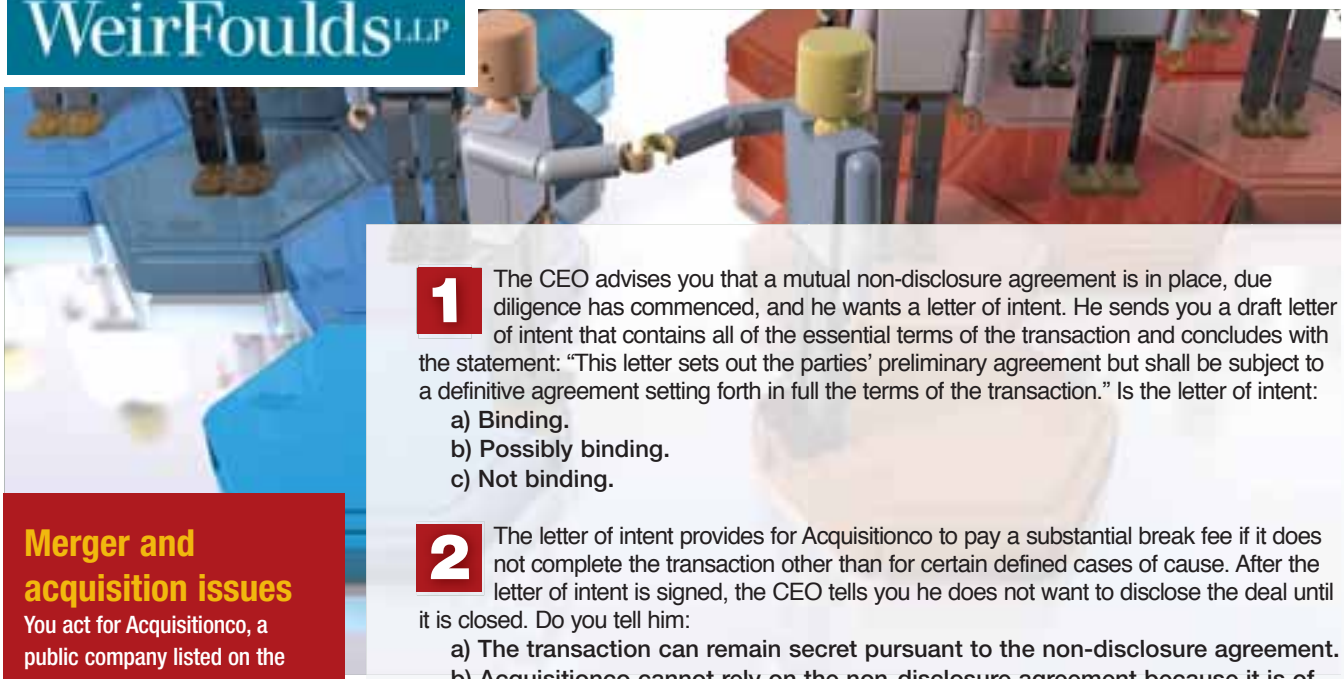
WeirFoulds LLP



Merger and acquisition issues

You act for Acquisitionco, a public company listed on the TSX that manufactures coating plants for photovoltaic solar cells. It wants to buy Targetco, a privately owned Business Corporations Act company located in Peterborough, Ont. Targetco engineers certain components of the production lines Acquisitionco uses in its plants. Since this would be a very significant transaction for Acquisitionco, it wants to "strike while the iron is hot." The CEO of Acquisitionco contacts you to get going on the deal.

1 The CEO advises you that a mutual non-disclosure agreement is in place, due diligence has commenced, and he wants a letter of intent. He sends you a draft letter of intent that contains all of the essential terms of the transaction and concludes with the statement: "This letter sets out the parties' preliminary agreement but shall be subject to a definitive agreement setting forth in full the terms of the transaction." Is the letter of intent:

a) Binding.
b) Possibly binding.
c) Not binding.

2 The letter of intent provides for Acquisitionco to pay a substantial break fee if it does not complete the transaction other than for certain defined cases of cause. After the letter of intent is signed, the CEO tells you he does not want to disclose the deal until it is closed. Do you tell him:

a) The transaction can remain secret pursuant to the non-disclosure agreement.
b) Acquisitionco cannot rely on the non-disclosure agreement because it is of no effect since the letter of intent was signed.
c) Something else.

3 The letter of intent provides that the parties shall "finalize a mutually acceptable structure either as a purchase of all of the shares of Targetco or as the purchase of assets and assumption of certain liabilities of Targetco." Acquisitionco would like to purchase assets. Among other reasons, Targetco owes a lot of money to former suppliers, some of whom are threatening to commence collections proceedings. Targetco has not paid such suppliers because it does not have the cash to do so, and because it has found alternative suppliers with cheaper products. Acquisitionco would prefer just to buy the assets that it wants and leave Targetco to deal with the debts owing to its former suppliers. Is there any issue with that?

a) Yes.
b) No.

4 Acquisitionco confirms that it will proceed with a share purchase. When you advise Targetco's counsel about this, she advises you that years ago Targetco issued a small number of shares to employees who have since left the company and are so hostile to management that they refuse to co-operate in the sale of their shares. Furthermore, there is no agreement that provides for an effective drag-along right to require recalcitrant shareholders to sell. Acquisitionco is only interested in buying 100 per cent of Targetco and does not want any minority shareholders. What do you advise Acquisitionco?

a) Reconsider an asset purchase since there is no way to force uncooperative shareholders to sell their shares.
b) As long as it can acquire at least 90 per cent of the issued shares of Targetco, it can rely on the compulsory sale provisions contained in the OBCA to force uncooperative shareholders to sell their shares.
c) Other.

5 The closing date is approaching and counsel to the sellers has not sent you a draft of the legal opinion that you requested. You follow up with a junior associate who has been working on the deal on the other side and are told the lead counsel is unreachable and has left instructions for the associate to do whatever is necessary to close the deal. The associate confesses that he is not familiar with legal opinions but he has a copy of your opinion request and will put in on his firm's letterhead, sign it, and send it to you for closing. What do you do?

a) Agree to the arrangement, close the deal, and accept the opinion.
b) Hang up and report the lead counsel to the Law Society of Upper Canada.
c) Something in between.

QUIZ ANSWERS

1 (B)

It may be fully binding. In Wallace v. Allen, the Ontario Court of Appeal examined a letter of intent that stated it "must be reduced into a binding agreement of purchase and sale by the parties within the next 40 days," as well as the parties' conduct surrounding the subject transaction and concluded that the parties' intent was for the letter of intent to be binding. Accordingly, Acquisitionco's letter of intent is potentially a legally binding agreement and should be redrafted to clearly reflect the parties' intentions.

2 (C)

Since Acquisitionco is a public company listed on the TSX, it is subject to disclosure obligations under the policies of the TSX and applicable securities laws. You must determine whether entering into the letter of intent constitutes a material fact that is required to be disclosed pursuant to applicable securities laws. In this case, the significance of the transaction to Acquisitionco and the size of the break fee favour the determination that the transaction is a material transaction of Acquisitionco that requires its disclosure. The non-disclosure agreement, if properly drafted, should provide for exceptions permitting Acquisitionco to make such disclosures as are required by law.

3 YES

You should advise Acquisitionco of the requirements of the Ontario Bulk Sales Act. This legislation is designed largely to protect unsecured creditors when a business is sold. To comply, Acquisitionco would have to receive from Targetco a statement showing all of its trade creditors and must then ensure that such creditors are paid or must pay the purchase price to a trustee if a certain percentage of such creditors agree. After the closing, Acquisitionco would have to file an affidavit with the court evidencing such compliance. If Acquisitionco does not do that, then if Targetco's trade creditors are not paid, Acquisitionco may have to account to them for the value of the assets purchased. Unless a creditworthy indemnity is available, Acquisitionco would run quite a risk if it bought Targetco's assets without complying with the Bulk Sales Act.

4 (C)

You might well reconsider the asset sale option, but there may be other options. It may be possible to structure the acquisition in such a way to "squeeze out" the recalcitrant shareholders through a court-ordered arrangement or through a post-closing amalgamation in which the shares of the recalcitrant shareholders are converted into fixed-value redeemable shares that are redeemed immediately following the amalgamation. Under the OBCA, such a transaction would result in the squeezed shareholders having dissent rights. The compulsory sale provisions contained in Part XV of the OBCA are only available where the target is an offering corporation.

5 (C)

Something in between is the best course. Some important factors come into play here. On the one hand, your client is eager for the deal to close and definitely does not want a delay due to issues regarding legal opinions. On the other hand, there are issues of professional ethics and basic integrity that are engaged such as the requirement of solicitor competence and honest dealing. An opinion accepted from a solicitor who you know is not competent to give one is of no value to you. You should ask the associate to obtain the assistance of a senior colleague with expertise in share purchases and transaction opinions. If he doesn't, it would be appropriate for you to contact a senior member of the associate's firm to require that the transaction be appropriately staffed.

YOUR RANKING?

- **One or less correct:** *might be time to brush up*
- **Two or Three correct:** *not bad, but some further work needed*
- **Four correct:** *very well done, but not perfect*
- **Five correct:** *impressive*