28] Prior to adopting an SRP, the issuer will often submit the draft plan to RiskMetrics Group. This organization focuses on corporate governance issues and will issue a voting recommendation on the SRP. Many Canadian institutional investors will vote against the SRP if RiskMetrics Group issues a negative recommendation.

SRPs would normally be triggered by a person becoming an "acquiring person," which is generally defined as the beneficial owner of a specified percentage (usually 20%) of the outstanding voting securities of the company. A buyer can prevent the triggering of the SRP by making a "permitted bid," which typically is a bid that is open for a minimum period (usually 60 days), requires as a condition of the bid that a minimum of 50% of the shares held by independent shareholders be deposited, and if the minimum is achieved, the bid be extended for at least 10 days to give the remaining shareholders an opportunity to accept the bid.

In 1997, a Manitoba court held that a bidder had triggered the target's SRP when it entered into a lock-up agreement with a significant shareholder (under which the shareholder agreed to tender its shares to the proposed bid)[29]. Since this decision, SRP's have generally excluded a "permitted lock-up agreement" from the definition of "beneficially owned" shares, so that the execution of a lock-up agreement will not trigger the SRP.

28 Toronto Stock Exchange Company Manual, s. 636(a); and TSX Venture Exchange Corporate Finance Manual, Policy 3.1, s. 12.3.

29 *United Grain Growers Ltd. v. 3339351 Canada Ltd.* (1997) 32 B.L.R. (2d) 132.

In the U.S., a proxy contest is often an important part of the take-over battle, since obtaining control of the board may be essential in order to dismantle the poison pill. This is not the case in Canada, where it has been common practice for the offeror to make application to a securities commission to have the target's SRP cease traded, resulting in numerous commission decisions on the subject.

The decision in *Re Royal Host Real Estate Investment Trust and Canadian Hotel Income Properties Real Estate Investment Trust* (1999), 22 OSCB 7819, is of particular significance since it was a decision of three of the major provincial securities commissions (British Columbia, Alberta and Ontario). In that case, the commissions attempted to reconcile various prior decisions. They indicated that there was no comprehensive and conclusive test that was required to be met. Instead, a commission must consider all of the relevant factors of the particular case when deciding whether or not to cease trade the SRP. The decision then went on to state at page 7828:

While it would be impossible to set out a list of all of the factors that might be relevant in cases of this kind, they frequently include:

- whether shareholder approval of the rights plan was obtained
- when the plan was adopted
- whether there is broad shareholder support for the continued operation of the plan
- the size and complexity of the target company
- the other defensive tactics, if any, implemented by the target company
- the number of potential, viable offerors
- the steps taken by the target company to find an alternative bid or transaction that would be better for the shareholders
- the likelihood that, if given further time, the target company will be able to find a better bid or transaction
- the nature of the bid, including whether it is coercive or unfair to the shareholders of the target company
- the length of time since the bid was announced and made
- the likelihood that the bid will not be extended if the rights plan is not terminated

In considering these factors in the hearings, the question that the Canadian securities commissions consistently addressed until 2007, was not "if" an SRP should be set aside, but rather "when" was it time for the SRP to go. The commissions had repeatedly stated that once the SRP had served the purpose of providing the board with adequate time to pursue alternatives, the pill had to be set aside and the commissions would intervene and cease trade the SRP.[30]

In a significant shift in policy in 2007, the Alberta Securities Commission allowed an SRP, that was approved by the target's shareholders during a hostile take-over bid, to remain in place and prevent the hostile bid from being completed.[31] The Ontario Securities Commission made a similar decision in 2009.[32] However, in a subsequent decision, the British Columbia Securities Commission refused to depart from the historical

30 *Re Canadian Jorex Ltd. and Mannville Oil & Gas Ltd.* (1992), 15 OSCB 257; and *Re MDC Corporation and Regal Greetings & Gifts Inc.* (1994), 17 OSCB 4971.
31 *Re Pulse Data Inc.*, 2007 ABASC 895.
32 *Re Neo Material Technologies Inc. and Pala Investments Holdings Limited* (2009), 32 OSCB 6941.

position of the securities commissions that the only acceptable use of an SRP during a hostile take-over bid is to assist the target's board in attempting to obtain an alternative transaction for shareholders.[33]

As a result of these conflicting decisions, there is currently a discrepancy among Canadian securities regulators in the manner that they view poison pills. Accordingly, since a securities regulatory hearing on a poison pill normally takes place in the province or territory of the target's head office, the target's location could determine the outcome of the hearing. Nevertheless, it is clear at the present time in Canada that if there is no vote of shareholders approving a poison pill during the hostile take-over bid, the position of the regulators is that the poison pill will not be permitted to impede the bid indefinitely, regardless of where the target is located.[34]

Obtaining the Balance of the Shares

Compulsory Acquisition

The compulsory acquisition provisions are contained in the corporate legislation of the jurisdiction in which the target is incorporated. However, in the case of an income trust or royalty trust, the compulsory acquisition right may not be available if such right is not contained in the declaration of trust which created the trust.

The compulsory acquisition procedures generally state that, if within 120 days after the date of a take-over bid the bid is accepted by the holders of not less than 90% of the shares of the class to which the take-over bid relates (other than shares held at the date of the bid by or on behalf of the offeror or an affiliate or associate of the offeror), the offeror is entitled, on complying with the procedures set out in the applicable corporate legislation, to acquire the shares held by those holders who did not tender to the take-over bid.[35] This right must generally be exercised within 60 days after the termination of the bid, and in any event, within 180 days after the date of the take-over bid (although the time limits are not identical in all the Canadian jurisdictions).[36] The amount paid for the remaining shares under these provisions will either be the same consideration that was paid for the shares purchased under the bid or, if the shareholder demands payment of the fair value of the shares, the amount as determined by the applicable court.

Second Step Transaction

When the offeror acquires less than 90% of the outstanding shares it did not hold prior to the commencement of the bid, the offeror will need to complete a subsequent acquisition transaction in order to acquire the remaining securities. A "going private" transaction is generally defined in corporate legislation as an amalgamation, arrangement, consolidation or other transaction in which a holder of a participating security (a security that carries a right to participate in the earnings of the issuer and, upon the liquidation or winding up of the issuer, in its assets) can be required, without the holder's consent, to surrender the security, without the substitution of another participating security of equivalent value in the corporation or a successor to the corporation. However, a "business combination," as defined in Multilateral Instrument 61-101 ("MI 61-101"), which is in force in Ontario and Quebec, is much broader than the historical definition found in the corporate legislation. In MI 61-101, a business combination is defined as:

33 *Re Icahn Partners LP and Lions Gate Entertainment Corp., 2010 BCSECCOM 233.*

34 For the Ontario Securities Commission, this was confirmed in *Re Baffinland Iron Mines Corporation* (2010) 33 OSCB 11385.

35 CBCA, ss. 206(2); ABCA, ss. 195(2); OBCA, ss. 188(1); BCBCA, s. 300; and QBCA, ss. 149(5).

36 CBCA, ss. 206(3); ABCA, ss. 196(1); OBCA, ss. 188(2); BCBCA, ss. 300(3) (the time limit under the BCBCA is within five months after making the bid); and QBCA, ss. 149(1).

> an amalgamation, arrangement, consolidation, amendment to the terms of a class of equity securities or any other transaction of the issuer, as a consequence of which the interest of a holder of an equity security of the issuer may be terminated without the holder's consent regardless of whether the equity security is replaced with another security, but does not include…[37]

A "related party" includes a person or company that beneficially owns or exercises control or direction over voting securities of the issuer carrying more than 10% of the voting rights attached to all outstanding voting securities of the issuer. As a result, any second step transaction by the offeror will be considered a business combination under MI 61-101.

MI 61-101 generally requires that a corporation proposing to carry out a business combination disclose the following in the information circular sent to shareholders:

1. every prior valuation in respect of the issuer which has been made in the 24 months before the date of the information circular and which was known to the issuer or any director or senior officer of the issuer; and
2. any bona fide prior offer which was received by the issuer during the 24 months before the transaction was agreed to.

Unless an exemption is available, MI 61-101 also requires the preparation of an independent valuation of the target company's shares (and, subject to certain exceptions, any non-cash consideration being offered therefor). An exemption from this requirement applies if:

1. the business combination is being effected by the same buyer that made a take-over bid (or by an affiliate of that buyer) and is in respect of the same class of securities that were the subject of the bid;
2. the business combination is completed no later than 120 days after the date of expiry of the take-over bid;
3. the intent to effect a business combination was disclosed in the take-overbid circular;
4. the consideration per security paid in the business combination is at least equal in value and in the same form as the consideration that was paid in take-over bid; and
5. the take-over bid circular described certain tax consequences of both the take-over bid and the subsequent business combination.

MI 61-101 also requires that, in addition to any other required shareholder approval, the approval of the "minority" holders of the target shares be obtained at the meeting. Shares tendered to a take-over bid (including shares which were tendered pursuant to a lock-up agreement) may be voted by the offeror in the subsequent acquisition transaction, if, among other things, the above criteria are met and if the shareholder who tendered such shares was treated the same as all other shareholders (i.e. the per-share consideration received by the holder was identical in value and in form as received by the other holders, and the holder received no other consideration or collateral benefit for tendering such shares).

37 S. 1.1.

Plan of Arrangement

A plan of arrangement is a multi-step transaction which may involve an amalgamation, an amendment to the corporation's articles, a transfer of property, an exchange of securities, a compromise with creditors or any combination of the above. The principal disclosure document is the information circular which is mailed to the target's security holders in respect of the meeting called to approve the arrangement.

A plan of arrangement involves two court appearances and a shareholders meeting. At the first court appearance, the parties request an interim order which provides for the calling of a special meeting of shareholders and sets out procedural matters, such as the determination of the classes which have the right to vote separately as a class and the percentage of approval required. The court will also ensure that shareholders are granted a dissent and appraisal right similar to the one they would have received if the corporation had proposed an amalgamation. At the second court appearance, which occurs after the shareholders meeting, the court is asked to issue a final order approving the plan of arrangement. Shareholders who object to the granting of the order may attend and present evidence at this hearing. In determining whether to grant the requested order, the court will consider whether the plan is "fair" to the shareholders. The court may approve the arrangement as proposed or as amended by the court. The plan of arrangement becomes effective once the necessary documents, which include the final order, are filed with the applicable corporate registry and, in certain circumstances, a certificate is issued by the corporate registrar.

Subsection 3(a)(10) of the U.S. *Securities Act of 1933* (the "1933 Act") provides an exemption from the registration requirement for the issuance of securities (if the issuance has been approved by a court of competent jurisdiction after a hearing on the fairness of the terms and conditions of issuance, of which all holders of the target's securities receive notice, and have an opportunity to attend and be heard). Canadian plans of arrangement have been expressly recognized by the SEC as satisfying the requirements of ss. 3(a)(10). As a result, the plan of arrangement is often used if a Canadian target has a significant number of U.S. shareholders, since it enables the buyer to issue its securities to the shareholders of the target pursuant to the plan of arrangement, without prior SEC review. In addition, Canadian foreign private issuers are exempt from the SEC proxy rules. Therefore, if a U.S. buyer's shareholders are not required to vote on the transaction, the SEC proxy rules will also not apply.

Depending on the issuer's jurisdiction of incorporation, an issuer proposing a plan of arrangement may be required to demonstrate to the court that it is "not practicable" to effect the proposal under any other provision of the incorporating statute. Where the proposed arrangement has consisted of nothing more than a share exchange or amalgamation, issuers have convinced Canadian courts that the inability to rely on ss. 3(a)(10) of the 1933 Act, with the resulting expense and time delay required to clear a registration statement, makes the other provisions of the incorporating statute "not practicable."

Advantages and Disadvantages

A plan of arrangement has a number of advantages. Firstly, it offers maximum structuring flexibility and may accommodate the needs of numerous classes of security holders. Another major advantage is that the offeror may acquire 100% of the target upon obtaining the approval of only two-thirds of the votes of each class of securities that are entitled to be voted at the meeting. Accordingly, there is no need for a "second step" transaction. Thirdly, the information circular with respect to the meeting does not generally need to be translated into French. Finally, most of the restrictive take-over bid rules, including the pre-integration rules and the collateral benefit rules, do not apply to a plan of arrangement (although persons receiving collateral benefits may, depending on the circumstances, be precluded from voting in a "minority approval" vote that securities regulations may require).

Disadvantages of the arrangement structure include the longer time frame (usually 60 days or longer if an exchangeable share structure is used) and the increased cost. In addition, even if the transaction is approved by the required percentage of shareholders, there is no guarantee that the transaction will be approved by the court, since a shareholder may appear before the court and argue that the transaction is not fair. Finally, a plan of arrangement may only generally be used in a friendly situation.

In a plan of arrangement, the terms of the transaction are normally negotiated between management of the target company and the buyer, and are set out in an acquisition or pre-acquisition agreement. This agreement is the contract that sets out the ground rules under which the transaction is proposed to be completed. The agreement sets out such matters as the consideration to be offered, the conditions precedent to the arrangement, and the representations and warranties of the target. The agreement will also deal with any existing shareholder rights plan. Perhaps the most contentious parts of the agreement relate to the scope of the "no shop" clause, the existence and amount of any break fees, and the terms of any required lock-up agreements from management.

When shares of a buyer form all or part of the consideration, the plan of arrangement is often structured as a three-cornered amalgamation in which the target company amalgamates with a subsidiary of the buyer (which has been incorporated for this purpose), pursuant to which the shareholders of the target receive shares of the buyer. This structure alleviates the need for the buyer to obtain the approval of its shareholders, provided that this approval is not required by a stock market on which the buyer's securities are listed. (For example, certain stock markets in the U.S. require shareholder approval if a listed company proposes to issue a number of shares exceeding 20% of its outstanding shares in an acquisition transaction, including a plan of arrangement.)

Exchangeable Share Transactions

Exchangeable share transactions are used commonly in plans of arrangement involving a Canadian target and a foreign buyer. The purpose of this structure is to provide Canadian resident shareholders of the target with a tax-deferred rollover on the exchange of their shares of the target company, for shares of a Canadian acquisition company that are exchangeable at the holder's option for common stock of the foreign public parent. The target's outstanding options are also usually replaced pursuant to the arrangement, with replacement options exercisable into exchangeable shares. In this structure, the shareholder's capital gain is deferred until the shareholder sells the exchangeable shares or exercises the exchange right, and acquires the publicly traded shares of the foreign parent company. In addition, the Canadian shareholder will receive the Canadian dividend tax credit on any dividends declared on the exchangeable shares. Exchangeable shares are normally subject to a forced exchange after a certain period of time (usually 5-10 years).

Exchangeable shares are structured to be, in essence, the economic equivalent of the foreign parent issuer's common stock. The exchangeable shares carry a right to receive dividends on a per-share-equivalent basis in amounts (or property in the case of non-cash dividends) which are the same as, and which are payable at the same time as, dividends declared on the buyer's common stock. The exchangeable shares carry a right to vote on a per-share-equivalent basis at all shareholder meetings, at which holders of the buyer's common shares are entitled to vote, usually through the medium of a special voting share in the capital of the buyer, carrying votes equal to the number of outstanding exchangeable shares. Exchangeable shares also carry the right to participate on a per-share-equivalent basis to that of the buyer's common stock in a liquidation, dissolution or other winding up of the buyer, or distribution of any assets of the buyer.

The terms of the exchangeable shares are established through a combination of documents, including the share provisions, a support agreement which provides covenants of the buyer to provide the necessary financial support to allow the Canadian subsidiary to declare dividends equivalent to those declared by the buyer, and a voting and exchange trust agreement which provides covenants of the buyer concerning the voting and exchange mechanics.

Exchangeable share transactions are usually done through a plan of arrangement and follow one of the following structures:

1. the buyer organizes a Canadian subsidiary and the Canadian shareholders exchange their shares in the target company for exchangeable shares of the foreign buyer's Canadian subsidiary;
2. a three-cornered amalgamation in which the target company amalgamates with a subsidiary of a foreign buyer that has been incorporated for this purpose, pursuant to which the shareholders resident in Canada receive exchangeable shares of the amalgamated company which are exchangeable into shares of the buyer; or
3. the target company undergoes a capital reorganization in which the common shares of the target company are converted into exchangeable shares of the target company.

The buyer may need shareholder approval to create a new class of shares, since in many exchangeable share transactions, a single "special voting share" is issued to the trustee and the voting rights of the holders of exchangeable shares are exercised through that special voting share.

Exchangeable shares issued in an arrangement involving a U.S. buyer are freely transferable under U.S. federal securities laws, except exchangeable shares which are held by persons who are deemed to be "affiliates" (as defined in the 1933 Act) of the target and buyer prior to the transaction, which shares may be resold by them only in transactions permitted by the resale provisions of Rule 145 under the 1933 Act, or as otherwise permitted under the 1933 Act. The buyer will file a registration statement prior to the effective time of the arrangement in order to register under the 1933 Act the issuance, from time to time, of the foreign parent's common shares in exchange for the exchangeable shares. It is often a condition for completion of the arrangement that the registration statement be declared effective by the SEC. The buyer also usually agrees to file a registration statement in order to register under the 1933 Act the issuance of its common shares, from time to time, after the effective date of the arrangement upon the exercise of any replacement options issued to replace the options of the target.

When a Canadian reporting issuer amalgamates with another company, the amalgamated company automatically becomes a reporting issuer in the same Canadian jurisdictions. The shares issued pursuant to the amalgamation are freely tradable if any amalgamating company has been a Canadian reporting issuer for at least four months. The result is similar in the case of an arrangement. For exchangeable shares, there is an exemption that relieves the issuer of the exchangeable shares from the continuous reporting requirements that normally apply to reporting issuers under Canadian securities laws. The exemption is subject to conditions relating to the dissemination of information regarding the foreign parent company. The effect of those conditions is to provide the holders of exchangeable shares with annual and interim consolidated financial statements, and other information regarding the foreign parent company, in lieu of financial statements and continuous disclosure documents of the issuer of the exchangeable shares.

Conclusion

Determining the best method of acquiring a Canadian public company will always depend on the particular circumstances, having regard to securities-related considerations and other factors. The choice will usually be between a take-over bid and a plan of arrangement, and there are advantages and disadvantages to each. In the case of an unsolicited or hostile transaction, a take-over bid will generally be the only option.

There are a number of features of Canadian securities law that are unique internationally, and this is particularly the case in the area of mergers and acquisitions. Of special note is the approach of the Canadian securities regulators with respect to take-over defensive tactics, which has not been entirely consistent among the provincial jurisdictions.

The Securities Group at Fraser Milner Casgrain LLP includes professionals with substantial experience, both as practitioners and regulators. We understand not only the black letter laws, but also the approach regulators take in applying those laws. This requires continuous monitoring of the regulatory changes that are taking place among the various provinces and territories of Canada. Armed with this knowledge, in combination with our considerable experience in acting for buyers and targets in both friendly and hostile situations, we are well positioned to provide clients with innovative strategies to accomplish their objectives, regardless of the complexity of the issues confronting them in an acquisition transaction.

About FMC

Fraser Milner Casgrain LLP (FMC) is one of Canada's leading business and litigation law firms with more than 500 lawyers in six full-service offices located in the country's key business centres. We focus on providing outstanding service and value to our clients and we strive to excel as a workplace of choice for our people. Regardless of where you choose to do business in Canada, our strong team of professionals has extensive knowledge and expertise on regional, national and cross-border matters. FMC's well-earned reputation for consistently delivering the highest quality legal services and counsel to our clients is complemented by an ongoing commitment to diversity and inclusion to broaden our insight and perspective on clients' needs.

Our Approach

At FMC, we understand the complexities posed by changing market conditions. We know that to serve your needs effectively, we must understand your business and objectives in a broad context in order to anticipate developments, identify opportunities and respond to challenges.

FMC prides itself on being able to deliver effective solutions which advance the strategic interests of its clients. We do this by combining and leveraging our diverse professional capabilities and strong business acumen, with a clear understanding of our clients' needs and priorities.

We believe, first and foremost, that our success is tied directly to the success of our clients. As such, our approach is client-focused and results-driven. We offer pragmatic advice and our effort is a collaborative exercise, led by the appropriate partner and assisted by the appropriate professionals.

Experience Worth Pursuing

Our Mergers and Acquisitions Group acts on takeover bids (hostile and friendly), amalgamations, arrangements, and other business combinations involving public or private companies, as well as share and asset purchases and joint ventures. Our firm provides innovative and sophisticated advice on all matters arising in connection with M&A transactions, including tax, competition, *Investment Canada Act* compliance, financing, environmental, government relations, employment, pension and intellectual property law. We provide strategic advice, prepare all documents, and appear before securities commissions and courts whenever challenges need to be made or defended.

Success in hostile and friendly takeover bids is often more a matter of innovative approach than application of conventional legal procedures. Our experience allows us to move quickly and efficiently to assure the best outcome for our clients. We know the players; we know the regulators; and we know how to structure a successful transaction. With offices across the country, industry expertise in Canada's principal business sectors, lawyers who have worked for the regulators and experts in relevant practice groups like tax, competition, foreign investment and litigation, we know how to get the deal done.

Contact Us

To contact us, please visit www.fmc-law.com/mergers_acquisitions

FMC
LAW

MONTRÉAL
OTTAWA
TORONTO
EDMONTON
CALGARY
VANCOUVER

Fraser Milner Casgrain LLP

fmc-law.com