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Key Considerations for Going-Private Transactions in Canada

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Introduction

To assist interested parties in navigating a going-private transaction in Canada, we have prepared the following summary of key considerations.

What is a Going-Private Transaction?

- A going-private transaction converts a public company into a private company, eliminating the public shareholders and consolidating share ownership under one or a few shareholders.
- There are two common reasons a going-private transaction is proposed:
    1. Management, or one or more shareholders of the target company, wants to buy-out the other public shareholders (called a Management Buyout or MBO)
    2. A third-party sponsor proposes to acquire the target company, with or without the support of management or a group of existing shareholders.
- Going-private transactions are also sometimes referred to as leveraged buyouts (LBOs) as the party leading the go-private will often finance the purchase through debt at the target operating company level.

Reasons to Go-Private

- To lessen the continous disclosure requirements placed on public companies by applicable securities regulatory authorities.
- To increase operational flexibility and focus on running the business with a view to maximizing long-term value.
- To reduce the expenses of being a public company, including financial reporting, regulatory, compliance, investor relations and professional services.
- To have an exit strategy for current shareholders or possible ways to achieve a transfer of business, more particularly with controlling shareholders.
- To lessen the likelihood of becoming a target of potentially opportunistic buyers.
- If a third-party LBO is proposed, going-private may provide the target company and its management with access to the sponsor's financial and operational expertise.
- For a sponsor, to take advantage of the opportunities resulting from weakened share prices.

Business Considerations

- Determining whether a particular company is a good candidate for going-private will be subject to, in part, an assessment of whether or not that company can actually get the deal done. This will be dependent on the type of transaction that is being proposed, the availability of financing and the level of shareholder approval that will be required, as well as the likelihood of receiving it.
- A good go-private candidate will typically be strong, a leading player in its given industry, have substantial management depth, have a good client base, and have good cash flow and good margins. An ideal candidate will also be trading below intrinsic value, have a large block of shares held by insiders and be thinly traded.
- A formal valuation will generally be required in the context of a going-private transaction where the party proposing the go-private transaction (Offeror) is an insider or person acting jointly or in concert with an insider of the target company.
- Under most going-private transactions, a plan of arrangement approved by a Canadian court will be utilized to effect the transaction and a judge will determine the fairness of the transaction. An understanding of the shareholder base and other stakeholders is important as all parties are given a forum to express an opinion and views on the transaction at the hearing.

Disadvantages in Being a Private Company

- The private company will not have the same access to public markets for financing in the future.
- Once the company is private, the remaining shareholders will no longer have a clear path to liquidity.
- Going-private transactions can be expensive (legal, accounting and advisory fees), complex and time consuming and cross-border transactions (e.g. U.S. Offeror and Canadian target) will add to such costs.

Transaction Structures

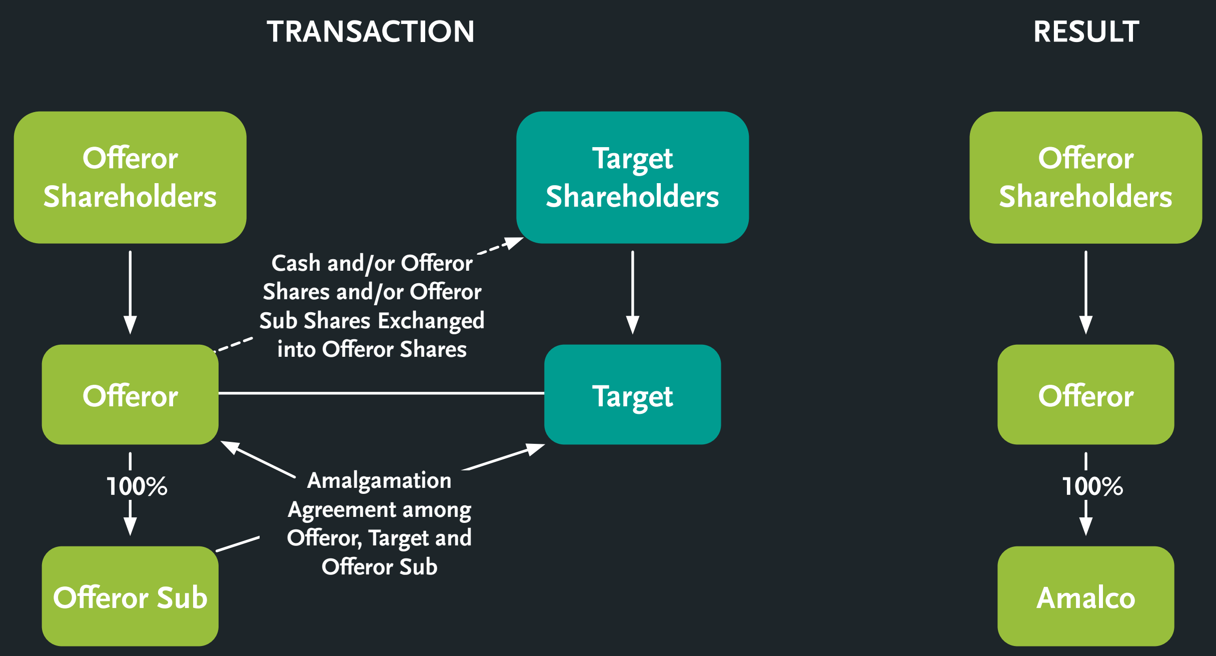
Special Features

- There is often an uneven playing field in terms of access to information about the company's business and prospect between the party proposing a go-private transaction and the remaining shareholders.
- In addition, there is a heightened potential for conflicts of interest if there is a significant shareholder implementing the transaction because such an Offeror is typically on "both sides of the table."
- Both corporate and securities laws are at play in going-private transactions. A shareholder could – without their approval – see their interest in the target company sold.
- To manage these challenges, regulatory authorities have prescribed various rules and regulations placing restrictions and obligations on the Offerer, the target company and related parties engaging in a going-private transaction, to ensure all shareholders are treated fairly.
- The rules and regulations generally require an independent valuation, full disclosure to shareholders of all pertinent matters, and majority of the minority shareholder approval of the transaction.

Selecting a Structure

- Generally, those wanting to implement a going-private transaction will want to accomplish it in a single step and would use a shareholder meeting for an amalgamation squeeze-out, share consolidation or plan of arrangement. Both amalgamations and share consolidation can be implemented by way of plan of arrangement.
- As part of a plan of arrangement a judge determines the fairness of the transaction, which provides some additional comfort to all involved in the transaction.
- Although most going-private transactions are conducted pursuant to a plan of arrangement, a number of significant transactions have also been accomplished by a take-over bid with a second step transaction (amalgamation or share consolidation) following as necessary.
- A take-over bid avoids certain negative tax consequences associated with going-private transactions such as partial deemed dividend treatment of the proceeds.

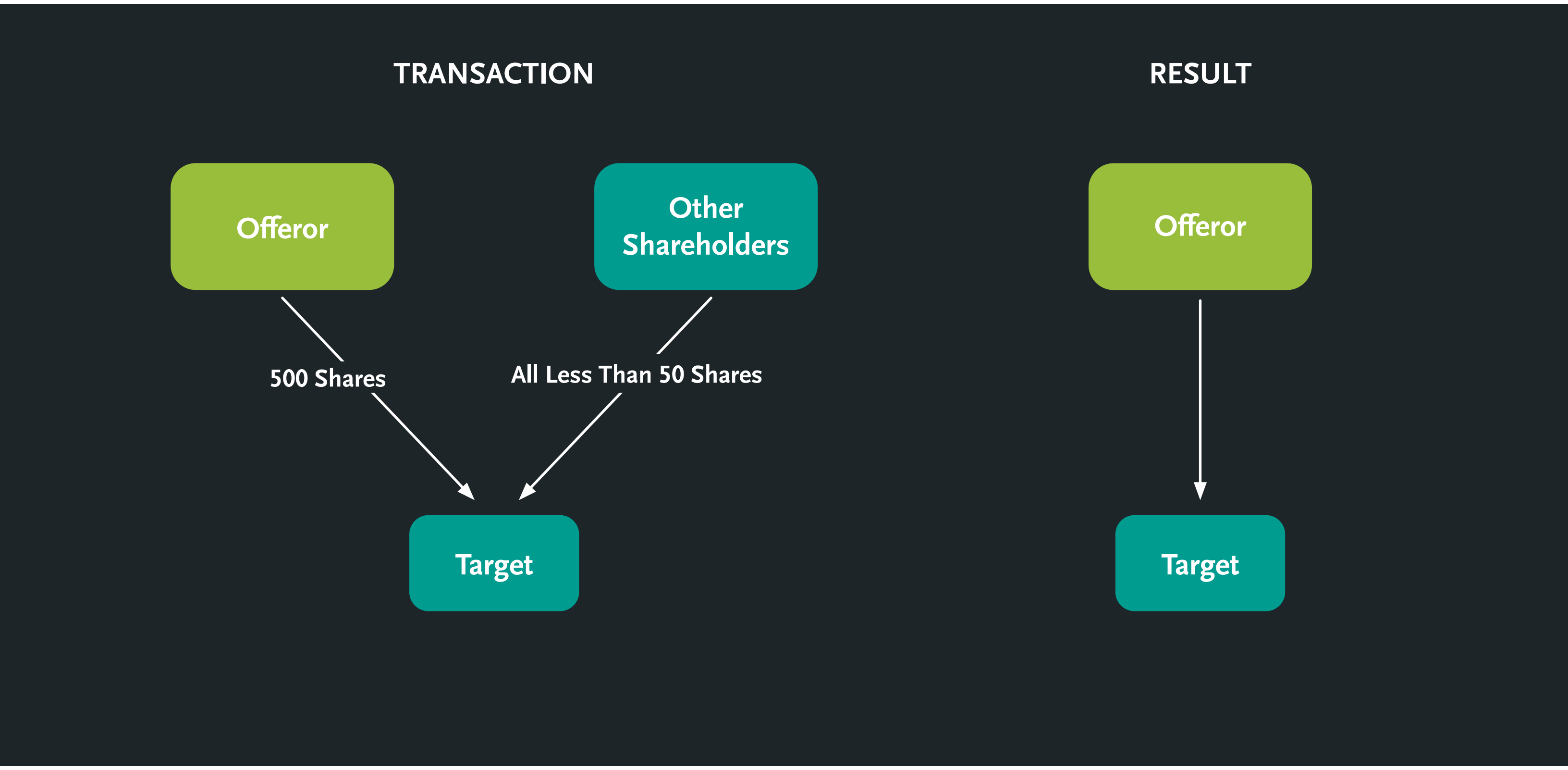
Amalgamation



Steps and Considerations:

- A shareholders meeting is convened to authorize the amalgamation of the target company with a subsidiary of the Offeror
- On amalgamation, (i) the target company shareholders receive redeemable shares in the capital of the amalgamated company which shares are immediately redeemed for cash, and (ii) the Offeror receives all of the voting shares of the amalgamated company
- Under corporate law the amalgamation must be approved by holders of two-thirds of the shares of the target company represented at the meeting, in person or by proxy.
- Under securities law, the amalgamation must be approved by a majority of the minority.

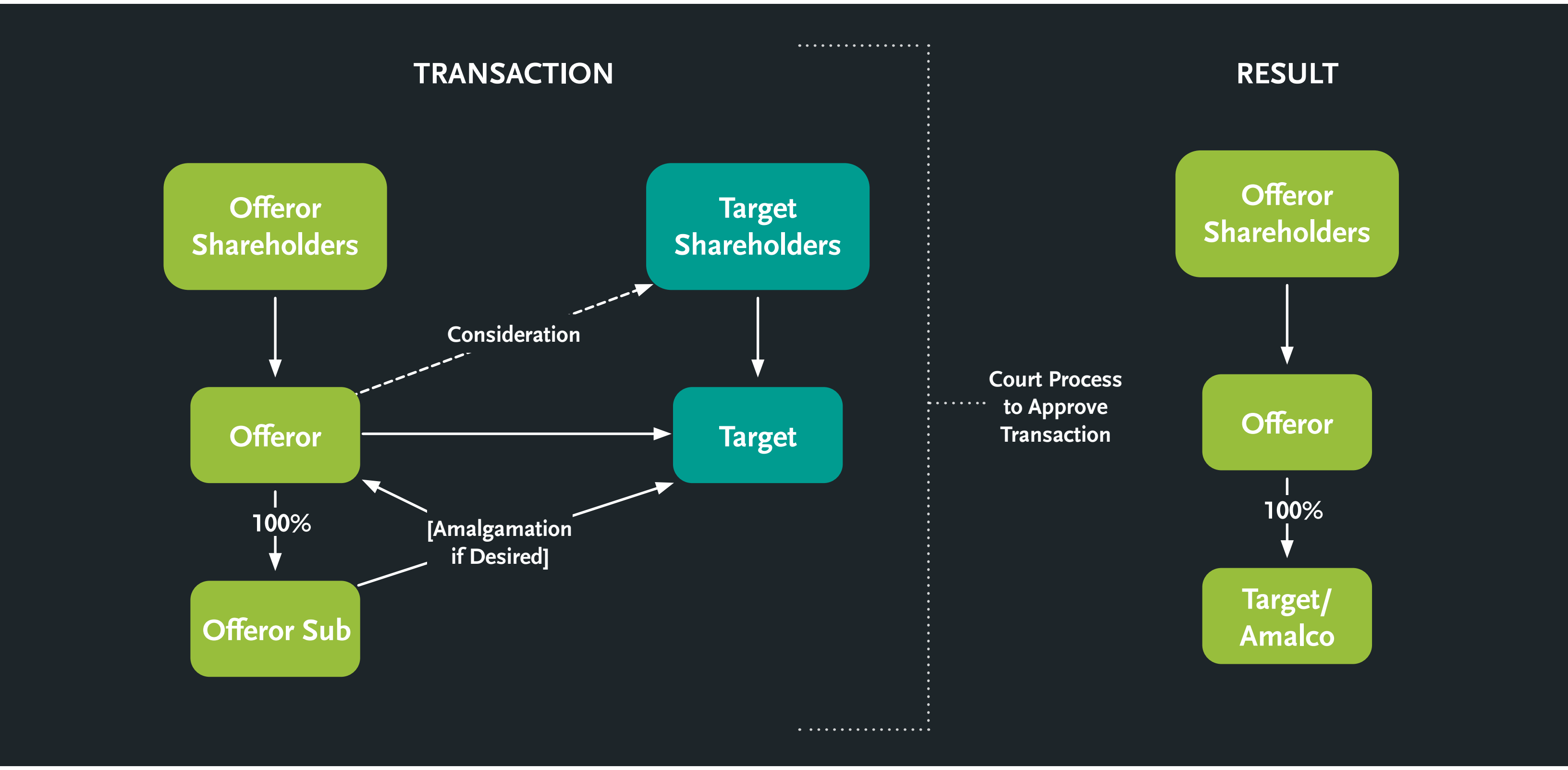
Share Consolidation



Steps and Considerations:

- A shareholders' meeting is convened to authorize the consolidation of the shares of the target company such that the Offeror remains the only significant holder of a whole number of shares (e.g., a consolidation of 500 shares to 5).
- The public then holds only fractional shares.
- The fractional shares are purchased for cash.
- Under corporate law, the share consolidation must be approved by holders of two-thirds of the shares represented at the meeting, in person or by proxy, including the Offeror.
- Under securities law, the share consolidation must be approved by a majority of the minority.

Plan of Arrangement



Steps and Considerations:

- A plan of arrangement is a court-approved process involving an appearance before a judge prior to mailing required materials to shareholders in respect of the proposed transaction and a second appearance following the shareholders' meeting, where a hearing is held to determine the fairness of the transaction.
- Both amalgamations and share consolidations can be implemented by way of a plan of arrangement.

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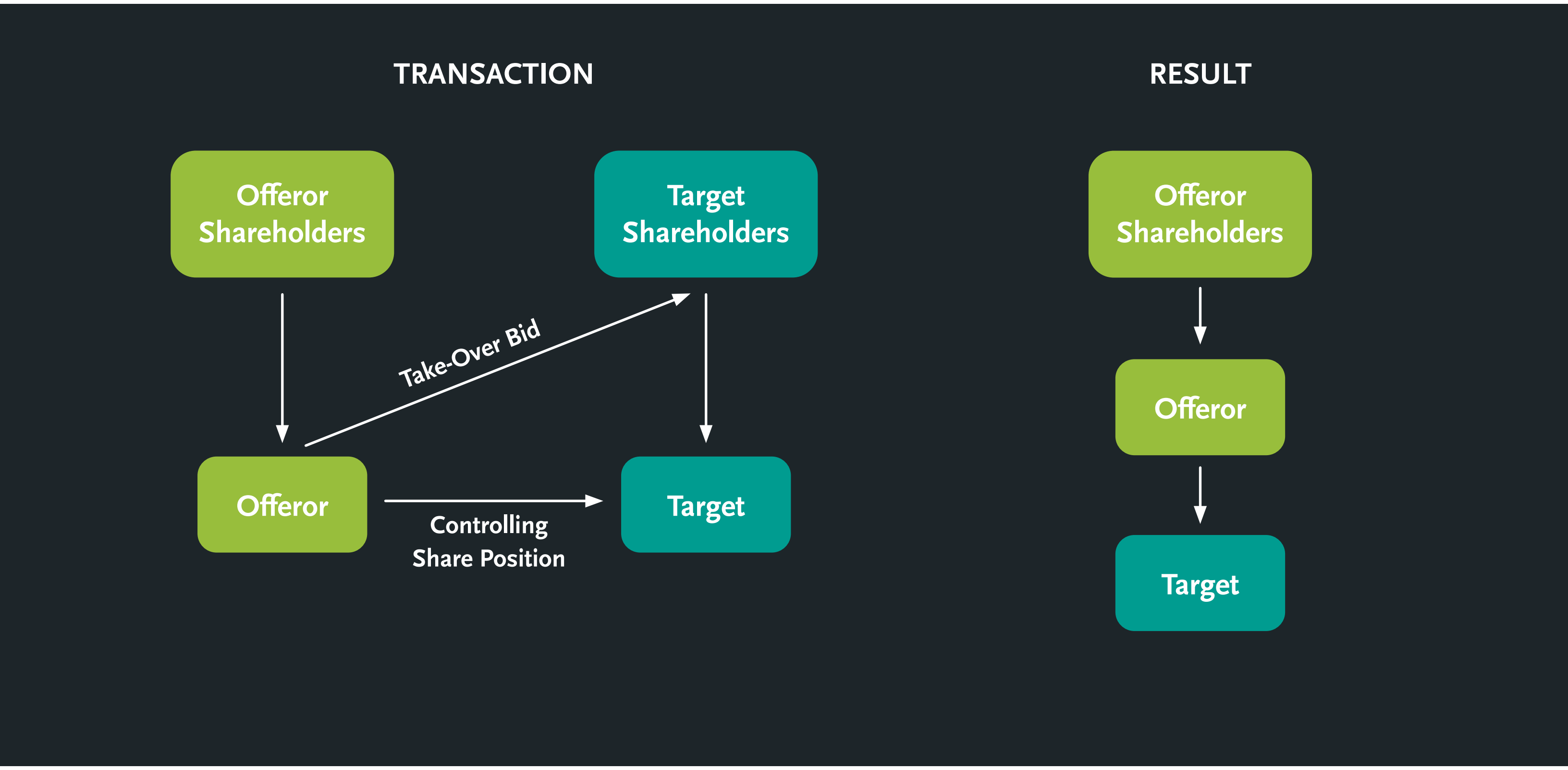
Take-Over Bid



Steps and Considerations:

- An Offeror makes a take-over bid for the outstanding shares.
- If there is a high acceptance level, the Offeror may acquire the balance under a "compulsory acquisition" notice. The Offeror must acquire 90% of those shares it does not already own in order to qualify to use this process.
- If a lower level of acceptance is achieved but a majority of the minority's shares are acquired, the success of a "second step" amalgamation squeeze-out or share consolidation is guaranteed.
- The shares purchased from the minority under the take-over bid may be voted in favour of the second step transaction by the Offeror.

How Long Will a Going-Private Transaction Take?

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

Process

- An independent committee of the board of directors is appointed by the target company.
- An independent financial advisor is selected and retained by the independent committee.
- The Offeror negotiates financing commitments and other arrangements.
- The Offeror and the independent committee finalize the price and terms of the transaction and related agreements.
- Finalization of valuation and fairness opinion (as required).
- The board of directors approves the transaction and agrees to support the transaction.
- The transaction is publicly announced.
- Disclosure documents are prepared; and mailing of circular for bid/meeting.
- Shareholder meeting/expiry of bid and closing.

Documenting a Going-Private Transaction

Confidentiality Agreement

- The Offeror and target company usually enter into a confidentiality agreement to facilitate access to the latter's due diligence materials.

Lock-up Agreements

- An Offeror often negotiates lock-up/voting agreements with directors, officers and large shareholders.
- These agreements can be:
  - Soft - A shareholder agrees to vote their shares in the favour of the going private transaction or tender into the takeover bid, but reserves the right to withdraw their support if a better offer appears.
  - Hard - A shareholder agrees to vote in favour of the applicable transaction or tender shares, regardless or whether or not a better offer appears.

Definitive Agreement

- Acquisition agreement setting out conditions, covenants, representations and warranties and indemnification agreements of all parties.

Deal Execution

Private Process

- It is not uncommon for an Offeror to quietly raise the possibility of a going-private transaction, subject to an indication of what any financial advisor's conclusion may be and an indication of the likelihood of support by the independent committee.
- Advantages of a private approach include avoiding disruption to the organization, minimizing employee departures, allowing the Offeror to avoid adverse publicity if the proposed price is not viewed as fair by the independent committee and avoiding introducing hedge funds into the shareholder base.

Public Approach

- A public approach, where an Offeror announces its intention to take the public company private before securing support of the independent committee, is used on occasion to attempt to avoid negotiation of a higher price and to indicate a certain degree of resolve to not go higher.
- A public approach could be expected where an Offeror anticipates offering only a very low price, but wants to have the transaction considered by shareholders in any event.
- Theoretically, there should be no timing difference between a public and private approach, however, in practice, a public process moves more slowly than a private process.

Role of the Board of Directors and Management

Chair of the Board

- The Chair is required to act impartially, make procedural decisions and ultimately be the focal point for the views of the independent directors, including those who are on the independent committee.
- Neither the proponents of the transaction, nor the officers who may have a conflict, including the CEO, should be chairing discussions with regard to the transaction.
- If the Chair is conflicted, then consideration should be given to appointing a lead director.

CEO

- The CEO will typically continue to be the company's prime public communicator.
- The CEO should refrain from stepping into areas of independent committee authority in public statements .
- The CEO should avoid discussing topics such as fairness and whether the CEO personally thinks the proposal is a good one or what the independent committee's position might be.

CFO and Senior Operations Executives

- The CFO and senior operations executives will usually be the parties tasked to collect all necessary information to help ascertain a value for the corporation.
- In particular, the process will involve technical presentations, financial presentations, reviewing forecasts, budgets and current operations and collecting all relevant information so that the financial advisor/valuator can assess it as well as conduct oral due diligence sessions with management.
- The CFO and senior operations executives will also have to present to the independent committee and the board as a whole so that the directors can assess the prospects of the company in relation to the valuation.
- The CFO and all senior operating executives should be cautious to avoid expressing views on the desirability of the transaction, the adequacy of consideration, or overall fairness.

Directors Duties Generally

- Directors are required, in exercising their powers and discharging their duties, to act honestly and in good faith with the view to the best interests of the corporation and to exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances. These duties apply to all deliberations of the board of directors and any committee of the board.

- The requirement that directors act in the best interests of the corporation means that when making decisions regarding the corporation, directors must consider the interests of all affected stakeholders (including shareholders, employees, creditors, consumers, governments and the environment, amongst others).
- In addition to the fiduciary duty, directors also have a duty of care, meaning they must take reasonable care in reaching decisions on behalf of the corporation. This standard of care applies to all deliberations of a board of directors or a committee of the board. Inherent in this duty is an obligation of a director to inform himself or herself of the issues relevant to the decisions he or she is making and to take sufficient time to consider them.
- The directors of the company will need to assess whether the going-private transaction is desirable or fair and in the best interests of the target company taking into account the interest of all stakeholders.
- In general, conflicted directors will be required to abstain from any vote on the merits of the transaction, but will still have an obligation to provide appropriate disclosure to shareholders in directors'/ information circulars.

Independent Committee

- Regardless of the structure employed for a going-private transaction, a committee of independent directors will likely be formed to supervise the process and, if needed, select an independent financial advisor and supervise the preparation of any required valuation.
- Significant shareholder nominees and management representatives should be excluded from serving on the independent committee. Any material commercial interest or other interest in the outcome of the transaction applicable to other directors, not including their shareholdings, should be carefully examined.
- The independent committee should establish its own procedures, appoint a Secretary and a Chair, set rules for calling meetings and keep minutes of its proceedings.
- The independent committee mandate is typically framed as follows: to negotiate the price and terms of the transaction with the Offeror (subject to board approval) and to make a recommendation to the board as to the appropriate advice to shareholders in respect of how the public should vote their shares or whether to tender to a take-over bid.
- Recommended guidelines for an independent committee include:
  - seek guidance from outside counsel as to the legal responsibilities of its members as "independent" and "disinterested" directors in the context of the proposed transaction;
  - consider the merits of the strategic alternatives, including their inherent benefits and risks;
  - consider and review proposals from potential counterparties, as well as the terms and conditions of any proposed transaction;
  - have access to senior officers of the company and all relevant information relating to the company and any proposed transaction, either directly or through the committee's advisors;
  - consider and understand the business, financial and tax implications of any proposed transaction and of not proceeding with the proposed transaction;
  - review with a third-party financial advisor the financial terms of any proposed transaction;
  - consider whether a fairness opinion from a third-party financial advisor would be desirable to support the directors' judgment on any proposed transaction and to evidence the discharge of their fiduciary duties, and review such opinion with the financial advisors and discuss with them the underlying investigations, assumptions, key factors and methodology adopted so that the independent committee has reasonable grounds for relying on the opinion;

- review and comment upon any related documentation and ensure that any proposed transaction, if approved, is appropriately documented;
- ensure that it takes adequate time to deliberate in reaching its decisions and that interested parties are not present at such deliberations;
- supervise the carrying out of any proposed transaction to ensure that there are no material changes subsequent to the independent committee's recommendation which might adversely affect the independent committee's recommendations or the corporation's shareholders; and
- ensure that minutes of meetings considering strategic alternatives and any proposed transaction are kept so that it is clear that the committee focused on the important issues, proceeded in a deliberative manner and acted in the best interests of the company.

- If an independent committee conducts itself according to these proposed guidelines and comes to a deliberate, informed, and unbiased decision that is reasonable in the circumstances, the courts are unlikely to interfere with the business judgment of the independent committee or of the board of directors in relying on recommendations of the independent committee.

Valuation

- An actual or perceived imbalance of access to information exists in going-private transactions, as between the Offeror on the one hand and public shareholders on the other hand.
- Public shareholders typically feel that if the Offeror is willing to buy more shares, the Offeror must "know something" the market does not.
- To address this issue, Canadian securities laws generally require the preparation of an independent valuation and extensive disclosure to public shareholders.
- The formal valuation must be prepared by a qualified independent valuation firm under the supervision of the independent committee of directors.
- The valuation is typically prepared based on discounted cash flow and liquidation value and would consider comparable transactions.
- The responsibility for selecting an independent valuator and supervising the preparation of the valuation is placed on the independent committee.
- The cost of preparing the formal valuation falls on the Offeror if a take-over bid is made and on the company if a corporate meeting is pursued, however, Offerors will frequently agree to cover the cost of the valuation if a transaction does not proceed.
- Offerors may be able to avail themselves of one of the statutorily defined exemptions from the valuation requirements if:
  - the target company's shares are not listed on a senior stock exchange; or
  - the Offeror has previously acquired shares from a significant shareholder in an arms-length transaction at a price equal to or greater, and in the same form as to be paid pursuant to the proposed transaction.

Fairness Opinion

- Though not generally legally required, it is common practice in the context of a going-private transaction for a board of directors or independent committee to obtain a fairness opinion from financial advisors to support their judgment and to evidence the discharge of their fiduciary duties. This fairness opinion is typically obtained from the financial advisors providing any required formal valuation.
- While a valuation may form the basis for the financial advisor's conclusions as to fairness, a fairness opinion is not a formal valuation and does not provide a conclusion as to the value of the entity or shares on which the valuator is opining. The fairness opinion merely speaks to the fairness of the transaction for the benefit of a defined group of shareholders. It should be noted that the fairness opinion only comments on whether a transaction is fair, not whether it is the most fair or whether other transaction alternatives exist that may maximize value to the subject shareholder group.

Minority Approval

- Two-thirds approval of holders of each class of shares in the target company must be obtained.
- Related party transactions require the approval of a majority of the minority shareholders.
- Definitions are technical but, in general, an Offeror, those connected to it and anyone being treated differently than the "public" are not entitled to vote.
- Locked-up shareholders are entitled to vote provided the consideration they will receive is identical to other public shareholders.

Dissent Process

- Generally, dissent rights are granted under corporate laws for amalgamations, plans of arrangement, or a sale of all or substantially all the corporate property.
- An Offeror will usually have a condition limiting the aggregate number of dissents to 5% or 10% of the outstanding shares.
- In the meeting context, a shareholder must dissent prior to the vote on the transaction.
- If the transaction is approved, the dissenter ceases to be a shareholder and has only a right to be paid fair value for his or her shares.
- Pursuant to corporate laws, expert evidence relating to fair value is required to be submitted and tested by parties and finally assessed by the Court.
- The dissent process is expensive and lengthy, but does not delay the transaction if there is otherwise sufficient support.
- Practically, the process is usually only used by well-funded, well-organized, large groups of shareholders who are, or a significant institutional shareholder who is, unhappy with the price being offered.

Other Regulatory Considerations

- ***Competition Act***
  - Depending on the size of a going-private transaction, the Offeror and the target company may be required to make pre-merger notification under the *Competition Act* (Canada). This generally will be required where the target is not already a subsidiary of the Offeror, the combined assets in Canada or combined gross revenues from sales in, from and into Canada of the Offeror and the target company together with their affiliates exceed C$400 million and the assets in Canada or revenues of the target company's business in and from Canada exceed C$96 million. If subject to notification, the Offeror and the target company must file a notification and not complete the transaction until expiry of a waiting period, unless the parties receive a waiver to the notification provisions.

- ***Investment Canada Act***
  - Where an Offeror that is a "non-Canadian" controlled by a "trade agreement investor" member country (i.e., the U.S.) proposes to acquire control of a target company and the "enterprise value" of the target company exceeds C$1.613 billion, approval by the relevant Minister may be necessary as a condition of closing the going-private transaction. For Offerors that are "world trade organization" country members, this enterprise value threshold falls to C$1.075 billion. For Offerors that are "state owned enterprises"the review threshold is a book value of the assets of the target of C$428 million. If subject to review, the Offeror may not close the transaction until the Minister under the ICA has approved the transaction.

Post-Closing

Regulatory and Securities Laws

- In order to cease being a public company, the target company will need to apply to delist from the relevant exchange and apply to cease to be a reporting issuer under Canadian securities laws.

De-listing

  - The target company may request to delist from the relevant stock exchange by submitting (i) a written request for delisting, (ii) a copy of the directors' resolution authorizing the delisting, and (iii) confirmation that all exchange invoices have been paid.
  - The relevant stock exchange will generally approve the delisting application so long as it is established that shareholders are not prejudiced. Lack of prejudice may be established where an issuer has redeemed its shares or where there is a lack of sufficient public shareholders to remain listed.

Ceasing Reporting

- A reporting issuer may apply to cease to report in a variety of circumstances but most commonly utilizes the simplified procedure provided under applicable securities laws based on going-private.
- In order to be eligible to apply for an order to cease being a reporting issuer under the simplified procedure, the target company must ensure that:
  - its outstanding securities, including debt securities, are beneficially owned, directly or indirectly, by fewer than 15 securityholders in each of the jurisdictions of Canada and fewer than 51 securityholders in total worldwide;
  - its securities, including debt securities, are not traded on a marketplace or any other facility for bringing together buyers and sellers of securities where trading data is publicly reported; and
  - it is not in default of securities legislation in any jurisdiction.

What Does a Recently Taken-Private Company Look Like?

- Significantly smaller shareholder base.
- Entry by the Offeror, management and other remaining shareholders into new agreements to govern the affairs of the company, including:
  - Unanimous Shareholder Agreement containing, among other terms:
    - restrictions on transfers of shares;
    - special majority approval rights of the Offeror;
    - ability of the Offeror to drive and compel the next "Liquidity Event" (sale of shares, sale of assets, business combination); and
    - minority protections for smaller shareholders.
  - Non-Competition Agreements;
  - New Employment Agreements; and
  - New Compensation Plans to align management and shareholders.

Bennett Jones

Authors

Darrell Peterson

403.298.3316
petersond@bennettjones.com

Gordon Cameron

646.992.4322
camerong@bennettjones.com

For more information on Bennett Jones' M&A, Corporate Finance and Private Equity and Investment Funds group's services and lawyers, please visit

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