

CANADIAN MERGERS & ACQUISITIONS

**A GUIDE FOR FOREIGN INVESTMENT
BANKS AND BIDDERS**

DAVIES

Canadian Mergers & Acquisitions

A GUIDE FOR FOREIGN INVESTMENT BANKS AND BIDDERS

7th Edition

ABOUT THIS GUIDE

Davies has extensive experience in multijurisdictional merger and acquisition transactions, advising Canadian and foreign bidders, targets and investment banks. This guide is intended to provide the reader with an insight into Canadian mergers and acquisitions and address specific issues faced by foreign bidders, targets and investment banks.

The contents of this Guide are intended as general information and not as legal advice or opinion. We invite you to contact any Davies lawyer to discuss your legal matters (go to our website at dwpv.com or contact one of our offices).

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Takeover Bid Rules: An Overview

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Takeover Bid Rules: An Overview

➔ Types of M&A Transactions

- Takeover bids (like a U.S. tender offer)
- Plans of arrangement
- Amalgamations (like a U.S. merger)
- Asset sales
- Share sales (e.g., private purchase of control block)
- Restructurings (e.g., spinoffs)
- Going-private transactions

➔ Takeover Bid Regulation: General

TAKEOVER BID REGULATION

- Takeover bids are regulated province by province, but Canadian securities regulators have harmonized the takeover bid regime across Canada under Multilateral Instrument 62-104 and National Policy 62-203 and, in Ontario, Part XX to the *Securities Act* and OSC Rule 62-504
- Applicable laws depend on where the target shareholders reside and where the target is incorporated
- Proposed amendments to takeover bid rules published in March 2015 would give target boards more time to respond and seek alternatives to a hostile bid. The proposed amendments would make bids more challenging for hostile bidders than they are under current Canadian takeover bid rules

WHAT IS A TAKEOVER BID?

- A takeover bid is an offer to acquire *voting* or *equity* securities made to persons in a Canadian jurisdiction where the securities subject to the bid plus securities beneficially owned by the bidder and its affiliates and joint actors constitute 20% or more of the outstanding securities (partially diluted) of a class of securities
- Equity securities include non-voting common shares
- A trap for the unwary: calculation of current beneficial ownership includes securities convertible within 60 days into the class of equity or voting securities

- Indirect offers:
 - “Anti-avoidance” rule
 - Indirect offers can apply where an acquirer acquires shares of a holding company that owns, where aggregated with the acquirer’s shares, more than 20% of the shares of a public company
 - The acquisition of convertible securities, particularly in-the-money convertible securities, could constitute an “indirect” offer for the underlying security

➔ Equal Treatment Rules

OFFER TO ALL

- Bid must be made to all holders of the class, but may be for less than all securities
- Circular must also be sent to holders of convertible securities, including option holders

IDENTICAL CONSIDERATION

- All holders must be offered identical consideration (or an identical choice of consideration)
- If the bidder increases the price during a bid, everyone gets the new price, even holders whose shares have been tendered and taken up
- Partial bids must be *pro rata*

NO “SIDE DEALS”

- No collateral benefits - that is, agreements or understandings that have the effect of providing a shareholder with consideration of greater value
- Exceptions permit certain employee compensation and severance arrangements for management and other employees of target
- Can also get securities commission ruling to permit a collateral agreement where there is a clearly established business or financial purpose relating to the making of the bid or the ongoing operations of target

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Takeover Bid Rules: An Overview

PRE-BID INTEGRATION

- Bidder cannot acquire securities outside of bid within 90 days preceding bid unless bidder offers the same consideration and acquires the same percentage from each holder under the bid
- Exception for normal course purchases on a stock exchange (pre-arranged trades are not normal course)
- Toehold acquisitions in which offeror intends to offer share consideration in the subsequent offer must be carefully planned
- Securities so acquired will not count toward the 90% compulsory acquisition threshold, or as part of the minority for a “majority of the minority” vote on a second-step going-private transaction

PURCHASES AND SALES DURING A BID

- Bidder cannot offer to acquire or enter into any agreement or understanding to acquire the securities subject to the bid until its expiry
- Bidder can purchase up to 5% of the outstanding securities on a recognized stock exchange if bidder states its intention to do so either in the takeover bid circular or in a subsequently filed press release. Purchases must be reported daily by press releases disclosing price and number
- Securities purchased during a bid will not count toward the 90% compulsory acquisition threshold, or as part of the minority for a “majority of the minority” vote on a second-step going-private transaction

POST-BID INTEGRATION

- Bidder cannot acquire securities outside of the bid within 20 business days of the expiry of the bid except by way of a transaction that is generally available to securityholders on identical terms or normal course purchases on a stock exchange

SELLING RESTRICTIONS

- Bidder cannot sell or enter into an agreement to sell target securities from the date of announcement of the intention to make a bid until expiry of the bid
- Bidder can agree to sell securities taken up under the bid at a future date, but only if it discloses its intention in the circular

Sufficient Time Rules

- Deposit period of at least 35 days is required
- Proposed amendments to takeover bid rules would require an initial deposit period of at least 120 days
 - Initial deposit period could be waived down to 35 days by target (which would apply in the case of contemporaneous bids)
 - Initial deposit period of contemporaneous bids would be reduced to 35 days in the event that target announces a plan of arrangement or similar change of control transaction to be approved by target shareholders
- No take-up for 35 days, but must take up and pay for securities if bid conditions have been satisfied or waived within 10 days of expiry of the bid
- Proposed amendments to takeover bid rules would require bidder to extend the bid for an additional 10 days after expiry of initial deposit period if bidder achieves the mandatory minimum tender condition, all other conditions have been satisfied or waived and bidder announces its intention to immediately take up and pay for securities deposited under the bid
- Withdrawal of tender is permitted in the following circumstances:
 - at any time before securities are taken up by bidder
 - for 10 days after a change in the bid, or
 - if securities have not been paid for within three business days of take-up
- Bid must be kept open for 10 days after an amendment (unless it is solely a waiver of a condition in an all-cash bid)
 - Proposed amendments to takeover bid rules would prohibit amendments after bidder becomes obligated to take up and pay for securities (other than an extension of the deposit period or an increase in consideration)

Sufficient Information Rules

- Bid can be commenced by either mailing or advertisement. Bid can be commenced by advertisement if, concurrently with (or before) the advertisement, the bid is filed and delivered to the target, a securityholders list is requested and within two business days of receipt of the securityholders list, the takeover bid circular is sent to securityholders on the list

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Takeover Bid Rules: An Overview

- Bidder must prepare and mail takeover bid circular to all holders of the class of securities sought and holders of convertible securities
- Bidder must make additional mailings if bid terms are changed or important information has changed or arisen (except changes out of bidder's control)
- Target must prepare and mail a directors' circular within 15 days of the bid containing an acceptance/rejection recommendation by the board
- If target board is unable to make a recommendation, the circular must disclose the reasons for not making a recommendation
- Bid may contain any conditions except a financing condition
- Bids typically include a minimum deposit condition to ensure that bidder can obtain the remaining shares not deposited through a second-step going-private transaction. Condition would typically require a deposit of at least (i) two-thirds of outstanding shares and (ii) a majority of the minority
- Proposed amendments to takeover bid rules would require all bids (including partial bids) to include a mandatory minimum tender condition of 50% of securities owned by persons other than the bidder
- If bid is an "insider bid" or "related party transaction" under applicable corporate or securities law, a valuation of target's securities and of any non-cash consideration being offered may be required unless an exemption is available
- In Canada, in contrast to the United States, no securities commission clearance is required for share exchange takeover bids

Abusive Transactions

- Securities regulators will intervene to halt a takeover bid, even if it complies with all of the foregoing rules, if it is abusive of the target shareholders, the public or the capital markets
- Securities regulators also have the power to intervene to prohibit target boards of directors from taking inappropriate defensive measures to block a bid for its securities

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Plans of Arrangement

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Plans of Arrangement

➔ What Is an Arrangement?

- Common alternative to takeover bids for negotiated M&A transactions
- Corporate reorganization of target under applicable corporate law
 - Agreement is negotiated with target and support agreements are often negotiated with significant securityholders
 - Independent committee of the board of directors of target may be formed when the transaction may give rise to potential conflicts of interest or is otherwise justified
 - Target applies to court for interim order prior to mailing the proxy materials specifying the required shareholder approval
 - Target calls special securityholders' meeting to approve the arrangement
 - Arrangement becomes effective after it is approved by target securityholders and by the court, and articles of arrangement are filed by target
- Securities of any class of target may be exchanged for any other securities or property, including cash. In addition, assets, including subsidiaries, can be distributed to shareholders or other parties, and the order of all the steps to be effected by the arrangement can be specified, which assists in tax planning
- Court will consider whether arrangement is "fair and reasonable"
 - In 2008 *BCE* decision, the Supreme Court of Canada articulated a framework to assess whether an arrangement is fair and reasonable. Court must be satisfied that (i) the arrangement has a valid business purpose, and (ii) the objections of those whose legal rights are being arranged are being resolved in a fair and balanced way
 - Determination is focused on securityholders whose legal rights are being arranged rather than securityholders affected only in respect of their economic interests
 - In determining whether these tests are met, court will consider (i) the necessity of the arrangement to the continued operations of the target, (ii) the level of approval by the target's securityholders, (iii) the proportionality of its impact on affected groups, (iv) the reputation of directors and advisers who endorse the arrangement, (v) whether the arrangement has been approved by a special committee of independent directors of the target, (vi) the presence of a fairness opinion from a reputable expert, and (vii) the access by shareholders to dissent and appraisal remedies

Advantages of Arrangements

- Lower acceptance thresholds than a bid
 - Generally two-thirds of the votes cast at the meeting in person or by proxy
 - No prohibition on a merger party voting target securities held by it, provided it is not an “interested party” for purposes of business combination rules in Multilateral Instrument 61-101
- One-step acquisition eliminates “bridging” and financing risks
- Tax planning opportunities
 - Ability to clearly order transaction steps around the effective time
 - Allocation of basis to assets to be divested
 - Distribution of safe income and return of capital
- Greater flexibility in dealing with target’s assets, including possible spinoff of assets
- Facilitates implementation of “exchangeable share” structure
- Flexibility in dealing with stock options and warrants
- Collateral benefits and pre-bid purchases not prohibited
- Possible to offer “unequal” consideration
- Permissibility of financing condition (although this would generally be unacceptable to target boards)
- Flexibility in dealing with public debt (and other creditors)
- Availability of 3a-10 registration exemption in the United States

Disadvantages of Arrangements

- More cumbersome and time-consuming than takeover bids because of proxy solicitation and court proceedings
- Potential timing disadvantage in the face of a subsequent competing bid
- Fairness hearing may be used as a forum for challenge by securityholders
- Ability of complainants to appeal court order may delay closing
- Process is target-driven, rather than acquirer-driven

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Pre-bid Considerations

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Pre-bid Considerations

➔ Pre-acquisition Preparation

DILIGENCE ISSUES

- Coattail provisions for non-voting shares
- Change of control consequences
- Regulatory requirements (e.g., Investment Canada, Competition, CRTC)
- Convertible securities or other rights to acquire
- Contingent liabilities
- Shareholder rights plan (existing or potential)
- Location of target's shareholders (including U.S.)

DILIGENCE PROCESS

- Target will require confidentiality agreement and usually a standstill agreement as a pre-condition to due diligence

FINANCING

- In Canada, cash takeover bids must be fully financed (at announcement, commitment letter signed, fee paid). This is in contrast to tender offers in the United States, which can be conditional on financing
- Offeror must make adequate arrangements before the bid to ensure that the required funds are available
- Offeror "must reasonably believe the possibility to be remote that the offeror will be unable to pay for securities deposited under the bid due to a financing condition not being satisfied"
- As a rule of thumb, the bid financing can be no more conditional than the bid itself

Share Accumulations

TOEHOLD ACQUISITION

- Purchases up to 19.9% (together with securities beneficially owned by purchaser and joint actors) are not a “takeover bid”, so no exemption is needed
- Open market purchases or private agreements are permitted (although market purchases may increase price or tip off target):
 - Often done to lower cost of acquiring target shares because no premium paid on shares
 - May reduce offeror’s risk by allowing it to recoup at least some of its costs by selling toehold shares to a superior competing offer
- Pre-bid integration rules should be considered at this stage because of implications for a later offer
- Securities so acquired will not count toward the 90% compulsory acquisition threshold, or as part of the minority for a “majority of the minority” vote on a second-step going-private transaction
- Purchases of 20% or more constitute a takeover bid that requires offer to all holders of the class unless an exemption is available

PRIVATE AGREEMENT EXEMPTION

- The principal exemption is for private agreements:
 - Five vendors or fewer, and consideration does not exceed 115% of 20-day average trading price
 - Critical tool for acquirer proposing a creeping acquisition of control

INSIDER TRADING PROHIBITION

- Once a person “is proposing to make a takeover bid” for a target, all persons who are insiders, affiliates, associates, professional advisers and officers, directors or employees of any of them are in a “special relationship” with the target and may not trade in securities of the target until the bid is announced
 - This restriction does not apply to the person proposing to make the bid itself

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Pre-bid Considerations

➔ Public Disclosure of Accumulations

EARLY WARNING REPORTING

- Intended to alert the market to the acquisition of significant holdings in a public company
- Acquisition of equity or voting securities representing 10% of the class (together with securities beneficially owned by purchaser and its joint actors) requires purchaser to issue forthwith a press release and file within two business days an “early warning” report. Disclosure must include the terms of any agreement with respect to the acquired securities, the price paid, the purpose of the purchase and any “future intention to acquire” additional securities
- Applies to acquisition of beneficial ownership of securities and to the acquisition of the power to exercise control or direction over securities. Must count in the 10% any securities that a person has the right or obligation, whether or not on conditions, to acquire within 60 days (e.g., warrants, share purchase agreement)
- No requirement for non-insiders to report economic interest under cash-settled equity swap
- Purchaser and its joint actors are prohibited from making additional acquisitions of the shares until the expiry of one business day from the date the required report is filed, unless the purchaser and its joint actors beneficially own over 20% of the class of securities (no similar U.S. restriction)
- Disclosure threshold is reduced to 5% when a takeover bid by another party or an issuer bid is outstanding, but the restriction on acquisitions until after the report is filed does not apply (trap for the unwary)
- For a target whose shares are registered with the SEC in the United States (e.g., targets with a U.S. listing), the disclosure of accumulations on Form 13D is required at the 5% level, but the purchaser is not prohibited from acquiring further securities pending filing of the 13D
- Change in material fact in the report or the acquisition of a further 2% of the class requires the purchaser to issue forthwith a further press release and file a report

- Proposed amendments to rules would require disclosure of 2% decreases in ownership and when a shareholder falls below the reporting threshold

INSIDER REPORTING

- Acquisition of more than 10% of voting securities of a public company, including securities issuable on the exercise of conversion or purchase rights or obligations, within 60 days, requires purchaser to file an initial insider report within 10 days
- Insider report must disclose the following:
 - o Ownership of voting securities
 - o Agreement, arrangement or understanding that has the effect of altering, directly or indirectly, the purchaser's economic interest in a security of the company or economic exposure to the company (a "related financial instrument")
 - o The material terms of any agreement, arrangement or understanding that, directly or indirectly, alters the purchaser's economic exposure to the company and involves a security of the company or a related financial instrument
- Insider must report within five days any change in its ownership of securities of the company or a related financial instrument, or any material amendment or termination of an agreement, arrangement or understanding required to be disclosed
- Directors and CEO, CFO and COO and certain other insiders of the purchaser also become reporting insiders of the company and must file insider reports
- Directors, CEO, CFO and COO must include in initial insider report transactions that occurred during the prior six-month period during which they held such position
- Exemption available for directors and officers of the purchaser who do not in the ordinary course receive or have access to information about material facts and material changes of the company, and are not otherwise insiders

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Pre-bid Considerations

→ Selecting Transaction Structure: Plan of Arrangement vs. Takeover Bid vs. Amalgamation

	PLAN OF ARRANGEMENT	TAKEOVER BID	AMALGAMATION
What is it?	<ul style="list-style-type: none">▪ Merger effected by securityholder vote and court approval	<ul style="list-style-type: none">▪ Purchase of shares effected by offer to securityholders	<ul style="list-style-type: none">▪ Merger effected by securityholder vote
How accomplished?	<ul style="list-style-type: none">▪ Acquirer and target enter into arrangement agreement▪ Acquirer may enter into support agreements with significant securityholders	<ul style="list-style-type: none">▪ Acquirer and target enter into support agreement (if friendly)▪ Acquirer may enter into lock-up agreements with significant securityholders	<ul style="list-style-type: none">▪ Acquirer and target enter into merger agreement▪ Acquirer may enter into support agreements with significant securityholders

	PLAN OF ARRANGEMENT	TAKEOVER BID	AMALGAMATION
	<ul style="list-style-type: none"> ■ Target mails proxy circular to securityholders (no regulatory review) 	<ul style="list-style-type: none"> ■ Acquirer mails takeover bid circular to securityholders of target (no regulatory review) 	<ul style="list-style-type: none"> ■ Target mails proxy materials to securityholders (no regulatory review)
	<ul style="list-style-type: none"> ■ Securityholders approve at meeting (locked-up shares can be voted) 	<ul style="list-style-type: none"> ■ Target mails directors' circular to securityholders of target (no regulatory review) 	<ul style="list-style-type: none"> ■ Securityholders approve at meeting (locked-up shares can be voted)
	<ul style="list-style-type: none"> ■ Obtain court approval as to "fairness" 	<ul style="list-style-type: none"> ■ Securityholders tender to offer 	
Consideration	<ul style="list-style-type: none"> ■ Cash and/or securities 	<ul style="list-style-type: none"> ■ Cash and/or securities 	<ul style="list-style-type: none"> ■ Cash and/or securities
	<ul style="list-style-type: none"> ■ Discrimination among securityholders permitted, subject to "fairness" and majority of minority approval 	<ul style="list-style-type: none"> ■ Discrimination among securityholders prohibited, except for certain employment arrangements or with securities commission approval (time requirement: approximately four weeks) 	<ul style="list-style-type: none"> ■ Discrimination among securityholders permitted, subject to majority of minority approval

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Pre-bid Considerations

	PLAN OF ARRANGEMENT	TAKEOVER BID	AMALGAMATION
Timing (See Appendix A)	<ul style="list-style-type: none"> Approximately 50 to 65 days from commencement of preparation of circular to consummation of transaction (but faster than takeover bid if bid requires second-stage transaction) 	<ul style="list-style-type: none"> Approximately 50 to 65 days from commencement of preparation of circular to consummation of transaction 	<ul style="list-style-type: none"> Approximately 45 to 60 days from commencement of preparation of circular to consummation of transaction
Shareholder approval/ acceptance requirement	<ul style="list-style-type: none"> 2/3 of votes cast by those voting at meeting (and majority of minority if related party receives a collateral benefit) 	<ul style="list-style-type: none"> 90% of all shares outstanding (in order to force out the remainder). If less than 90% acquired, must do second-stage squeeze-out, requiring 2/3 vote and majority of minority vote (shares acquired under the bid can be counted as part of minority in certain circumstances) 	<ul style="list-style-type: none"> 2/3 of votes cast by those voting at meeting (and majority of minority if related party receives a collateral benefit)
Conditions	<ul style="list-style-type: none"> Unrestricted 	<ul style="list-style-type: none"> Financing condition prohibited 	<ul style="list-style-type: none"> Unrestricted
Dissent rights	<ul style="list-style-type: none"> Yes 	<ul style="list-style-type: none"> Yes, on exercise of force out right or second-stage transaction 	<ul style="list-style-type: none"> Yes
Pre-transaction purchases of Target stock	<ul style="list-style-type: none"> Not restricted, subject to insider trading restrictions 	<ul style="list-style-type: none"> Restricted (offer terms must be as favourable as pre-offer transactions) 	<ul style="list-style-type: none"> Not restricted, subject to insider trading restrictions

	PLAN OF ARRANGEMENT	TAKEOVER BID	AMALGAMATION
French translation	<ul style="list-style-type: none"> ■ Depends on connecting factors to Québec (e.g., size of shareholder base, location of head office or majority of target's business) 	<ul style="list-style-type: none"> ■ Yes 	<ul style="list-style-type: none"> ■ Depends on connecting factors to Québec (e.g., size of shareholder base, location of head office or majority of target's business)

Structuring the Offer

CONSIDERATION: CASH OR SECURITIES?

- If securities offered as consideration, prospectus-level disclosure about issuer of securities and the issuer's financial statement disclosure will be required
- May also require *pro forma* combined financial information
- Also requires detailed disclosure of plans and proposals bidder has for target post-closing
- Bid circular is not reviewed by the securities commission, so there is no timing disadvantage where share consideration is offered
- Bidder that offers share consideration may become a "reporting issuer" and subject to Canadian public company disclosure requirements

CONDITIONS

- Any conditions (except financing in a takeover bid) are permitted and frequently include the following:
 - o Minimum tender for takeover bid: if seeking control, 51% as condition; if seeking 100%, minimum tender should be greater of 66 2/3% and majority of the minority to have certainty of execution of second-step going-private transaction
 - o No rights plan or waiver of application of rights plan to bid

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Pre-bid Considerations

- o Competition, Investment Canada, HSR approvals and any regulatory approvals for change of control
- o No material adverse change

COATTAILS

- Dual class companies listed on TSX are required to provide coattails - that is, provisions that effectively entitle holders of non-voting or subordinate voting shares to participate in a bid for voting or multiple voting shares
- Older companies with dual class structures may allow purchase of control without an offer to non-voting or subordinate voting shares
- Coattails are typically triggered when a non-exempt takeover bid is made for the voting/multiple voting shares, unless offers are made for other shares on the same basis
- Acquisition made by way of plan of arrangement may not trigger typical coattail

SHAREHOLDERS LIST

- Offeror can request a list from target by following the procedure under the applicable corporate statute. Target must respond to the request within 10 days
- Offeror permitted to commence the bid by an announcement, but must request the shareholders list on or before the date the bid is advertised, and must send bid to shareholders within two business days of receiving list

SHAREHOLDER APPROVAL FOR SHARE EXCHANGE OFFER

- TSX-listed bidder proposing to make a share exchange offer must obtain shareholder approval when number of securities issuable on acquisition exceeds 25% of outstanding securities of issuer (on a non-diluted basis).

U.S. SHAREHOLDERS OF CANADIAN TARGET

- If U.S. securityholders hold less than 40% of "foreign private issuer" target shares, MJDS generally exempts a bid by Canadian public company that is a foreign private issuer from U.S. tender offer regulation and from SEC review of the registration statement filed in respect of the share exchange bid (U.S. anti-fraud provisions, Schedule 13D and Schedule 13E-3 still apply)
- MJDS can be used by non-Canadian bidder only in a cash deal; in a share exchange bid, both bidder and target must be Canadian foreign private issuers for bidder to use the MJDS registration exemption

- If MJDS is unavailable for the share exchange bid (e.g., because target is not a “foreign private issuer”), it may be possible to avoid SEC registration requirement by making “vendor placement” or excluding U.S. shareholders from the bid

Lock-Up Agreements

- Securityholder’s commitment to tender into offeror’s takeover bid (or vote in support of arrangement or amalgamation)
- Securityholder may have right to withdraw and tender to higher offer
- Contributes to certainty of execution; locked-up securities count toward 90% compulsory acquisition threshold
- Multilateral Instrument 61-101 permits securities acquired under a lock-up agreement to be voted as part of the minority in a majority of the minority vote if the locked-up securityholder is treated identically to all other securityholders under offer
- Entering into a lock-up agreement does not generally trigger a typical Canadian “poison pill” if securityholder has the right to withdraw and tender to a higher offer
- Lock-up agreements must be filed publicly

04

Post-bid Cleanup

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Post-bid Cleanup

➔ **Compulsory Squeeze-Out**

- Generally, under corporate law, if within 120 days of bid, the bid is accepted by 90% of class of shares subject to bid (other than shares held by bidder or its affiliates or associates), bidder can require hold-outs to sell to bidder for same price as bid
- Once notice is sent, bidder will be entitled to acquire shares of non-tendering shareholders within 30 days, but each shareholder may apply to court to fix "fair value"
- For corporations incorporated in Ontario, procedure is available only if bid was for voting securities
- For corporations incorporated federally, procedure is available only if the bid is made to all shareholders (e.g., cannot exclude U.S. holders in share exchange bid) unless an order is obtained

➔ **Second-Step Business Combination/Going-Private Transaction**

- If bidder acquires between 66 2/3% and 90%, it can still take company private by means of a second-step shareholder-approved amalgamation or plan of arrangement
- Under Multilateral Instrument 61-101, shares acquired under bid can be counted as part of minority in second-step amalgamation/plan of arrangement if the intention to do so is disclosed in bid circular, the second-step transaction provides for the same consideration as the bid and the tendering shareholder did not receive a collateral benefit

05

Multilateral Instrument 61-101

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Multilateral Instrument 61-101

→ Purpose

- Intended to level playing field for minority when transactions are proposed in which significant shareholder could have advantage by virtue of voting power, board representation or increased access to information
- Affects business combinations, related party transactions, second-step going-private transactions, issuer bids and insider bids

→ Types of Transactions Covered

Four transaction types caught:

1. Insider Bids: Takeover bid by holder of shares carrying more than 10% of voting rights or other insider
2. Issuer Bids: Acquisition by issuer of its own securities
3. Business Combinations: Transaction whereby holder of equity security can be required to sell its shares, regardless of whether equity security is replaced by another security, but only if transaction involves related party of issuer and related party is not treated identically to other holders or receives consideration of greater value than other holders
4. Related Party Transactions: Transaction between issuer and significant shareholder or other related party
 - o A "related party" includes a holder who has the ability to affect materially the control of the issuer and a holder of securities carrying more than 10% of the voting rights

→ Four Requirements

1. Independent valuation
2. Minority shareholder approval
3. Enhanced disclosure
4. Special committee

INDEPENDENT VALUATION

- Valuation - Fairness Opinions:

- o Valuations required for insider bids (unless no access because bidder is an “outside” insider), issuer bids (unless there will be a “liquid market” following the bid), business combinations (but only if an “interested party” is acquiring or combining with the issuer) and related party transactions (but only if the subject matter of the related party transaction exceeds 25% of the issuer’s market capitalization)
- o Loss of control in valuation process (e.g., in an insider bid, valuation is done at expense of offeror and included in the takeover bid circular, but is prepared under the supervision of target’s special committee of independent directors)
- o Valuation cannot be more than 120 days old
- Independence of Valuator:
 - o Valuator is deemed non-independent if it is an associated or affiliated entity or an external auditor (some exceptions), or if success fees are provided
 - o Other relationships simply require consideration and disclosure (e.g., led or co-led underwriter relationship in past 24 months)
- Valuation Exemptions:
 - o Previous arm’s-length negotiations: Consideration offered is at least equal in value and is in the same form as agreed to in arm’s-length negotiations not more than 12 months prior by a 10% securityholder (5%, if bidder already has 80% of the target securities) holding at least 20% of the outstanding securities not owned by bidder
 - o Auction: One or more other transactions or bids are outstanding and equal access to data room information is provided to all
 - o Second-step business combination: Within 120 days following a formal bid that disclosed intent to effect a second-step transaction as well as tax consequences of that transaction, and consideration has the same value and is in the same form as paid under a formal bid
 - o *Pro rata* related party transaction: Rights offerings, dividends, asset distributions or share reorganizations where the interested party is treated identically to all holders
 - o Lack of knowledge and board representation (for insider bids)
- Disclosure of Prior Valuations - Preceding 24 Months:
 - o Includes internal appraisals of securities or material assets

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Multilateral Instrument 61-101

- o Must be careful characterizing advice to boards and fairness opinion analysis
- o Does not include a valuation prepared for the purpose of assisting an interested party in determining the price to be offered (unless made available to any of the independent directors of target)

MINORITY SHAREHOLDER APPROVAL

- Shareholder approval by a “majority of the minority”

ENHANCED DISCLOSURE

- MI 61-101 contains detailed disclosure rules for affected transactions, primarily to level the informational playing field between the proponent of the transaction and the minority

SPECIAL COMMITTEE

- A special committee of directors who are independent of the proponent of the transaction is often formed for MI 61-101 transactions (CSA is considering making this mandatory for all MI 61-101 transactions)
- Reports to the full board, which then makes a recommendation to shareholders on the transaction
- Supervises the valuation/fairness opinion process

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Directors' Duties and Defensive Mechanisms

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Directors' Duties and Defensive Mechanisms

➔ Directors' Duties

FIDUCIARY DUTIES

- Directors have (i) a fiduciary duty to the corporation to act in the best interest of the corporation, and (ii) a duty to exercise the care, diligence and skill of a reasonably prudent person in comparable circumstances
- Directors must exercise their powers for the benefit of the corporation and not for an improper purpose such as the entrenchment of directors and management
- Directors must consider the best interests of the corporation. It may also be appropriate, although not mandatory, to consider the impact of corporate decisions on shareholders or particular groups of stakeholders, including employees, suppliers, creditors, consumers, governments and the environment
- Shareholders, including controlling shareholders, do not owe fiduciary duties to other shareholders

DIRECTORS' DUTIES IN CHANGE OF CONTROL TRANSACTIONS

- Supreme Court of Canada affirmed in the *BCE* decision that, in determining what is in the best interests of the corporation, there is no priority rule that requires that shareholders' interests prevail in all cases
- In Canada, a board is not required to conduct an auction in every change of control transaction. Canadian courts have generally given boards considerable latitude in change of control transactions, deferring to the reasonable and informed business judgment of the directors. Canadian courts have specifically rejected the *Revlon* line of cases requiring the maximization of shareholder value where the board decides to sell the company

DIRECTORS' DUTIES IN RESPONDING TO UNSOLICITED BID

- U.S. courts have held that if directors of a target company have reasonable grounds for believing that a threat to the company (such as the possibility of a coercive or unfair bid) exists, they discharge their duties if they adopt measures that are reasonable in relation to the threat posed and they act diligently and on the basis of full information
- Canadian courts have held that the conduct of directors is subject to the objective prospective reasonability principle of *Paramount Communications*

(i.e., if the board selected one of several reasonable alternatives, a court should not second-guess that choice even though it might have decided otherwise or subsequent events may have cast doubt on the board's determination)

BUSINESS JUDGMENT RULE

- The business judgment rule protects business decisions that have been made by the board of directors honestly, prudently, in good faith and on reasonable grounds. In such cases, the board's decisions will not be subject to judicial review of the merits of the business decision and a court will generally give deference to the business judgment of directors, so long as a decision lies within a range of reasonable alternatives
- "Honestly, prudently, in good faith and on reasonable grounds" means that directors must exercise their judgment (i) free of any conflict of interest (corporate statutes generally require directors to disclose any conflict of interest and to refrain from voting), (ii) based on a full understanding of all relevant facts and with the benefit of expert advice, and (iii) in the best interests of the corporation and not for an improper purpose
- If a board of directors has acted on the advice of a committee composed of persons having no conflict of interest and committee members have exercised their judgment in compliance with the foregoing principles, the business judgment rule will apply to protect the business decisions of the board of directors

INDEPENDENT COMMITTEE

- If circumstances indicate a real threat of an offer or if an offer is made, the board should consider whether to establish an independent committee composed of non-management directors
- The independent committee will assess any offer and develop recommendations for the full board with respect to the offer and any potential alternatives and, depending upon the circumstances, will negotiate or supervise the negotiations with the bidder or others

OPPRESSION REMEDY

- Corporate conduct that is oppressive or unfairly prejudicial to, or that unfairly disregards the interests of, any securityholder, creditor, director or officer can be challenged under the statutory oppression remedy
- Complainant must demonstrate that it had a reasonable expectation that has been violated by corporate conduct at issue

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Directors' Duties and Defensive Mechanisms

- Factors that are relevant in determining whether a reasonable expectation exists include general commercial practice, the nature of the corporation, the relationship between the parties, past practice, steps the claimant could have taken to protect itself, representations and agreements and the fair resolution of conflicting interests between corporate stakeholders

➔ Structural Defences

- Structural defences generally consist of defensive provisions contained in a target company's articles and bylaws and shareholder rights plans (poison pills). Generally, structural defences do not work as well in Canada as they do in the United States

SHAREHOLDER RIGHTS PLAN

- The shareholder rights plan is the primary structural defence used in Canada, and many Canadian companies have introduced shareholder rights plans
- As a result of the TSX requirement for shareholder approval of rights plans, the formal review process conducted by ISS on rights plans proposed by Canadian companies, and the tendency of Canadian institutional shareholders to follow ISS recommendations, pre-existing Canadian rights plans tend to be very uniform and relatively benign compared to some U.S. rights plans
- Rights plans in Canada are not designed, and will not operate, to block an unsolicited bid but rather are intended to encourage the fair treatment of shareholders in connection with a bid and to provide sufficient time for the board and shareholders to properly consider and respond to an offer and for the board to determine if there are other alternatives available to enhance shareholder value
- In a typical Canadian rights plan, the plan would be "triggered" by the acquisition by any person or group of beneficial ownership of 20% or more of the company's common shares, calculated on a partially diluted basis
- If the plan is triggered, all shareholders other than the triggering shareholder and certain related parties have the right to acquire additional common shares of the company from treasury at a substantial discount to market price, theoretically resulting in substantial dilution to the hostile bidder
- Since Canadian rights plans, unlike U.S. rights plans, typically include a "permitted bid" concept and will generally be cease traded by a securities

commission after a certain period of time, they cannot be used by a target to shield itself indefinitely from a hostile bidder. Rather, they can be used only to secure additional time for the target board to evaluate alternatives and to attempt to pursue other transactions

- A permitted bid is typically a bid made to all shareholders that remains open for 60 days and is conditional upon acceptance by independent shareholders holding more than 50% of the shares not owned by the bidder (and related parties), but may be a partial bid or a non-cash bid
- Experience has shown that bidders do not make permitted bids, but rather make bids that comply with applicable law and then apply to securities regulators for orders cease trading the plan, arguing that the target board is improperly preventing shareholders from having the opportunity to consider the offer and that, accordingly, “the time has come for the pill to go”
- It is generally considered that a target board will be afforded 45 to 70 days for this purpose by Canadian securities regulators so long as there is evidence that the target is actively seeking a competing bid or alternative transaction. There have been instances in which boards have received much shorter or longer periods in light of the particular facts (e.g., WIC Western International Communications - 27 days; Fonorola - more than 70 days, principally due to the complexity of the regulatory environment for non-Canadian investment in the Canadian telecom industry; Falconbridge - 72 days due to regulatory approvals extending the length of one auction party’s bid; Augusta - 156 days, principally due to strong shareholder support for the continuation of the plan and to allow more time for Augusta to obtain material permits, which would have increased shareholder value)
- As in Augusta, shareholder approval of the rights plan after the commencement of the hostile bid may also result in a lengthier period of time for the plan to remain in effect
- Proposed amendments to the takeover bid rules would extend the minimum deposit period to 120 days, from 35, giving target boards a longer period of time to seek value-enhancing alternatives or make the case for rejecting the bid
- If a company does not have a shareholder rights plan in place, the board could consider refraining from introducing a rights plan until an unsolicited proposal arises and then introducing a U.S.-style “tactical” rights plan with no permitted bid. Tactical plans typically have a duration that is less than the six-month shareholder approval period mandated by the TSX and are not typically put forward for shareholder approval

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Directors' Duties and Defensive Mechanisms

CHARTER AND BYLAW PROVISIONS

- Structural defences commonly contained in the constating documents or bylaws of U.S. companies are rare in Canada, as some of the most popular U.S. charter document structural defences are not required or are ineffective under Canadian law

Fair Price Provisions

- Fair price provisions are included in a company's articles and are designed to deter coercive, front-end loaded offers, generally requiring that shareholders receive equivalent consideration at each step of a two-step acquisition unless special majority of the minority approval is obtained
- Much (but not all) of the protection afforded by fair price provisions is also afforded by Multilateral Instrument 61-101

Supermajority Voting Provisions

- Supermajority voting provisions are often used with fair price provisions in the United States to require higher levels of shareholder approval or majority of the minority approval of certain corporate transactions involving significant shareholders
- These provisions require an amendment of the company's articles passed by a special resolution of shareholders
- These provisions do not deter a bidder who is prepared to make an offer to acquire the entire company, although they may increase the minimum tender condition in the bid of an acquiring party whose financing sources require it ultimately to acquire 100% of the company, thereby weakening the strength of the offer

Approvals by "Continuing Directors"

- There is a significant risk that such provisions, to the extent inconsistent with Canadian corporate law, would be held invalid

Increased Quorum and Notice Provisions

- Bylaws may be amended to impose increased quorum and advance notice provisions in respect of any meeting called to remove directors, elect or appoint new directors not nominated by the continuing directors, or vary the qualifications of directors
- Although such bylaw amendments require shareholder ratification at the next meeting, they are valid in the interim

- These provisions are most useful as a structural defence in the context of a proxy contest, and proxy contests are not required to remove a shareholder rights plan (as a result of the current practice of Canadian securities regulators to cease trade rights plans)

Staggered Board Provisions

- These provisions are ineffective because in Canada, a bidder that acquires 50.1% in a bid can immediately move to replace the existing board

→ Tactical Defences

- National Policy 62-202, a policy adopted by Canadian securities regulators, regulates generally the defensive tactics that may be employed by a target company in advance of or in the face of a takeover bid and expresses the Policy view that unrestricted auctions produce the most desirable results in takeover bids
- The Policy warns that the securities regulators may take action where defensive measures are likely to deny or limit severely the ability of shareholders to respond to a takeover bid, although it recognizes that defensive measures may be taken in order to obtain a better bid

“JUST SAY NO”

- It is generally accepted that “just say no” can work in Canada only if the board can convince shareholders that it is in their interest to reject the bid
- The U.S.-style “just say no” defence has not been tested by Canadian courts. Depending on the circumstances, a company may be able to convince a court that the implementation of a “just say no” defence is consistent with the fiduciary duties of the directors and that the business judgment of the directors should be afforded deference by the courts

RESTRUCTURING/RECAPITALIZATION

- The goal is to give shareholders the opportunity to receive substantial cash value on a current basis while preserving the independence of the company
- One possible restructuring transaction would be a sale or spinoff of a significant asset or assets
 - o Substantial advance analysis and planning is required, including tax analysis

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Directors' Duties and Defensive Mechanisms

- o Identification of assets, the sale or disposition of which would further a defensive strategy, may depend on the identity and strategic position of bidder
- o Transaction must have a demonstrable business purpose, and be undertaken with a view to the best interests of the company or it will be subject to being set aside by a court as an improper exercise of the directors' fiduciary duties
- Another example of this would be a substantial increase in long-term debt combined with a special dividend or issuer bid to distribute cash to shareholders
 - o Transaction provides shareholders with an opportunity to realize cash value in respect of a significant portion of their investment
 - o Tax analysis is required to ascertain whether monies received by shareholders on a restructuring/recapitalization can be received tax-free

ACQUISITION OF SIGNIFICANT ASSETS

- An acquisition of significant assets may make the company more leveraged and less attractive to a bidder, and make the transaction prohibitively expensive or cause the bidder antitrust problems
- Advance identification, analysis and planning, as well as negotiation with the seller, would be required. An acquisition can be extremely difficult to implement in the face of a bid absent significant advance work
- Again, there must be a demonstrable business purpose and the acquisition must be undertaken by the directors with a view to the best interests of the company, and not solely for the purpose of fending off the bid

STRATEGIC INVESTOR OR ALLIANCE

- Such an investment or alliance could be in respect of all or any of the businesses owned by the target
- The transaction could be implemented through a private placement for cash or assets or a private placement share exchange with a compatible company to result in interlocking shareholdings (with standstills)
- TSX will require majority shareholder approval in the following circumstances:
 - o more than 25% of the outstanding shares are issued and the price is less than the market price

- o more than 25% of the outstanding shares are issued in exchange for assets or shares, or
- o the transaction results in a new holding of more than 20% of the voting securities, or otherwise “materially affects control”
- Early identification of possible parties and analysis of the strategic rationale for any transaction would be important to demonstrate a proper business purpose

EMPLOYMENT AGREEMENTS

- Change of control employment agreements or “golden parachutes” for key employees as well as a retention plan for a broader group of senior employees are critical to ensure the continuity of corporate policy and effectiveness through the time of uncertainty that will result from an unsolicited offer

WHITE KNIGHT TRANSACTIONS

- Target may agree to deal-protection mechanisms in a white knight transaction. Mechanisms may include break fee, no-shop clauses, asset options and stock options
- Ontario courts have acknowledged that deal-protection mechanisms in a white knight context are appropriate where they are required to induce a competing bid; the competing bid represents sufficiently better value for shareholders to justify their use; and they represent a reasonable commercial balance between their potential negative effect as auction inhibitors and their potential positive effect as auction stimulators

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Competition Act, Investment Canada Act and Other Restrictions on Foreign Ownership

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Competition Act, Investment Canada Act and Other Restrictions on Foreign Ownership

➔ **Competition Act (Canada): Pre-merger Notification**

- Pre-merger notification requirements apply in respect of any merger that meets certain financial and voting interest thresholds, including an acquisition of a foreign corporation with assets in Canada
- Pre-merger notification is made to the Competition Bureau, which is headed by the Commissioner of Competition (Commissioner)

FINANCIAL AND SHAREHOLDING THRESHOLDS

- To be notifiable, the transaction must exceed both of the following thresholds:
 1. Size of transaction - \$86 million (adjusted annually) in Canadian assets (book value) or gross revenues from sales generated from those assets in or from Canada
 2. Size of parties - all parties and their affiliates (in aggregate) - \$400 million in Canadian assets or gross revenues from sales in, from or into Canada
- When there is an acquisition of shares, the voting interest following the transaction must also exceed 20% (public company) or 35% (private company) or, if that threshold is already exceeded, then the voting interest must exceed 50% following the transaction

FILING INFORMATION

- Each party to a notifiable transaction must file certain basic information, including a description of the transaction and information regarding their top customers and suppliers, as well as any documents similar to those caught by item 4(c) of the *Hart-Scott-Rodino Antitrust Improvements Act* in the United States

TIMING

- Parties to a notifiable transaction are prohibited from completing the transaction before the expiry of a statutory waiting period. The Canadian merger review process and, in particular, the waiting periods, are closely aligned with the U.S. merger review process
 - The waiting period in Canada expires 30 days following the pre-merger notification filings unless, prior to the end of that 30-day period, the Commissioner issues a “supplementary information request” to the

merging parties for production of documents and/or responses to questions (similar to a U.S. second request)

- o If a “supplementary information request” is issued, then a new waiting period is triggered and expires 30 days following compliance with the request
- The Commissioner may terminate or waive the waiting period (including the initial waiting period) at any time by issuing an advance ruling certificate or no-action letter indicating that the Commissioner does not currently intend to challenge the transaction
- In an unsolicited takeover bid, where a bidder files a pre-merger notification under the *Competition Act*, the Commissioner is required to immediately notify the target company, whereupon the target company is required to file a pre-merger notification within 10 days. The timing of the target’s response does not, however, affect the running of the waiting period

ADVANCE RULING CERTIFICATE (ARC) AND “NO-ACTION” LETTERS

- When an acquisition is clearly unlikely to give rise to any substantial lessening or prevention of competition in Canada, the Commissioner may issue an ARC
- If obtained, an ARC bars the Commissioner from challenging the transaction (provided it is completed within one year) and provides an exemption from pre-merger notification requirements (including statutory waiting periods)
- If an ARC is not obtained, a “no-action” letter, which also provides substantial comfort, will be issued in appropriate circumstances where the Commissioner decides not to challenge a proposed transaction at that time

ADDITIONAL CONSIDERATIONS

- A transaction subject to pre-merger notification under the *Competition Act* could also require notice to the Minister of Transportation and potentially a public interest review if the transaction involves a transportation undertaking
- Amendments are pending relating to some technical provisions intended to expand the application of aspects of the merger notification provisions to non-corporate entities

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Competition Act, Investment Canada Act and Other Restrictions on Foreign Ownership

FILING FEE

- \$50,000 for statutory pre-merger notification and/or ARC/no-action letter application

➔ **Competition Act (Canada): Substantive Provisions**

- The Competition Bureau tends to focus on horizontal mergers between competitors. Vertical mergers between a customer and a supplier rarely raise serious issues

SUBSTANTIVE TEST

- The substantive merger provisions apply independently of the notification provisions. Thus, even non-notifiable transactions can be challenged on substantive grounds. The last successful non-notifiable merger challenge brought by the Commissioner was in 2012
- The Commissioner may challenge a merger on substantive grounds until one year after substantial completion of the transaction
- The test for imposing a remedy is whether the proposed merger is likely to lessen or prevent competition substantially in a market in Canada (e.g., will the merged entity be able to raise prices or to reduce service, quality or innovation?) The Commissioner will also assess the merger's impact on buying power and ability to suppress prices paid to suppliers below competitive levels
- Product and geographic market definition play a key role in assessing whether a merger is likely to substantially lessen or prevent competition
- Even if a proposed merger is *prima facie* anti-competitive, it may be possible to raise an "efficiencies" defence, namely that the merger should be approved if efficiency gains from the merger are greater than and offset the anti-competitive effects. To date it has proven very difficult to convince the Competition Bureau to approve a merger on the basis of efficiencies arguments

SAFE HARBOURS

- The Competition Bureau's Merger Enforcement Guidelines provide that mergers will generally not be challenged on the basis of concerns related to unilateral market power where the post-merger market share of the combined entity will be less than 35%

- Although possible, challenges based on concerns about coordinated behaviour by firms are rare. The Competition Bureau's Merger Enforcement Guidelines provide that a merger will generally not be challenged on the basis of an increase in scope for coordinated behaviour if the following conditions are met:
 - o the aggregate post-merger market share of the four largest firms in the relevant market will be less than 65%, or
 - o the post-merger market share of the merged entity will be less than 10%
- Market shares above these levels are not necessarily challenged, but require more analysis of barriers to entry, remaining competition and other relevant factors

SERVICE STANDARD TIME PERIODS

- The Competition Bureau has adopted the following service standards reflecting the time in which it aims to complete reviews of mergers:
 - o "Non-complex" mergers have an absence of competition issues and include transactions with no or minimal overlap between parties, assuming properly defined product and geographic markets. The service standard is 14 calendar days (most merger transactions in Canada fall into this category)
 - o "Complex" mergers generally involve transactions between competitors, or between customers and suppliers, where there are indications that the transaction may, or is likely to, create, maintain, or enhance market power. The service standard is 45 calendar days, unless a supplementary information request is issued, in which case the service standard is extended to 30 calendar days from when the Commissioner receives a complete response to the request from all parties
- Service standard periods typically begin after the Competition Bureau has received the complete information it needs to conduct its analysis. The Competition Bureau is not legally obligated to meet the service standard time frames and service standards do not modify statutory waiting periods

REMEDIES

- The most common remedy for a challenged merger is a consent agreement negotiated between the Commissioner and the parties to the transaction
- Remedies the Commissioner may seek from the Competition Tribunal (the specialized adjudicative body for competition matters in Canada) include injunctions to prevent or delay closing, and post-closing divestitures or

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Competition Act, Investment Canada Act and Other Restrictions on Foreign Ownership

dissolution. The Commissioner may also seek or accept a “hold separate” undertaking or consent agreement to permit closing pending completion of the Competition Bureau’s review

- The Commissioner has extensive investigatory powers (e.g., compulsory information requests and/or interviews) and use of such powers has increased in recent years
- There is no private right of action to challenge mergers in Canada

HOSTILE BIDS

- Competition law can be used as a shield if the hostile bidder is (or is potentially) a significant competitor
- Pre-merger notification by the bidder triggers a similar filing requirement for the target. The Commissioner is required to notify the target that a filing has been made. The target then has 10 days to provide pre-merger notification information. The target’s response time does not affect the running of the 30-day statutory waiting period, which still begins when the bidder files a complete notification

DOCUMENT PREPARATION

- The Commissioner will often request or even compel parties to a merger to provide documents created by the parties or the parties’ respective advisers (e.g., offering memoranda, internal strategic plans and memoranda) that can be used in the analysis as evidence in a challenge. To avoid raising competition concerns by giving the wrong impression in documents, it is important to do the following:
 - o Avoid potentially misleading phrases such as “barriers to entry” and “dominant position”. Better phrases include discussions of “competitive advantages”, “efficiencies” and “leading position”
 - o Avoid use of the word “market” in favour of terms such as “business”, “segment” or “industry”
 - o Avoid speculating on possible “competition law” problems and potential divestiture scenarios to address such problems

Investment Canada Act

APPLICABILITY

- In general, any acquisition by a “non-Canadian” of control of a business carried on in Canada is either notifiable or reviewable under the *Investment Canada Act* (ICA), Canada’s foreign investment review legislation
- Whether an acquisition is reviewable depends on the type of transaction, the value of the Canadian business being acquired, whether the investor is considered a “state-owned enterprise” and the industry sector of the Canadian business
- The ICA applies whether or not the business is currently controlled by Canadians and also applies where a Canadian business is acquired indirectly by the acquisition of a foreign corporation with a Canadian subsidiary
- Investments may be reviewed under the ICA on the basis of a “net benefit to Canada” test and on a “national security” basis
- If an acquisition is subject to review under the ICA, the investor may be prohibited from acquiring or be required to divest the Canadian business, unless the acquisition is approved by the relevant Minister
- The Minister of Canadian Heritage reviews all cultural sector investments and the Minister of Industry is responsible for all other matters

ACQUISITION OF CONTROL

- The net benefit review provisions of the ICA apply where there is an “acquisition of control”
 - The acquisition of a majority of the voting interests of an entity is deemed to be an “acquisition of control”
 - The acquisition of less than a majority of the voting interests of an entity other than a corporation (e.g., a trust or partnership) is deemed not to be an acquisition of control
 - The acquisition of less than a majority but 1/3 or more of the voting shares of a corporation is presumed to be an acquisition of control, unless it can be established that the corporation will not be controlled in fact by the investor through the ownership of voting shares
 - The acquisition of less than 1/3 of the voting shares of a corporation is deemed not to be an acquisition of control

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Competition Act, Investment Canada Act and Other Restrictions on Foreign Ownership

- o The acquisition of all or substantially all of the assets used in carrying on a Canadian business is an acquisition of control of that business
- Special considerations apply to the acquisition of any interest in a Canadian business by a state-owned enterprise (discussed below)

NOTIFICATION

- Acquisitions of control that do not exceed the prescribed review thresholds (discussed below) are rarely reviewable and instead require a relatively straightforward notification. Notifications may be made up to 30 days following closing and involve the filing of information concerning the investor and the acquired business
- Notification is not an impediment to the closing of an acquisition

REVIEWABLE TRANSACTIONS – WTO INVESTORS

- A direct acquisition of control by or from a “WTO investor” (i.e., an entity ultimately controlled by citizens of a World Trade Organization member state, such as the United States or China) is generally reviewable only when the *enterprise value* of the entity carrying on the Canadian business and all other entities in Canada, the control of which is being acquired, is \$600 million or more (effective April 24, 2015; this figure will be gradually increased to \$1 billion in subsequent years)
 - o In the case of an acquisition of control of a Canadian business that is publicly traded, the enterprise value of the Canadian business is its market capitalization plus its liabilities (excluding operating liabilities) and minus its cash and cash equivalents. Market capitalization is determined on the basis of the average daily closing price of each class of security outstanding multiplied by the average number of that security outstanding, calculated over a prescribed time period
 - o In the case of an acquisition of control of a Canadian business that is not publicly traded or in the case of an asset acquisition, the enterprise value of the Canadian business is the acquisition value plus liabilities assumed (excluding operating liabilities) and minus cash and cash equivalents
- A direct acquisition by or from a WTO investor where the purchaser is a “state-owned enterprise” (discussed below) is reviewable when the *book value* of the assets of the entity carrying on the Canadian business and all other entities in Canada, the control of which is being acquired, is \$369 million or more (for 2015; adjusted annually)

- An indirect acquisition of control by or from a WTO investor is generally not subject to review, regardless of the value of the Canadian business, but is still subject to notification
- Reviewable transactions must be approved before closing

SPECIAL REVIEW THRESHOLDS

- Acquisitions of control that do not involve WTO investors and acquisitions of control of Canadian “cultural businesses” are subject to lower thresholds for review
 - o These lower thresholds are (i) \$5 million in book value of assets for direct acquisitions; and (ii) \$50 million in book value of assets for indirect acquisitions, except that the \$5 million threshold applies to indirect acquisitions if the asset value of the Canadian business being acquired exceeds 50% of the asset value of the global transaction
- A “cultural business” includes a business that engages in the publication, production, distribution, exhibition or sale of books, magazines, periodicals, newspapers, film, video or music
 - o There is no *de minimis* exception to the determination of whether or not a business constitutes a cultural business. For example, department or convenience stores are cultural businesses if they sell even a few books and magazines
- There is no financial threshold applicable to national security review (see further details below)

STANDARD FOR NET BENEFIT REVIEW

- The test that is applied to assess transactions under the ICA is whether the transaction is likely to result in “net benefit to Canada”. The factors that the relevant Minister considers in assessing “net benefit” include the effect of the investment on (i) the level and nature of economic activity in Canada; (ii) participation by Canadians in the business; (iii) competition, research and development, efficiency and productivity in Canada; and (iv) federal and provincial government policies. It is customary for the Minister to seek input from affected provinces and other governmental departments

STATE-OWNED ENTERPRISES

- A “state-owned enterprise” includes an entity that is controlled or influenced, either directly or indirectly, by a government of a foreign state (whether federal, state or local) or an agency of such a government and

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an individual who is acting under the direction or the influence, directly or indirectly, of a government or agency of a foreign state

- Special considerations apply if the investor is a state-owned enterprise
- As discussed above, lower review thresholds apply to direct acquisitions of control by state-owned enterprises
- Potential broader application of the ICA to certain investments involving state-owned enterprise investors
 - The relevant Minister may deem any entity that otherwise qualifies as Canadian to be a non-Canadian if the Minister considers that the entity is controlled in fact by a state-owned enterprise
 - The Minister may also override the acquisition of control rules (discussed above) and deem a transaction to be an acquisition of control if the Minister considers there to have been an acquisition of control in fact of a Canadian business by a state-owned enterprise
- In addition to general net benefit review factors, if the investor is a foreign state-owned enterprise, the net benefit review will focus on whether the investor adheres to Canadian standards of corporate governance and whether the Canadian business will continue to operate on a commercial basis
- A government policy statement has indicated that investment by foreign state-owned enterprises to acquire control of a Canadian oil sands business will be found to be of net benefit on an exceptional basis only

UNDERTAKINGS

- When an acquisition is subject to a net benefit review, the investor typically must provide undertakings to the relevant Minister in order to obtain approval. Undertakings are typically for a three- to five-year term and cover areas such as employment, capital expenditures, technology transfer, research and development in Canada, and maintaining a Canadian head office and management. Undertakings to address issues with state-owned enterprises may be for longer terms or indefinite in duration
- Investors who fail to comply with their undertakings may be subject to a variety of court-ordered remedies, including orders to comply with the original undertakings or revised undertakings, to divest the Canadian business or to pay monetary penalties

TIME LIMITS

- Within 45 days of receiving an application for review, the relevant Minister must indicate whether the investment is likely to be of net benefit to Canada. This period may be unilaterally extended by the Minister for a further 30 days, which is common. Additional extensions can occur only with the investor's consent, although such consent is typically provided
- If the Minister gives notice that he or she is not satisfied that the transaction is likely to be of net benefit, the investor then has 30 days (or more on consent) in which to make further representation to the Minister

FILING FEES

- There are no fees for filing either notifications or applications for review under the ICA

NATIONAL SECURITY REVIEW

- Regardless of whether an investment is subject to a net benefit review, the ICA provides for the review of investments that "could be injurious to national security"
- The Minister of Industry has broad discretion to subject a proposed investment by a non-Canadian to a national security review
 - The expression "national security" is not defined and there are no monetary thresholds that must be exceeded to trigger a national security review
 - There is no requirement that there be an acquisition of control of a Canadian business. A national security review could occur when there has been an acquisition "in whole or in part" of a Canadian business
- The Minister has until 45 days following the filing of a notification or an application for review, or until 45 days following implementation of a transaction not subject to notification or review, to issue a notice to a non-Canadian that its proposed investment may be subject to a national security review (alternatively, a national security review can be initiated within the same time period without a notice first being sent). The entire review process can take up to 200 days
- Once the Minister issues such a notice (or once a national security review has been ordered if no notice was first sent), if the investment has not yet been implemented, it cannot be implemented unless the investor receives notice of a discontinuance of the national security review or, following a national security review, it is determined that the investment will not be injurious to national security

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Competition Act, Investment Canada Act and Other Restrictions on Foreign Ownership

- If, following the review, the Minister of Industry is satisfied that the investment would be injurious to national security, the federal Cabinet may take any measures that it considers advisable to protect national security, including imposing conditions on the investment or the outright prohibition of a proposed investment (or a divestiture in the case of a completed investment)
- The discretionary nature of the national security review provisions, including the lack of definition of “national security” and the potentially long time frames for review has introduced uncertainty into the application of the ICA to certain foreign investments in Canada

➔ **Other Foreign Ownership Restrictions**

- In addition to the generally applicable provisions in the ICA, there are also specific restrictions on foreign ownership applicable to certain industries, such as telecommunications, broadcasting, newspapers, magazines and periodicals

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Selected Canadian Tax Issues in M&A Transactions

➔ Acquirer Considerations

CANADIAN BIDCO

- A foreign acquirer typically will establish a Canadian company (Bidco) to effect a Canadian acquisition for the following reasons:
 - To permit the deduction of financing expenses against target income
 - To allow the repatriation of funds from Canada to the foreign parent free of Canadian withholding tax
 - To accommodate a “stepup” of the tax cost of target’s non-depreciable capital assets where available
- In Canada there is no tax consolidation within a corporate group. For financing expenses to be deductible against the target’s earnings, Bidco should be the borrower and, on or after the acquisition, it should merge with the target. Further structuring will be required where the target has a holding company structure, with taxable income being earned in lower-tier entities
- A non-public company (for tax purposes) may return paid-up capital to a non-resident shareholder free of the Canadian withholding tax that applies to dividend payments. There is no requirement that earnings be distributed before paid-up capital is returned. Typically Bidco’s paid-up capital will exceed target’s historical paid-up capital, allowing for greater returns of capital. Foreign tax considerations will be relevant in considering whether this provides overall tax savings
- In qualifying circumstances, a merger of Bidco and the target will permit the tax cost of the target’s qualifying non-depreciable capital property (such as shares of subsidiaries and land (but not buildings or resource properties)) to be stepped up to fair market value at the time control is acquired
 - This allows greater flexibility in dealing with assets in post-acquisition planning (see “Bump” and Associated Planning below)

FINANCING CONSIDERATIONS

- There is no Canadian withholding tax on interest paid to non-resident lenders that deal at arm’s length with the borrower for tax purposes, provided the interest is not participating interest
- Interest paid to non-arm’s-length non-residents is subject to Canadian withholding tax at the rate of 25%, subject to reduction where a Canadian tax treaty applies. Interest paid to non-arm’s-length persons entitled to the

benefits of the Canada-U.S. tax treaty is not subject to withholding tax, provided the interest is not participating interest

- Dividends paid to non-residents are subject to withholding tax at the rate of 25%, unless a Canadian tax treaty applies. Typically tax treaties reduce the rate to 15%, or to 5% for shareholders that are corporations owning at least 10% of the dividend payer's voting shares
- Thin capitalization rules deny the deduction of interest paid by Canadian corporations to "specified non-residents" to the extent it relates to debt owing to specified non-residents that exceeds 1.5 times the relevant equity. Similar rules apply for partnerships, trusts and non-resident entities carrying on business in Canada
 - Under these rules, up to 60% of the acquirer's equity can be invested as shareholder debt generating tax deductions in Canada
 - Essentially, a specified non-resident is a non-resident that holds 25% or more of borrower's shares (by votes or value), either alone or with non-arm's-length persons and taking into account rights in respect of shares, or a non-resident that does not deal at arm's length with a shareholder with such a shareholding
 - In general, only debt that is owed to specified non-residents is taken into account, so arm's-length deal financing typically does not affect thin capitalization limits
 - An anti-avoidance rule may apply to "back-to-back" loans where a specified non-resident provides credit support to a third party that lends funds to the Canadian corporation. These rules are intended to prevent the use of accommodation party financing to skirt the thin capitalization rules, but also limit the ability of corporate groups to funnel financing through entities located in jurisdictions with favourable tax treaty rates (such as the United States)
 - Relevant equity is computed as the total of (i) paid-up capital and contributed surplus that is attributable to specified non-resident shareholders, and (ii) retained earnings
 - Interest that is not deductible because of the thin capitalization rules is treated as a dividend for withholding tax purposes
 - The payment of dividends or returns of capital by the Canadian corporation will reduce its relevant equity for thin capitalization purposes (although the payment of a dividend that increases a deficit has no effect). Accordingly, careful planning is required

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Selected Canadian Tax Issues in M&A Transactions

- If the Canadian target derives significant value (generally more than 75%) from interests in foreign subsidiaries or other foreign corporations, a Canadian Bidco that is controlled by a non-resident corporation will be subject to additional restrictions under “foreign affiliate dumping” rules intended to prevent “debt-dumping” into the Canadian corporate group or the synthetic extraction of Canadian group surpluses
 - Where they apply, the rules can result in a reduction of cross-border capital, or a deemed dividend subject to withholding tax
 - The foreign affiliate dumping rules will also apply to any Canadian corporation that is controlled by a non-resident corporation that invests in foreign subsidiaries. Extremely careful planning is required for both the initial capitalization of Bidco and any additional post-acquisition funding or expansion of foreign operations

“BUMP” AND ASSOCIATED PLANNING

- Following the acquisition of control and merger of Bidco and the target, it may be possible to step-up (or “bump”) the tax cost of qualifying non-depreciable capital properties owned by the target at the time control is acquired, such as shares, partnership interests and land
- Bidco must acquire 100% of the target to undertake a bump (i.e., control alone is not sufficient)
- A bump is particularly desirable where target assets are to be sold or where target assets include shares of foreign subsidiaries that are to be transferred within the purchaser’s corporate group to optimize the group structure
 - The foreign affiliate dumping rules referred to above may place a premium on transferring the target’s foreign subsidiaries out of Canada to a location elsewhere in the purchaser group
- The bump provisions contain extensive rules to prevent the bump from benefiting selling shareholders of the target. They impose significant limitations on transferring target assets or property that derives its value in whole or in part from target assets to selling target shareholders (individually or as a group)
- The amount of “bump room” available is largely dependent on the cost of target shares to Bidco. Where a rollover is provided to selling shareholders to defer their tax on sale, the amount of bump room will be reduced

- o However, the bump can be applied selectively to target assets, meaning that a fully taxable purchase often is not necessary to accommodate selective bump planning
- The bump works best in an all-cash bid, but it can also work in circumstances where the consideration includes Bidco shares. Selling shareholders cannot acquire exchangeable shares (see below) or shares of a foreign parent
- In a friendly transaction, the target may agree to reorganize its assets before control is acquired to accommodate the bump (e.g., by transferring a division or business to a subsidiary on a tax-deferred basis). However, it is not possible to reorganize into partnership structures in contemplation of a bump transaction

TARGET CONSIDERATIONS

- The acquisition of control of the target will result in a number of tax consequences to the target and its Canadian subsidiaries
- Generally control is *de jure* control (e.g., acquisition of sufficient target voting shares to elect a majority of the target's board of directors). Acquisition of control of the target will also cause an acquisition of control of the target's controlled Canadian subsidiaries
- The acquisition of control results in a taxation year-end
- The target will be required to realize any accrued losses on depreciable and non-depreciable capital assets, inventory and accounts receivable in the taxation year ending on the acquisition of control
- Capital losses and non-capital losses from "property sources" (e.g., from making loans or earning interest or dividends) for pre-acquisition of control periods (including any arising on acquisition of control write-downs) do not survive the acquisition of control
- Pre-acquisition of control non-capital losses from a business (including any arising on acquisition of control write downs) may be carried forward on a restricted basis. Following the acquisition of control they will be deductible if the business giving rise to the loss is carried on with a reasonable expectation of profit throughout the taxation year in which the loss is to be deducted, and against income only from that business and similar businesses
- The tax cost of target assets can be selectively stepped up on an acquisition of control, providing an opportunity to use losses that otherwise would not

survive the acquisition of control or that would be less useful as a result of acquisition of control restrictions

Shareholder Considerations

DISPOSITION OF TARGET SHARES

- The disposition of shares to the acquirer typically is a taxable transaction to the shareholder
 - o Canadian residents include 50% of any capital gain in their income
 - o A non-resident typically is not subject to Canadian tax on the disposition of publicly listed shares unless at any time in the prior five years the non-resident (taking into account non-arm's-length persons and, under proposed amendments, certain partnerships) held 25% or more of shares of any class of target and at that time the shares derived more than 50% of their value from Canadian situate real property (including oil and gas and mineral properties)
- Tax-deferral can be provided to selling shareholders when the consideration includes equity
 - o On a share-for-share takeover bid, when a Canadian acquirer (Bidco) issues treasury shares to the selling shareholders, there is an automatic tax deferral for most shareholders dealing at arm's length with Bidco
 - o When consideration includes both treasury shares and cash or other assets, tax-deferral is available by joint election of the selling shareholder and Bidco up to the extent of the value reflected in the Bidco shares
 - In both of these cases, Bidco will inherit a lower tax cost in the target shares, which may be disadvantageous in some circumstances, such as where a bump is planned
 - No tax-deferral is available when shares of the Canadian target are exchanged for shares of a foreign acquirer or where a subsidiary delivers shares of its parent as consideration
 - When consideration would otherwise include publicly listed shares of a foreign acquirer, tax deferral may be achieved through the use of "exchangeable shares". Bidco would issue treasury shares to target shareholders on a tax-deferred basis that "track" to the publicly

listed shares. Generally, they have dividend and liquidation rights that match the listed parent shares, and are provided voting rights at the foreign parent. The shares may be exchanged by the holder on a one-for-one basis for the listed parent shares. Generally, the tax will be deferred until the Bidco shares are exchanged for the listed parent shares

- Exchangeable shares cannot be used where the acquirer is planning on using the “bump”
- Dividends on exchangeable shares must be paid out of taxed earnings or the issuer is subject to a penalty tax

SAFE INCOME PLANNING

- Intercorporate dividends between Canadian companies are tax-free in many cases
- Dividends paid by the target to a corporate shareholder in advance of a sale may reduce the shareholder’s capital gain on the sale. However, the dividend can be recharacterized as a capital gain where it exceeds the shareholder’s “safe income”
- Safe income often approximates the target’s taxed retained earnings on hand that accrued during the shareholder’s holding period, on a consolidated basis
- A dividend to all shareholders to access safe income planning is usually not possible or desirable (e.g., withholding tax for non-resident shareholders)
- Very significant taxable Canadian shareholders of the target may access safe income to step-up the cost of their shares as part of the sale transaction. Typically this involves the acquirer purchasing the shares of a holding company that has been established by the corporate shareholder that holds only target shares. The shareholder will have used the safe income to step-up the tax cost of the holding company shares without involving target’s other shareholders

MERGERS (AMALGAMATIONS)

- On a merger, target shareholders who receive only shares of the merged company or its Canadian parent can have a complete deferral of tax, provided all target shareholders receive only shares of the amalgamated corporation or its Canadian parent in exchange for their target shares
- Where consideration will include cash or other non-share consideration, two steps are required: redeemable preferred shares are issued on the

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Selected Canadian Tax Issues in M&A Transactions

amalgamation followed by immediate redemption of those shares for other consideration. This is often done through a plan of arrangement to allow immediate execution

- Redemption of the transitory shares can give rise to a deemed dividend (withholding tax for non-residents) or a capital gain depending on the circumstances, and it often is possible to plan for either outcome
- An amalgamation will often result in an acquisition of control of the target, with the consequences described above

SPINOFFS

- In Canada, a tax-deferred spinoff is available only in limited circumstances
- Where a spinoff qualifies, deferral is available to the company effecting the spinoff and its shareholders
- Acquisition of control of a company undertaking a spinoff (or of the subsidiary spun off) as part of the series of transactions that includes the spinoff results in loss of tax-deferral
- Typically only effected with the benefit of the advance income tax ruling from Canadian revenue authorities

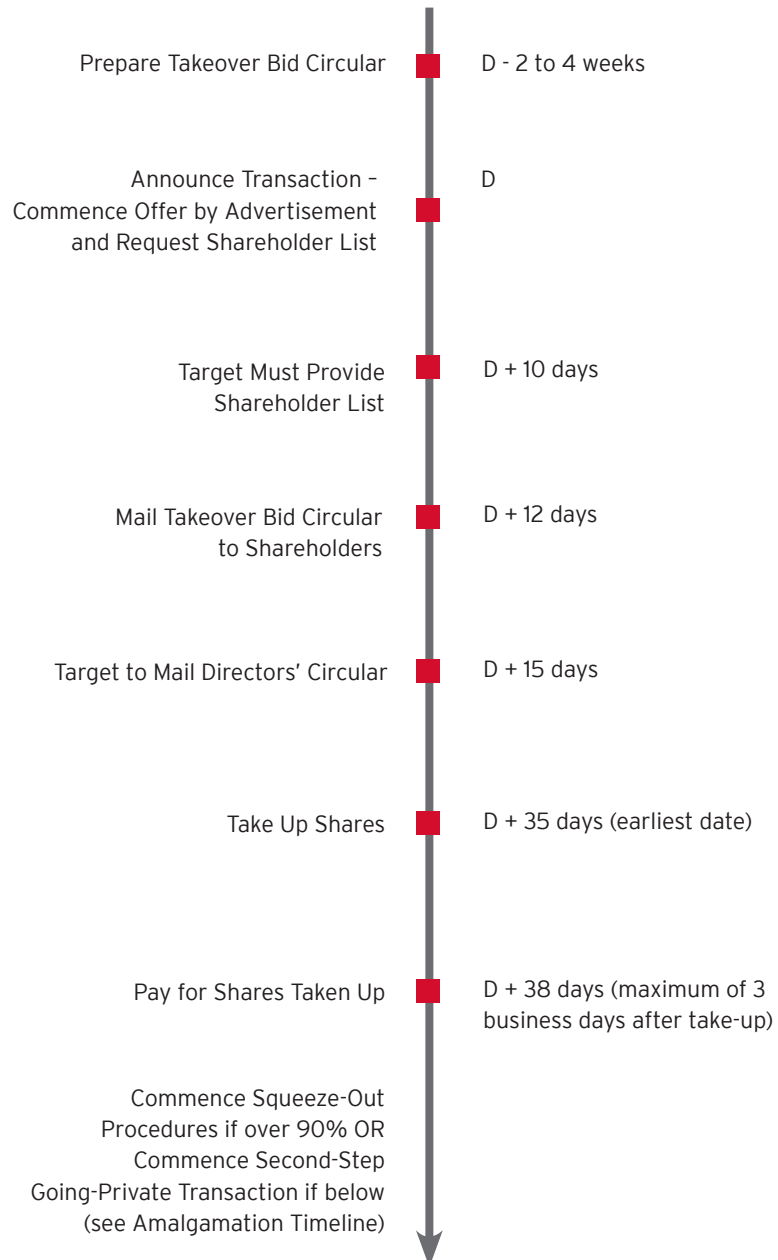
SPINOUTS

- Where the acquirer wishes to spin out certain target assets to the selling shareholders (e.g., exploration stage resource assets in a more mature company) it is possible to package the assets in a new company and spin the shares of that company out to shareholders as part of the acquisition
- Target will realize any gain in the assets being spun out
- The spinout can be a reduction of capital to shareholders when the target has sufficient capital. The reduction of capital will not be taxable, but will increase the gain on a sale of target shares
- For this reason, a spinout is most effective where the acquirer is offering a tax-deferred purchase of the target
- Spinouts typically involve a number of intermediary steps and are undertaken through a plan of arrangement

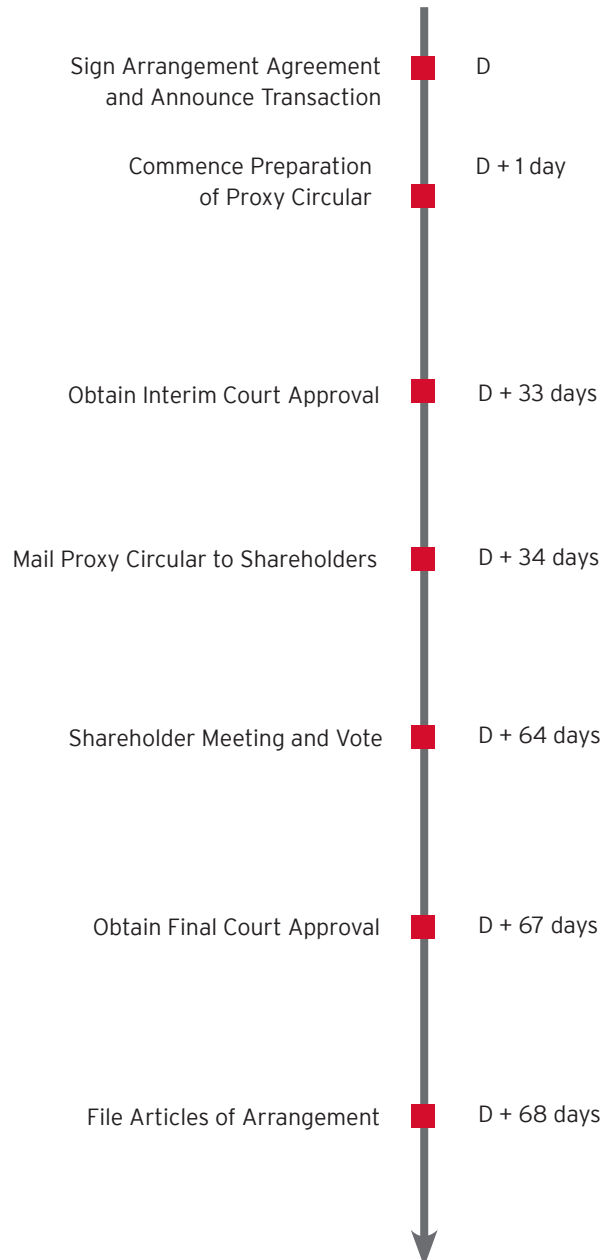
Appendix A: Summary Transaction Timelines

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→ Takeover Bid Timeline

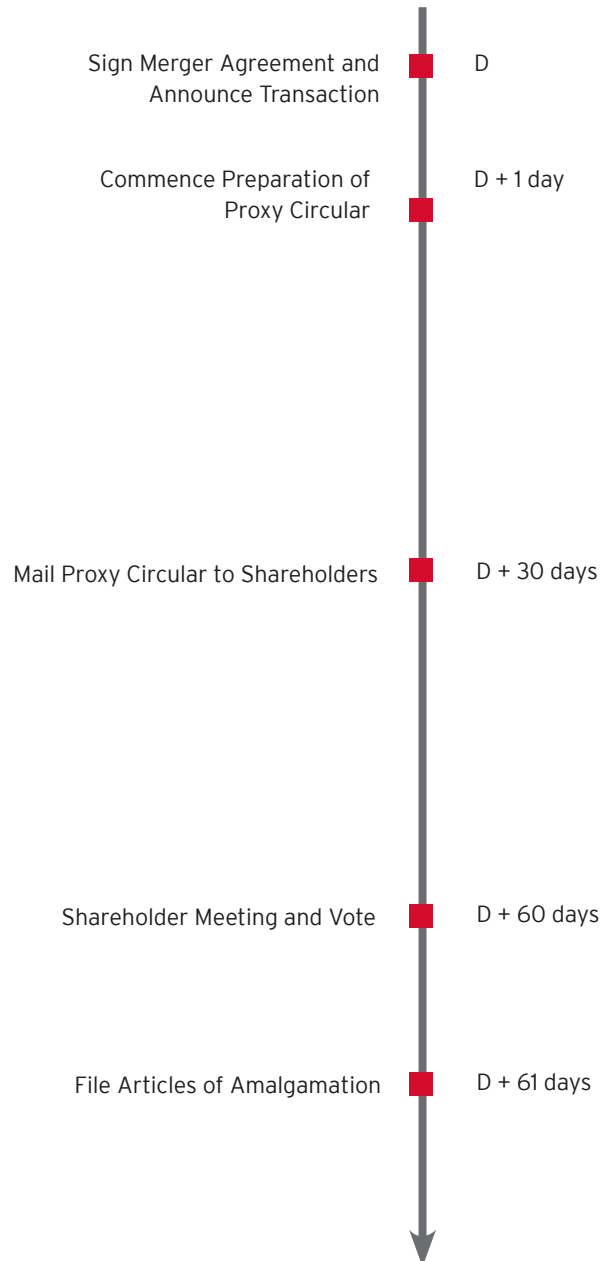


➔ Plan of Arrangement Timeline



Appendix A:
Summary
Transaction
Timelines

➔ **Amalgamation Timeline**



If you are interested in receiving more information, please contact us or visit our website at www.dwpv.com.

The information in this guide should not be relied upon as legal advice. We encourage you to contact us directly with any specific questions.

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