Global M&A Playbook: What's the Deal in Canada?

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Merger and acquisition deal practice is similar in many countries, particularly the United States and Canada. For many U.S. and other non-Canadian deal lawyers experienced on Canadian cross-border transactions, Canada likely feels quite familiar to their home jurisdiction. All provinces except Quebec have the English tradition of the common law (Quebec's legal regime is based on the civil law system) and, for the most part, the form of agreement typically used to acquire the assets or shares of a Canadian company looks and feels like a U.S. form of agreement.

But, if you get involved in a Canadian or cross-border deal, you'll discover that some things are done a bit differently in Canada. This article highlights some of the differences in Canadian deal practice and the legal environment that you should know if you have a deal in Canada, and some current developments and trends.

Regulation of M&A Activity

M&A activity in Canada is regulated under provincial and federal corporate laws, provincial securities laws (in each of the 10 provinces and three territories) and stock exchange rules. 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 M&A activity.

The provincial and territorial securities regulatory authorities coordinate their activities through the Canadian Securities Administrators (CSA), a forum for developing a harmonized approach to securities regulation across the country. The CSA has developed a system of mutual reliance pursuant to which one securities regulatory authority acts as the lead authority for reviewing regulatory filings of "reporting issuers" (e.g., Canadian public companies). The Ontario Securities Commission (OSC) is generally regarded as the lead securities regulatory authority in Canada.

Forms of Public Company Acquisition

The three principal methods to acquire a public company in Canada are take-over bids (the Canadian version of a tender offer), "plans of arrangement" and amalgamations (similar to a Delaware merger).

A take-over bid results when the securities subject to a bid combined with the securities owned by the bidder and parties acting jointly with the bidder constitute 20% or more of the outstanding securities of any class. Take-over bids must be left open for at least 35 days, and have the advantage of bypassing management of the target. Take-over bids cannot be conditioned upon the bidder arranging financing.

Most mergers and acquisitions involving public companies in Canada are completed by way of a statutory plan of arrangement under the corporate law of the target's jurisdiction. Plans of arrangement are typically completed pursuant to arrangement agreements negotiated between the bidder and the target. Plans of arrangement are subject to the approval of the target's board and shareholders as well as court approval. Unlike a take-over bid, an arrangement can have a financing condition.

A merger of two or more companies may be completed as an amalgamation. This method is rarely used, but it may be useful in straightforward consensual mergers because it avoids the necessity of court proceedings.

Proposed Changes to the Take-Over Bid Regime

The CSA has proposed that take-over bids must remain open for at least 120 days (rather than 35 days as currently required) and that they be subject to a 50% minimum tender condition. In essence, these proposed changes would incorporate into law shareholder-friendly elements of "poison pill" shareholder rights plans (but would provide for 120

days rather than 60 days typically provided for in Canadian shareholder rights plans). The comment period for these proposed changes closed on June 29, 2015, and new rules could take effect as early as 2016.

Proposed Changes to Early Warning Regime Abandoned

In October 2014, the CSA announced they had abandoned a proposal to lower the "early warning" stock ownership reporting threshold from 10% to 5%. If the proposal had been implemented, it would have made the Canadian regime stricter than the U.S. regime. The decision not to lower the reporting threshold in Canada is favorable to shareholder activists, who can continue to acquire up to 10% of an issuer's stock without reporting their holdings.

Recent Changes to Investment Review Regime

The *Investment Canada Act* requires that any non-Canadian that acquires control of a Canadian business (whether or not that business is controlled by Canadians prior to the acquisition) must file either a notification or an application for review. For the purposes of the Act, a non-Canadian includes any entity that is not ultimately controlled or beneficially owned by Canadians.

If an investment meets the financial thresholds for review, a review application must be filed and a determination made by a Minister of the Federal government whether the transaction is of "net benefit to Canada". The review thresholds are complex, and the thresholds for review recently were increased materially. Generally, a direct investment (i.e., the acquisition of the shares or assets of a Canadian corporation) by a WTO Investor (i.e., controlled by persons from countries that are members of the WTO) is reviewable if the target has an enterprise value of C$600 million at the time the transaction is completed. Indirect investments by WTO Investors are not reviewable, except as noted below.

Special rules and significantly lower thresholds apply in respect of direct and indirect acquisitions of so-called "cultural" businesses (e.g., broadcasting, film, video, audio, books, magazines). Special rules also permit a national security review, without regard to the value of the target's assets.

An investment that is not reviewable must be notified. Notification is made by completing a simple two-page form which can be filed any time prior to or within 30 days of the closing.

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Key Deal Terms May Differ

When negotiating a purchase and sale agreement involving Canadian parties, U.S. deal lawyers will confront many of the same issues arising on a U.S. transaction, whether the negotiations relate to the scope of the representations and warranties and the use of materiality and knowledge qualifiers, the conditions precedent to closing or the procedures for dealing with post-closing adjustments to the purchase price and delivery of closing financial statements.

Where you are likely to see differences, however, are in the following areas:

- Indemnity caps are typically higher in Canada than in the U.S. It's not uncommon for Canadian purchasers to insist on a cap in excess of 50% of the purchase price and in many cases up to 100% of the purchase price.
- Holdbacks in support of indemnity claims are not as common in Canadian deals as in the U.S.
- Exceptions to the foregoing often involve Canadian private equity investors, who, like their U.S. counterparts, understand the need for low indemnity caps (perhaps 10-15% of the purchase price), supported by holdbacks deposited in escrow, thereby permitting a private equity vendor to disburse sales proceeds to its limited partners immediately following closing with little or no risk of a clawback.
- General survival periods for representations and warranties are longer in Canada (often 18-24 months) and it is not uncommon to have three to five year survival periods for specific matters such as pensions and environmental claims and even longer periods for claims relating to title.
- Earnouts are used much less frequently in Canadian deals than in the U.S.
- Transaction legal opinions, once a standard closing condition in Canadian M&A transactions and often the subject of heated negotiation between legal counsel, are becoming less and less common in Canada.

These and other trends are detailed in the ABA M&A Committee's *2014 Canadian Private Target M&A Deal Points Study.*

Take the lead and connect with us today.

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