CPTS Annual Conference - June 6, 2023

Recent Transactions of Interest

Dan Jankovic, Partner, Blake, Cassels & Graydon LLP

Dion Legge, Partner, Norton Rose Fulbright Canada LLP

Outline

- Introduction
- Recent transactions of interest
  - Teck Resources Limited proposed spin-off of steelmaking coal assets
  - Enerflex Ltd. acquisition of Exterran Corporation
- Questions / Comments

Introduction

- Discussion of Teck spin-off and Enerflex acquisition is based on publicly available information – including the relevant information circulars and annual information forms from both issuers.
- In certain respects some of our comments on the Teck proposed spin-off are speculative given then neither Norton Rose Fulbright nor Blakes provided tax advice in connection with that proposed transaction.
- We also made certain assumptions on the corporate structure based on publicly available information.
- Our comments are not intended to be exhaustive of all of the relevant steps in the proposed transactions or all of the potential tax implications; rather we intend to discuss select steps and select tax issues.

Teck Resources Limited

Proposed Spin-off of Steelmaking Coal Business

Defined Terms

Abbreviation	Party
EMLP	Elkview Mine Limited Partnership, which owns the Elkview coal project
EVR	Elk Valley Resources Ltd.
NSC	NS Canadian Resources Inc., an affiliate of Nippon Steel Corporation
POSCAN	POSCP Canada Limited, an affiliate of POSCO
TCP	Teck Coal Partnership
TCL	Teck Coal Limited
Teck	Teck Resources Limited, which was to be renamed Teck Metals Corp. upon completion of the proposed transactions
6069789 Canada	6069789 Canada Inc.

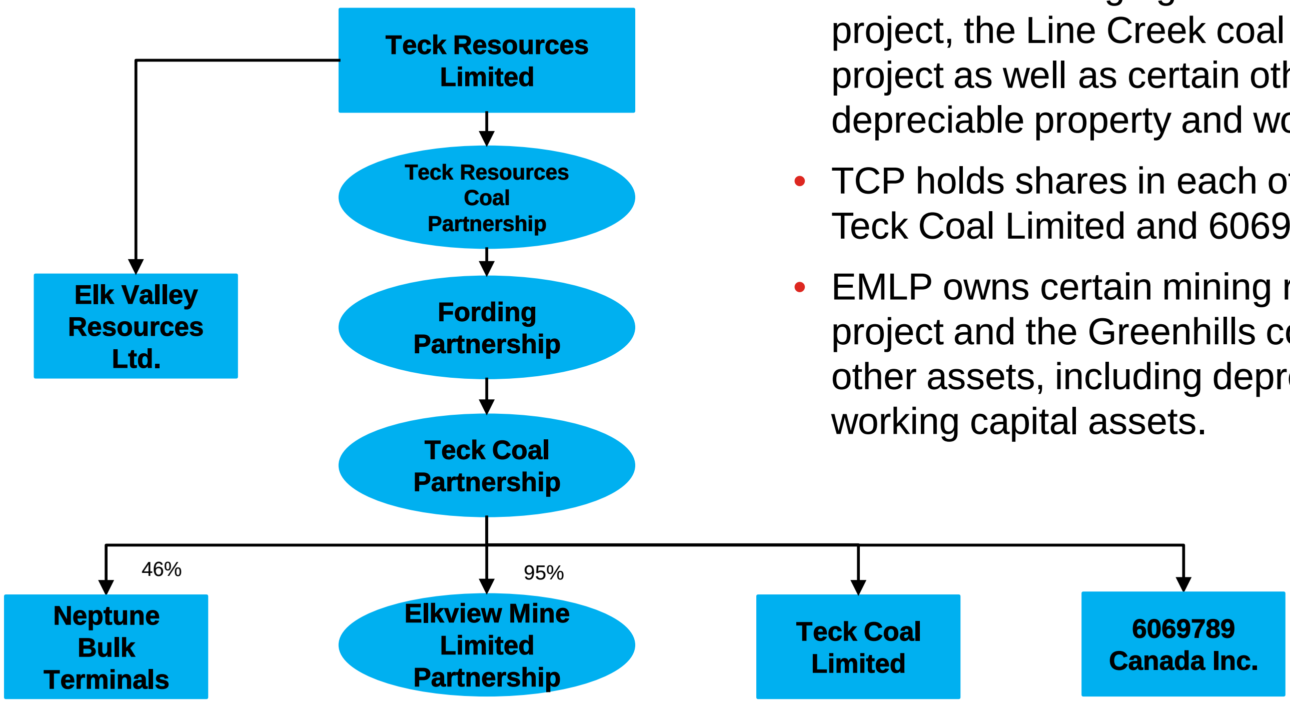
Timeline for proposed separation

- **February 21, 2023**
  - Teck announced a proposal to reorganize its business into two separate companies to be known as Teck Metals and Elk Valley Resources and to spin off the steelmaking coal business to shareholders
  - Teck Metals was intended to be a growth-oriented producer of energy transition metals
  - Elk Valley Resources was intended to be a pure-play, high-margin steelmaking coal producer
  - Teck Metals was to retain approximately 90% of the steelmaking coal cash flows for a transition period that was expected to be approximately 5.5 years
  - Retained cash flow was to be used by Teck to fund copper growth
- **April 13, 2023**
  - Teck announced an amendment to the terms of the separation to reduce the time period for the retention of steelmaking coal cash flows from approximately 5.5 years to 3 years
- **April 26, 2023**
  - Teck withdrew separation proposal

Transactions with NCS and POSCAN

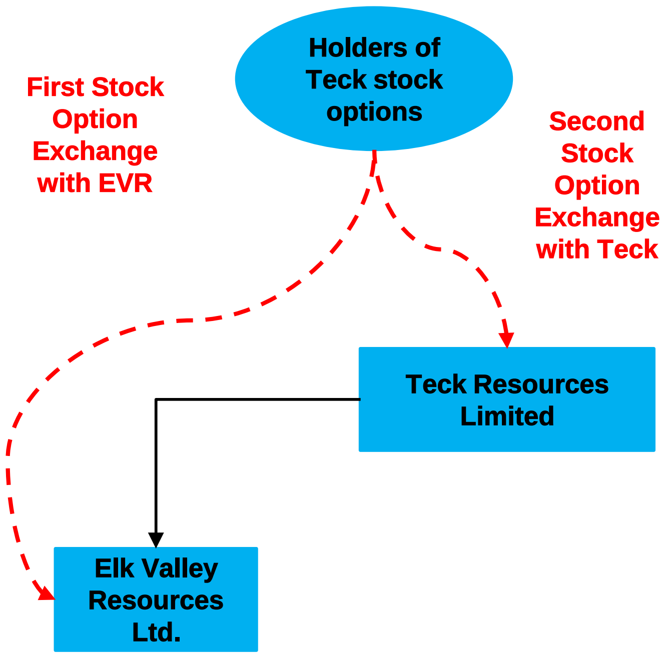
- **NSC**
  - NSC owned a 2.5% limited partner interest in EMLP
  - NSC agreed to transfer its indirect interest in the Elkview coal project in exchange for common shares and preferred shares of EVR
  - NSC also agreed to acquire an interest in the EVR royalty (described below) and to subscribe for preferred shares of EVR for approximately $1 billion in aggregate
- **POSCAN**
  - POSCAN also owned a 2.5% limited partner interest in EMLP and also held a 20% interest in the Greenhills coal project
  - POSCAN agreed to transfer indirect interest in the Elkview coal project and its interest in the Greenhills coal project to Teck in exchange for 2.5% of the common shares of EVR and a 2.5% interest in the cash flow to be received by Teck from EVR
- Publicly available materials do not indicate how those transactions were structured or the Teck entities involved in those transactions

Anticipated Partial Pre-Transaction Corporate Structure for Steelmaking Coal Assets



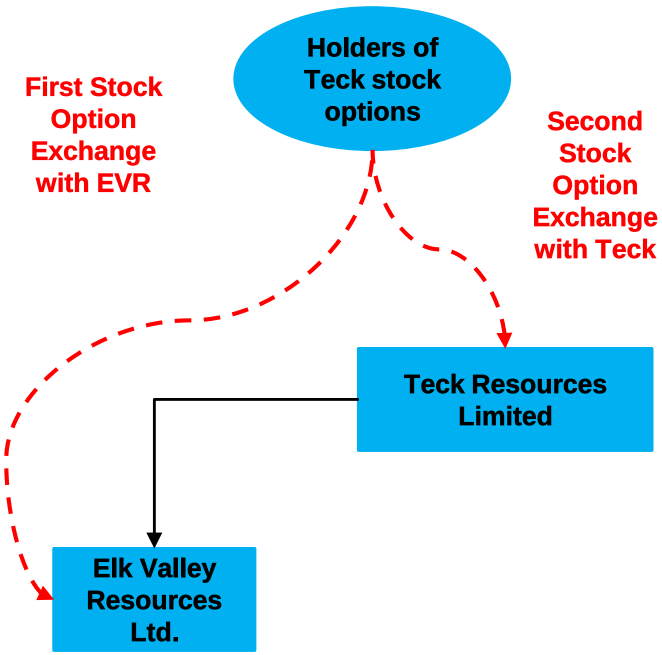
- TCP holds mining rights in the Fording River coal project, the Line Creek coal project and the Greenhills project as well as certain other assets, including depreciable property and working capital assets.
- TCP holds shares in each of Neptune Bulk Terminals, Teck Coal Limited and 6069789 Canada.
- EMLP owns certain mining rights on the Elkview coal project and the Greenhills coal project as well as certain other assets, including depreciable property and working capital assets.

Select Plan of Arrangement Steps – Option Exchanges



- Holders of Teck stock options transfer a portion of their existing Teck stock options to EVR for new EVR stock options issued by EVR to the optionholder.
  - Under the new EVR options, the optionholder has a right to acquire 1 common share of EVR for every 10 Class B shares of Teck underlying the Teck stock option.
  - Exercise price of the new EVR options was pro-rated based on exercise price of Teck options.
- Following the option exchange, a portion of the remaining Teck stock options is exchanged for new repriced Teck stock options.
  - New Teck options were repriced to reflect the expected reduced fair market value of a Teck share following completion of the separation.
- Commercial result is that Teck optionholders were to receive EVR stock options and re-priced Teck options.

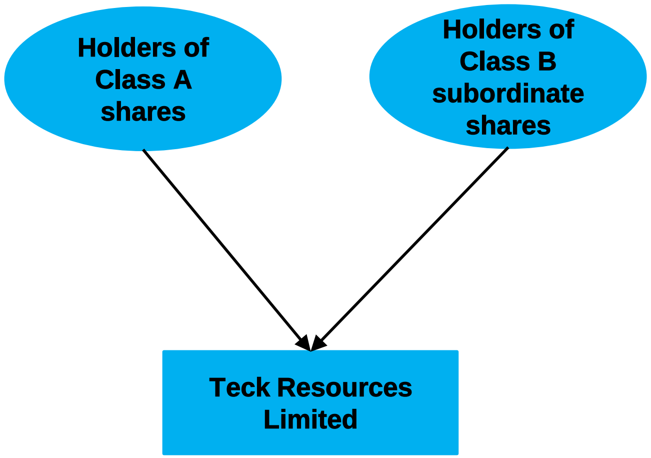
Select Plan of Arrangement Steps – Option Exchanges (continued)



<u>Select Canada Tax Comments</u>

- Both option exchanges appear to have been structured to comply with subsection 7(1.4) such that the option exchanges were tax-deferred for Canadian income tax purposes and the right to the paragraph 110(1)(d) deduction was maintained.
- In particular:
  - The first option exchange occurred when EVR and Teck were non-arm's length for tax purposes.
  - No consideration other than new options was received by the optionholders.
  - The arrangement steps were structured to ensure the aggregate "in-the-money amount" of the new EVR options and new Teck options was not greater than the aggregate "in-the-money amount" of the old Teck options.

Select Plan of Arrangement Steps – Stated Capital Equalization



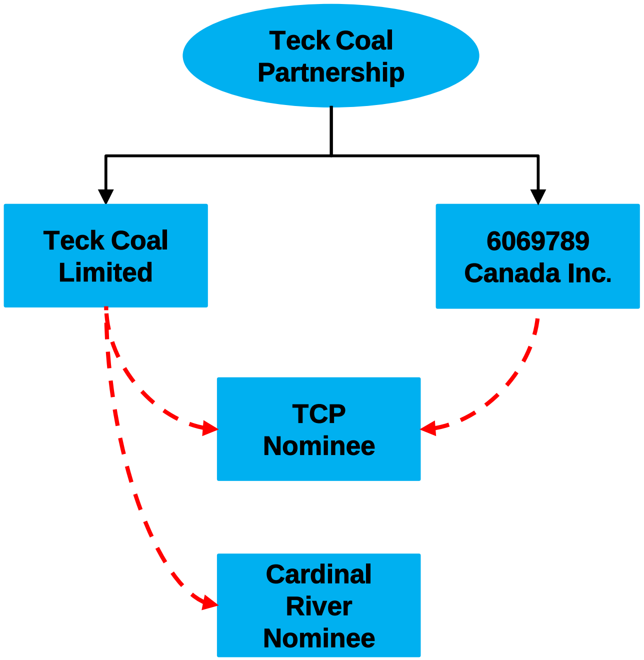
Stated Capital Equalization

- Stated capital of the Teck Class A Shares is increased by an amount equal to the "Stated Capital Equalization Amount".
- Stated capital of the Teck Class B Subordinate Voting Shares is decreased by the same amount.
- Essentially a shift of stated capital (and paid-up capital) from the Class B Subordinate Voting Shares (held by the public) to the Class A Shares.

Select Canada Tax Comments

- Should not be any Canadian tax consequences to holders of Class B Subordinate Voting Shares.
- Presumably it was expected that paragraph 84(1)(c) would be applicable to prevent a deemed dividend to the holders of Class A Shares.

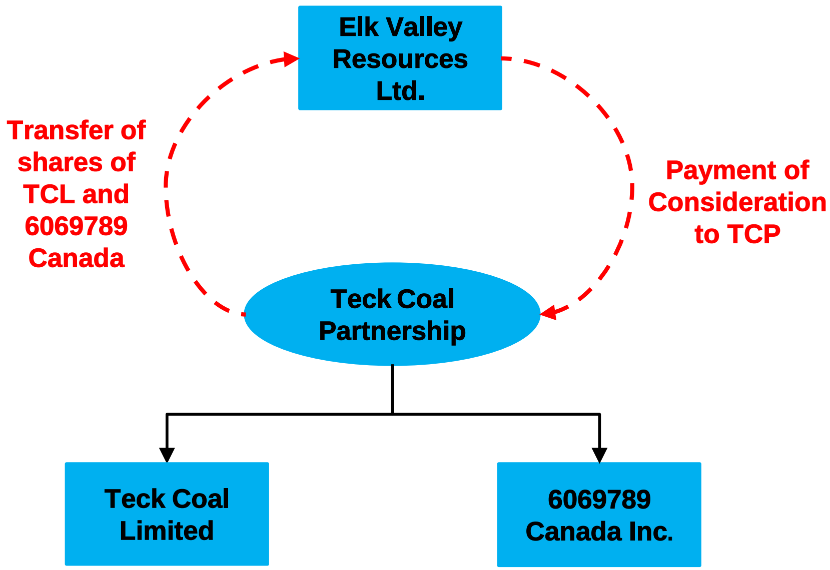
Select Plan of Arrangement Steps – Excluded Assets and Excluded Liabilities



Carve out of Excluded Assets and Excluded Liabilities

- TCL and 6069789 Canada each transfer and assign to the New TCP Nominee certain excluded assets not related to the Cardinal River Property paid by assumption of excluded liabilities.
- TCL transfers the Cardinal River Property to the Cardinal River Nominee in exchange for the assumption of liabilities associated with the Cardinal River Property.
- Presumably these are taxable dispositions, resulting in income/gain/loss to TCL and 6069789 Canada and/or reduction of tax attributes (UCC and CDE) equal to the fair market value of the various assets transferred.
- In particular, it appears that Cardinal River Property is a historic coal mine which is on care and maintenance so may not have material fair market value.

Select Plan of Arrangement Steps – Share Transfer by TCP



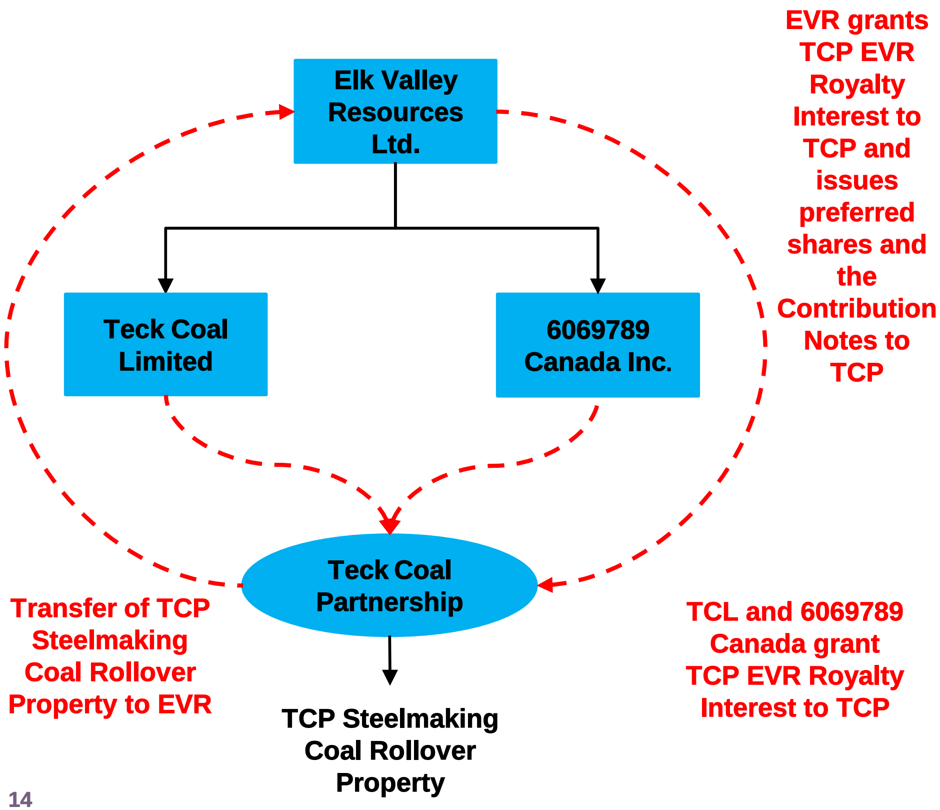
Share Transfer by TCP

- TCP transfers and assigns the shares of TCL and 6069789 Canada to EVR.
- Plan of arrangement does not indicate the consideration that would have been paid by EVR for these shares or whether a section 85 election was expected to be filed.
- Presumably consideration was to be described in the proposed Separation Agreement, which was to be finalized closer to implementation of the transaction.

Select Canadian Income Tax Comments

- We assume this was expected to be a taxable disposition by TCP, thereby giving rise to gain (loss) to the extent the fair market value of the transferred shares exceeded (was less than) their adjusted cost base.

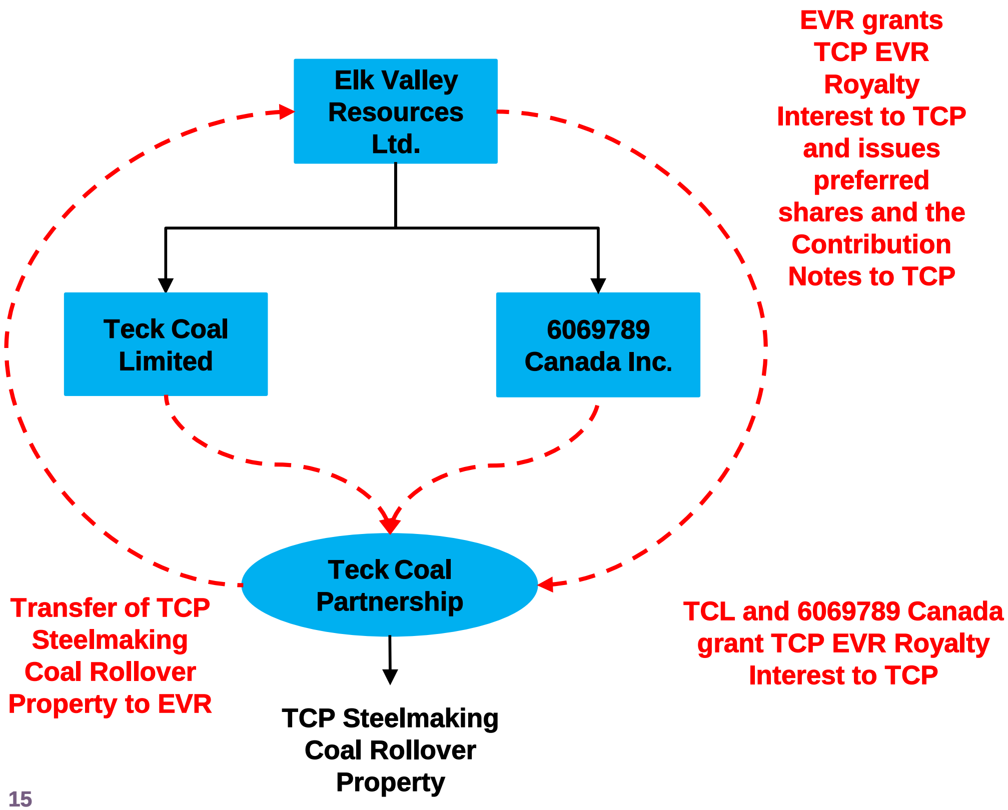
Select Plan of Arrangement Steps – First Transfer by TCP



First Transfer by TCP

- TCP transfers to EVR certain property that is eligible property under subsection 85(1.1) of the Tax Act (referred to as the "**TCP Steelmaking Coal Rollover Property**") in consideration for:
  - EVR, TCL and 6069789 Canada granting a royalty to TCP referred to as the TCP EVR Royalty Interest;
  - the issuance by EVR of preferred shares to TCP;
  - the issuance by EVR of promissory notes to TCP (referred to as the "**Contribution Notes**"); and
  - the assumption by EVR of a portion of the liabilities of TCP.
- We assume the TCP Steelmaking Coal Rollover Property included the shares of Neptune Bulk Terminals as well as TCP's interest in the Fording River coal project, the Line Creek coal project and the Greenhills project.

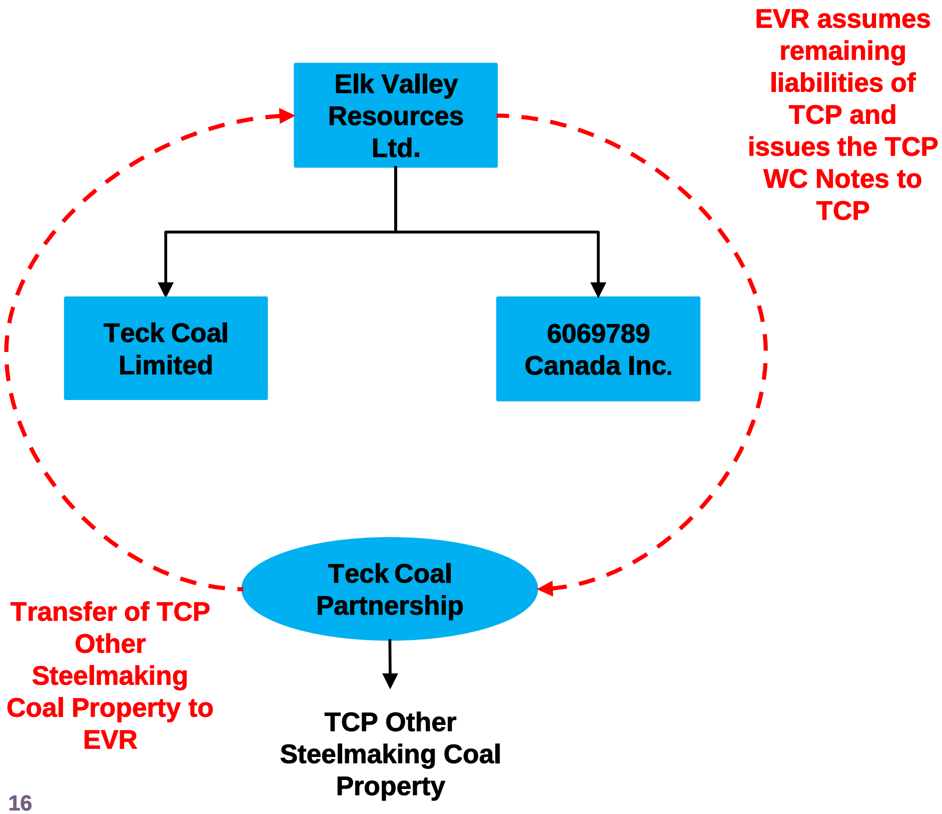
Select Plan of Arrangement Steps – First Transfer by TCP (continued)



<u>Select Canadian Income Tax Comments</u>

- An election under subsection 85(2) of the Tax Act was contemplated so that the transfer would have been tax-deferred to TCP to the extent the tax cost of the transferred assets did not exceed the non-share consideration.
- Expected tax advisor to Teck to consider issues relating to tax pool reductions/additions (i.e., CDE/UCC) for the disposition and acquisition of mining rights/properties and depreciable property.
- Similarly, assuming the underlying coal properties and the TCP EVR Royalty Interest were Canadian resource properties, the grant of the TCP EVR Royalty Interest may have given rise to CDE reductions and additions.
- Not clear from the plan of arrangement whether TCL and 6069789 Canada received some form of consideration from EVR for granting the TCP EVR Royalty Interest to TCP.

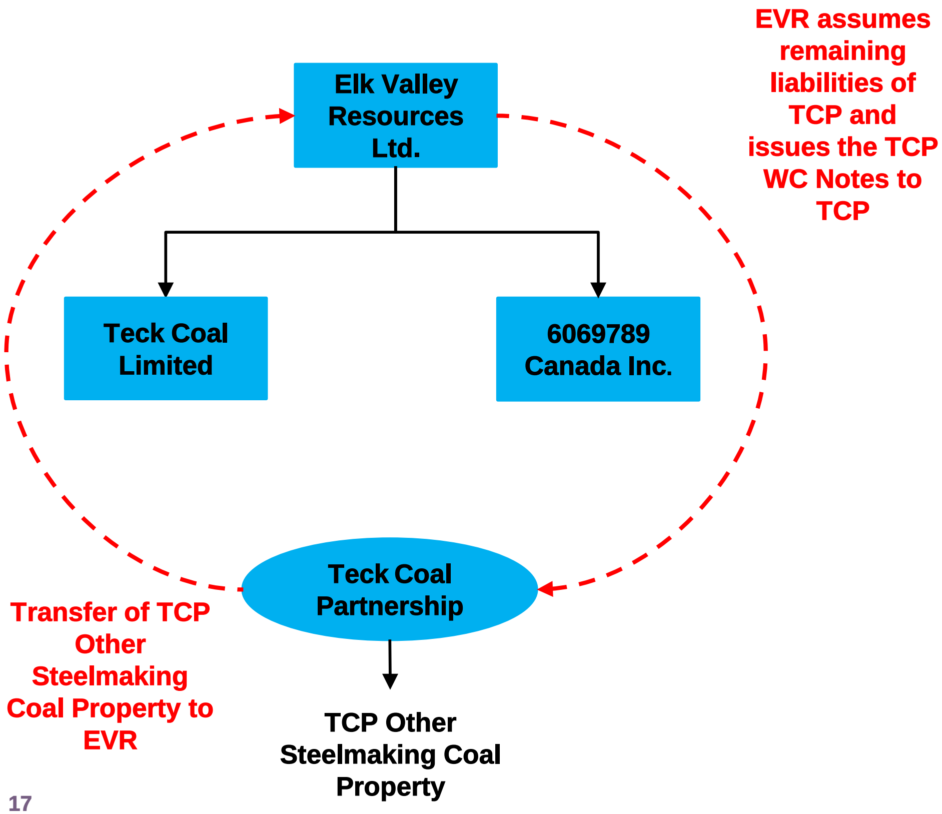
Select Plan of Arrangement Steps – Second Transfer by TCP



<u>Second Transfer by TCP</u>

- TCP transfers certain property that is not eligible property under subsection 85(1.1) of the Tax Act (referred to as the "**TCP Other Steelmaking Coal Property**") in consideration for:
  - the assumption by EVR of the remaining liabilities of TCP; and
  - if required, the issuance by EVR to TCP of promissory notes (referred to as the "**TCP WC Notes**").

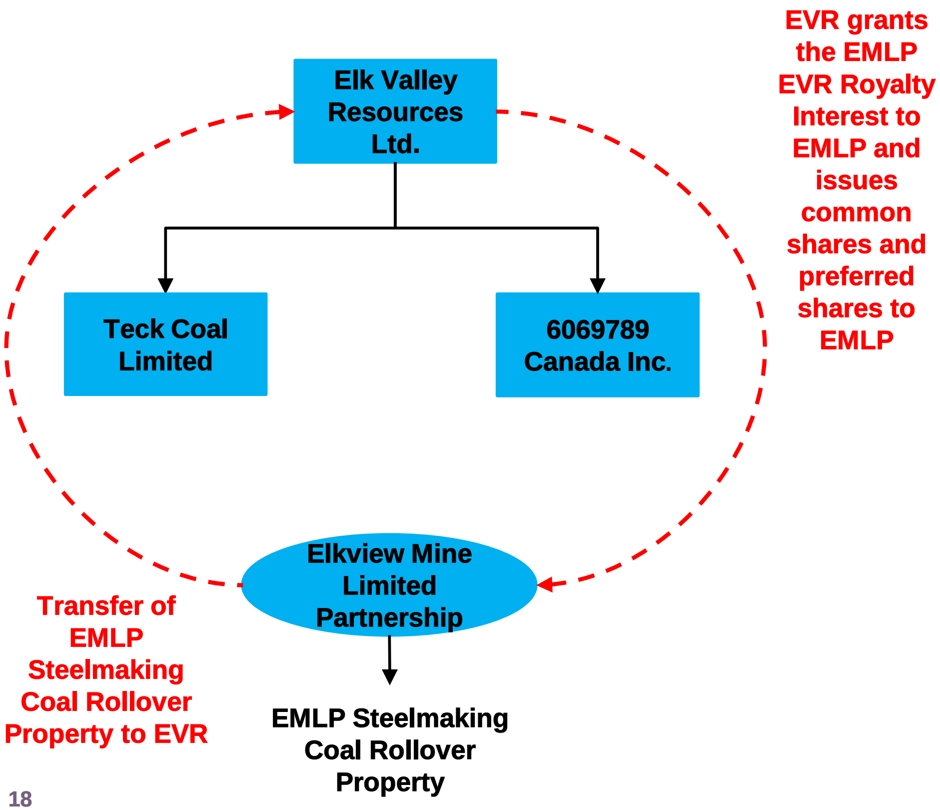
Select Plan of Arrangement Steps – Second Transfer by TCP (continued)



Select Canadian Income Tax Comments

- Fully taxable disposition to TCP but presumably no material gain/loss would have been realized due to the nature of the assets.

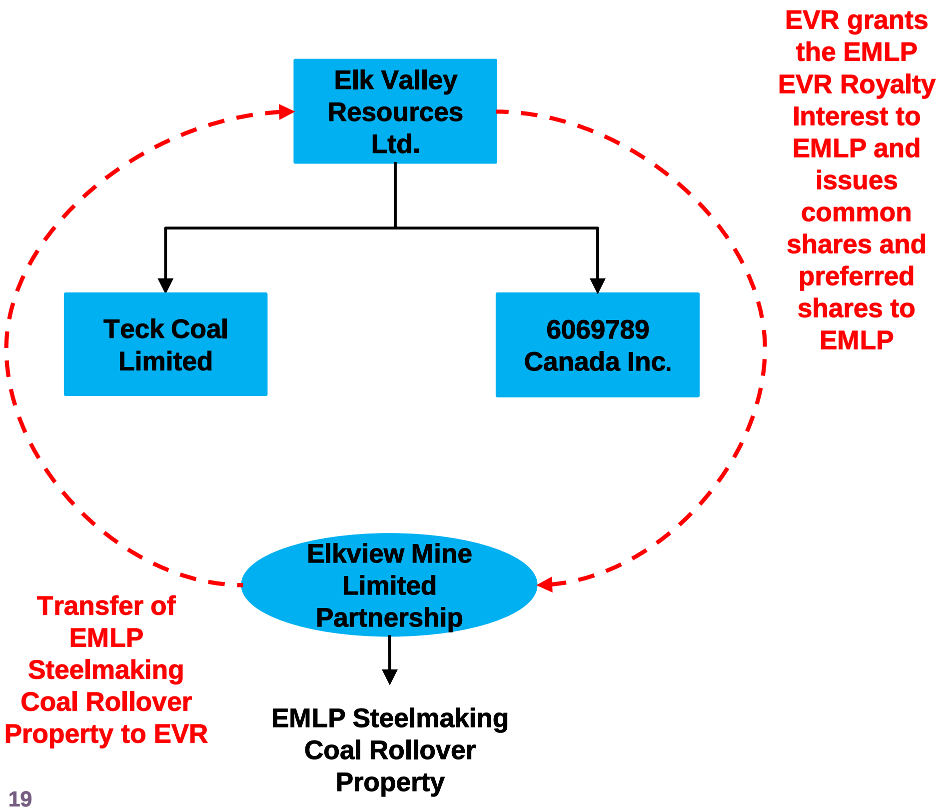
Select Plan of Arrangement Steps – First Transfer by EMLP



First Transfer by EMLP

- EMLP transfers to EVR certain property that is eligible property under subsection 85(1.1) of the Tax Act (referred to as the "**EMLP Steelmaking Coal Rollover Property**") in consideration for:
  - EVR granting a royalty to EMLP referred to as the EMLP EVR Royalty Interest;
  - the issuance by EVR of common shares and preferred shares to EMLP; and
  - the assumption by EVR of a portion of the liabilities of EMLP.
- We assume that the EMLP Steelmaking Coal Rollover Property included EMLP's interest in the Elkview coal project and the Greenhills coal project.

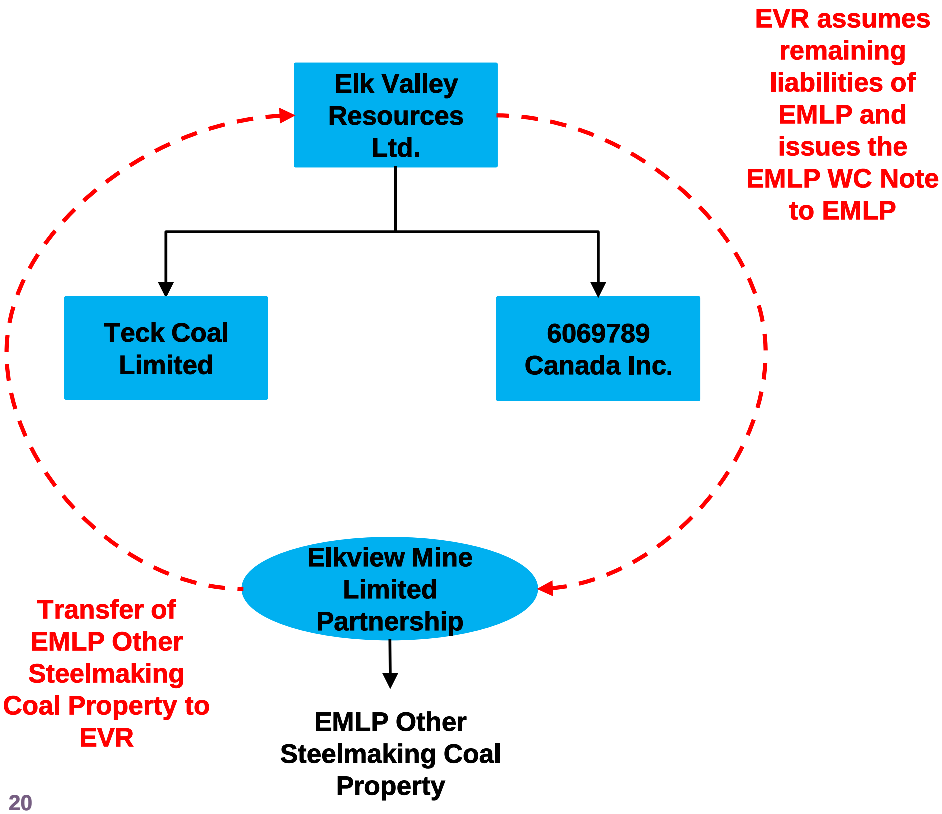
Select Plan of Arrangement Steps – First Transfer by EMLP (continued)



Select Canadian Income Tax Comments

- An election under subsection 85(2) of the Tax Act was contemplated so that the transfer would be tax-deferred to EMLP to the extent the tax cost of the transferred assets did not exceed the non-share consideration.
- Expected tax advisor to Teck to consider issues relating to tax pool reductions/additions (i.e., CDE/UCC) for the disposition and acquisition of mining rights/properties and depreciable property.
- Similarly, assuming the underlying coal properties and the EMLP EVR Royalty Interest were Canadian resource properties, the grant of the EMLP EVR Royalty Interest may have given rise to CDE reductions and additions.
- Consider any terminal losses that may have arisen from the transfer?

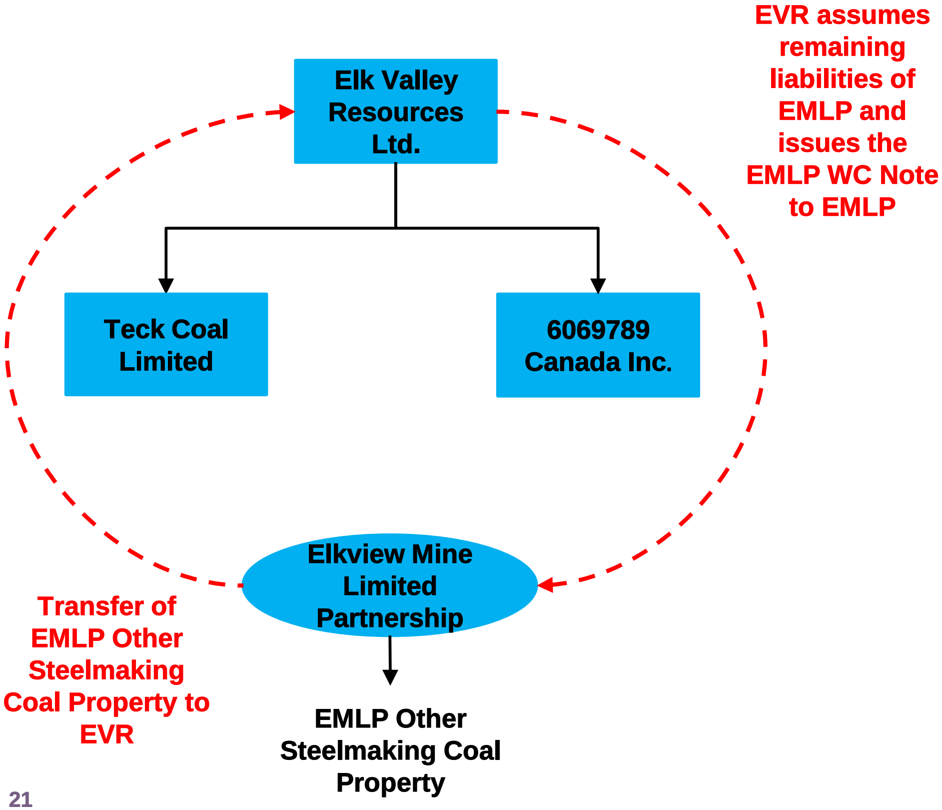
Select Plan of Arrangement Steps – Second Transfer by EMLP



<u>Second Transfer by EMLP</u>

- EMLP transfers certain property that is not eligible property under subsection 85(1.1) of the Tax Act (referred to as the EMLP Other Steelmaking Coal Property) in consideration for:
  - the assumption by EVR of the remaining liabilities of EMLP; and
  - if required, the issuance by EVR to EMLP of a promissory note referred to as the "EMLP WC Note".

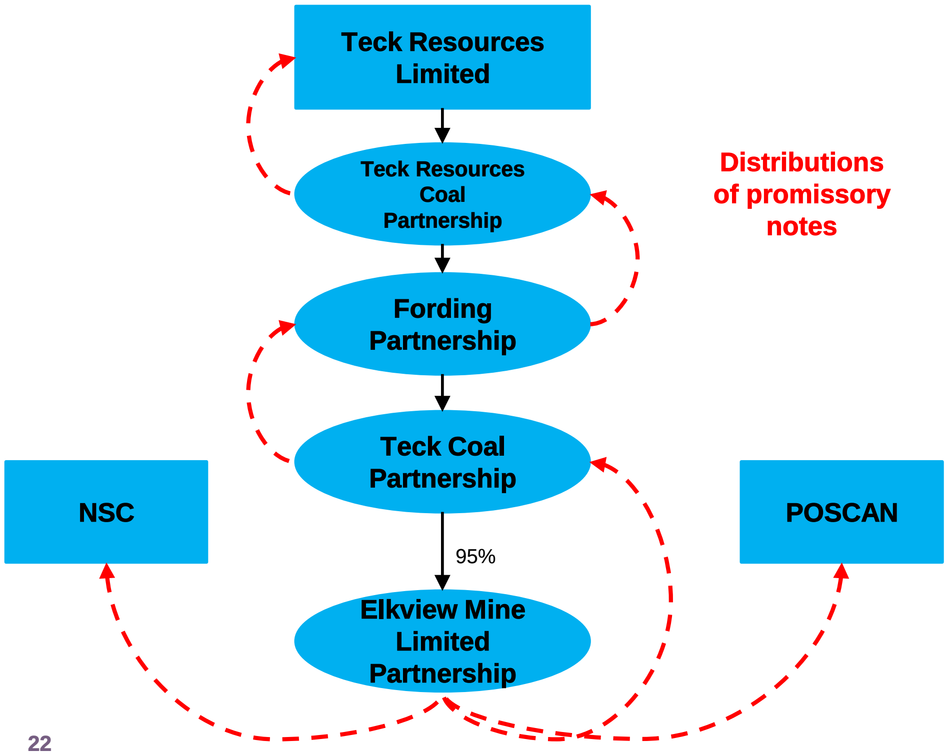
Select Plan of Arrangement Steps – Second Transfer by EMLP (continued)



Select Canadian Income Tax Comments

- Fully taxable disposition to EMLP but presumably no material gain/loss would have been realized due to the nature of the assets.

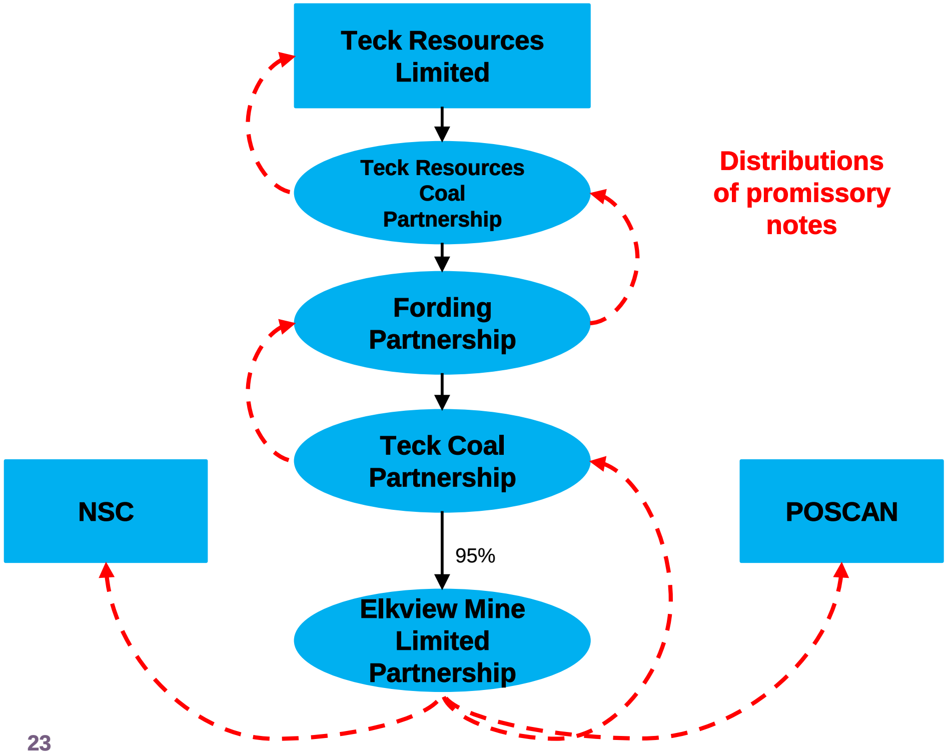
Select Plan of Arrangement Steps – Distribution of Promissory Notes



Distribution of Promissory Notes

- If the EMLP WC Note was issued, EMLP makes a pro-rata distribution of the EMLP WC Note to TCP, NSC and POSCAN as a return of partnership capital.
- TCP distributes its interest in the Contribution Notes, the TCP WC Notes and, if the EMLP WC Note is issued, the EMLP WC Note (collectively, the "**Elk Valley Notes**") to Fording Partnership as a reduction of partnership capital.
- Fording Partnership distributes the Elk Valley Notes to Teck Resources Coal Partnership as a reduction of partnership capital.
- Teck Resources Coal Partnership distributes the Elk Valley Notes to Teck as a reduction of partnership capital.

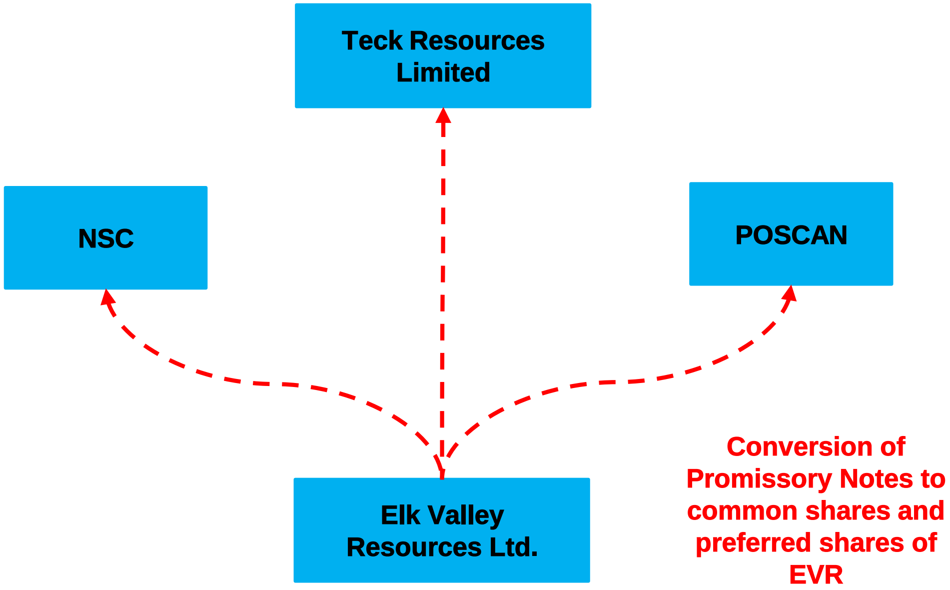
Select Plan of Arrangement Steps – Distribution of Promissory Notes (continued)



Select Canadian Income Tax Comments

- Distribution of the promissory notes would be expected to reduce the adjusted cost base of the various partnership interests under subparagraph 53(2)(c)(v).
- Presumably there was sufficient ACB such that the distributions would not result in negative ACB that would give rise to a deemed gain under subsection 40(3.1) for any “limited partners” or "specified members" of any of the partnerships.
- Would not generally be expected to be an issue for a general partnership such as TCP and Fording Partnership.

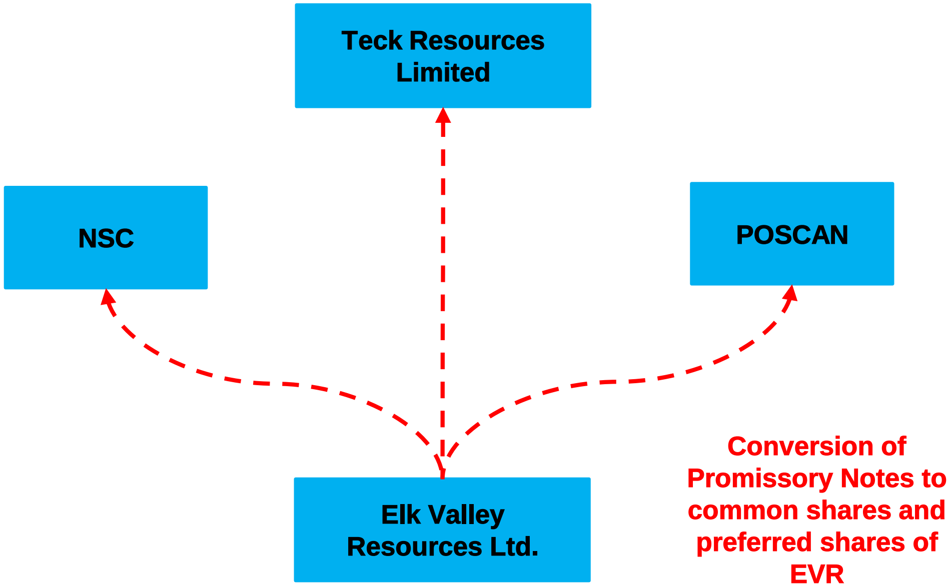
Select Plan of Arrangement Steps – Conversion of Promissory Notes



Conversion of Promissory Notes

- Teck converts the full principal amount of the Contribution Notes and TCP WC Notes into common shares and First Preferred Shares of EVR.
- If the EMLP WC Note is issued, Teck, POSCAN and NSC will convert the full principal amount of the EMLP WC Note to common shares of EVR.
- The stated capital account of the common shares and First Preferred Shares of EVR increased by the principal amount of the notes converted.
- The EVR common share issued to Teck upon incorporation of EVR will be repurchased by EVR for fair market value.

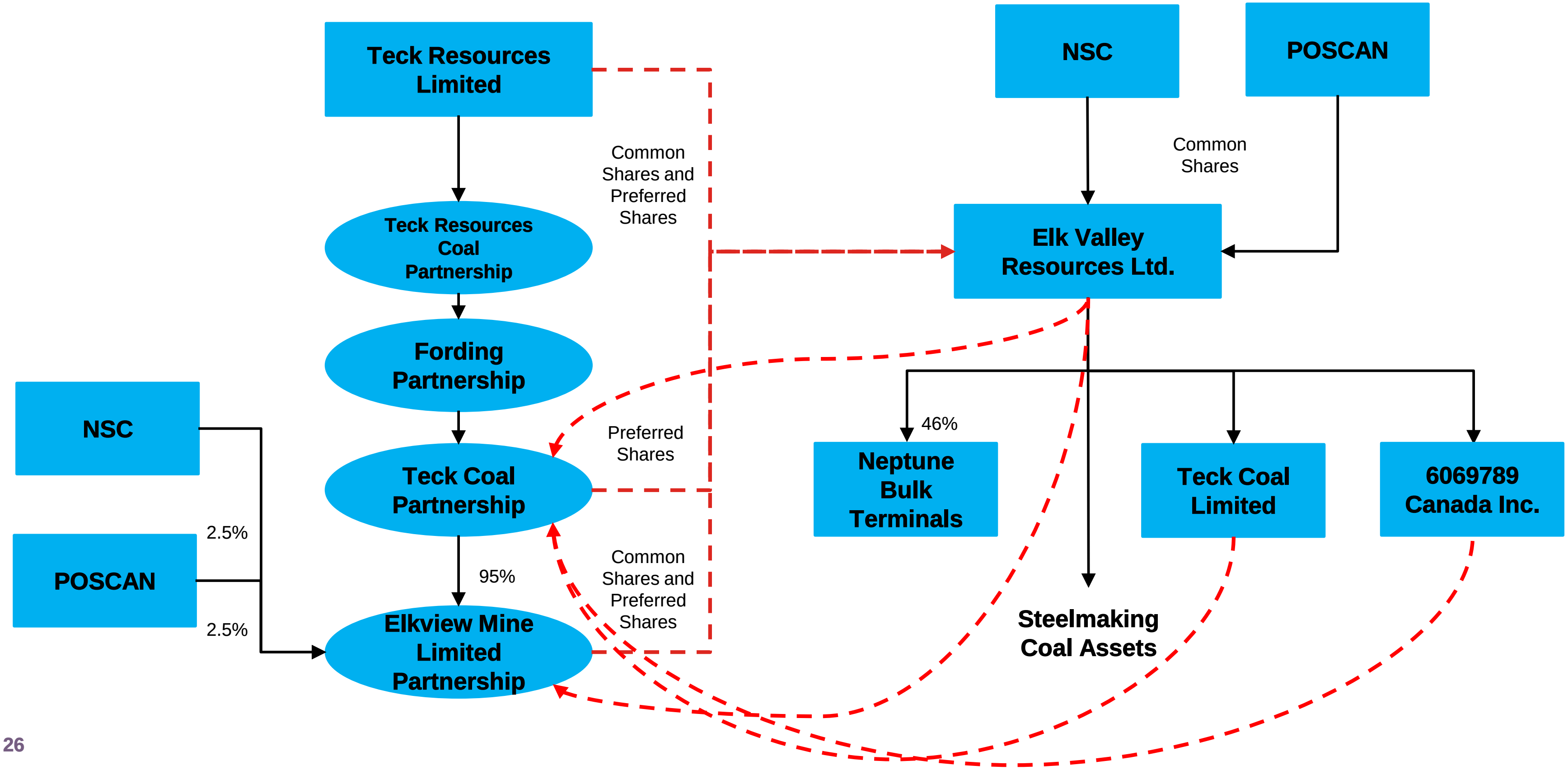
Select Plan of Arrangement Steps – Conversion of Promissory Notes (continued)



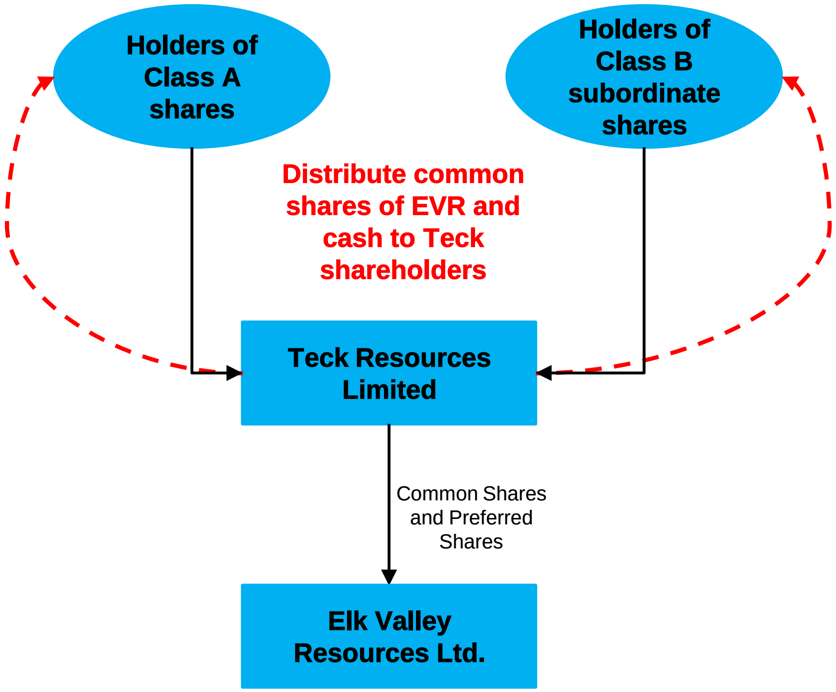
Select Canadian Tax Commentary

- The conversion of the Contribution Notes and the TCP WC Notes into common shares and First Preferred Shares of EVR should not have given rise to gain or loss to Teck since Teck would have had fair market value ACB in the notes.
- The conversion of the EMLP WC Note into common shares of EVR should not have given rise to gain or loss.
- Similarly the conversion of the promissory notes should not have given rise to a forgiven amount to EVR under the debt forgiveness rules on the assumption that the fair market value of the shares issued was equal to the principal amount of the various notes.

Final Structure before Distribution to Teck Shareholders



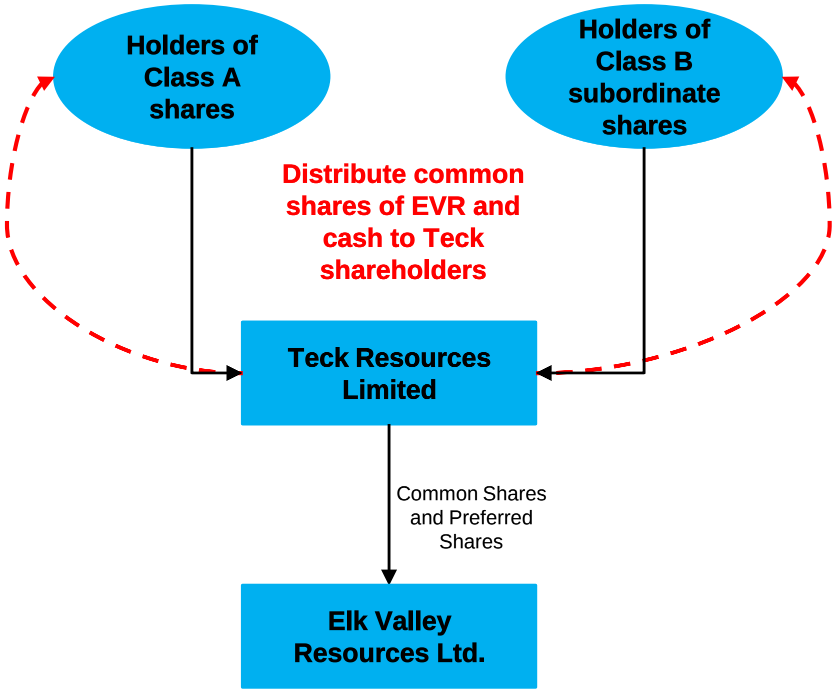
Select Plan of Arrangement Steps – Distribution to Teck Shareholders



Distribution to Teck Shareholders

- Teck will distribute to the Teck shareholders, as a reduction of stated capital on the Class A Shares and Class B Subordinate Voting Shares, all of the common shares of EVR held by Teck plus $200 million in cash.
- Results in a distribution of 0.10 of a common share of EVR and $0.39 in cash for each Class A Share or Class B Subordinate Voting Share.
- Election mechanic permitted Teck shareholders to elect to maximize the amount of cash or common shares of EVR they would receive, subject to proration.

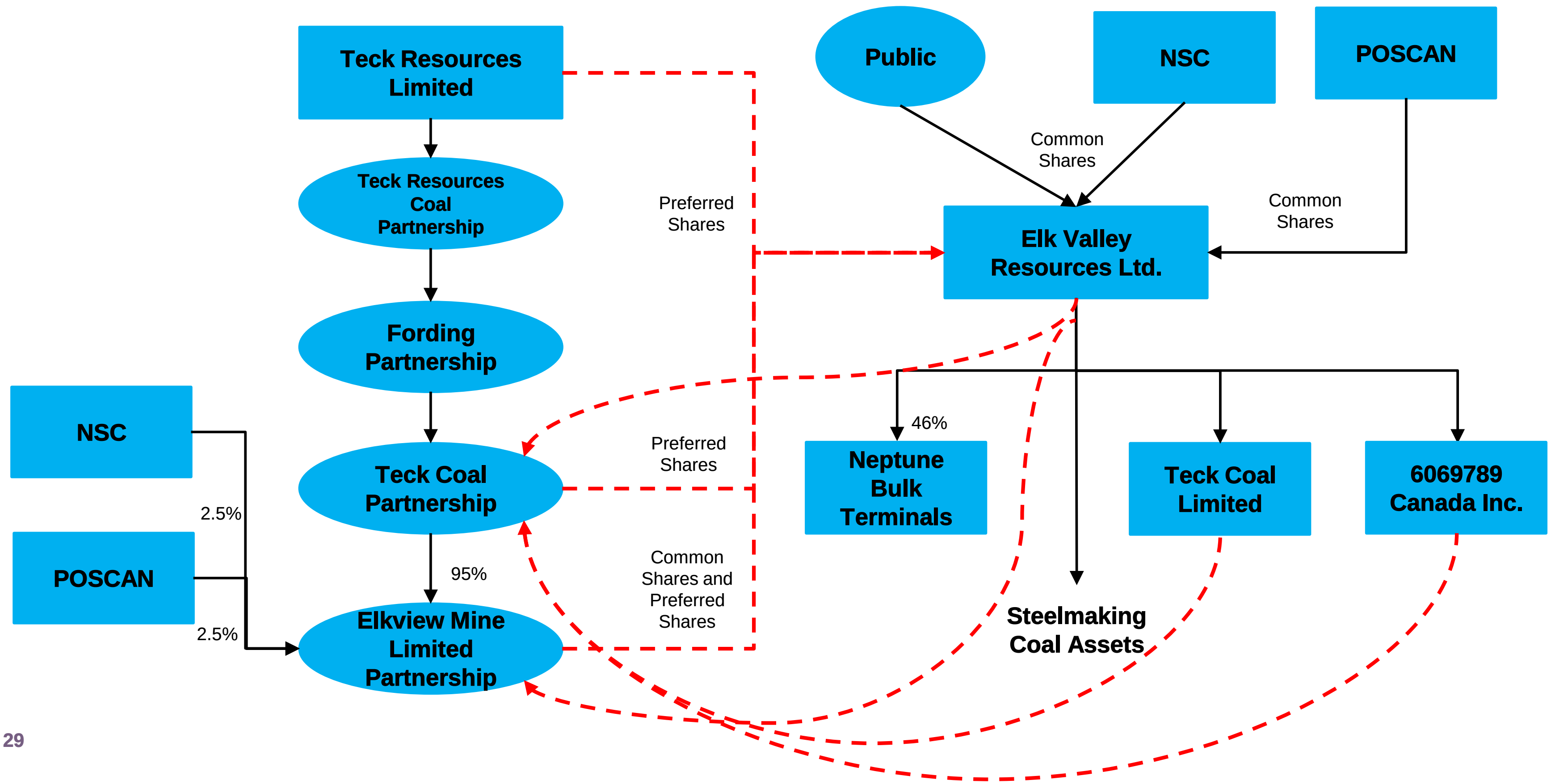
Select Plan of Arrangement Steps –Distribution to Teck Shareholders (continued)



<u>Select Canadian Tax Comments</u>

- Teck would not be expected to realize gain/loss on the disposition of the common shares of EVR because the ACB should have been equal to fair market value.
- The information circular indicated that the Teck shareholders should not realize a dividend on the distribution; rather the return of capital should result in a reduction in the ACB of their Teck shares.
- Section 84(4.1) does not appear to have been applicable; rather it appears that it was intended that subsection 84(2) would be applicable, with no deemed dividend because the distribution represented a return of capital that was less than PUC.
- To the extent ACB was negative, a gain would arise to the Teck shareholder.
- Eligibility for investment by deferred plans.

Final Structure if Separation Proceeded



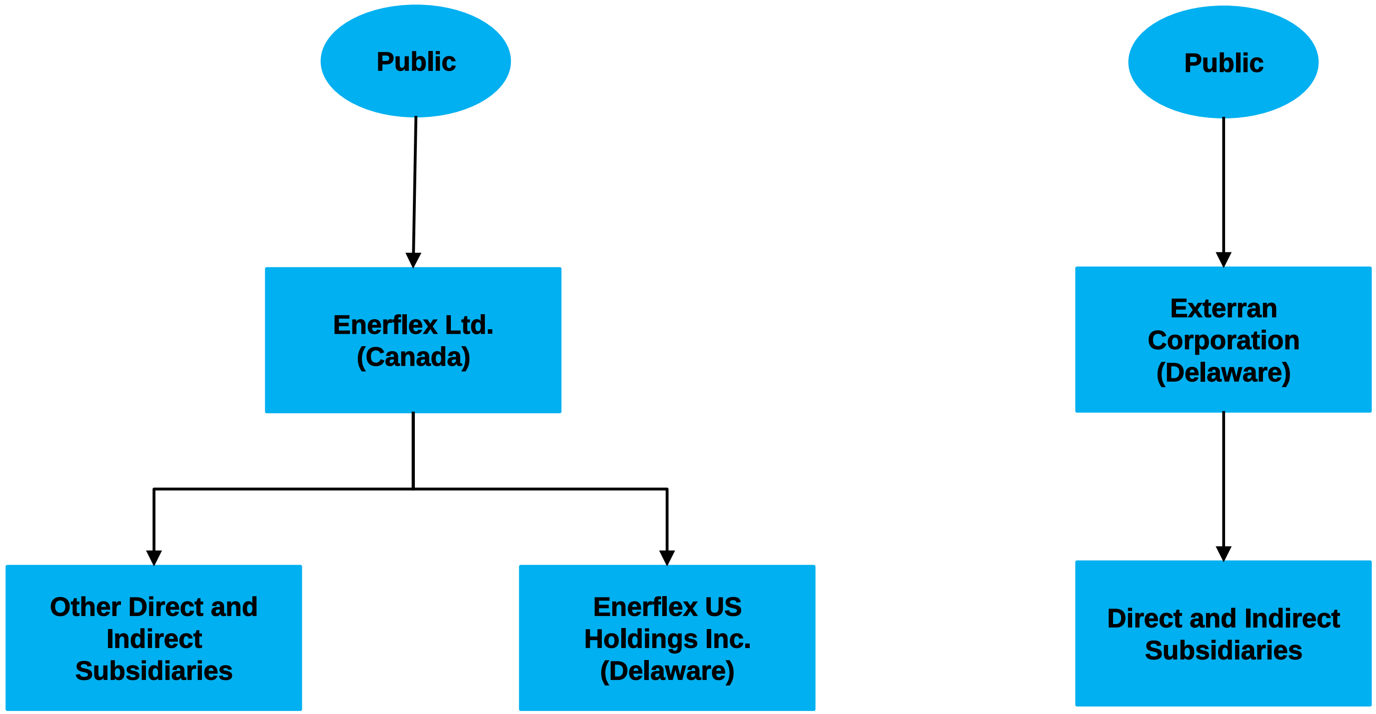
Additional Canadian Tax Matters if Separation Had Proceeded

- **EVR Preferred Shares**
  - The preferred shares that would have been held by Teck, TCP and EMLP may have been taxable preferred shares.
  - Share terms required EVR to elect to pay Part VI.1 tax at 40% so the holders were not subject to Part IV.1 tax.
  - Presumably EVR was expected to be cash taxable such that it could use the paragraph 110(1)(k) deduction to reduce its Part I tax.

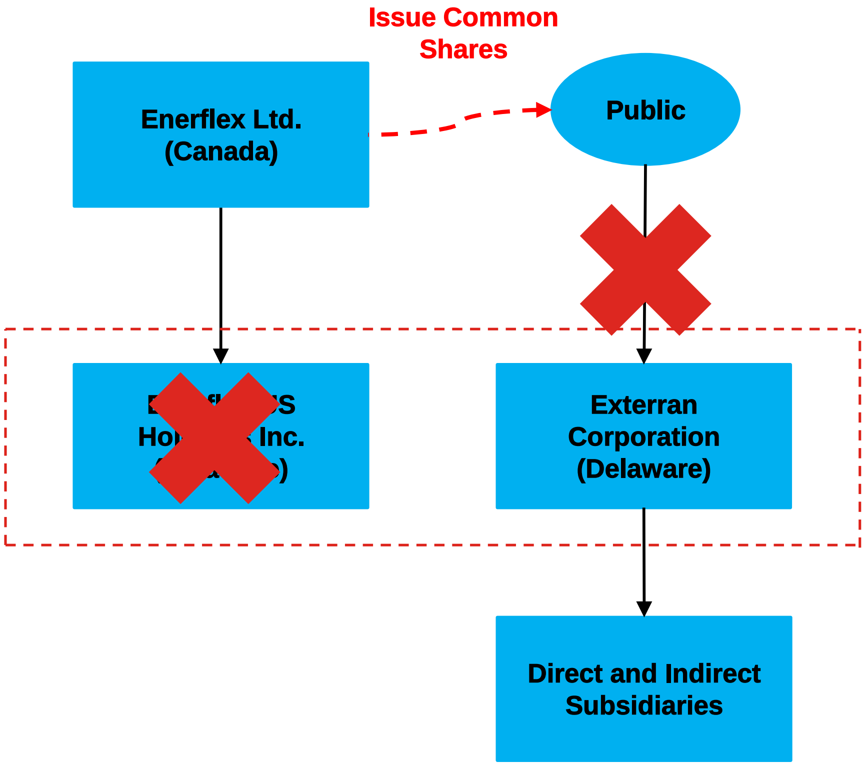
Enerflex Ltd.

Acquisition of Exterran Corporation

Starting Partial Corporate Structures



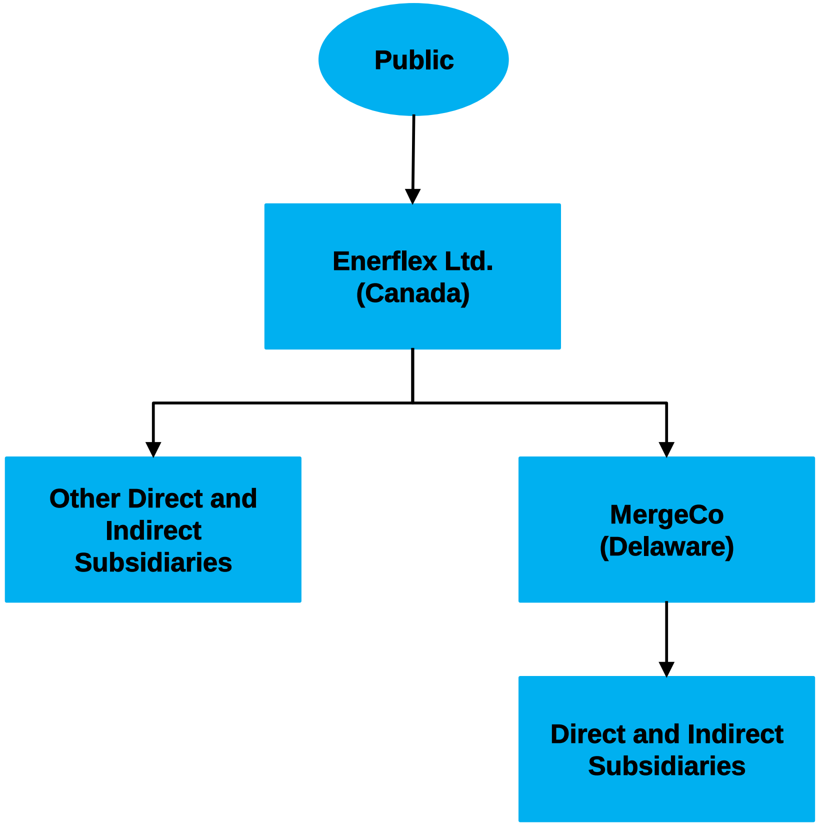
Acquisition Merger



Acquisition Merger

- Enerflex US Holdings Inc. merged with and into Exterran Corporation ("**Exterran**") under Delaware law, with Exterran Corporation being the surviving entity in the merger ("**MergeCo**").
- On the merger, the separate existence of Enerflex US Holdings Inc. ceased and Enerflex Ltd. ("**Enerflex**") became the sole shareholder of MergeCo.
- Each share of common stock of Exterran was converted automatically into the right to receive common shares of Enerflex (based on the exchange ratio) and cash in lieu of fractional shares.
- Each share of common stock of Enerflex US Holdings Inc. owned by Enerflex was converted into one share of common stock of MergeCo.
- As a result, the Exterran shareholders became shareholders of Enerflex and MergeCo was wholly-owned by Enerflex.

Post-Merger Partial Corporate Structure



Select Canadian Income Tax Issues

ACB in Shares of Surviving Corporation

- To compensate Enerflex for the issuance of the Enerflex common shares to the Exterran shareholders, the Merger Agreement contemplated that MergeCo would issue additional shares of its common stock to Enerflex.
  - The issuance of "compensatory shares" is not unique to the Enerflex transaction.
  - We generally see the same (or a similar) approach taken in cross-border merger transactions where shares of the Canadian parent are issued to target shareholders.
- For Canadian income tax purposes, the aggregate adjusted cost base of the "compensatory shares" issued by MergeCo to Enerflex should be equal to the aggregate fair market value of the Enerflex shares issued to the former Exterran shareholders (which should be equal to the fair market value of the Exterran shares that were exchanged for Enerflex common shares less any cash that was paid in lieu of fractional shares).
  - See CRA Document No. 2001-0092693 and CRA Document No. 2001-0076353.

Select Canadian Income Tax Issues

Termination Fees

- The Merger Agreement contemplated that a termination fee could become payable by Enerflex to Exterran or by Exterran to Enerflex in certain circumstances.
- If the termination fee became payable by Enerflex, the payment would have given rise to a number of Canadian income tax questions, including whether the break-fee would have been deductible to Enerflex and whether the break fee would have been subject to Part XIII withholding tax since it was payable to a non-resident of Canada.
- With respect to the withholding tax question, the issue is whether the termination fee was a restrictive covenant for the purposes of section 56.4 and, if so, then the fee would have been subject to Part XIII withholding tax under paragraph 212(1)(i).
- In CRA Document No. 2010-0366321I7, CRA stated that the definition of a restrictive covenant in subsection 56.4(1) may be broad enough to apply to a break fee paid to an acquirer/buyer.
- In CRA Document No. 2017-0688301I7, the CRA reiterated its view that section 56.4 could apply to break fees.

Select Canadian Income Tax Issues

<u>Termination Fees (continued)</u>

- A restrictive covenant is defined broadly to mean an **<u>agreement</u>** entered into, **<u>an undertaking</u>** made, or a **<u>waiver of an advantage</u>** or right by the taxpayer, whether legally enforceable or not, **<u>that affects, or is intended to affect, in any way whatever, the acquisition or provision of property</u>** or services by the taxpayer or by another taxpayer that does not deal at arm's length with the taxpayer, other than an agreement or undertaking:

  (a) to dispose of the taxpayer's property; or

  (b) in satisfaction of an obligation described in section 49.1 that is not a disposition.
- This definition was interpreted broadly in *Pangaea One Acquisition Holdings XII SARL v. Canada*, 2020 FCA 21, although that case did not deal with break fees.
- While it is not clear whether a termination fee/break fee is considered a restrictive covenant, it may be important to ensure potential withholdings taxes are addressed in the acquisition agreement.
- A break fee may also be exempt from Canadian tax under certain tax treaties if the break fee constitutes business profits that are not derived from a permanent establishment in Canada.

Questions / Comments