Canadian Public Company Mergers & Acquisitions
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Mergers & Acquisitions

This guide is designed as a practical, hands-on tool to assist directors and officers, potential acquirors and investors in understanding the issues surrounding acquisitions of public companies in Canada.

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While several different methods exist to acquire control of a Canadian public company, M&A transactions in Canada are most commonly effected by way of “take-over bid” or “plan of arrangement.” These transactions are outlined in detail below.

**TAKE-OVER BID**

**Overview**
A take-over bid is a transaction by which the acquiror 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 make a recommendation to its shareholders as to the adequacy of the offer, the take-over bid is ultimately accepted (or rejected) by the shareholders. As the support of the board of directors is not legally required to make a take-over bid, a bid is the only structure available, as a practical matter, to effect an unsolicited or hostile acquisition. Take-over bids are also regularly used for friendly transactions when the parties agree that there is no compelling reason to make use of a plan of arrangement. A take-over bid is the substantive equivalent to a tender offer under United States securities laws.

**Legislation and Governing Principles**
Take-over bids are regulated under provincial securities legislation, as there is currently no federal securities regulator in Canada. Accordingly, public company take-over bids are generally structured to comply with the securities legislation of each jurisdiction in which the target company’s shareholders reside, a process which is assisted by each province and territory having essentially adopted the same take-over bid regime (with the exception of Ontario, which has passed equivalent legislation).

A take-over bid must be made to all holders of the class of voting or equity securities being purchased (and any holders of securities convertible into such voting or equity securities), but need not be made for all shares of that class, such that “partial bids” are permitted. The same price per security must be offered to each holder of the class of securities subject to the bid.
There are also minimum standards relating to the conduct of the bid, including disclosure, the timing and delivery of take-over bid materials, and rules designed to ensure the equal treatment of all security holders.

A take-over bid is made pursuant to a disclosure document commonly referred to as a take-over bid circular. This document must contain prescribed information about the offer, the offeror and the target company. When the offered consideration consists (in whole or in part) of securities of the offeror, the circular must also include prospectus-level disclosure about the offeror. It is generally not necessary to pre-clear the contents of a take-over bid circular with the securities regulators in Canada and the take-over bid circular is not generally subject to their review once it is filed.

**Take-Over Bid Rules**

**When does a Take-over Bid Occur?**

Determining whether a take-over bid exists is based on objective factors and, in particular, is based on the percentage of voting or equity securities to be owned by the offeror following the successful completion of the take-over bid (as opposed to the more subjective factors used in the United States, such as the method and timing of acquisition). The take-over bid threshold is 20% of any class of voting or equity securities. It is important to bear in mind that there are special rules which must be considered when determining whether the threshold level of ownership by the offeror will be crossed. Among other things, the number of securities owned by the offeror includes securities that could be acquired through rights or obligations to acquire securities within 60 days (e.g., through options, warrants or convertible securities) and securities held by affiliated entities and joint actors.

**Equal Treatment of Shareholders**

A cornerstone objective of the take-over bid regime is the equal treatment of all security holders of a target company. To this end, the take-over bid rules: (i) limit the number of securities that an offeror can acquire other than through the take-over bid by means of “bid integration” rules; (ii) require that all holders of the same class of securities of the target company be offered identical consideration; and (iii) prohibit side deals or “collateral benefits” from being provided to security holders that would have the effect of providing certain holders with consideration of greater value than other holders.

**Timing and Delivery Requirements**

Take-over bids may be commenced by publishing an advertisement in at least one major daily newspaper in each province (including an advertisement in French in the Province of Québec in circumstances where the target company has shareholders in Québec) provided that the offeror files the bid circular with securities regulators and delivers it to the target company on or before the date of the advertisement and requests a shareholders’ list from the target company. The take-over bid circular must be delivered to the target company’s shareholders within two business days of receipt by the offeror of the shareholders’ list. The target company is, in turn, required to file with securities regulators and deliver to the target company’s shareholders a directors’ circular no later than 15 days after the date of the take-over bid. This directors’ circular must: contain a recommendation that shareholders accept or reject the take-over bid; adopt a neutral position to the effect that the board is not making a recommendation and the reasons why the directors have remained neutral; or provide an explanation why the directors are not yet in a position to make a recommendation.
Take-over bids must be open for acceptance for at least 35 days. When all the terms and conditions of the bid have been satisfied or waived, the offeror must take up and pay for all deposited securities not later than 10 days after expiry of the bid. Securities taken up must be paid for not later than three business days after the taking up of the securities. Shares deposited to a bid may be withdrawn at any time up to 35 days from the date of the offer and thereafter at any time if the securities have not been taken up by the offeror. As well, deposited shares which have not been taken up may be withdrawn at any time up to 10 days after the date of any variation in the offer unless the variation consists solely of the waiver of a condition in an all cash bid, or solely of an increase in price and the bid is not extended for more than 10 days.

Bid Conditions
A take-over bid may be subject to the satisfaction of conditions, including conditions relating to regulatory approvals, material adverse changes, market interruptions and other contingencies. However, a take-over bid may not be conditional upon financing. Where the consideration offered pursuant to a take-over bid is cash or has a cash component, the offeror must make adequate arrangements prior to launching the bid to ensure that required funds are available to make full payment for the target company’s securities. Accordingly, it is customary for the offeror to obtain a binding commitment from a financing source prior to the launch of the take-over bid. The financing arrangements required to be put in place may themselves be subject to conditions if the offeror reasonably believes the possibility to be remote that, if the conditions in the take-over bid circular are satisfied or waived, the offeror will be unable to effect payment due to a condition to the financing not being satisfied. Accordingly, most offerors ensure that, at least substantively, the conditions in the take-over bid include any conditions to the financing.

Structure of Minimum Tender Condition
If the offeror’s objective is simply to acquire control of the target company, the minimum tender condition is typically set at 50.1% (i.e., a simple majority). Where the offeror’s objective is to acquire all of the outstanding shares of the target company, the minimum tender condition is typically set at 90%, or at least 66 2/3% (75% for some jurisdictions) in order for the offeror to achieve a level of certainty regarding the outcome.

If an acquiror acquires more than 90% of the securities subject to the offer (other than those it previously held), both Canadian federal and provincial corporate legislation provide a procedure for the compulsory acquisition of the balance of shares. No shareholder vote is required, though shareholders have the right to dissent and be paid the fair value of their shares. When less than 90% but more than 66 2/3% (or 75% in some jurisdictions) of the outstanding shares are acquired, the offeror can complete the acquisition of 100% of the target company by means of a subsequent going private transaction. This will require holding a special meeting of the shareholders of the target company to vote on the transaction. In this circumstance, the offeror can vote the shares that were deposited under the offer. Since the voting threshold under applicable corporate law for approval of a going private transaction, such as an amalgamation, is 66 2/3% (or 75% in some jurisdictions) of the shares voting at the meeting of shareholders the offeror can be assured that the transaction will be approved.
In circumstances where the offeror (or its affiliates or joint actors) owned shares of the target company prior to the commencement of the take-over bid, it could be necessary to adjust the minimum tender condition because, in addition to the approval requirements under corporate law, a subsequent going private transaction must be approved by a majority of the “minority” shares voted at the meeting of shareholders. Generally speaking, the minority shareholders are those other than the offeror (or its affiliates or joint actors) at the commencement of the take-over bid. This requirement is commonly referred to as the requirement to have “majority of the minority” approval.

Integration of Market Purchases
A take-over bid must be made for at least the same price and for at least the same percentage as any purchases made by the offeror from any target company shareholder within the 90 days preceding the bid, unless those purchases were normal course purchases on a published market. Once the take-over bid is announced, the offeror is generally prohibited from making any purchases other than through the take-over bid until the take-over bid expires. However, the offeror is permitted to purchase up to 5% of the class of securities subject to the bid (including securities convertible into that class) if, among other things: (i) the intention to make such purchases is disclosed in the take-over bid circular or in a news release issued at least one business day prior to making such purchases; (ii) the purchases are made in the normal course on a published market; and (iii) the offeror files a daily press release disclosing (among other things) the number of securities purchased and the price paid. As well, the offeror is generally prohibited from making any further purchases for 20 business days after the expiration of a take-over bid.

Take-over Protection for Inferior-Voting Rights
Several Canadian companies have made use of non-voting, restricted-voting and multiple-voting securities in their financing and capital structures. Under Toronto Stock Exchange rules, listed companies with such a share structure are generally required to provide take-over “protection” (known as a “coat-tail”) to holders of non-voting or restricted voting shares. The coat-tail provisions are included in the share provisions of the non-voting or restricted voting shares or are included in a trust agreement between the target company and a trustee for the benefit of the holders of those non-voting or restricted shares. Coat-tail provisions generally permit holders of non-voting or restricted shares to participate rateably in a take-over bid for superior voting shares or other change of control transaction.

PLAN OF ARRANGEMENT
Overview
A plan of arrangement is a “voting transaction.” It is first negotiated with the target company’s board of directors and remains subject to the approval of the target company’s shareholders at a special meeting held to vote on the proposed acquisition. Governed by the corporate laws of the target company’s jurisdiction of incorporation, a plan of arrangement also requires court approval. Due to its ability to effect the acquisition of all of the outstanding securities of a target in a single step and its substantial structuring flexibility, an arrangement is often a preferred transaction structure.
An arrangement is often a preferred transaction structure, given its substantial structuring flexibility.

**Court Supervision and Approval**

Unlike any other transaction structure, an arrangement is a court-approved process.

The target company applies to the relevant provincial court to begin the process of effecting the arrangement. An initial appearance will be made before the court for an interim order setting the procedural ground rules for the arrangement transaction. The interim order will specify, among other things: (i) the manner in which a special meeting of the shareholders will be called (e.g., form of proxy materials to be distributed, notice periods, time and place of meeting, etc.); (ii) the persons entitled to vote at the meeting; (iii) whether any class of persons will be entitled to a separate class vote; and (iv) the approval thresholds required to approve the arrangement.

Once the meeting of the target company shareholders is held and the arrangement resolution is approved by the shareholders, the target company attends again at court to seek a final order approving the arrangement. The final order will be granted if the court is satisfied as to the arrangement being “fair and reasonable.”

**Shareholder Approval**

Although the shareholder approval threshold for an arrangement is generally subject to the discretion of the court and addressed at the procedural hearing when the interim order is made, an acquiror will typically propose that it seek the same approval threshold as would be required for another type of fundamental change under the applicable corporate law statute governing the target company. In most Canadian jurisdictions this threshold is 66 2/3% (though certain jurisdictions have a 75% threshold) of the votes cast at the meeting of the target company’s shareholders. The approval of a majority of the minority shares voted at the meeting may also be required in circumstances where the business combination rules under securities law are applicable (see “Minority Shareholder Protections” below).

**Advantages & Disadvantages**

An arrangement is often a preferred transaction structure due in part to the ability to effect the acquisition of all outstanding securities of a target company in a single step and in part, to its substantial structuring flexibility. In particular, arrangements are not circumscribed by the take-over bid rules or the structural parameters set by other forms of corporate transactions (e.g., amalgamations and capital reorganizations) and, importantly, arrangements facilitate structuring, strategic and tax planning objectives by enabling an acquiror (and a target) to set out the precise series of steps that must occur prior to and at the effective time of an arrangement.

In acquisitions of a target company with shareholders in the United States involving a share exchange, it may also be desirable to proceed by way of an arrangement because the structure may enable an acquiror (who is also the issuer of securities) to make use of an exemption from the registration requirements of the United States Securities Act of 1933 available in the context of a court-approved fairness hearing, thereby potentially avoiding the requirement to file a registration statement with the U.S. Securities and Exchange Commission with respect to the securities proposed to be used as acquisition currency.

In addition to the flexibility of an arrangement for implementing complex transactions, the directors of the target company may take comfort from the fact that an arrangement has been court approved and determined to be fair and reasonable, potentially insulating the transaction from criticism post-closing.
**BID vs. ARRANGEMENT**

The following chart highlights some of the key advantages and disadvantages of a take-over bid and an arrangement.

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<tr>
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<th>Advantages</th>
<th>Disadvantages</th>
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<tr>
<td><strong>Take-Over Bid</strong></td>
<td>• Offeror controls the agenda and deal documents;</td>
<td>• Bid may not result in the acquisition of all the outstanding shares and may need to be followed by a second-step going private transaction if less than 90% of the shares are tendered.</td>
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<td>• As the offer is extended directly to shareholders in a non-friendly context, there is no need to negotiate any agreement with target’s board of directors;</td>
<td>• A second-stage going private transaction will add an additional six to eight weeks to transaction timing.</td>
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<td>• If the target does not have a shareholder rights plan (i.e. poison pill) in place or waives its plan, the take-over bid may be completed slightly more quickly than a plan of arrangement or corporate transaction (approximately 35 to 45 days following commencement of the take-over bid);</td>
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<td>• Facilitates a hostile or unwanted offer; and</td>
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<td></td>
<td>• No dissent and appraisal rights given to target company shareholders.</td>
<td></td>
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<tr>
<td><strong>Arrangement</strong></td>
<td>• Achieves acquisition of all outstanding target company securities in a single-step transaction;</td>
<td>• Court-supervised process and fairness hearing on arrangement creates incremental execution risk and may be used as a forum for objections and complaints by security holders;</td>
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<tr>
<td></td>
<td>• Single step eliminates bridge financing risk;</td>
<td>• Target controls the agenda and deal documents;</td>
</tr>
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<td></td>
<td>• Substantial flexibility in structuring, dealing with convertible securities (e.g., options, warrants) and achieving tax planning objectives;</td>
<td>• Additional time, cost and complexity to implement transaction; and</td>
</tr>
<tr>
<td></td>
<td>• Financing conditions, collateral benefits and other prohibitions under take-over bid rules are permissible; and</td>
<td>• Dissent and appraisal rights typically given to target company shareholders.</td>
</tr>
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<td>• Potential availability of registration exemption under U.S. securities laws in share exchange merger transaction.</td>
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OTHER TRANSACTION STRUCTURES

Other common forms of acquisition transaction structures include a statutory amalgamation and a capital reorganization involving mandatorily transferable securities. Both are corporate transactions that require the approval of the target’s board of directors and its shareholders.

An “amalgamation” is a close substantive equivalent to a “merger” under the state corporation laws in the United States. However, there is no legal concept of a merger under Canadian corporate law (meaning 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 reorganization can be used as an acquisition structure through an amendment to the share capital of the charter documents of a target company that results in a mandatory transfer of the target’s shares to the acquirer in exchange for cash and/or shares of the acquirer.

In both cases, the acquirer will generally need approval of 66⅔% (or 75% in some jurisdictions) of the votes cast at the meeting of the target company’s shareholders.
Acquirors may want to consider accumulating shares of a target company before making an offer.

TOEHOOLD POSITIONS

Once an offeror has publicly announced its intention to make a take-over bid, there exist only limited exemptions under which the acquiror may purchase shares of a target company outside the take-over bid. Accordingly, it is common for acquirors to consider whether to accumulate shares of a target company before commencing an offer in order to acquire a “toehold” position in the company. Prospective offerors typically acquire a toehold through open market purchases or private agreement transactions. The advantages and disadvantages of acquiring a toehold position must be carefully evaluated.
The following chart highlights some of the key advantages and disadvantages to acquiring a toehold position.

<table>
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<tr>
<th>Advantages to a toehold position</th>
<th>Disadvantages to a toehold position</th>
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<tr>
<td>• May provide the offeror with leverage when dealing with a target’s management;</td>
<td>• Buying the target’s shares may increase the offeror’s cost and risk of loss if a transaction is not consummated;</td>
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<tr>
<td>• Affords the opportunity to acquire shares without paying a significant premium, thereby saving money that can be used to subsidize a higher price in a formal bid and, ultimately, lowering the average cost of the acquisition if the take-over bid is successful;</td>
<td>• The acquisitions may increase the likelihood of premature disclosure of the offeror’s intentions;</td>
</tr>
<tr>
<td>• The initial purchase may either deter potential third party offerors or increase the possibility of recouping transaction expenses should a competing offer top the offeror’s offer (in the latter situation, the offeror may profit from selling its shares of the target to the competing offeror); and</td>
<td>• Market movement could increase the price of the target’s shares, thereby increasing the price that the offeror must pay in further accumulations of shares;</td>
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<tr>
<td>• Initial purchases may permit the offeror to assert rights under corporate law available to shareholders, including the right to demand a shareholder list or requisition a meeting of shareholders.</td>
<td>• Substantial initial purchases without the approval of target’s management might alienate management; and</td>
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<td>• Any shares acquired prior to the date of a takeover bid may not be counted for purposes of the “majority of the minority” shareholder vote in respect of a second-step going private transaction following a takeover bid, or for purposes of the compulsory acquisition procedure available under federal and most provincial corporate statutes.</td>
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The amount of any accumulation of shares will generally be limited by the liquidity of the shares and the applicable take-over bid rules relating to pre-bid integration and early warning reporting obligations.

**EARLY WARNING REPORTING DISCLOSURE**

Canadian securities laws contain an “early warning” reporting system relating to the acquisition of securities of public companies. When a purchaser acquires sufficient voting or equity securities of any class of securities such that it beneficially owns or has control or direction over 10% or more of the securities, the purchaser is required to issue a press release and file an early warning report within two business days. Further press releases and reports are required upon the acquisition of each additional 2% or more of the outstanding securities. The disclosure required in the press releases and reports must cover, among other things: (i) the number and percentage of securities acquired; (ii) the purpose for acquiring the securities; and (iii) any further intention to acquire additional securities. There is also a cooling-off period that prohibits further purchases by the purchaser until one business day after each report is filed. The cooling-off period ceases at the 20% ownership level, at which point the take-over bid rules are engaged.

**“FRIENDLY” TAKE-OVER**

A key consideration in structuring a public M&A transaction is whether the target board’s cooperation is necessary or desirable. Proceeding with the support of a target’s board (whether by way of bid, arrangement or otherwise) affords an acquirer several advantages:

- access to confidential information (typically in exchange for the acquirer agreeing to be bound by a confidentiality and “standstill” agreement) and the corresponding ability to conduct more extensive due diligence investigations beyond the public disclosure record;
- the negotiation of deal protections (such as break fees, no-shop provisions and the right to match a topping bid) designed to secure the successful outcome of the proposed acquisition;
- the achievement of tax efficiencies and benefits through a mutually structured transaction;
- a united front toward the resolution of regulatory concerns (where the target is in a concentrated or regulated business or where foreign investment or national security review considerations are at play);
- the ability to retain management and key employees who may be inclined to leave in the face of a hostile take-over; and
- the avoidance of defensive measures being adopted by the board of a target company and the subsequent exploration of value-maximizing alternatives, which make unsolicited bids more complex and costly.

A key consideration in structuring a public M&A transaction is whether the target board’s cooperation is necessary or desirable.
As the support of the target company’s board of directors is not required for a take-over bid, this is the only practical structure available to effect an unsolicited or hostile take-over.

“HOSTILE” TAKE-OVER
There may be circumstances in which it makes sense for an acquirer to decide to proceed by way of a “hostile” or “unsolicited” transaction where, for example:
• friendly overtures have failed to result in an acquisition transaction;
• the acquirer has set its price and does not anticipate any interlopers with the result that it would prefer not to negotiate with the target board which may seek a price increase in exchange for a favourable recommendation;
• the acquirer’s objectives may not be to acquire control of the target company but rather to instigate change or exert influence over the board; and
• there is such a wide valuation gap between the views of the acquiror and the target board that the acquiror is left with no choice but to extend an offer directly to the target’s shareholders.

As the support of the target company’s board of directors is not required for a take-over bid, this is the only practical structure available to effect an unsolicited or hostile take-over.

LOCK-UP AGREEMENTS
Acquirors may choose to enter into a lock-up agreement with the principal shareholder(s) of the target in order to increase the probability of a successful transaction. Under the lock-up, shareholders will agree to tender their shares to the take-over bid or, in the case of a voting transaction, vote in favour of the transaction. The agreement may be “hard,” in which case the tendered shares may be acquired by the acquiror irrespective of whether a topping bid emerges that is ultimately supported by the board of the target, or “soft,” in which case the shareholder has the right to terminate the lock-up and tender its shares to a higher offer. Lock-up agreements may trigger early warning reporting requirements and may not be possible if the target has a shareholder rights plan in place. Shares tendered in a take-over bid pursuant to lock-up agreements may be counted for purposes of determining whether an acquiror has accumulated 90% or more of the target’s outstanding shares in connection with a compulsory acquisition procedure following a take-over bid, and may also be counted toward the “majority of the minority” shareholder approval requirement in a second-step going private transaction that follows a take-over bid.

BUY-SIDE SHAREHOLDER APPROVAL
In a share-for-share transaction in which capital stock of the acquiror is proposed to be issued to target shareholders, it is essential to consider whether buy-side shareholder approval is required. Under the Toronto Stock Exchange 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% of the outstanding shares of the acquiror on a non-diluted basis. In calculating the number of shares issued in payment of the purchase price for an acquisition, any shares issued or 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 where the cash is raised in a concurrent or linked private placement financing transaction.
Acquisition transactions involving related parties such as significant or controlling shareholders, board members or senior management raise conflict of interest concerns and require special review and consideration where a related party has an advantage (through access to additional information or voting position) over other shareholders.

Canadian securities regulators have established specific rules applicable to:

- insider bids;
- issuer bids (self tender transactions);
- certain types of related party transactions; and
- certain types of business combinations.

These rules are set out in Multilateral Instrument 61-101 – Protection of Minority Security Holders in Special Transactions (“MI 61-101”) and are designed to neutralize the conflicts of interest that are present in transactions involving related parties. For example, a take-over bid may engage the “insider bid” rules in addition to the take-over bid rules in circumstances where an “insider” (e.g., a holder of more than 10% of the outstanding shares of the target) proposes to effect a take-over. An arrangement may also engage the “business combination” rules in circumstances where a shareholder is compelled to sell its shares as a consequence of the transaction and where the transaction involves a related party and the related party is not treated identically to the general body of shareholders.

MI 61-101 regulates these transactions by giving minority shareholders the following procedural protections:

- a formal valuation by an independent valuator supervised by an independent committee of directors of the target company;
- “majority of the minority” shareholder approval; and
- enhanced disclosure, including disclosure of prior valuations prepared and offers received for the target in the past two years.

MI 61-101 provides exemptions from the formal valuation and minority approval requirements in circumstances where, in general terms, there are no conflict of interest concerns between the related party and the target company and where there is no informational advantage about the target in the possession of the insider. These are highly technical rules and need to be carefully considered in the context of an M&A transaction.
The corporate statutes in Canada impose two principal duties on directors: the fiduciary duty and the duty of care. Directors cannot contract out of these responsibilities and may be held personally liable for any breach of these duties.

**FIDUCIARY DUTY**

Directors are fiduciaries of the corporation they serve.

The Supreme Court of Canada described the content of the directors’ fiduciary duty in *Peoples Department Stores* as follows:

“The statutory fiduciary duty requires directors and officers to act honestly and in good faith vis-à-vis the corporation. They must respect the trust and confidence that have been reposed in them to manage the assets of the corporation in pursuit of the realization of the objects of the corporation. They must avoid conflicts of interest with the corporation. They must avoid abusing their position to gain personal benefit. They must maintain the confidentiality of information they acquire by virtue of their position. Directors and officers must serve the corporation selflessly, honestly and loyally.”

This long-standing principle is codified in the corporate statutes by the requirement that directors act “honestly and in good faith with a view to the best interests of the corporation” in exercising their powers and discharging their duties.

A director’s responsibilities to the corporation are not diminished, and may not be compromised, by other relationships the director may have. This applies to directors who are nominated by particular parties such as a major shareholder, a class of shareholders, a creditor or employees. The overriding principle governing a director’s behaviour is that the director has a fiduciary responsibility to the corporation, rather than to one or more shareholders or any other constituency.

In determining whether directors are acting in the best interests of the corporation, directors may consider the interests of various stakeholders. The fiduciary duty comprehends a duty to treat individual stakeholders affected by corporate actions equitably and fairly. Directors must therefore think carefully about whether a course of
action will benefit the corporation, while ensuring they have also considered the impact of that course of action on those whom it will affect.

**DUTY OF CARE**

In discharging their duties, directors must also "exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances." This standard of care can be achieved by any director who devotes reasonable time and attention to the affairs of the corporation and exercises informed business judgment. The standard of care is measured against the objective standard of what a reasonably prudent person would do in comparable circumstances. Failure to meet the standard often stems from passivity and a failure to inquire.

In *BCE Inc.*, the Supreme Court of Canada confirmed the existence of a Canadian “business judgment rule” under which courts will defer to directors’ reasonable business decisions so long as they are within a range of reasonable alternatives. Courts defer to decisions of directors taken in good faith in the absence of conflicts of interest, provided the directors undertook reasonable investigation and considered the alternatives and acted fairly. Courts will not substitute their view for that of the directors, even if subsequent developments show that the directors did not make the best decision.

It is typically recommended that boards constitute a special committee of independent directors to review and consider a take-over bid or genuine M&A transaction proposal. An independent committee is a classic mechanism by which to minimize conflicts of interest and demonstrate a proper process was followed in discharging the duty of care.

The purpose of a special committee independent of management and controlling shareholders is to protect the interests of minority shareholders and to bring a measure of objectivity to the assessment of take-over bids.

**IS WHAT IS IN THE BEST INTERESTS OF THE CORPORATION ALWAYS IN THE BEST INTERESTS OF ITS SHAREHOLDERS?**

In many instances, the distinction between what is good for the corporation and what is good for the shareholders is not significant since what is good for the corporation will also typically benefit its shareholders. Maximizing value for shareholders is also, in many cases, consistent with the best interests of the corporation. Nevertheless, there may be instances where the interests of the corporation and its shareholders or separate classes of securityholders diverge. The interests of the common shareholders may be in realizing a short-term gain on their investment, a goal which the directors may conclude is not in the long-term best interests of the corporation. Moreover, the interests of majority shareholders may not be the same as the interests of the corporation. A controlling shareholder may want the corporation to take actions that may be in its interest, but not necessarily in the best interests of the corporation. As the Supreme Court of Canada indicated in *BCE Inc.*, “There is no principle that one set of interests – for example the interests of shareholders – should prevail over another set of interests. Everything depends on the particular situation faced by the directors and whether, having regard to that situation, they exercised business judgment in a responsible way.”
**OPPRESSION REMEDY**

While not expressed as a duty of directors, also relevant to an examination of the exercise by the board of its powers in respect of the management of the corporation’s affairs is the oppression remedy provided by the federal corporate statute and most provincial corporate statutes. Under the oppression remedy, courts are granted broad remedial powers if a court is satisfied, among other things, that the powers of the directors have been exercised in a manner “that is oppressive or unfairly prejudicial or that unfairly disregards the interests of any security holder.” Although it is not necessary for an oppression remedy complainant to establish that directors have breached their fiduciary duty in order to succeed in an oppression claim, demonstration of compliance with the board of directors’ fiduciary duty is of valuable assistance towards protecting the board of directors against such claims.

The objective of the remedy is to protect the reasonable expectations of shareholders and other stakehold- ers, giving the court (as described by the Supreme Court of Canada in *BCE Inc.*) “broad, equitable jurisdiction to enforce not just what is legal but what is fair.” In determining whether a particular decision of a board was oppressive, the court must necessarily assess the impact of the business decision made by the board.

If a court finds oppression, it may make any order it considers appropriate to remedy an oppressive or unfair situation.

Where a company has debt or equity securities outstanding that are not subject to the offer to acquire, particular care needs to be taken to ensure that the interests of holders of such securities have been fully considered.

**DIRECTORS’ ACTIONS IN THE CONTEXT OF A POTENTIAL ACQUISITION**

Directors of a widely-held public company will not normally have much notice that the corporation is to be the subject of a take-over bid. Accordingly, they should generally try to establish a defensive strategy in advance of any bid to enable the corporation to respond effectively and efficiently.

A commonly adopted defensive tactic is a shareholder rights plan or “poison pill”. The Toronto Stock Exchange rules require that a rights plan, which typically becomes effective when adopted by the board, be ratified by a shareholder vote within six months. It is possible for a target company’s board to adopt a limited duration “tactical” rights plan in response to a specific takeover. Such a strategy gives the board more time than would be available under the take-over bid regime to pursue its alternatives. A board adopting a plan in response to a bid may very well find itself before a securities regulator justifying its action. Typically, in past bids in which an offeror has challenged the continued application of a plan, Canadian securities regulators have been willing to address and determine circumstances in which a plan may remain in place and to issue orders cease trading the rights. In contrast to U.S. courts, the question for Canadian securities regulators has not been whether, but when, it is time for the pill to go. Generally, plans have been cease traded within 45 to 65 days after the commencement of a bid (although in exceptional cases the regulators have provided a target company more time).
In responding to a take-over bid, the target company’s directors will be required to first make a judgment as to whether the bid has put their company “in play,” that is, whether a change of control is likely to occur. Most bids for widely-held companies will have this effect, but change of status is not automatic. For example, the take-over bid conditions may not be achievable in the judgment of the board. The board may also conclude that the value of the consideration offered is inadequate and opportunistic and, therefore, refuse even to open negotiations with the offeror. Taking a hard line with an offeror may attract the attention of, among others, the securities regulators, who generally favour giving shareholders the choice whether to accept or reject an offer, rather than having the directors effectively preclude the shareholders from judging the bid.

The judgment of whether the target company is in play will assist the board in setting out its priorities. If the board believes that its company is in play, in general terms, the board should undertake a strategy designed to maximize value, including the value to be realized by shareholders. At the same time, a board will want to structure a process that allows it to consider the impact of the transaction on affected stakeholders.

The Supreme Court of Canada explicitly rejected the U.S. Revlon principle that where the interests of shareholders conflict with those of other stakeholders, the interests of the shareholders prevail. The corporation and shareholders are entitled to maximize profit, but not by treating individual stakeholders unfairly.
Osler, Hoskin & Harcourt LLP

Competition Law and Foreign Investment Review

COMPETITION ACT

Canada’s Competition Act (“CA”) provides a procedure for the review of transactions that involve the acquisition of a business in Canada.

Pre-Merger Notification

Subject to certain exceptions, the CA requires pre-merger notification of transactions which meet the following two thresholds:

• all parties and their affiliates have assets in Canada the aggregate gross book value of which exceeds $400 million, or have aggregate gross revenues from sales in, from or into Canada that exceed $400 million; and

• the book value of the assets being acquired or the gross revenues from sales in or from Canada generated from those assets, exceed $70 million.

If the transaction is an acquisition of shares, an additional threshold requires that the voting interest of the purchaser post-transaction exceed 20% for a public company (or 50% if the 20% threshold is already exceeded).

Where a notification is required, the parties must provide certain information to the Competition Bureau, including transaction details, affiliate information, product descriptions, customer and supplier lists, and certain pre-existing documents that assess the competitive impact of the transaction. The transaction cannot close until the expiry of a 30 day statutory waiting period. If, prior to expiry of the waiting period, the Commissioner of Competition issues a supplementary information request (“SIR”), the waiting period is extended for an additional period ending 30 days following full compliance with the SIR.

In the case of a hostile transaction, the waiting period commences once the offeror has submitted its portion of the notification. After the Commissioner advises the target company of the offeror’s notification, the target company then has ten days to file its portion of the notification.

Where there is no or minimal competitive overlap, the parties may request that the Commissioner issue an advance ruling certificate (“ARC”), or in the alternative, a no-action letter, which usually can be obtained within 14 days. Where an ARC is issued, the Commissioner cannot challenge the transaction and
the transaction is exempt from the pre-merger notification requirement. Where a no-action letter is issued, the Commissioner states that she does not intend to challenge the transaction (but retains the right to do so), and the transaction is exempt from the pre-merger notification requirement. If an ARC is not issued, but the Commissioner has issued a no action letter or the waiting period has expired, then she still may challenge a transaction up until one year after closing. The Commissioner also has the right to review and challenge transactions regardless of whether they are notifiable.

**Standard of Review**
The substantive test is whether the transaction is likely to lessen or prevent competition substantially in a market in Canada. When conducting this analysis, the Competition Bureau will consider the appropriate product and geographic markets, market share and concentration, anti-competitive effects, entry of other competitors, whether the target company is a failing firm, and the countervailing power of purchasers. Transactions that result in a combined post-merger market share of greater than 35% generally receive a more detailed review by the Competition Bureau, but market share and concentration are not determinative. There are many examples of mergers that were permitted to proceed where the parties’ combined market share exceeded 35%. Where a transaction is likely to lessen or prevent competition substantially, the Commissioner may seek from the Competition Tribunal an order such as an injunction or a divestiture.

The CA process will likely only impact the timing and closing of a transaction where the business activities of the purchaser, its affiliates or entities in which it has a significant interest compete with those of the target company in Canada, or the purchaser has some significant “vertical” relationship (such as that of being a major supplier or customer) with the target.

**INVESTMENT CANADA ACT**
In general, the Investment Canada Act ("ICA") applies when a non-Canadian business proposes to acquire control of a Canadian business (as defined in the ICA) directly or indirectly.

**Acquisition of Control**
Generally, an acquisition of control occurs where the investor acquires one-third or more of the voting shares of a corporation (unless it can be established that the corporation will not be controlled in fact by the investor). Where the Canadian business is engaged in a cultural business the Minister of Canadian Heritage has the discretion to make a determination that an acquisition of control has occurred regardless of these rules.

**Application for Review and Post-Closing Notification**
Investments exceeding certain monetary thresholds are reviewable by the Minister of Industry (or the Minister of Canadian Heritage where the Canadian business is engaged in a cultural business), while all other acquisitions of control are subject to post-closing notification. For 2010, a direct investment by a non-Canadian to acquire control of a Canadian business is reviewable if the book value of the assets of the Canadian business as at the end of its most recent fiscal year exceeds $299 million. Proposed amendments contemplate changing the direct investment review threshold to $600 million based on enterprise value (a figure that will rise progressively to $1 billion over a four year period). An indirect investment (an acquisition of a foreign company with a Canadian
subsidiary) is not reviewable unless the Canadian business is a cultural business. Review thresholds for investments involving cultural businesses are $5 million for direct investments and $50 million for indirect investments (unless greater than 50% of the assets are in Canada, in which case the threshold is $5 million).

Where an acquisition is reviewable, the parties cannot close the transaction until approval is granted by the reviewing Minister. The application for review includes transaction details, information on the investor and the Canadian business, and the investor’s plans for the Canadian business. The investor is usually required to submit written binding undertakings that will generally remain in force for three to five years, in order to confirm its commitment to perform key components of its plans.

The reviewing Minister has up to 45 days to determine whether the investment should be approved (which may be unilaterally extended by the Minister for an additional 30 days). The review period may be extended for a further period as agreed upon by the Minister and the investor.

Where only a post-closing notification is required, it must be filed within 30 days of closing and requires very limited information.

**Standard of Review**

The standard of review is whether the investment is of “net benefit to Canada.” The reviewing Minister will consider the following statutory factors: effect of the investment on economic activity in Canada; participation of Canadians in the Canadian business; effect of the investment on productivity, technological development and products in Canada; effect of the investment on competition in Canada; compatibility of the investment with national industrial, economic and cultural policies; and contribution of the investment to Canada’s ability to compete globally. Where the investor is a state-owned enterprise (“SOE”) the reviewing Minister will also consider the nature and extent of control by a foreign government, the SOE’s corporate governance, operating and reporting practices, and whether the acquired Canadian business will retain the ability to operate on a commercial basis.

**ADDITIONAL CONSIDERATIONS**

**National Security Review**

The ICA provides for the review of any investment where it could be “injurious to national security” (and this is regardless of whether the investment exceeds the identified monetary thresholds or whether an acquisition of control occurs). “National security” is not defined in the ICA or the regulations.

For an investment involving an acquisition of control, an investor may obtain comfort on national security issues by submitting a notification at any time prior to, or within 30 days after implementing an investment, or by submitting an application for review at any time prior to implementing an investment. There is no prescribed clearance process for investments which do not involve an acquisition of control.

A full national security review could take up to 130 days. If the reviewing Minister is of the opinion that the investment may be “injurious to national security,” he can refer the investment to the Governor in Council (“Cabinet”). Cabinet may take any measures it considers advisable to protect national security, including directing the investor not to implement the investment (or divest if the investment has been implemented), or permitting the investment subject to certain conditions.
How Can We Help?

Mergers and acquisitions transactions, whether large or small, have inherent complexities that need to be clearly understood and properly addressed. Experienced legal counsel is essential on all M&A transactions and for all clients, ranging from local start-ups to global conglomerates.

With decades of experience advising successfully on M&A transactions, Osler can be trusted to provide clients with the right level of legal advice required to lead a successful deal, for several reasons:

**Involvement in High Volume and Range of Transactions**

We are effective at advising on and staffing all types and sizes of transactions, be it for domestic, cross-border or multi-national companies. We have designed and implemented innovative legal structures that have revolutionized the M&A landscape and continue to provide valuable solutions to our clients.

**Breadth and Depth of Related Expertise**

Our leading M&A practitioners are complemented by top-ranked expertise in tax, competition/antitrust, securities/regulatory, banking & financial services, litigation, pensions, employment/executive compensation and all other specialized areas that are key to effecting a successful M&A transaction. Taxation, for instance, is integral to accomplishing strategic M&A initiatives and no other Canadian law firm has been so consistently recognized for the excellence of its tax practice.

**Client Focus**

We understand the business imperative behind a transaction and the business environments in which our clients operate. Our “client first” approach pervades every aspect of our firm culture and we bring that approach to the way we structure a deal, negotiate a deal, mitigate risk and staff and efficiently manage files.

**U.S./Cross-Border Legal Services**

We offer seamless legal services north and south of the border. Our Canadian and New York offices are regularly involved in complex, multi-jurisdictional M&A transactions, providing strategic, innovative advice. Our distinct cross-border orientation enables us to represent U.S. companies doing business in Canada as well as Canadian companies expanding their businesses to the south.

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