GOING PRIVATE TRANSACTIONS IN CANADA: KEY CONSIDERATIONS

Posted on August 10, 2022

Categories: Insights, Publications

Canadian equity markets have had a significant downturn in 2022. Year-to-date, the S&P/TSX Index has returned -7.38% and the S&P/TSX-Venture Index returned -28.95% in 2022. The total amount of capital raised in Canadian equity financings during the period from January 2022 to May 2022 has declined to $10.5 billion, down 57% compared to the same period last year.[1] Additionally, since the start of 2022, the Bank of Canada has aggressively raised its benchmark interest rate to 2.5%. The current market has many Canadian public companies considering whether remaining a public company makes sense for their business and presents capitalized dealmakers with potentially undervalued take-over targets. This bulletin provides an overview of how Canadian public companies may effect a going private transaction and summarizes several key benefits of going private.

Going Private Transactions

A "going private transaction" refers to a transaction or series of transactions that has the effect of converting a public company into a private company. Practically, the process entails: (i) the transfer of a public company's equity securities from many public shareholders to one or few shareholders; (ii) a delisting of the company's securities from a stock exchange; and (iii) the company ceasing to be a "reporting issuer" (as defined in the applicable Canadian provincial securities laws). A going private transaction is typically completed by management of the public company taking the company private (i.e., an insider bid) or a third-party seeking a friendly or hostile take-over of the public company.

A Canadian incorporated public company may structure a going private transaction a number of ways. In Canada, the three most common ways are a Court approved plan of arrangement, a take-over bid (with a squeeze-out or second step transaction to follow, as necessary) or an amalgamation. The choice of structure is driven by numerous factors including which facilitates the fastest path to closing the deal, financing requirements, required security holder approvals, required third party approvals (such as stock exchange, *Competition Act* (Canada), *Investment Canada Act* or industry specific regulatory bodies), how liquid or illiquid the stock of the target is and the risks associated with each of these factors. A holistic assessment of these and other deal specific factors is required to assess the likelihood of a transaction successfully completing.

Process for Going Private

Structuring the Transaction

Plan of arrangement. In Canada, most going private transactions are effected pursuant to a plan of arrangement. A plan of arrangement is a Court supervised process effected under the provisions of the target public company's governing corporate statute. A plan of arrangement is typically negotiated between the prospective purchaser and the target public company's board of directors or a special committee of the board and is subject to both securityholder and Court approval; the latter requiring the Court's determination that the terms of the arrangement are "fair and reasonable" to the affected parties.

To effect a going private transaction by way of plan of arrangement, parties enter into an arrangement agreement that establishes the principal terms of the transaction. Following the execution of the arrangement agreement, the parties apply to Court for an "interim order". The interim order describes the process of calling and giving notice of the meeting of securityholders, the conduct of the meeting, and the level of approval by which securityholders of each class must approve the arrangement (generally 66⅔% to 75%, depending on the province of incorporation of the target company and whether the holders of equity securities or creditors of the target will be statutorily required to vote respecting the plan of arrangement). The Court will almost always grant a right of dissent to each securityholder, providing securityholders entitled to vote at the meeting who oppose the proposed transaction to dissent and receive "fair value" for their voting securities as determined by a Court. Once the target public company obtains the interim order, it is required to prepare and distribute a management information circular to securityholders prior to the meeting. A final order of the Court is obtained following the meeting if the securityholders approve the arrangement. Thereafter, provided other closing conditions are satisfied under the arrangement agreement, the transaction may close.

Take-over bid. A take-over bid is an offer to acquire voting or equity securities of a target company made to securityholders in a Canadian jurisdiction where the securities subject to the offer, plus any securities beneficially owned or over which control or direction is exercised by the bidder and any person acting jointly or in concert with the bidder prior to the bid, constitute 20% or more of the outstanding class of securities on a partially diluted basis. Take-over bids are regulated by the securities laws of the provinces and territories where the holders of securities of the relevant class are located. The Canadian securities regulators have harmonized the take-over bid regime across all of the jurisdictions within Canada.

To effect a take-over bid, the bidder is required to send a written offer to purchase (an "**Offer to Purchase**") and take-over bid circular to all securityholders entitled to receive it (the "**Circular**"). The Offer to Purchase and Circular must contain information required to be disclosed pursuant to Canadian securities laws under National Instrument 62-104 *Take-Over Bids and Issuer Bids*. The directors of the target company must prepare

a response to the Offer to Purchase recommending whether or not the securityholders should accept the offer.

The take-over bid is generally considered completed once the offer has expired and the bidder has taken up and paid for the securities validly deposited by the securityholders pursuant to the Offer to Purchase. If at least 90% of the voting securities are tendered to the bid, the bidder completes a compulsory acquisition under the applicable corporate statute, which obligates the remaining securityholders to tender their voting securities to the bidder, subject to the dissent rights of the remaining securityholders. If less than 90% of the securities subject to the take-over bid are tendered to the bid, a subsequent acquisition transaction is required to take the company private. Generally, if the bidder has acquired or exercises control over 66⅔% of the voting securities following the take-over bid and sufficient votes are cast by holders to constitute "minority approval" pursuant to Multilateral Instrument 61-101 *Protection of Minority Security Holders in Special Transactions* ("**MI 61-101**"), the bidder may proceed with a second step arrangement or amalgamation.

Amalgamation. An amalgamation is a statutory transaction under corporate law combining two or more companies into a single successor company. An amalgamation may be structured in a number of ways. In a typical amalgamation, the purchaser will create a wholly owned subsidiary acquisition vehicle that will amalgamate with the target public company so at completion of the amalgamation the purchaser will control all of the voting shares of the amalgamated "go-forward company" (essentially the business of the former public target company). Procedurally upon amalgamation, the purchaser receives all of the voting shares of the amalgamated company in exchange for all of its acquired shares in the target company and all shareholders of the target receive either cash or more commonly, redeemable shares in the amalgamated company which are then immediately redeemed for cash to be distributed pro rata to target shareholders. To approve an amalgamation, a shareholder meeting of the target company is called and under corporate law, the amalgamation must be approved by holders of two-thirds of the shares represented at the meeting, in person, or by proxy. The same approval threshold is required of the newly formed purchaser acquisition vehicle although this approval is largely a formality as the purchaser parent company controls all of the voting shares of the acquisition vehicle. An amalgamation may be effected pursuant to a plan of arrangement.

Additional Considerations

Conflicts of Interest. MI 61-101 may trigger obligations to establish a special committee of independent directors of the target public company and require specific disclosure, formal valuation and shareholder approval processes in connection with certain types of going private transactions involving one or more "related parties" of the target public company. A formal valuation is an opinion of the valuator as to a value of the securities that are the subject of the transaction, and, if applicable, any non-cash consideration involved and any non-cash assets involved in a related party transaction. MI 61-101 requires a qualified and independent valuator (usually an accounting firm or investment bank) to prepare the formal valuation.

Fairness Opinion. A fairness opinion is an opinion as to the fairness of the transaction's terms to the issuer's shareholders from a financial perspective. The financial advisor providing the fairness opinion is typically retained by the target public company's board of directors, or the special committee formed by the target public company. Fairness opinions are not required in Canadian going private transactions pursuant to any statute or common law ruling, but help demonstrate that the board has satisfied their fiduciary duty in approving a transaction and that the transaction is fair and reasonable. Despite the fact that obtaining a fairness opinion is not legally required, it has become common practice in the Canadian market.

Delisting and Ceasing to be a Reporting Issuer

To delist the target public company's securities from a stock exchange and apply to cease being a reporting issuer in Canada, the target company is required to:

a. submit a written application to the applicable Canadian stock exchange where its securities are listed for a delisting pursuant to the policies of said exchange; and
b. file an application with its principal regulator for an order that the company ceases to be a reporting issuer in all jurisdictions of Canada where it is a reporting issuer pursuant to National Policy 11-206 *Process for Cease to be a Reporting Issuer Applications*.

The Benefits

Potential advantages resulting from going private include:

Providing an immediate liquidity event for shareholders. Going private typically provides the majority of shareholders (other than substantial shareholders that may be leading the bid and will continue to be shareholders of the private company) of the target company with cash for their shares.

Reducing costs and regulatory compliance requirements. Canadian public companies are subject to continuous disclosure requirements and filing obligations imposed by Canadian securities laws and stock exchange rules. Adherence to these obligations is time consuming and resource intensive. No longer having to satisfy these obligations presents annual cost savings and savings on management time and effort.

Avoiding hostile takeover threats. In the current public market, the share price of many companies (especially in the mining and tech industry) is trading at prices far below their initial listing price or intrinsic value. Whether due to an overall softened market, a rotation of investor capital into another industry sector, limited or negative analyst coverage or other market factors, a depressed market price for a company's voting securities (as compared to the value of the company's assets) provides an opportunity for a hostile take-over of the company.

Avoiding public disclosure of competitive information. Required disclosure under Canadian securities laws and exchange rules may include information regarding research and development plans, material contracts, growth and acquisition strategies, and key pieces of financial information. Disclosure of this information is useful to a public company's competitors and enables them to react at an early stage to this information.

Avoiding shareholder litigation. Class actions may be brought against companies by investors alleging misrepresentation in an issuer's continuous disclosure record or a failure to make timely disclosure of a material change in the affairs of the issuer. Responding to these allegations is a costly and time consuming process that diverts attention and resources away from the core business. Privately held companies do not have the same disclosure obligations and therefore are not subject to litigation of this kind.

Please contact McMillan LLP for further guidance on navigating a going private transaction in Canada.

[1] "*Bay Street's big chill sets in as share sales crater, sapping fees from investment banks*", 6/7/22 globeandmail.com (Toronto) (Pg. Unavail. Online) 2022 WLNR 17863914.

by Jeffrey Gebert, Alex Bruvels, Matthew DeAmorim

A Cautionary Note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.

© McMillan LLP 2022