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Whopper of a Deal with a Double-Double Take on the Canadian Exchangeable Share Structure

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The most talked about Canadian deal of 2014 was Burger King's acquisition of Tim Hortons. This deal made headlines because of its size, its iconic players and the mark that the combined Canadian company, Restaurant Brands International (now commonly referred to by its ticker symbol QSR), would make in the global quick-service restaurant industry. Much of the buzz centred on the complexity and novelty of the structure. To make the structure work, the Burger King deal team reinvented the conventional exchangeable share structure.

The Exchangeable "Up-C" Combo: A Fresh Look at the Traditional Canadian Structure

Under the merger agreement, Burger King's stockholders could elect to exchange their stock for exchangeable units of Restaurant Brands International Partnership (Partnership), a publicly traded Canadian Partnership, rather than taking common shares of QSR, its public parent. Exchanging their stock for Partnership units afforded these holders a tax deferral of U.S. capital gains they would have otherwise triggered in exchanging stock for QSR shares. A similar tax deferral is achieved by Canadian shareholders in a conventional exchangeable share structure. However, in this case, it was the U.S., not the Canadian, shareholders who required a rollover.

To accomplish the rollover, the QSR structure combined elements of a conventional Canadian exchangeable share structure with a U.S. Up-C structure – a structure that has been used frequently in the United States, in the initial public offering of companies that have historically operated as partnerships or LLCs. In the Up-C structure, a new corporation that issues shares to the public is created above the partnership and controls the partnership. The historical owners retain their partnership interests and receive special voting shares in the public corporation, which gives them voting control proportionate to their economic interest in the partnership. By preserving the partnership under the public corporation, income can continue to be passed through to the historical partners and taxed directly to the partners. Corporate tax at the public corporation level is limited to the corporation's proportionate interest in the partnership.

Consistent with a conventional Canadian structure, an exchangeable unit of the Partnership affords its holders voting rights equivalent to those they would have had holding a QSR common share. Such voting rights are achieved through a special voting share of QSR (held by a trustee) and a voting trust agreement. The exchangeable units are also entitled to distributions from the Partnership in an amount equal to, and at the same time as, dividends and other distributions declared on QSR common shares.

However, there are some differences in the economic rights of exchangeable units and QSR common shares that are not present in a conventional exchangeable structure. Some of these differences are a function of U.S. tax law imperatives that are reflected in the U.S. Up-C structure.

The following are the key differences:

- While a typical Canadian exchangeable share issuer is a "shell" company, the Partnership is instead a direct subsidiary of QSR, indirectly holding all the assets and business of the consolidated enterprise.
- In a Canadian structure, the exchangeable share is immediately exchangeable for common shares; here the exchange right is not exercisable during the first year.
- Unlike a Canadian exchangeable share, the exchangeable units are not automatically exchangeable for QSR shares upon a dissolution or winding up of the Partnership or QSR.

- QSR has the ability to settle the exchangeable units in cash instead of in QSR shares.

Thinking Outside the Box

As a result of these differences, a considered approach was therefore needed to impose structural limits on the potential for meaningful economic differences between an exchangeable unit and the QSR shares and provide exchangeable unit holders with economic rights that were substantially equivalent to those afforded to holders of QSR common shares. Central to this approach were distribution features that guard against disproportionate assets or liabilities at QSR relative to the Partnership, such as the requirement that QSR contribute its net proceeds from any equity issuance to the Partnership. In addition, the Partnership is permitted to make distributions to QSR for only two purposes: to fund distributions on the QSR common shares (for which the Partnership will make equivalent distributions on the exchangeable units) and the QSR preferred shares and to fund QSR expenses incurred to manage the Partnership and its businesses. Further, on any dissolution of the Partnership, those QSR expenses would be funded prior to any common equity distributions at the Partnership or QSR.

In addition to these structural limits, the QSR structure also improves on the conventional exchangeable share structure in several ways. For example, it confers contractually on exchangeable unit holders a number of the additional statutory rights they would have had as a QSR shareholder that are missing in a conventional structure. Such statutory rights complement a shareholder's voting rights, such as the right to call a shareholders' meeting, make a shareholder proposal or request a shareholders list.

Getting Novel Regulatory Relief

Under section 13.3 of National Instrument 51-102, typical exchangeable issuers are afforded exemptions from most of their continuous disclosure and reporting obligations under Canadian securities law on the basis that the reports filed by their parent companies provide sufficient disclosure. However, these exemptions are premised on a conventional exchangeable structure in which the exchangeable security provides its holder with "economic and voting rights which are, as nearly as possible except for tax implications, equivalent to the underlying securities". As a result of the differences noted above, the Partnership did not qualify for these exemptions. In order to obtain equivalent relief, it was necessary to demonstrate to Commission staff that, due to the aforementioned structural limits, the consolidated financial positions of the Partnership and QSR will remain identical in all material respects, and QSR will not have any business other than through its interest in the Partnership.

In the course of the application process, the regulators raised numerous novel issues such as whether both the QSR common shares and the exchangeable units should have "coattail provisions"; whether the issuance of voting preferred shares by QSR would result in the QSR common shares being characterized as "restricted securities"; and whether coattail provisions should attach to the QSR common shares and the Partnership's exchangeable units in the event of an acquisition of the voting preferred shares. Although all these issues were ultimately resolved, as reflected in the decision granted on October 31, 2014 (a copy of which can be viewed in the [OSC Bulletin \(Volume 37, Issue 46\)](#)), the next issuer to come to market with exchangeable shares, conventional or otherwise, or voting preferred shares can expect to confront the same issues.

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