5. Acquiring a Canadian Business

General Considerations

There are two threshold issues to consider when acquiring a Canadian business. The first is whether the company is publicly listed or privately held, as this will affect the approach strategy and the amount of regulatory compliance involved in the transaction. The second is the mode of acquisition, as businesses can be acquired through either a share purchase or an asset purchase.

In addition to these general considerations, it may be necessary to obtain approvals under the *Investment Canada Act* (see Chapter 3) or the *Competition Act* (see Chapter 4), depending on the size of the transaction and its impact on the market or the relevant industry or sector.

Share Purchase: Publicly Listed Company

The acquisition of the shares of a publicly listed company requires compliance with Canadian securities laws. Unlike in the United States, there is no single securities regulator such as the Securities and Exchange Commission (SEC). Each of Canada's 10 provinces and three territories has its own securities regulator, although securities regulation across Canada has been harmonized and is coordinated to a significant extent. For further details, refer to the section entitled "Securities Legislation" in Chapter 6.

Approach

The first step is to determine whether to take a friendly or a hostile approach. A friendly take-over is done with the co-operation of the target company's board of directors. The purchaser submits a letter of intent, and the parties enter into negotiations to determine how best to go about the transaction. Often, friendly take-overs are precursors to amalgamations or mergers of two companies with compatible corporate strategies.

On the other hand, a hostile take-over is a direct offer to the shareholders of the target either without prior notification to the target's board or after the acuiror has made an approach and been refuted by the target. If successful, a hostile take-over will usually result in the replacement of the target's entire board. Hostile take-overs are often the result of shareholder dissatisfaction with a board's performance or strategic acquisitions by competitors.

Due Diligence

In a hostile bid situation, due diligence will often be limited to publicly available information. In a friendly transaction, prior to beginning the due diligence process, the parties involved sign a confidentiality agreement and, very likely, a standstill agreement preventing the acquiror from acquiring shares of the target or taking other action that is not supported by the board of directors of the target for a period of time.

Key issues to consider in the due diligence phase are:

- Change-of-control consequences for any material contracts
- Regulatory requirements
- Outstanding options or warrants
- Existence of any bonds, debentures, convertible securities, or rights to acquire securities
- Contingent liabilities
- Coattail provisions for non-voting or low-vote shares
- Location of the target's shareholders (including the United States)

Existing and potential shareholder rights plans (also known as "poison pills") can be of particular concern, especially in the context of a hostile take-over. These types of hurdles can increase the cost of an acquisition substantially, to the point of making the transaction prohibitively expensive.

Financing

There is one fundamental difference between the US tender offer rules and the Canadian take-over bid rules. In Canada, like in the UK,. In Canada, take-over bids cannot be conditional on the purchaser obtaining the necessary financing to complete the bid. More precisely, securities laws stipulate that the purchaser must make "adequate arrangements before the bid to ensure that the required funds are available." At a minimum, this usually involves obtaining a signed letter of commitment from a bank and paying any applicable fees. However the other forms of acquisitions discussed below, do not have a ``fully-funded`` rule and can provide for a financing condition.

Share exchanges are another area of difference. In Canada, the exchange of shares in a take-over does not require review by any securities commission. In the United States, bid documents may be reviewed by the SEC where a share exchange is involved. It is nevertheless important to remember that a share exchange will require significant level of disclosure by the purchaser regarding its financial situation and plans for the target after the acquisition has been completed.

Securities regulators have jurisdiction to review take-over bids for compliance with relevant securities legislation. This jurisdiction is often exercised in a hostile bid situation when a target alleges deficiencies in a competitor's offer or is asked to conduct such a review by a competing bidder.

Getting a Toehold

The threshold for triggering Canadian take-over bid rules is the acquisition of 20% of the voting rights of a corporation. As a result, the purchaser may wish to gain an intial position or ``toehold`` in the company prior to announcing the take-over bid. The level of a toehold will depend on strategic considerations and whether the acquioror wishes to disclose its position before making the bid. In Canada, the level at which a holder of public company shares is first required to disclose its position is 10% as opposed to 5% in the US.

If a purchaser acquires 20% or more of the voting rights – whether alone or working in conjunction with other parties (a purchasing group) – the purchaser will be required to offer to purchase the shares of all of the registered shareholders of the same class unless an exemption is available. For example, a private agreement exemption can be a critical tool for those seeking a creeping acquisition, as opposed to an all-or-nothing acquisition.

Under a private agreement exemption, the consideration for the shares cannot exceed 115% of the 20-day trading average of the company, and there can be no more than five parties tendering their shares to the purchaser. In addition, the normal course purchase exemption allows for open-market purchases not exceeding 5% of the company's shares in a given 12-month period.

Transaction Structures

There are three basic ways to structure a take-over transaction. First, there is the take-over bid, which is an offer to purchase the shares of the target company. Second, there are plans of arrangement, which are performed with the supervision and approval of a court. Finally, there are amalgamations, or mergers, which are completed through a vote by the shareholders.

(a) *Take-over Bid*

Regardless of whether the take-over is friendly or hostile, the purchaser will likely wish to "lock up" certain significant shareholders, whereby the shareholders promise to tender their shares at the appropriate time through a lock-up agreement. In addition, if the take-over is friendly, the purchaser may also enter into a support agreement with the target. The bid is launched through either an announcement in Canada's major newspapers or sending the take-over bid to the shareholders of the target. The target's directors then respond in kind by mailing their own circular in which they recommend or decline to recommend the takeover bid.

There is a 50% minimum tender requirement for all formal bids. The bid is open for a minimum of 105 days, subject to the target board's ability to shorten the period, to permit shareholders adequate time to consider the offer and tender their securities. If at the expiry of the initial bid period the minimum tender requirements and all other conditions of the bid have been satisfied or waived, the purchaser must extend the period for at least 10 days to allow additional shareholders to tender. At the expiration of the bid period, the purchaser takes up the shares and pays the tendering shareholders. If 90% of the shares have been tendered and taken up, the shareholders of the remaining 10% can be forced to tender their shares. However, where fewer than 90% but more than 66 2/3% of the shares (or 75% in the case of some British Columbia corporations) have been taken up and the purchaser wishes to acquire the remainder, the purchaser will then be required to do a second-stage squeeze-out, which generally requires the approval of two-thirds (or 75% in the case of some British Columbia corporations) of the shareholders and possibly a majority of the minority shareholders. Locked-up shares can be counted as part of the minority vote if the shares were given identical treatment.

Shareholders will be accorded dissent rights when being forced out or during the second-stage squeeze-out.

There can be no discrimination (except with the approval of the securities commissions) between shareholders under a take-over bid. This means that significant shareholders must receive the same consideration per share as an individual who owns a single share of the company.

There are also restrictions on the purchases of the target's securities prior to the bid. Essentially, the terms of the bid must be as favourable to the target's shareholders as any pre-bid transactions. French translations of the bid documents will be required if the target company has shareholders in the province of Quebec.

In a friendly context, the takeover bid process will take approximately 50 to 65 days (from commencement of the preparation of the circular) to complete. However, the process may take longer if the purchaser is forced to go through with a second-stage squeeze-out.

(b) *Plan of Arrangement*

Plans of arrangement are used very often in friendly transactions, particularly where the buyer is a private equity fund. This form of transaction allows for a significant amount of structuring flexibility. In a plan of arrangement, the parties enter into an agreement. Often, the purchaser will seek out significant shareholders and enter into support agreements with them whereby the shareholders commit to vote in favour of the arrangement. The purchaser will then apply to the court for approval and direction as to how to proceed.

Once the approval has been obtained, the purchaser will mail out a proxy circular and the board of the target will call a meeting of its shareholders to approve the arrangement (a two-thirds majority for federally incorporated and most provincially incorporated companies and a majority of minority if the related party receives a collateral benefit). Once the arrangement has been completed, the purchaser then returns to court to obtain final approval. It is important to note that the court is not bound by the vote of the shareholders. The key consideration for court approval in an arrangement transaction is fairness to both the corporation and the affected stakeholders.

Different prices can be offered to different shareholders in an arrangement transaction, subject to the court's fairness review and shareholder approval.

To proceed by way of an arrangement, the corporation applying to the court must be solvent. Shareholders are usually accorded dissent rights, and there is no restriction on the purchase of the target's shares prior to the transaction, subject to insider trading restrictions. A French translation of the arrangement documents may be required, depending on the extent of the transaction's connection to Quebec and the number of shareholders located in that province.

The entire process (ending with final court approval) takes approximately 50 to 65 days (from commencement of the preparation of the circular) to complete. An arrangement can be faster than a take-over bid if the take-over involves a second-stage squeeze-out.

An additional advantage to using a plan of arrangement is where share exchanges involving securities of US companies are offered. Under the Securities Act of 1933, where securities are offered as consideration in a transaction, there is a requirement to register those securities with the SEC in addition to subjecting the offer to disclosure requirements and US tender offer rules. However, there is an exemption for securities issued under the supervision and approval of a court after a hearing on the fairness of the transaction. As a result, Canada's arrangement structure has been recognized as fitting under this exemption. One of the things to consider when deciding on whether to use plan of arrangement is whether there are any stakeholders who may oppose the transaction in the context of the court approval process.

(c) *Amalgamation*

In an amalgamation, the parties enter into a merger agreement. Once again, the purchaser may wish to enter into lock-up agreements with significant shareholders to secure their votes. The merger documents and proxy circular are then mailed to the shareholders, and a meeting is called to approve the amalgamation (a two-thirds majority for federally incorporated and most provincially incorporated companies and a majority of minority if the related party receives a collateral benefit).

In an amalgamation, there are no restrictions as to the treatment of shareholders. In other words, the purchaser seeking to lock up a significant shareholder may have to pay a premium to secure that shareholder's vote.

Dissenting shareholders will usually be offered a cash alternative for the value of their shares. There are no restrictions on pre-amalgamation purchases of the target's securities, subject to insider trading restrictions. A French translation of the amalgamation documents is not required, subject to connecting factors to Quebec, such as the location of the head office and the size of the shareholder base. Amalgamations are usually faster than the other transaction structures and normally take anywhere from 45 to 60 days (from commencement of the preparation of the circular) to complete.

Share Purchase: Privately Held Company

Approach

The main issue when acquiring the shares of a private company is the reliability of information. In contrast to public companies, which have continuous disclosure obligations to keep their information (financial statements, press releases, annual information forms, and the like) public, true, and current, private companies have no such obligations.

A purchaser must approach the share purchase of a private company with a proper understanding and appreciation of the risks involved. Private companies often lack the resources to properly maintain their corporate minute books and have less developed document filing systems, and their directors (who are also usually the shareholders) often have rarely, if ever, had to deal with a process as complex as being acquired. A cool, calm, and collected approach on the part of the purchaser will enable the process to go smoothly and allow the parties to remain focused on completing the transaction.

Due Diligence

The due diligence process and the negotiation that follows are aimed at ensuring the accuracy of the information provided by the private target to the purchaser. Purchasers will want the target to represent and warrant that the target's information is as accurate and complete as possible, while the target will want to represent and warrant only as much as is required to sell the company's shares. These representations and warranties are a pivotal aspect of the Share Purchase Agreement.

A due diligence process that reveals anomalies in the target's corporate history or potential future liabilities (e.g., environmental contamination) will place deflationary pressure on the offering price.

Financing

The purchaser can make the transaction conditional on obtaining financing. This condition is usually made clear at the outset in a letter of intent. However, it is not unlikely for a target to request that the purchaser obtain a letter of commitment from a bank prior to submitting to the due diligence process and incurring significant legal expenses.

Transaction Structure

Acquiring a private company's shares can be completed through either the amalgamation or the arrangement provisions discussed above.

Asset Purchases

Where the existing liabilities of a target are a concern, the purchaser may opt to acquire the assets of the corporation instead. In addition to the foreign investment and competition issues discussed in the preceding chapters, there is also the issue of consent by the key stakeholders.

The major assets of a company (e.g., a factory, leased IT infrastructure, mortgaged real estate, or other leased real property) will often require a purchaser to obtain the consent of the target's creditors prior to completing the purchase. The consent of shareholders may also be necessary. If this is the case, it may be necessary for the target to call an extraordinary meeting of its shareholders to approve the asset purchase by special resolution.

In addition to the purchaser obtaining the consent of creditors and shareholders, in certain circumstances third-party consent may be required. A corporate vendor, for example, may own a number of assets that are not automatically transferred if the business is sold by way of an asset transaction, therefore requiring the consent of a third party to have the assets properly conveyed.

Asset purchases may also trigger the application of legislation that would not otherwise need to be considered in a share purchase. For example, since contracts of employment for the target's employees are not automatically assigned to a purchaser in an asset transaction, application of the various provincial labour relations legislation and employment standards acts will need to be considered.

Generally speaking, asset purchases are less advantageous for the target, as there is likely to be a recapture of depreciation on the assets acquired by the purchaser. Also, the sale of any inventory may result in a tax liability on the income realized from that sale if a doubtful debt reserve has been claimed.

On the other hand, asset purchases can be advantageous for a purchaser, particularly when real estate is involved. In this regard, purchasers will seek to allocate a greater proportion of the purchase price to depreciable property like buildings, as this reduces the amount of taxable income generated from those depreciable assets in the future. It is imperative that the parties (dealing at arm's length) agree in writing that the purchase price allocated to the relevant assets is of fair market value and that both parties agree to file their income tax returns according to the same allocation. Otherwise, the parties will be leaving open the possibility for the tax authorities to reallocate the purchase price in a less advantageous manner.

Other Issues

The decision to acquire a Canadian business does not end with a discussion of the transaction and the consequences of each possibility. Potential purchasers must also consider financing the operation post-acquisition, general tax considerations, labour and employment matters, executive immigration issues, privacy laws, and much more.

The following chapters present a more complete picture of what it means to conduct business in Canada.