



CANADIAN MERGERS AND ACQUISITIONS

FAQs and 2018 Trends

Blakes
CANADIAN LAWYERS

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INTRODUCTION

Our *Canadian Mergers and Acquisitions: FAQs and 2018 Trends* answers frequently asked questions regarding the regulation of public M&A in Canada and provides an outlook for what 2018 may hold based on significant developments we observed from the Canadian deal environment in 2017.

While global M&A aggregate value surpassed US\$3-trillion for the fourth consecutive year in 2017, it dipped slightly from the previous year. Total deal value in the Canadian M&A landscape experienced a similar fate. Despite the dip in total value, the past year brimmed with innovation, including a sharpened focus on maximizing opportunities in the tech space, a frenzy in cryptocurrency and the emergence of the cannabis industry, all of which could make for a strong 2018.

FREQUENTLY ASKED QUESTIONS ABOUT CANADIAN PUBLIC M&A

1

Who regulates trading in securities in Canada?

Trading in securities, including in M&A transactions, is largely regulated through securities legislation enacted by each of the provinces and territories. Each provincial or territorial securities act creates and empowers a provincial or territorial securities regulator to enforce such laws. These regulators have enacted a number of national, multilateral and local rules and policies that, among other things, seek to harmonize the application of certain aspects of securities laws across the country, including in relation to M&A transactions. In addition, companies whose securities are listed for trading on a stock exchange in Canada are subject to rules imposed by such stock exchange.

2

How are Canadian public issuers typically acquired?

Canadian public companies are typically acquired by way of either a plan of arrangement or take-over bid. A plan of arrangement is akin to a U.S. merger transaction with the addition of court supervision. Often, “friendly” M&A transactions are structured as plans of arrangement, with take-over bids being principally used for unsupported or “hostile” transactions. In the 2018 *Blakes Canadian Public M&A Deal Study*, we found that 90 per cent of the friendly transactions we reviewed were completed by way of a plan of arrangement, while two per cent of such deals were completed by way of a take-over bid and six per cent were completed by way of another shareholder-approved structure, such as an amalgamation.



Plan of Arrangement

A plan of arrangement is a shareholder and court-approved transaction governed by the corporate legislation of the target. An arrangement practically requires the target's involvement and support but is subject to a less prescriptive regulatory regime as compared to take-over bids.

The parties to a plan of arrangement generally enter into a definitive transaction document known as an "arrangement agreement" setting out the basis for the combination, which is followed by an application to a provincial court for approval of the process. The court order will require the calling of a target shareholders' meeting (typically held 45 to 90 days after an arrangement agreement is entered into), specify the approval threshold (typically two-thirds of the votes cast at the meeting) and provide for the grant of dissent rights. A meeting circular will then be sent to target shareholders that provides a broadly similar level of disclosure to what would be provided by a take-over bid circular and, like a take-over bid circular, is not subject to regulatory pre-clearance review. Where the offered consideration includes securities of the offeror, the circular must contain prospectus-level disclosure regarding the offeror's business and financial results. Unlike a take-over bid circular, a meeting circular does not need to be translated into the French language.

Arrangements have a number of advantages over take-over bids. For example, they can facilitate dealing with multiple classes of securities (particularly convertible instruments), provide for acquisition of 100 per cent of the target shares in a single step without the need for a subsequent exercise of compulsory acquisition rights or another second-step transaction and, if securities of the offeror are to be offered to U.S. shareholders of the target, provide an exemption under U.S. securities laws from the requirement to register securities.

Take-Over Bid

Unlike plans of arrangement, take-over bids may be made with or without the agreement of the target. If the bid is successful, a "second-step" transaction is required in order to acquire 100 per cent of the target shares (in connection with which dissent rights will be applicable).

Canadian securities legislation contains detailed procedural and substantive requirements applicable to take-over bids governing such things as timing, conditionality, share purchases outside of the bid, and rules applicable to deposit, withdrawal and take-up. The take-over bid circular must set out prescribed information about the offer and the parties, including securityholdings and past dealings by the offeror and related parties in securities of the target, the nature of any financing relating to the bid and prospectus-level disclosure regarding the offeror if the bid consideration includes offeror securities.

If the target company has Quebec securityholders, the circular must also be prepared in the French language and mailed to Quebec holders. The directors of the target issuer must deliver their own circular to securityholders in response to the bid.

Certain amendments to the take-over bid rules came into effect in 2016, harmonizing the take-over bid regime across Canada and, among other things, providing target boards with additional time and discretion when responding to a take-over bid — bids must now remain open for at least 105 days (an increase from 35 days), unless the target board waives that minimum in favour of a shorter period (not less than 35 days) or unless the target enters into certain alternative transactions in response to the bid (in which case the period moves to 35 days).

3

We're considering investing in a Canadian public issuer. At what stage would we have to publicly disclose our investment?

There are two regimes that require disclosure of a holding in a Canadian public issuer: insider reporting and early warning reporting. Upon acquiring or obtaining control or direction over 10 per cent or more of the voting securities of a Canadian public issuer, the offeror becomes an "insider" of that issuer, and any trading in securities of that issuer while above the 10 per cent threshold must be publicly disclosed.

Under the early warning regime, the acquisition of, or ability to exercise control or direction over, 10 per cent or more of the voting or equity securities of a Canadian public issuer must be promptly publicly disclosed via press release and regulatory filing. Subsequent acquisitions or dispositions while above the 10 per cent threshold of two per cent or more of voting or equity securities must also be disclosed, including when ownership levels fall below the 10 per cent reporting threshold. However, once below the 10 per cent threshold, subsequent disclosure would only be required where an acquisition would again result in securityholdings at or above the 10 per cent threshold. Notably, the early warning disclosure threshold is reduced to five per cent for so long as a take-over bid or issuer bid is outstanding. In addition, eligible institutional investors can avail themselves of an alternative reporting regime.

Offerors must also be wary of Canadian “pre-bid integration rules,” designed to ensure that all of a target’s securityholders are treated equally in the context of a take-over bid. The rules “integrate” pre-bid purchases (other than qualifying purchases made over a stock exchange) by requiring that consideration offered under any subsequent formal bid be at least equal in form (or cash equivalent thereof), amount and proportion to the consideration paid in any such purchases made within the previous 90 days.

4

We’re considering increasing our stake in a Canadian public issuer. At what stage would we have to make a public take-over bid?

Subject to reliance on an available exemption, any offer to acquire outstanding voting or equity securities made to anyone in Canada that would result in the offeror holding 20 per cent or more of the voting or equity securities of any class of a Canadian public issuer will constitute a take-over bid and require that an offer be made to all securityholders of the class in Canada on the same terms and conditions.

5

What can we do to avoid triggering the take-over bid requirements?

Exemptions from the take-over bid rules are available in certain circumstances. One of the most commonly used exemptions is the “private agreement” exemption, under which purchases may be made by way of private agreements with five or fewer vendors without complying with the take-over bid rules (which would otherwise require an offer be made to all securityholders of the class). Canadian laws exempt such purchases only if the purchase price (including brokerage fees and commissions) does not exceed 115 per cent of the market price of the securities.

6

If we approach a Canadian public issuer about a possible M&A transaction, when would that transaction need to be publicly disclosed?

Canadian public issuers are required to promptly disclose any “material changes” in their affairs. Material changes are defined as changes in the business, operations or capital of an issuer that would reasonably be expected to have a significant effect on the market price or value of any of its securities. This concept includes a decision by either the board of the applicable issuer to implement a change or senior management if they believe that approval of the board is probable.

Preliminary discussions and conditional proposals where material terms have not been agreed are not generally viewed as disclosable. However, any determination of the existence of a material change is highly fact-specific and needs to be carefully considered in the context of a specific transaction.

7

Should we expect the target board to insist on an auction?

A board of a target company is not required to hold an auction before entering into an agreement for the sale of the company and often will enter into such agreements without an auction. However, a target board may determine that an auction or more limited market check before entering into an M&A transaction is in the best interests of the corporation and proceed on that basis.

8

Are defences to unsolicited take-over bids available to target boards?

A target facing an unsolicited take-over bid has a number of options available to it to defend against the hostile transaction. In fact, the Canadian securities regulators have provided guidance that supports the use of defensive tactics in appropriate circumstances (e.g., where taken by a target board in a genuine attempt to obtain a better bid). That said, Canadian securities regulators are of the view that unrestricted auctions produce the most desirable results in change of control contests. They have also indicated that tactics that could deny or severely limit the ability of target securityholders to decide for themselves whether to accept an offer may result in regulatory action.

Poison Pills

Historically, one of the most common defensive tactics employed by Canadian target boards was securityholders' rights plans (commonly known as a "poison pills"). Poison pills deter hostile bids by imposing substantial dilution upon any offeror that acquires shares in excess of a specified ownership threshold without approval of the target.

Canadian securities regulators will generally not allow a "poison pill" to permanently block a bid. Prior to the changes to the bid regime, poison pills were used to provide target boards additional time to respond to a hostile bid, typically being "cease-traded" by securities regulators within 50 to 70 days following commencement of a hostile bid. The change to the bid regime to increase the minimum bid period from 35 to 105 days is generally seen as providing target boards sufficient time to identify and explore other value-maximizing alternatives. As such, the role previously played by poison pills is expected to drastically reduce, and this expectation is being confirmed by early experiences.

Private Placements

Another defensive tactic that a target facing a hostile bid could employ is a "tactical" private placement. Unlike rights plans, a private placement may be more attractive as a result of the changes to the bid rules, as a non-exempt take-over bid must now be conditional on more than 50 per cent of all outstanding target shares (other than those held by the offeror and its joint actors) being tendered. A substantial private placement of target shares to a shareholder friendly to the target could undermine the ability of that irrevocable minimum tender condition to be satisfied by a hostile bidder. Of course, targets with significant market capitalizations may not be able to carry out a private placement of sufficient magnitude to achieve this result.

Not surprisingly, private placements with material dilutive impact undertaken in the face of hostile bids have been the subject of frequent review by Canadian securities regulators. When reviewing such transactions, the regulators consider and balance competing factors, including the extent to which the private placement serves a *bona fide* corporate objective of the target and the principle of facilitating shareholder choice in an open and even-handed bidding process. Recent jurisprudence suggests that, when balancing these factors, the regulators will afford significant deference to the business judgment of target boards. In other words, the mere fact that a substantial private placement is undertaken in the face of a hostile bid will not necessarily result in the securities regulators concluding that the placement is an impermissible defensive tactic.

9

Can a significant securityholder enter into an agreement to agree to vote in favour of our plan of arrangement or tender to our bid? Can we offer any inducements to tender or vote?

Offerors commonly enter into support agreements with significant securityholders or target management and directors whereby such securityholders agree to vote in favour of a plan of arrangement or tender to the offeror's take-over bid.

In considering support agreements in the context of a take-over bid, it is important to note that Canadian securities laws provide that all holders of a target's securities must be offered identical consideration in a take-over bid and prohibit an offeror from entering into a separate agreement that has the effect of providing to one securityholder greater consideration for its securities than that offered to the other securityholders (subject to certain limited exceptions). Offering non-identical consideration can also introduce additional complexity in the context of a plan of arrangement and would need to be carefully considered in the context of a specific transaction prior to extending any such offers.

10

Once a friendly deal has been negotiated, what deal protection measures are commonly used in Canada?

There are a number of deal protection measures commonly used in Canada, including:

- **No shop.** Offerors typically negotiate a "no-shop" clause under which the target board is prohibited from soliciting or encouraging competing bids from other buyers. The no-shop clause will usually provide the board of the target with a "fiduciary out" that permits the board to respond to and potentially accept a competing proposal if it constitutes a "superior proposal."
- **Right to match.** The offeror is frequently granted an opportunity to match any superior proposal that, if matched, would result in the original deal (as modified) proceeding.

- **Break fees.** Break fees in Canadian deals generally range between two to five per cent of target equity value. Reciprocal or reverse break fees, pursuant to which an offeror is obligated to pay a fee to the target if the transaction fails for specified reasons, are not uncommon in Canada, including in mergers of equals, transactions where significant regulatory issues exist or sponsor-backed deals. In the 2018 *Blakes Canadian Public M&A Deal Study*, we found that 48 per cent of the transactions reviewed included reciprocal break fees, with the average fee being 4.5 per cent of the target's undiluted equity value.
- **Go shop.** So-called "go-shop" provisions, pursuant to which a target board is granted a specified period of time in which to actively seek out alternative proposals, have not seen widespread adoption in Canada, but have been used in a few instances.

11

What types of M&A transactions are subject to Canada's antitrust law?

Canada's antitrust law is set out in the *Competition Act*, which is federal legislation of general application. The *Competition Act* is administered and enforced by the Commissioner of Competition (Commissioner), who heads the Competition Bureau.

There are two parts of the *Competition Act* that apply to M&A transactions: the pre-merger notification provisions and the substantive merger review provisions. All transactions are subject to the latter, while only those transactions that exceed certain thresholds are subject to the former. Because all M&A transactions are subject to the *Competition Act*, it is critical that the parties to a transaction plan early to determine whether competition concerns are raised, namely on the basis of whether the transaction is likely to prevent or lessen competition substantially in a market, in order to consider such matters as risk allocation and closing conditions.

Completing a transaction that is subject to pre-merger notification is a criminal offence, unless the applicable statutory waiting period has expired, been waived or terminated early. A transaction is notifiable if each threshold test for pre-merger notification is exceeded:

- **Size of parties test.** The parties to the transaction, together with their affiliates, must have aggregate assets in Canada with a book value, or aggregate gross revenues from sales in, from or into Canada, in excess of C\$400-million.

- **Size of transaction test.** The aggregate value of the assets in Canada, or aggregate gross revenues from sales in or from Canada generated from the assets in Canada, of the target and its subsidiaries (or, in the case of an asset transaction, from the assets being acquired) must exceed C\$92-million (2018). Notably, a separate test applies to an amalgamation, and the target must own or control an operating business in Canada (or, in an asset transaction, the assets being acquired must be from an operating business).
- **Equity interest test.** The transaction contemplates the acquisition of more than 20 per cent of the voting shares of a public entity (35 per cent in the case of a private entity), provided that, where the buyer already holds in excess of such applicable ownership threshold at launch (but less than a majority), the threshold for notification is the contemplated acquisition of more than 50 per cent of the voting shares.

Where a transaction is notifiable and the parties file a formal notification to start a waiting period (the parties alternatively could elect to proceed with an informal request for clearance without starting a waiting period), that period runs for an initial 30 days. At the end of that period, the parties are legally entitled to close their transaction, even if the Commissioner's review is ongoing, unless the Commissioner issues a supplementary information request (SIR) to the parties, which is similar to a second request under the *U.S. Hart-Scott-Rodino Antitrust Improvements Act, 1976*. If a SIR is issued, the parties cannot lawfully close their transaction until 30 days after the day on which both parties have complied with the SIR. A SIR is issued in relatively rare cases involving significant competitive overlap between the parties (approximately seven to 10 per cent of notified transactions). Note that there is a special provision available for an unsolicited offer for a corporation that is designed to prevent a target from holding up the start of the waiting period.

While the parties to a notifiable transaction are generally free to complete their transaction following the expiry of the statutory waiting period, the Commissioner's review can, and often does, take longer than the statutory waiting period. The Commissioner has the statutory right to review and challenge any M&A transaction within one year after closing, unless an advance ruling certificate is issued, confirming the Commissioner's determination that he does not have cause to challenge the transaction.

Alternatively, the Commissioner may issue a lesser form of comfort, called a no-action letter, indicating that, at that time, he does not intend to challenge the transaction but retains the right to challenge the M&A transaction at any time before or within one year following its substantial completion. As a practical matter, however, we are not aware of any situation in which the Commissioner has challenged a transaction post-closing after having issued an unqualified "no-action" letter.

If the transaction is subject to Canada's antitrust law review, what is the test for challenging the transaction?

Regardless of whether a transaction is subject to notification or not, the test applicable to any M&A transaction is whether the transaction prevents or lessens, or is likely to prevent or lessen, competition substantially. The analysis has historically taken place in the context of a relevant market that is defined on the basis of product and geographic dimensions, though market definition has been de-emphasized to an extent in favour of closeness of competition between merging parties under the most recent iteration of the Merger Enforcement Guidelines.

The *Competition Act* provides that the factors relevant to assessing the competitive impact of an M&A transaction include:

- The extent to which acceptable substitutes are available
- Barriers to entry
- Whether effective competition would remain
- Whether a vigorous and effective competitor would be removed
- The nature of change and innovation in a relevant market
- The extent of foreign competition
- Whether the business being purchased has failed or is likely to fail
- Any other factor relevant to competition

The *Competition Act* contains an express efficiency defence — unique to Canada — that allows an M&A transaction to proceed provided it generates gains in efficiency that are greater than, and offset, the anticompetitive effects resulting from the transaction.

Does Canada have rules restricting foreign investment?

The *Investment Canada Act* applies to every establishment of a new Canadian business or acquisition of control of a Canadian business by a non-Canadian. An acquisition of more than 50 per cent of the votes of a corporation or non-corporate entity is deemed to be an acquisition of control. The acquisition of between one-third and one-half of the votes of a corporation creates a rebuttable presumption that control has been acquired while, subject to certain exceptions, the acquisition of less than one-third of the votes of a corporation or less than a majority of the votes of a non-corporate entity is deemed not to constitute an acquisition of control for these purposes.

Notwithstanding the above, the *Investment Canada Act* provides that the responsible minister under the Act can determine that control in fact will be or has been acquired, even below the previously noted thresholds, in the following circumstances:

- The acquisition of a Canadian cultural business (as such term is defined)
- The acquisition by a state-owned enterprise (SOE) (as such term is defined)
- Where the acquisition could be injurious to Canada's national security

A direct acquisition of control of a Canadian business that exceeds the applicable review threshold cannot be completed until the responsible minister under the *Investment Canada Act* has reviewed the investment and declared, or is deemed to have declared, that the investment is likely to be of net benefit to Canada. The review threshold is exceeded where the Canadian business has book value of assets of C\$5-million and greater, and either the World Trade Organization (WTO) investor rule, discussed below, is not satisfied or the Canadian business qualifies as a cultural business.

The WTO investor rule is satisfied where the transaction is being carried out by an investor ultimately controlled in a WTO member country or where the Canadian business is, immediately before the implementation of the investment, controlled by a WTO investor other than a Canadian. A higher monetary threshold applies where the Canadian business is not a cultural business and the WTO investor rule applies. In that case, the investment is subject to review only where the Canadian business, along with any businesses that it controls, has (1) for non-SOE investors, an enterprise value of C\$1-billion or more, or (2) for SOE investors, a book value of C\$379-million (2017) or greater.

Other than in respect of cultural businesses, if the Canadian business is being acquired indirectly (e.g., the shares of the Canadian business will be acquired indirectly through the acquisition of the voting shares of a foreign corporation), and the WTO investor rule is met, or if the applicable review threshold is not exceeded, the transaction is subject only to a post-closing notice requirement.

Under the terms of the recently signed Comprehensive Economic and Trade Agreement (CETA) with the European Union, acquisitions of control of Canadian businesses with an enterprise value of less than C\$1.5-billion by investors of a CETA signatory country are not subject to review under the *Investment Canada Act*, with some industry-specific exceptions. This threshold also applies to investors from certain jurisdictions that have free trade agreements with Canada, namely the United States, Mexico, Chile, Colombia, Panama, Peru, Honduras and South Korea. The rebranded Comprehensive and Progressive Trans-Pacific Partnership (CPTPP) is expected to be signed in March 2018, and the 11 members of the CPTPP are thereafter expected to also benefit from the same C\$1.5-billion threshold once the agreement is finalized.

For those transactions that are reviewable, the investor is required to submit an application for net benefit review, and the transaction will require the approval of the responsible minister. The initial waiting period is up to 45 days, which can be extended unilaterally by a further 30 days and, thereafter, only with the consent of the responsible minister and investor. In almost all cases, the responsible minister requires the parties to submit written undertakings in order to conclude that the proposed investment is likely to be of net benefit to Canada.

All investments involving a Canadian entity, whether or not the investment is direct or indirect and whether or not control will be acquired, are subject to possible review on grounds of whether an investment is likely to be injurious to national security. Cabinet has broad powers under the national security provisions of the *Investment Canada Act* to direct parties not to implement an investment or to implement it with conditions. Where a review takes place after closing, cabinet's powers include the right to require the divestiture of control or to impose terms and conditions on the investment. In December 2016, the Minister of Innovation, Science and Economic Development released guidelines relating to the national security review of investments, providing increased clarity to investors regarding the types of investments that may raise concerns under these provisions.

In addition to the *Investment Canada Act*, other federal statutes regulate and restrict foreign investment in specialized industries and sectors, such as transportation, telecommunications, broadcasting, newspapers and financial institutions.





2018 TRENDS IN CANADIAN PUBLIC AND PRIVATE M&A

The Canadian M&A deal market followed the global pace with a decrease in total deal value from C\$392-billion in 2016 to C\$351-billion in 2017. There was also a reduction in average deal size, which fell from C\$127-million in 2016 to C\$110-million in 2017 (due in part to fewer “megadeals” over C\$1-billion). Despite the dip in total value and deal size, this past year saw the number of deals increase from 3,088 in 2016 to 3,196 in 2017, reflecting a strong Canadian market.

Looking back on the 2017 Canadian M&A market, below is a discussion of some noteworthy trends and expectations for 2018.

1

Cross-Border Transactions

Cross-border transactions had strong momentum throughout the year, showing a significant increase from 77 per cent of total volume in 2016 to 83 per cent of total volume in 2017. In terms of inbound and outbound M&A in Canada, the past year broke some established patterns. For the first time since 2013, outbound deals decreased by 29 per cent, from C\$251-billion in 2016 to C\$179-billion in 2017, whereas inbound deals increased by 15 per cent, from C\$37-billion in 2016 to C\$43-billion in 2017. In looking at all outbound activity, Canadian buyers acquired more businesses in the U.S. than in any other country in 2017.

Uncertainty persists with the U.S. landscape and Canada’s relationship with its neighbours south of the border, as ongoing U.S. political headwinds and the renegotiation of the North American Free Trade Agreement (NAFTA) remain unsettled. As NAFTA negotiations are ongoing, we anticipate that the geopolitical uncertainty regarding U.S. cross-border transactions will continue for much of 2018. However, we may see a countervailing trend as companies seek to expand operations into either the U.S. or Canada in preparation for the potential demise of NAFTA. In addition, signs of clarity have emerged, with, for example, the U.S. tax reforms taking shape. A clearer path ahead on the U.S. tax reform could encourage U.S. outbound M&A activity as Canadian companies seek to take advantage of the favourable tax environment.

Canada is also potentially well positioned to benefit from the geopolitical uncertainty surrounding the U.S. and its protectionist mindset, as foreign investors looking to invest in North America may be steered toward Canada instead of the U.S.

Technology

Canada's technology sector continued to experience growth in 2017, with the number of deals and deal value increasing from 327 to 426 and US\$11-billion to US\$16-billion, respectively.

Noteworthy trends in the technology space in 2017 include:

- **FinTech.** The momentum for fintech remains relatively strong in Canada. U.S.-based Vista Equity Partners LLC announced a C\$4.8-billion acquisition of Toronto-based DH Corp. Moreover, the fintech market seems to be attracting major institutional investors, particularly pension funds. During 2017, Quebec-based pension fund Caisse de dépôt et placement du Québec invested US\$100-million in AvidXchange, a U.S.-based payments automation company.

Canadian banks are similarly exhibiting an interest in fintech, as they develop partnerships with fintech companies. In 2017, RBC partnered with start-up company League Inc., marking its entrance into the insurtech space, and in early 2018, TD Bank Group announced its acquisition of Layer 6 Inc., an artificial intelligence company.

- **Cryptocurrencies and blockchain technology.** Cryptocurrency mania characterized much of 2017, as cryptocurrencies like Bitcoin experienced parabolic increases in value: one Bitcoin traded for US\$1,000 in January 2017 and reached a high of US\$19,500 in December 2017. As of February 2018, the currency had lost more than half its value since its December high, and the price continues to fluctuate. Although we have yet to see M&A activity involving cryptocurrency, there have been several M&A deals involving blockchain technology. Blockstation announced the acquisition of ApexDX Ltd., which develops a technology to source, liquidate, store and manage digital currencies for enterprise, institutional clients and individuals.



Cannabis

Canadian companies involved in the cannabis sector are in an unparalleled race to increase their production capacity, market position, capitalization and access to capital ahead of Canada's planned recreational cannabis legalization in July 2018.

In 2017, the cannabis industry saw its first hostile take-over bid, with a bid launched by Aurora Cannabis Inc. (Aurora) for CanniMed Therapeutics Inc. (CanniMed) that ultimately resulted in a negotiated cash and stock deal valued at C\$1.1-billion. Prior to its bid for CanniMed, Aurora had successfully acquired H2 Biopharma Inc., a Montréal-based cannabis production company, as well as Larssen Ltd., a Canadian-based greenhouse facility design company. In addition, Canopy Growth Corporation announced that the U.S. alcohol-giant Constellation Brands Inc. purchased a 9.9 per cent stake in the company for C\$245-million, demonstrating that cannabis-related M&A activity in Canada is attracting U.S. players.

However, the cross-border movement may remain one directional, as in late 2017, the Toronto Stock Exchange (TSX) announced that due to the U.S. position that U.S. federal law classifies marijuana as a Schedule 1 illegal drug, any TSX-listed companies operating in U.S. states where marijuana is legal are not in compliance with the TSX listing requirements and may be at risk of delisting. As a result, Canadian-based Aphria Inc. (Aphria) recently announced the C\$20-million disposition of its minority stake in Arizona cannabis company Copperstate Farms to Liberty Health Sciences Inc., reducing its direct involvement in the U.S. We may see additional divestitures going forward in 2018 as companies in the cannabis industry aim to work collaboratively with the TSX and Canadian securities regulators in a growing sector.

Despite the uncertainty surrounding cannabis and the U.S., deal activity within the Canadian borders continues to be strong as 2018 begins. In fact, the year is off to a blistering start. In January 2018 alone, there were multiple deals announced (including the CanniMed transaction noted above), with a total value of more than C\$2.5-billion. Investment activity also continues to rise in the cannabis sector as companies look for strategic investment opportunities. For example, Aurora recently announced its strategic investment in Liquor Stores N.A. Ltd. (Liquor Stores) by way of a non-brokered private placement, the proceeds of which will be used by Liquor Stores to establish and launch a leading brand of cannabis retail outlets.

4

Investment from China

The Liberal government is increasingly positioning Canada as a country that welcomes foreign investment, including from China.

On a trade mission to China in June 2017, Canada's Natural Resources Minister, Jim Carr, stated that Canada welcomes Chinese investment, including in the oil sands. Canada and China are also holding exploratory discussions regarding a possible free trade agreement. Chinese investment in Canada was second only to investments from the U.S. in 2017, and total investment from China actually exceeded that of the U.S. in terms of asset value.

Other noteworthy developments initiated by the Liberal government that indicate a desire to promote foreign investment from China include:

- The reversal of a decision of the previous Conservative government requiring a Chinese investor, O-Net Communications Holdings Limited, to divest its controlling interest in a Canadian company on grounds that it would be injurious to Canada's national security
- The approval of a C\$1-billion acquisition of Vancouver-based Retirement Concepts by Cedar Tree Investment Canada, which is controlled by China's Anbang Insurance, after a finding that the investment was of net benefit to Canada
- The approval of an acquisition of Vancouver-based Norsat International Inc. by the privately owned Chinese company, Hytera Communication Co., Ltd., after conducting a preliminary security screening process rather than a full national security review

The Liberal government's demonstrated commitment to an open approach in reviewing foreign investments may promote foreign capital investment growth through 2018.



5

Insurance

Despite a slight dip in 2016, insurance M&A activity in Canada continued its upward trend in 2017. Canada's largest independent and privately owned insurance services provider, SCM Insurance Services (SCM), announced that it received a majority investment from the global private equity firm Warburg Pincus, which will provide SCM with access to capital and strategic resources to grow its business in Canada and its recent entry into the U.S. market. In addition, Canadian investment and insurance company Fairfax Financial Holdings Limited acquired Swiss-headquartered Allied World Assurance Company Holdings, AG in a cash and stock deal valued at US\$4.9-billion.

Looking forward in 2018, M&A activity in the insurance space may continue its forward momentum, as global insurance companies that may be experiencing strain due to losses from recent catastrophes could turn to M&A as a way to increase capital. Additionally, as the insurtech sector continues to grow, insurance companies in Canada and worldwide are expected to continue to engage with domestic and foreign start-ups and early-stage companies in this space through M&A activity and minority investments.

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Oil & Gas

Relative stability in global oil prices allowed Canadian oil and gas companies to accelerate M&A activity in 2017. However, the same pattern occurring in 2018 is unlikely. This past year, many foreign investors exited the Canadian oil and gas sector by selling their Canadian oil sands assets. Going forward, there may be a decrease in big energy deals in Canada, as many of the larger foreign players pulled out of the market, and many of the buying opportunities may have passed.

However, energy infrastructure may be an exception to this trend, with major oil and gas infrastructure projects underway to produce, transport or add value to the industry in 2018, such as the construction of the C\$7.4-billion Kinder Morgan Trans Mountain pipeline expansion and the C\$3.5-billion Inter Pipeline Heartland Petrochemical Complex.

Notable transactions in the Canadian oil and gas sector in 2017 include Cenovus Energy Inc.'s C\$17.7-billion acquisition of ConocoPhillips' western Canadian oil and gas assets, Canadian Natural Resources Ltd.'s C\$11.1-billion acquisition of oil sands assets in the Athabasca oil sands project and Pembina Pipeline Corp.'s C\$9.7-billion acquisition of Veresen Inc.

Private Equity and Pension Funds

Private equity and pension funds have been highly active in the Canadian M&A space, with activity growing 35 per cent in volume of buy-side and sell-side deals in 2017, which on the private equity side is likely attributable to private equity firms' vast pools of available capital to be invested.

This past year, private equity and pension funds participated in some notable megadeals, including New York-based Rhône Capital's US\$2.2-billion acquisition of Montréal-based private security company GardaWorld Security Corporation, and Los Angeles-based investment firm Platinum Equity's US\$3.85-billion acquisition of Ontario-based plastic specialist Husky IMS International Ltd., which involved the Ontario Municipal Employees Retirement System (OMERS) relinquishing its ownership of the Canadian-headquartered company.

Private equity and pension fund investments also began to transition into the C\$20-million to C\$50-million deal value range in 2017, suggesting additional demand for quality mid- to small-cap businesses or transactions from private equity and pension funds.

Canadian private equity and pension funds continue to expand into other countries, with a particular emphasis on renewable energy, data infrastructure and cannabis. For example, Brookfield Asset Management recently announced a US\$4.6-billion bid to acquire the nuclear power giant Westinghouse Electric Co. from Japan's Toshiba Corp., and Caisse de dépôt et placement du Québec purchased a C\$288-million stake in Boralex Inc., which operates wind, solar and hydro projects in Canada, France and the U.S.

As Canadian pension funds continue to aggressively pursue overseas investments in high-quality operating businesses and assets, it is common to find these entities partnering with local private equity groups on potential investments to leverage their internal private equity capabilities. While Canada's big investors may continue to look abroad for deals in 2018, other international buyers may gravitate toward Canada for acquisition opportunities in the mid-market space, as Canada has gained recognition and competitive strength in the market due to its expertise in fast-growing fields, such as cannabis and blockchain.

Interest Rate Increases

For the first time in seven years, interest rates in Canada increased. In fact, the Bank of Canada increased interest rates by 25 basis points twice in 2017, raising the overnight lending rate from 0.50 per cent to one per cent.

In the beginning of 2018, the Bank of Canada announced another increase to its overnight interest rate target of an additional 25 basis points to 1.25 per cent, citing slower economic growth and higher inflation. Shortly thereafter, the Parliamentary Budget Officer announced that it expects the Bank of Canada to further raise interest rates in April 2018 by another 25 basis points to 1.50 per cent.

Going forward, we may see an impact on Canadian M&A activity in the long term if interest rates in Canada continue to rise, making borrowing costs in Canada more expensive. In the short term, an increase in M&A activity may be seen as purchasers look to borrow ahead of the rising rates.



Regulators Provide Guidance on Fairness Opinions

The Yukon Court of Appeal's decision in *InterOil Corporation v. Mulacek (InterOil)* in late 2016 raised questions with respect to the provision of fairness opinions by financial advisers in M&A transactions in Canada. In *InterOil*, the court blocked the proposed US\$2.3-billion acquisition of InterOil, noting that the transaction was not fair and reasonable in large part due to the lack of disclosure provided to shareholders, particularly with respect to the financial analysis underlying the fairness opinion that was provided.

The decision sparked debate in the legal and investment banking community as to whether:

- Standard market practice in Canada will require that the financial analysis undertaken by a financial adviser in providing a fairness opinion also be disclosed to target shareholders
- It is appropriate for a financial adviser that is providing a fairness opinion in connection with a transaction to receive a fee that is contingent on the successful completion of that transaction
- Independent committees are required to be constituted in all sale transactions in Canada

In 2017, regulators weighed in with guidance on fairness opinions in the context of "material conflict of interest transactions" that are captured by Multilateral Instrument 61-101 – *Protection of Minority Security Holders in Special Transactions* (MI 61-101), such as insider bids, issuer bids, business combinations and related-party transactions. The notice provides more insight on regulators' expectations with respect to enhanced disclosure, as well as the role of special committees, all in respect of material conflict of interest transactions (i.e., specified transactions governed by MI 61-101).

It remains unclear whether, and to what extent, the guidance provided by the regulators will affect the provision of fairness opinions in non-MI 61-101 transactions. However, the notice demonstrates the greater regulatory scrutiny of the process for, and disclosure of, fairness opinions obtained from financial advisers in connection with transactions where conflicts of interest may arise, and time will tell if these enhanced disclosure requirements will become a standard industry practice in the general M&A landscape in Canada.

OFFICES



TORONTO

199 Bay Street
Suite 4000, Commerce Court West
Toronto ON M5L 1A9
Canada
Telephone: 416-863-2400
Facsimile: 416-863-2653
Email: toronto@blakes.com

CALGARY

855 - 2nd Street S.W.
Suite 3500, Bankers Hall East Tower
Calgary AB T2P 4J8
Canada
Telephone: 403-260-9600
Facsimile: 403-260-9700
Email: calgary@blakes.com

VANCOUVER

595 Burrard Street
P.O. Box 49314
Suite 2600, Three Bentall Centre
Vancouver BC V7X 1L3
Canada
Telephone: 604-631-3300
Facsimile: 604-631-3309
Email: vancouver@blakes.com

MONTRÉAL

Blake, Cassels & Graydon LLP
1 Place Ville Marie
Suite 3000
Montréal QC H3B 4N8
Canada
Telephone: 514-982-4000
Facsimile: 514-982-4099
Email: montreal@blakes.com

OTTAWA

340 Albert Street
Suite 1750, Constitution Square, Tower 3
Ottawa ON K1R 7Y6
Canada
Telephone: 613-788-2200
Facsimile: 613-788-2247
Email: ottawa@blakes.com

NEW YORK

Blake, Cassels & Graydon (U.S.) LLP
126 East 56th Street
Suite 1700, Tower 56
New York NY 10022
U.S.A.
Telephone: 212-893-8200
Facsimile: 212-829-4948
Email: newyork@blakes.com

LONDON

23 College Hill
5th Floor
London EC4R 2RP
England
Telephone: +44-20-7429-3550
Facsimile: +44-20-7429-3560
Email: london@blakes.com

RIYADH*

Dr. Saud Al-Ammari Law Firm
in association with
Blake, Cassels & Graydon LLP
Office No. S5/1B, 2nd Block
P.O. Box 94026
Al-Fazari Complex
Diplomatic Quarter
Riyadh 11693
Telephone: +966-11-418-7400
Facsimile: +966-11-254-7755
E-mail: saud.ammari@blakes.com

AL-KHOBAR*

Dr. Saud Al-Ammari Law Firm
in association with
Blake, Cassels & Graydon LLP
P.O. Box 1404
Apicorp Building
Al-Khobar 31952
Kingdom of Saudi Arabia
Telephone: +966-13-847-5050
Facsimile: +966-13-847-5353
Email: saud.ammari@blakes.com

BAHRAIN

Blake, Cassels & Graydon LLP
in association with
Dr. Saud Al-Ammari Law Firm
5th Floor, GB Corp Tower
P.O. Box 11005
Bahrain Financial Harbour
Manama
Kingdom of Bahrain
Telephone: +973-1715-1500
Facsimile: +973-1710-4948
Email: bahrain@blakes.com

BEIJING

Unit 3011, North Tower
Beijing Kerry Centre
1 Guanghai Road
Chaoyang District
Beijing, China 100020
Telephone: +86-10-6530-9010
Facsimile: +86-10-6530-9008
Email: beijing@blakes.com

* Associated Offices

TORONTO
CALGARY
VANCOUVER
MONTRÉAL
OTTAWA
NEW YORK
LONDON
RIYADH*
AL-KHOBAR*
BAHRAIN
BEIJING

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