Recent developments in Canadian M&A

William J Braithwaite and John Ciardullo of Stikeman Elliott address recent developments of importance in Canadian M&A

After a number of years of robust activity, the global credit crisis and related economic uncertainty greatly impacted the volume of Canadian M&A activity in 2008. According to data compiled by Financial Post Crosbie: M&A in Canada, there were C$114.8 billion of deals in 2008, down a remarkable 69% over the record C$370 billion of deals in 2007. Further, there were only 21 mega deals (defined as transactions valued above C$1 billion) in 2008 versus 60 in 2007. Not surprisingly, 2008 saw an increase in strategic deals and financial buyers had significantly less presence.

Most Canadian M&A practitioners expect the trend towards strategic deals to continue in 2009, and reduced valuations and economic challenges to create a buyer's market. These factors and gaps between buyer and seller expectations are also expected to lead to an increase in unsolicited mergers and acquisitions.

Transactions of note (announced or completed) in 2008 included:

- the $14.1 billion acquisition of Fording Canadian Coal by Teck Cominco;
- the $2.5 billion acquisition of George Weston Limited's US fresh baked goods business by Grupo Bimbo;
- the C$2 billion acquisition of Tanganyika Oil by Sinopec International Petroleum Exploration and Production;
- the C$1.6 billion acquisition of SaskFerco Products by Yara International;
- the C$1.4 billion merger of Metallica Resources, Peak Gold and New Gold;
- the C$1.2 billion acquisition of Aurelian Resources by Kinross Gold; and
- the C$900 million acquisition of First Calgary Petroleums by ENI Spa.

Key developments in 2008

Supreme Court of Canada addresses directors' duties in the M&A context

In the landmark litigation surrounding the proposed C$52 billion privatisation of BCE by a buying consortium led by the Ontario Teachers' Pension Plan, the Supreme Court of Canada was given a rare opportunity to address matters including the duties of directors in the M&A context.

The transaction was structured as a court-approved plan of arrangement under the Canada Business Corporations Act. As part of the transaction, BCE was expected to assume C$38.5 billion of debt, C$30 billion of which would be guaranteed by a wholly-owned subsidiary, Bell Canada, which had issued debentures guaranteed by BCE. While the transaction provided a premium of about 40% to holders of BCE's common shares, it was expected to result in a significant downgrade of Bell Canada's credit rating, which resulted in a decrease of about 20% in the trading value of the debentures. As a result, a group of disgruntled debenture holders initiated litigation in an attempt to block the deal, in part based on some dicta from a 2004 Supreme Court decision outside of the M&A context in *Peoples Department Stores v Wise* which held that directors owe their fiduciary duties to the corporation as a whole, as opposed to any particular stakeholder.

In its decision released in December 2008, the Supreme Court reaffirmed its decision in *Peoples,* noting that even in the M&A context, the fiduciary duty of a director is to act in the best interests of the corporation as a whole, and not any particular stakeholder. The Supreme Court thereby rejected any notion of a strict Revlon duty to maximise shareholder value in the context of a change of control transaction. However, the Supreme Court strongly endorsed the business judgment rule, noting that courts should give deference to the business judgement of directors who take into account these ancillary interests, so long as the directors' decision was within a range of reasonableness.

The Supreme Court also provided guidance concerning the threshold considerations for a Canadian statutory oppression claim, which gives a court broad remedial discretion where, among other things, the powers of the directors of a corporation have been exercised in a manner that is oppressive or unfairly prejudicial to or that unfairly disregards the interests of any security holder, creditor or other claimant. In this regard, the Supreme Court noted that a finding of oppression requires that a complainant have a reasonable expectation and that such reasonable expectation be unfairly disregarded or violated as a result of conduct that is oppressive or unfairly prejudicial. The relevant factors noted by the Supreme Court in determining whether an expectation is reasonable were general commercial practice, the relationship between the parties, past practice, steps the claimant could have taken to protect itself, representations and agreements and the fair resolution of the conflicting interests of different corporate stakeholders.

On the facts of this particular case, the Supreme Court ultimately found that while the debenture holders had a reasonable expectation that the directors would consider their interests, the directors did consider their position, but reasonably concluded that it was not appropriate to protect the debenture holders beyond respecting their contractual rights. Accordingly, the claim of the debenture holders was unsuccessful, although the transaction ultimately did not proceed for other reasons.

However, the nebulous description of the fiduciary duty enunciated in the decision, coupled with such a strong endorsement of the business judgement rule, leaves open a variety of questions, such as the extent to which target defensive mechanisms should be permissible, the question as to whether a board of directors can reject an offer that provides a higher value to shareholders in support of one that treats other stakeholders better and how a court is likely to interpret the reasonable expectations of a shareholder in the M&A context and the implications of such determination.

Shareholder approval in dilutive transactions

As we have reported upon in previous editions of the IFLR Year in Review, a hot button issue

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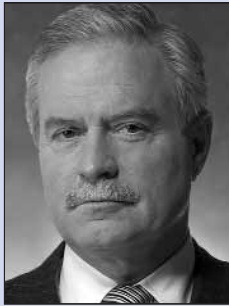
Author biographies



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William Braithwaite is a senior partner and former head of the corporate group. He is also a member of the executive committee and partnership board. He practises in securities and corporate law, specialising in M&A and corporate finance. He represents a range of corporations, boards of directors and institutional shareholders, and advises governments and regulatory authorities on policy and other initiatives.

Braithwaite is recognised The Canadian Legal Lexpert Directory and IFLR's Guide to the World's Leading Financial Law Firms 2009 as a leading lawyer in M&A. Braithwaite was counsel to the IDA Task Force that examined the modernisation of Canada's securities legislation. He is a member of the senior securities legal advisory group to the OSC and previous chairman of the advisory committee of the OSC. Braithwaite is a special lecturer in Osgoode Hall's part-time LLM programme.

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John Ciardullo is a partner in the Toronto office of Stikeman Elliott. He practices corporate and securities law, with a particular emphasis on public M&A transactions. He also has significant experience with proxy contests and contested shareholder meetings. Ciardullo is recognised in the 2009 Chambers Global's Guide to the World's Leading Lawyers for Business in Corporate/M&A, the 2008 Lexpert Guide to the Leading U.S./Canada Cross-border Corporate Lawyers in Canada and in The Canadian Legal Lexpert Directory as one of Canada's top lawyers under 40 in 2007. Ciardullo is currently a member of the Securities Advisory Committee to the Ontario Securities Commission, a body that provides advice to the regulator and its staff on a variety of matters including policy initiatives and capital markets trends. He has authored many articles and publications on corporate and securities law, particularly on the topic of mergers and acquisitions.

in Canada for some time has been the question of whether and in what circumstances Canadian regulators should impose a shareholder approval requirement on the buyer in the context of a share-exchange M&A transaction.

While Toronto Stock Exchange (TSX) rules require shareholder approval for acquisitions involving dilution in excess of 25%, this requirement does not generally apply where the target is a public company with 50 or more beneficial shareholders. Although the TSX retains the discretionary authority to impose a requirement for shareholder approval upon the buyer in such a transaction, this has historically not happened and the efforts of unhappy shareholders of a buyer to force a vote in situations such as Robert McEwan in GoldCorp and Enterprise Capital Management in Manitoba Telecom Services have been unsuccessful. Having said this, the discretionary authority of the TSX is broad, and in exercising it the effect that the transaction may have on the quality of the marketplace can be considered.

In a late-2008 transaction involving HudBay Minerals and Lundin Mining, the TSX refused to exercise its discretionary authority to impose a shareholder vote on the acquiring company, HudBay. However, in an interesting twist, the decision was appealed to the Ontario Securities Commission (OSC), which has regulatory oversight over the TSX, and the OSC overturned the decision and ordered that the transaction could not proceed without a HudBay shareholder vote. In coming to this conclusion, the OSC noted the impact of the transaction on shareholders of HudBay (post-announcement, HudBay's stock price declined 40%), the level of dilution (the fact that the transaction was essentially a merger of equals begged the question as to why Lundin shareholders were entitled to a vote but not HudBay shareholders), the proposed reconfiguration of the board of directors of the combined entity (of which 5 of 9 directors would be former Lundin directors) and questioned the appropriateness of HudBay's governance practices in deciding to proceed without voluntarily putting the transaction to a shareholder vote. The decision, coupled with the opposition of a large number of HudBay shareholders, ultimately led to the termination of the proposed transaction and the HudBay board was ousted after a proxy contest.

While full reasons for the decision have not yet been released, it can be expected that for a merger of equals transaction, or a transaction that resembles a merger of equals, the acquiring company will also want or be required to put the transaction to a shareholder vote. This will impact deal certainty and raise other issues such as the requirement for mutual deal protections and break fees. The HudBay decision has also resulted in some uncertainty as to when a buyer in a highly dilutive M&A transaction short of a merger of equals will need to put the deal to a vote of its shareholders. The TSX will also be more likely to require such votes in the future, and more reluctant to give advance comfort on whether it will require a vote of the acquiring company's shareholders. This situation is also likely to lead to a rule change.

Misuse of confidential information

In two recent Ontario Supreme Court of Justice decisions, a prospective acquirer has been prevented from proceeding with an unsolicited take-over bid due to the alleged misuse of confidential information.

In a decision of the Ontario Superior Court of Justice in *Research in Motion (RIM) v Certicom,* the Court issued a permanent injunction restraining a hostile take-over bid by RIM (the maker of the Blackberry device) after determining that RIM had breached certain confidentiality provisions in a non-disclosure agreement. More specifically, a confidentiality agreement entered into between the parties outside the context of a strategic transaction and without a standstill contained an express-purpose clause, prohibiting RIM from using any confidential information it obtained for any purpose other than the contemplated commercial arrangement. After finding that the RIM deal team had used confidential information in assessing the desirability of launching its hostile bid for Certicom, the Court determined that RIM had breached the agreement and granted an injunction prohibiting the hostile bid. However, the Court left room for the transaction to proceed under a separate deal team who did not have access to any confidential information, which subsequently occurred and the transaction was successfully completed. The decision emphasizes that a standstill provision and a non-disclosure (or use) provision are properly interpreted as two separate clauses, providing different protections. The decision further suggests that an express purpose clause in a confidentiality agreement may have the same effect as a standstill provision, and has lead the Canadian M&A bar to more carefully consider the permitted uses of confidential information when drafting non-disclosure agreements.

In another decision of the Ontario Superior Court of Justice in *Gold Reserve v Rusoro Mining and Endeavour Financial*, the Court granted an interlocutory order restraining Rusoro Mining from proceeding with an unsolicited bid for Gold Reserve on the basis that Rusoro had benefited from Gold Reserve confidential information obtained by its

financial advisor, Endeavour Financial. During the four years preceding the hostile bid, Endeavour had been retained as financial advisor to Gold Reserve in various capacities pursuant to an agreement that contained confidentiality obligations, required Endeavour to advise Gold Reserve of any material conflict and that Endeavour not knowingly act against the interests of Gold Reserve. The agreement was not terminated prior to the launch of Rusoro's unsolicited bid for Gold Reserve. The Court found that in advising Rusoro on its hostile bid for Gold Reserve, there was a serious issue as to whether Endeavour breached certain covenants in its agreement with Gold Reserve.

On this basis, the Court precluded Endeavour from acting as a financial advisor to Rusoro in respect of a hostile bid for Gold Reserve. In addition, the Court enjoined Rusoro's unsolicited bid because it concluded that Rusoro may have or knowingly did receive confidential information concerning Gold Reserve from Endeavour. Both Endeavour and Rusoro are seeking leave to appeal. This case highlights the importance of clearly delineating advisory mandates (and their exit points) as well as the importance of maintaining ethical walls and other procedures designed to limit conflicts.

Reduced bid prices midstream

There have recently been several unsolicited take-over bids in Canada where the bidder has reduced its offer price following the commencement of the bid:

- Borealis Acquisition reduced the price of its offer for Teranet Income Fund from C$11.00 per unit to C$10.25 per unit. The reasons for reducing the bid were stated to be the result of the deterioration in economic and financial market conditions and an increase in Borealis' cost of capital;
- Jaguar Financial reduced the price of its partial bid for Royal Laser from C$0.80 per share to C$0.63 per share. The reasons for the reduction in the offer price were stated to be a major decline in markets generally and in the share price of Royal Laser; and
- Andlauer Management Group reduced the price of its insider bid for ATS Andlauer Income Fund from C$11.75 per unit to C$10.75 per unit. The reasons for the reduction in the offer price were stated to be a material deterioration in economic conditions and credit markets.

Canadian securities regulators did not publicly intervene in any of the situations referred to above and perhaps not coincidently, the unsolicited bids for Teranet and ATS Andlauer were successful notwithstanding the price reductions.

Unlike certain other jurisdictions, the Canadian take-over bid regime does not generally impose any restrictions on the conditions that a hostile bidder can impose, or on a bidder being positioned to subjectively determine whether or not such conditions have been met. As a result, unsolicited bids typically contain a number of conditions that a bidder might seek to rely upon to support a price reduction on the basis that a condition of the bid would not ultimately be satisfied. In fact, in each of the transactions noted above, the offers were subject to broad material adverse changes and market-out conditions, capable of being triggered at the sole discretion of the bidder. However, certain Canadian securities regulators and members of the M&A bar are quick to point out the negative implications that a price reduction may have. In fact, draft take-over bid legislation proposed within the past few years would have prevented a bidder from unilaterally reducing the price of a bid, although this approach was abandoned in favour of cautionary language to the effect that a price reduction following the commencement of a take-over bid may cause the Canadian securities regulators to review the bid or exercise their public interest jurisdiction to cease trade the bid, require that the deposit period be extended or require that a bidder commence a new bid with the varied conditions to ensure that target security holders are not prejudiced by the variation.

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As market conditions improve, prospective bidders should expect that a price reduction will attract enhanced scrutiny from the Canadian securities regulators and may result in intervention.

Canadian take-over bid regime moves closer to national harmony

Through rule changes that became effective on February 1 2008, Canadian securities regulators introduced a new regime designed to harmonise and streamline the requirements applicable to Canadian take-over bids.

While the regime still consists of separate rules in Ontario and all jurisdictions other than Ontario, it results in identical or similar requirements across the country.

In conjunction with the implementation of the new take-over bid regime, the OSC and the AMF have implemented (also effective February 1, 2008) a joint rule imposing additional requirements on certain transactions such as insider bids, going-private (business combination) transactions, related-party transactions and issuer bids, which replaces separate regimes that existed in these jurisdictions.

The new regime is principally a harmonising and consolidation effort, but it also codifies certain historical discretionary exemptions and contains some substantive changes.

Competition and antitrust regulations

The *Competition Act* (Canada) is administered and enforced by the Commissioner of Competition who is the head of the Competition Bureau.

Notification requirements

The Competition Act establishes a regime for compulsory pre-merger notification of certain acquisitions and business combinations that exceed specified monetary and shareholding thresholds (where applicable). Pre-merger notification triggers a mandatory waiting period which must expire, or be terminated or waived, before closing may occur.

The pre-merger notification provisions of the Competition Act apply to several types of transactions, namely acquisitions of assets or shares, business combinations and the formation of, or acquisition of interests in, unincorporated business combinations. A pre-condition to notification, however, is that the target of the acquisition must own or control an operating business in Canada. Certain exemptions also apply.

Determination of whether a transaction exceeds the thresholds for pre-merger notification under the Act depends on the specific structure of a given transaction. Generally, however, a proposed transaction requires notification if it exceeds:

- the size of parties threshold: a book value of assets in Canada or gross revenues in, from or into Canada of all of the parties,

together with their affiliates, of more than C$400 million;
- the size of transaction threshold: generally C$70 million, indexed annually, based on the book value of the assets in Canada being acquired or the Canadian assets of the entity the shares of which are being acquired, or gross revenue from sales in or from Canada generated by those assets; and
- in the case of share acquisitions, an additional shareholding threshold must be exceeded. As a result of the transaction, the purchaser and its affiliates must hold more than 20% of the voting securities of a public corporation or more than 35% of the voting securities of a private corporation. If these ownership levels are already exceeded, the purchaser is required to file if its ownership of voting securities of a public or private corporation exceeds 50% as a result of the transaction.

It is noteworthy that even where a transaction does not trigger a mandatory pre-merger notification filing; it remains subject to the substantive merger review provisions of the Competition Act for a period of one year following closing.

Recent policy developments

In early 2009, the federal government enacted sweeping amendments to Canada's competition and foreign investment law regimes. With respect to the merger review process under the Competition Act, the amendments have created a US-style merger review process, whereby an initial 30-day waiting period applies upon the notification of a transaction, within which the Commissioner of Competition may issue a request for additional information, causing the waiting period to extend until 30 days after compliance with the request for additional information has occurred. This change is likely to lengthen significantly reviews of acquisitions raising competition concerns. There was essentially no public consultation with respect to this controversial amendment, and it is unknown how the Competition Bureau will use its second request powers.

The Investment Canada Act

Regime Summary

The Investment Canada Act (ICA) applies to any acquisition of control by a non-Canadian (by a purchaser the ultimate control of which resides outside of Canada) of a Canadian business (a business carried on in Canada that has a place of business in Canada, an individual or individuals in Canada who are employed or self-employed in connection with the business and assets in Canada used in carrying on the business). Where these criteria are met, a proposed transaction triggers an obligation to file either a notification or an application for review regardless of whether the Canadian-based business is Canadian-controlled.

A notification is essentially an administrative formality, constituting notice of the investment (with certain required information in respect of the investment) to be filed within 30 days of closing. A review application, on the other hand, is more onerous and generally constitutes a bar to closing until receipt of requisite approvals under the ICA. Investments are only reviewable, however, where certain thresholds are met.

Assuming a purchaser is a WTO Investor (ultimately controlled by WTO nationals) within the meaning of the ICA, a review application is required for direct acquisitions if the value of the assets (as set out in the financial statements for the most recently completed fiscal year) of the Canadian businesses, and all other entities in Canada the control of which is being acquired, equals or exceeds C$312 million (likely to change to a C$600 million enterprise value threshold in the third of fourth quarter of 2009 pursuant to ICA amendments). Indirect acquisitions (the acquisition of a Canadian business by consequence of the acquisition of a corporation outside Canada that controls an entity in Canada carrying on the Canadian business) are typically exempt from review if either the purchaser or the vendor is WTO-controlled.

It should be noted that the C$312 million threshold in respect of direct acquisitions is reduced to only C$5 million, and indirect acquisitions are reviewable where the value of the assets (as set out in the financial statements for the most recently completed fiscal year) of the Canadian businesses, and all other entities in Canada the control of which is being acquired, equals or exceeds C$50 million, in respect of investments in Canadian cultural businesses.

In recent years, the ICA process has been gaining greater attention as there has been an increasing concern, in certain circles, regarding the alleged hollowing out of corporate Canada. This has led to more extensive, rigorous and sometimes lengthier binding undertakings being demanded as a condition to clearing a transaction under the ICA process. In 2008, ATK's proposed acquisition of MDA was rejected under the ICA by the Minister of Industry, likely due to some unique issues it raised related to the extensive government funding of MDA and MDA's ownership of space technology including Radarsat-2. This was the first time a transaction had ever been rejected under the ICA.

Recent developments

The ICA was amended significantly in March of 2009. The most notable of the amendments created a national security review process to screen investments that are potentially injurious to national security. The salient elements of the national security review process are:
- There is no definition of national security and no illustrative list of the types of transactions that would be caught. Thus, there is some uncertainty about the potential scope of a national security review;
- The federal cabinet is empowered to prohibit closing of the investment, to authorise the investment on certain conditions or undertakings by the non-Canadian or require the divestiture of the Canadian business;
- There is no minimum review threshold with the result that transactions involving very small targets are potentially reviewable. Similarly, national security screening applies whether or not control has been acquired;
- National security may apply to transactions with relatively tenuous connections to Canada;
- There is no formal requirement to notify the government pre-closing if ministerial approval is not otherwise required pre-closing. In such an instance, the investor may only learn that the transaction is subject to national security review following closing upon receipt of notice from the minister; and
- The national security review screening procedure would apply retroactively to transactions closed after February 6 2009.

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