

The International Comparative Legal Guide to:
Mergers and Acquisitions 2009

A practical insight to cross-border Mergers and Acquisitions



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1 Relevant Authorities and Legislation

1.1 What regulates M&A?

Canada's federal structure divides the power to legislate between the national (federal) and provincial governments. The provinces are responsible for securities laws. Despite the general adoption by provincial securities commissions of consistent national rules and policies with uniform application, there are certain differences.

In addition, a Canadian corporation and the rights of its shareholders may be governed by provincial or federal law, depending upon which corporate statute applies. For example, a Canadian corporation may be incorporated under the (federal) *Canada Business Corporations Act* or the (provincial) *Business Corporations Act* (Ontario).

The principal regulatory issues of general application in public company purchases relate to competition or anti-trust (*Competition Act*) and foreign ownership approval (*Investment Canada Act*). Certain businesses are subject to additional regulation at the federal level because there are statutes that regulate and restrict foreign and other ownership. For example, to acquire a 10% or greater interest in a bank requires the approval of the Minister of Finance. Telecommunications companies, insurance companies and airlines are also subject to additional federal regulatory restrictions. There are also provincial restrictions that apply to some businesses.

1.2 Are there different rules for different types of public company?

Canadian securities regulations generally apply to companies that have done public offerings or become listed in Canada. Former public companies of this type that have "gone private", as well as non-Canadian public companies that are engaged in securities or M&A transactions with a Canadian nexus, tend to be subject to fewer rules.

1.3 Are there special rules for foreign buyers?

The primary investment restrictions imposed on foreign buyers relate to foreign ownership. There are different rules depending on the country of ultimate control of the buyer and the nature of the industry of the company that the buyer is looking to acquire.

In the event that a foreign buyer is ultimately controlled in a country that is not a member of the World Trade Organization (WTO), the federal government will screen the transaction if: (i) the buyer

proposes a direct acquisition of a Canadian business with assets with a book value of C\$5 million or more; or (ii) the buyer proposes an indirect acquisition of a Canadian business (i.e., an acquisition of a Canadian business through the acquisition of a foreign corporation) with assets with a book value of C\$50 million or more.

If a foreign buyer is ultimately controlled in a country that is a member of the WTO, the federal government will screen the transaction if the buyer proposes a direct acquisition of a Canadian business with assets with a book value of C\$295 million or more.

All foreign buyers who intend to acquire a business in a "sensitive sector", regardless of the country in which they are ultimately controlled, will be subject to the lower review thresholds (i.e., C\$5 million (direct) and C\$50 million (indirect)). The following types of businesses have been placed in the "sensitive sector" category: (i) uranium production and ownership; (ii) financial services; (iii) transportation services; and (iv) "cultural business" (i.e., publication, distribution or sale of books, magazines, periodicals, newspapers or music in print; production, distribution, sale or exhibition of audio, film, video or music-video recordings; or broadcasting). The federal Department of Heritage also has the jurisdiction to review any acquisition of a "cultural business", regardless of the asset value.

1.4 Are there any special sector-related rules?

The Telecommunications Act, the Bank Act and the Insurance Companies Act are examples of federal legislation that place certain limitations on foreign or other ownership in specific sectors. Ontario's Paperback and Periodical Distributors Act and Mortgage Brokers Act, and Quebec's Cinema Act, also include prohibitions or restrictions against the practice of certain trades or the carrying on of certain kinds of business by non-Canadians or non-residents of those provinces. There are also other examples.

1.5 What are the principal sources of liability?

The principal sources of liability relate to failures to address the technical rules that apply to the offer process (e.g. take-over bid rules) and to any misrepresentation made by an offeror in offer documents. There are additional rules of general application that apply to such matters as insider trading, market manipulation or engaging in conduct inconsistent with the "public interest". Penal and civil sanctions can apply to companies and, as well, to their directors, officers and other joint actors.

2 Mechanics of Acquisition

2.1 What alternative means of acquisition are there?

The three most prevalent ways to acquire control of a public company in Canada are by way of: (i) a take-over bid (or tender offer) with consideration of cash, securities or a combination of cash and securities; (ii) a statutory merger known as an “amalgamation” (which is used rarely); or (iii) a court-supervised merger or “plan of arrangement”.

2.2 What advisers do the parties need?

The principal advisors will almost always include legal counsel and financial advisors. Auditors are invariably involved, as financial reports are usually an essential part of disclosure. In some transactions and industries, consulting engineers, public relations advisors, proxy solicitors and other experts will be retained.

The role of legal counsel is primarily to provide strategic advice, navigate the relevant legislation, assist in the preparation of disclosure and offering documents, negotiate and prepare contracts and provide any required legal opinions to the parties. Financial advisors often provide strategic and financial analysis, prepare valuations, advise boards of directors and provide fairness opinions, if required.

2.3 How long does it take?

The timetable for a transaction varies with the form chosen. Taking into account regulatory approval requirements and statutory procedures, a three-month time frame is a fair estimate of the time required to conclude most acquisitions that are not in a “sensitive sector”.

2.4 What are the main hurdles?

The principal milestones are usually: (i) if applicable, entering into “lock-up” agreements with key shareholders of the target; (ii) entering into a “merger” or “support” agreement with the target (or the launch of an offer if it is hostile); (iii) shareholder approval in the prescribed form or in response to the offer; (iv) applicable regulatory and third party approvals; and (v) court approval, if the transaction is being done by way of a “plan of arrangement”.

2.5 How much flexibility is there over deal terms and price?

The general rule is that all shareholders must be offered the same consideration and no other agreement or understanding can provide a collateral benefit to one or more but not all holders. Pre-bid integration rules require that, if stock is purchased within 90 days preceding a take-over bid, all offerees under the bid are generally entitled to receive the same consideration as was previously offered. There are several technical exceptions to this general rule and the rule only applies expressly to tender offers, thus providing more flexibility in non-tender offers (where generally votes will be disenfranchised in an additional minority approval process).

2.6 What differences are there between offering cash and other consideration?

While take-over bids in Canada can be made by way of cash,

securities or some combination thereof as consideration, there are several factors that are relevant to the decision as to whether to proceed by way of a cash offer or a share (or combination) exchange offer. The following differences merit highlighting: (i) disclosure obligations; (ii) target shareholders’ preferences; and (iii) tax considerations.

The threshold (for cash, securities or a combination) is that information must be sufficient to allow shareholders to make an informed decision about whether to tender their shares. In the event that securities are offered, prospectus-level disclosure (“full, true and plain disclosure” without material omissions) regarding the securities offered is required. Subject to certain exemptions (for companies that report under US or international GAAP, for example), compliance with Canadian accounting standards is an important requirement.

If the bidder was not previously a “reporting issuer” in the applicable province(s), there may be securities commission review of the take-over bid circular. Lower levels of disclosure are required for all cash offers. Discretionary exemptions are available from these obligations but they are not frequently given by the securities regulators.

As a general rule, “public” shareholders prefer cash, particularly where there are alternative investment vehicles in the target’s industry. Canadian taxpayers (which do not generally include pension funds and other tax exempt institutions) may prefer shares of Canadian companies as consideration, as deferrals or “tax free rollovers” can be material. Foreign companies have used exchangeable share structures to allow Canadian taxpayers to achieve this result.

2.7 Do the same terms have to be offered to all shareholders?

See question 2.5 above.

2.8 Are there any limits on agreeing terms with employees?

There is no general requirement to consult with or seek approval from employees on a change of control. Existing employee benefit arrangements must always be addressed as part of any acquisition and may ultimately be a factor in the approach a bidder takes to the acquisition of the target. There are restrictions on the use of collateral benefits to those employees who are also shareholders. In the event that collateral benefits are offered to employees of the target in a take-over bid context, it must be clear these benefits are in an employment and not in an investment capacity, and certain restrictions apply. In certain kinds of mergers, their votes may not count. See question 2.5 above.

2.9 What documentation is needed?

With a take-over bid, the principal documents are the take-over bid circular, applications for regulatory approval and credit documentation, if any. To acquire the balance of shares not tendered, a notice of compulsory acquisition (if 90% of the shares not previously owned by the offeror have been tendered) or a notice of a shareholders meeting and proxy circular (if a second step merger transaction is required) comprise the principal documents. A wide range of correspondence, regulatory filings and agreements may also be needed.

Where an amalgamation or plan of arrangement is sought, the principal document will be a “merger agreement” and, in the case of a plan of arrangement, court documents will need to be prepared.

Shareholder meeting documentation will be required for both.

If there is a substantial shareholder, a “lock up” agreement may also be used.

2.10 Are there any special accounting procedures?

Historical audited, unaudited and pro forma financial information is required whenever securities are offered as consideration and may be required in any event depending on what shareholder approvals are sought.

2.11 What are the key costs?

Borrowing costs, if any, may be significant, as would be the fees of the financial advisors, legal costs, audit charges, consulting fees and printing and mailing charges. Depending on the size of the transaction and the industry of the target, there could also be significant costs associated with filings and obtaining requisite regulatory and third party consents.

2.12 What consents are needed?

The principal consents that are typically necessary to execute the transaction are: (i) shareholder approvals; (ii) applicable regulatory and judicial consents; and (iii) any applicable third party consents, such as for a change of control.

2.13 What levels of approval or acceptance are needed?

In most cases, the objective of the bidder will be to obtain 100% of the common shares of the target, for which there are generally two options. Where a bidder through the take-over bid acquires more than 90% of the shares of the target that the bidder did not own at the start of the bid, the bidder can take advantage of the “compulsory acquisition” provisions of most corporate statutes. Where a bidder falls short of that threshold but still acquires enough shares so that it owns more than 66⅔% (75% in some cases) of the shares of each class, it can usually effect a squeeze-out transaction (i.e., through an amalgamation, consolidation or capital reorganisation, which will accomplish the same objective). In the case of material related party transactions, the transaction may in certain cases also need to be approved by a majority of “disinterested” shareholders - what is called a “majority of the minority”. The general rule is that all shares beneficially owned or over which control or discretion is exercised by the related party and any of its joint actors cannot be included as part of the minority for the purposes of this vote, although previously tendered shares of minority holders may be counted in certain cases.

2.14 When does cash consideration need to be available?

See question 2.5 above. The procedures for the settlement of consideration will depend on the type of acquisition the bidder has chosen. For example, in the event that a take-over bid is used, the consideration must be paid within three business days of the securities being taken up by the bidder. In the event that an amalgamation or a plan of arrangement is used, the “merger agreement” will provide for payment, typically at the time of closing of the transaction.

3 Friendly or Hostile

3.1 Is there a choice?

It is generally possible to engage in a hostile acquisition in Canada.

3.2 How relevant is the target board?

The target’s directors must respond to a take-over bid and advise the shareholders within 15 days of the bid. Directors may: (i) recommend in favour of the bid; (ii) recommend against the bid; or (iii) decline to make a recommendation as long as they provide reasons for so doing. Although directors are “gatekeepers” and only “advise”, negative recommendations supported by compelling financial and other arguments are often persuasive.

With amalgamations and plans of arrangement, directors of the target must generally initiate an important part of the process when they negotiate a merger agreement and convene shareholders’ meetings and prepare meeting materials. Hostile amalgamations or plans of arrangement are, therefore, very problematic and rare.

3.3 Does the choice affect process?

A hostile transaction is generally commenced with a take-over bid whereas other types of transactions generally involve a negotiation process and agreement.

4 Information

4.1 What information is available to a buyer?

The only information available to a bidder in a hostile transaction would be the target’s public file, including financial statements, prior prospectuses, charter documents, annual information forms (similar to a 10-K), proxy circulars, material change reports, certain key agreements and press releases.

4.2 Is negotiation confidential?

Undisclosed negotiations may be permitted on the basis that there is nothing to disclose that would be less than misleading until the transaction is finally agreed. However, a recent ruling by the Ontario Securities Commission held that a material change can occur in advance of the signing of a definitive agreement, but it is not a “bright line” test whether a material change has occurred. Factors to consider in this determination include the level of commitment from the parties to proceed with the transaction and whether there is a substantial likelihood that the preliminary agreements will be completed. It is also problematic when discussions leak, or there are unexplained increases in the stock price, and the parties would otherwise prefer to deny the facts. There is no universal rule or safe harbour, and practices vary.

4.3 What will become public?

Take-over bid rules require disclosure of the acquisition process. Documentation required must include details with respect to prior negotiations related to the transaction.

4.4 What if the information is wrong or changes?

Take-over bid rules require both the bidder and target to update their disclosure in the event of any change in information that would reasonably be expected to affect the decision of a holder of affected securities. Assuming an acquiror has included appropriate conditions (as part of an offer), in the event of such changes, the acquiror may not need to proceed.

5 Stakebuilding

5.1 Can shares be bought outside the offer process?

A stake of up to 10% (5% if another bid is outstanding) can be built before it must be reported.

In building a stake, the pre-bid integration rules are a critical consideration since this activity can affect the price, form of consideration and percentage of stock a bidder must buy later. Once a bid is announced, an acquiror can reserve the right to acquire up to 5% of the class for which the bid is made, subject to daily reporting of purchases. Generally, except for this exception, no sales may be made by an offeror during a bid. In addition, no purchases may be made within 20 business days after the expiry of a bid even if no stock was taken up by the acquiror, unless the transaction is available on identical terms to all security holders.

5.2 What are the disclosure triggers?

After a 10% level (5% if another bid is outstanding) is reached, if the acquiror continues to acquire shares, there is accelerated reporting each time another 2% is purchased or other changes in previously declared facts occur. Above 10%, the acquiror is an insider and may become subject to insider bid rules if it proceeds to above 20%. A purchase that will take an acquiror over the 20% threshold is, unless an exemption is available, a take-over bid to which additional rules apply.

5.3 What are the limitations?

See questions 5.1 and 5.2 above. Also, a substantial number of companies have “poison pills” in place.

6 Deal Protection

6.1 Are break fees available?

It is possible to obtain a “break fee” or other inducement fee from a target. The total of all fees typically ranges from 1-5% of a deal’s equity value, often around 2-3%.

6.2 Can the target agree not to shop the company or its assets?

The target may agree not to solicit other competing offers or transactions, or to co-operate or provide information to others. This kind of agreement generally includes a fiduciary duty carve-out for unsolicited superior proposals, subject to a time-limited right to match, and may on occasion include so-called “go shop” provisions.

6.3 Can the target agree to issue shares or sell assets?

Subject to fiduciary duty obligations, a target can issue stock and sell crown jewels. All issuances of stock are subject (if the target is listed on the Toronto Stock Exchange) to the approval of the Toronto Stock Exchange and in the event the issuance of stock will have a material impact on the control of the company, shareholder approval will likely be required. Dispositions of assets may be subject to shareholder approval where they comprise “all or substantially all” of the corporate assets or involve related parties.

6.4 What commitments are available to tie up a deal?

The break fee is the most prevalent incentive. A target can issue an option to acquire stock, or a bidder can acquire stock itself, which would discourage a third party, or make an acquisition of 100% of the target problematic. Asset sales can be justified as can joint ventures that would “disqualify” certain bidders. Shareholder rights plans (or “poison pills”), can slow the third party, and leveraged recapitalisations can also take place.

7 Bidder Protection

7.1 What deal conditions are permitted?

It is common for unsolicited bids, in particular, to include broadly worded conditions, giving wide discretion to determine whether the conditions have been satisfied. Conditions can include access to any data room made available to others, absence of any material adverse change (however defined), “market outs”, and receipt of regulatory and third party approvals, among other things. The only item that likely cannot be the subject of a “condition” is a bidder’s financing for the acquisition, since securities legislation in Canada requires that bidders make adequate arrangements to ensure that funds required to pay for the cash portion of the consideration will be available prior to launching a bid.

7.2 What control does the bidder have over the target during the process?

See question 7.1 above. Also, agreements with the target can provide additional rights.

7.3 When does control pass to the bidder?

Control will pass to the bidder once the board of directors of the target has resigned and the bidder has replaced the board of directors with its own board. In the interim, negative covenants, subject to competition restrictions and the receipt of any necessary approvals, can apply.

7.4 How can the bidder get 100% control?

See question 2.13 above.

8 Target Defences

8.1 Does the board of the target have to tell its shareholders if it gets an offer?

See question 3.2 above.

8.2 What can the target do to resist change of control?

In 1997, the Canadian Securities Administrators adopted National Policy 62-202 with respect to responses to take-over bids, which provides that the decision on whether a bid succeeds should ultimately rest with the target's shareholders rather than with its board of directors. Any activity that denies or severely limits shareholders' ability to make a decision regarding a take-over bid may lead the securities regulators to intervene.

The policy is that defensive tactics are acceptable if undertaken by the board in a genuine effort to elicit a better bid. Among measures that the board of directors might pursue are the following: (i) arrangements with third parties, including negotiated sales, asset sales, asset purchases, share sales and other "strategic alliances"; (ii) a shareholder rights plan; (iii) an internal business reorganisation; (iv) share buy-backs and special dividends; (v) challenging the bid through regulators or in court; or (vi) lobbying politicians. Also see question 6.4 above.

8.3 Is it a fair fight?

Some have argued that Canada's regime does not provide the target company's board of directors with sufficient discretion to fend off a hostile approach. Under the current regime, the target company usually has less than 60 days from the day of a hostile bid to respond, and Canada's securities regulators strike down "poison pills" more readily than U.S. judges on grounds of prejudice to shareholders' interests.

9 Other Useful Facts

9.1 What are the major influences on the success of an acquisition?

The principal factors likely to influence the outcome are: (i) price; (ii) regulatory issues; (iii) competing bidders; (iv) the successful use of defensive tactics (in the event the process is hostile); and (v) external events that adversely affect the share price of the bidder (in the event that the bidder is using shares as consideration for the acquisition).

9.2 What happens if it fails?

Arguably, the worst outcome for a bidder is one in which the bidder acquires an illiquid minority position in a target.

10 Updates

10.1 Please provide a summary of any new cases, trends and developments in M&A Law in Canada.

Canadian M&A activity declined relative to the previous year largely as a result of the global reduction of credit availability. Nevertheless, there were a number of strategic acquisitions, particularly in the natural resources area, of which announced examples were Kinross' acquisition of Aurelian Resources and Teck Cominco's proposed acquisition of Fording Canadian Coal Trust. The BCE acquisition by financial buyers has cleared regulatory and judicial hurdles and is scheduled to be completed in 2008.

Prompted by the increase in highly visible hostile bids for marquee Canadian companies in 2007, the federal government created a panel to review key elements of Canada's competition and investment policies. The panel released its report in June 2008 and recommended narrowing the scope of the *Investment Canada Act* in part by increasing the minimum review thresholds (except for cultural businesses) and eliminating the separate threshold that applies to businesses engaged in a "sensitive sector". It also recommended improving transparency and predictability in the administration of the *Investment Canada Act*, implementing a more stream-lined process of review under the *Competition Act* and reducing the period in which the Commissioner of Competition may challenge a completed merger. There are no assurances that these recommendations will be implemented by the government.

The Supreme Court of Canada overturned the decision of the Québec Court of Appeal which held that a plan of arrangement involving BCE Inc. was not "fair and reasonable" since it did not adequately take into account the interests of certain debenture holders. The written decision of the Supreme Court has not yet been published, but it should clarify the duty of directors of a target to take into account the interests of non-shareholder stakeholders in an M&A context and to prioritise the interests of shareholders of solvent companies.

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