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# Cross-Border Mergers and Acquisitions: A Tool Kit for Northbound Acquisitions

By Jay Hoffman and Barbara Doherty

The number of acquisitions by U.S. and other non-Canadian entities of Canadian public companies has increased dramatically in recent years. Several acquisition methods are available to prospective buyers, some of which are particularly advantageous to certain non-Canadian buyers. While it is true that many Canadian deal acquisition techniques are based on similar principles to those applied for domestic U.S. only acquisitions, the techniques used and the legal issues encountered in an acquisition of a Canadian target differ, in many respects, from those that arise under U.S. law. These acquisition methods and related matters should be carefully reviewed by U.S. buyers and their advisors early in the planning process. In this article, we briefly outline several deal acquisition techniques that may be used in a cross-border acquisition of a Canadian target company and discuss some of the issues a non-Canadian buyer should consider when planning a cross-border acquisition.

## ACQUISITION TECHNIQUES

### Take-Over Bid

A take-over bid is an offer to acquire 20% or more of a class of the outstanding voting or equity securities of a target company. The securities of the target already beneficially owned or controlled by the bidder and joint actors at the time the offer is made are included in the calculation of this threshold. Bids are governed by applicable Canadian provincial securities laws, corporate legislation and stock exchange rules. A bid must remain open for a minimum of 35 calendar days. Successful bids are usually followed by a second stage squeeze-out transaction to allow for the purchase by the buyer of any securities of the target not acquired by it under the bid. This allows the buyer to take the target private. Second stage transactions occur where the buyer acquires at least two thirds of the fully-diluted voting securities under the bid. When the acquisition is a “friendly” deal, the target will typically agree up front, in a support agreement, to facilitate the second stage transaction.

Under Canadian take-over bid rules, target companies are not permitted to use many of the defensive tactics available to a U.S. target. For example, the “just say no” defence is not available to the Board of a Canadian target. Shareholder rights plans permit the Board of a Canadian target to buy some time to seek a better offer, but are never used, and regulators will not tolerate the use, to block a bid. Other measures, such as staggered boards, used by U.S. targets as defences, are generally ineffective under Canadian rules because directors can be removed at any time by a simple majority of shareholders.

### Plan of Arrangement

A Plan of Arrangement is a widely used court supervised procedure under applicable corporate legislation for effecting business combinations approved by shareholders of a Canadian target company. Under this technique, a Canadian Court issues an initial order setting out the process for a shareholders’ meeting to be held to consider the business combination. Typically, the shareholder meeting is held about 30 days after the mailing of a proxy circular for the meeting. If the requisite majority of shareholders of the target (usually 66 2/3%) approve the business combination, the Court will then proceed to assess the fairness and reasonableness of the proposed transaction at a hearing that typically follows the shareholders meeting by a few days. If the Court is satisfied with the fairness of the transaction, it issues a final order. Shortly after the final order is issued by the Court, the transaction becomes effective according to the Plan of Arrangement. There is no need for a second stage transaction.

### Amalgamation

An Amalgamation is a procedure under applicable corporate legislation for effecting business combinations and requires approval of shareholders of a Canadian target company. It is used less frequently for cross-border acquisitions than the Plan of Arrangement technique. If the requisite majority of shareholders of the target (usually 66 2/3%) approve the business combination, the acquiror (usually a

newly incorporated Canadian subsidiary of the non-Canadian buyer) combines with the target as one company which has all of the property, rights and privileges and is subject to all of the liabilities of the acquiror and the target.

## Exchangeable Share Technique

In the event that a non-Canadian buyer offers securities as all or part of the consideration for the securities of the Canadian target company, "exchangeable shares" of the target company are often issued to Canadian shareholders of the target in exchange for their shares in the target. The exchangeable share technique has evolved to address the special tax concerns of Canadian shareholders. Canadian tax law generally treats the exchange of shares of a foreign corporation as a taxable event for Canadian taxpayers, even in what would otherwise be a tax-free reorganization for U.S. shareholders under U.S. federal income tax law.

The exchangeable share technique is designed to provide an opportunity for Canadian shareholders to defer recognition of any appreciation in value of their shares of the target company for Canadian tax purposes. This technique typically involves a recapitalization of the target which results in the U.S. buyer holding all of the voting shares of the target and the Canadian shareholders of the target holding exchangeable shares of the target. The exchangeable shares that would be issued by the target: (i) are non-voting, but holders of the exchangeable shares receive voting rights essentially identical to the voting rights of holders of the common stock of the buyer; (ii) give the holder the right to receive dividends equal to any dividends paid by the U.S. buyer to holders of the common stock of the buyer; (iii) have a right to participate pro rata with the stockholders of the U.S. buyer on any liquidation, dissolution or winding-up of the buyer; and (iv) are exchangeable at any time for common stock of the buyer. As a result, exchangeable shares are the economic equivalent of the common stock of the buyer and provide the holder of an exchangeable share with voting rights as if they held the common stock of the buyer.

## Which Technique Should the Buyer Use?

The selection by the prospective buyer of the appropriate deal acquisition technique requires careful consideration of a number of factors that are particular to the terms of the proposed acquisition. If the deal is for cash consideration, a take-over bid has the benefit of potentially allowing for an acquisition of control of the target company in a shorter time frame than the time typically required to complete a Plan of Arrangement. That said, a take-over bid may not be a faster road to control if there are competing bids. Competing bids may arise even in a negotiated, "friendly" deal, as the support agreement between the buyer and the target will still provide for a "fiduciary out" where a superior offer arises. A take-over bid usually requires a second stage transaction to acquire the securities not tendered into the bid. A second stage transaction is not required for a Plan of Arrangement or an Amalgamation. It should also be noted that a take-over bid is the only method available to do an acquisition without the agreement and cooperation of the Board of the target because it allows the buyer to make an unsolicited offer directly to the shareholders of the target.

A Plan of Arrangement is usually the preferred acquisition technique for friendly transactions where the buyer offers its securities as all or part of the consideration. One reason for this preference is that the securities offered by the buyer may be offered without the buyer registering those securities under applicable U.S. securities laws. An exemption is available from registration requirements under U.S. securities laws where the issuance of the securities by the buyer is made under a court order (including a court order granted by a Canadian court) which states that the transaction is fair.

A Plan of Arrangement is a very flexible deal structure and it is an extremely beneficial structure where the transaction involves a number of steps, for tax or other reasons, as all of the steps in the Plan become effective by operation of law in the precise sequence set out in the Plan on the day that the transaction becomes effective. Yet another reason for using a Plan of Arrangement is that a financing condition is permissible whereas under Canadian take-over bid rules, financing must be in place before commencement of the bid. Lastly, the Plan binds all securityholders and is the most effective method to acquire options or warrants which cannot by their terms be terminated on an acquisition.

Exchangeable Shares should be considered where the consideration for the shares of the target company includes shares of a non-Canadian buyer. An exchangeable share structure could be implemented with a take-over bid, a plan of arrangement or an amalgamation structure, but it is most often used with a plan of arrangement.

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