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Canada

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1 Types of transaction

How may businesses combine?

A business combination involving a publicly traded target may be structured as a takeover bid or a corporate transaction.

A takeover bid is the Canadian equivalent of a US tender offer and is defined as an offer to acquire outstanding voting or equity securities of a class where the securities subject to the offer, together with the shares already owned by the offeror, constitute 20 per cent or more of the shares of the class. Under securities law in Canada, a non-exempt takeover bid:

- must be made to all shareholders by way of a prescribed form of offer document and may be commenced by way of an advertisement or by mailing the offer documents;
- must be open for acceptance for a period of at least 35 days; and
- must offer identical consideration or choice of consideration (which can include cash, shares or other securities – or a combination of these) to all shareholders and may not, subject to certain exceptions, include a collateral benefit which has the effect of providing one shareholder with consideration of greater value than that offered to other shareholders.

Corporate transactions typically take the form of a court-approved plan of arrangement, statutory amalgamation, sale of assets or other fundamental corporate reorganisation, and require the approval of the target's shareholders.

2 Statutes and regulations

What are the main laws and regulations governing business combinations?

Business combinations are regulated under the following.

Corporate statutes

Canadian companies may be incorporated under the federal Canada Business Corporations Act (CBCA) or one of the similar provincial or territorial business corporations acts. These statutes regulate a variety of ordinary and extraordinary corporate transactions. Extraordinary corporate transactions (such as plans of arrangement and statutory amalgamations) must generally be approved by a special resolution of shareholders (typically two-thirds of the votes cast). Shareholders generally have the right to dissent from extraordinary corporate transactions and demand payment of the 'fair value' of their shares (as ultimately determined by a court, if challenged). Canadian courts have broad remedial powers under Canadian corporate statutes to intervene in respect of transactions that are oppressive or unfairly prejudicial to, or that unfairly disregard the interests of, shareholders and other stakeholders.

Securities laws

Securities regulation in Canada is the responsibility of the 10 provinces and three territories. Although each province and territory has its own legislation and securities regulatory authority that regulates, among other things, takeover bids, the rules have been largely harmonised and are generally very similar if not identical in most cases. Certain provinces have rules (including approval by a 'majority of the minority' shareholders and independent valuation of the subject matter of the transaction) designed to ensure fair treatment of minority shareholders in connection with certain types of transactions involving controlling shareholders or other 'related parties' (which include shareholders owning 10 per cent or more of the voting securities of a company).

Stock exchanges and other regulations

The two principal stock exchanges in Canada are the Toronto Stock Exchange (TSX) (senior market) and the TSX Venture Exchange (junior market). These exchanges regulate selected aspects of business combinations. In particular, the TSX requires a listed company to obtain shareholder approval of an acquisition if the acquisition would result in the issuance of more than 25 per cent of the outstanding shares of the acquirer on a non-diluted basis.

A business combination may also involve approvals or filings under the Competition Act (Canada) (see question 4) and statutes regulating foreign ownership (see question 11).

Regulatory laws

Business combinations may also be governed by regulatory laws in Canada, most notably, the Competition Act and the Investment Canada Act. Please see questions 4 and 11 for further information in relation to these statutes.

3 Governing law

What law typically governs the transaction agreements?

In a negotiated transaction, the acquirer and the target will enter into a support agreement (in the case of a takeover bid) or a merger or combination agreement (in the case of a corporate transaction). These agreements typically provide representations and warranties and pre-closing covenants from the target in favour of the acquirer, termination rights in favour of the target, indemnity provisions and deal protection measures (see question 10).

An acquirer may also enter into lock-up agreements with significant shareholders of the target, pursuant to which the shareholders agree to tender their shares to a takeover bid or provide voting support for a corporate transaction. These agreements may contain termination rights in favour of the shareholders (most commonly, if a 'superior proposal' is made by a third party or the transaction terms are changed without the consent of the shareholders).

These agreements are typically governed by the laws of a specified province.

4 Filings and fees

Which government or stock exchange filings are necessary in connection with a business combination? Are there stamp taxes or other government fees in connection with completing a business combination?

The filings required in connection with a business combination depend on the structure of the transaction and the jurisdictions involved, but generally include the filing of a takeover bid circular and a directors' circular (containing the directors' recommendations to shareholders) and related materials with the securities regulatory authorities (in the case of a takeover bid), and a management information circular and related materials with the securities regulatory authorities and amendments to constating documents with the corporate regulatory authorities (in the case of a corporate transaction). The filings must comply with applicable requirements, but are not subject to a pre-review or pre-clearance process. The regulators may, however, selectively review documents that have been filed. The fees payable in connection with these filings depend on the structure and size of the transaction and the federal and provincial jurisdictions involved.

Stock exchange listing approvals will be required where securities issued by the acquirer in consideration for the target's shares are to be listed on a Canadian stock exchange. Fees will vary based on the exchange and the number of securities to be listed.

If a business combination involves the acquisition of a business that holds assets in Canada (directly or indirectly) and the following thresholds are met, the business combination is, generally speaking, a notifiable transaction under part IX of the Competition Act:

- the parties' (including affiliates) aggregate assets in Canada or annual gross revenues from sales in, from or into Canada exceed C\$400 million;
- the target's Canadian assets or annual gross revenues from sales in or from Canada generated by those assets exceed C\$73 million for 2011 (indexed annually for inflation); and
- the acquirer will hold more than 20 per cent (35 per cent for a private company) of the voting shares or more than 50 per cent of the voting shares if the acquirer already holds 20 per cent (35 per cent for a private company) of the voting shares.

Notifiable transactions may not close until a filing has been made with the Commissioner of Competition (the Commissioner) and a statutory waiting period has expired (or notice of early termination of the waiting period has been given by the Commissioner). The waiting period is 30 days; however this may be extended if a 'supplementary information request' (SIR) is made by the Commissioner, in which case the waiting period is extended to 30 days after compliance with the request for information. Parties may apply for an advance ruling certificate (ARC) which, if issued, exempts the transaction from the filing and waiting period requirements. A filing fee of C\$50,000 is payable in all circumstances.

Whether or not it is a notifiable transaction, the Commissioner may review a business combination under part VIII of the Competition Act to determine whether it prevents or lessens competition substantially. Where a business combination raises concerns and the parties would like to obtain some comfort that the combination will not be challenged, it may be appropriate to seek an ARC or 'no action' letter from the Commissioner. The timing of the Commissioner's substantive review under part VIII may or may not coincide with the applicable waiting period for notifiable transactions.

Filings or approvals may also be required under the legislation regulating foreign ownership (see question 11).

There are no stamp taxes in Canada.

5 Information to be disclosed

What information needs to be made public in a business combination? Does this depend on what type of structure is used?

In a takeover bid, the acquirer is required to mail a takeover bid circular containing prescribed information, including: the terms of the offer, disclosure with respect to pre-offer share ownership and trading activities and whether the acquirer intends to initiate a second stage transaction as described in question 14, and any other information that would be material to shareholders. The directors of the target are required to prepare and mail to shareholders, within 15 days of the takeover bid, a directors' circular containing prescribed information, including the board's recommendation as to whether shareholders should accept or reject the offer and the reasons for doing so, and, if the directors are unable to make a recommendation, the reason why. In a negotiated takeover bid, the takeover bid circular and the directors' circular (containing a favourable recommendation) are often mailed together to shareholders.

A business combination effected by way of a corporate transaction usually requires the target to prepare and mail to shareholders a management information circular containing prescribed information, including the terms of the transaction and the negotiation and approval process, and any other information that would be material to shareholders.

Certain additional information must be provided in respect of business combinations involving 'related parties' of the target (see question 7) and in circumstances where securities of the acquirer will be issued in consideration for the target's shares. In the latter case, the disclosure document must generally contain the same information that a prospectus of the acquirer would contain.

6 Disclosure of substantial shareholdings

What are the disclosure requirements for owners of large shareholdings in a company? Are the requirements affected if the company is a party to a business combination?

A person who acquires beneficial ownership of, or the power to exercise control or direction over, or securities convertible into, 10 per cent (5 per cent if a takeover bid is outstanding) or more of a class of voting or equity securities of a Canadian public company is required to issue a press release and file a report containing prescribed information. A further press release and report is required upon the acquisition of each additional 2 per cent or if there is a change in any material fact contained in the report.

7 Duties of directors and controlling shareholders

What duties do the directors or managers of a company owe to the company's shareholders, creditors and other stakeholders in connection with a business combination? Do controlling shareholders have similar duties?

Directors in Canada owe three basic statutory duties – the duty to manage or supervise the management of the company; a duty of care; and a fiduciary duty (duty of loyalty) to act honestly and in good faith in the best interests of the company. In a recent decision (*BCE Inc v 1976 Debentureholders*), the Supreme Court of Canada (SCC) emphasised that the duty of loyalty was owed to the company itself, and not necessarily the shareholders. The SCC further noted that in considering what is in the best interests of the company, directors may look to the interests of, among others, shareholders, employees, creditors, consumers, governments and the environment to inform their decisions. As a practical matter, directors will continue to make shareholders and shareholder value a primary (if not the primary) focus in evaluating business combinations since shareholder approval is critical as to whether a business combination will or will not proceed. Canadian courts are reluctant to overturn decisions made by directors in circumstances where the directors can demonstrate that

they have made an informed decision following a careful and prudent process that takes into account, among other things, the interests (and reasonable expectations) of all stakeholders. This is the so-called ‘business judgement rule’. In the *BCE* decision, the SCC recognised that, depending on the circumstances, when directors make decisions that are in the best interests of the company, some stakeholders may be ‘winners’ and some stakeholders may be ‘losers’.

If the acquirer is a ‘related party’ of the target (eg, owns 10 per cent or more of the voting shares of the target) or the business combination has been negotiated with a related party which is acting together with the acquirer, the transaction will generally be subject to enhanced fairness rules which (subject to prescribed exceptions):

- require the preparation of a formal valuation of the target’s shares by an independent and qualified valuer (the valuation must be summarised and a copy of the valuation report is typically included in the documents delivered to shareholders); and
- require approval by a ‘majority of the minority’ of disinterested shareholders.

Shareholders, including controlling shareholders, do not generally owe fiduciary duties to other shareholders.

8 Approval and appraisal rights

What approval rights do shareholders have over business combinations? Do shareholders have appraisal or similar rights in business combinations?

Corporate transactions require the approval of the target’s shareholders (typically two-thirds of the votes cast). Also, ‘majority of minority’ approval may be required in connection with corporate transactions involving related parties (see question 7).

Shareholders typically have dissent rights and appraisal remedies in connection with business combination transactions, such as a plan of arrangement (see question 14).

9 Hostile transactions

What are the special considerations for unsolicited transactions?

In recent years, acquirers have shown increased willingness to launch unsolicited (hostile) takeover bids. This is probably more a reflection of market conditions than anything else. There are, however, some regulatory factors that make hostile takeover bids easier to make in Canada than in other jurisdictions. For example, a Canadian target usually cannot just say no to a hostile takeover bid nor can it maintain many of the defensive tactics that are used in the United States. However there have been recent rulings of securities regulators in Canada to suggest that a just-say-no defence may work in very limited circumstances. Notwithstanding these factors, the successful implementation of hostile takeover bids is limited by other factors, including:

- relative concentration of share ownership in Canada which promotes negotiated transactions; and
- the target’s inability to just say no in most cases will force it to seek out alternative buyers (so-called ‘white knights’) who may have a number of advantages (eg, access to confidential information and deal protection) relative to the hostile bidder.

Shareholder rights plans (or ‘poison pills’), which if triggered dilute an acquirer’s voting rights and economic interest in the target, are the most common defensive tactic used in Canada. A poison pill will usually be triggered when an acquirer acquires or announces its intention to acquire a specified percentage (often 20 per cent) of the securities of the target, unless the acquirer does so pursuant to a ‘permitted bid’ allowed by the poison pill (typically an offer to all shareholders that is open for acceptance for at least 60 days).

Canadian securities regulators have typically not been prepared to permit a poison pill to be used to deny shareholders the opportunity to make their own decision with respect to a bid, and have generally

been prepared to cease-trade a poison pill if the target is unable to demonstrate that it is actively pursuing alternative transactions or if there seem to be no prospective alternative bids.

Other pre-emptive defensive tactics, such as ‘shark repellents’, are not popular or, as in the case of staggered boards, do not work as a result of relevant corporate law or regulatory restrictions.

10 Break-up fees – frustration of additional bidders

Which types of break-up and reverse break-up fees are allowed?

What are the limitations on a company’s ability to protect deals from third-party bidders?

The use of deal protection measures is not specifically regulated in Canada and has received limited judicial consideration. Subject to the duties described in question 7, a board of directors may agree to a variety of deal protection measures in a negotiated business combination including break fees, no-shop clauses, matching rights, and asset and stock options. In the context of ‘white knight’ transactions, Canadian courts have acknowledged that deal protection measures are appropriate where:

- they are required to induce a competing bid;
- the competing bid represents sufficiently better value for shareholders to justify their use; and
- they represent a reasonable commercial balance between their potential negative effect as auction inhibitors and their potential effect as auction stimulators.

Break-up fees are common in most negotiated business combinations in Canada. A break-up fee (sometimes referred to as a termination fee) is intended to compensate an acquirer with a cash payment in the event that the proposed transaction is terminated, generally because the target accepts a superior proposal from a third party. Break-up fees are used primarily to attract an acquirer to make an offer, protect the acquirer from competing offers after its offer is accepted and compensate the acquirer for the costs of making an offer and foregone opportunities. The fee often ranges from 2 per cent to 4 per cent of the equity value of the transaction.

Reverse break-up fees are a relatively recent development in Canada. A reverse break-up fee is intended to compensate the target with a cash payment in the event that the proposed transaction is terminated by the target as a result of the acquirer’s failure to perform (eg, failure by a strategic purchaser to obtain required regulatory or shareholder approval). The remedies of the parties on termination of an agreement will be a matter of negotiation and depend on the language of the transaction agreements.

In terms of financial assistance, a takeover bid cannot be made conditional upon financing. An offeror that proceeds by way of takeover bid is generally unable to secure any necessary bid financing against the assets of the target until all of the shares have been acquired, which often involves a delay of a few months and can constrain a bidder’s willingness (or ability) to proceed by way of takeover bid. A negotiated corporate transaction, on the other hand, can result in an acquirer owning 100 per cent of the shares of the target in a single step, which can facilitate financing arrangements that involve the target (subject to the duties of the board of directors of the target).

11 Government influence

Other than through relevant competition regulations, or in specific industries in which business combinations are regulated, may government agencies influence or restrict the completion of business combinations, including for reasons of national security?

In the case of acquisitions by investors whose ultimate country of control is a member of the WTO (which accounts for nearly all countries), the acquisition by a non-Canadian of ‘control’ of a Canadian business is reviewable under the Investment Canada Act if:

- the target has assets with a book value of C\$312 million (for 2011 and indexed annually for inflation) or more. Recent amendments will, when the related regulations are promulgated, increase this threshold to an 'enterprise value' of C\$600 million; thereafter, this threshold will increase in increments to C\$1.0 billion; or
- the target has assets with a book value of C\$5 million or more (or is a subsidiary of a foreign company and has Canadian assets of C\$50 million or more) and is in a cultural business (the federal Department of Heritage also has the jurisdiction to review any acquisition of a cultural business regardless of asset value).

Lower thresholds apply to investors whose ultimate country of control is not a member of the WTO. Transactions below the applicable monetary thresholds are subject to a 'tick the box' notification process which may be made post-closing. If a transaction is reviewable, the acquirer is prohibited from acquiring the Canadian business until the relevant authorities issue a notice that they are satisfied that the acquisition is likely to be of 'net benefit to Canada'. The relevant authorities issue a 'net benefit to Canada' clearance in the overwhelming majority of transactions.

The initial review period for a reviewable transaction is 45 days. This period may be, and often is, extended by an additional 30 days (or longer with the consent of the parties). There is no filing fee.

The Investment Canada Act also provides for the review of any foreign investment that could be 'injurious to national security', regardless of its size.

Certain other Canadian statutes limit foreign ownership in specified industries (eg, financial services, broadcasting, telecommunications and transport).

12 Conditional offers

What conditions to a tender offer, exchange offer or other form of business combination are allowed? In a cash acquisition, may the financing be conditional?

Generally, a business combination may be subject to a number of conditions, the only real restriction being market acceptance (and what a target is willing to accept, in the context of a negotiated transaction).

A cash takeover bid may not be conditional upon obtaining financing, as an offeror must make adequate arrangements to ensure the availability of funds to effect payment under the bid before the bid is launched. Financing arrangements may be subject to conditions if, at the time the bid is commenced, the offeror reasonably believes that the likelihood that it will be unable to pay for the securities deposited under the bid solely due to a financing condition not being satisfied is remote. In practice, financing conditions are typically structured to largely track the conditions of the takeover bid. While the same prohibitions do not, strictly speaking, apply to corporate transactions, a target will frequently insist that committed financing be in place before entering into a binding agreement.

13 Financing

If a buyer needs to obtain financing for a transaction, how is this dealt with in the transaction documents? What are the typical obligations of the seller to assist in the buyer's financing?

A target will generally require evidence that committed financing is in place, and transaction agreements will typically include representations and warranties from the buyer to this effect, as well as more or less detailed covenants from the buyer to obtain the committed financing (or, if necessary, replacement financing), with the degree of detail often varying depending on whether the buyer is a strategic buyer or a financial buyer. Similarly, financial buyers (and occasionally strategic buyers) will also often require a target to cooperate with the buyer in obtaining the financing, such as by preparing any necessary offering documents, dealing with lenders

and ratings agencies, and generally acting to facilitate a draw down on the committed financing.

14 Minority squeeze-out

May minority stockholders be squeezed out? If so, what steps must be taken and what is the time frame for the process?

If:

- 90 per cent or more of the outstanding shares are tendered to a takeover bid (excluding shares held by the acquirer on the date of the bid) within 120 days of the date the bid was made, the acquirer is generally entitled to exercise a statutory right of acquisition to squeeze out any non-tendering shareholders by requiring them to elect to tender their shares for the bid consideration or to receive the 'fair value' of their shares; and
- less than 90 per cent of the outstanding shares are tendered to a takeover bid, the balance may be acquired through a second stage corporate transaction pursuant to which the acquirer is generally entitled to vote the shares acquired under the takeover bid (a minimum tender condition of two-thirds will therefore generally be sufficient to ensure that the acquirer has sufficient votes to approve the corporate transaction).

The statutory right of acquisition may generally be implemented immediately. A second stage corporate transaction requires a shareholder meeting, and so generally involves a delay of 30 to 60 days.

Shareholders typically have dissent and appraisal remedies in connection with squeeze-out transactions. The determination of fair value (if contested) is made by a court.

15 Cross-border transactions

How are cross-border transactions structured? Do specific laws and regulations apply to cross-border transactions?

Canada and the United States are parties to a bilateral multi-jurisdictional disclosure system (MJDS), which generally facilitates the implementation of certain cross-border business combinations in compliance with home jurisdiction requirements. Under MJDS, a business combination involving a Canadian target with shareholders in both Canada and the United States may be implemented using substantially Canadian documents and procedures if less than 40 per cent of the target's securities are held in the United States. Also, if securities are being issued by the acquirer in consideration for the target's shares, the acquirer may use its home jurisdiction documents if the acquirer meets specified reporting history and market capitalisation thresholds.

Canada does not have similar arrangements with other countries.

16 Waiting or notification periods

Other than as set forth in the competition laws, what are the relevant waiting or notification periods for completing business combinations?

A takeover bid must remain open for at least 35 days from the commencement of the bid.

If a corporate transaction involves a shareholders' meeting, a record date will have to be fixed and a management information circular mailed to shareholders in advance of the meeting. Generally, the notice of the meeting and the record date for the meeting must be published at least 25 days before the record date; the record date must be at least 30 days before the meeting date; and the information circular must be mailed to shareholders at least 24 days before the meeting date. These time periods may be compressed if the materials for the meeting are sent to all beneficial shareholders at least 21 days before the meeting date.

See questions 4 and 11 for the Competition Act and Investment Canada Act review periods.

17 Sector-specific rules

Are companies in specific industries subject to additional regulations and statutes?

Companies in certain specific industries, including financial services, broadcasting, telecommunications and transport, are subject to additional regulations and statutes which may affect a business combination, including foreign ownership rules.

18 Tax issues

What are the basic tax issues involved in business combinations?

The basic tax issues to be considered include:

- shareholders of the target may realise capital gains or deemed dividends or may be entitled to tax deferrals in certain circumstances and not in others;
- for non-resident shareholders of the target, withholding tax and rollover eligibility may be important;
- for the acquirer, consideration should be given to the most effective way of financing the transaction where cash or debt is being used;
- there can be significant tax issues associated with the acquisition of control of a Canadian company (eg, the loss of tax loss carry-forwards); and
- exchangeable shares are often used in stock-for-stock deals involving a foreign acquirer to provide rollover (deferral) of capital gains for Canadian resident shareholders of the target – exchangeable shares are often issued by a special-purpose Canadian subsidiary of the foreign acquirer and are designed to be the economic and functional equivalent of stock of the foreign parent.

In certain circumstances, a corporate transaction (in particular, a plan of arrangement) may offer more flexibility than a takeover bid in achieving certain tax objectives that may be attractive to the acquirer or the shareholders of the target.

19 Labour and employee benefits

What is the basic regulatory framework governing labour and employee benefits in a business combination?

In general, the continuing company or the acquirer will become the successor employer and will assume the associated liabilities. None of the Canadian provinces have the concept of 'employment at will' and the cost of firing employees in any post-closing downsizing may be considerable.

Update and trends

See section 'Merger Control in Canada', which highlights significant recent developments, on following pages.

20 Restructuring, bankruptcy or receivership

What are the special considerations for business combinations involving a target company that is in bankruptcy or receivership or engaged in a similar restructuring?

Insolvent companies are generally restructured pursuant to court-sanctioned processes under the Companies' Creditors Arrangement Act (CCAA) or the Bankruptcy and Insolvency Act. Most major restructurings are carried out under the CCAA as it affords more flexibility.

21 Anti-corruption and sanctions

What are the anti-corruption and economic sanctions considerations in connection with business combinations?

The Criminal Code of Canada provides for fines and imprisonment in respect of a person who, directly or indirectly, corruptly gives or offers to the holder of a judicial office, a member of the Canadian parliament or of the legislature of a province of Canada, any money or other valuable consideration for any act or omission by that person in their official capacity.

The corruption of Foreign Public Officials Act (Canada) is the recently enacted Canadian equivalent of the US Foreign Corrupt Practices Act and criminalises the provision of benefits by a company or its agents to a foreign government official in consideration of any act to be undertaken by that official.

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