MERGER AND ACQUISITION STRATEGIES

RICHARD A. SHAW, Q.C.*

This article examines merger and acquisition strategies under corporate securities legislation of the Provinces of Alberta and Ontario and the corporate legislation of Canada. The author begins by defining terms that are integral to mergers and acquisitions and then moves on to discuss some preliminary considerations. Four takeover alternatives are presented: (1) purchase of treasury shares by private agreement; (2) exempt takeover by private agreement; (3) formal takeover bid; and (4) negotiated acquisition by amalgamation or arrangement. For each of these alternatives the author first looks at procedural and technical requirements, and then discusses the advantages and disadvantages of the particular procedure. The author then reviews the impact of the Ontario Securities Commission Policy No. 9.1 on merger and acquisition strategies. Finally, the author briefly looks at the multijurisdictional disclosure system adopted in Canada and the United States.

TABLE OF CONTENTS

I. DEFINITIONS AND ASSUMPTIONS 631
II. PRELIMINARY CONSIDERATIONS 632
 A. INCOME TAX CONSIDERATIONS 632
 B. PROFESSIONAL ADVISORS 634
 C. BOARD OF DIRECTORS 634
 D. TIMELY DISCLOSURE 635
 E. SHAREHOLDER RIGHTS PLANS 635
 F. REGULATORY APPROVALS 636
 G. TIMING 637
III. TAKEOVER ALTERNATIVES 638
 A. PURCHASE OF TREASURY SHARES BY PRIVATE AGREEMENT 638
 B. EXEMPT TAKEOVER BY PRIVATE AGREEMENT 641
 C. FORMAL TAKEOVER BID 644
 D. NEGOTIATED ACQUISITION BY AMALGAMATION OR ARRANGEMENT 649
IV. ONTARIO SECURITIES COMMISSION POLICY NO. 9.1 655
 A. PURPOSE AND APPLICATION 656
 B. SPECIFIC REQUIREMENTS 657
 C. MINORITY SQUEEZE-OUT TRANSACTIONS 659
 D. MULTI-STAGE TRANSACTIONS 660
V. MULTIJURISDICTIONAL DISCLOSURE SYSTEM 661
VI. CONCLUSION 661
SCHEDULE "A": TABLE 1, POLICY 9.1 REQUIREMENTS FOR PARTICULAR TRANSACTIONS 662
SCHEDULE "B": TABLE 2, POLICY 9.1 REQUIREMENTS FOR MINORITY SQUEEZE-OUT TRANSACTIONS 663

---

* Partner, McCarthy Tétrault. The author expresses his appreciation to his partner Douglas S. Ewens, Q.C. for furnishing the material on "Income Tax Considerations."

I. DEFINITIONS AND ASSUMPTIONS

The headline read "Watch For Oil and Gas Takeovers to Heat Up."[1] The story noted that although it was not exactly a stampede, industry watchers believed that takeover activity in the oil and gas sector was expected to increase in the next few months. In anticipation of this increase in merger activity, it is appropriate to examine the various methods by which mergers and acquisitions may occur and the reasons and strategies underlying the use of one method of acquisition as opposed to another.

There are a number of different methods and techniques by which one corporation may take over another. This article examines merger and acquisition strategies under corporate and securities legislation of the Provinces of Alberta and Ontario and the corporate legislation of Canada.

For the purposes of this article, the term *takeover* is used interchangeably with the terms *merger* and *acquisition*. The term *merger* does not have a defined legal meaning in Canadian law as it does in American jurisprudence.[2] In the Canadian context, *merger* is commonly used to refer to any transaction whereby one corporation acquires control of another, whether by takeover bid, amalgamation or arrangement.

Securities legislation broadly defines a takeover bid as being an offer to acquire voting or equity securities of the target, which together with the securities of the target owned by the offeror would constitute 20 percent (10 percent for targets governed by the *Canada Business Corporations Act*[3]) or more of the outstanding securities of that class.[4] For this purpose the offeror is also deemed to own securities held by persons acting jointly or in concert with the offeror, securities held by the offeror and such persons that are convertible within sixty days of the offer or securities which the offeror or such persons have the right or obligation to acquire within such sixty days.[5]

To focus this discussion, certain factual assumptions have been made: (1) the client and potential acquiror is a public corporation incorporated under the laws of Canada; (2) the target is a public corporation incorporated in Canada with shares listed on the Toronto Stock Exchange ("TSE") and a reporting issuer under each of the provincial securities acts in Canada; (3) the target has no securities registered with the Securities and Exchange Commission ("SEC") in the United States, although it has some

---

1 M. Ingram, "Watch for Oil and Gas Takeovers to Heat Up" *The Globe and Mail* (22 February 1995) B11.

2 See *Fletcher Cyclopedia of the Law of Private Corporations*, vol. 15 (Illinois: Callaghan & Co., 1991) at 8, §7041. Under United States law, a *merger* is a statutory procedure and is defined as "the absorption of the corporation by another; the latter retains its name and corporate identity with the added capital, franchises and powers of the merged corporation. It is the uniting of two or more corporations by the transfer of property to one of them, which continues in existence, the others being merged into it."

3 R.S.C. 1985, c. C-44 [hereinafter *CBCA*].

4 *Securities Act*, R.S.O. 1990, c. S.5, s. 89(1) [hereinafter *OSA*]; *Securities Act*, R.S.A. 1981, c. S-6.1, s. 131(1)(r) [hereinafter *ASA*]; *CBCA*, *ibid.*, s. 194.

5 *OSA*, *supra* note 4, s. 90(1); *ASA*, *supra* note 4, s. 131(4).

shareholders resident in the United States; (4) it has one or a few large shareholders and one class of common shares outstanding; and (5) the acquiror owns less than 10 percent of the outstanding voting shares of the target.

II. PRELIMINARY CONSIDERATIONS

When a client advises its counsel that consideration is being given to acquiring another corporation, there are certain preliminary steps which should be taken immediately to assist in developing the acquisition strategy. These would include: (1) obtaining complete copies of the target's incorporating documents and, if available, its by-laws; (2) searching public filings at the securities commissions to obtain copies of recent annual reports, management proxy circulars, annual information forms, prospectuses, material change and insider trading reports; (3) conducting searches of public registries such as that maintained under personal property security legislation and action searches at courthouses; (4) determining whether or not a shareholder rights plan (or poison pill) has been implemented by the target; and (5) obtaining recent articles on the target appearing in the financial press. Usually the client will have obtained much of this material before counsel is advised about the proposed takeover. It is important that the material be carefully reviewed by counsel; particularly the incorporating documents, any shareholder rights plan, and the terms and conditions of any financing instruments or bank loan agreements (to the extent the same are determinable). This information provides a base from which to develop the appropriate acquisition strategy.

Specific matters that should be raised with the client are as follows.

A. INCOME TAX CONSIDERATIONS

Income tax planning is an essential element of every acquisition. A review of income tax consequences and planning opportunities may be decisive in determining the manner in which to proceed with the acquisition.

For income tax purposes, where a person or group of persons "acquires control" of a corporation, the following adverse tax consequences may result:

(1) All of the corporation's past capital losses are wiped out.

(2) All of the corporation's accrued but unrealized capital losses are crystallized, and except and to the extent that the corporation has assets in respect of which an equivalent amount of capital gains have accrued and the corporation elects to crystallize them, the accrued capital losses are wiped out.[6]

---

[6] *Income Tax Act*, R.S.C. 1985, (5th Supp.), c-1 , ss. 111(4)(d)-(e) [hereinafter *ITA*]. An example is losses incurred by an "acquisition subsidiary," where the losses consist of interest expense on the acquisition debt.

(3) Non-capital losses that have not been sustained in the course of the corporation carrying on a *business* are wiped out.[7]

(4) All of the corporation's non-capital losses that have been sustained in connection with the carrying on of a business are restricted, such that the corporation can utilize these losses in the future only if it carries on the business in which the losses were sustained with a reasonable expectation of profit, and only to the extent of the corporation's income from that business and from any other business involving the sale, leasing, rental, or development of properties or services *similar* to those sold, leased, rented, or developed by the corporation prior to the acquisition of control.[8]

(5) The corporation's resource tax pools[9] become "successored," with the result that the corporation can claim deductions in respect of such pools only to shelter income from, and proceeds of disposition of, resource properties owned by the corporation at the time of the acquisition of control.[10]

Under income tax law, an "acquisition of control" differs from a "change of control." A good illustration of the difference between the two concepts is where a parent company that owns more than 50 percent of the voting shares of a corporation completes a secondary distribution of the control block, resulting in the control block becoming widely held. In these circumstances, usually no "group of persons" is considered to have acquired control of the corporation. Revenue Canada's administrative position is that in order for a group of persons to exist, they must act in concert together in some respect beyond simply having ownership of shares of the corporation in common. In other words, even though the parent company has ceased to control the corporation, in the income tax world no person or group of persons has acquired control.

Reverse takeovers have been used to limit the adverse tax consequences which otherwise would result from a straightforward acquisition of control of a loss corporation. Assume that a corporation currently paying income tax ("TaxCo") has a net worth of $50 million and it wishes to merge with a loss corporation ("LossCo") that has a net worth of $5 million but tax losses or tax attributes totalling $15 million. Both TaxCo and LossCo are widely held. If TaxCo were simply to acquire all the shares of LossCo and merge LossCo into TaxCo, all of the adverse tax consequences outlined above would befall LossCo. To avoid that result, the merger would be effected by having LossCo acquire all the shares of TaxCo in exchange for issuing new treasury shares of LossCo to the shareholders of TaxCo (who would end up owning roughly 90 percent of the shares of LossCo, given that the net worth of TaxCo is ten times that of

---

7 *Ibid.* s. 111(4).

8 *Ibid.*, s. 111(5).

9 *E.g.* cumulative Canadian exploration expense, cumulative Canadian development expense and cumulative Canadian oil and gas property expense.

10 These types of income are referred to as "streamed income" because they are streamed to (*i.e.*, associated with) the corporation's "pre-acquisition of control" resource properties.

LossCo). As long as the shareholders of TaxCo do not act in concert in respect of their shares of LossCo, no group of persons would have acquired control of LossCo. Although LossCo itself will have acquired control of TaxCo, very few adverse tax consequences result from that acquisition of control.[11]

Unfortunately, on April 26, 1995 the Department of Finance released extensive proposed amendments to the *ITA*. One of these[12] would deem the shareholders of TaxCo to constitute a "person or group of persons" who "acquired control" of LossCo, with the result that the adverse tax consequences described above would befall LossCo to the same extent as they would if TaxCo had directly acquired control of LossCo.[13]

Although these new rules will certainly curtail the use of the reverse takeover technique, they will not apply in a number of circumstances, such as where the effect of the reverse takeover is that the shareholders of TaxCo end up owning less than a majority of the voting shares of LossCo. That kind of transaction would give the shareholders of TaxCo effective control, but not legal control, of LossCo. From an income tax standpoint, an acquisition of effective control does not trigger these adverse tax consequences.

B. PROFESSIONAL ADVISORS

Mergers and acquisitions are the bread and butter of professional advisors — merger and acquisition specialists, investment advisors, valuators, chartered accountants, bankers, proxy solicitation agents and lawyers on both sides — all who contribute to the success or failure of the transaction and to its costs. The acquiror will seek advice from counsel on the strengths and weaknesses of potential advisors that the acquiror might engage and whom the target might be expected to hire. Counsel will review comparable public transactions to advise the client on representative fee ranges for the engagement of investment bankers and valuators. In most instances, the chosen professional advisors are those with existing longer-term relationships with the acquiror. Engagement letters setting out the terms and conditions of and the fees payable to the investment bankers should be executed at an early stage in the transaction. Customary terms of the engagement letter include a strongly worded indemnity by the acquiror in favour of the investment bankers against all claims or liabilities arising against the investment banker, other than those caused by its own negligence or wilful default.

C. BOARD OF DIRECTORS

Counsel should brief the board of directors of the acquiror on their duties and responsibilities in a takeover contest, the corresponding duties and responsibilities of the board of directors of the target in responding to the takeover, and what responses

---

11 The reason is that normally the streamed income of TaxCo far exceeds its successored tax pool balances and TaxCo often has no realized or accrued capital losses or non-capital losses.

12 *ITA*, s. 256(7)(c) [proposed].

13 Consistent with this result, proposed s. 256(7)(d) would deem TaxCo *not* to have undergone an acquisition of control.

are permitted by corporate and securities law. Directors and officers of the client should be reminded not to trade in any securities of the acquiror or the target and not to "tip" information concerning the transaction to third parties, except on a need-to-know basis. Securities legislation prohibits a person from trading in securities of a public corporation with the knowledge of a material fact or material change that has not been generally disclosed or from disclosing that information to third parties except in the "necessary course of business."[14] Persons breaching these provisions risk significant civil and criminal liability.[15]

D. TIMELY DISCLOSURE

Securities legislation[16] and policy[17] and stock exchange rules[18] mandate timely disclosure of material changes or facts concerning public corporations. Information about potential mergers and acquisitions will require disclosure at an appropriate point in time under these requirements. To carry an acquisition to a successful conclusion, it is critical that information concerning the transaction be maintained in the strictest confidence until it is "ready" to be publicly disclosed. Only those employees of the acquiror and personnel of professional advisors who "need to know" about the transaction should be informed. Careless lips will severely hinder the process and may bring it to an end. The importance of maintaining secrecy must be emphasized to the client and its advisors so as not to jeopardize the transaction. Consider with the working group what responses will be made to the TSE should unsubstantiated rumours be circulated in the market place. Also, review at what point public disclosure must be made of the transaction in accordance with securities and stock exchange rules.

E. SHAREHOLDER RIGHTS PLANS

Many public corporations have in place shareholder rights plans or poison pills. If the target has implemented a rights plan, care must be taken by the acquiror not to inadvertently trigger the rights plan which would result in massive dilution of its investment in the target. A critical element in acquisition strategy is to render the rights plan ineffective by having the target's board waive its application, by redeeming the rights for nominal consideration, by having the plan cease-traded by a securities commission or by having the rights plan declared invalid by a court of law.

Plans typically provide that the rights become severable from the underlying shares eight trading days after the earlier of: (1) a public announcement that a take-over bid has been commenced for the target; or (2) upon the target learning that an acquiror has acquired beneficial ownership of a specified percentage, usually 20 percent (but sometimes as low as 10 percent) of the voting shares of the target. In the first instance,

---

14 *OSA*, *supra* note 4, ss. 76(1)-(3); *ASA*, *supra* note 4, ss. 119(2)-(4).

15 *OSA*, *ibid.*, ss. 134, 122; *ASA*, *ibid.*, ss. 171, 161.

16 *OSA*, *ibid.*, s. 75; *ASA*, *ibid.*, s. 118.

17 National Policy No. 40, "Timely Disclosure" (1993), 16 O.S.C.B. 2722.

18 See *e.g. The Toronto Stock Exchange Company Manual*, in *Canadian Stock Exchanges Manual*, vol. 1 (North York: CCH Canadian Limited) 825-616ff, s. 406ff.

the board of directors of the target has authority to postpone the exercise date; in the second instance there is no such power. Once the specified percentage of ownership is reached by the acquiror, shareholders of the target (other than the acquiror) may purchase shares of the target at 50 percent of the prevailing market price — thus the massive dilution. No acquiror will risk or has risked this dilution.

Rights plans are designed to give the target board additional time to respond to an unexpected or hostile takeover. With the additional time, the board has a better chance to seek a competing bid or to improve the terms of the first bid — all with a view to maximizing shareholder value. When the competing bid is obtained or the acquiror increases its bid to an appropriate level, the board may waive the rights plan and let the shareholders decide the matter. Recent rights plans limit the ability of a target board to waive the plan to only those circumstances where the takeover is made by takeover bid circular. The power to redeem the rights by paying a nominal sum may also require shareholder approval.[19] A target board's flexibility in responding to a takeover may be severely restricted by the terms of the rights plan.

The presence of a rights plan in a target becomes a critical timing consideration for the acquiror. Recent decisions of the Ontario Securities Commission ("OSC") indicate that once a takeover bid has been launched, the target can only expect to retain the rights plan in place for forty-five to sixty days at the outside.[20] Unless a competing bid has surfaced by that time or cogent evidence has been presented to the OSC that an alternate transaction providing increased value to target shareholders is imminent, the OSC will take appropriate action to allow shareholders to respond to the bid or bids that are outstanding.

F. REGULATORY APPROVALS

The provisions of the *Competition Act*[21] and the *Investment Canada Act*[22] may have application to an acquisition. Pre-merger notification is required under Part IX of the *Competition Act* if the parties to the acquisition have assets or gross revenues in Canada in excess of $400 million and the target corporation has assets or gross revenues in Canada in excess of $35 million.[23] Many acquisitions would meet these threshold tests. The acquiror may satisfy the requirements of the *Competition Act* by filing the prenotification materials and waiting for the expiry of the maximum delay period of twenty-one days, or obtaining an advance ruling from the Director under the

---

19 For example, the Shareholder Rights Plan Agreement of TransCanada PipeLines Limited dated December 2, 1994, as amended, does not require shareholder approval for the board of directors to exercise the redemption power; the Shareholder Rights Agreement of Alcan Aluminium Limited as amended and restated on April 24, 1995 does require shareholder approval for the board of directors to exercise the waiver power.

20 *Re Lac Minerals Ltd. and Royal Oak Mines Inc.* (1994), 17 O.S.C.B. 4113; *Re MDC Corporation and Regal Greetings & Gifts Inc.* (1994), 17 O.S.C.B. 4431.

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

22 R.S.C. 1985 (1st Supp.), c. I-28.

23 *Supra* note 21, ss. 109, 110.

Competition Act.[24] This will not unduly delay the transaction. Experience shows that very large mergers can be completed without significant concerns about an investigation being launched by the Director under the *Competition Act.*

If the offeror is a non-Canadian within the meaning of the *Investment Canada Act*, the investment must be approved by Investment Canada as being of "net benefit to Canada."[25] Investment Canada is required to give an initial response to any application for approval within forty-five days of its receipt of the completed application.[26] The length of time required to receive a decision from Investment Canada must be factored into the transaction timetable. Where the non-Canadian is a national of a member country of the World Trade Organization (a "WTO National") — which would include Americans — the threshold level at which direct acquisitions are to be reviewed is $160 million as opposed to $5 million.[27] This heightened threshold is not applicable to acquisitions of Canadian businesses involved in the production and ownership of uranium, the provision of financial services or transportation services, or cultural businesses, for which the original $5 million threshold remains in place.[28] Limits on indirect acquisitions (*i.e.* acquisitions of Canadian corporations by acquiring the offshore parent) by WTO Nationals of Canadian businesses have been eliminated.[29] Mexican investors receive similar treatment under the *Investment Canada Act* as a consequence of the *North American Free Trade Agreement.*[30]

G. TIMING

Often, a client's first question of counsel is how long will it take to complete an acquisition. The answer will vary according to the method adopted for the takeover, the need to comply with OSC Policy No. 9.1,[31] the presence of a shareholder rights plan, and the defensive posture and response of the target. Timing considerations will be a key element in the takeover strategy.

A takeover bid by formal circular may proceed in as little as thirty-one days (ten days to obtain the shareholders' list and twenty-one days for the bid); where the target has a rights plan this period will be forty-five to sixty days. An arrangement or amalgamation will take a minimum of forty-two days to call and hold the required

---

24 *Ibid.*, ss. 123(b), 102(1).

25 *Supra* note 22, s. 21(1).

26 *Ibid.*

27 *Ibid.*, ss. 14.1(2), (3).

28 *Ibid.*, s. 14.1(5)(a)-(d).

29 *Ibid.*, s. 14.1(4).

30 Enacted in Canada by the *North American Free Trade Implementation Act*, S.C. 1993, c. 44.

31 OSC Policy No. 9.1, "Disclosure, Valuation, Review and Approval Requirements and Recommendations for Insider Bids, Issuer Bids, Going-Private Transactions and Related Party Transactions" (1992), 15 O.S.C.B. 2930 [hereinafter Policy 9.1]. The Quebec Securities Commission also has in place a similar policy: Policy Statement No. Q-27, "Requirements for Minority Security Holders Protection in Certain Transactions" (1993), 4 Can. Sec. L. Rep. (CCH) 570-027 [as amended].

shareholders' meeting — seven days to publish notice of the record date,[32] which in turn must be at least thirty-five days before the meeting date according to National Policy No. 41 of the Canadian Securities Administrators.[33] Where Policy 9.1 applies and a valuation of the target shares or of the offeror's shares is required, an additional five to six weeks must be added to the timetable in each instance. Regulatory approvals, except for those required under the *Investment Canada Act*, would normally not impact the timetable.

III. TAKEOVER ALTERNATIVES

In light of these considerations, it is appropriate to determine how best to proceed with the acquisition. There are four major methods that may be followed by a corporation seeking to acquire a control position in, or the takeover of, a corporation:

(1) purchase of treasury shares by private agreement;

(2) purchase by exempt takeover bid of shares from not more than five shareholders;

(3) formal takeover bid; and

(4) negotiated acquisition by amalgamation or arrangement.

The procedural and technical requirements of each of these alternatives and their respective advantages and disadvantages are examined separately below.

A. PURCHASE OF TREASURY SHARES BY PRIVATE AGREEMENT

Under this method, the acquiror will enter into a subscription agreement with the target corporation for the purchase of treasury shares. This technique is often used where the target is in significant need of an equity infusion or as a defensive response to a threatened takeover by another corporation. A recent example of an equity infusion is the purchase by a group led by Torch Energy Advisors Inc. ("Torch") of approximately $300 million of treasury shares of Gulf Canada Resources Limited ("Gulf Canada") resulting in a holding by the group of 25 percent of the outstanding common equity of Gulf Canada.

1. Procedural and Technical Requirements

a. Confidentiality Agreement

The acquiror will be anxious to conduct due diligence on the books and records of the target and will be particularly anxious to obtain confidential information about the

---

32 *CBCA*, *supra* note 3, s. 134(4); *Business Corporations Act (Alberta)*, S.A. 1981, c. B-15, s. 128(4) [hereinafter *ABCA*].

33 National Policy No. 41, "Shareholder Communication" (1987), 10 O.S.C.B. 6307, s. 1.

target. The target, as well as any major shareholder of the target, will enter into a confidentiality agreement with the acquiror pursuant to which the additional information will be disclosed. Usually this disclosure is done by the target establishing a controlled-access data room containing all material information about the target. Representatives of the acquiror (and often other competing acquirors) will review the information in the data room, taking appropriate notes on, and when allowed, copies of, pertinent material. Apart from the requirement to maintain non-public information in confidence for a specified term (which may range from two to five years), the agreement will also contain a standstill clause whereby the offeror, if it does not proceed with the transaction, agrees for a period of time (typically twelve to eighteen months) not to initiate or engage in any other transaction whereby it will acquire outstanding securities of the target or any significant assets of the target without the prior written consent of the target. Where the treasury purchase is being made as a defensive tactic to an unwelcome takeover bid, the standstill provisions will last for a significantly longer period of time. The confidentiality agreement may also contain a restriction on the acquiror hiring away employees of the target.

b. Purchase Price

There are no restrictions on the purchase price which the acquiror may pay for the treasury shares.

c. Subscription Agreement

The acquiror, the target and the major shareholder will enter into a share subscription agreement containing customary representations, warranties and covenants, and the following special clauses:

(1) a "no-shop" clause to the effect that the target and the major shareholder will not solicit, initiate, encourage, or invite submissions, proposals, or offers from any other person for the shares of the target, including the shares owned by the major shareholder;

(2) often a "fiduciary out" clause in favour of the target and the major shareholder, allowing them to accept a better offer from someone else in the exercise by the boards of directors of the target or the major shareholder of their jurisdiction to act in the best interests of the target and its shareholders or in the best interests of the major shareholder and its shareholders; and

(3) if there is a "fiduciary out" clause in favour of the target or the major shareholder, a "break-up fee" clause, which takes effect if the target or major shareholder accepts a better offer with the fee being set at a dollar amount or a formula based on the incremental increase in value of the better offer.

d. Shareholders' Agreement

Where there is another major shareholder of the target, the new investor and the major shareholder may often enter into a shareholders' agreement relating to the management of the target and the manner in which both investors will vote their shares in the target. In the Torch/Gulf Canada transaction, the Torch group entered into a shareholders' agreement with A&G Resources Corporation as the holder of 52 percent of the outstanding voting equity shares of Gulf Canada. That shareholders' agreement contained covenants regarding the voting of shares for the election of directors, the designation of the chief executive officer and chairman of the board of Gulf Canada, consultation on matters to be submitted to a vote of shareholders, the disposition of certain of the shares of Gulf Canada and termination provisions pertaining to such obligations.[34]

e. Stock Exchange Requirements

The by-laws of the TSE require that the TSE approves the treasury issue.[35] Notification of the treasury issue must be given promptly to the TSE and may not be proceeded with without its consent.[36] Shareholder approval may be required as a condition of approval where the transaction may materially affect control of the target, has not been negotiated at arm's length, or is of such a nature as to make shareholder approval desirable, having regard to the interests of the company, its shareholders and the investing public.[37] Generally, shareholder approval of a transaction will be required where the new investor will hold 25 percent or more of the outstanding voting equity of a target. This requirement is often satisfied by one or more shareholders of the target, who hold more than 50 percent of the voting shares, consenting in writing to the transaction; a procedure that avoids the calling and holding of a shareholders' meeting.

2. Advantages and Disadvantages of Treasury Purchase

Advantages	Disadvantages
Due Diligence: The acquiror is able to conduct all required due diligence to become more comfortable with the investment. *Simplicity*: Documentation is relatively simple and straightforward, consisting of a share subscription	*Minority Shareholders*: The acquiror does not obtain control of all of the voting equity of the corporation and perhaps not even a majority of the voting equity of the corporation. In subsequent dealings by the acquiror with the target, significant issues may arise concerning minority shareholders

[34] For further detail, reference should be made to the Management Proxy Circular of Gulf Canada Resources Limited dated 24 March 1995.

[35] *The Toronto Stock Exchange By-laws*, s. 19.06(1), in *Canadian Stock Exchanges Manual*, vol. 1 (North York: CCH Canadian Limited) at 803-921.

[36] *Ibid.*

[37] *Ibid.*, s. 19.06(2).

agreement with customary representations, warranties and covenants by the issuer, perhaps a standstill agreement and a shareholders' agreement with any other major shareholders. There are customary terms and conditions for each of these agreements.

Timing: It may be possible to proceed expeditiously and without the need for any shareholder approval if one or more major shareholders holds more than 50 percent of the outstanding voting shares of the target corporation.

and the manner in which the minority shareholders are to be dealt with. This results in additional procedural safeguards being necessary in connection with further corporate restructurings or reorganizations, such as the use of special committees of directors and majority of the minority voting procedures.

Shareholder Approval: It will likely be necessary for the target to hold a meeting of its shareholders to obtain majority approval of the proposed treasury issue in accordance with the rules of the TSE. This will entail delays and create a risk that the target will be put "in play" such that competing bids emerge.

Poison Pill: Depending on its terms, if the target has a shareholder rights plan in place, the directors of the target may have limited power to waive or redeem the plan and shareholder approval may be needed to waive the plan.

B. EXEMPT TAKEOVER BY PRIVATE AGREEMENT

This method takes advantage of the private purchase agreement exemption from takeover bids contained in securities legislation.[38] The acquiror enters into a share purchase agreement to buy a control block of shares of the target from not more than five shareholders of the target at a price not in excess of 115 percent of the market price.

1. Procedural and Technical Requirements

a. Confidentiality Agreement

As in a purchase of treasury shares, the acquiror will enter into a confidentiality agreement with the selling shareholders to examine non-public information concerning the target which is held by the selling shareholders. The acquiror would prefer that the target also be a party to this agreement so that the acquiror may examine all the non-public information held by the target. In this day of enhanced corporate governance principles, it can be expected that the independent directors on the board of the target would react negatively to any such cooperation by the target, as minority shareholders will not have any opportunity to sell their shares to the acquiror and to share in any premium to the market price that is paid. Such access may be available if the size of the selling shareholder's position in the target is sufficiently large. The target in these

[38] *OSA*, *supra* note 4, s. 93(1)(c); *ASA*, *supra* note 4, s. 132(1)(c).

circumstances may consider it important from the perspective of both the acquiror and target company management that a reasonably cooperative and friendly relationship be established at an early date. From a legal standpoint, the target company management is not required to provide any such confidential information. However, as a matter of business practicalities, it may be prepared to do so, subject to the approval of the board of directors. The confidentiality agreement will contain covenants of the acquiror similar to those referred to under the purchase from treasury procedure.[39]

b. Purchase Price

In a private agreement transaction, the maximum price payable by the acquiror is 115 percent of the market price.[40] Securities regulations define market price of a class of securities on a published market, such as the TSE, at any date to be an amount equal to the simple average of the closing price of securities of that class for each of the business days on which there was a closing price falling not more than twenty business days before that date.[41] The 115 percent maximum includes any brokerage fees or commissions.[42] It is essential while negotiating a private purchase transaction that the market price as defined be tracked each day during the negotiations. The "date" on which the calculation is made is the date on which an enforceable agreement of purchase and sale is entered into by the parties. A letter of intent or heads of agreement would normally not suffice to fix the market price. The market price provision limits the premium that a selling shareholder may obtain in a private transaction to a maximum of 15 percent of the market price. This limit reflects a public policy decision that a significant shareholder should not be entitled to receive an excessive premium for its "control" position. Many controlling shareholders believe that their investment is worth a premium substantially in excess of this limit. Where the purchase price will exceed 115 percent of the market price, the private purchase agreement exemption from the takeover bid provisions is not available and the acquiror will have to complete the acquisition by another method, such as a formal takeover bid, amalgamation or arrangement.

One of the techniques that has been used to allow a controlling shareholder to receive a premium in excess of 15 percent of the market price is to make a public announcement that the controlling shareholder is seeking offers for its control block and will be conducting an auction for the sale of its control block. Sometimes the controlling shareholder will indicate that in any such transaction the interests of minority shareholders will also be protected. Often this announcement results in the shares of the target corporation being bid up, based upon takeover speculation. As a consequence, a new threshold level from which to calculate the 15 percent premium will develop.

---

39 See Part III.A, above, for a discussion of this issue.

40 *OSA*, *supra* note 4, s. 93(1)(c); *ASA*, *supra* note 4, s. 132(1)(c).

41 R.R.O. 1990, Reg. 1015, s. 183(1); Alta. Reg. 58/90, s. 172(1).

42 *OSA*, *supra* note 4, s. 93(1)(c); *ASA*, *supra* note 4, s. 132(1)(c).

The OSC has considered several cases of this kind.[43] In its decisions, the OSC has indicated that it will exercise its public interest jurisdiction to prevent a private purchase transaction from proceeding in circumstances where it considers there has been abuse of the public security markets.

c. Share Purchase Agreement

The share purchase agreement with the selling shareholder or shareholders will contain customary representations, warranties and covenants on the part of both parties as well as a "no-shop" clause, often a "fiduciary out" clause, and in the latter event a provision for a "break-up" fee.[44]

d. Stock Exchange Requirements

No stock exchange approvals are required for the purchase of the target's shares from the major shareholders.

e. Examples

A significant recent example of the use of this exemption is the $1.2 billion purchase by IPL Energy Inc. of 85 percent of the shares of the Consumers' Gas Company Ltd. in 1994 from British Gas plc. An older example is the purchase by TransCanada PipeLines Limited of approximately 50 percent of the outstanding shares of Alberta Natural Gas Company Ltd. from Pacific Gas Transmission Company in 1992.

2. Advantages and Disadvantages of Private Agreement Purchase

Advantages	Disadvantages
Timing: The purchase may be completed expeditiously, subject only to delays that might be imposed by the *Competition Act* or the *Investment Canada Act*. No meetings of shareholders are required.	*Purchase Price*: The 115 percent price limitation will often by itself make it impossible for the acquiror to reach an agreement with the selling shareholder, which in turn will lead to another type of transaction, such as a takeover bid or arrangement, being agreed to.
Costs: Costs of this transaction will likely be somewhat less than those incurred for a takeover bid or a corporate transaction such as an amalgamation or arrangement, as no takeover bid circular or management proxy circular for the purposes of a shareholders' meeting needs to be prepared. In the context of a large acquisition these costs are relatively minor.	*Selling Shareholders*: The limit of five selling shareholders restricts the usefulness of the exemption as there may not be five shareholders holding enough shares to permit the acquiror to obtain a sufficiently large control block of the target.

43 See *e.g. Re Selkirk Communications Limited* (1988), 11 O.S.C.B. 286; *Re H.E.R.O. Industries Ltd.* (1990), 13 O.S.C.B. 3775.

44 See Part III.A, above, for a discussion of this issue.

Competitive Advantage: By negotiating the transaction privately with one or more shareholders, the acquiror is able to obtain the control position without the target being put into play and having to compete with other bidders.

Minority Shareholders: It is not necessary to deal with minority shareholders in the transaction, simplifying the transaction overall.

Due Diligence: The acquiror will most likely only be able to obtain non-confidential information in the hands of the selling shareholder and be unable to conduct a due diligence investigation of the target's books and records.

Minority Shareholders: The acquiror will have a control position in the target, but minority shareholders will continue to exist, resulting in the ongoing expenses associated with a public company, including compliance with securities commissions' policies pertaining to related party transactions. This may eventually lead to a subsequent transaction to squeeze out the minority shareholders.

Poison Pills It will not be possible to purchase a large block by way of private agreements if a shareholder rights plan is in place without dealing with the board of the target. The ability of the board to waive or redeem the plan for purposes of these private purchases, where other shareholders do not share in any premium to market, may be restricted and the target board of directors may view such a waiver or redemption as an improper exercise of their fiduciary duty.

C. FORMAL TAKEOVER BID

In this procedure, the acquiror or offeror makes a formal public offer by way of takeover bid circular to all shareholders to buy their shares in accordance with the specific requirements of securities legislation.[45] The bid may be for cash or shares of the offeror or a combination of both. The offeror will retain a financial advisor to provide financial advice and to act as a soliciting dealer for the bid to encourage shareholders of the target to tender their shares into the bid.

1. Procedural and Technical Requirements

a. Lock-Up Agreement

Before commencing the bid, the offeror will seek to enter into lock-up agreements with one or more major or controlling shareholders of the target under which the shareholder will be obligated to tender its target shares into the bid if the bid is successful. By having the locked-up shareholders agree to tender their shares to the bid

[45] See *OSA*, *supra* note 4, Part XX; *ASA*, *supra* note 4, Part 13.

only if it is successful, rather than purchasing the shares prior to the bid, the bidder will be able to count the shares so tendered for the purposes of determining whether or not more than 90 percent of the shares not held by the bidder have been tendered to the bid. If such 90 percent threshold is met, the offeror will have the right to automatically acquire any remaining shares not tendered to the bid.[46] The agreement will also contain clauses similar to those found in the subscription agreement described above.[47]

b. Confidentiality Agreement

While settling the terms of the lock-up agreement the acquiror and major shareholder may also enter into a confidentiality agreement to permit the acquiror to conduct a due diligence investigation of non-public information on the target in the hands of the major shareholder. Similar considerations apply as in a private purchase transaction although at this stage it is likely that no contact would be made with the target.

c. Takeover Bid Circular

The takeover bid will be announced by press release and a formal takeover bid circular, the contents of which are prescribed by securities legislation, will be mailed to the target shareholders. To do this, the offeror will require a shareholders' list. Where a corporation has distributed its securities to the public, corporate legislation permits any person, on payment of a reasonable fee and on sending to the corporation or its transfer agent a specified affidavit, to obtain a shareholders' list within ten days from the receipt of the affidavit made out to a date not more than ten days before the date of receipt of the affidavit.[48] The ten-day lead time must be factored into the timing for a takeover bid and it is at this stage that the bidder will most likely issue the press release announcing the bid since requests for the shareholders' list will make the bid known to the target. If the consideration being offered includes any shares of the offeror, then the circular must contain prospectus level disclosure on the offeror.[49]

d. Offer Price

The statutory rules relating to pricing require: (1) that all shareholders must be offered the same price for their target shares;[50] (2) the offeror may not make any collateral agreement with a target shareholder that has the effect of giving a greater value for its target shares than is offered to shareholders generally in the bid;[51] and (3) any increase in the offer price must be paid to all shareholders, including those whose shares were tendered and taken up before the increase in the offer price.[52]

---

46 *CBCA*, *supra* note 3, s. 206(2); *ABCA*, *supra* note 32, s. 188(2).

47 See Part III.A, above, for a discussion of this issue.

48 *CBCA*, *supra* note 3, s. 21(3); *ABCA*, *supra* note 32, s. 21(5).

49 *Supra* note 41, s. 189(a), Form 32; *supra* note 41, s. 177, Form 31.

50 *OSA*, *supra* note 4, s. 97(1); *ASA*, *supra* note 4, s. 136(1).

51 *OSA*, *ibid.*, s. 97(2); *ASA*, *ibid.*, s. 136(2). See *e.g.* the decisions of the OSC in *Re Gestion Claupier Inc.* (1994), 17 O.S.C.B. 2633; *Re Quebecor Printing Inc.* (1993), 16 O.S.C.B. 3539; and *Re Newport Petroleum Corp.* (1993), 16 O.S.C.B. 1355.

52 *OSA*, *ibid.*, s. 97(3); *ASA*, *ibid.*, s. 136(3).

e. Purchases and Sales Before, During and After Bid

Securities legislation restricts purchases and sales by the offeror of target shares outside of the bid.

(i) Before the Bid

The pre-bid integration rules require that if an offeror has bought shares of the target privately, namely other than through the stock exchange on a non-pre-arranged basis within ninety days before making a formal takeover bid, then the price offered under the bid must be at least as high as the highest price paid in the pre-bid purchases and the offeror must offer in the bid to buy a percentage of the target shares at least equal to the percentage of the seller's shares purchased in the pre-bid purchase.[53] So if the offeror bought all of a person's target shares in a pre-bid purchase, then the offeror must offer to purchase all of the target shares in the formal takeover bid. Bidders must examine their pre-bid purchases to determine if they are subject to these rules. If the bidder purchases 10 percent or more of the voting securities of the target, it will be necessary to file an insider trading report[54] and issue a press release, and file an early warning report.[55] The press release and notice must give information on the number of voting securities acquired by the bidder and the purpose of the bidder in making the purchases.[56] A similar press release and report must be filed on the acquisition of an additional 2 percent or more of the voting securities.[57] The offeror may not make any further purchases of securities until the expiry of one business day from the date that the required report is filed.[58]

(ii) During the Bid

The offeror may buy up to 5 percent of the target's shares through the stock exchange during the bid commencing with the third business day following the date of the bid, if the intention to do so was stated in the circular and a press release is filed on each day that purchases are made disclosing the purchases.[59] In the recent bid by IPL Energy Inc. for Producers' Pipelines Inc., the OSC ruled that IPL Energy Inc. had not complied with the applicable restrictions on acquisitions of shares during the bid.[60]

---

53 *OSA*, *ibid.*, s. 94(5); *ASA*, *ibid.*, s. 134.1(2).

54 *OSA*, *ibid.*, s. 107(1); *ASA*, *ibid.*, s. 147(1).

55 *OSA*, *ibid.*, s. 101(1); *ASA*, *ibid.*, s. 141(1). In the United States, a report must be filed with the SEC when the 5 percent level is exceeded: *Securities Exchange Act of 1934*, §13(d)(1) 2 Fed. Sec. L. Rep. (CCH) §20,336 (codified at 15 U.S.C. ss. 78a-79jj).

56 *Supra* note 41, s. 197(1); s. 181.5(2).

57 *OSA*, *supra* note 4, s. 101(2); *ASA*, *supra* note 4, s. 141(2).

58 *OSA*, *ibid.*, s. 101(3); *ASA*, *ibid.*, s. 141(4).

59 *OSA*, *ibid.*, s. 94(3); *ASA*, *ibid.*, s. 134(3).

60 *Re IPL Energy Inc. and Fortis Inc. and Producers' Pipelines Inc.* (1995), 18 O.S.C.B. 1251.

(iii) After the Bid

For twenty days after the expiry of the bid, the offeror may only buy shares of the target through a stock exchange and not on a pre-arranged basis.[61] The offeror may not sell shares of the target during the bid or enter into an agreement during the bid to sell shares of the target unless in the latter case the intention to do so was disclosed in the takeover bid circular.[62]

f. Conditions to the Bid

Takeover bids will be subject to a number of conditions, any of which may be waived by the bidder. The more important conditions are:

(i) Level of Acceptance

The most significant condition will be the percentage of shares that must be tendered into the bid before the bidder will take up the shares. A 50 percent level of acceptance will give the bidder bare majority control of the corporation; a 66-2/3 percent level of acceptance will allow the offeror to more easily implement significant corporate changes or a second stage going-private transaction to squeeze out the minority; and a 90 percent acceptance level, excluding target shares that are already owned by the offeror, will give the offeror the right to acquire the remaining shares not tendered to the bid at the same price or at the fair value as determined by a court of law pursuant to the force-out provisions of corporate legislation.[63]

(ii) Other conditions

Typically other conditions will include: (1) obtaining necessary regulatory approvals from security commissions, stock exchanges and under the *Competition Act* and the *Investment Canada Act*; (2) waiver or defeat of any shareholder rights plan or poison pill; (3) no material lawsuits; (4) no material change in the business of the target; (5) no material changes in tax laws; and (6) no defensive measures by the target such as selling a significant portion of its assets or issuing significant securities to a white knight.

g. Bid Rules

The rules for making a bid are mandated by securities legislation.[64] The bid must be open for at least twenty-one days and no securities may be taken up until the expiration of twenty-one days.[65]

---

[61] *OSA*, *supra* note 4, s. 94(6); *ASA*, *supra* note 4, 134.1(1).

[62] *OSA*, *ibid.*, ss. 94(8)-(9); *ASA*, *ibid.*, ss. 134.1(4)-(5).

[63] *Supra* note 46.

[64] *OSA*, *supra* note 4, ss. 95-100; *ASA*, *supra* note 4, ss. 135-39.

[65] *OSA*, *ibid.*, ss. 95(2)-(3); *ASA*, *ibid.*, ss. 135(c)-(d).

h. Stock Exchange Requirements

TSE approval will be required for the issue of treasury shares as part or all of the consideration for the target shares.[66]

(i) Examples

Recent examples of acquisitions made by formal takeover bid circular are:

(1) offer dated May 30, 1995 of Gulf Canada Resources Limited for all of the shares of Mannville Oil and Gas Ltd.;

(2) offer dated May 4, 1995 of Gardiner Oil and Gas Limited for all of the shares of Rising Resources Ltd.;

(3) offer dated March 13, 1995 of Castlefin Inc. for all the shares of Maple Leaf Foods Inc.;

(4) offer dated July 29, 1994 of American Barrick Resources Corporation to purchase all the common shares of Lac Minerals Ltd. in competition with bid by Royal Oak Mines Limited; and

(5) offer dated February 14, 1994 of Rogers Communications Inc. to purchase all the common shares of MacLean Hunter Limited.

2. Advantages and Disadvantages of a Takeover Bid

Advantages

Timing: In theory a takeover bid may be accomplished in as little as twenty-one days, although there must be added to this the time required to obtain the shareholders' list and the time necessary to deal with any defensive measures which may be taken by the target's board of directors, such as the implementation or continuing in place of a shareholder rights plan, efforts to seek an alternative transaction with another bidder, dispositions of material assets or the issue of significant amounts of securities.

Costs: Potential transaction costs, apart from advisor and consultant fees, may be less than would be the case in an amalgamation or arrangement transaction. If hostility develops between the bidder

Disadvantages

Uncertainty: The conditions to the bid may not be met or the target may launch a vigorous defense to the bid and obtain an alternative competing bid.

Costs: It will be the most expensive way to proceed where the target resists or a bidding war is commenced.

Competition: A formal takeover bid shows that a target is in play and if the bidder does not have a significant amount of the outstanding shares locked up, there will often be a bidding war.

Due Diligence: The bidder will not have any opportunity to review confidential books and records of the target and must rely upon publicly

66 See Part III.A, above, for a discussion of this issue.

and the target, costs will escalate and significantly exceed the costs of a transaction completed by any other method.

Force Out: When at least 90 percent of the target shares not owned by the offeror are tendered into the bid, the offeror has the right to buy the remaining shares at the same price from shareholders who have not tendered to the bid or at fair value as determined by the court.

Poison Pill: The board of the target may have the ability to waive the application of any shareholder rights plan that may be in place. If the board fails to do so on a timely basis (*i.e.* about forty-five to fifty days after the bid) the offeror will be able to seek relief from the plan before the OSC or the court.

disclosed information and information in the hands of major shareholder in assessing the risks and opportunities of making the bid. Practically speaking, this may not be a concern as applicable securities legislation requires that all material changes affecting the business and affairs of the corporation are to be disclosed by issue of a press release and filing of a material change report.

Flexibility: The acquiror may only bid for and acquire securities of the target. It is not possible at the same time to deal with a capital restructuring and debt compromises, as is the case with an arrangement.

Acceptance Level: If the 90 percent acceptance threshold cannot be achieved then the minority shareholders will still exist, resulting in the ongoing expenses associated with a public company or the necessity of completing an expensive and time-consuming second stage squeeze-out transaction.

D. NEGOTIATED ACQUISITION BY AMALGAMATION OR ARRANGEMENT

Under this method, the acquiror will enter into an amalgamation or arrangement agreement with the target which will describe the terms and conditions of the transaction, contain mutual representations, warranties and covenants and provide for the calling of a shareholders' meeting to vote on the amalgamation or arrangement which, if successful, will result in all the shareholders of the target exchanging their shares for shares of the acquiror, cash, or a combination of shares and cash. Such a transaction may only proceed with the cooperation of the board of directors and the management of the target.

1. Procedural and Technical Requirements

a. Confidentiality Agreement

Following the opening of discussions by the acquiror with management of the target, and an indication by the target that it is amenable to proceeding with the transaction subject to settlement of financial and other terms, a confidentiality agreement will be entered into between the parties to permit detailed due diligence to be conducted by each party of the other. Sometimes the target will wait to receive an indication of the consideration to be offered by the acquiror before conducting any of its own due diligence. Where the consideration to be paid consists of shares of the acquiror, in whole or in part, appropriate due diligence of the acquiror must be conducted by the target prior to announcement of the transaction. The confidentiality agreement will also contain the other customary terms and conditions referred to above[67] including a stand-still provision to the effect that the acquiror will not proceed with any transaction to acquire shares of the target without the consent of the board of directors.

b. Nature of Amalgamation and Arrangement

In an amalgamation, two or more corporations combine their business and operations together under a statutory procedure to create a single new corporation. Both corporations must be incorporated in the same jurisdiction. Often the acquiror and the target are incorporated in different jurisdictions. To carry forward the transaction, the acquiror will incorporate a wholly-owned subsidiary in the jurisdiction of incorporation of the target and complete a three-cornered amalgamation where shareholders of the target exchange their shares for cash or shares of the acquiror and the acquiror receives all of the shares of the company resulting from the amalgamation of the wholly-owned subsidiary and the target.[68] This approach avoids the need to have a meeting of the acquiror's shareholders to approve the amalgamation and is the preferred structure even where the acquiror and target are incorporated in the same jurisdiction. Amalgamations provide limited opportunity for restructuring the capital of the corporation, other than its share capital.

The arrangement provisions of the *CBCA* were introduced to allow complicated transactions where no one or more of the fundamental change provisions of the *CBCA* could be used. The term *arrangement* has no precise legal meaning. It may be regarded as describing any form of internal reorganization of a corporation or its affairs.[69] The provisions of the *CBCA* concerning arrangements reflect their unlimited scope and include:

(1) an amendment to the articles of a corporation;

(2) an amalgamation of two or more corporations;

(3) an amalgamation of a body corporate not subject to the *CBCA* with a corporation that results in an amalgamated corporation subject to the *CBCA*;

(4) a division of the business carried on by a corporation;

(5) a transfer of all or substantially all of the property of a corporation to another body corporate in exchange for property, money or securities of the body corporate;

(6) an exchange of securities of a corporation held by security holders for property, money or other securities of the corporation or property, money or

[67] See Part III.A, above, for a discussion of this issue.

[68] *CBCA*, *supra* note 3, s. 182(1); *ABCA*, *supra* note 32, s. 176(1).

[69] *Palmer's Company Law*, 25th ed. (London : Sweet & Maxwell Ltd., 1992) at 12009, para. 12.001.

securities of another body corporate that is not a takeover bid as defined in the *CBCA*;

(7) a liquidation and dissolution of a corporation; and

(8) any combination of the foregoing.[70]

The definition is an inclusive one and the types of arrangements are not restricted to the listed items. The "exchange of securities" clause in this definition is the acquisition or takeover provision of the statutory arrangement section. Typically it involves an exchange of securities or cash or a combination of both by the offeror for shares of the target.

c. Prerequisites to an Arrangement

To avail itself of the statutory arrangement provisions, a corporation must establish that: it is not practicable to complete the transaction in any other manner;[71] the corporation must not be insolvent;[72] and, in an acquisition or takeover type of arrangement, the transaction must not be a takeover bid as defined in the statute.[73]

In complex arrangements the "not practicable" threshold is easily overcome.[74] In less complicated corporate transactions, the courts have given a practical business-oriented meaning to the word *impractical* and have made it a simple threshold to overcome.[75] An applicant need only demonstrate that it would otherwise be expensive and cause delay to proceed in any other manner. Where a public corporation has United States shareholders and a fundamental change in the business and affairs of the corporation is completed by way of an arrangement sanctioned by a court order after a hearing upon the fairness of the transaction where all persons affected may appear, there is no requirement to file a registration statement under the United States *Securities Act of 1933* where the arrangement involves the issue of securities to United States resident shareholders.[76] Other reasons cited for proceeding by arrangement are: income tax flexibility; the ability to deal with more than one class of security holder, including debt holders at the same time; and the ability to accomplish in one document a series of different steps in a transaction.

---

70 *CBCA*, *supra* note 3, s. 192(1); *ABCA*, *supra* note 32, s. 186(1).

71 *CBCA*, *ibid.*, s. 192(3); *ABCA*, *ibid.*, s. 186(3).

72 *CBCA*, *ibid.*, s. 192(3). No similar requirement is found in the *ABCA*.

73 *CBCA*, *ibid.*, s. 192(1)(f); *ABCA*, *supra* note 32, s. 186(1)(f).

74 *Savage* v. *Amoco Acquisition Company* (1988), 59 Alta L.R. (2d) 260 (C.A.); leave to appeal refused (1988), 60 Alta. L.R. (2d) 1 (S.C.C.); *Trizec Corp.* (1994), 21 Alta. L.R. (3d) 435 (Q.B.). See also *Re Gentra Inc.*, [1993] O.J.No. 2078 (Gen. Div.) (Q.L.).

75 *Imperial Trust Co.* v. *Canbra Foods Ltd.* (1987), 50 Alta. L.R. (2d) 375 (Q.B.); *Deprenyl Research Ltd.* (1994), 17 B.L.R. (2d) 102 (Ont. Gen. Div.).

76 *Securities Act of 1933*, §3(a)(10); 1 Fed. Sec. L. Rep. (CCH) §541 (codified at 15 U.S.C. ss. 77a-77a.a).

The insolvency restriction may be overcome by having a solvent applicant make the application to the court where the corporation whose security holders will be affected by the arrangement is insolvent.[77]

The requirement that the transaction not be a takeover bid is potentially the most restrictive one. Case law indicates that a transaction will not run afoul of this restriction where it amounts to more than a "simple offer to acquire" shares.[78] Arrangements that involve a simple acquisition of shares would appear not to meet this test. In practice, the test is not rigidly applied by the courts. A takeover conducted by arrangement often involves much more than an acquisition of shares. It may deal with employee share options, warrants or debt securities convertible into shares of the target, changes in the terms of outstanding debt securities of the target, or substitution of such debt securities. Such additional complexities will assist in removing the arrangement from the category of a takeover bid.[79]

d. Shareholder and Court Approvals

Corporate law requires that amalgamations be approved by a special resolution, being one passed by 66-2/3 percent of the votes cast by shareholders at a meeting duly called and held to approve the transaction. Each class of shares will be entitled to vote on the transaction and a class or a series of shares may be granted a separate vote from another class or series if the rights attaching to those shares are being changed.[80] In an arrangement, the court determines the classes of shareholders entitled to vote on the arrangement and the percentage of votes that must be cast by shareholders to approve the arrangement. In practice, these majorities and the rules as to splitting the vote into separate classes are the same as in an amalgamation but may be varied in difficult cases.[81]

An arrangement will also require court approval and will normally involve two court applications: the first will be a preliminary application in chambers at which the court will give directions on the calling and holding of the shareholders' meetings, the notices to be given and the documentation to be forwarded to shareholders and other procedural matters; the second will be a hearing which will follow the shareholders' meeting at which all security holders will be entitled to appear and at which the court will be asked to approve the arrangement.[82] In sanctioning an arrangement, a court will apply a twofold test: it will (1) ascertain that the statutory requirements have been strictly complied with and (2) determine if the arrangement is fair and reasonable to the shareholders.[83]

---

77 *Savage* v. *Amoco Acquisition Company, supra* note 74.

78 *Ibid.* at 263.

79 For a lengthier discussion concerning these matters, see R.A. Shaw, "Acquisitions and Takeovers by Arrangement under the *Canada Business Corporations Act*" (1989), 2 C.C.L.R. C 47.

80 *CBCA, supra* note 3, ss. 183(1), (4); *ABCA, supra* note 32, ss. 177(1), (4).

81 *Savage* v. *Amoco Acquisition Co., supra.* note 74.

82 *CBCA, supra* note 3, s. 192(3); *ABCA, supra* note 32, s. 186(2).

83 For case references and a fuller discussion, see Shaw, *supra* note 79 at C 57ff.

In an amalgamation or arrangement, all the shares of the target corporation are acquired in one step; no shares remain in the hands of minority shareholders. In a takeover bid, the offeror can only be assured of acquiring all the outstanding shares of the target where the holders of not less than 90 percent of the shares of that class, other than shares held at the date of the takeover bid by the offeror, accept the offer. In that case, the offeror may compulsorily acquire the shares that were not tendered to the bid.[84] This lower shareholder approval threshold to acquisition of the shares of the target is usually the most compelling reason to choose an amalgamation or arrangement transaction for an acquisition as opposed to a takeover bid.

e. Amalgamation or Arrangement Agreement

The transaction will be carried out under the terms and conditions contained in an amalgamation or arrangement agreement entered into among the parties to the transaction. In addition to representations, warranties and covenants of the respective parties, the agreement will contain the following:

(1) An obligation on the target to call and hold a meeting of its shareholders prior to a specified date to vote on the transaction and, if it is an arrangement, to apply for court approval.

(2) An obligation on the directors of the target to recommend that the shareholders vote in favour of the transaction and that the directors, subject to their fiduciary obligations, not take any steps to interfere with completion of the transaction. The agreement will also contain a "no-shop" clause, likely a "fiduciary out" clause and, in the latter event, a "break-up" fee.[85]

Where there is a major shareholder, a lock-up agreement may also be entered into with that shareholder on terms similar to those discussed for formal takeover bids.[86]

f. Management Proxy Circular

The target must prepare and mail a management proxy circular to its shareholders for the purposes of the shareholders' meeting called to consider and vote on the transaction. This document will describe the transaction and contain prospectus-level disclosure concerning the acquiror or the amalgamated company which will result from the transaction where shares are to be issued to the target shareholders in exchange for their shares. In nearly all instances, a fairness opinion prepared by a financial advisor to the board of directors of the target will be included in the documentation stating that the transaction is fair, from a financial point of view, to the shareholders of the target.

---

84 *Supra* note 46.

85 See Part III.A, above, for a discussion of this issue.

86 *Ibid.* at Part III.C.

g. Appraisal or Dissent Rights

Shareholders of the target who are not in favour of an amalgamation may exercise dissent rights and be paid the "fair value" of their shares.[87] In an arrangement, the court has the power to grant dissent rights and invariably does so.[88] To exercise dissent rights, a shareholder must give notice of his or her dissent prior to the commencement of the meeting of shareholders at which the transaction is to be considered and voted on. Before proceeding with the transaction, the parties will be aware of the number of shareholders that have dissented. If this number is sufficiently large and the payment to them of the fair value of the shares will be excessive in the light of the transaction as a whole, the parties may choose not to proceed with the transaction. Such a right is normally contained in the arrangement or amalgamation agreement. A detailed procedure must be followed by both the dissenting shareholder and the target in exercising dissent rights. If the target and the dissenting shareholders are unable to reach agreement on the "fair value" of the shares, it will be determined by a court. In practice, dissenters' rights are not usually a problem but they can create substantial expense and add additional time to the process.

h. Stock Exchange Requirements

TSE approval will be required for the issue of treasury shares as part or all of the consideration for the target shares.[89]

i. Examples

Recent examples of transactions of this kind are:

(1) amalgamation of Boomerang Resources Inc. and Laurasia Resources Limited: joint proxy circular dated May 12, 1994; and

(2) arrangement whereby Talisman Energy Inc. acquired Bow Valley Energy Inc.: management information circular of Bow Valley Energy Inc. dated June 30, 1994.

---

87 *CBCA*, *supra* note 3, ss. 190(1), (3); *ABCA*, *supra* note 32, ss. 184(1), (3).

88 *CBCA*, *ibid.*, s. 192(4)(d); *ABCA*, *ibid.*, s. 186(4)(c)(iv).

89 See Part III.A, above, for a discussion of this issue.

2. Advantages and Disadvantages of Amalgamations and Arrangements

Advantages

Simplicity: The acquiror obtains 100 percent control of the target in one step.

Competitive Advantage: By negotiating the transaction with the target the acquiror is able to preempt other interested parties and substantially limit the opportunity for the target to be put "in play."

Due Diligence: The acquiror will be able to conduct substantial due diligence of the target before proceeding with the transaction.

Flexibility: In an arrangement, the parties may construct a transaction to deal with complex share and debt structures and to complete a series of steps at one time.

U.S. Securities Law Exemption: In an arrangement, it will not be necessary to register any securities under the U.S. *Securities Act of 1933*[90] where the target shareholder will receive shares of the acquiror.

Approval Thresholds: Shareholder approval thresholds are substantially lower than is required in a takeover bid for the acquiror to obtain 100 percent of the control of the target in one step.

Poison Pills: Shareholders of the target may give any required approvals under the shareholder rights plan at the meeting called to approve the transaction.

Disadvantages

Timing: A transaction takes substantially longer to complete, typically three to four months.

Uncertainty: The transaction must be approved by the shareholders and, if an arrangement, by the court. In practice this is usually not a large concern.

Dissent Rights: The exercise of dissent rights by shareholders may add significantly to the expense and time required to wrap up the transaction.

IV. ONTARIO SECURITIES COMMISSION POLICY NO. 9.1

Merger and acquisition strategy is critically impacted by Policy 9.1. Additional procedures and technical requirements will need to be satisfied where a transaction falls within its ambit.

[90] *Supra* note 76.

A. PURPOSE AND APPLICATION

Policy 9.1 was implemented by the OSC with a view to ensuring that all shareholders of a corporation are treated fairly, and are seen to be treated fairly, in transactions where the independence of the major parties to the transaction cannot be assumed. Policy 9.1[91] applies to:

(1) "insider bids": takeover bids by insiders of the target or by associates or affiliates of such insiders or of the target itself. Insiders include directors and senior officers of the target and any shareholder that beneficially owns more than 10 percent of the voting rights attaching to all voting securities of the target;[92]

(2) "issuer bids": bids by a corporation or a wholly-owned subsidiary for securities of the corporation;

(3) "going private transactions": an amalgamation, arrangement, consolidation or other transaction in which a holder of a participating security can be required without his consent to surrender his interest, other than by the exercise of an existing redemption right or a statutory purchase right, without the substitution of another participating security (of equivalent value) in the corporation or a successor; and

(4) "related party transactions": potentially the broadest category, any transaction in which an asset, treasury security or liability is acquired or transferred by a corporation to or from a "related party," including a person or company which alone or in combination with others holds securities carrying more than 10 percent of the voting rights attached to all outstanding securities of the corporation or which otherwise are sufficient "to affect materially the control" of the corporation, or a director, senior officer or affiliate of the corporation. The value of the asset or the treasury security being acquired or transferred or the liability being assumed must exceed 25 percent of the issuer's market capitalization.[93] For this purpose, market capitalization is the sum of the market values of outstanding equity securities of the issuer, where market value for publicly traded equity securities is the product of the weighted monthly average number of such equity securities outstanding for the three calendar months preceding the transaction and the simple average of the closing price of such securities on the last trading day of each such calendar month. For other equity securities, it is the book value of the securities as at the end of the issuer's last financial year.[94]

---

91 *Supra* note 31, s. 3.1.

92 *OSA*, *supra* note 4, s. 1(1); *ASA*, *supra* note 4, s. 1(i).

93 Policy 9.1, *supra* note 31, s. 18.1.

94 *Ibid.*, s. 2.2(9).

A third-party takeover bid by an unrelated bidder will not ordinarily fall within Policy 9.1 and the independence of a target and its directors from the bidder and its directors will typically be apparent, but Policy 9.1 should in all cases be reviewed for potential application.

B. SPECIFIC REQUIREMENTS

Where applicable, Policy 9.1 can require, or at least recommend as "good practice," one or more of the following:

1. Directors' Recommendations[95]

In a Policy 9.1 transaction, the corporation, and thus the directors, must provide sufficient information to security holders in the documentation sent to security holders to enable them to make an informed decision; in all transactions involving an "interested party," the directors are to make useful recommendations to security holders. The directors should in particular express their reasonable belief, and disclose in reasonable detail the material factors from which such belief derives, as to the desirability or fairness to shareholders of the proposed transaction.

2. Special Committee[96]

It is recommended that the board of the target consider appointing a special committee of directors to review the transaction and that each member of the special committee be independent of the insider or issuer making an insider or issuer bid or of the related party in a going private or related party transaction. Independence is to be assessed in light of such factors as prior employment by, or affiliation with, an interested party and ability to benefit from a transaction in a manner different from minority shareholders.

3. Valuations[97]

A formal valuation of the target corporation's shares (or of the asset or liability, as the case may be) and, where the bidder offers to pay for target securities by the issuance of its own securities, of the bidder's securities and the public disclosure of such valuations and any prior relevant valuations within two years preceding the date of the transaction are normally required by Policy 9.1. The persons charged with engaging a valuator (typically, the special committee of independent directors) will be obliged to satisfy themselves as to the independence and competence of the valuator.

What constitutes a "prior valuation" is often the subject of much debate. Internal valuation work that is not made available to, or does not involve the participation of,

---

95 *Ibid.*, ss. 28-29.

96 *Ibid.*, s. 27.

97 *Ibid.*, ss. 24.2(1), 24.6(1), 23.4.

senior officers or directors of the affected corporation is excluded.[98] From a conservative viewpoint, any valuation work prepared in anticipation of proceeding with a going-private or related party transaction which is within the two-year time limit is likely to require public disclosure. To limit the amount of disclosure required on prior valuations, care should be taken to advise the acquiror and its financial advisors to make an effort to limit the amount of valuation work to that which is reasonably necessary for the board of directors to make an informed decision on the consideration to be offered to target company shareholders.

4. Advisors

The special committee of the target acts independently of the target and the bidder and will engage its own financial advisors and counsel, at the expense of the target or the acquiror, depending on the circumstances, following a screening of potential candidates.

5. Majority of the Minority Vote[99]

Policy 9.1 requires a transaction to receive the approval of a specified majority of shareholders unrelated to the bidder or related party, commonly referred to as majority of the minority approval.

Majority of the minority approval must be by two-thirds majority vote of the minority where: (1) in a going-private transaction, the consideration is not paid in cash within thirty-five days of approval being received or is less than the per security value or the mid-point of the valuation range of the security established by the formal valuation; or (2) in a related party transaction, the value to be paid by the party acquiring the shares in the related party transaction is less than the value or the mid-point of the valuation range of the shares established by the formal valuation. Otherwise approval is by simple majority vote of the minority. In counting the minority vote, votes held by the offeror, its affiliates, their respective directors and senior officers and certain others are excluded. No minority approval is required in a going-private transaction or in a related party transaction if the acquiror holds 90 percent or more of each class of the participating and voting securities of the target and a statutory appraisal remedy or dissent rights are available to the minority security holders.

6. Costs and Timing

Transaction costs will increase due to the involvement of the special committee and the lengthier timetable that prevails in a Policy 9.1 transaction. The special committee will require time to perform its functions and this will impact the transaction timetable. Appointing a special committee to conduct a valuation and consider and make recommendations to the board of the target on the proposed transaction will usually add about five to six weeks to the timetable.

---

98 *Ibid.*, s. 24.6(2).

99 *Ibid.*, ss. 31.1, 15.2(2), 20.2(2).

7. Disclosure

In general, extensive and detailed disclosure of the proposed transaction, the nature and substance of the analysis undertaken or considered by the directors, and clear recommendations must be made to the minority shareholders. The level of disclosure, except in respect of valuations, is not usually more extensive than that found where Policy 9.1 does not apply.

8. Exemptions

Policy 9.1 exempts a variety of transactions (on the basis of their nature or size) from the valuation and majority of minority vote requirements[100] and, as indicated earlier, a typical third-party takeover should not be subject to Policy 9.1 in the first instance. Policy 9.1 also allows the Director of the OSC or the OSC to grant exemptions from its application. In light of the amendments to the *OSA* granting rule making power to the OSC, the OSC has apparently ceased to provide these exemptions pending the re-establishment of Policy 9.1 as a rule although a comfort letter from staff may be available.[101]

The steps imposed or recommended in Policy 9.1 may be viewed as a codification of what regulatory authorities consider desirable or appropriate conduct in transactions involving or affecting public security holders. Directors themselves may increasingly look to these rules and recommendations as illustrative of conduct in situations, including third-party takeover bids, in which, although Policy 9.1 does not apply, the underlying purpose — treatment of shareholders that is, and is perceived to be, fair and equal — is relevant. Table I in Schedule "A" summarizes the principal features of Policy 9.1 applicable to particular transactions.

C. MINORITY SQUEEZE-OUT TRANSACTIONS

A corporation holds a control position in a target (often well in excess of 50 percent of the common shares), and determines to acquire the shares held by the minority. Table II in Schedule "A" shows the acquisition methods available to accomplish this result, the type of Policy 9.1 transaction involved and the elements of Policy 9.1 that may be applicable to the transaction. Where the acquisition of the minority position is made by an amalgamation or arrangement, only one transaction will be needed to allow the majority shareholder to acquire all the shares of the minority. If the acquiror chooses to proceed by takeover bid, a second stage amalgamation or arrangement transaction may be required to eliminate the remaining minority shareholders, resulting in additional costs and lengthening the timetable.

---

100 *Ibid.* ss. 5.2, 9.2, 13.3, 15.2, 19.2, 20.2.

101 See Can. Sec. L. Rep. (CCH), vol. 3 (North York: CCH Canadian Ltd. (looseleaf)) at 472-301ff for waiver decisions of the Executive Director of the OSC under Policy 9.1.

D. MULTI-STAGE TRANSACTIONS

Where the offeror in a takeover bid is not successful in acquiring 90 percent of the target shares which it does not already own, it will be necessary to complete an amalgamation or an arrangement to squeeze out the remaining minority shareholders. Policy 9.1 permits the acquiror in the subsequent transaction to count for the purposes of the majority of the minority vote the shares tendered by minority shareholders to the takeover bid in the first transaction where: (1) the intent to effect the subsequent transaction was disclosed at the time of the prior transaction; (2) a valuation was provided of the target shares at the time of the prior transaction unless no valuation is required under Policy 9.1; and (3) the consideration in the subsequent transaction is at least equal in value to the consideration per share paid in the prior transaction. Excluded from this count are shares tendered to the takeover bid pursuant to a lock-up agreement. Certain other information must be disclosed in the prior transaction including any different income tax treatment to a minority shareholder as a consequence of accepting one or the other of the transactions.[102]

In the bid by Castlefin Inc., the company formed by Wallace McCain of McCain Foods fame, for all of the shares of Maple Leaf Foods Inc., an arrangement was effected concurrently with completion of a takeover bid. This assured that upon completion of the takeover bid, if 90 percent of the shares of the target were not tendered to the bid, all shares of the target would be held by the bidder on completion of the arrangement and no additional time would be required to complete a second stage transaction. The bidder was entitled to vote shares tendered to the bid for the purposes of the two-thirds majority of the minority vote required by Policy 9.1 to approve the arrangement. In that transaction, Hillsdown Holdings plc, the holder of 56 percent of the shares of Maple Leaf Foods Inc. did not enter into a lock-up agreement with Castlefin Inc. As a consequence, Castlefin Inc. was able to count target shares held by Hillsdown Holdings plc that were tendered to the bid for purposes of the two-thirds majority of the minority vote on the arrangement.

1. Examples

Recent examples of Policy 9.1 transactions are:

a. Insider Bids and Going Private Transactions

(1) purchase by Norcen Energy Resources Limited of all outstanding shares of North Canadian Oils Limited: offer dated October 7, 1994;

(2) purchase by B.C. Gas Inc. of all the shares of Trans Mountain Pipe Line Company Ltd.: offer dated September 13, 1994;

(3) purchase by Texaco Acquisitions Inc. of all the common shares of Texaco Canada Petroleum Inc.: offer dated April 12, 1995.

---

[102] Policy 9.1, *supra* note 31, s. 32.

b. Related Party

(1) arrangement involving Scurry-Rainbow Oil Limited and Home Oil Company Limited: management information circular dated September 24, 1993;

(2) arrangement involving Canadian Roxy Petroleum Ltd. and Numac Energy Inc.: information circular dated February 15, 1994; and

(3) arrangement involving Encor Inc. and Talisman Energy Inc.: information circular dated April 16, 1993.

V. MULTIJURISDICTIONAL DISCLOSURE SYSTEM

Securities regulators in Canada and the United States have adopted the multijurisdictional disclosure system ("MJDS").[103] Under the MJDS, a public corporation incorporated in Canada that meets the qualification criteria may distribute its securities in the United States by filing and clearing a prospectus with a provincial securities commission in Canada pursuant to Canadian disclosure requirements and filing the prospectus with the SEC without SEC review. Public corporations based in the United States that meet the qualification criteria may distribute their securities in Canada by filing and clearing a prospectus with the SEC under applicable SEC disclosure requirements and filing the prospectus with the provincial securities commissions in Canada without review by such commissions.

Canadian corporations engaged in merger and acquisition transactions that satisfy certain prerequisites have the ability to make use of MJDS for takeover bids or amalgamations where the target has United States resident shareholders. This may allow the acquiror to use Canadian disclosure documentation for the purposes of satisfying SEC requirements for cash or securities exchange takeover bids and amalgamations. United States securities counsel should be consulted for further details.

VI. CONCLUSION

Corporate and securities legislation in Canada gives an acquiror a variety of methods to complete a merger or acquisition. Policy 9.1, where applicable, is an additional complication. Each acquisition method has benefits and detriments that are to be measured against the facts of the proposed acquisition before a decision is made on the appropriate acquisition strategy to pursue.

---

[103] "Multijurisdictional Disclosure System" (1991), 14 O.S.C.B. 2863 (including National Policy Statement No. 45 (1991), 14 O.S.C.B. 2889)); "The Multijurisdictional Disclosure System July 5, 1991," *Alberta Securities Commission Summaries* 260, and SEC Rel. No. 33-6902 (21 June 1991).

SCHEDULE "A"

TABLE I
Policy 9.1 Requirements for Particular Transactions

Transaction Type	Special Committee	Valuation	Majority of the Minority Approval
Going Private	Consider Yes, in practice	Yes. Shares of target corporation	Yes
Insider Bid	Consider Yes, in practice	Yes. Shares of target; shares of offeror if a share exchange	Not applicable
Issuer Bid	Consider Yes, in practice	Yes. Shares of issuer	Not applicable
Related Party	Consider Yes, in practice	Yes. Shares of target; shares of offeror if a share exchange. Only applies where value of asset or liability acquired or disposed of exceeds 25 percent of the target's market capitalization	Yes, but only if value of asset or liability acquired or disposed of exceeds 25 percent of the target's market capitalization

SCHEDULE "B"

TABLE II

Policy 9.1 Requirements for Minority Squeeze-Out Transactions

Acquisition Methods Available	Policy 9.1 Type			Applicable Policy 9.1 Elements			Second Stage Transaction
	Going Private	Insider Bid	Related Party	Special Committee	Valuation	Minority Vote	
Takeover Bid	No, if target shareholders may receive equity shares of bidder. Otherwise yes.	Yes	Yes	Recommended	Yes. Target shares and any securities of bidder offered as consideration	No	Will be required if 90 percent of shares held by minority are not tendered to bid
Amalgamation	No, if target shareholders may receive equity shares of bidder. Otherwise yes.	No	Yes	Recommended	Yes. Target shares and any securities of bidder offered as consideration	Yes	Not required
Arrangement	No, if target shareholders may receive equity shares of bidder. Otherwise yes.	No	Yes	Recommended	Yes. Target shares and any securities of bidder offered as consideration	Yes	Not required