July 2013

Legal-Framework and Mechanics of Going Private Transactions in Canada

Recently, many China-based issuers listed on Canadian stock exchanges (a "**Canadian Exchange**") have sought to complete a going private transaction ("**GPT**").[1] A GPT is a transaction, or series of transactions, which has the intended result of transforming a public company into a private company. At the end of a GPT, the company will no longer be listed on a Canadian Exchange or be a reporting issuer in Canada.

This bulletin discusses three primary types of GPTs, including plans of arrangement, take-over bids, and amalgamations. We note that in Canada, most friendly GPTs are completed by way of a plan of arrangement. However, if the acquiror is confident that shareholders of the acquiree holding greater than 90% of the outstanding shares (excluding those shares held by the acquiror and co-operating acquirors) will tender to the bid, then a takeover bid, coupled with a compulsory squeeze out, will be the most efficient process. The squeeze-out amalgamation, on the other hand, could be the simplest solution but compared to the other two options, it may carry a higher risk of litigation by disgruntled minority shareholders in the circumstances where the majority of minority shareholders approval and formal valuation are exempted (as discussed in more details below).

Plan of Arrangement

The process affecting a plan of arrangement is set out in Canadian corporate legislation, i.e., the *Canada Business Corporation Act* and its equivalent provincial corporation statutes. Under the *British Columbia Business Corporations Act* (the "**BCA**"), for instance, a plan of arrangement must be submitted to shareholders of the acquiree for their approval. The required shareholder approval is generally 66 2/3% of votes cast at a duly called shareholder meeting of the acquiree, and a simple majority of minority approval is required if the transaction involves an insider or interested parties. If the acquiree has multiple class of shares outstanding, each class must pass a special resolution by at least 66 2/3% of those security holders who vote at the meeting.

[1] For instance, Zongshen PEM Power Systems Inc. has completed the GPT by way of a plan of arrangement in December 2012; Yalian Steel Corporation has completed the GPT in May 2013 by way of insider bid; and Hanfeng Evergreen Inc. (TSX: HF) has received a shareholder approval with respect to a privatization proposal launched by its founder, which transaction has not closed at of the date of this bulletin.

Principal Documents

The two principal documents in the plan of arrangement process are the arrangement agreement (the "**Arrangement Agreement**") and a management information circular (the "**Circular**"). The Arrangement Agreement is agreed to among the acquiror and the acquiree and will contain the plan of arrangement which sets out the process for completing the arrangement. A Circular will need to be prepared and mailed to shareholders (and potentially other security holders if they are to be affected by the plan of arrangement) in order to solicit their votes for the plan of arrangement. The Circular will include comprehensive information as to the background of the arrangement, the steps taken by the board of directors in evaluating the fairness of the arrangement and the recommendation of the directors as to shareholder approval of the arrangement. The Circular is not reviewed by a regulator before it is sent to shareholders.

Court Approval

A plan of arrangement must be approved by a court (the "**Court**"), e.g., the Supreme Court of British Columbia in the province of British Columbia. Typically, an interim order of the Court covering the holding of the shareholder meeting is obtained prior to mailing the Circular. A final order of the Court would then follow the meeting if the shareholders have voted to approve the arrangement. In determining whether to approve the arrangement, the Court will make a determination that the business combination is fair to shareholders. In making this determination, the Court would expect to have before it some evidence that the offered price is fair to shareholders. This will typically be in the form of a "fairness opinion".

Formal Valuation and Fairness Opinions

Unless an exemption is available, MI 61-101(as defined below) requires a reporting issuer proposing to carry out a business combination to obtain a formal valuation from a qualified independent valuator and to provide the holders of the affected securities such valuation, or a summary thereof. One of the exemptions from delivering a formal valuation under MI 61-101 is that the issuer's securities are not listed on a senior exchange, such as Toronto Stock Exchange.[2] As such, if the acquiree is the TSX Venture issuer, a formal valuation is not required in a GPT to be conducted by way of a plan of arrangement or amalgamation squeeze-out (as discussed thereinafter).

In almost all cases, before proposing to shareholders a plan of arrangement, the board of the directors or special committee of the acquiree (or a tender offer under a take-over bid) will obtain a fairness opinion from a qualified investment dealer. This opinion comments on whether the offer is fair, from a financial point of view, to the shareholders of the acquiree. A second fairness opinion, organized and obtained by the special committee, might also be obtained if the dealer providing the primary opinion to the board is receiving a success fee (in which case a concern over impartiality is raised). The second opinion would be provided on a flat fee basis.

Requirements of a Special Committee

A special committee of the board of directors of the acquiree should be constituted to evaluate and make recommendations as to any arrangement transaction. It should be comprised solely of independent directors who do not have any interest in the arrangement and provides a means of mitigating the risks of litigation from the dissented minority shareholders.

The structure and operation of the special committee will be crucial to the fairness of the process, which is also an important consideration of the Court in its "fairness" review of the transaction. Key factors for the structure and operation of the special committee include the following:

- the special committee will need sufficiently broad authorization from the board of directors, including authority to negotiate the deal with the acquiror and to "just say no";
- the negotiations between the special committee and the acquiror must be "arm's length";
- the special committee should be authorized to hire its own legal counsel and financial advisers at the acquiree's expense; and
- the proceedings of the special committee should be thoroughly documented to demonstrate the knowledge, diligence and deliberations of the members of the special committee.

Majority of the Minority Approval

In addition to obtaining 66 2/3% approval of votes cast at a duly called shareholders meeting , if the GPT undertaken by way of a plan of arrangement involves an insider or interested parties, then a simple majority of minority approval from shareholders is also required. This is governed by the Multilateral Instrument 61-101 *–Protection of Minority Shareholders in Special Transactions*("**MI 61-101**"). Under MI 61-101, any "interested party" to an arrangement will have their shares excluded from the majority of the minority vote. For instance, if the acquiror is an insider of the acquiree, the acquiror's shares will be excluded from the majority of the minority vote. Also, if co-operating acquirors are to receive treatment under the arrangement for their shares that is not identical to the treatment received by other shareholders, they would be considered "interested parties" under MI 61-101 and would be prohibited from voting their shares in the majority of the minority vote. Moreover, with limited exceptions, the minority approval must be obtained from the holders of every class of affected securities of the acquiree.

MI 61-101 also applies if, as a consequence of the completion of the plan of arrangement, senior officers of the acquiree receive termination or other collateral employment payments. In such cases, the typical outcome is that the acquiree will need to have the plan of arrangement approved by a majority of the votes cast on the resolution excluding the votes of the acquiree

executives receiving the collateral benefits. If, however, all the shares held by the executive officers and directors (with the exception of the nominated officers or directors by the acquiror) are treated in the same fashion under the arrangement as the shares held by any other shareholders, then their shares can be included in determining whether the minority approval is obtained.

Support Agreements

Support agreements, often referred to as lock-up agreements, with key shareholders are typically negotiated up-front in order to increase the prospect of a successful outcome of an arrangement. Under such support agreements, shareholders agree to, among other things, vote all of the securities beneficially owned by them or their affiliates in favour of the plan of arrangement and in opposition to any proposed action by the acquiree that would impede or interfere with the plan of arrangement. Shareholders would also agree not to take any action that would frustrate or in any way hinder or delay the completion of the plan of arrangement. It should be noted that for the purposes of the majority of the minority vote discussed above, if a shareholder who merely enters into a support agreement with the acquiror agreeing to vote in favour of the plan of arrangement, such an agreement, in and of itself, does not constitute the shareholder as a joint actor. In other words, a mere support agreement may not exclude the supporting shareholder from counting their shares out of the minority approval.

Dissent and Appraisal Rights

Under the BCA and its equivalent federal and provincial corporate statutes, certain fundamental changes to a company including a plan of arrangement triggers statutory dissent rights. Shareholders who oppose the proposed transaction will be entitled to dissent and receive fair value for their shares as determined by a court. The acquiror and acquiree when considering the GPT should always take into account the potential risk of litigation from the dissented minority shareholders.

Stock Options

Under a plan of arrangement, existing stock options will need to be addressed. Generally, if the share price of the acquiree at the time of the arrangement exceeds the exercise price of the stock options, then the options may either be exercised and the shares acquired by the acquiror, or may be surrendered in consideration for a payment equal to the difference between the offer price and the exercise price. If the exercise price exceeds the offer price, then the stock options may simply be surrendered with no compensation.

Tax Considerations

A plan of arrangement is not necessarily a different set of mechanics from a tax point of view. If the arrangement has the effect of having the acquiror transfer their shares to another entity, the Canadian tax consequences to the shareholders should be essentially the same as those set

out under a take-over bid in this bulletin. In any event, however, it is always prudent and highly recommended to consult a competent tax advisor such as a tax lawyer before setting up any GPT structure and implementing the transaction.

Timeline for Going Private via Plan of Arrangement

Included as **Appendix A** to this bulletin is a sample timeline to complete a plan of arrangement. The timeline does not account for the receipt of any third party, stock exchange or regulatory approvals or consents.

Take-Over Bid

The take-over bid option for completing the GPT is in theory faster than the other two going private options discussed herein. However, success is contingent upon at least 90% of the acquiree's shares (excluding those shares held by the acquiror and co-operating acquirors) being tendered to the offer. If less than 90% of the subject shares are attained, then the threshold for completing the compulsory acquisition under corporate legislation would not be met, and a "second step" amalgamation or an arrangement may be required.

The Offer

Under the take-over bid rules, the bidder (the "**Bidder**") would purchase outstanding shares of the acquiree excluding those shares held by the acquiror and co-operating acquirors (the "**Subject Shares**") directly from the acquiree's shareholders. The Bidder will be required to send to shareholders a written offer to purchase (an "**Offer to Purchase**") which will contain the disclosures required under Canadian securities laws. The acquiree's directors will prepare a response to the Offer to Purchase that provides a recommendation to the shareholders as to whether they should accept the offer. Neither the Bidder's offer nor the directors' circular in response is reviewed by a regulator before it is sent to shareholders.

The take-over bid must remain open for acceptance for a minimum of 35 days. Any variation in the terms of a bid will generally extend the bid by up to an additional 10 days.

After the take-over bid is completed, assuming that at least 90% of the Subject Shares were tendered to the bid, the Bidder would complete a compulsory acquisition under the corporate statutes which will obligate the remaining shareholders to tender their Subject Shares to the Bidder, subject only to the dissent rights of the remaining shareholders to seek a court order amending or blocking the acquisition.

As is seen under an arrangement process, in order to ensure procedural fairness, the board of directors should constitute a special committee and engage a financial advisor to prepare a formal valuation. The valuation, which will be required under MI 61-101, will form the basis of the board's recommendation that shareholders accept or reject the tender offer.

Overview of Potential Ancillary Agreements

Assuming that the GPT by way of a take-over bid is "friendly", the Bidder will negotiate a support agreement with the board of directors of the acquiree pursuant to which the acquiree's board will agree to support the take-over bid and recommend shareholders accept the offer.

To increase the prospects of the offer being successful, a lock-up agreement can be pursued with co-operating shareholders. Under such an agreement, the co-operating acquirors would be required to vote in favour of the Bidder's offer and, if applicable, tender their Subject Shares to the offer. A provision could also be included providing that the co-operating acquirors would agree to vote against any competing offer, if one were to arise, within a set period of time.

If any co-operating acquirors wish to remain shareholders after the GPT, a collateral agreement can be signed under which they would agree not to tender their Subject Shares to the offer, and to, if necessary, act jointly and in concert with the Bidder in connection with a second stage compulsory acquisition with respect to all the remaining shareholders.

Subsequent Acquisition Transaction

If less than 90% of the Subject Shares are tendered to the bid, then a subsequent acquisition transaction will be required. Typically, if the Bidder has more than 66 2/3% of the shares following the take-over bid and sufficient votes are cast by "minority" holders to constitute "minority approval" pursuant to MI 61-101, the Bidder may proceed with a second stage arrangement or amalgamation (the "**Subsequent Acquisition Transaction**").

Risks arise when certain minority shareholders hold a large enough portion of the minority shares to thwart the GPT. In such a case, the Bidder proposing the GPT may ultimately have to increase the offer price to the public shareholders in order to get their support for the transaction. This type of situation would obviously increase the cost, delay completion time and cause uncertainties.

Tax Considerations

In a take-over bid, the tendering shareholders will sell their shares for cash and generally realize capital gains or loss, based on the difference between the purchase price and the individual "adjusted cost base" of their shares. To reduce the chances of capital gains tax (and compliance issues) for non-resident shareholders, it is usually preferred to maintain the listed status of the shares until the share acquisition is completed.

Timeline for Going Private via Take-Over Bid

The take-over bid can be completed in approximately 60 days if at least 90% of the Subject Shares are tendered to the bid. For an insider bid or bid involving an interested party, an additional three weeks or more should be allowed for preparing a formal valuation report. However, as stated above, the uncertainty in terms of timing would increase for the Bidder if

not enough Subject Shares are acquired and a Subsequent Acquisition Transaction needs be undertaken.

Amalgamation Squeeze-Out

An amalgamation is a statutory means under corporate legislation of combining two or more companies into a single entity. There are a variety of ways in which a GPT may be structured as an amalgamation and a simple one could be described as follows:

1. The Bidder (and along with its joint actors), usually a controlling shareholder in a GPT, sets up a new wholly-owned subsidiary in the same jurisdiction of the acquiree (the "**BidCo**"), to which the Bidder transferred all of its shares of the acquiree;

2. An amalgamation of BidCo and acquiree is proposed and negotiated between the Bidder and the acquiree;

3. A shareholders meeting of the BidCo and acquiree is called, respectively, and both BidCo and acquiree shall approve the amalgamation by a special resolution (i.e., 2/3 of votes cast of the shareholders who vote on the resolution);

4. Upon amalgamation, the Bidder (and along with its joint actors) receives all of the voting shares of the amalgamated company in exchange for its shares in BidCo and all the shareholders of the acquiree receive either cash or, more commonly, redeemable shares in the amalgamated company; and

5. When the transaction is completed, the redeemable shares of the amalgamated company are immediately redeemed for cash. At the end of the day, the Bidder (along with its joint actors) becomes the sole shareholder of the amalgamated company.

6. Different from a plan of arrangement, the amalgamation transaction does not require a Court approval, but it shall obtain an approval by a special resolution of generally 66 2/3% of the shares represented in person or by proxy at a shareholders' meeting of both BidCo and the acquiree. With limited exceptions (as discussed below), a separate approval by a majority of minority shareholders of the acquiree is also required under MI 61-101 if an insider or interested parties are involved, which is usually the case in a GPT.

In a GPT, if the Bidder, in combination with any potential co-operating acquirors, beneficially owns more than 90% of the shares of the acquiree before commencing the amalgamation, then MI 61-101 may exempt the requirement of majority of minority approval. MI 61-101 provides that the minority approval requirement does not apply to an issuer (the acquiree) if, among other things, (i) one or more persons that are interested parties beneficially own, in the aggregate, 90% or more of the outstanding securities of a class of affected securities at the time that the business combination (e.g. any type of GPT discussed herein other than a take-over bid without the Subsequent Acquisition Transaction) is agreed to, and (ii) an appraisal remedy (i.e., dissent right) is available for the holders of the class of affected securities under

the corporate statute. As such, if (i) a Bidder, together with co-operating acquirers, owns greater than 90% of the acquiree's shares, and (ii) the corporate legislation (such as BCA) under which the acquiree is incorporated provides statutory dissent rights, then the minority approval may be exempted under MI 61-101 where the structure the GPT is proposed as an amalgamation squeeze-out.

It should be noted, however, that an amalgamation squeeze-out for a TSX Venture issuer, might be regarded as lack of sufficient protection for the minority shareholders, in that, such an amalgamation does not require a formal valuation (by applying the same exemption as discussed in the plan of arrangement) nor a majority of minority shareholders approval. In addition, the Court will not be required to review the fairness of the price offered to the minority shareholders nor scrutinize the procedural fairness of such an amalgamation. Those factors will largely increase the risk of litigation by the disgruntled minority shareholders as the mere remedy for the minority shareholders whose interests are affected is to commence a lawsuit and seek the court's determination on the fairness of the price and procedures with respect to the amalgamation squeeze-out. A lawsuit by shareholders (especially a class action) would be very costly, time-consuming and create greater uncertainties on the timeline to close the Transaction.

Tax Considerations

An amalgamation squeeze-out that has the effect of seeing the acquiree's shareholders be bought out, raises the prospect that a part of the redemption proceeds may be treated as a deemed dividend rather than as a capital gain. A deemed dividend, if material, could be especially challenging if there are many non-resident shareholders, since dividends are subject to withholding tax. As such, proper tax advice should be sought for prior to determining the transaction structure.

Conclusion

This article outlines the legal framework and three principal mechanics of GPTs in Canada of a general nature and for information purpose. Any participants involved in a GPT in Canada should fully consider, valuate and understand the risks, timeline, costs and various statutory implications associated with each mechanism of the GPTs. Competent and proper financial, legal, and tax advice shall be obtained in structuring, undertaking and completing the transaction.

APPENDIX A
Sample Timeline for a Plan of Arrangement

Day 1:	Bidder submits proposal to the board of directors of the acquiree.
Day 2-10:	Meeting of the entire board of directors to consider proposed terms of the Transaction. Significant shareholders whose support is required to approve the proposal would be advised of the terms of the transaction and asked to consider entering into a support agreement. Special committee of the board of directors is constituted to evaluate and make recommendation as to the tender offer. Board of directors authorizes management, with the assistance of the special committee as needed, to continue to negotiate the proposed financial terms of the Transaction. The board and special committee, with the guidance of management, continues with the process of determining the appropriateness of entering into the Transaction.
Day 11-15:	Management and counsel negotiate, and management signs, a letter of intent with the Bidder. The special committee engages a financial advisor and, if required independent counsel.
Day 16-37:	Financial advisors conduct due diligence regarding the valuation of the acquiree and the financial terms of the proposal. Legal counsel negotiates the form of the arrangement agreement, support agreement or lock-up agreement. Financial advisors present completed valuation information at a joint meeting of management and special committee. Final negotiations on arrangement agreement (including plan or arrangement) and support agreements

Day 37 or so:	After market close, special committee meeting at which financial advisors deliver definitive opinion on fairness. Special committee determines fairness of the terms of the proposal. Special committee meeting is followed by a board of directors meeting at which special committee reports its belief that the terms of the proposal are fair to the non-purchasing shareholder and the board receives the opinion of its primary financial advisor. Board of directors accept the special committee's recommendation regarding the proposal, authorize the entering into of the arrangement agreement and approve the dates for a special meeting of shareholders. Before market opens, acquiree and proponent execute arrangement agreement and support agreements are signed with significant shareholders and the directors and officers of the acquiree. The acquiree issues press release announcing proposed transaction. The acquiree advises its transfer agent of proposed shareholder meeting date.

Days commencing after the Arrangement Agreement is signed

Day 1-30:	Preparation of management information circulars by the acquiree.
Day 31:	Interim order of the court obtained authorizing meeting of shareholders of the aquiree to approve the plan of arrangement.
Day 34-35:	Call the special shareholders meeting. Print and mail the information circular and meeting materials.
Day 69-70:	Hold the special meeting of shareholders of the acquiree and obtain requisite shareholders.
Day 70-72:	Court approval of the plan arrangement.
Day 72:	Implementation of the plan of arrangement completion of the business combination.

[2] This exemption is not applicable for an insider bid. Any offeror (as opposed to the issuer) in an insider bid must obtain a formal valuation and make proper disclosures as provided in MI 601-101.

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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.