The Mergers & Acquisitions Review

Twelfth Edition

Editor
Mark Zerdin

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CONTENTS

PREFACE vii
Mark Zerdin

Chapter 1 EU OVERVIEW 1
Mark Zerdin

Chapter 2 EUROPEAN PRIVATE EQUITY 11
Benedikt von Schorlemer and Jan van Kisfeld

Chapter 3 M&A LITIGATION 19
Roger A Cooper, Meredith Kotler and Vanessa C Richardson

Chapter 4 PRIVATE EQUITY: AN OFFSHORE PERSPECTIVE 26
Rolf Lindsay

Chapter 5 ARGENTINA 30
Fernando S Zoppi

Chapter 6 AUSTRIA 38
Clemens Philipp Schindler

Chapter 7 BRAZIL 51
Adriano Castello Branco and João Marcelino Cavalcanti Júnior

Chapter 8 BRITISH VIRGIN ISLANDS 60
Richard May and Richard Spooner

Chapter 9 CANADA 70
Robert Yalden, Emmanuel Pressman and Jeremy Fraiberg

Chapter 10 CAYMAN ISLANDS 84
Suzanne Correy and Daniel Lee

Chapter 11 CHINA....93
Wei (David) Chen, Yuan Wang and Kai Xue

Chapter 12 COLOMBIA....104
Juan Manuel del la Rosa, Alexandra Montealegre and Lina Téllez

Chapter 13 COSTA RICA....115
John Aguilar Quesada and Marco Solano

Chapter 14 DOMINICAN REPUBLIC....121
Georges Santoni Recio, Mónica Villafaña Aquino and Laura Fernández-Peix Pérez

Chapter 15 ECUADOR....130
Fabricio Dávila Lazo

Chapter 16 EGYPT....138
Mohamed Gabr, Ingy Darwish and Engy ElKady

Chapter 17 FINLAND....148
Jan Ollila, Wilhelm Eklund and Jasper Kuhlefelt

Chapter 18 FRANCE....160
Didier Martin

Chapter 19 GERMANY....180
Heinrich Knepper

Chapter 20 GREECE....197
Cleomenis G Yannikas, Sophia K Grigoriadou and Vassilis S Constantinidis

Chapter 21 HONG KONG....208
Jason Webber

Chapter 22 HUNGARY....218
József Bulcsú Fenyvesi and Mihály Barcza

Chapter 23 ICELAND....228
Hans Henning Hoff

Chapter 24 INDIA....235
Justin Bharucha

Chapter 25 INDONESIA 251
Yozua Makes

Chapter 26 ISRAEL 261
Clifford Davis and Keith Shaw

Chapter 27 ITALY 269
Mario Santa Maria and Carlo Scaglioni

Chapter 28 JAPAN 281
Hiroki Kodate and Yuri Totsuka

Chapter 29 KOREA 290
Ho Kyung Chang, Alan Peum Joo Lee and Robert Dooley

Chapter 30 LUXEMBOURG 301
Philippe Hoss and Thierry Kauffman

Chapter 31 MALTA 314
James Scicluna, Ramona Azzopardi and Rachel Vella Baldacchino

Chapter 32 MEXICO 327
Eduardo González, Jorge Montaño and Humberto Botti

Chapter 33 MYANMAR 335
Krishna Ramachandra, Rory Lang and Bei Wang

Chapter 34 NETHERLANDS 351
Meltem Koning-Gungormez and Hanne van 't Klooster

Chapter 35 NIGERIA 361
Lawrence Fubara Anga and Maranatha Abraham

Chapter 36 NORWAY 365
Ole K Aabø-Evensen

Chapter 37 PANAMA 395
Andrés N Rubinoff

Chapter 38 PORTUGAL 403
Francisco Brito e Abreu and Joana Torres Ereio

Chapter 39 QATAR 415
Michiel Visser and Charbel Abou Charaf

Chapter 40 ROMANIA 427
Horea Popescu and Claudia Nagy

Chapter 41 SINGAPORE 438
Lim Mei and Lee Kee Yeng

Chapter 42 SPAIN 445
Christian Hoedl and Miguel Bolívar Tejedo

Chapter 43 SWITZERLAND 458
Manuel Werder, Till Spillmann, Thomas Brönnimann, Philippe Weber, Ulysses von Salis, Nicolas Birkhäuser, Elga Reana Tozzi

Chapter 44 TURKEY 467
Emre Akın Sait

Chapter 45 UKRAINE 475
Viacheslav Yakymchuk and Olha Demianiuk

Chapter 46 UNITED ARAB EMIRATES 490
James Bowden, Danielle Lobo and Abdus Samad

Chapter 47 UNITED KINGDOM 499
Mark Zerdin

Chapter 48 UNITED STATES 520
Richard Hall and Mark Greene

Chapter 49 VENEZUELA 558
Guillermo de la Rosa Stolk, Juan Domingo Alfonzo Paradisi, Valmy Diaz Ibarra and Domingo Piscitelli Nevola

Chapter 50 VIETNAM 570
Hikaru Oguchi, Taro Hirosawa and Ha Hoang Loc

Appendix 1 ABOUT THE AUTHORS 583
Appendix 2 CONTRIBUTING LAW FIRMS' CONTACT DETAILS 615

PREFACE

Despite a slight decrease in overall activity compared with 2016, 2017 was a strong year for global M&A activity as, for the fourth consecutive year, global deal-making activity exceeded US$3 trillion with announced transaction volumes reaching US$3.7 trillion. Even though 2017 did not replicate the record-breaking number of mega-deals in 2015 nor the high volume seen in 2016, market participants in a number of sectors took advantage of continued access to cheap capital globally to engage in M&A activity.

The United States remained the most active region, although aggregate deal value decreased by 16 per cent year on year. However, deal volume surged with a record 12,400 individual deals, largely due to an increase in transactions with a value of less than US$1 billion. The relative decline in mega-deals in 2017 is largely attributable to continued regulatory uncertainty, particularly in the United States, where President Donald Trump's electoral rhetoric on antitrust has led to an increase in scrutiny for M&A deals. In Europe, however, continuing uncertainty arising out of the stuttering progress in the Brexit negotiations and a number of significant elections within the European Union did little to halt the momentum of the M&A market as aggregate deal value in Europe increased by 12.1 per cent in 2017 to reach a post-financial crisis high of more than €830 billion. Notably, the industrials and chemicals M&A sector flourished, with record high aggregate deal value and deal volume. Chinese outbound M&A was limited during 2017 by both a new capital-controls regime and increased scrutiny from the US and European governments.

On the back of tax reform in the United States and encouraging economic growth in Europe, the first quarter of 2018 has displayed record-breaking deal-making activity. However, global political uncertainty presents a threat to global M&A in 2018. Although there were positive signs from the European M&A market in 2017 and Europe registered the largest year-on-year increase in deal volume in the first quarter of 2018, the rise of anti-EU populist parties threatens to derail the buoyant global M&A market. Notably, the election of an anti-EU populist government in Italy, formed from a coalition of the Five Star Movement and the League, threatens to unnerve foreign investors and increase uncertainty about the integrity of the eurozone.

In addition, President Trump's imposition of tariffs and protectionist instincts have raised concerns about the possibility of a global trade war. It is hoped that a resolution to Brexit-related uncertainty and a settling of trade worries will foster an environment in which markets can thrive. All that being said, markets have shown during the past two years that despite an ever-evolving geopolitical landscape, there are numerous opportunities for those market participants who are keen to pursue them.

I would like to thank the contributors for their support in producing the 12th edition of *The Mergers & Acquisitions Review*. I hope the commentary in the following 50 chapters will provide a richer understanding of the shape of the global markets, and the challenges and opportunities facing market participants.

Mark Zerdin
Slaughter and May, London
July 2018

Chapter 9

CANADA

Robert Yalden, Emmanuel Pressman and Jeremy Fraiberg[1]

I OVERVIEW OF M&A ACTIVITY[2]

After a sluggish start to 2016, Canadian deal-making increased through the latter half of 2016 and into 2017, buoyed by solid economic growth in Canada and the United States. The pace of activity saw 2,991 deals announced in 2017, an increase on the 2,685 announced deals in 2016. At the same time, the mixture of deals was evolving. The total transaction value of C$252 billion in 2017 was down 24 per cent from the 2016 level (C$331.5 billion), revealing a lower volume of mega-deals but a meaningful increase in activity in the mid-market.

The most active sector by deal count in 2017 was metals and mining, with 453 transactions announced. However, the utilities sector was the most vibrant when measured by deal value, representing some C$55 billion in transactions, largely due to several announced mega-deals. These included the C$22 billion acquisition of Calpine Corporation (America's largest generator of electricity from natural gas and geothermal resources) by Energy Capital Partners and a consortium led by Canada Pension Plan Investment Board (CPPIB) and Access Industries, Hydro One's C$6.7 billion acquisition of Avista Corporation, and the C$6.3 billion acquisition of an Asian wind and solar renewable energy asset portfolio from Equis Funds Group by a consortium led by Global Infrastructure Partners III in conjunction with the Public Sector Pension Investment Board (PSP) and CIC Capital Corporation.

The energy sector was also very active, with some 204 deals that included several mega-deals: for example, Cenovus Energy's C$18 billion acquisition of ConocoPhillips assets that included a 50 per cent interest in the FCCL Partnership (a jointly owned oil sands venture operated by Cenovus) and Pembina Pipeline Corporation's C$7.1 billion acquisition of Veresen. Other sectors that saw sustained activity were traditional pillars of the Canadian M&A market such as financial services and real estate, but there was also considerable activity in the increasingly vibrant information technology and healthcare sectors, as well as in the consumer staples sector.

Trends that are characteristic of M&A in Canada came into even sharper focus during 2017; for example, companies continued to be active in pursuing international expansion. Indeed, some 847 deals announced in 2017 involved outbound transactions, while there

1 Robert Yalden, Emmanuel Pressman and Jeremy Fraiberg are corporate partners at Osler, Hoskin & Harcourt LLP. The authors would like to acknowledge the contributions of fellow partners Patrick Marley and Shuli Rodal. The authors (ex-Yalden) also wish to thank Robert Yalden for his invaluable contributions to our firm, his friendship and his partnership. After nearly 30 years, Robert is retiring to join the Queen's University Faculty of Law as the inaugural holder of the Stephen Sigurdson Chair In Corporate Law and Finance.

2 Data on M&A activity cited in this chapter are sourced from Crosbie & Company Canadian M&A reports.

were 539 announced inbound deals. This ratio of 1.6 to 1 was somewhat higher than 2016. Notwithstanding the frequently expressed concern that Canadian companies are being acquired by non-Canadians, the reality is that for many years there have been meaningfully more outbound transactions than inbound, in particular, as measured by volume. Some of the drivers of this activity continue to be Canadian pension funds, as they remain active in leading large deals abroad for assets that offer exposure to stable returns. In addition to some of the examples listed above involving CPPIB and PSP, Quebec's CDPQ partnered up in Q1 not only with Suez SA with respect to the C$4.5 billion acquisition of GE water, but also with KKR & Co to acquire USI Insurance Services from Onex Corporation for C$5.8 billion. In Q4 2017, CDPQ partnered with CKD Infraestructura to purchase a portfolio of renewable power generation assets in Mexico from Enel Green Power Mexico for C$1.7 billion.

Another trend that we flagged in the last edition of *The Mergers & Acquisitions Review* and that continued to play out in 2017 was the importance of mid-market M&A. As noted, much of the increase in the number of deals announced in 2017 was attributable to this slice of the market and there is every reason to believe that this will remain a fundamental feature of current Canadian M&A not only domestically but also internationally.

The end of 2017 and the beginning of 2018 saw a particularly interesting development in Canada, as the anticipated federal legalisation of recreational cannabis set off a flurry of deal-making. Companies already in the business of selling medically regulated cannabis scaled up in anticipation of a significantly expanded market, sometimes giving rise to hostile M&A (e.g., Aurora Cannibis Inc's C$1.1 billion hostile-turned-friendly bid for Cannimed Therapeutics Inc in November 2017 and Aurora's announcement in May 2018 of a C$3.2 billion acquisition of MedReleaf Corp). At the same time, at least one sizeable company in the wine and spirits sector sought to gain a foothold in this nascent sector of the Canadian economy when Constellation Brands made its 9.9 per cent strategic investment in Canopy Growth Corporation for C$245 million.

II GENERAL INTRODUCTION TO THE LEGAL FRAMEWORK FOR M&A

Although M&A activity in 2017 involved a range of public and private company transactions, M&A regulatory developments were most prevalent in the public company context. In contrast, private M&A is predominantly the result of negotiated acquisitions governed by the terms of individual contracts. While contracts will necessarily vary with the circumstances of every transaction, in general, the overall framework of a negotiated acquisition agreement is consistent with that seen in other jurisdictions, such as the United States; accordingly, they will be familiar to many non-Canadian M&A practitioners.

While several different methods to acquire control of a Canadian public company exist, typically Canadian M&A transactions are consummated by way of a 'takeover bid' or a 'plan of arrangement'.

i Takeover bid

A takeover bid is a transaction by which the acquirer makes an offer directly to the target company's shareholders to acquire their shares. Although the board of directors of the target company has a duty to consider the offer and an obligation to make recommendations to its shareholders as to the adequacy of the offer, the takeover is ultimately accepted (or rejected) by the shareholders. Since the support of the board of directors is not legally required to effect

a takeover bid, as a practical matter a bid is the only structure available to effect an unsolicited or hostile takeover. The conduct and timing of a takeover bid, and the delivery and disclosure requirements of offer documents, are regulated by provincial securities laws.

A takeover is the substantive equivalent to a tender offer under US securities laws. There are, however, several key differences between the takeover bid and tender offer regimes. Among them, the determination of whether a takeover bid has been made is based on an objective, bright line test: unless exempted from the takeover bid rules, a formal takeover bid is required to be made to all shareholders when a person offers to acquire 20 per cent or more of the outstanding voting or equity securities of the target company. Moreover, where a bid is made for cash consideration or has a cash component, the bidder must make adequate arrangements prior to launching the bid to ensure that the required funds are available to make full payment for the target company's shares. This means that financing conditions are not included in takeover bids in Canada.

Under Canadian law, all non-exempt takeover bids (including partial bids) are subject to the following requirements:

a bids are subject to a mandatory minimum tender requirement of more than 50 per cent of the outstanding securities of the class that are subject to the bid, excluding those beneficially owned, or over which control or direction is exercised, by the bidder and its joint actors;

b following the satisfaction of the minimum tender requirement and the satisfaction or waiver of all other terms and conditions, bids will be required to be extended for at least an additional 10-day period; and

c bids are required to remain open for a minimum of 105 days, subject to two exceptions. First, the target issuer's board of directors may issue a 'deposit period news release' in respect of a proposed or commenced takeover bid providing for an initial bid period that is shorter than 105 days but not less than 35 days. If so, any other outstanding or subsequent bids will also be entitled to the shorter minimum deposit period counted from the date that other bid is made. Second, if an issuer issues a news release that it has entered into an 'alternative transaction' – effectively a friendly change of control transaction that is not a bid, such as an arrangement – then any other outstanding or subsequent bids will be entitled to a minimum 35-day deposit period counted from the date that other bid was or is made.

ii Plan of arrangement

A plan of arrangement is a voting transaction because, unlike a bid, a meeting of the target company's shareholders is called by the board of directors and held to vote on the proposed acquisition. An arrangement is governed by the corporation laws of the target company's jurisdiction of incorporation, and requires the approval of the target's board of directors and shareholders. It is the substantive equivalent of a scheme of arrangement under English law. Notably, unlike any other transaction structure, an arrangement is a court-supervised process and must be judicially determined to be 'fair and reasonable' to be approved by a court.

Arrangements are often a preferred transaction structure because of their substantial flexibility. In particular, arrangements are not circumscribed by the takeover bid rules or the structural parameters set by other forms of corporate transactions (e.g., amalgamations and capital reorganisations) and, importantly, arrangements facilitate structuring, strategic and tax-planning objectives by enabling an acquirer (and a target) to set out the precise series of steps that must occur prior to, and at the effective time of, an arrangement.

iii Other transaction structures

The other forms of M&A transaction structure that are occasionally used are a statutory amalgamation or a capital reorganisation (also governed by the corporation laws of the target's jurisdiction of incorporation). An amalgamation is a close equivalent to a 'merger' under the state corporation laws in the United States. There is, however, no legal concept of a merger under Canadian corporate law (whereby one corporation merges into another, with the former disappearing and ceasing to have any legal identity, and the latter surviving and continuing in existence). Rather, under Canadian corporate law, the amalgamating corporations effectively combine to form a single corporation. The rights, assets and liabilities of each amalgamating corporation continue as the rights, assets and liabilities of the amalgamated corporation. A capital reorganisation involves an amendment to the share capital of the charter documents of a target company that results in a mandatory transfer of the target company's shares to the acquirer in exchange for cash or shares of the acquirer.

iv Protection of minority shareholders in conflict of interest transactions

There is a significant number of public companies with controlling shareholders and corporate groups with multiple public company members. Transactions with controlling shareholders, directors or senior management, or involving members of the same corporate group, often raise conflict of interest concerns that require consideration where a related party has an informational advantage over other security holders. In response to this distinct feature of the Canadian corporate economy, securities regulators have established special rules applicable to insider bids, issuer bids (self-tender transactions) and certain types of related-party transactions and business combinations.[3] These rules are designed to protect minority shareholders by requiring enhanced disclosure, minority shareholder approval and formal valuations for such transactions in certain prescribed circumstances.

In an important Staff Notice published on 27 July 2017, staff of the securities regulatory authorities in each of Ontario, Quebec, Alberta, Manitoba and New Brunswick (Staff) have indicated that they intend to subject material conflict of interest transactions regulated by Multilateral Instrument 61-101 Protection of Minority Security Holders in Special Transactions (MI 61-101) to greater regulatory scrutiny. Material conflict of interest transactions will now be reviewed in real time to assess compliance with the requirements of MI 61-101 and to determine whether a transaction raises potential public interest concerns.

Staff have also provided guidance regarding their expectations of enhanced disclosure and the active role to be played by special committees of independent directors.

Moreover, where a fairness opinion is obtained for a material conflict of interest transaction, Staff are requiring disclosure of the structure of a financial adviser's compensation (but not the amount of the adviser's fee) and the financial analysis underlying the opinion.

v Defensive tactics and shareholder rights plans

The most common defensive tactic available to Canadian companies is a shareholder rights plan or 'poison pill'. Rights plans are well established in Canada and have many features in common with their US counterparts. Since they must be approved by shareholders within six months of adoption if they are to remain in place, institutional shareholders, proxy advisory

3 These rules are set out in Multilateral Instrument 61-101 – Protection of Minority Security Holders in Special Transactions.

firms and corporate governance advocates have had considerable influence over their terms, which have become fairly standardised in both form and substance. Although similar in form, Canadian pills are less effective and less durable than US pills, due in large measure to differences in the way disputes over their application have been litigated in the two countries.

In the United States, challenges to shareholder rights plans appear before the courts, which apply a directors' duties analysis in determining whether a board can implement and maintain a plan. In Canada, the provincial securities regulators have typically exercised their jurisdiction to issue cease-trade orders to invalidate poison pills. The regulators have weighed the interest of shareholders in not being deprived of the ability to decide whether to accept a bid. Ultimately, it has been a question of when, not if, the pill should be struck down.[4] This means that there have only been isolated occasions when a Canadian board of directors could 'just say no' for any significant length of time. Generally speaking, once a Canadian target company is put in play, a change of control transaction is very likely to be completed (either by the initial bidder or a white knight). As a consequence, the Canadian takeover bid landscape has historically been considered to be distinctly more 'bidder-friendly' than its US counterpart.

With the adoption of the new takeover bid regime in May 2016, which now provides for a 105-day deposit period as compared to the previous 35 days, it was expected that there would be fewer rights plan hearings. The lengthening of the bid period to 105 days was intended to give target board's more time to respond to a bid and to provide greater timing certainty as compared with the previous regime, in which regulators were frequently called on to determine when a pill should be struck down. Accordingly, there is less of an incentive for issuers to adopt rights plans either 'strategically' at their annual meetings or 'tactically' in the face of a bid as compared with the previous regime.

As the amendments do not apply to exempt bids, there is still a role for rights plans in protecting target issuers against 'creeping bids', such as those made through the normal course purchase and private agreement exemptions, and to prevent hard lock-up agreements. Issuers may also attempt to adopt tactical 'voting pills' in proxy contests (e.g., a rights plan with a lower than 20 per cent threshold). As a result, a number of Canadian companies have continued to adopt or renew rights plans.

In December 2017, the Ontario Securities Commission and the Financial and Consumer Affairs Authority of Saskatchewan issued an order after a joint hearing that immediately cease-traded a tactical shareholder rights plan that a target had adopted in response to an unsolicited takeover bid. This represents the first 'poison pill' decision by Canadian securities regulators since the new takeover bid regime was adopted across Canada in May 2016. The decision suggests that tactical shareholder rights plans will be cease-traded if no auction or market canvass is under way. It remains to be seen whether strategic rights plans (i.e., ones that have received shareholder approval) will be allowed to remain in effect for longer periods, and whether tactical rights plans that are adopted in conjunction with the target running an

4 National Policy 62-202 – Defensive Tactics of the Canadian securities regulators provides, in effect, that it is not permissible for the board of directors of a target company to engage in defensive measures that have the effect of denying the shareholders the ability to decide for themselves whether to accept or reject a takeover bid, thus frustrating the takeover bid process. Accordingly, the securities regulatory response to a takeover bid is principally based on a shareholder primacy model, which does not typically defer to the business judgement of directors in considering whether certain defensive tactics are appropriate.

active sales process will be allowed to remain in place for any reasonable period. In any event, our expectation is that rights plans will not be permitted to remain in effect after a 105-day formal bid, absent unusual circumstances.

vi Stock exchange requirements

Most public companies are listed for trading on the Toronto Stock Exchange (TSX), which has its own rules that govern listed companies. Among other things, in a share-for-share transaction in which share capital of the acquirer is proposed to be issued to target company shareholders as acquisition currency, it is necessary to consider whether buy-side shareholder approval is required (in addition to the sell-side shareholder approval customarily required to be obtained in M&A transactions). Under the TSX rules, listed issuers are required to obtain buy-side shareholder approval for public company acquisitions that would result in the issuance of more than 25 per cent of the outstanding shares of the acquirer on a non-diluted basis. In calculating the number of shares issued in payment of the purchase price for an acquisition, any shares issuable upon a concurrent private placement of securities upon which the acquisition is contingent or otherwise linked must be included. Accordingly, the buy-side shareholder approval requirement is equally applicable in the context of a cash acquisition transaction if the cash is raised in a concurrent or linked private placement financing transaction.

III FOREIGN INVOLVEMENT IN M&A TRANSACTIONS

Canada views itself as generally open to foreign investment. While Canada continues to review on a mandatory basis certain foreign investments to ensure they are of 'net benefit' to Canada, the financial threshold for review has been raised significantly during the past few years, with the result that only a small number of large transactions will be subject to net benefit review. While a more restrictive approach applies in the case of proposed foreign investments that involve state-owned enterprises (SOEs), there has been some indication that the current federal government may be taking a less restrictive approach to foreign investment. However, there are important cases before the federal government that had not been decided at the time of writing.

With respect to foreign investment review, approval is required under Canada's foreign investment review legislation, the Investment Canada Act (ICA), for certain large transactions that confer control over Canadian businesses to non-Canadians to ensure they are likely to be of 'net benefit' to Canada.

The threshold for review of World Trade Organization (WTO) private sector direct investment in Canadian businesses outside the cultural sector is now C$1 billion, based on 'enterprise value'. Further, as a result of the proclamation into force of the Canada–European Union Comprehensive Economic and Trade Agreement Implementation Act, the 'net benefit' review threshold is C$1.5 billion for investors from EU Member States and from other countries entitled to most-favoured-nation treatment pursuant to trade agreements with Canada.

The net benefit review threshold for non-WTO acquisitions, acquisitions involving SOEs and acquisitions of cultural businesses is based on asset book value. The current book value threshold applicable to direct non-cultural acquisitions by SOEs is C$398 million and the threshold for any direct cultural acquisitions and non-WTO acquisitions is C$5 million.

The ICA gives the government discretion in determining whether a foreign investor has a sufficient connection to an SOE such that it should be treated under the new SOE rules, and whether an investment will confer 'control' on an SOE based on indicia of 'control in fact'.[5]

Enterprise value in the case of an acquisition of a publicly traded entity is determined based on the target's market capitalisation, plus its total liabilities but excluding its operating liabilities and minus its cash and cash equivalents. Market capitalisation is to be calculated by using the average daily closing price of the target's quoted equity securities on the entity's principal market over the most recent 20 days of trading ending before the first day of the month that immediately precedes the month in which the application for review or notification is filed. In addition, if there are unlisted equity securities, the fair market value of such securities, as determined by the board of directors or other person authorised to make that determination, is to be included.

There are additional rules for private company acquisitions, partial acquisitions and asset acquisitions, each of which requires considerable valuation analysis. Direct acquisitions of Canadian businesses when the thresholds are not met, and indirect WTO investments, including by SOEs, are subject to notification only and are not subject to automatic review. These transactions may still be subject to review on national security grounds (see below). Indirect investments by non-WTO investors in non-WTO controlled targets or indirect acquisitions of cultural businesses by any investor are subject to review post-closing if the book value of assets is C$50 million or more (or C$5 million in certain cases).

In general, Canada has exercised restraint in disapproving foreign investment on net benefit grounds. Only two major transactions outside the cultural sector (the *Alliant/MacDonald, Dettwiler* case in 2008 and the *BHP/Potash* case in 2010) were disapproved after failing to meet the net benefit test under the ICA since its enactment in 1985. In each case, there were several specific and somewhat unique factors that are likely to have contributed to the outcome. However, both cases have made it clear that the ICA review process can become high-profile and politicised. Accordingly, it is important for foreign investors to carefully consider their strategies for communicating the benefits to Canada of proposed investments that are subject to the ICA.

SOEs continued to make significant cross-border investments in Canada. Chinese investment, both in terms of number of discrete investments and the aggregate enterprise value of those investments, was second only to investments from the United States in FY 2017. In terms of asset value of the investments, total cross-border M&A flows from China exceeded that of the United States.

In terms of investment by SOEs in high-profile and sensitive sectors and companies, there were clear indications from the previous federal government (in addition to the decision to preserve the lower review threshold) that a more restrictive approach would be taken, particularly in the case of proposed control investments by SOEs in the oil sands and in leading Canadian companies in other sectors. By contrast, there have been strong indications that the current Liberal government under Prime Minister Justin Trudeau is more receptive to SOE investment.

Several high-profile transactions from Chinese investors were reviewed and approved by the government in 2017. These include Anbang Insurance's takeover of Retirement Concepts, which operates retirement homes in British Columbia, Alberta and Quebec.

5 Industry Canada: Investment Canada Act. Guidelines – Investment by state-owned enterprises – Net benefit assessment: www.ic.gc.ca/eic/site/ica-lic.nsf/eng/lk00064.html#p2.

Anbang, which is privately owned and one of China's largest insurers, has faced questions in the United States relating to its ownership structure and possible ties to the government of China. The Canadian government approved the transaction as being of a net benefit to the Canadian economy. As discussed below, a greater receptiveness to Chinese investment has also been evident in the federal government's approach to applying the national security provisions of the ICA. However, there are important cases before the federal government that are being closely watched, notably a proposed investment by CCCC International Holding Limited in Aecon Group Inc that has attracted considerable public attention and has not yet been decided.

In addition to the ICA regime for 'net benefit' review of certain foreign investments, the government has the right to review on a discretionary basis, and prohibit or impose conditions on, a broad range of investments by non-Canadians on national security grounds. This regime, in effect since 2009, puts the ICA on a similar footing with equivalent statutory provisions in many other jurisdictions, including the United States. The scope of foreign investments that may be subject to review on national security grounds is much broader than that subject to a 'net benefit' review. The test applied is whether an investment is 'injurious to national security'.

The phrase 'injurious to national security' is not defined in the ICA. However, in December 2016, the government released Guidelines on the National Security Review of Investments under the Investment Canada Act. This is the first time the government has provided official insight into the national security process that has been in place since 2009. The National Security Guidelines adopt a broad approach, although they provide some useful insight into the types of investments that may give rise to national security concerns. They list nine factors the government considers when assessing whether an investment poses a national security risk:

a the potential effects of the investment on Canada's defence capabilities and interests;

b the potential effects of the investment on the transfer of sensitive technology or know-how outside Canada;

c involvement in the research, manufacture or sale of controlled goods identified in the Defence Production Act (e.g., firearms, military equipment, weapons, aircraft and defence systems);

d the potential impact of the investment on the security of Canada's critical infrastructure. 'Critical infrastructure' is broadly defined with reference to processes, systems, facilities, technologies, networks, assets and services essential to the health, safety, security or economic wellbeing of Canadians and the effective functioning of government;

e the potential impact of the investment on the supply of critical goods and services to Canadians, or the supply of goods and services to the government;

f the potential of the investment to enable foreign surveillance or espionage;

g the potential of the investment to hinder current or future intelligence or law enforcement operations;

h the potential impact of the investment on Canada's international interests, including foreign relationships; and

i the potential of the investment to involve or facilitate the activities of illicit actors, such as terrorists, terrorist organisations or organised crime.

There is limited information on the transactions that are subject to review on national security grounds, although statistics released by the government indicate that full national security reviews remain rare.

The 2016-2017 Investment Canada Act Annual Report (Annual Report) includes statistics on the national security review process, providing insight into a process that has historically been opaque. The Annual Report indicates that national security reviews are rarely conducted, as only five of the 737 investments subject to at least notification under the ICA were formally reviewed for national security reasons in FY 2017. While very few transactions have been blocked, subject to commitments, or materially delayed because of national security concerns, it should be noted that these statistics do not reflect the full impact of the national security review process; for example, the statistics do not include potential transactions that were abandoned at an early stage because of concerns raised informally.

Further, experience shows that a larger number of investments are screened informally prior to determining that no formal national security review will be conducted. In some cases, this involves asking investors to provide additional information voluntarily about their businesses and activities. Accordingly, identifying potential issues in advance and, when appropriate, proactively addressing them, may help to clarify any issues and avoid delays in execution.

According to the Annual Report, the three most important factors that led to national security reviews in FY 2017 were the potential for transfer of sensitive dual-use technology or know-how outside Canada, the potential for negative impacts on the supply of critical services to Canadians or the government, and the potential to enable foreign surveillance or espionage.

In terms of action formally taken under the national security provisions, in October 2013, the government rejected Accelero Capital Holdings' proposed acquisition of the Allstream division of Manitoba Telecom Services Inc, which represented the first transaction to be expressly disallowed on national security grounds since the creation of the national security regime in 2009. Since that time a number of national security reviews have been undertaken, with reports that investment restrictions and divestitures have been required in a small number of cases.

In 2015, a media report disclosed that a proposed investment by Chinese company Beida Jade Bird to establish an alarm manufacturing facility near a Canadian Space Agency facility was prohibited.

Later the same year, the government under Prime Minister Steven Harper ordered the divestiture of ITF Technologies by Chinese company O-Net on the basis that it was deemed to be injurious to Canada's national security. ITF operations include manufacturing and distribution of optical components and modules for the telecom market and producing high-power devices and sub-assemblies for the industrial market. O-Net challenged in Federal Court the government's order-in-council, demanding that O-Net divest itself of ITF.

As noted, greater receptiveness to Chinese investment has been evident in the federal government's approach to applying the national security provisions of the ICA. In November 2016, the federal government under Prime Minister Trudeau agreed to revisit the Cabinet order against O-Net issued by the previous Conservative government. On 27 March 2017, O-Net announced that the Cabinet had approved the acquisition, and it appears that an order imposing conditions was issued. The conditions imposed have not been disclosed and the unique facts of the O-Net transaction may limit its precedential

value. However, it does stand as another example of the government's willingness to work with investors and find solutions in certain circumstances where a viable path to approval previously may not have been possible.

Hytera's takeover of Norsat International (Norsat) is another recent high-profile example of Canada's approach to investment from China. Norsat, based in Vancouver, produces satellite equipment and transceivers, including those for military applications. Hytera, a private Chinese firm, proposed a friendly takeover and, despite considerable criticism – including from the United States – the transaction was approved by the Canadian government. The approval was granted without a full national security review, instead requiring only a 45-day extension on the standard 45-day initial review period stipulated by the ICA. The lack of a full national security review, particularly in light of the government's hesitation in the past to allow Chinese investors to acquire assets in sensitive industries, was a surprising development and was the subject of considerable media comment in Canada and the United States.

The government's approach to investment from China continues to evolve, and it is still the case that certain types of investments would be expected to attract a high level of scrutiny. As noted, the proposed acquisition of Aecon is being closely watched.

IV SIGNIFICANT TRANSACTIONS, KEY TRENDS AND HOT INDUSTRIES

i Key sectors

The energy sector has witnessed a marked improvement in deal-making following two years of lacklustre performance and despite weak oil prices, as global energy giants implemented strategic divestitures in furtherance of reallocations of capital to global portfolios. Deals in 2017 included Royal Dutch Shell's C$11 billion sale of its Canadian oil sands businesses to Canadian Natural Resources, ConocoPhillips' C$18 billion sale of its Canadian oil and gas assets to Cenovus Energy, Apache's C$500 million sale of Apache Canada to Paramount Resources, Chevron's C$1.5 billion sale of its downstream fuel business to Parkland Fuel and Statoil's C$830 million sale of its Canadian oil sands interests to Athabaska Oil.

The technology sector was also very active across a broad range of micro-cap and emerging companies and mid- and large-cap enterprises, as US-based private equity sponsors and strategic acquirers alike made material inbound investments in the Canadian tech sector. Deals included Microsoft's acquisition of Maluuba, Airbnb's acquisition of Luxury Retreats, Chan Zuckerberg Initiative's acquisition of Meta, Stryker's acquisition of NOVADAQ, Vector Capital's acquisition of Halogen Software and Francisco Partners' acquisition of Sandvine.

In addition to energy and technology, the real estate, mining, utilities and healthcare sectors also contributed to Canadian M&A activity in 2017 and 2018 to date.

ii Significant transactions

The largest transaction involving a Canadian acquirer in 2017 was Cenovus Energy's C$18 billion acquisition of ConocoPhillips' Canadian oil and gas portfolio, which transformed Cenovus into one of the three largest oil sands producers in Canada. The deal represents a theme of global energy giants making strategic divestitures with Canadian industrial counterparties. In addition to the industrial logic behind these M&A transactions, many of the deal structures involved the foreign sell-side party accepting share consideration of the Canadian buy-side party, with the result that material investments have been made by global majors in the Canadian energy sector.

The largest announced domestic transaction in 2017 was the all-stock merger of equals between Agrium and Potash (renamed Nutiren), which created the third-largest natural resources company in Canada with a C$45 billion enterprise value, continuing a trend of global consolidation in the agriculture and chemicals sectors.

In addition to these strategic transactions, Vista Equity Partners' C$4.8 billion acquisition of DH Corporation, Rhône Capital's C$2.3 billion acquisition of Garda World Security from Apax Partners, Ontario Teachers' Pension Plan's (OTPP) C$1.03 billion acquisition of Constellation Brands' Canadian wine business and Vector Capital's C$300 million acquisition of Halogen Software are representative of private equity's significant role in the Canadian M&A market across a range of sectors and sizes.

iii Cross-border inbound investment

Buyers from outside Canada are not uncommon, and inbound cross-border M&A, particularly from the United States, has traditionally been a significant source of M&A activity. There was considerable improvement during 2017 in that regard relative to 2016. The most significant inbound transactions included Vista Equity Partners' C$4.8 billion acquisition of DH Corporation, Starwood Capital's C$4 billion acquisition of Milestone Apartment REIT, The Washington Companies' C$1.7 billion acquisition of Dominion Diamonds, Rayonier Advanced Materials' C$1.1 billion acquisition of Tembec and Stryker's C$925 million acquisition of NOVADAQ Technologies. In addition to US-driven, cross-border M&A flows, China and Europe contributed to M&A activity as illustrated by the C$2 billion proposed acquisition of Aecon Group by CCCC International Holding and the C$2.9 billion acquisition of Atrium Innovations by Nestlé Health Science SA from a group of private equity and pension funds.

iv Foreign Outbound Investment

Compared with the proliferation of foreign outbound M&A by Canadian strategic acquirers during 2015–2016, 2017 was relatively subdued. Nevertheless, there were significant outbound transactions, including Hydro One's C$7 billion acquisition of Avista, SNC Lavalin's C$3.5 billion acquisition of WS Atkins, Macdonald Dettwiler's C$2.5 billion acquisition of DigitalGlobe and OpenText's C$2.1 billion acquisition of Dell EMC's enterprise content division. Overall, about 44 per cent of all transactions in 2017 involved a foreign target or buyer, with Canadian outbound acquisitions outnumbering foreign inbound acquisitions by a ratio of 1.6:1.

Purely domestic transactions involving Canadian buyers and Canadian target companies have predominantly taken place in the mid-market – a traditional area of strength for Canadian M&A and a cornerstone of the Canadian deal landscape. In 2017, transaction volume for deals under C$250 million represented roughly 90 per cent of all transactions.

A noteworthy trend has been the continuing dominance of Canadian pension funds in leading and sponsoring material domestic and global transactions; for example, OTPP acquired the Canadian wine business of Constellation Brands for approximately C$1.03 billion, the Canada Pension Plan Investment Board partnered with Blackstone to acquire Ascend Learning from OTPP and Providence Equity Partners, British Columbia Investment Management Corporation participated in Macquarie Infrastructure's consortium bid to acquire Endeavour Energy for approximately C$11.8 billion and Caisse de dépôt et placement du Québec and SUEZ acquired General Electric's water and process technologies business for approximately C$4.4 billion.

V FINANCING OF M&A: MAIN SOURCES AND DEVELOPMENTS

Canadian pension funds and the alternative lending arms of global private equity firms represent significant sources of capital and acquisition financing, and they remained major players on the global investment landscape in 2016 and early 2017. Importantly, the pension funds do not simply represent alternative financing sources of M&A activity. Rather, they have become Canada's most significant participants in global private equity, by both investing and direct investing in infrastructure and real estate assets; for example, Caisse de dépôt et placement du Québec's and CIC Capital Corporation's C$2.3 billion acquisition of FONCIA Groupe SAS from Bridgepoint Advisers Limited and Eurazeo, CPPIB's C$1.7 billion acquisition of Hotelbeds Spain, SLU from Tui Group in partnership with Cinven Limited, CPPIB's C$3.2 billion acquisition of a 40 per cent stake in Glencore Plc's agricultural products business and Alberta Investment Management Company's, OTPP's and OMERS' C$3.8 billion acquisition of London City Airport Ltd. In general, Canadian credit markets continued to be relatively robust because of low interest rates, especially for investment grade debt issuers, with the result that acquisition financing is generally readily available. Moreover, the Canadian public equity and debt capital markets have traditionally been material sources of financing for large capitalisation M&A transactions.

VI TAX LAW

i Extension of reassessment period could impact scope of diligence

The 2018 Canadian federal budget proposed several tax measures, some of which could affect M&A transactions. The budget proposed to give the Canada Revenue Agency a three-year extension for reassessments in respect of income arising in connection with a foreign affiliate of a taxpayer (extending the total reassessment period to either seven or eight years). Previously the extended reassessment period only applied in respect of certain transactions involving the taxpayer and a non-arm's length non-resident person. This change could alter the scope of due diligence that is completed in respect of M&A transactions by extending the scope of taxation years that should be reviewed as part of the diligence process.

ii Attorney–client privilege in the transactional context

The Canadian Federal Court of Appeal released the *Iggillis Holdings Inc and Ian Gillis v. Minister of National Revenue* (2018 FCA 51) decision (*Iggillis*) that confirms certain key features of the Canadian attorney–client privilege, and overturns a troublesome lower court judgment that curtailed the scope of attorney–client privilege in the transactional context.

Generally, communication between an attorney and a client in Canada that entails the seeking or giving of legal advice where that advice is intended to be confidential is subject to attorney–client privilege. This privilege belongs to the client and, generally, can be waived only by the client. The courts have also accepted that by divulging privileged information to a third party, a client may waive the attorney–client privilege against everyone; in other words, the divulged information is no longer subject to attorney–client privilege. The Canadian courts have generally agreed that there is no waiver of attorney–client privilege if information that is subject to attorney–client privilege is shared in confidence with a party that has a common interest in completing a transaction (common interest privilege).

The lower court in *Iggillis* relied on certain US jurisprudence to reject the notion that common interest privilege has a place in Canadian law. The Canadian Federal Court

of Appeal unanimously overturned the lower court's decision, finding that the sharing of information (in that case a tax planning memorandum), in confidence, with other parties that have a common interest in completing the transaction would not result in a waiver of attorney–client privilege.

iii General

It continues to generally be desirable for Canadian corporations to be acquired through a Canadian acquisition company, rather than having a non-resident acquire the Canadian corporation directly. In particular, this may assist in maximising the amount of cross-border paid-up capital (PUC) of the Canadian parent company that may be distributed to its non-resident shareholders free of Canadian withholding tax. Maximising PUC also assists in maximising the available borrowing room under Canada's 1.5:1 debt-to-equity thin capitalisation rules, which can allow increased related party debt without triggering a denial of interest deductibility (or deemed dividend withholding tax). Subject to a set of detailed rules, use of a Canadian acquisition company may also make it possible to combine the Canadian acquisition company with the acquired Canadian corporation to increase or 'bump' the tax cost of subsidiary shares following the combination as an amalgamation or wind-up.

iv International

In an effort to address treaty abuse in its tax treaties, Canada signed the OECD's Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI). Canada intends to complete its domestic ratification process in 2018. As a result, it is expected that the MLI's 'principal purpose test' will apply to limit access to various tax treaty benefits (after Canada's relevant treaty partners also complete their domestic ratification processes).

VII COMPETITION LAW

Canada's competition law merger review regime is, to a large extent, aligned with its US counterpart. Subject to certain exceptions, the Competition Act requires parties planning to undertake certain types of transactions that affect businesses with assets or sales revenue in Canada (even if only indirectly as a result of a transaction occurring principally outside Canada) to file a pre-merger notification with the Competition Bureau prior to completing a transaction. In general, a transaction is notifiable where both the party size and transaction size thresholds are exceeded:

a The 'party size' threshold is exceeded if the parties to the transaction, including affiliates, have assets in Canada with an aggregate gross book value that exceeds C$400 million, or aggregate gross revenues from sales in, from or into Canada that exceed C$400 million.

b The 'transaction size' threshold is exceeded, if, for an acquisition of assets in Canada of an operating business, the aggregate value of those assets, or the gross revenues from sales in or from Canada generated from those assets, exceed C$92 million; or if, for an acquisition of voting shares of a corporation, the aggregate value of the assets in Canada of the corporation, or the gross revenues from sales in or from Canada generated from those assets, exceed C$92 million.

If the transaction is an acquisition of shares, an additional threshold requires that the voting interest of the purchaser post-transaction exceeds 20 per cent for a public company and 35 per cent for a private company (or 50 per cent if the lower threshold is already exceeded).

Upon receipt of the parties' filing, the Competition Bureau will conduct a substantive merger review to determine whether the proposed transaction will be 'likely to prevent or lessen competition substantially'. The transaction may not be completed until the expiry of a 30-day waiting period, following which the parties can close, provided the Commissioner of Competition has not exercised his or her discretion to extend the waiting period by requiring the notifying parties to supply additional information (a supplemental information request (SIR)). Upon the issuance of an SIR, the waiting period stops until a complete response has been submitted. Once the response to the SIR is submitted, a further 30-day period starts to run and the parties can close their transaction following its expiry, unless the Commissioner challenges the transaction or obtains an injunction to prevent or delay closing, or the parties have agreed otherwise. The issuance of an SIR is typically reserved for transactions between competitors when there is a serious concern about a potential prevention or lessening of competition.

The Competition Act also provides for a procedure pursuant to which transactions that do not give rise to significant substantive merger issues may be exempted from the pre-merger notification requirements and from substantive review. This procedure allows the Commissioner to issue an advance ruling certificate in cases where he or she is satisfied that there are not sufficient grounds on which to seek an order from the Competition Tribunal in respect of a transaction.

The Commissioner has a general discretionary right to review (and challenge) on substantive competition law grounds any merger, including mergers that do not meet the thresholds for mandatory pre-merger notification, until one year after closing (unless this discretionary authority has been relinquished, which is rare). If the Commissioner challenges a transaction, the Competition Tribunal may make an order prohibiting a merger, dissolving a completed merger or requiring other remedial action, such as divestitures.

VIII OUTLOOK

There was a significant increase in the volume of M&A activity during 2017, and the early part of 2018 suggests that this upward trend is likely to continue in the short term. It bodes well for the year ahead that aggregate deal value remains at near-record levels, thanks to a number of large mega-deals, but the fact that a strong, resurgent mid-market is once again the driving force behind Canadian deal-making is an equal reason for optimism. Despite this positive momentum, much will depend on whether the outbound deal-making that drove M&A activity in the 2015–2017 period will continue throughout 2018, and whether changes on the international political scene, such as Brexit negotiations in the United Kingdom and negotiations concerning NAFTA with a protectionist administration in the United States, ultimately cool this important source of Canadian M&A.

The outlook for domestic deal-making is more certain. It has increased again in the first quarter of 2018, and the transaction volume of 834 announced deals is the highest level for a given quarter in six years. We anticipate that buoyant equity markets and continued low borrowing costs will help market conditions in Canada remain very attractive for domestic buyers, and so we expect to see more corporations seeking M&A opportunities in furtherance of strategic growth throughout 2018.

Appendix 1

ABOUT THE AUTHORS

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Robert Yalden is a partner in Osler, Hoskin & Harcourt LLP's business law department. He is co-chair of the firm's mergers and acquisitions group, and head of the Montreal office's corporate law group. Mr Yalden's career with Osler spans over 25 years, during which he has participated in some of Canada's most innovative and pioneering transactions. He was intimately involved with implementing the first poison pill in Canada and has since worked with many companies on their defence strategies. He led the Osler team involved in Canada's largest-ever completed leveraged buyout, and the Osler teams involved in some of the largest private equity deals in Quebec. He also led the Osler team involved with significant proxy fights that have seen the problem of 'empty voting' on the part of hedge funds receive considerable public scrutiny in Canada. Mr Yalden advises management and boards of directors in connection with a wide range of M&A transactions, including hostile and friendly business acquisitions, the implementation of defensive strategies, going-private transactions and strategic alliances. Mr Yalden is a former Supreme Court of Canada law clerk, serves as adjunct professor at McGill University's Faculty of Law, and has written extensively on business law issues. From August 2018, he will be the inaugural holder of the Stephen Sigurdson Professorship In Corporate Law and Finance at Queen's University.

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Manny Pressman is chair of the corporate department and former head of the mergers and acquisitions group. He represents public and private companies, private equity sponsors, special committees, boards and financial advisers involved in takeover bids, proxy contests, joint ventures, negotiated and contested mergers and acquisitions, and a range of corporate transactions and restructurings. His clients have included Magna International, Fairfax Financial, KingSett Capital, Walter Energy, The ADT Corporation, Shoppers Drug Mart, Blackstone and Vector Capital. Manny is repeatedly recognised as a leading M&A practitioner, including by *Who's Who Legal* (M&A, corporate governance), *IFLR 1000* (M&A), *Chambers Global: The World's Leading Lawyers for Business* (corporate/M&A), The Lexpert/AmLaw *Guide to the Leading 500 Lawyers in Canada* (corporate/M&A), *The Legal 500* (corporate/M&A), *The Best Lawyers in Canada* (M&A) and *The Canadian Legal Lexpert Directory* (M&A, corporate finance, corporate mid-market). He is a frequent speaker at conferences relating to

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