Acquisitions of Private Businesses in Canada
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This guide is designed as a practical, hands-on tool to assist directors and officers and potential purchasers in understanding the issues surrounding acquisitions of private businesses in Canada.

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The purpose of this guide is to provide an overview of the mechanics involved in the acquisition of a private business in Canada.

Most businesses in Canada that are not operated as sole proprietorships or general partnerships will be incorporated as a business corporation, under either the federal Canada Business Corporations Act or the equivalent statute in one of the ten provinces or three territories. Most Canadian jurisdictions also allow for the formation of limited partnerships, which can serve as fiscally transparent vehicles. Certain provinces do permit the formation of unlimited liability companies, which can serve as hybrid entities, making them fiscally transparent for U.S. tax purposes but they are treated as corporations (and therefore not fiscally transparent) for Canadian purposes.

This guide will focus on acquisitions of private businesses operated by corporations in Canada. However, many of the issues would be relevant to the acquisition of other entities or businesses.
The threshold decision any purchaser must make is whether to purchase assets or shares. While there are a number of factors that influence the decision as to whether to proceed by way of asset acquisition or share acquisition, a purchaser will generally prefer to proceed by way of asset purchase and a seller will generally prefer to proceed by way of share sale. However, as with all commercial negotiations, the specific facts at hand and the bargaining power of the parties involved will dictate the transaction structure that is ultimately used.

**ASSET PURCHASE**

In an asset purchase transaction, a purchaser will enter into an agreement with a corporation to acquire only those assets that it desires to purchase, and to assume only specified liabilities. The rest of the business (particularly unwanted contingent and unknown liabilities) remains with the selling corporation.

A simple diagram of an asset purchase follows:

The ability to pick and choose the assets to acquire and the liabilities that it is willing to assume is an important advantage from a purchaser’s perspective. A purchaser will perform due diligence to provide additional comfort that it has properly identified the assets to be purchased and liabilities to be assumed, and will obtain representations and warranties from the selling corporation as to the completeness of the assets being purchased. From a tax perspective, a purchaser will generally prefer an asset purchase to a share purchase, unless the purchaser wishes to acquire certain tax attributes of the target corporation.

Where the target corporation is only selling part of its business, or holds more businesses than the one being sold (for example, where it carries on business through various divisions), an asset sale may be the only viable transaction structure (either directly or indirectly, for example by transferring assets to a new corporation, the shares of which are sold).
SHARE PURCHASE

In a share purchase transaction (illustrated simply below), the purchaser acquires all of the shares of the corporation itself and, as a result, acquires all of its assets and liabilities, known and unknown. The seller will generally prefer a share sale to ensure that, subject to any indemnity that it provides, it will no longer be responsible for any of the liabilities of the target business.

The principal benefit of a share transaction to both the seller and the purchaser is its comparative simplicity, including:

- the need for only one share transfer, instead of individual conveyances for each asset;
- maintaining consistency of the employer, simplifying employee and pension/benefits issues; and
- avoiding transfer issues for governmental authorities and licenses (as the holder will not change).

Note however, that it would be typical in a share purchase transaction to perform more extensive due diligence on the assets and liabilities held by the target corporation, as well as a review of the corporate records of the corporation, so there is often not a substantial difference in the amount of work involved in a share acquisition as compared to an asset acquisition.

In addition, sellers will also generally prefer to sell shares so as to realize capital gains on the sale of those shares as capital gains in Canada are favourably taxed as compared to other types of income.

OTHER STRUCTURES

In addition, a private acquisition of equity interests in Canada can be effected by the following other means:

- an amalgamation of two or more corporations, where the surviving corporation is literally a union of the amalgamating corporations, which continue together as one entity (unlike a U.S. merger that extinguishes the legal existence of all parties but the surviving corporation);
- an arrangement, which is a court approved process through which corporations may amalgamate or transfer assets or securities.
Regardless of the structure chosen, the following documents are typically entered into early in the negotiations:

**TERM SHEET**

The term sheet may also be referred to as a letter of intent or a memorandum of understanding.

Executed by both the seller and purchaser, the term sheet provides the general framework of the transaction and usually includes:

- the type of transaction being contemplated;
- the type and amount of consideration to be paid;
- certain important terms and conditions; and
- a timeline for completion of the transaction.

The term sheet will typically provide that it is not legally binding, with the following exceptions:

- confidentiality;
- access to information;
- transaction expenses; and
- exclusivity.

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NON-DISCLOSURE (CONFIDENTIALITY) AGREEMENT

This agreement prevents the purchaser from disclosing the existence of the negotiations as well as from disclosing or using the information provided by the seller for any purpose other than evaluating the transaction. It is required by the seller and the target company in order to maintain confidentiality with respect to information disclosed as part of the due diligence or negotiation process in the event the transaction is not completed.

Additional terms may include the non-solicitation of customers and employees of the target business. If the purchaser will be disclosing any of its confidential information to the target company, it would be common to make the non-disclosure agreement mutual.

EXCLUSIVITY AGREEMENT

Purchasers may require an exclusivity agreement prior to expending significant resources to conduct due diligence investigations and negotiate definitive documentation in order to ensure that they are not competing with other prospective purchasers. This may be a stand-alone agreement providing that the seller will not solicit, initiate, enter into or continue discussions with any other potential purchaser of the shares or assets of the target, or those concepts can be built into the term sheet or non-disclosure agreement.
In the course of either an asset purchase or share purchase transaction, purchasers will conduct a due diligence investigation to gain a level of comfort about the target business.

The legal portion of this investigation will typically include:

• a review of contracts to which the target business is a party;
• public record searches for registered security on corporate assets;
• a review of any litigation to which the target business is a party, and
• a review of intellectual property owned or used by the business.

Legal due diligence is in addition to a review of the financial and tax position, marketing and operations of the target business, which is generally conducted by the purchaser or its financial advisers. Depending on the nature of the business being acquired, additional due diligence (e.g., environmental) may also be relevant.

In a share purchase transaction, a purchaser should also perform a review of the corporate records of the target corporation to confirm that the purchaser is acquiring all of the shares of the corporation. Minutes of board meetings may also contain discussions concerning corporate strategy, contemplated transactions, potential liabilities and other matters that might affect the target corporation going forward, and therefore may be a valuable source of due diligence information.
The documentation required for an asset purchase transaction and share purchase transaction will be similar in most respects. Each type of transaction will have an acquisition agreement, disclosure schedules and ancillary documents, though an asset purchase will require more ancillary documents as a result of the additional conveyances required for each asset.

**PURCHASE AGREEMENT**

Agreements used to acquire private Canadian businesses follow a similar format to purchase agreements used in the U.S. and elsewhere. The following provisions will normally be included:

**Subject Matter and Consideration**

In an asset purchase, the agreement will describe in detail the assets and liabilities being acquired by the purchaser. A share purchase transaction will list the shares to be acquired. In either case, the agreement will also outline the consideration the seller is receiving and how it is to be paid. A purchase price adjustment based on the working capital and/or debt of the acquired business determined at the closing date is often included.

**Representations and Warranties**

It is customary for a seller to provide extensive representations and warranties regarding the business to be acquired. An agreement will usually provide representations and warranties covering a wide range of matters relating to the business and to the financial information that has been provided by the seller, as well as to the authority and ability of the seller to enter into the agreement. Conversely, a purchaser’s representations and warranties are normally restricted to its authority and ability to enter into and complete the transaction.

**Pre-Closing Covenants**

A purchaser will want to ensure that the target business does not change in a material way between the signing of the agreement and closing. The purchase agreement will therefore require that the target maintain business operations in the normal course, and may restrict specifically enumerated actions.
Other common pre-closing covenants include a requirement for the seller to provide access to the purchaser for due diligence purposes, and to use an agreed upon level of effort to complete the steps necessary to close the transaction.

**Conditions to Closing**
Common conditions include accuracy of representations and warranties, compliance with covenants, obtaining of all required contractual and regulatory consents, and delivery of all closing documentation including an opinion of the seller’s counsel.

**Post-Closing Covenants**
Post-closing covenants may include requirements to maintain confidentiality and agreements as to how tax returns for the business will be prepared and filed.

**Indemnities**
It is common for the seller to indemnify the purchaser for any breach of the seller’s representations and warranties, as well as for certain other specific matters such as claims relating to taxes or environmental matters. Claims for breaches of most representations and warranties are usually limited in time for a one to two year survival period. Claims relating to taxes and environmental matters will survive for a longer period of time and claims relating to fundamental representations and warranties (such as title to the shares or assets being sold) typically survive for an indefinite period. The indemnity is often capped at the purchase price or some lower amount, and a portion of the purchase price is sometimes held back or placed in escrow as security for the indemnity obligations.

**Other Provisions**
Acquisition agreements will also include standard terms such as the law which is to govern the agreement and the mechanics for closing, any purchase price adjustment, and the operation of the indemnity provisions.

**DISCLOSURE SCHEDULES**
Representations and warranties in the purchase agreement will often be qualified by referring to attached disclosure schedules (or sometimes a separate disclosure letter), which contain the specific information or exceptions relating to the representations and warranties.

**ANCILLARY DOCUMENTS**
Conveyancing documents will be necessary to effect the completion of either a share or asset transaction. For a share purchase, the certificates representing the shares being acquired will be delivered together with a share transfer form. For an asset purchase, a general conveyance by which the seller transfers the purchased assets and the purchaser agrees to assume the assumed liabilities is typically used. Other documents will be needed to transfer specific types of assets, such as patent and trade-mark assignment agreements, vehicle transfers and assignments of leases and contracts.

Other common ancillary documents include employment or consulting agreements with key employees, and a transition services agreement (particularly in an asset sale where only part of an operating business is being acquired).
Liabilities Imposed on Purchasers

ASSET ACQUISITIONS

Successor Liability

In Canada, there is no general legal theory under which a purchaser of assets would be found to have assumed successor liability in respect of general liabilities of the target business, for example, on the basis that the purchaser will be operating the business as the successor to the seller or has acquired substantially all of the assets of the seller.

However, there are a number of instances in which liabilities of the target business may follow the assets when acquired by the purchaser, at least to the extent of the value of the assets acquired. To address this contractually, the purchaser can seek indemnities from the seller with respect to any such liabilities, although the value of those indemnities will be dependent on the creditworthiness of the seller.

Bulk Sales Legislation

Most Canadian jurisdictions have repealed their bulk sales or bulk transfer legislation, with the exception of Ontario and Newfoundland and Labrador. This legislation applies to a sale outside of the ordinary course of business of personal property in bulk. Where bulk sales legislation is not complied with, the transaction may be voidable and the purchaser may be liable to account to the creditors of the seller for the value of the purchased property.

To comply with this legislation, the purchaser can either obtain court approval of the transaction or identify the affected creditors and make appropriate arrangements for them to be paid in connection with the completion of the transaction.

In the majority of cases, rather than complying with these requirements, purchasers will obtain from the seller an appropriate indemnity except where the purchaser is concerned about the continued creditworthiness of the seller and cannot protect itself through other means (such as an appropriate holdback or escrow of funds). In those cases, the purchaser may choose to comply with the bulk sales legislation to avoid that risk.
Fraudulent Conveyances
Where the seller is insolvent or it is established that the seller is transferring assets to avoid creditors, the transaction may be challenged under applicable bankruptcy or fraudulent conveyance legislation. Generally, where the purchaser can establish that it paid fair value for the purchased assets, it will have a defence to such an action.

Other Obligations
Where there are unionized employees of the target business, Canadian law will generally require the purchaser to assume existing collective agreements and responsibility for other rights of unionized employees to the extent it is determined to be a successor employer. In Québec, there are Civil Code provisions that could have the effect of making the purchaser responsible for the terms of employment (including credit for length of service) of non-unionized employees as well.

If any interests in real property are being acquired (including leasehold interests), Canadian environmental law may operate to make the purchaser responsible for any prior environmental liabilities associated with the affected real estate.

SHARE TRANSACTIONS
Successor Liability
In a share acquisition, the purchaser effectively acquires all of the liability of the target corporation along with its assets. Any reallocation of that liability back to the seller must be effected through representations, warranties, covenants and indemnities in the share purchase agreement or other transaction documents.
## Consents and Approvals

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<td><strong>Share Transactions</strong></td>
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<td>• If the assets being sold constitute “substantially all” of the seller’s assets, the transaction will require the approval of two-thirds majority of the shareholders of the seller. A transaction may qualify as involving “substantially all” of the assets of a corporation on either a quantitative or qualitative basis.</td>
<td>• The articles of many non-public Canadian corporations contain restrictions on the transfer of their shares (such as board of directors or shareholder approval to transfer) in order to assist the corporation in qualifying for certain exemptions from securities laws. This can easily be determined as part of the purchaser’s legal due diligence, as corporate articles must be filed and are available publicly.</td>
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<td>• Where shareholder approval is required, where there is more than one class of shares and where the proposed sale may affect each class in a different manner, each class may be entitled to vote separately in providing the required approval, even where a particular class of shares is not normally entitled to vote.</td>
<td>• Many private corporations having more than one shareholder will have a shareholders’ agreement in effect, and a purchaser will want to be satisfied (either through appropriate representations and warranties or an opinion from the seller’s counsel) that the agreement has been complied with in effecting the share sale.</td>
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<td>• Shareholders who dissent in connection with the resolution to approve the transaction have remedies available to them, including the right to be paid fair value for their shares from the corporation.</td>
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<td>• Pre-closing review may be required under the <em>Competition Act</em> (see “Other Considerations” on page 16).</td>
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<td>• Depending upon the nature of the assets being acquired, specific regulatory approvals may be required in order for the transaction to proceed. For example:</td>
<td>• Depending upon the nature of the assets held by the target corporation, specific regulatory approvals may be required in order for the transaction to proceed. See the discussion relating to asset transactions on page 10.</td>
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<td>- Government permits or licenses will typically require the consent of the issuing authority for transfer (or the purchaser will be required instead to apply for and obtain its own versions).</td>
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<td>- Ownership of agricultural land is regulated in certain jurisdictions, and consent may be required for its acquisition by an entity resident outside of the jurisdiction.</td>
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<td>- Acquisitions in certain regulated industries (such as communications and broadcasting and certain transportation industries) may entail detailed and elaborate approval processes that can be both time consuming and expensive.</td>
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<td>Contractual Approvals</td>
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<td>• Many contracts prevent a party from assigning the contract without the consent of the other party.</td>
<td>• Contracts entered into by the target corporation may contain terms that trigger a default if a change of control of the target corporation occurs without the consent of the counterparty to the contract.</td>
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<td>• Where the affected contracts are material to the business being acquired, the purchaser may wish to make obtaining consent of the counterparty a condition to completing the transaction.</td>
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PAYMENT
Payment upon closing within Canada is typically made either by certified cheque or by Large Value Transfer System (LVTS) transfer. Certified cheques are generally used for smaller transactions (under $25 million). An LVTS transfer must be used for larger payments, but can be used for any size of transfer. The LVTS is a system of virtually instantaneous, final and irrevocable wire transfers operated under the oversight of the Bank of Canada.

POST-CLOSING CONSIDERATIONS
Many, though not all, jurisdictions in Canada require a minimum number of resident Canadians on the board of directors of corporations incorporated in their jurisdiction (for example, at least 25% of the directors of federal and Ontario corporations must be resident Canadians). Foreign parent corporations that wish to avoid such a requirement may either incorporate their acquisition vehicle or holding corporation in a province that does not have such a requirement or put in place a nominal board that meets the statutory requirements but then remove all of the powers of that board under the terms of a “unanimous shareholder declaration” or “unanimous shareholder agreement” (following which those powers would be exercised by the shareholder(s)).

A newly incorporated Canadian corporation used as an acquisition vehicle will begin to carry on the acquired business immediately upon the closing. A federally incorporated corporation must register in each of the provinces in which it carries on business. Similarly, provincially incorporated corporations must register in each province in which they do business other than the province in which they were incorporated. Registration is a straightforward administrative process. Similar registration requirements would apply if a foreign corporation purchased business assets directly in Canada.

The Canada Business Corporations Act and corresponding provincial and territorial statutes regulate in a general way the types of business records that must be maintained by businesses in Canada, and where they must be maintained. Where records are permitted to be maintained outside the jurisdiction (for example, in the United States), the statutes generally regulate the access that must be maintained to those records within the jurisdiction.
Other Considerations

TAX ISSUES
The structuring of any acquisition is inevitably impacted by a multiplicity of tax issues that arise depending on the nature of the business, as well as the specific circumstances of the parties. Some of these issues include:

• capital gains issues;
• the ability to retain tax loss carry-forwards;
• allocation of the purchase price; and
• residency of the seller.

FOREIGN INVESTMENT
Foreign acquisitions of Canadian businesses are subject to regulation under the Investment Canada Act. Large transactions, transactions involving “cultural” businesses such as book publishing or distribution or any transaction that is potentially injurious to national security, can be reviewed by the government of Canada and, in the extreme, rejected on the basis that the transaction would not represent a “net benefit to Canada.” While most transactions are not reviewable under this Act, those that are may be subject to pre-closing delays as the review process is completed and the purchaser negotiates contractual commitments with the government of Canada in order to satisfy the “net benefit to Canada” standard.

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COMPETITION LAW
Under the Competition Act (Canada), mergers and acquisitions are subject to pre-closing review if they meet certain thresholds. Recent changes have brought greater convergence with the review process that applies in the U.S. under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended.

Where the thresholds are met, the parties must submit a pre-merger notification filing. The notification triggers a 30-day waiting period during which the transaction may not be completed. In cases that raise potentially significant competition issues, a “supplementary information request” (SIR) may be issued by the Canadian competition regulatory authorities prior to expiry of that waiting period, which extends the waiting period for a further period of 30 days following full compliance with the SIR. Expiry of the applicable waiting period constitutes competition law clearance, although the Canadian competition regulatory authorities have a residual power to challenge an acquisition for up to one year following closing.

EMPLOYMENT MATTERS
Implications relating to employees that must be considered in any acquisition include:

• employment contracts;
• non-competition agreements;
• privacy matters;
• collective bargaining agreements;
• workers’ compensation programs; and
• pension plans.
How We Can Help

Mergers and acquisitions transactions, whether large or small, have inherent complexities that need to be clearly understood and properly addressed. Experienced legal counsel is essential on all M&A transactions and for all clients, ranging from local start-ups to global conglomerates.

With decades of experience advising successfully on M&A transactions, Osler can be trusted to provide clients with the right level of legal advice required to lead a successful deal, for several reasons:

Involvement in High Volume and Range of Transactions
We are effective at advising on and staffing all types and sizes of transactions, whether for domestic, cross-border or multi-national companies. We have designed and implemented innovative legal structures that have revolutionized the M&A landscape and continue to provide valuable solutions to our clients.

Breadth and Depth of Related Expertise
Our leading M&A practitioners are complemented by top-ranked expertise in tax, competition/antitrust, securities/regulatory, banking & financial services, litigation, pensions, employment/executive compensation and all other specialized areas that are key to effecting a successful M&A transaction. Taxation, for instance, is integral to accomplishing strategic M&A initiatives and no other Canadian law firm has been so consistently recognized for the excellence of its tax practice.

Client Focus
We understand the business imperative behind a transaction and the business environments in which our clients operate. Our “client first” approach pervades every aspect of our firm culture and we bring that approach to the way we structure and negotiate a deal, mitigate risk and staff and efficiently manage files.

U.S./Cross-Border Legal Services
We offer seamless legal services north and south of the border. Our Canadian and New York offices are regularly involved in complex, multi-jurisdictional M&A transactions, providing strategic, innovative advice. Our distinct cross-border orientation enables us to represent U.S. companies doing business in Canada as well as Canadian companies expanding their businesses to the south.

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