Absorptive Mergers Gain a Foothold in Canadian Plans of Arrangement

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While they are commonplace in U.S. M&A, "absorptive" mergers have only recently begun to make inroads in Canada as a mechanism to manage tax and regulatory considerations and risks associated with statutory plans of arrangement.

- In an absorptive merger, instead of two entities merging (or amalgamating) to form a new and separate merged entity, one of the two absorbs the other and continues on as the same entity, albeit now merged with the other.
- This type of merger therefore differs from the "confluence of two streams" concept in Canadian law as set out by the Supreme Court of Canada in *R. v Black & Decker Manufacturing Co.*
- While expressly contemplated by the laws of various U.S. states, including Delaware, absorptive mergers are not expressly permitted by either the *Canada Business Corporations Act* ("CBCA") or the Alberta *Business Corporations Act* ("ABCA"), as each contemplates only the "merger of entities" approach articulated by Justice Dickson in *Black & Decker*.
- In spite of the lack of express recognition in the CBCA and ABCA (and other similar provincial legislation), several cases in recent years – including two recent Alberta decisions – have permitted absorptive mergers to proceed in the context of statutory plans of arrangement.

Existing Case Law

Absorptive mergers appear to have been considered by a Canadian court for the first time by the Ontario Superior Court in *In the Matter of Section 192 of the Canada Business Corporations Act, and In the Matter of Proposed Arrangement involving Fairmont Hotels and Resorts* (2006). In that decision, Justice Farley held that notwithstanding the fact that such mergers were not expressly contemplated by the CBCA, the provisions of section 192 of the CBCA dealing with statutory plans of arrangement were broad and expansive enough to encompass an absorptive merger as a valid and approvable component of such plans of arrangement.

Recently in unreported Alberta decisions, Justice Romaine in the *Baytex/Raging River* case and Justice Nixon in the *Xtreme Drilling/Akita Drilling* case each held that an absorptive merger is permitted under the provisions of section 193 of the ABCA. It is worth noting that section 193 of the ABCA is arguably more expansive than section 192 of the CBCA in its definition of an "arrangement", as held by Chief Justice Wittmann in *Enbridge Income Fund Holdings Inc., Re*.

Absorptive Mergers: Going Forward

Although widespread use of absorptive mergers has not yet occurred in Canadian plans of arrangement, it is expected that absorptive mergers will continue to rise in popularity as merger partners seek out beneficial tax and regulatory outcomes that can be facilitated by these types of mergers. For instance, the Canada Revenue Agency has recognized that absorptive mergers may qualify as amalgamations for purposes of the *Income Tax Act*, offering potential U.S. tax benefits, including as a result of being characterized as a tax-deferred reorganization.

From the perspective of obtaining approval of plans of arrangement which contain absorptive merger steps, each case of course turns on its particular facts. Alberta courts have considered these mergers both in a separate application brought by the merger parties seeking section 193 approval and within the purview of the usual application for final approval brought by the arranged entity. Based on recent experience, it appears that the Alberta court (and arguably the court in Ontario) have developed an understanding of the issues surrounding such mergers and a comfort level with transactions involving them, presuming of course that an applicant satisfies the statutory provisions of the CBCA, ABCA or other governing business corporations legislation as well as the legal test outlined in *BCE Inc. v. 1976 Debentureholders*.