The Mergers & Acquisitions Review

Eighth Edition

Editor
Mark Zerdin

Law Business Research

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EDITOR'S PREFACE

There is cause for optimism and caution in light of the past year's events.

First, we can be tentatively optimistic about Europe. The possibility of a euro breakup appears to have faded, and European equities markets performed, on the whole, exceptionally well in 2013. Indeed, the euro/dollar basis swap has moved sufficiently to open up euro capital markets to borrowers wishing to swap proceeds to dollars; the World Bank sold its first euro benchmark bond for more than four years in November 2013, and non-European companies like Sinopec and Korea Natural Gas have issued large euro bonds in recent months. If the European economy continues to grow (and analysts are expecting growth to quicken), it is hoped that the prospect of crisis will continue to fade.

Second, though 2013 was a comparatively languid year for global M&A, the buoyancy of the credit and equity markets cannot be ignored. In terms of financing, the seeming willingness of banks to allow for looser borrower constraints, to underwrite jumbo facilities in small syndicates, and to offer flexible and fast bridge-financing for high-value acquisitions, presents a financing climate that should be particularly amenable to corporate M&A. It is also notable that continued political and economic instability did not impede the completion of some standout deals in 2013, including the *Glencore/Xstrata* tie-up and Vodafone's disposal of its shareholding in Verizon Wireless. These deals show that market participants are able, for the right deal, to pull out all the stops. After a period of introspection and careful balance sheet management, corporates may be increasingly tempted to put cash to work through M&A.

There remains, however, cause for prudence. There is considerable uncertainty as to how markets will process the tapering of quantitative easing (QE) by the US Federal Reserve. The merest half-mention by Ben Bernanke, in May 2013, of a possible end to QE was enough to shake the markets, and to nearly double the 10-year US Treasury yield in a matter of months. Emerging markets are particularly sensitive to these shocks. The oncoming end of QE may already have been priced into the markets, but there is a possibility that its occurrence will cause further, severe market disruption. In addition, there are concerns around how the funding gap left by huge bank deleveraging will be filled, and centrifugal pressures continue to trouble European legislators. Finally, there are broader concerns as to the depth of the global economic recovery as growth in the BRIC economies seems to slow. Optimism should, therefore, be tempered with caution.

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

Mark Zerdin
Slaughter and May
London
August 2014

Chapter 12

CANADA

Robert Yalden and Emmanuel Pressman[1]

I OVERVIEW OF M&A ACTIVITY

When we surveyed the M&A landscape in Canada a year ago, we noted that the last quarter of 2012 had seen robust deal activity that suggested M&A markets in Canada might be picking up steam. 2013 did not, however, fulfil expectations and activity levels declined relative to 2012. Some 934 deals were announced in 2013, with the total transaction value of C$158 billion representing a 13.9 per cent decrease relative to 2012. As these numbers suggest, there was only limited appetite for very large deals, with much of the action continuing to take place in the mid-market. Indeed, while 2012 had seen something of a resurgence in mega-deals (with some 41 transactions over C$1 billion), 2013 saw the number of mega-deals dip to 29. Mid-market activity, on the other hand, remained on a par with 2012. As it turned out, the fourth quarter of 2012 was something of an exception and the cautious mindset and selective approach to deal making seen through much of 2012 continued throughout 2013.

The list of transactions rejected by the federal government on regulatory, policy and national security grounds continued to grow last year, increasing uncertainty associated with deals in regulated and politically sensitive industries, and making deal-makers generally more hesitant to proceed with major transactions in sensitive sectors. That said, as in previous years, strategic buyers, private equity and pension funds were active in deploying their significant cash reserves. Compensating for weakness in the energy and mining sectors, activity in the real estate sector grew by 13 per cent in 2013, proving it

1 Robert Yalden and Emmanuel Pressman are corporate law partners at Osler, Hoskin & Harcourt LLP. The authors would like to thank their partners, Patrick Marley, Kimberley Wharram and Shuli Rodal, for their valuable assistance with the preparation of this chapter. Data on M&A activity cited in this article is sourced from Financial Post Crosbie: Mergers & Acquisitions in Canada.

was still a powerful driver of Canadian M&A activity. Mid-market transactions remain essential to Canadian M&A, accounting for roughly 88 per cent of deal activity in 2013, even if only 27 per cent of deal value. Another trend of considerable interest is reflected in the return of strategic deals. Significant strategic transactions included deals in the retail, real estate and health-care sectors, such as Loblaw Companies Limited's acquisition of Shoppers Drug Mart Corporation, and Valeant Pharmaceuticals International, Inc's acquisition of Bausch + Lomb Holdings Inc.

On the one hand, 2014 to date has continued to reflect the overall slowdown in deal volume, with 189 announced transactions valued at C$31.1 billion compared to 262 deals valued at C$35.2 billion in the last quarter of 2013. Nevertheless, there are signs of an M&A recovery. The quarter saw several announced mega-deals in the energy and mining sectors (including Canadian Natural Resources Ltd's C$3.1 billion offer for Devon Canada Corporation, Baytex Energy Corp's C$2.3 billion offer for Australia-based Aurora Oil & Gas Ltd, and Goldcorp Inc's C$2.6 billion hostile takeover bid for Osisko Mining Corp, ultimately topped by a C$3.9 billion joint bid by Yamana Gold Inc and Agnico Eagle Gold Inc) as well as the largest cross-border M&A announcement of the year to date as a result of Valeant Pharmaceuticals International Inc's partnership with Pershing Square Capital Management LP and its C$53 billion hostile exchange offer to acquire Allergan Inc.

II GENERAL INTRODUCTION TO THE LEGAL FRAMEWORK FOR M&A

Although M&A activity in 2013 and 2014 to date 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.

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 to 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 due to 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 common forms of M&A transaction structure are a statutory amalgamation and 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

In Canada, there are 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, self-tender transactions and certain types of related-party transactions and business combinations.[2] 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.

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 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. This is one reason why rights plans continue to be adopted with relative frequency in Canada, whereas the trend in the United States is towards a reduction in the implementation of rights plans in the face of institutional investor opposition to poison pills.

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 weigh 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.[3] This means that in Canada there have only been isolated occasions when a Canadian board of directors could 'just say no' for any significant length

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

3 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.

of time. Generally speaking, once a Canadian target company is put in play, a change of control transaction has been almost a foregone conclusion. As a consequence, the Canadian takeover bid landscape has historically been considered to be distinctly more 'bidder-friendly' than its US counterpart. However, as discussed below, the provincial securities regulators have proposed a number of potentially fundamental changes to the regulation of poison pills and defensive tactics, which may have a significant impact on the use of poison pills.

vi Stock exchange requirements

Most Canadian 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 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 where the cash is raised in a concurrent or linked private placement financing transaction.

III DEVELOPMENTS IN CORPORATE AND TAKEOVER LAW AND THEIR IMPACT

i Proposed changes to the early warning reporting system

The rise of shareholder activism has led the Canadian Securities Administrators (CSA) to propose significant amendments to the early warning reporting requirements relating to the acquisition of securities of public companies. The proposed reforms have not been adopted since initially proposed in June 2013 as the CSA continues to re-examine the proposals and address hedge fund and institutional investor resistance to change. The CSA has suggested decreasing the reporting threshold from 10 per cent to 5 per cent. It would also require the filing of an early warning update not only in the event of an increase of a reportable position by 2 per cent or more, but also in the event that a reportable position is either decreased by an increment of 2 per cent or more, or falls below the 5 per cent reportable threshold. The CSA believes that providing investors with an earlier 'early warning' about accumulations of ownership positions is appropriate given that 5 per cent is the threshold under Canadian corporate law for a shareholder to requisition a special meeting of shareholders (a course of action that shareholder activists have shown a growing willingness to undertake). The change would also harmonise Canadian reporting thresholds with the standards seen in several major foreign jurisdictions, including the United States and the United Kingdom.

Changes are also proposed to disqualify eligible institutional investors (EIIs) from using the more permissive alternative monthly reporting system (AMR)[4], in the event that they intend to solicit proxies on matters relating to the election of directors or reorganisations, amalgamations, mergers, arrangements or similar business combinations. Previously, the disqualification only applied if an EII was accumulating shares and intended to make a formal takeover or propose a reorganisation, amalgamation, merger, arrangement or similar business combination. The changes are therefore aimed at addressing concerns that activist investors have been able to make use of the AMR system to delay reporting share accumulations in circumstances where they intend to use the proxy system to put pressure on an issuer to change its board or its business strategy. The addition of a disqualification from the AMR system tied to an intention to solicit proxies would result in earlier disclosure of the ownership positions and intentions of activist EIIs (notably hedge funds and activist investors).

Finally, the CSA would expand the disclosure framework in order to address concerns about 'hidden ownership' and 'empty voting'. Current disclosure requirements do not necessarily capture derivatives and securities lending arrangements, which can be used either to accumulate a substantial position in an issuer without public disclosure ('hidden ownership'), or to accumulate significant voting rights in an issuer without an equivalent economic stake in the issuer ('empty voting'). With respect to derivatives, the proposed amendments would require investors to include equity derivative positions that are substantially equivalent in economic terms to conventional equity holdings in calculating their ownership levels. With respect to securities lending arrangements, the CSA has clarified its view that it is not necessary to amend the existing early warning reporting requirements in this regard as they already apply to both borrowers and lenders in such transactions. These reforms are subject to ongoing debate and the CSA's proposal is expected to be re-issued for further comment later in 2014.

ii Securities regulators propose alternative approaches to defensive tactics and shareholder rights plans

The securities regulators have also been active in dealing with issues concerning defensive tactics. A CSA rule on shareholder rights plans and an alternative proposal on defensive tactics from the Autorité des marchés financiers (AMF) in Quebec would, if adopted, each result in significant changes to the regulation of hostile takeover bids in Canada.

The CSA Proposal[5] provides that shareholders voting at a meeting would determine whether a rights plan should stay in place. As a result, provincial securities

4 The AMR is provided under National Instrument 62-103 – Early Warning System and Related Take-Over Bid and Insider Reporting Issues. A key difference between the conventional early warning system and the AMR system is that while the conventional system currently requires the prompt issuance of a press release and the filing of an early warning report within two business days of a reporting trigger, the AMR system allows the reporting of ownership positions to be made only on a monthly basis, with each filing due within 10 days of the end of the month.

5 The CSA Proposal is contained in National Instrument 62-105 – Security Holder Rights Plans dated 14 March 2013.

regulators would get out of the business of holding hearings to cease trade rights plans (absent exceptional circumstances) and the new regime would provide boards of directors of target companies more time to respond to hostile takeover bids than the 45–70 days typically allowed by the regulators. At a minimum, a company would have up to 90 days after adopting a rights plan to take it to a vote of its shareholders. A plan that received shareholder approval could then stay in place for a year before having to go back to shareholders for a vote. As a result, issuers facing a hostile bid that did not already have a rights plan in place could adopt one and expect to have at least 90 days to respond to the bid. Issuers that already had a shareholder-approved rights plan in place would, in turn, likely have to deal with a requisition (on the part of the bidder or shareholders wishing to sell) to call a shareholder meeting to revoke the rights plan. In either case, it is to be expected that proxy fights would become a more frequent occurrence in the context of hostile M&A transactions in Canada.

The AMF Proposal,[6] for its part, considers defensive tactics more generally and is not limited to rights plans. Under the AMF Proposal, securities regulators would not regulate rights plans in the manner that the CSA proposes. Instead, courts would determine the propriety of defensive tactics – including rights plans – as part of their jurisdiction over the discharge of directors' fiduciary duties. Securities regulators would only intervene where a board's actions or decisions were abusive of shareholders' rights or negatively affected the efficiency of capital markets.

If adopted, the AMF Proposal would mark a more sweeping change to the current regulatory landscape than the CSA Proposal and would, in turn, move Canada closer to the approach taken in the United States to regulate defensive tactics. Judicial review of defensive tactics could be expected to result in more deference being given to directors' decisions than is currently given by securities regulators. That said, given the absence of effective staggered boards in Canada and the ability of shareholders holding 5 per cent of a Canadian company's shares to requisition a meeting, Canadian companies would still be more vulnerable to potential acquirers than companies in the United States. Directors of a Canadian target could potentially be replaced at a shareholders' meeting within a limited period of time following a shareholder requisition by the bidder with a slate of directors that supports the bid.

The two proposals have provided an important opportunity for Canadian capital market participants to engage in a debate about issues such as the balance of power between boards of directors, bidders and shareholders, and whether courts or securities regulators should adjudicate disputes regarding defensive tactics. After more than one year since the reforms were made public, it still remains to be seen whether either approach will be implemented.

iii Poison pill developments

On 2 May 2014 the British Columbia Securities Commission (BCSC) ruled in favour of Augusta Resource Corporation, permitting Augusta's shareholder rights plan to remain

6 The AMF Proposal was published in a consultation paper entitled 'An Alternative Approach to Securities Regulators' Intervention in Defensive Tactics' dated 14 March 2013.

in effect for an additional 75 days. HudBay Minerals Inc, which commenced its any and all offer for Augusta on 10 February 2014, had applied for an order cease trading the Augusta rights plan. Just hours prior to the conclusion of the hearing, Augusta shareholders overwhelmingly approved retaining Augusta's rights plan, with holders of 73.78 per cent of the outstanding shares voting in favour of the retention of the rights plan, representing 94 per cent of all votes cast by Augusta shareholders other than HudBay. The BCSC ruled that the rights plan would remain in place unless HudBay extended its offer to 16 July 2014 and committed to extend its offer for an additional 10 days if shares were taken up by HudBay under its offer. If HudBay did extend its offer to 16 July 2014 and amended its offer to include an automatic 10-day extension, the rights plan would be cease traded effective as of 5:00pm (Pacific Time) on 15 July 2014.

The decision of the BCSC is not surprising given the overwhelming shareholder support for the continuance of the Augusta rights plan, the commitment previously given by Augusta to waive the rights plan if any bid met certain conditions, and the fact that HudBay's any and all take-over bid could have resulted in HudBay attaining a blocking position and thereby frustrating other potential offers for Augusta. Augusta had previously committed to waive the rights plan if any bid, including HudBay's, was outstanding for 60 days, had a majority of independent shares deposited to the bid and a commitment to provide an additional 10 days to deposit after the first take up of shares under the offer.

Given the proposed regulatory reforms described above, the *Augusta* decision is noteworthy in that in seeking shareholder approval of a rights plan in the face of a hostile bid, the Augusta board aligned itself with the approach favoured by the CSA Proposal. The BCSC stopped short of permitting Augusta's rights plan to remain in effect until Augusta's next annual meeting – which is a feature of the CSA Proposal – opting instead to allow the rights plan to remain in effect for an additional 75 days. This may reflect new thinking by the regulators regarding the longevity of a rights plan and whether a bidder must requisition a meeting to seek a shareholder vote on a rights plan. In addition, by mandating an automatic 10 day extension upon take up of any shares by HudBay, the BCSC adopted one of the recommendations of the AMF Proposal as well as a long-standing feature of 'permitted bid' provisions found in Canadian shareholder approved rights plans.

iv Judicial opinions on utility of fairness opinions in court-approved arrangement transactions

As noted, a court-approved plan of arrangement is a commonly used public company acquisition structure. In the *BCE v. 1976 Debentureholders* decision, the Supreme Court of Canada stated that 'the presence of a fairness opinion from a reputable expert' is among the indicia of fairness in considering whether a proposed plan of arrangement is fair and reasonable. Accordingly, it is common practice in seeking court approval of an arrangement to note that a fairness opinion was obtained by a board of directors.

In that context, the Ontario Superior Court of Justice (Commercial List) recently made some noteworthy observations about the evidentiary utility of fairness opinions. The decision, *Re Champion Iron Mines Limited*, arose out of the fairness hearing to approve the proposed acquisition of Champion Iron by Mamba Minerals. The Court had no difficulty concluding the arrangement was fair and reasonable for reasons including the substantial premium paid, the overwhelming shareholder approval and the extremely low level of dissent rights exercised. However, the Court placed no weight on the fairness opinion in conducting its fairness analysis. The Court noted that shareholders considering the fairness opinion did not have disclosure of the fees payable to the adviser to assess how much work was performed and, further, the fairness opinion did not include any of the underlying financial analysis performed by the adviser. As a result, the Court concluded that it could not place any weight on the fairness opinion in arriving at its fairness determination. The Court went on to state that the lack of supporting reasoning in the typical form of fairness opinion renders them inadmissible for the purpose of asking the Court to rely on their content in support of an arrangement order. The ruling called into question whether, in the future, courts would look for fairness opinions and disclosure documents that summarise fairness opinions to contain enhanced disclosure of the underlying financial analysis performed by, and fees paid to, bankers.

In two recent decisions, however, separate judges from the same Court questioned the correctness of the decision and reverted to the Court's traditional practice of considering 'the presence of a fairness opinion from a reputable expert' as among the indicia of fairness when considering whether a proposed plan of arrangement is fair and reasonable. In *Re Bear Lake Gold Ltd*, Justice Wilton Siegel held that, in the context of M&A transactions, a fairness opinion is admissible both as evidence that the plan of arrangement is being put forward in good faith, as well as evidence of the fairness and reasonableness of the proposed transaction. In particular, Justice Wilton-Siegel found that: a fairness opinion constitutes evidence that the board of directors considered the fairness and reasonableness of the transaction based on objective evidence; and the disclosure of the fairness opinion to shareholders as part of the proxy circular and, in particular, the reaction of shareholders and the market can provide further evidence as to the fairness and reasonableness of the proposed transaction and the integrity of the board of directors' process. In *Royal Host*, Justice Newbould expressly adopted the reasoning of Justice Wilton-Siegel in *Bear Lake Gold* and added that, contrary to the ruling in *Champion Iron Mines*, the purpose of a fairness opinion was a commercial one and a fairness opinion is not intended to be an expert report in a litigation context.

These decisions highlight the continued utility to a board of directors of receiving expert financial advice and fairness opinions from reputable financial advisers as an important part of the process by which directors discharge their duty of care and make informed decisions in the M&A context.

IV FOREIGN INVOLVEMENT IN M&A TRANSACTIONS

Canada's foreign investment review legislation, the Investment Canada Act (ICA), views itself as generally open to foreign investment. While this is generally true for the majority of foreign investments, it is increasingly apparent that a more restrictive approach applies in the case of proposed foreign investments that involve SOEs.

With respect to foreign investment review, approval is required under the 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 current threshold for review of transactions outside the cultural sector is C$354 million in book value of assets of the Canadian business being acquired. However, this threshold is expected to increase significantly other than for foreign investments made by investors that are controlled or influenced by SOEs. Amendments to increase the ICA review threshold were first enacted in 2009. These amendments were intended to raise the threshold for review of foreign investments involving all WTO members but also change the basis for assessment to ensure that takeovers of large Canadian businesses in non asset-intensive sectors (such as technology) are subject to 'net benefit' review. The amendments were anticipated to raise the threshold for review under the ICA from the current value of C$354 million (based on book value of assets of the Canadian business) to C$600 million (based on 'enterprise value'), a figure that would rise to C$800 million after two years and then to C$1 billion after a further two years. However, the 2009 amendments did not take effect because regulations necessary to define 'enterprise value' were not finalised. On 29 April 2013, the government proposed new legislation to again raise the review threshold on the same basis as previously proposed but only for WTO investments that are not made by entities influenced or controlled by SOEs. The higher thresholds applicable to non-SOE investments will come into force only once regulations defining 'enterprise value' are enacted. The timing for the enactment of such regulations remains uncertain.

The efforts to raise the threshold for ICA review are consistent with Canada's approach to welcoming foreign investment for private parties. 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) have been disapproved after failing to meet the net benefit test under the ICA since its enactment in 1985. In each case there were a number of specific and somewhat unique factors that likely contributed to the outcome. However, both cases of disapproval were recent and have made clear that the ICA review process has become more 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.

With respect to proposed investments from SOEs, there have been clear indications from the government (in addition to the decision to preserve the lower review threshold) that a more restrictive approach will be taken, particularly in the case of proposed control investments by SOEs in the oil sands as well as in leading Canadian companies in other sectors. In 2012, two significant acquisitions by non-Canadian SOEs were proposed, namely Progress Energy Resources Corp's (Progress) C$6 billion acquisition by Malaysian government-controlled PETRONAS and Nexen Inc's (Nexen) C$15.1 billion acquisition by China National Offshore Oil Corporation. Both transactions ultimately received ministerial approval under the ICA on 7 December 2012. However, Prime Minister Harper indicated that, going forward, the Minister will find the acquisition of control of a Canadian oil-sands business by a foreign SOE to be of net benefit, only in exceptional circumstances; control investments in leading Canadian companies in other industry sectors will generally not be permitted; and more rigorous guidelines to assess the 'net benefit to Canada' that would result from SOE investments will be applied.[7] Furthermore, subsequent amendments to the ICA give the government greater discretion in determining whether a foreign investor has a sufficient connection to an SOE 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'.[8] Accordingly, while there is still meaningful investment opportunity for SOEs in Canada (and particularly minority investments) the investment climate for SOEs in Canada is significantly more restrictive than for private investors.[9]

In addition to the ICA regime for 'net benefit' review of certain foreign investments, the Canadian government also 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'. To date, the government has not issued any guidelines to assist investors in understanding whether their investments may be 'injurious to national security' and the phrase itself is not defined in the ICA.

V SIGNIFICANT TRANSACTIONS, KEY TRENDS AND HOT INDUSTRIES

i Strategic dealmaking

Although overall M&A volumes trended down in 2013, the M&A markets witnessed increased confidence in strategic deal making as well as investor receptivity to mergers with sound business logic and demonstrable synergistic value. Significant strategic transactions of this nature undertaken in 2013–2014 include deals in the retail, real estate and health-care sectors, such as Valeant Pharmaceuticals' alliance with Pershing Square and its proposed US$53 billion acquisition of Allergan, Valeant's completed US$8.7 billion acquisition of Bausch + Lomb, and Loblaw's completed C$12.4 billion acquisition of Shoppers Drug Mart. Other strategic deals in these sectors include Sobeys' acquisition of Canada Safeway Ltd and Hudson's Bay Co's acquisition of Saks Inc. Interestingly, the buy-side stock price after announcement of all of these transactions increased substantially, evidencing investor appetite for strategic growth. Ordinarily,

7 'Statement by the Prime Minister of Canada on foreign investment' (7 December 2012), online: Prime Minister of Canada www.pm.gc.ca/eng/media.asp?category=3&id=5195.

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

9 For further information refer to: Michelle Lally et al, 'New Rules for Foreign Investment by State-Owned Enterprises - Do They Strike the Right Balance?' (9 December 2012), online: Osler www.osler.com/NewsResources/New-Rules-for-Foreign-Investment-by-State-Owned-Enterprises-Do-They-Strike-the-Right-Balance/.

sell-side stock prices rise, while buy-side stock prices tend to dip due to factors such as dilution, hedging, deal risk and concerns about overpayment for a coveted asset.

ii Regulatory intervention in M&A

The list of transactions rejected by the federal government on regulatory, policy and national security grounds continued to grow in 2013–2014. BCE's acquisition of Astral Media finally closed in 2013 after having been initially rejected by the Canadian Radio-television and Telecommunications Commission in 2012. That deal was made possible, in part, by a series of specialty television channel and radio station divestitures that Bell Media agreed to make to Corus Entertainment. The federal government also rejected TELUS Corporation's proposed acquisition of Mobilicity on regulatory grounds, and the Minister of Industry rejected Accelero Capital's proposed acquisition of the Allstream division from Manitoba Telecom Services on national security grounds.

iii Shareholder activism

Proxy contests and other forms of shareholder activism continued to be a growth industry and a significant part of the M&A landscape in 2013–2014. Activist initiatives represent a cost-effective way in which to effect a change in corporate control as compared to committing the funds required to launch a hostile takeover bid. Activist initiatives can often be undertaken confidentially and thus the reputational risk of being associated with a failed deal can be potentially avoided. Further, higher (10 per cent) 'early warning' reporting requirements in Canada allow activists to engage in stealth accumulations and shield their investment intentions for a longer period of time than would be the case in the United States (although, as noted, greater conformity between the Canadian and US reporting regimes has been proposed by Canadian securities regulators). Further, the absence of staggered boards gives activist shareholders the opportunity to achieve their objectives over a shorter period of time than is the case in jurisdictions where staggered boards are common. Not surprisingly, Canada has seen increasing levels of shareholder activism over the past couple of years by both domestic and US-based funds. Activists are also targeting larger companies, as evidenced by Carl Icahn's recent investment in Talisman Energy, resulting in two board seats in exchange for standstill commitments; Jana Partners' failed proxy battle for Agrium; and activist overtures made to Tim Hortons.

VI FINANCING OF M&A: MAIN SOURCES AND DEVELOPMENTS

Canadian pension funds continue to represent a significant capital pool as well as significant investors on the global investment landscape. Pension funds participated in many of the year's most noteworthy transactions: the Alberta Investment Management Corporation and the Ontario Municipal Employees System jointly acquired Vue Entertainment for C$1.48 billion; the Ontario Teachers' Pension Plan provided equity financing to the Hudson's Bay Company for its US$2.9 billion acquisition of Saks Inc; and the Canada Pension Plan Investment Board, together with US private equity fund, Ares, acquired upscale retailer Neiman Marcus for US$6 billion. As a whole, Canadian pension funds continued to focus on alternative asset allocation as an investment strategy throughout 2013–2014. Pension funds have increased their direct investments in private equity, infrastructure and real estate as they continue to seek to align fund investment horizons with their long-term liability profile and reap the rewards of higher returns. In general, Canadian credit markets have been relatively robust, made possible by low interest rates, with the result that acquisition financing is generally readily available and an increasing number of strategic transactions in 2013 and 2014 to date were financed exclusively with cash on hand and debt financing.

VII TAX LAW

i Treaty shopping proposals

On 19 July 2013, the Organization of Economic Co-operation and Development (OECD) released its Action Plan on Base Erosion and Profit Shifting (the BEPS Plan) aimed at curtailing perceived abuses of national tax systems by multinational enterprises. The BEPS Plan focuses on tax-planning strategies that exploit differences in domestic tax rules and international standards that shift profits to jurisdictions with a favourable tax treatment where there may be little or no economic activity, and addresses such key areas as the digital economy, coherence of corporate income tax, treaty shopping, transfer pricing as well as transparency, certainty and predictability of taxation. The 2014 Canadian Federal Budget included a consultation on a proposed new anti-treaty shopping rule. Unlike the OECD's 2014 discussion draft on treaty shopping that focused on treaty-based solutions, Canada's proposal would be enacted under domestic law and would apply to Canada's tax treaties generally where 'one of the main purposes' for undertaking a transaction was to obtain a benefit under a tax treaty with Canada.

ii Thin capitalisation rules

Under Canada's existing thin capitalisation rules, interest paid by certain taxpayers (including corporations, trusts and certain partnerships) on outstanding debts to a specified non-resident is not deductible, where the amount of such debts exceeds a debt to equity ratio of 1.5:1. The 2014 Federal Budget introduced proposed anti-avoidance provisions intended to target certain back-to-back loans and other financings provided to a Canadian by a related non-resident via an intermediary in order to avoid adverse Canadian tax consequences that would otherwise arise if the financing were provided directly. However, as currently drafted, the proposals could apply to a broader range of commercial arrangements. In particular, the anti-avoidance provisions will apply to arrangements where, as part of a transaction of series of transactions, a Canadian taxpayer becomes obligated to pay an amount to an intermediary, and a non-resident person has directly or indirectly provided to the intermediary an interest in property as security for the Canadian taxpayer's obligation, such as the provision of a secured guarantee; or the intermediary has an outstanding debt or other obligation to pay an amount to a non-resident person for which recourse is limited to the Canadian taxpayer's obligation.

iii Foreign affiliate dumping rules

The foreign affiliate dumping rules, which were introduced in the 2012 Canadian Federal Budget, generally apply to a Canadian corporation (Canco) that is controlled by a non-resident corporation (parent), where a Canco makes an investment in a non-resident corporation that is a foreign affiliate (FA) of a Canco (determined immediately after the investment is made). In August 2013, the FA dumping rules were proposed to be refined in a number of key respects, including the following:

a to clarify that if a corporation resident in Canada (CRIC) is not controlled by the parent at the time the investment is made the rules will only apply if the CRIC becomes controlled by the parent after the investment time and if, at the time of the investment: the parent, either alone or together with any persons that do not deal at arm's length with the parent, owned 25 per cent or more of the shares of the CRIC, based on either votes or fair market value; the investment is an investment in preferred shares of an FA of the CRIC that is not a wholly owned subsidiary of the CRIC; or under an arrangement entered into in connection with the investment, a person or partnership that is not related to the CRIC has, in any material respect, the risk of loss or opportunity for gain or profit in respect of a property that can reasonably be considered to relate to the investment;

b to simplify the conditions necessary to qualify for a reduction of the paid-up capital of the shares of the CRIC (rather than a deemed dividend) if the foreign affiliate dumping rules apply and to extend the paid-up capital reinstatement rule to distributions that can be traced to proceeds received by the CRIC from the repayment or disposition of certain debts owing to the CRIC;

c to introduce a new anti-avoidance rule which provides that the corporate reorganisation exception will not apply to an acquisition of property by a CRIC if such property can reasonably be considered to have been received by the CRIC as a repayment, in whole or in part, or in settlement of a pertinent loan or indebtedness; and

d to refine the strategic business expansion exemption to allow officers of certain Canadian corporations that are non-arm's length with the CRIC to be included in determining whether a majority of officers of the CRIC exercised the principal decision-making authority with respect to the FA investment.

VIII 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 in the following circumstances:

a 'party size' threshold, where 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; and *b* ‘transaction size’ threshold, where, 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$82 million; or where, 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$82 million.

If the transaction is an acquisition of shares, an additional threshold requires that the voting interest of the purchaser post-transaction exceed 20 per cent for a public company or 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 has not exercised his discretion to extend the waiting period by requiring the notifying parties to supply additional information (a supplemental information request or 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 where there is a serious concern about a potential prevention or lessening of competition.

The Competition Act also provides 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 is satisfied that he would not have 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). Where 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.

IX OUTLOOK

Although many of the conditions that should be favourable to more vibrant M&A markets are in place, there are no obvious signs pointing to a dramatic increase in activity levels for the balance of 2014. Despite a high performing stock market, the availability of capital and strong corporate balance sheets (outside the mining sector), there is nevertheless continued caution on the part of strategic dealmakers, as well as concerns about the strength of commodity prices and the pace of infrastructure development in the energy sector. We anticipate that in 2014 we will see more M&A transactions in furtherance of strategic growth – albeit in a slow and steady manner consistent with the cautious approach to strategic decision making we have witnessed for several years, as well as an increase in private equity exit activity as fund managers take advantage of high valuations across private and public markets to sell assets.

Appendix 1

ABOUT THE AUTHORS

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Robert Yalden is a partner in Osler, Hoskin & Harcourt LLP's business law department and is recognised as one of Canada's leading business lawyers. He was co-chair of the firm's mergers and acquisitions group for 10 years prior to becoming a member of the executive committee. Mr Yalden's career with Osler spans over 20 years, during which he has participated in some of Canada's most innovative and groundbreaking 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. He also recently 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 board 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, teaches a course in comparative corporate governance at McGill University's Faculty of Law, and has written extensively on business law issues.

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Emmanuel (Manny) Pressman is a partner in the business law department and chair of the mergers and acquisitions group. He has acted for acquirors, targets, selling shareholders, boards, special committees and financial advisers that have been involved in friendly and contested takeover bids, proxy contests, going-private transactions, negotiated acquisitions and a range of corporate transactions and restructurings. He is

a 'frequently recommended' corporate/M&A lawyer in *Lexpert's Guide to the Leading Corporate Lawyers in Canada* and was a recipient of *Lexpert*'s 'Top 40 Lawyers Under 40' in 2010. Recent assignments include acting for Shoppers Drug Mart in its merger with Loblaw Companies; KingSett Capital in its hostile takeover bid for Primaris Retail REIT and ultimately, friendly plan of arrangement with H&R REIT, RioCan REIT and Primaris REIT; The ADT Corporation in its acquisition of Reliance Protectron from Alinda Capital; Walter Energy in its acquisition of Western Coal; and *Magna* International in its dual-class share recapitalisation. Mr Pressman is a frequent speaker at conferences relating to M&A and developments in corporate and securities law and has guest lectured at the McGill University Faculty of Law and the University of Toronto Faculty of Law. He received a JD from the Western University Faculty of Law in 1996 and was called to the Ontario Bar in 1998.

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