

DAVIES

# Canadian Mergers & Acquisitions

A Guide for Investment  
Banks, Bidders and Boards

10th Edition



# DAVIES

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# About This Guide

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Davies' *Canadian Mergers & Acquisitions* draws on our multijurisdictional M&A experience to offer guidance on both the legal framework and the practical aspects of Canadian mergers and acquisitions, including critical tax and regulatory considerations. It is a valuable resource for foreign and domestic acquirers, targets, investment banks, shareholders and directors.

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The contents of this guide are intended as general information and not as legal advice or opinion. We invite you to contact any Davies lawyer to discuss your legal matters. Visit our website at [dwpv.com](http://dwpv.com) or contact one of our offices.

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# Takeover Bid Regulation: An Overview

## Types of M&A Transactions

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- Takeover bids (like a U.S. tender offer)
- Plans of arrangement
- Amalgamations (like a U.S. merger)
- Asset sales
- Share sales (e.g., private purchase of control block)
- Restructurings (e.g., spinoffs)
- Going-private transactions

## Takeover Bid Regulation: General

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### TAKEOVER BID REGULATION

- Takeover bids are regulated by each province, but Canadian securities regulators have harmonized the takeover bid regime across Canada under National Instrument 62-104 and National Policy 62-203.
- Applicable laws depend on where the target shareholders reside and where the target is incorporated and listed.

### WHAT IS A TAKEOVER BID?

- Rules provide a “bright line” test to determine whether a party is making a takeover bid.
- A takeover bid is an offer to acquire voting or equity securities of a class made to persons in a Canadian jurisdiction where the securities subject to the offer plus securities beneficially owned by the bidder and its affiliates and joint actors constitute 20% or more of the outstanding securities of the class (calculated on a partially diluted basis).
- Equity securities include non-voting common shares.
- A trap for the unwary: calculation of current beneficial ownership includes securities convertible within 60 days into the class of equity or voting securities (e.g., options and warrants).
- Indirect offers:
  - > “Anti-avoidance” rule.
  - > Indirect offer rule could apply when an acquirer acquires shares of a holding company that owns more than 20% of the shares of a public company when aggregated with the acquirer’s shares.

- > The acquisition of convertible securities, particularly in-the-money convertible securities, could constitute an “indirect” offer for the underlying security.

## Equal Treatment Rules

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### OFFER TO ALL

- The bid must be made to all holders of the class, but may be for less than all securities (i.e., a “partial bid”).
- Take-up under partial bids must be pro rata.
- The bid circular must be sent to all holders of the class and all holders of convertible securities (e.g., options).

### IDENTICAL CONSIDERATION

- All holders must be offered identical consideration (or an identical choice of consideration).
- If the bidder increases the price during a bid, all holders receive the new price, even holders whose shares have already been tendered and taken up.

### NO “SIDE DEALS”

- No collateral agreements are permitted – that is, agreements or understandings between the bidder and a shareholder that have the effect of providing the shareholder with consideration of greater value.
- Exceptions permit certain employee compensation and severance arrangements for management and other employees of the target.
- Securities commission may provide exemptive relief to permit a collateral agreement when there is a clearly established business or financial purpose relating to the making of the bid or the ongoing operations of the target.

### PRE-BID INTEGRATION

- The bidder cannot acquire securities in the 90 days preceding the bid unless the bidder offers the same consideration (amount and type, or cash equivalent) and acquires the same percentage from each holder under the bid.
- Exceptions for normal course purchases on a stock exchange (pre-arranged trades are not normal course) and for purchase of newly issued shares from the issuer.



- Toehold acquisitions must be carefully planned if the bidder intends to offer share consideration in the subsequent bid.
- Securities acquired prior to the bid will not count
  - > toward the 90% compulsory acquisition threshold;
  - > in determining if the 50% mandatory minimum tender condition has been satisfied; and
  - > as part of the minority for purposes of a majority-of-the-minority vote on a second-step going-private transaction.

### **PURCHASES AND SALES DURING A BID**

- The bidder cannot offer to acquire or enter into an agreement to acquire the securities subject to the bid from the date of announcement of the intention to make a bid until expiry of the bid, except pursuant to the bid.
- The bidder can purchase up to 5% of the outstanding securities on a recognized stock exchange if it states its intention to do so either in the takeover bid circular or in a subsequently filed press release. Purchases must be reported daily by press releases disclosing price and number.
- Securities purchased during a bid will not count toward the 90% compulsory acquisition threshold or toward the 50% mandatory minimum tender condition, or as part of the minority for purposes of a majority-of-the-minority vote on a second-step going-private transaction.

### **POST-BID INTEGRATION**

- The bidder cannot acquire securities outside of the bid within 20 business days of the expiry of the bid except by way of a transaction that is generally available to securityholders on identical terms or normal course purchases on a stock exchange.

### **SELLING RESTRICTIONS**

- The bidder cannot sell or enter into an agreement to sell target securities from the date of announcement of the intention to make a bid until expiry of the bid.
- The bidder can agree to sell securities taken up under the bid at a future date, but only if it discloses its intention in the circular.

### **MINIMUM TENDER CONDITION**

- All bids (including partial bids) are subject to a statutory non-waivable minimum tender condition that more than 50% of securities owned by persons other than the bidder and its joint actors be tendered to the bid before the bidder can acquire any securities tendered.

- Bids typically include a higher minimum tender condition to ensure that the bidder can obtain the remaining shares not deposited through a second-step going-private transaction. The condition would typically require a tender of at least (i) two-thirds of outstanding shares and (ii) a majority-of-the-minority.

## Sufficient Time Rules

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- The bid must be open for an initial deposit period of at least 105 days.
  - > The initial deposit period can be waived down to 35 days by the target.
  - > This shorter bid period will apply to any other bid outstanding at the time and to certain other bids commenced thereafter.
  - > If the target enters into an “alternative transaction” (e.g., a merger, amalgamation or other similar shareholder-approved transaction), the minimum deposit period is reduced automatically to 35 days for any bid outstanding at the time or any bid commenced after the announcement of the alternative transaction but before the completion/termination of the transaction alternative.
    - This creates an incentive for a target to structure a “white knight” transaction as a bid rather than as an “alternative transaction.”
- The bidder is required to take up and pay for securities within 10 days of expiry of the bid if the bid conditions have been satisfied or waived.
- The bidder must extend the bid for an additional 10 days after expiry of the initial deposit period if the bidder satisfies the mandatory minimum tender condition, all other conditions have been satisfied or waived and the bidder announces its intention to immediately take up and pay for securities deposited under the bid.
- Withdrawal of a tender is permitted in the following circumstances:
  - > at any time before securities are taken up by the bidder;
  - > for 10 days after a change in the bid; or
  - > if securities have not been paid for within three business days of take-up.
- The bid must be kept open for 10 days after an amendment (unless it is solely a waiver of a condition in an all-cash bid). Amendments are prohibited after the bidder becomes obligated to take up and pay for securities (other than an extension of the deposit period or an increase in consideration).

## Sufficient Information Rules

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- The bid can be commenced by either mailing or advertisement. The bid can be commenced by advertisement if, concurrently with (or before) the advertisement, the bid is filed and delivered to the target, a securityholders list is requested and, within two business days of receipt of the securityholders list, the takeover bid circular is sent to securityholders on the list.
- The bidder must prepare and mail a takeover bid circular to all holders of the class of securities sought and holders of convertible securities.
- The bidder must make additional mailings if bid terms are changed or important information has changed or arisen (except changes out of the bidder's control).
- The bid may contain any conditions except a financing condition.
- If the bid is an "insider bid," an independent valuation of the target's securities and of any non-cash consideration being offered may be required unless an exemption is available.
- Within 15 days of the bid, the target must prepare and mail a directors' circular containing an acceptance/rejection recommendation by the board.
- If the target board is unable to make a recommendation, the circular must disclose the reasons for not doing so.

## Securities Commission Intervention

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- In Canada, in contrast to the United States, no securities commission clearance is required for share exchange takeover bids.
- Unlike in the United States, most litigation regarding takeover bids takes place before securities regulators rather than courts.
- Securities regulators will intervene to halt a takeover bid if it is abusive of the target shareholders or the capital markets, even if it complies with all of the foregoing rules.
- Securities regulators also have the power to intervene to prohibit target boards of directors from taking inappropriate defensive measures to block a bid for its securities.

# Plans of Arrangement

## What Is an Arrangement?

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- Common alternative to takeover bids for negotiated M&A transactions.
- Corporate reorganization of the target under applicable corporate law.
  - > Unlike a takeover bid, an arrangement is a one-step transaction approved by target securityholders at a special meeting.
  - > Agreement is negotiated with the target, and voting support agreements are often negotiated with significant securityholders.
  - > Independent committee of the board of directors of the target may be formed when the transaction may give rise to potential conflicts of interest or is otherwise justified.
  - > The target applies to court for an interim order prior to mailing the proxy materials specifying the required securityholder approval.
  - > The target calls a special shareholders' meeting to approve the arrangement.
  - > Arrangement becomes effective after it is approved by target securityholders and by the court, all other closing conditions are satisfied and articles of arrangement are filed by the target.
- Securities of any class of the target may be exchanged for any other securities or property, including cash. In addition, assets, including shares of subsidiaries, can be distributed to shareholders or other parties, and the order of all the steps to be effected by the arrangement can be specified, which assists in tax planning.
- Court will consider whether arrangement is "fair and reasonable."
  - > Court must be satisfied that (i) the arrangement has a valid business purpose; and (ii) the objections of those whose legal rights are being arranged are being resolved in a fair and balanced way.
  - > Determination is focused on securityholders whose legal rights are being arranged rather than securityholders affected only in respect of their economic interests.
  - > In determining whether these tests are met, considerations will include:
    - o level of approval by the target's securityholders;
    - o proportionality of the arrangement's impact on affected groups;
    - o whether the arrangement has been approved by a special committee of independent directors of the target;
    - o existence of a fairness opinion from a reputable expert and, depending on circumstances, whether the expert is independent and whether adequate disclosure of analysis underlying the opinion is made; and
    - o availability to shareholders of dissent and appraisal remedies.

## Advantages of Arrangements

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- Lower acceptance thresholds than a bid:
  - > Generally requires two-thirds of the votes cast at the meeting in person or by proxy.
  - > No prohibition on an acquirer voting securities it holds in the target, provided it is not a “related party” of the target (e.g., a holder of more than 10% of target shares) under business combination rules in Multilateral Instrument 61-101.
- One-step acquisition eliminates “bridging” and financing risks.
- Tax-planning opportunities:
  - > ability to clearly order transaction steps around the effective time;
  - > allocation of basis to assets to be divested;
  - > distribution of safe income and return of capital.
- Greater flexibility in dealing with target’s assets, including possible spinoff of assets.
- Implementation of “exchangeable share” structure facilitated.
- Flexibility in dealing with stock options and warrants.
- No prohibition of collateral benefits and pre-bid purchases.
- Possible to offer “unequal” consideration.
- Permissibility of financing condition.
- Flexibility in dealing with public debt (and other creditors).
- Availability of section 3(a)(10) registration exemption in the United States.

## Disadvantages of Arrangements

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- More cumbersome and time-consuming than a friendly takeover bid because of proxy solicitation and court proceedings
- Fairness hearing may be used as a forum for challenge by securityholders
- Ability of complainants to appeal court order may delay closing
- Dissent and appraisal remedy generally available
- Process is target-driven, rather than acquirer-driven

Pre-bid  
Considerations

## Pre-acquisition Preparation

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### KEY DILIGENCE ISSUES

- Change of control consequences
- Regulatory requirements (e.g., Investment Canada, including national security review, Competition Bureau, CRTC)
- Convertible securities or other rights to acquire shares
- Contingent liabilities
- Shareholder rights plan (existing or potential)
- Location of target's shareholders (including U.S.)
- Coattail provisions for non-voting shares or subordinate voting shares

### DILIGENCE PROCESS

- The target will require a confidentiality agreement with a “use” clause and usually a standstill agreement as a pre-condition to due diligence and may agree to an exclusivity agreement.

### FINANCING (TAKEOVER BIDS)

- In Canada, cash takeover bids must be fully financed (at announcement, commitment letter signed, fee paid). This is in contrast to tender offers in the United States, which can be conditional on financing.
- Bidder must make adequate arrangements before the bid to ensure that the required funds are available.
- Bidder must reasonably believe the possibility to be remote that it will be unable to pay for securities deposited under the bid due to a financing condition not being satisfied.
- As a general rule, the bid financing can be no more conditional than the bid itself.



# Share Accumulations

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## TOEHOLD ACQUISITION

- Purchases up to 19.9% (together with securities beneficially owned by purchaser and joint actors) are not a “takeover bid.”
- Open market purchases or private agreements are permitted (although market purchases may increase price or tip off target)
  - > Often done to lower cost of acquiring target shares because no premium is paid on shares
  - > May reduce acquirer’s risk by allowing it to recoup at least some of its costs by selling toehold shares to a superior competing offer
- Pre-bid integration rules should be considered at this stage because of implications for a later takeover bid.
- Securities so acquired will not count toward the 50% mandatory minimum tender condition, the 90% compulsory acquisition threshold or as part of the minority for a majority-of-the-minority vote on a second-step going-private transaction.
- Purchases that would result in a holding of 20% or more constitute a takeover bid that requires an offer to all holders of the class unless an exemption is available.

## PRIVATE AGREEMENT TAKEOVER BID EXEMPTION

- The principal exemption from the takeover bid rules is for private agreements:
  - > five sellers or fewer, and consideration not exceeding 115% of 20-day average closing price
  - > critical tool for acquirer proposing a creeping acquisition of control

## INSIDER TRADING PROHIBITION

- Once a person “is considering, evaluating or proposing to make a takeover bid” for a target, or becoming a party to a merger or other business combination with a target, all persons who are insiders, affiliates, associates, professional advisors and officers, directors or employees of any of them are in a “special relationship” with the target and may not trade in securities of the target until the transaction is announced.
  - > This restriction does not apply to the person proposing to make the bid itself.

## Public Disclosure of Accumulations

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### EARLY WARNING REPORTING

- Similar to U.S. 13D/13G filings, intended to alert the market to the acquisition of significant holdings in a public company.
- Acquisition of equity or voting securities representing 10% or more of the class (together with securities beneficially owned by purchaser and its joint actors) requires purchaser to issue a press release no later than opening of trading on the business day following the acquisition, and to file an “early warning” report within two business days.
- The purchaser and its joint actors are prohibited from making additional acquisitions of the shares until the expiry of one business day from the date the early warning report is filed, unless the purchaser and its joint actors beneficially own 20% or more of the class of securities (no similar moratorium on purchases under U.S. law).
- Applies to acquisition of beneficial ownership of securities and to the acquisition of the power to exercise control or direction over securities. Must count in the 10% any securities that a person has the right or obligation, whether or not on conditions, to acquire within 60 days (e.g., options, warrants, share purchase agreement).
- Equity derivatives may constitute beneficial ownership of underlying securities if the investor has the ability, formally or informally, to obtain the securities or to direct the voting of securities held by a counterparty.
- No requirement for non-insiders to report economic interest under cash-settled equity swap, although there could be “public interest” considerations which militate in favour of disclosure.
- Disclosure must include the terms of any agreement with respect to the acquired securities, the price paid and the purpose of the purchase. Must also disclose any “plans or future intentions” with respect to specific actions enumerated in the rule, including the acquisition or disposition of additional securities, corporate transaction, board change or proxy solicitation.
- Disclosure must include the material terms of related financial instruments, any securities lending agreements and any other arrangements involving the securities.
- Trap for the unwary: disclosure threshold is reduced to 5% when a takeover bid by another party or an issuer bid is outstanding, but the restriction on acquisitions until after the report is filed does not apply.
- For a target whose shares are registered with the SEC in the United States (e.g., targets with a U.S. listing), the disclosure of accumulations on Form 13D is required at the 5% level, but the purchaser is not prohibited from acquiring further securities pending filing of the 13D.
- A change in material fact in the report or an increase or decrease in ownership equal to 2% of the outstanding shares requires the purchaser to “promptly” issue a further press release and file a report. In addition, shareholders are required to report when they have fallen below the 10% threshold.

## INSIDER REPORTING

- Acquisition of more than 10% of voting securities of a public company, including securities issuable on the exercise of conversion or purchase rights or obligations, within 60 days, requires purchaser to file an initial insider report within 10 days.
- Insider report must disclose
  - > ownership of voting securities;
  - > agreement, arrangement or understanding that has the effect of altering, directly or indirectly, the purchaser's economic interest in a security of the company or economic exposure to the company (a related financial instrument); and
  - > material terms of any agreement, arrangement or understanding that, directly or indirectly, alters the purchaser's economic exposure to the company and involves a security of the company or a related financial instrument.
- An insider must report within five days any change in ownership of securities of the company or a related financial instrument, or any material amendment or termination of an agreement, arrangement or understanding required to be disclosed.
- Directors, CEO, CFO and COO and certain other insiders of the purchaser also become reporting insiders of the company and must file insider reports.
- Directors, CEO, CFO and COO must include in the initial insider report transactions that occurred during the prior six-month period in which they held such positions.
- Exemption available for directors and officers of the purchaser who do not, in the ordinary course, receive or have access to information about material facts and material changes of the company and are not otherwise insiders.

## Selecting Transaction Structure: Plan of Arrangement vs. Takeover Bid vs. Amalgamation

	Plan of Arrangement	Takeover Bid	Amalgamation
What is it?	<ul style="list-style-type: none"> <li>– Merger effected by securityholder vote and court approval</li> </ul>	<ul style="list-style-type: none"> <li>– Purchase of shares effected by offer directly to securityholders</li> </ul>	<ul style="list-style-type: none"> <li>– Merger effected by securityholder vote</li> </ul>
How is it accomplished?	<ul style="list-style-type: none"> <li>– Acquirer and target enter into arrangement agreement</li> <li>– Acquirer may enter into voting support agreements with significant securityholders</li> <li>– Target mails proxy circular to securityholders (no regulatory review)</li> <li>– Securityholders approve at meeting (locked-up shares can be voted)</li> <li>– Obtain court approval as to “fairness”</li> </ul>	<ul style="list-style-type: none"> <li>– Acquirer and target enter into support agreement (if friendly)</li> <li>– Acquirer may enter into lock-up agreements with significant securityholders</li> <li>– Acquirer mails takeover bid circular to securityholders of target (no regulatory review)</li> <li>– Target mails directors’ circular to securityholders of target (no regulatory review)</li> <li>– Securityholders tender to offer</li> </ul>	<ul style="list-style-type: none"> <li>– Acquirer and target enter into merger agreement</li> <li>– Acquirer may enter into voting support agreements with significant securityholders</li> <li>– Target mails proxy materials to securityholders (no regulatory review)</li> <li>– Securityholders approve at meeting (locked-up shares can be voted)</li> </ul>
Consideration	<ul style="list-style-type: none"> <li>– Cash and/or securities</li> <li>– Discrimination among securityholders permitted, subject to “fairness” and majority-of-the-minority approval</li> </ul>	<ul style="list-style-type: none"> <li>– Cash and/or securities</li> <li>– Discrimination among securityholders prohibited, except for certain employment arrangements or with securities commission approval (time requirement: approximately four weeks)</li> </ul>	<ul style="list-style-type: none"> <li>– Cash and/or securities</li> <li>– Discrimination among securityholders permitted, subject to majority-of-the-minority approval</li> </ul>
Timing (See Appendix)	<ul style="list-style-type: none"> <li>– Approximately 50 to 65 days from commencement of preparation of circular to consummation of transaction (but faster than takeover bid if bid requires second-step transaction)</li> </ul>	<ul style="list-style-type: none"> <li>– Approximately 50 to 65 days from commencement of preparation of circular to consummation of transaction, assuming target board waives minimum bid period of 105 days down to 35 days</li> </ul>	<ul style="list-style-type: none"> <li>– Approximately 45 to 60 days from commencement of preparation of circular to consummation of transaction</li> </ul>

	Plan of Arrangement	Takeover Bid	Amalgamation
Shareholder approval/ acceptance requirement	<ul style="list-style-type: none"> <li>– typically, 2/3 of votes cast by those voting at meeting (and majority-of-the-minority if related party is acquiring the target or receives a collateral benefit)</li> </ul>	<ul style="list-style-type: none"> <li>– Non-waivable mandatory condition that more than 50% of shares not owned by bidder be tendered to the bid</li> <li>– 90% tender required in order to force out remainder</li> <li>– If less than 90% acquired, must do second-step squeeze-out, requiring 2/3 vote and majority-of-the-minority vote (shares acquired under the bid can be counted as part of minority in certain circumstances)</li> </ul>	<ul style="list-style-type: none"> <li>– 2/3 of votes cast by those voting at meeting (and majority-of-the-minority if related party is acquiring the target or receives a collateral benefit)</li> </ul>
Conditions	<ul style="list-style-type: none"> <li>– Unrestricted</li> </ul>	<ul style="list-style-type: none"> <li>– Financing condition prohibited</li> <li>– Non-waivable minimum tender condition (more than 50%) required</li> </ul>	<ul style="list-style-type: none"> <li>– Unrestricted</li> </ul>
Dissent rights	<ul style="list-style-type: none"> <li>– Yes</li> </ul>	<ul style="list-style-type: none"> <li>– Yes, on exercise of compulsory acquisition right or second-step transaction</li> </ul>	<ul style="list-style-type: none"> <li>– Yes</li> </ul>
Pre-transaction purchases of target stock	<ul style="list-style-type: none"> <li>– Not restricted, subject to insider trading restrictions</li> </ul>	<ul style="list-style-type: none"> <li>– Restricted (offer terms must be as favourable as pre-offer transactions)</li> </ul>	<ul style="list-style-type: none"> <li>– Not restricted, subject to insider trading restrictions</li> </ul>
French translation	<ul style="list-style-type: none"> <li>– Depends on connecting factors to Québec (e.g., size of shareholder base, location of head office or majority of target's business)</li> </ul>	<ul style="list-style-type: none"> <li>– Yes</li> </ul>	<ul style="list-style-type: none"> <li>– Depends on connecting factors to Québec (e.g., size of shareholder base, location of head office or majority of target's business)</li> </ul>

## Structuring the Offer

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### CONSIDERATION: CASH OR SECURITIES?

- If securities are offered as consideration, prospectus-level disclosure about the acquirer, including the acquirer's financial statement disclosure, will be required.
- If the acquirer is a mining company offering shares, independent technical reports on material properties may be required.
- May also require pro forma combined financial information.
- Also requires detailed disclosure of the bidder's plans and proposals for target post-closing.
- The bid circular is not reviewed by the securities commission, so there is no regulatory timing disadvantage when share consideration is offered.
- A bidder that offers share consideration may become a "reporting issuer" and subject to Canadian public company disclosure requirements.

### CONDITIONS

- Any conditions (except financing in a takeover bid) are permitted and frequently include the following:
  - > no rights plan or waiver of application of rights plan to bid
  - > Competition, Investment Canada, HSR approvals and any regulatory approvals for change of control
  - > no material adverse change
- All bids are subject to a statutory minimum tender condition requiring more than 50% of target securities held by persons other than the bidder and its joint actors to be tendered before the bidder can take up any securities under the bid.
  - > If the bidder is seeking 100%, minimum tender should be the greater of 66 $\frac{2}{3}$ % and majority-of-the-minority to have certainty of execution of second-step going-private transaction.

### COATTAILS

- Dual class companies listed on the TSX are required to provide coattails – that is, provisions that effectively entitle holders of non-voting or subordinate voting shares to participate in a bid for voting or multiple voting shares.
- Companies with long-standing dual class structures may have avoided coattail requirements so a purchase of control may be made without an offer to non-voting or subordinate voting shares.
- Coattails are typically triggered when a takeover bid is made for the voting/multiple voting shares, unless offers are made for other shares on the same basis.
- Acquisition made by way of plan of arrangement may not trigger a typical coattail.

## SHAREHOLDERS LIST

- Bidder can request a list from the target by following the procedure under the applicable corporate statute. The target must respond to the request within 10 days.
- Bidder permitted to commence the bid by advertisement, but must request the shareholders list on or before the date the bid is advertised, and must send the bid circular to shareholders within two business days of receiving list.

## SHAREHOLDER APPROVAL FOR SHARE EXCHANGE OFFER

- A TSX-listed bidder proposing to make a share exchange offer must obtain shareholder approval when number of securities issuable on acquisition exceeds 25% of outstanding securities of issuer (on a non-diluted basis).

## U.S. SHAREHOLDERS OF CANADIAN TARGET

- If U.S. securityholders hold less than 40% of “foreign private issuer” target shares, the multijurisdictional disclosure system (MJDS) generally exempts a bid by a Canadian public company that is a foreign private issuer from U.S. tender offer regulation and from SEC review of the registration statement filed in respect of the share exchange bid (U.S. anti-fraud provisions, Schedule 13D and Schedule 13E-3 still apply).
- MJDS can be used by a non-Canadian bidder only in a cash deal; in a share exchange bid, both bidder and target must be Canadian foreign private issuers for the bidder to use the MJDS registration exemption.
- If MJDS is unavailable for the share exchange bid (e.g., because the target is not a foreign private issuer), it may be possible to avoid the SEC registration requirement by making “vendor placement” or excluding U.S. shareholders from the bid.

## Lock-Up Agreements

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- Securityholder commitment to tender to a takeover bid (or vote in support of arrangement or amalgamation) is permissible and common.
- Securityholder may have right to withdraw and tender to a higher offer.
- Contributes to certainty of execution; locked-up securities count toward 90% compulsory acquisition threshold and to 50% minimum tender condition.
- Multilateral Instrument 61-101 permits securities acquired under a lock-up agreement to be voted as part of the minority in a majority-of-the-minority vote if the locked-up securityholder is treated identically to all other securityholders under offer.
- Entering into a lock-up agreement does not generally trigger a typical Canadian “poison pill” if securityholder has the right to withdraw and tender to a higher offer.
- Lock-up agreements must be filed publicly.

# Post-bid Cleanup



## Compulsory Acquisition

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- Generally under corporate law, if within 120 days of the bid, it is accepted by 90% of class of shares subject to bid (other than shares held by the bidder or its affiliates or associates), the bidder can require hold-outs to sell to the bidder for the same price as the bid.
  - > The bid period of 105 days allows a successful bidder that achieves less than 90% to extend its bid for a further 10-day period in an effort to reach 90% and still have five days to commence the compulsory acquisition process.
- Once notice is sent, the bidder will be entitled to acquire shares of non-tendering shareholders within 30 days, but each shareholder may apply to court to fix "fair value."
- For targets incorporated in Ontario, the procedure is available only if the bid was for voting securities.
- For targets incorporated federally, the procedure is available only if the bid is made to all shareholders (e.g., cannot exclude U.S. holders in share exchange bid) unless an order is obtained.

## Second-Step Business Combination/ Going-Private Transaction

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- If the bidder acquires between 66 2/3% and 90%, it can still take the company private by means of a second-step shareholder-approved amalgamation or plan of arrangement.
- Under Multilateral Instrument 61-101, shares acquired under the bid can be counted as part of the minority in a second-step amalgamation/plan of arrangement if the intention to do so is disclosed in the bid circular, the second-step transaction provides for the same consideration as the bid, the tendering shareholder did not receive a collateral benefit and certain other statutory requirements are met.

# Acquisitions by Related Party

## Related Party Acquisitions

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- Management buyout offers, insider bids and other acquisitions by or involving a significant shareholder or other related party of the target are regulated under MI 61-101.

## Purpose of MI 61-101

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- Intended to level the playing field for the minority when transactions are proposed in which a significant shareholder or other insider could have advantage by virtue of voting power, board representation or increased access to information
- Affects business combinations, related party transactions, second-step going-private transactions, issuer bids and insider bids

## Types of Transactions Covered

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Transaction types caught include:

- Insider bids: Takeover bid by holder of shares carrying more than 10% of voting rights or other insider (e.g., directors and officers).
- Business combinations: Transaction whereby holder of equity security can be required to sell its shares, regardless of whether equity security is replaced by another security (e.g. plan of arrangement or amalgamation), but only if transaction involves related party of issuer that is acquiring the issuer, or is not treated identically to other holders or receives consideration of greater value than other holders.
- Related party transactions: Transaction between issuer and significant shareholder or other related party.
  - > “Related party” includes a director or officer, or a holder that has the ability to materially affect the control of the issuer and a holder of securities carrying more than 10% of the voting rights.

## Procedural and Substantive Requirements

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- Independent valuation
- Minority shareholder approval

- Enhanced disclosure
- Special committee of independent directors

## INDEPENDENT VALUATION

- Valuation Requirements:
  - > Valuations are required for insider bids (unless the bidder is an “outside” insider); business combinations (but only if an “interested party” is acquiring or combining with the issuer); and related party transactions (but only if the subject matter of the related party transaction exceeds 25% of the issuer’s market capitalization).
  - > Valuation must be “en bloc” value, with no liquidity or minority discount.
  - > Bidder loses control in valuation process (e.g., in an insider bid, valuation is done at expense of bidder and included in the takeover bid circular, but is prepared under the supervision of the target’s special committee of independent directors).
  - > Valuation cannot be more than 120 days old.
- Independence of Valuator:
  - > Valuator is not independent if it is an associated or affiliated entity or an external auditor (some exceptions), or entitled to success fees.
  - > Other relationships simply require consideration and disclosure (e.g., lead or co-lead underwriter relationship in past 24 months).
- Valuation Exemptions:
  - > Previous arm’s-length negotiations: Consideration offered is at least equal in value and is in the same form as agreed to in arm’s-length negotiations not more than 12 months earlier by a 10% securityholder (5% if the bidder already has 80% of target’s securities) holding at least 20% of the outstanding securities not owned by the bidder.
  - > Auction: One or more other transactions or bids are outstanding, and equal access to data room information is provided to all.
  - > Second-step business combination: Within 120 days of a formal bid that disclosed intent to effect a second-step transaction as well as tax consequences of that transaction, and consideration has the same value and is in the same form as paid under a formal bid.
  - > Pro rata related party transaction: Rights offerings, dividends, asset distributions or share reorganizations in which the interested party is treated identically to all holders.
  - > Lack of knowledge of undisclosed material information and no board or management representation (for insider bids).

- Disclosure of Prior Valuations – Preceding 24 Months:
  - > Includes internal appraisals of securities or material assets
  - > Must be careful characterizing advice to boards and fairness opinion analysis
  - > Does not include a valuation prepared for the purpose of assisting an interested party in determining the price to be offered (unless made available to any of the independent directors of target)

### **MINORITY SHAREHOLDER APPROVAL**

- In addition to approvals under corporate law, shareholder approval by a majority-of-the-minority, that is, more than 50% of the votes cast by disinterested shareholders at a meeting is required.
  - > Although shares held by an acquirer are excluded from the minority, shares acquired under a bid can be counted toward the majority-of-the-minority approval of the second-step transaction.
  - > Shares held by related party that receives a collateral benefit or different consideration are excluded.

### **ENHANCED DISCLOSURE**

- MI 61-101 requires detailed disclosure, primarily to level the informational playing field between the proponent of the transaction and the minority.
- Requires a detailed description of the board's review and approval process, including any materially contrary view or abstention by a director and any material disagreement between the board and special committee.

### **SPECIAL COMMITTEE**

- A special committee of directors who are independent of the proponent of the transaction is typically formed for MI 61-101 transactions (only mandatory in case of an insider bid, but recommended for all material conflict of interest transactions).
- Reports to the full board, which then makes a recommendation to shareholders on the transaction.
- Supervises the valuation process.

# Directors' Duties and Defensive Mechanisms

# Directors' Duties

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## FIDUCIARY DUTIES

- Directors have (i) a fiduciary duty to the corporation to act in the best interests of the corporation; and (ii) a duty to exercise the care, diligence and skill of a reasonably prudent person in comparable circumstances.
- Directors must exercise their powers for the benefit of the corporation and not for an improper purpose such as the entrenchment of directors and management.
- Directors must consider the best interests of the corporation. Directors may also consider the interests of shareholders or particular groups of stakeholders, including employees, suppliers, creditors, consumers, governments and the environment.
- Shareholders, including controlling shareholders, do not owe fiduciary duties to other shareholders.

## DIRECTORS' DUTIES IN CHANGE OF CONTROL TRANSACTIONS

- The Supreme Court of Canada affirmed in the *BCE* decision that, in determining what is in the best interests of the corporation, there is no priority rule that requires that shareholders' interests prevail in all cases.
- In Canada, a board is not required to conduct an auction in every change of control transaction. Canadian courts have generally given boards considerable latitude in change of control transactions, deferring to the reasonable and informed business judgment of the directors. Canadian courts have specifically rejected the *Revlon* line of cases, which requires the maximization of shareholder value when the board decides to sell the company.

## DIRECTORS' DUTIES IN RESPONDING TO UNSOLICITED BIDS

- U.S. courts have held that if directors of a target company have reasonable grounds for believing that a threat to the company exists (such as the possibility of a coercive or unfair bid), they discharge their duties if they adopt measures that are reasonable in relation to the threat posed, and they act diligently and on the basis of full information.
- Canadian courts have held that the conduct of directors is subject to the objective prospective reasonability principle of *Paramount Communications* (i.e., if the board selected one of several reasonable alternatives, a court should not second-guess that choice even though it might have decided otherwise or subsequent events may have cast doubt on the board's determination).

## BUSINESS JUDGMENT RULE

- The business judgment rule protects business decisions that have been made by the board of directors honestly, prudently, in good faith and on reasonable grounds. In these cases, the board's decisions will not be subject to judicial review of the merits of the business decision, and a court will generally give deference to the business judgment of directors, so long as the decision lies within a range of reasonable alternatives.
- “Honestly, prudently, in good faith and on reasonable grounds” means that directors must exercise their judgment (i) free of any conflict of interest; (ii) on the basis of a full understanding of all relevant facts and with the benefit of expert advice; and (iii) in the best interests of the corporation and not for an improper purpose.
- If a board of directors has acted on the advice of a committee composed of persons having no conflict of interest and the committee members have exercised their judgment in compliance with the foregoing principles, the business judgment rule will apply to protect the business decisions of the board of directors.

## INDEPENDENT COMMITTEE

- If circumstances indicate a real threat of an offer or if an offer is made, the board should consider whether to establish an independent committee composed of non-management directors.
- The independent committee will assess any offer and develop recommendations for the full board with respect to the offer and any potential alternatives and, depending upon the circumstances, will negotiate or supervise the negotiations with the bidder or others.

## OPPRESSION REMEDY

- Corporate conduct that is oppressive or unfairly prejudicial to, or that unfairly disregards the interests of, any securityholder, creditor, director or officer can be challenged under the statutory oppression remedy.
- The complainant must demonstrate that it had a reasonable expectation that has been violated by the corporate conduct at issue.
- Factors that are relevant in determining whether a reasonable expectation exists include general commercial practice, the nature of the corporation, the relationship between the parties, past practice, steps the complainant could have taken to protect itself, representations and agreements and the fair resolution of conflicting interests between corporate stakeholders.



# Structural Defences

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- Structural defences generally consist of defensive provisions contained in a target company's articles and bylaws and shareholder rights plans (poison pills). Generally, structural defences do not work as well in Canada as they do in the United States.

## SHAREHOLDER RIGHTS PLAN

- The shareholder rights plan is the primary structural defence used in Canada, and many Canadian companies have shareholder rights plans.
- Canadian rights plans adopted otherwise than in response to a specific bid tend to be very uniform and relatively benign compared to some U.S. rights plans as a result of the TSX requirement for shareholder approval of rights plans, the formal review process conducted by ISS on rights plans proposed by Canadian companies and the tendency of Canadian institutional shareholders to follow ISS recommendations.
- Rights plans in Canada are not designed, and will not operate, to block an unsolicited bid; rather, they are intended to encourage the fair treatment of shareholders in connection with a bid and to provide sufficient time for the board and shareholders to properly consider and respond to an offer, and for the board to determine whether there are alternatives available to enhance shareholder value.
- In a typical Canadian rights plan, the plan would be triggered by the acquisition by any person or group of beneficial ownership of 20% or more of the company's common shares, calculated on a partially diluted basis.
- If the plan is triggered, all shareholders other than the triggering shareholder and certain related parties have the right to acquire additional common shares of the company from treasury at a substantial discount to market price, theoretically resulting in substantial dilution to the hostile bidder.
- Canadian rights plans, unlike U.S. rights plans, typically include a "permitted bid" concept.
- Prior to 2016, when the bid rules were amended to extend the minimum bid period to 105 days, poison pills were almost always cease-traded by a securities commission after a certain period of time. Poison pills could not be used by a target to shield itself indefinitely from a hostile bid; rather, they could be used only to secure additional time for the target board to evaluate alternatives and attempt to pursue other transactions.
- Given the significant extension of the statutory minimum bid period to 105 days under the takeover bid rules, it is likely that the use of a rights plan to further postpone take-up by a hostile bidder will be subject to challenge before a securities commission.

- Rights plans continue to be relevant, though for more limited purposes: in particular, to regulate the ability of shareholders to accumulate a holding of 20% or more in a company through limited private transactions that are exempt from the takeover bid rules (so-called creeping bids); or, potentially, to restrict a bidder's ability to enter into swaps, even if cash settled, or to use the 5% exemption to effect market purchases during a bid.
- If a company does not have a shareholder rights plan in place, the board could consider refraining from introducing a rights plan until an unsolicited proposal arises and then introducing a U.S.-style "tactical" rights plan with no permitted bid. Tactical plans typically have a duration that is less than the six-month shareholder approval period mandated by the TSX and are not typically put forward for shareholder approval.

## CHARTER AND BYLAW PROVISIONS

- Structural defences commonly contained in the constating documents or bylaws of U.S. companies are rare in Canada because some of the most popular U.S. charter document structural defences are not required or are ineffective under Canadian law.

### Supermajority Voting Provisions

- Supermajority voting provisions can be used to require higher levels of shareholder approval or majority-of-the minority approval of certain corporate transactions involving significant shareholders.
- These provisions require an amendment of the company's articles passed by a special resolution of shareholders.
- These provisions do not deter a bidder that is prepared to make an offer to acquire the entire company, although they may increase the minimum tender condition in the bid of an acquiring party whose financing sources require it ultimately to acquire 100% of the company, thereby weakening the strength of the offer.

### Increased Quorum and Notice Provisions

- Bylaws may be amended to impose increased quorum and advance notice provisions in respect of any meeting called to remove directors, elect or appoint new directors not nominated by the continuing directors or vary the qualifications of directors.
- Although these bylaw amendments require shareholder ratification at the next meeting, they are valid in the interim.
- These provisions are most useful as a structural defence in the context of a proxy contest.

### Staggered Board Provisions

- These provisions are ineffective because under nearly all Canadian corporate statutes, an acquirer that acquires more than 50% in a bid can proceed to replace the existing board.

# Defensive Measures

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- National Policy 62-202 sets out the views of the Canadian securities regulators with respect to the defensive tactics that a target company may employ in advance or in the face of a takeover bid. The Policy expresses securities regulators' view that unrestricted auctions produce the most desirable results in takeover bids.
- The Policy warns that the securities regulators may take action where defensive measures are likely to deny or severely limit the ability of shareholders to respond to a takeover bid, although it recognizes that defensive measures may be taken to obtain a better bid.

## “JUST SAY NO”

- It is generally accepted, as a matter of securities law and policy, that boards cannot “just say no” to a bid in Canada, but must rather be able to convince shareholders that it is in their interest to reject the bid.
- The U.S.-style “just say no” defence has not been tested by Canadian courts. Depending on the circumstances, a company may be able to convince a court that the implementation of a “just say no” defence is consistent with the fiduciary duties of the directors and that the business judgment of the directors should be afforded deference by the courts.

## DEFENSIVE PRIVATE PLACEMENTS

- A private placement of securities made in the face of an actual or impending takeover bid can be challenged before the Canadian securities regulators as an improper defensive tactic.
  - > Since the 2016 bid amendments, the utility of a private placement as a defensive tactic has increased because an issuance of shares by the target may make it difficult for the bidder to satisfy the 50% minimum tender condition.
  - > In the 2016 decision of the Ontario and British Columbia securities commissions in *Re Hecla Mining Company*, the commissions established an analytical framework for determining when they will intervene to cease-trade a private placement. In summary, if the *effect* of the private placement is to impair the bid and the *intention* of the target in making the private placement was to alter the dynamics of the bid process, securities regulators will intervene if investor protection concerns outweigh the board's business judgment in deciding to issue shares in the face of the bid.

## RESTRUCTURING/RECAPITALIZATION

- The goal is to give shareholders the opportunity to receive substantial cash value on a current basis while preserving the independence of the company.
- One possible restructuring transaction would be a sale or spinoff of a significant asset or assets.
  - > Substantial advance analysis and planning is required, including tax analysis.

- > Identification of assets, the sale or disposition of which would further a defensive strategy, may depend on the identity and strategic position of the bidder.
- > The transaction must have a demonstrable business purpose and be undertaken with a view to the best interests of the company, otherwise it will be at risk of being set aside by a court as an improper exercise of the directors' fiduciary duties.
- An example of a recapitalization transaction would be a substantial increase in long-term debt combined with a special dividend or issuer bid to distribute cash to shareholders.
  - > This transaction provides shareholders with an opportunity to realize cash value in respect of a significant portion of their investment.
  - > Tax analysis is required to ascertain whether monies received by shareholders on a restructuring/recapitalization can be received tax-free.

### ACQUISITION OF SIGNIFICANT ASSETS

- An acquisition of significant assets may make the company more leveraged and less attractive to a bidder; it could make the transaction prohibitively expensive or cause the bidder antitrust problems.
- Advance identification, analysis and planning, as well as negotiation with the seller, would be required. An acquisition can be extremely difficult to implement in the face of a bid, absent significant advance work.
- Again, there must be a demonstrable business purpose, and the acquisition must be undertaken by the directors with a view to the best interests of the company, not primarily for the purpose of fending off the bid.

### STRATEGIC INVESTOR OR ALLIANCE

- Such an investment or alliance could be in respect of all or any of the businesses owned by the target.
- The transaction could be implemented through a private placement for cash or assets or through a private placement share exchange with a compatible company, resulting in interlocking shareholdings (with standstills).
- TSX will require majority shareholder approval in the following circumstances:
  - > More than 25% of the outstanding shares are issued at a price lower than the market price;
  - > More than 25% of the outstanding shares are issued in exchange for assets or shares; or
  - > The transaction results in a new holding of more than 20% of the voting securities, or otherwise “materially affects control.”
- Early identification of possible parties and analysis of the strategic rationale for any transaction would be important in demonstrating a proper business purpose.

## WHITE KNIGHT TRANSACTIONS

- The target may agree to deal-protection mechanisms in a white knight transaction. Mechanisms may include a break fee, no-shop clauses, asset options and stock options.
- Ontario courts have acknowledged that deal-protection mechanisms in a white knight context are appropriate where they are required to induce a competing bid; the competing bid represents sufficiently better value for shareholders to justify their use; and they represent a reasonable commercial balance between their potential negative effect as auction inhibitors and their potential positive effect as auction stimulators.

*Competition Act,  
Investment Canada  
Act and Other  
Restrictions on  
Foreign  
Ownership*

## Competition Act (Canada): Pre-merger Notification

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- Pre-merger notification requirements apply to any merger that meets certain financial and voting interest thresholds, including in respect of an acquisition of a foreign corporation with assets in Canada.
- Pre-merger notification is made to the Competition Bureau (Bureau), which is headed by the Commissioner of Competition (Commissioner).
- A government consultation on potential reforms to the *Competition Act* is underway at the time of writing, and a number of potential amendments under consideration would introduce material changes to both the process for reviewing mergers as well as the substantive scope for challenging them.
- In addition, the federal government has tabled a “first set” of proposed amendments to the *Competition Act* that includes repealing the “efficiencies” defence currently available under the merger provisions (as discussed further below).

### FINANCIAL AND SHAREHOLDING THRESHOLDS

- To be notifiable, the transaction must exceed both of the following thresholds:
  - > Size of target (or transaction): \$93 million for 2023 (adjusted annually) in Canadian assets (book value) or annual gross revenues from sales generated from those assets in or from Canada.
  - > Size of parties – all parties and their affiliates (in aggregate): \$400 million in Canadian assets or annual gross revenues from sales in, from or into Canada.
- In addition to these financial thresholds, for an acquisition of voting shares of a corporation to be notifiable, the acquirer’s voting interest following the transaction must exceed 20% (public company) or 35% (private company) or, if that threshold is already exceeded, the voting interest must exceed 50% as a result of the transaction. Similar thresholds apply to the acquisition of interests in certain non-corporate entities (e.g., a limited partnership).

### FILING INFORMATION

- Each party to a notifiable transaction must file certain basic information, including a description of the transaction and information regarding the party’s top customers and suppliers, as well as any documents similar to those caught by item 4(c) of the *Hart-Scott-Rodino Antitrust Improvements Act* in the United States (e.g., board and executive level competition analyses of the transaction).

## TIMING

- Parties to a notifiable transaction are prohibited from completing the transaction before the expiry of a statutory waiting period. The Canadian merger review process and, in particular, the waiting periods, are closely aligned with the U.S. merger review process.
  - > The waiting period in Canada expires 30 days after the pre-merger notification filings unless, prior to the end of that 30-day period, the Commissioner issues a “supplementary information request” to the merging parties for production of documents and/or responses to questions (similar to a U.S. second request).
  - > If a “supplementary information request” is issued, a new waiting period is triggered and expires 30 days after compliance with the request.
- The Commissioner may terminate or waive the waiting period (including the initial waiting period) at any time by issuing an advance ruling certificate (ARC) or no-action letter indicating that the Commissioner does not currently intend to challenge the transaction.
- In an unsolicited takeover bid, when a bidder files a pre-merger notification under the *Competition Act*, the Commissioner is required to immediately notify the target company.

## ADVANCE RULING CERTIFICATE AND “NO-ACTION” LETTERS

- When an acquisition is clearly unlikely to give rise to any substantial lessening or prevention of competition in Canada, the Commissioner may issue an ARC.
- If obtained, an ARC bars the Commissioner from challenging the transaction absent new information (provided that the transaction is completed within one year) and provides an exemption from pre-merger notification requirements (including statutory waiting periods).
- If the Commissioner determines that an ARC is not appropriate, the Commissioner may issue a no-action letter, which also provides substantial comfort, where the Commissioner decides not to challenge a proposed transaction at that time. A no-action letter may also be issued together with a waiver of the obligation to comply with the formal pre-merger notification requirements (including the statutory waiting periods).

## ADDITIONAL CONSIDERATIONS

- A transaction subject to pre-merger notification under the *Competition Act* also requires notice to the federal Minister of Transportation, and potentially a public interest review, if the transaction involves a transportation undertaking.



## FILING FEE

- There is a filing fee of \$82,719.12 in 2023 (adjusted annually) for statutory pre-merger notification and/or an ARC/no-action letter application.

## *Competition Act (Canada): Substantive Provisions*

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- The Bureau tends to focus on horizontal mergers between competitors. Vertical mergers between a customer and a supplier have rarely been a standalone basis for challenging a merger in Canada but vertical relationships between merging parties may lead to extensive questions and delay in the merger review process.

## SUBSTANTIVE TEST

- The substantive merger provisions apply independently of the notification provisions. Thus, even non-notifiable transactions can be challenged on substantive grounds, and the Bureau actively monitors merger activity for transactions that fall below the notification thresholds. The last litigated non-notifiable merger challenge brought by the Commissioner was in 2019, and remedies (interim and final) have been obtained by the Commissioner on a consensual basis in a number of non-notifiable mergers since then.
- Currently, the Commissioner may initiate a challenge to a merger on substantive grounds until one year after substantial completion of the transaction.
- The test for imposing a remedy is whether the proposed merger is likely to lessen or prevent competition substantially in a market in Canada (e.g., the merged entity will be able to raise prices or to reduce service, quality or innovation). The Commissioner will also assess the merger's impact on buying power and the merged firm's ability to suppress prices paid to suppliers below competitive levels, as well as the impact of the merger on non-price factors or aspects of competition such as "network effects", quality, consumer choice and consumer privacy.
- Product and geographic market definition play a key role in assessing whether a merger is likely to substantially lessen or prevent competition.
- Even if a proposed merger is prima facie anticompetitive, it may be possible to raise an "efficiencies" defence – namely, that the merger should not be blocked if efficiency gains from the merger are likely to be greater than, and offset, the anticompetitive effects. Despite a handful of cases in which the Bureau has decided not to challenge a transaction or aspects of a transaction on efficiencies grounds, to date it has proven very difficult to convince the Bureau to clear a merger solely on the basis of efficiencies. Merging parties wishing to do so will normally be expected by the Bureau to agree not to close their transactions pending a process for the review of efficiencies and the resulting trade-off against anticompetitive effects. That process would extend beyond statutory time frames and involve reviewing significant amounts

of documents and data from the merging parties. It would also require engagement between the Bureau and the merging parties, their counsel, business people and their experts. The “efficiencies” defence has been the subject of significant policy debate in Canada, and the federal government has recently tabled proposed legislation that would repeal the defence. It is not presently clear whether and how efficiencies may continue to be factored in merger review in the absence of a statutory defence.

### SAFE HARBOURS

- The Bureau’s (non-binding) *Merger Enforcement Guidelines* provide that mergers will generally not be challenged on the basis of concerns related to unilateral market power if the post-merger market share of the combined entity will be less than 35%.
- Although possible, challenges based solely or primarily on concerns about coordinated behaviour by firms are rare in Canada. The Bureau’s *Merger Enforcement Guidelines* provide that a merger will generally not be challenged on the basis of an increased scope for coordinated behaviour if the following conditions are met:
  - > the aggregate post-merger market share of the four largest firms in the relevant market will be less than 65%, or
  - > the post-merger market share of the merged entity will be less than 10%.
- Market shares above these levels are not necessarily challenged, but require more analysis of barriers to entry, remaining competition and other relevant factors.

### SERVICE STANDARD TIME PERIODS

- The Bureau has adopted the following service standards reflecting the time in which it aims to complete reviews of mergers:
  - > “Non-complex” mergers have an absence of competition issues and include transactions with no or minimal overlap between parties, assuming properly defined product and geographic markets. The service standard is 14 calendar days. Most merger transactions in Canada fall into this category.
  - > “Complex” mergers generally involve transactions between competitors or between customers and suppliers, where there are indications that the transaction may, or is likely to, create, maintain or enhance market power. The service standard is 45 calendar days unless a supplementary information request is issued, in which case the service standard is extended to 30 calendar days from when the Commissioner receives a complete response to the request from all parties.
- Service standard periods typically begin after the Bureau has received the complete information it needs to conduct its analysis. The Bureau is not legally obligated to meet the service standard time frames, and service standards do not modify statutory waiting periods. Therefore, it is possible that the statutory waiting period will expire before expiry of the service standard period

and the Bureau's completion of its review. In such circumstances, even though the *Competition Act* contains no statutory impediment to closing upon expiry of any applicable waiting period until and unless the Commissioner obtains an injunction, parties often wait until positive clearance has been received from the Bureau before closing. If parties do choose to proceed to close before receiving clearance, they run the risk that the Bureau will seek to enjoin closing or challenge the transaction up to one year after closing. The Commissioner has recently demonstrated a greater willingness to seek interim injunctive relief, including in relation to mergers, pending resolution of a trial on the merits.

## REMEDIES

- The most common remedy for a challenged merger is a consent agreement negotiated between the Commissioner and the parties to the transaction.
- Remedies the Commissioner may seek from the Competition Tribunal (the specialized adjudicative body for competition matters in Canada) include injunctions to prevent or delay closing, and post-closing divestitures or dissolution. The Commissioner may also seek or accept a “hold separate” undertaking or consent agreement to permit closing pending completion of the Bureau's review.
- The Commissioner has extensive investigatory powers (e.g., compulsory information requests and/or interviews), and the use of such powers has increased in recent years.
- There is no private right of action to challenge mergers in Canada under the *Competition Act*.

## HOSTILE BIDS

- Competition law can be used as a shield if an unsolicited bidder is (or is potentially) a significant competitor.
- Pre-merger notification by the bidder triggers a similar filing requirement for the target. The Commissioner is required to notify the target that a filing has been made. The target then has 10 days to provide pre-merger notification information to the Bureau. The target's response time does not affect the running of the 30-day statutory waiting period, which still begins when the bidder files a complete notification.

## DOCUMENT PREPARATION

- The Commissioner will often request or even compel parties to a merger to provide documents created by the parties or the parties' respective advisors (e.g., offering memoranda, internal strategic plans, emails and memoranda) that can be used in the analysis or as evidence in a challenge. Note the following in order to avoid raising unfounded competition concerns by giving the wrong impression in documents:
  - > Avoid using potentially misleading phrases such as “barriers to entry” and “dominant position.” Better phrases may include discussions of “competitive advantages,” “efficiencies” and “leading positions.”

- > Avoid using the word “market” in favour of terms such as “business,” “segment” or “industry.”
- > Avoid speculating on possible “competition law” or “antitrust” problems or potential divestiture scenarios to address such problems.

## *Investment Canada Act*

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### APPLICABILITY

- In general, any acquisition by a “non-Canadian” of control of a business carried on in Canada is either notifiable or reviewable under the *Investment Canada Act* (ICA), Canada’s foreign investment review legislation.
- Whether an acquisition is reviewable depends on a number of factors, including the type of transaction, the country of origin of the investor’s ultimate controller(s), the value of the Canadian business being acquired and its industry sector, and whether the investor is considered a “state-owned enterprise.”
- The ICA applies whether or not the target business is currently controlled by Canadians and also applies when a Canadian business is acquired indirectly by the acquisition of a foreign entity with a Canadian subsidiary.
- Acquisitions may be reviewed under the ICA on the basis of a “net benefit to Canada” test and “national security.” Investments reviewable for net benefit to Canada are now relatively infrequent due to the Canadian government’s decision to apply in most cases relatively high target enterprise value thresholds for such a review. At the same time, however, an increasing number of investments are being screened and reviewed for potential national security concerns.
- If an acquisition is subject to review under the ICA, the investor may be prohibited from acquiring or be required to divest the Canadian business unless the acquisition is approved by the relevant Minister or the federal cabinet in the case of national security reviews.
- The Minister of Canadian Heritage reviews all cultural sector investments, and the Minister of Innovation, Science and Industry is responsible for all other matters.

### ACQUISITION OF CONTROL

- The net benefit review provisions of the ICA may apply when there is an “acquisition of control.”
  - > The acquisition of a majority of the voting interests of an entity is deemed to be an “acquisition of control.”
  - > The acquisition of less than a majority of the voting interests of an entity other than a corporation (e.g., a trust or partnership) is deemed not to be an acquisition of control.
  - > The acquisition of less than a majority but 1/3 or more of the voting shares of a corporation is presumed to be an acquisition of control unless it can be established that the corporation will not be controlled in fact by the investor through the ownership of voting shares.

- > The acquisition of less than 1/3 of the voting shares of a corporation is deemed not to be an acquisition of control.
- > The acquisition of all or substantially all of the assets used in carrying on a Canadian business is an acquisition of control of that business.
- Special considerations apply to the acquisition of any interest in a Canadian business by a state-owned enterprise (discussed below).
- Less-than-control investments remain subject to scrutiny under the ICA's national security review jurisdiction.

## NOTIFICATION

- Acquisitions of control that do not exceed the prescribed net benefit review thresholds (discussed below) are rarely reviewable and instead require an informational notification. Notifications may be made up to 30 days after closing. Notifications have the effect of triggering timelines under the ICA's national security review screening process.
- A notification requirement is not currently an impediment to the closing of an acquisition. However:
  - > Given that a notification commences the timelines within which the government may assess an investment on national security grounds, investors may elect to file a notification pre-closing and allow national security screening timeframes to lapse, in order to obtain comfort that the transaction will not be subject to a national security review after closing.
  - > In addition, at the time of writing Parliament is considering draft legislation that would introduce a mandatory pre-closing notification and national security screening process for investments in certain sensitive sectors that have yet to be defined.

## TRANSACTIONS REVIEWABLE FOR NET BENEFIT TO CANADA: TRADE AGREEMENT AND WTO INVESTORS

- A direct acquisition of control by or from a “trade agreement investor” (i.e., an entity ultimately controlled by citizens of a country with which Canada has a trade agreement) is generally reviewable for net benefit to Canada only when the enterprise value of the entity carrying on the Canadian business and all other entities in Canada whose control is being acquired is \$1.931 billion or more for 2023 (adjusted annually). Currently, the list of trade agreement countries includes the United States, the European Union and its member states, the United Kingdom, Australia, New Zealand, Japan, South Korea, Singapore, Malaysia, Brunei, Vietnam, Chile, Colombia, Honduras, Mexico, Panama, and Peru. The review threshold is lower, \$1.287 billion or more in enterprise value for 2023 (adjusted annually), where the direct acquisition of control is by or from a “WTO investor” (i.e., an entity ultimately controlled by citizens of a World Trade Organization member state) that is not also a trade agreement investor. (The vast majority of Canada's trading partners are WTO members.)
  - > In the case of an acquisition of control of a Canadian business that is publicly traded,

the enterprise value of the Canadian business is its market capitalization plus its liabilities (excluding operating liabilities), minus its cash and cash equivalents. Market capitalization is determined on the basis of the average daily closing price of each class of security outstanding multiplied by the average number of that security outstanding, calculated over a prescribed time period.

- > In the case of an acquisition of control of a Canadian business that is not publicly traded or in the case of an asset acquisition, the enterprise value of the Canadian business is the acquisition value plus assumed liabilities (excluding operating liabilities), minus cash and cash equivalents.
- A direct acquisition by or from a WTO investor when the purchaser is a state-owned enterprise (discussed below) is reviewable when the *book value* of the assets of the entity carrying on the Canadian business and all other entities in Canada whose control is being acquired is \$512 million or more for 2023 (adjusted annually).
- An indirect acquisition of control by or from a WTO investor is generally not subject to net benefit review, regardless of the value of the Canadian business, but is still subject to notification.
- Transactions reviewable for net benefit to Canada must be approved before closing.

### SPECIAL NET BENEFIT REVIEW THRESHOLDS

- Acquisitions of control that do not involve WTO investors (including trade agreement investors) and acquisitions of control of Canadian cultural businesses are subject to lower thresholds for review.
  - > These lower thresholds are (i) \$5 million in book value of assets for direct acquisitions; and (ii) \$50 million in book value of assets for indirect acquisitions, except that the \$5-million threshold applies to indirect acquisitions if the asset value of the Canadian business being acquired exceeds 50% of the asset value of the global transaction.
- A “cultural business” includes a business that engages in the publication, production, distribution, exhibition or sale of books, magazines, periodicals, newspapers, film, video or music.
  - > There is no *de minimis* exception to the determination whether or not a business constitutes a cultural business. For example, department or convenience stores may be cultural businesses if they sell even a few books and magazines. Moreover, the concept of a cultural business may evolve as it has, for example, with respect to certain video game businesses which have in numerous cases been considered to be “cultural businesses” since they involve one or more elements of film, video, audio and music.
  - > In addition, even where the acquisition of a cultural business does not exceed the applicable financial thresholds for a net benefit review such that only a notification is required, the Minister of Canadian Heritage may nevertheless decide to commence a net benefit review within 21 days of receiving a notification.
- There is no financial threshold applicable to a national security review (see further details below).

## STANDARD FOR NET BENEFIT REVIEW

- The test that is applied to assess transactions under the ICA is whether the transaction is likely to result in “net benefit to Canada.” The factors that the relevant Minister considers in assessing “net benefit” include the effect of the investment on (i) the level and nature of economic activity in Canada; (ii) participation by Canadians in the business; (iii) competition, research and development, efficiency and productivity in Canada; and (iv) federal and provincial government policies. It is customary for the Minister to seek input from affected provinces and other governmental departments.

## STATE-OWNED ENTERPRISES AND NET BENEFIT REVIEW

- A “state-owned enterprise” includes an entity that is controlled or influenced, either directly or indirectly, by a government of a foreign state (whether federal, state or local) or an agency of such a government and an individual who is acting under the direction or the influence, directly or indirectly, of a government or agency of a foreign state.
- Special considerations apply if the investor is a state-owned enterprise.
- As discussed above, lower net benefit review thresholds apply to direct acquisitions of control by state-owned enterprises.
- The ICA may also apply more broadly to certain investments involving state-owned enterprise investors.
  - > The relevant Minister may deem any entity that otherwise qualifies as Canadian to be a non-Canadian if the Minister considers that the entity is controlled in fact by a state-owned enterprise.
  - > The Minister may also override the acquisition of control rules (discussed above) and deem a transaction to be an acquisition of control if the Minister considers there to have been an acquisition of control in fact of a Canadian business by a state-owned enterprise.
- In addition to general net benefit review factors, if the investor is a foreign state-owned enterprise, the net benefit review will focus on whether the investor adheres to Canadian standards of corporate governance and whether the Canadian business will continue to operate on a commercial basis.
- Government policy statements have indicated that investments by foreign state-owned enterprises to acquire control of a Canadian oil sands business or a Canadian critical minerals business will be found to be of net benefit on an exceptional basis only. In addition, as a result of the conflict in Ukraine, the government has issued a policy statement that acquisitions of Canadian businesses (in any sector) by direct or indirect Russian investors will also only exceptionally be found to be of net benefit to Canada.
- More generally, recent ministerial statements have clearly stated that all foreign investments by state-owned investors or private investors assessed as being closely tied to or subject to direction from foreign governments will undergo enhanced scrutiny under the ICA, whether on net benefit grounds or in relation to potential national security concerns (discussed below).

## NET BENEFIT UNDERTAKINGS

- When an acquisition is subject to a net benefit review, the investor typically must provide undertakings to the relevant Minister in order to obtain approval. Undertakings are typically for a three- to five-year term and cover areas such as employment, capital expenditures, technology transfer, research and development in Canada and maintaining a Canadian head office and management. Undertakings to address issues with state-owned enterprises may be for longer terms or indefinite in duration.
- Investors who fail to comply with their undertakings may be subject to a variety of court-ordered remedies, including orders to comply with the original undertakings or revised undertakings, to divest the Canadian business or to pay monetary penalties.

## NET BENEFIT REVIEW PERIOD

- Within 45 days of receiving an application for review, the relevant Minister must indicate whether the investment is likely to be of net benefit to Canada. This period may be unilaterally extended by the Minister for a further 30 days, which is common. Additional extensions can occur only with the investor's consent, although such consent is typically provided.
- If the Minister gives notice that they are not satisfied that the transaction is likely to be of net benefit to Canada, the investor then has 30 days (or more on consent) in which to make further representations to the Minister.

## FILING FEES

- There are no fees for filing either notifications or applications for review under the ICA.

## NATIONAL SECURITY REVIEW

- Regardless of whether an investment is subject to a net benefit review, the ICA provides for the review of investments that “could be injurious to national security.”
- The Minister of Innovation, Science and Industry has broad discretion to subject a proposed investment by a non-Canadian to a national security review.
  - > The expression “national security” is not defined in the ICA and there are no monetary thresholds that must be exceeded to trigger a national security review.
  - > There is no requirement that there be an acquisition of control of a Canadian business. A national security review could be ordered whenever there has been an acquisition “in whole or in part” of a Canadian business.
- The Minister has until 45 days after the filing of a notification or an application for net benefit review to issue a notice to a non-Canadian that its investment may be subject to a national security review (alternatively, a national security review can be initiated within the same time period without such a notice first being sent). For transactions not subject to notification or net benefit review (and that are not voluntarily notified), the timeframe for the Minister to issue such a notice extends to five years after implementation of the investment.



- > In the absence of a pre-closing review for net benefit to Canada, parties seeking greater regulatory certainty with respect to a potential national security review increasingly choose to file a notification or engage with the government well in advance of closing. If a transaction is not technically subject to a notification requirement under the ICA (e.g., certain minority acquisitions), investors may voluntarily file a notification to trigger the ICA's national security screening and review process.
- > While the decision to file a notification pre- or post-closing currently rests with the investor, a bill currently before Parliament would introduce a mandatory pre-closing notification and screening regime for investments in Canadian businesses falling within (yet to be defined) sensitive sectors.
- Once the Minister issues a notice that an investment may be subject to a national security review (or once a national security review has been ordered if no such notice was first sent), if the investment has not yet been implemented, it cannot be implemented unless the investor receives notice of a discontinuance of the national security review or, following a national security review, it is determined that the investment will not be injurious to national security.
- If, following a national security review, the Minister is satisfied that the investment would be injurious to national security, the federal Cabinet may take any measures that it considers advisable to protect national security, including imposing conditions on the investment or prohibiting a proposed investment outright (or ordering a divestiture in the case of a completed investment). The entire review process can take up to 200 days or more.
- Since the national security review regime was introduced in 2009, the Canadian government has initiated more than fifty formal national security reviews. The number of national security reviews and the number of notices of potential national security reviews have increased steadily in recent years (reaching a total of 24 in 2021/22). While the government has used its authority to block or unwind transactions because of national security concerns in only relatively few instances, these instances have been increasing. In some cases, transactions have been permitted to proceed subject to divestitures or the investor agreeing to meet certain conditions. In yet other cases, transactions were apparently discontinued or never proceeded because of national security concerns, although formal proceedings were never taken.
- The discretionary nature of the national security review provisions, including the lack of definition of “national security” and the potentially long time frames for review, has introduced uncertainty into the application of the ICA to certain foreign investments in Canada. The *Guidelines on National Security Review of Investments* (National Security Guidelines) provide some public information on how the national security review provisions are administered and include a non-exhaustive list of factors that may give rise to a national security order, such as whether the investment is likely to
  - > impact national defence capabilities;
  - > enable espionage;
  - > impact critical infrastructure or the delivery of critical goods and services to Canadians; or
  - > involve access to sensitive personal data, sensitive technologies or critical minerals.

- The federal government has also made a series of recent policy announcements identifying particular types of investors and/or sectors that are more likely to give rise to potential national security concerns, specifically:
  - > foreign investments in Canadian businesses related to public health, as well as all investments by foreign state-owned investors, will be subject to “enhanced scrutiny” under the ICA in general;
  - > foreign investments, regardless of value, with ties to an individual or entity associated with, controlled by or subject to influence by the Russian state will support a finding by the Minister that there are reasonable grounds to believe that the investment could be injurious to Canada’s national security (i.e., there will be grounds to conduct enhanced national security screening or to commence a national security review); and
  - > investments by a foreign state-owned enterprise (or foreign-influenced private investor) involving a Canadian business or entity operating in a critical minerals sector in Canada will support a finding that there are reasonable grounds to believe the investment could be injurious to national security. This policy applies to critical minerals investments regardless of value, whether direct or indirect, whether controlling or non-controlling, and across all stages of the value chain (e.g. exploration, development and production, resource processing and refining, etc.). Shortly after issuing its critical minerals policy, the government announced that it had ordered three Chinese mining companies to divest minority investments in Canadian critical minerals companies.
- In 2022, the government disclosed that, in the context of a national security review of a transaction in the forest products industry that was not subject to a net benefit review, the foreign investor provided commitments that included ensuring strong levels of investment in facilities in the Province of Quebec, maintaining existing Canadian patents, maintaining Canadian participation on the acquired company’s board and senior management and adhering to Canadian employment and environmental laws. The scope of these commitments (involving matters that have in the past been addressed in net benefit reviews) suggests the potential for expansive national security reviews beyond typical national security considerations.
- The Minister provides information on the national security review process, as well as high-level data relating to transactions reviewed under the national security provisions, in annual reports that are made available online. The annual reports provide, among other things, information about investor country of origin, target business industry and the kinds of mitigation measures that were considered in relation to investments that have been subject to national security review. In addition, since October 2022, the government’s policy is to announce all final decisions that involve an order to block or divest an investment, or allow an investment to proceed only on the basis of mitigation measures.

## PROPOSED AMENDMENTS TO THE NATIONAL SECURITY REVIEW PROCESS

- In December 2022, the federal government introduced draft legislation that would make significant changes to the ICA’s national security regime, including: a new pre-closing notification filing regime for investments in certain (yet-to-be) prescribed sensitive sectors;

stronger penalties for non-compliance with the ICA; expanded decision-making powers at the Ministerial (as opposed to Cabinet) level to extend national security reviews, impose conditions during a national security review and accept undertakings to mitigate national security risk; expanded ability to share information obtained during the national security review process with international counterparts; and new rules for the protection and use of sensitive information (e.g., classified materials) in legal proceedings arising from enforcement under the ICA.

## Other Foreign Ownership Restrictions

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- In addition to the generally applicable provisions in the ICA, there are also specific restrictions on foreign ownership applicable to certain industries, such as airlines, telecommunications, broadcasting, newspapers, magazines and periodicals.

# Selected Canadian Tax Issues in M&A Transactions

# Acquirer Considerations

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## CANADIAN BIDCO

A foreign acquirer will typically establish a Canadian company (Bidco) to effect a Canadian acquisition for the following reasons:

- > To permit the deduction of financing expenses against target income;
  - > To allow the repatriation of funds from Canada to the foreign parent free of Canadian withholding tax; or
  - > To accommodate a “bump” or “step-up” of the tax cost of the target’s non-depreciable capital assets under Canada’s tax bump rules where available.
- In Canada there is no tax consolidation within a corporate group. For financing expenses to be deductible against the target’s earnings, Bidco should be the borrower and it should merge with the target on or after the acquisition. Further structuring will be required when the target has a holding company structure, with taxable income being earned in lower-tier entities.
  - A Canadian corporation that is not a public corporation may return paid-up capital to a non-resident shareholder free of the Canadian withholding tax that applies to dividend payments by passing a shareholder resolution. A public corporation may also be able to make tax-free return of capital payments in certain limited circumstances. There is no requirement that earnings be distributed before paid-up capital is returned. Typically, Bidco’s paid-up capital will exceed the target’s historical paid-up capital, allowing for greater returns of capital. Foreign tax considerations will be relevant in considering whether this provides overall tax savings.
  - In qualifying circumstances, a merger of Bidco and the target will permit the tax cost of the target’s qualifying non-depreciable capital property (such as shares of subsidiaries and land, but not buildings or resource properties) to be bumped or stepped up to fair market value at the time control is acquired.
    - > This will allow greater flexibility in dealing with assets in post-acquisition planning (see Bump and Associated Planning below).

## FINANCING CONSIDERATIONS

- There is generally no Canadian withholding tax on interest paid to non-resident lenders that deal at arm’s length with the borrower for tax purposes, provided that the interest is not participating interest or part of a back-to-back arrangement with a non-resident that does not deal at arm’s length with the Canadian borrower.

- Interest paid to non-arm’s-length non-residents is subject to Canadian withholding tax at the rate of 25%, subject to a reduction when a Canadian tax treaty applies. Interest paid to non-arm’s-length persons entitled to the benefits of the Canada–U.S. tax treaty is not subject to withholding tax, provided the interest is not contingent interest (as defined in the Canada–U.S. tax treaty).
- Dividends paid to non-residents are subject to withholding tax at the rate of 25% unless a Canadian tax treaty applies. Typically, tax treaties reduce the rate to 15%, or to 5% for shareholders that are corporations owning at least 10% of the dividend payer’s voting shares.
- Thin capitalization rules deny the deduction of interest paid by Canadian corporations to specified non-residents to the extent that it relates to debt owing to specified non-residents that exceeds 1.5 times the relevant equity. Similar rules apply to partnerships, trusts and non-resident entities carrying on business in Canada.
  - > Under these rules, up to 60% of the acquirer’s equity can be invested as shareholder debt, generating tax deductions in Canada.
    - Essentially, a “specified non-resident” is (i) a non-resident that holds 25% or more of borrower’s shares (by votes or value), either alone or with non-arm’s-length persons and taking into account rights in respect of shares, or (ii) a non-resident that does not deal at arm’s length with a shareholder with such a shareholding.
    - In general, only debt that is owed to specified non-residents is taken into account, so arm’s-length deal financing typically does not affect thin capitalization limits.
    - An anti-avoidance rule may apply to “back-to-back” loans when a specified non-resident provides credit support to a third party that lends funds to the Canadian corporation. These rules are intended to prevent the use of accommodation party financing to skirt the thin capitalization rules, but the rules also limit the ability of corporate groups to funnel financing through entities located in jurisdictions with favourable tax treaty rates.
    - Relevant equity is computed as the total of (i) paid-up capital and contributed surplus that is attributable to specified non-resident shareholders, and (ii) retained earnings.
    - Interest that is not deductible because of the thin capitalization rules is treated as a dividend for withholding tax purposes.
    - The payment of dividends or returns of capital by the Canadian corporation will reduce its relevant equity for thin capitalization purposes (although the payment of a dividend that increases a deficit has no effect). Accordingly, careful planning is required.
- The Excessive Interest and Financing Expenses Limitation (EIFEL) rules are expected to apply to taxation years beginning on or after October 1, 2023, to generally limit the deductibility of net interest and financing expenses of corporations and trusts to a fixed percentage of EBITDA. For taxation years that begin on or after January 1, 2024, the limitation will be equal to a fixed percentage of 30% of EBITDA.
- Certain public-private partnerships, small Canadian-controlled private corporations and entities with less than \$1 million of net interest and financing expenses may be exempt from the EIFEL rules. A limited exemption may also be available for Canadian resident entities that, in general

terms, have no material non-Canadian assets or activities and have no material (25% or greater) shareholders.

- While the EIFEL rules conceptually overlap with the thin capitalization rules, as described above, the thin capitalization rules apply first in priority to the EIFEL rules. Consequently, any amounts for which a deduction is denied by application of the thin capitalization rules will be excluded from a taxpayer's interest and financing expenses for the purposes of the EIFEL limitation.
- If the Canadian target derives significant value (generally more than 75%) from interests in foreign subsidiaries or other foreign corporations, a Canadian Bidco that is controlled by a nonresident corporation will be subject to additional restrictions under the "foreign affiliate dumping" rules intended to prevent "debt-dumping" into the Canadian corporate group or the synthetic extraction of Canadian group surpluses.
  - > Where they apply, these rules can result in a reduction of cross-border capital or a deemed dividend subject to withholding tax.
- The foreign affiliate dumping rules will also apply to any Canadian corporation that is controlled by a non-resident corporation that invests in foreign subsidiaries. Extremely careful planning is required for both the initial capitalization of Bidco and any additional post-acquisition funding or expansion of foreign operations.

## **BUMP AND ASSOCIATED PLANNING**

- Following the acquisition of control and merger of Bidco and the target, it may be possible to step up (or bump) the tax cost of qualifying non-depreciable capital properties such as shares and land owned by the target at the time control is acquired.
- Bidco must acquire 100% of the target to undertake a bump (i.e., control alone is not sufficient).
- A bump is particularly desirable when target assets are to be sold or when target assets include shares of foreign subsidiaries that are to be transferred within the purchaser's corporate group to optimize the group structure.
  - > The foreign affiliate dumping rules referred to above may place a premium on transferring the target's foreign subsidiaries out of Canada to a location elsewhere in the purchaser group.
- The bump provisions contain extensive rules to prevent the bump from benefiting selling shareholders of the target. These provisions impose significant limitations on transferring target assets or property that derives its value in whole or in part from target assets to selling target shareholders (individually or as a group).
- The amount of "bump room" available is largely dependent on the cost of target shares to Bidco. When a rollover is provided to selling shareholders to defer their tax on sale, the amount of bump room will be reduced.
  - > However, the bump can be applied selectively to target assets, meaning that a fully taxable purchase is often not necessary to accommodate selective bump planning.

- The bump works best in an all-cash bid, but it can also work in circumstances in which the consideration includes Bidco shares. Selling shareholders cannot acquire exchangeable shares (see below) or shares of a foreign parent (unless the value of the target represents less than 10% of the total value of the foreign parent).
- In a friendly transaction, the target may agree to reorganize its assets before control is acquired to accommodate the bump (e.g., by transferring a division or business to a subsidiary on a tax-deferred basis). However, it is not possible to reorganize into partnership structures in contemplation of a bump transaction.

### TARGET CONSIDERATIONS

- The acquisition of control of the target will result in a number of tax consequences to the target and its Canadian subsidiaries.
- Generally control is *de jure* control (i.e., acquisition of sufficient target voting shares to elect a majority of the target's board of directors). The *General Anti-Avoidance Rule* will need to be considered in relation to structures intended to avoid triggering an acquisition of *de jure* control but provide significant economic and legal rights to an acquirer. Acquisition of control of the target will also cause an acquisition of control of the target's controlled Canadian subsidiaries.
- The acquisition of control results in a taxation year-end.
- The target will be required to realize any accrued losses on depreciable and non-depreciable capital assets, inventory and accounts receivable in the taxation year ending on the acquisition of control.
- Capital losses and non-capital losses from “property sources” (e.g., from making loans or earning interest or dividends) for pre-acquisition of control periods (including any arising on acquisition of control writedowns) do not survive the acquisition of control.
- Pre-acquisition of control non-capital losses from a business (including any arising on acquisition of control writedowns) may be carried forward on a restricted basis. Following the acquisition of control, they will be deductible if the business giving rise to the loss is carried on with a reasonable expectation of profit throughout the taxation year in which the loss is to be deducted, and against income only from that business and similar businesses.
- Pre-acquisition of control losses can be used to selectively step up the tax cost of target assets, providing an opportunity to use losses that otherwise would not survive the acquisition of control or that would be less useful as a result of acquisition of control restrictions.

### REPORTING OBLIGATIONS

- New mandatory disclosure rules, which became law in June 2023, generally require corporations and other taxpayers and, in certain circumstances, their legal and other advisors to promptly report “reportable transactions.”



- “Reportable transactions” are tax avoidance transactions that have one of the three following “hallmarks”: (i) the fees of the advisor or promoter are based or contingent upon a resulting tax benefit or attributed to the number of participants or those offered an opinion or advice; (ii) the advisor or promoter has “confidential protection” (i.e., participants have a legal obligation not to disclose the transaction to third parties, including the tax authorities); and/or (iii) any person, advisor or promoter receives “contractual protection” (i.e., any direct or indirect form of insurance against the tax risk of the transaction).
- Certain corporations with assets of at least \$50 million must report any uncertain tax positions reflected in their audited financial statements.
- Penalties for non-disclosure can be significant and the limitation period of reassessment of taxes will not commence where there has been a failure to report.

## Shareholder Considerations

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### DISPOSITION OF TARGET SHARES

- The disposition of shares to the acquirer is typically a taxable transaction to the shareholder.
  - > Canadian residents include 50% of any capital gain in their income.
  - > A non-resident is typically not subject to Canadian tax on the disposition of publicly listed shares unless at any time in the previous 60 months the non-resident (taking into account non-arm’s-length persons and certain partnerships) held 25% or more of shares of any class of the target and, at that time, the shares derived more than 50% of their value from Canadian-situated real property (including oil and gas and mineral properties).
- Tax deferral can be provided to selling shareholders when the consideration includes equity of a Canadian corporation.
  - > On a share-for-share takeover bid, when a Canadian corporate acquirer (Bidco) issues treasury shares to the selling shareholders, there is an automatic tax deferral for most shareholders dealing at arm’s length with Bidco.
  - > When consideration includes both treasury shares and cash or other assets, tax deferral is available by joint election of the selling shareholder and Bidco up to the extent of the value reflected in the Bidco shares.
    - In both of these cases, Bidco will inherit a lower tax cost in the target shares, which may be disadvantageous in some circumstances, such as when a bump is planned.
    - No tax deferral is available when shares of the Canadian target are exchanged for shares of a foreign acquirer or when a subsidiary delivers shares of its parent as consideration.
    - When consideration would otherwise include publicly listed shares of a foreign acquirer, tax deferral may be achieved through the use of “exchangeable shares.” Bidco would

issue treasury shares to target shareholders on a tax-deferred basis that “track” to the publicly listed shares. Generally, the exchangeable shares have dividend and liquidation rights that match the listed parent shares and the target shareholders are provided with voting rights at the foreign parent. The shares may be exchanged by the holder on a one-for-one basis for the listed parent shares. Generally, the tax will be deferred until the Bidco shares are exchanged for the listed parent shares.

- Exchangeable shares cannot be used when the acquirer is planning to use the bump unless it can be concluded that the value of the target will at all times during the series of transactions be less than 10% of the total value of the foreign parent.
- Dividends on exchangeable shares must be paid out of taxed earnings otherwise the issuer will be subject to a penalty tax. However, variations of the exchangeable structure can be considered to solve this issue when material dividends are expected.

### EMPLOYEE STOCK OPTIONS

- Generally, when a stock option is exercised, the difference between the strike price and the fair market value of the option at the time it is exercised is included in the employee’s income as a taxable benefit. Employees are generally able to access preferential personal income tax treatment on qualifying stock options by claiming an offsetting deduction equal to 50% of the benefit.
- For stock options granted after June 30, 2021, the 50% deduction may be limited to the extent that the fair market value of the securities under the options exceeds \$200,000 at the time the options are granted.
- Provided that an employer complies with certain notification requirements, the portion of the deduction that is denied to the employee is deductible by the employer in that year.
- The stock option rules do not apply to Canadian-controlled private corporations (CCPCs) or non-CCPC employers with consolidated group revenue of \$500 million or less.

### SAFE INCOME PLANNING

- Intercorporate dividends between Canadian companies are tax-free in many cases.
- Dividends paid by the target to a corporate shareholder in advance of a sale may reduce the shareholder’s capital gain on the sale. However, the dividend can be recharacterized as a capital gain when it exceeds the shareholder’s “safe income.”
- Safe income often approximates the target’s taxed retained earnings on hand that accrued during the shareholder’s holding period, on a consolidated basis.
- A dividend to all shareholders to access safe income planning is usually not possible or desirable (e.g., withholding tax for non-resident shareholders).

- Very significant taxable Canadian shareholders of the target may access safe income to step up the cost of their shares as part of the sale transaction. Typically this involves the acquirer purchasing the shares of a holding company that has been established by the corporate shareholder that holds only target shares. The shareholder will have used the safe income to step up the tax cost of the holding company shares without involving the target's other shareholders.

## MERGERS (AMALGAMATIONS)

- On a merger, target shareholders who receive only shares of the amalgamated company or its Canadian parent can have a complete deferral of tax, provided that all target shareholders receive only shares of the amalgamated corporation or its Canadian parent in exchange for their target shares.
- When consideration includes cash or other non-share consideration, two steps are required to fit within the Canadian tax-deferred merger rules: redeemable preferred shares are issued on the amalgamation followed by immediate redemption of those shares for other consideration. This is often done through a plan of arrangement to allow immediate execution.
- Redemption of the transitory shares can give rise to a deemed dividend (withholding tax for nonresidents) or a capital gain, however, depending on the circumstances, it is often possible to plan for either outcome.
- The 2023 federal budget introduced draft legislation to implement a new 2% tax on share buybacks (the “Buyback Tax”). As drafted, the Buyback Tax is expected to apply to share repurchases (including the redemption of transitory shares as described previously) that occur on or after January 1, 2024. The Buyback Tax will generally be equal to 2% of a specified entity's net repurchases of equity each taxation year.
- The Buyback Tax will not apply to repurchases occurring under a defined category of “reorganization or acquisition transactions.” This would generally include equity repurchased, redeemed or cancelled in the course of amalgamations or equity exchanges whereby a holder receives only equity consideration, windings-up and so-called butterfly transactions. Several common types of transactions would fall outside the reorganization exception and be subject to the Buyback Tax (including, for example, common “squeeze out” transactions and shares repurchased under both substantial issuer bids and normal course issuer bids).
- An amalgamation will often result in an acquisition of control of the target, with the consequences described above.

## SPINOFFS

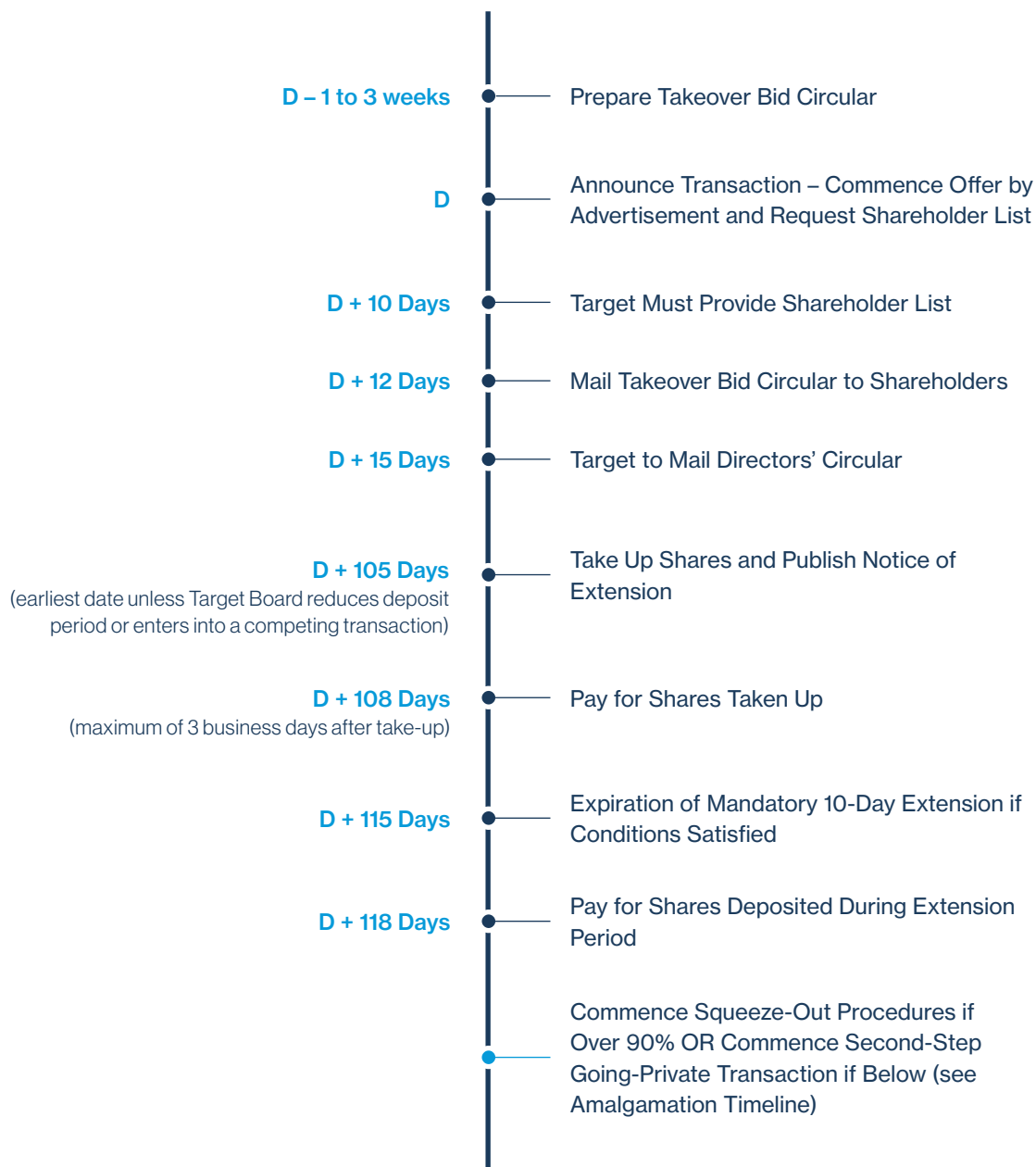
- In Canada, a tax-deferred spinoff is available only in limited circumstances.
- When a spinoff qualifies, deferral is available to the company effecting the spinoff and its shareholders.

- Acquisition of control of a company undertaking a spinoff (or of the subsidiary spun off) as part of the series of transactions that includes the spinoff results in loss of tax deferral.
- Typically, a spinoff is effected only with the benefit of the advance income tax ruling from Canadian revenue authorities.

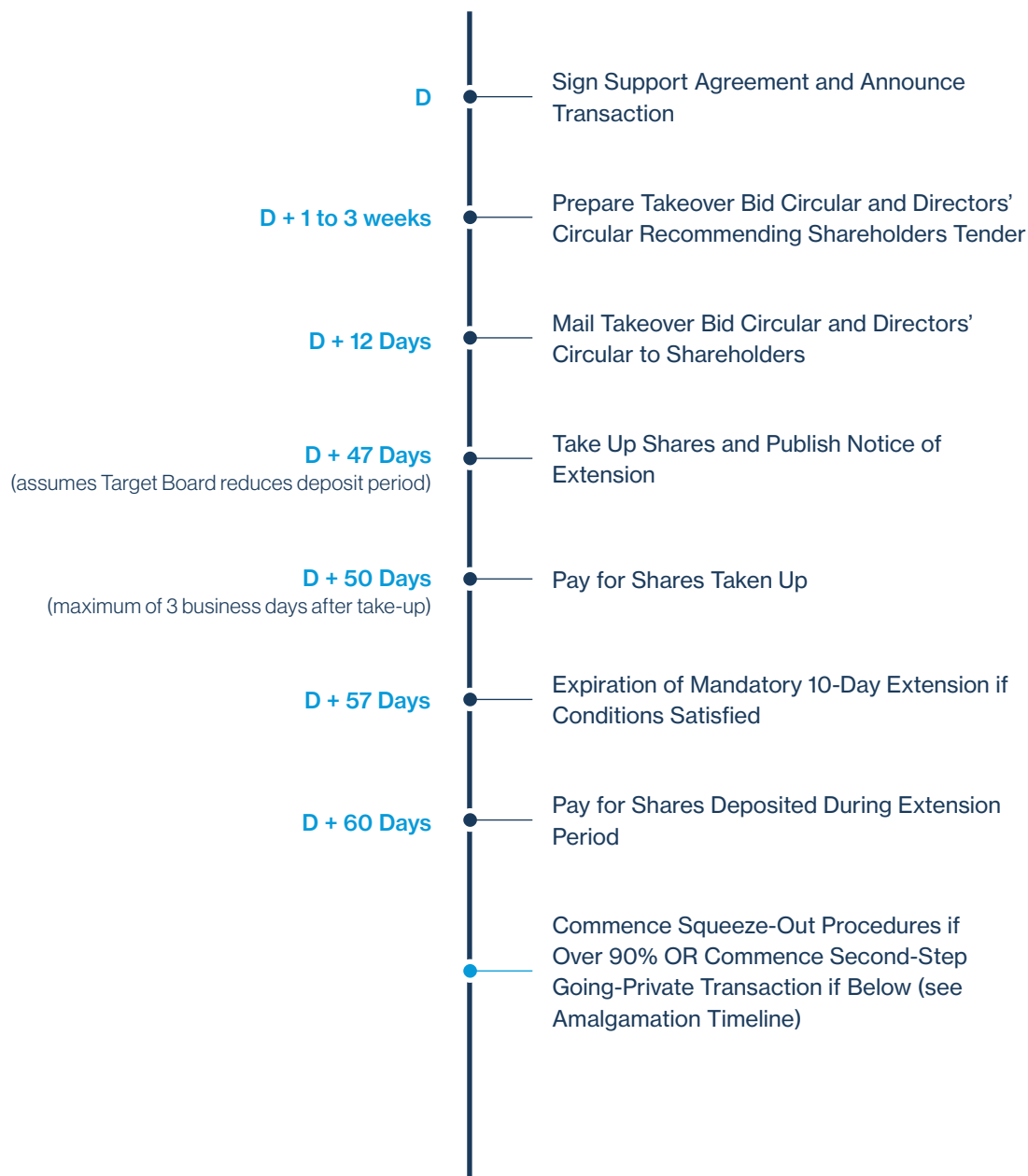
## SPINOUTS

- When the acquirer wishes to spin out certain target assets to the selling shareholders (e.g., exploration stage resource assets in a more mature company), the assets can be packaged in a new company and the shares of that company spun out to shareholders as part of the acquisition.
- The target will realize any gain in the assets being spun out.
- The spinout can be a reduction of capital to shareholders when the target has sufficient capital. The reduction of capital will not be taxable, but will increase the gain on a sale of target shares.
- Spinouts typically involve a number of intermediary steps and are undertaken in connection with a plan of arrangement.

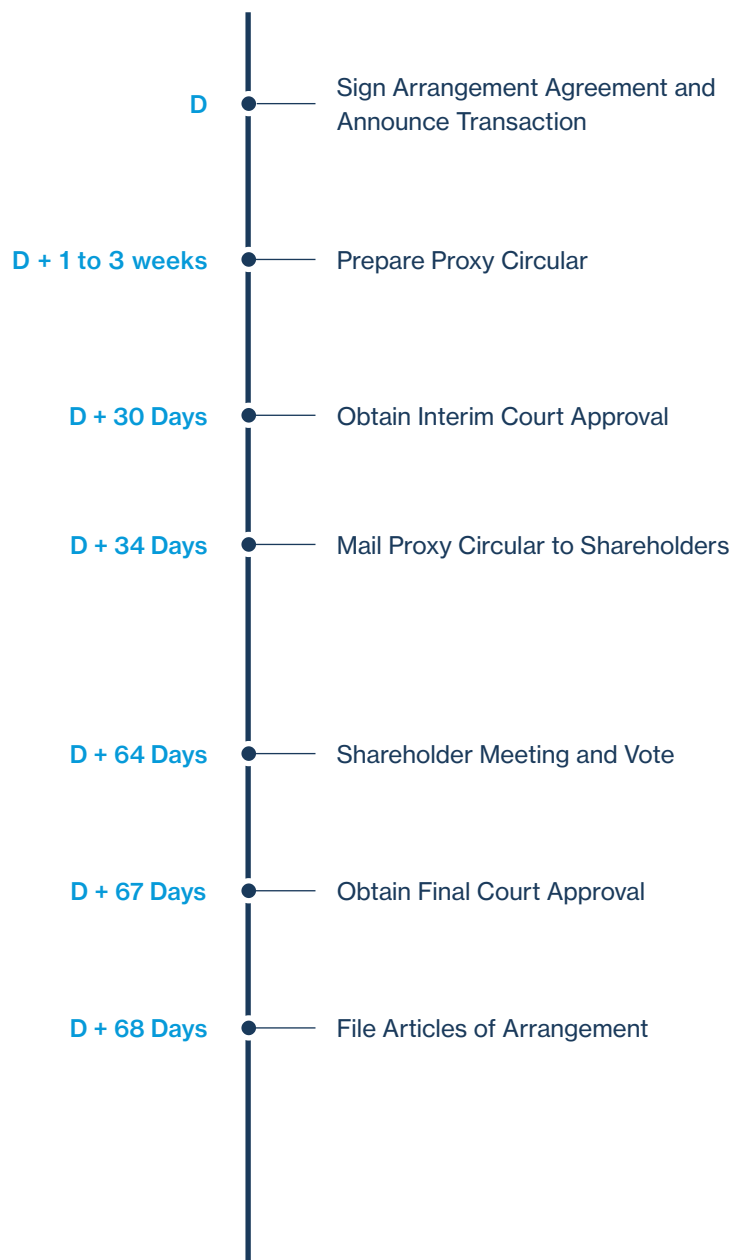
## Takeover Bid Timeline – Unsolicited



## Takeover Bid Timeline – Friendly

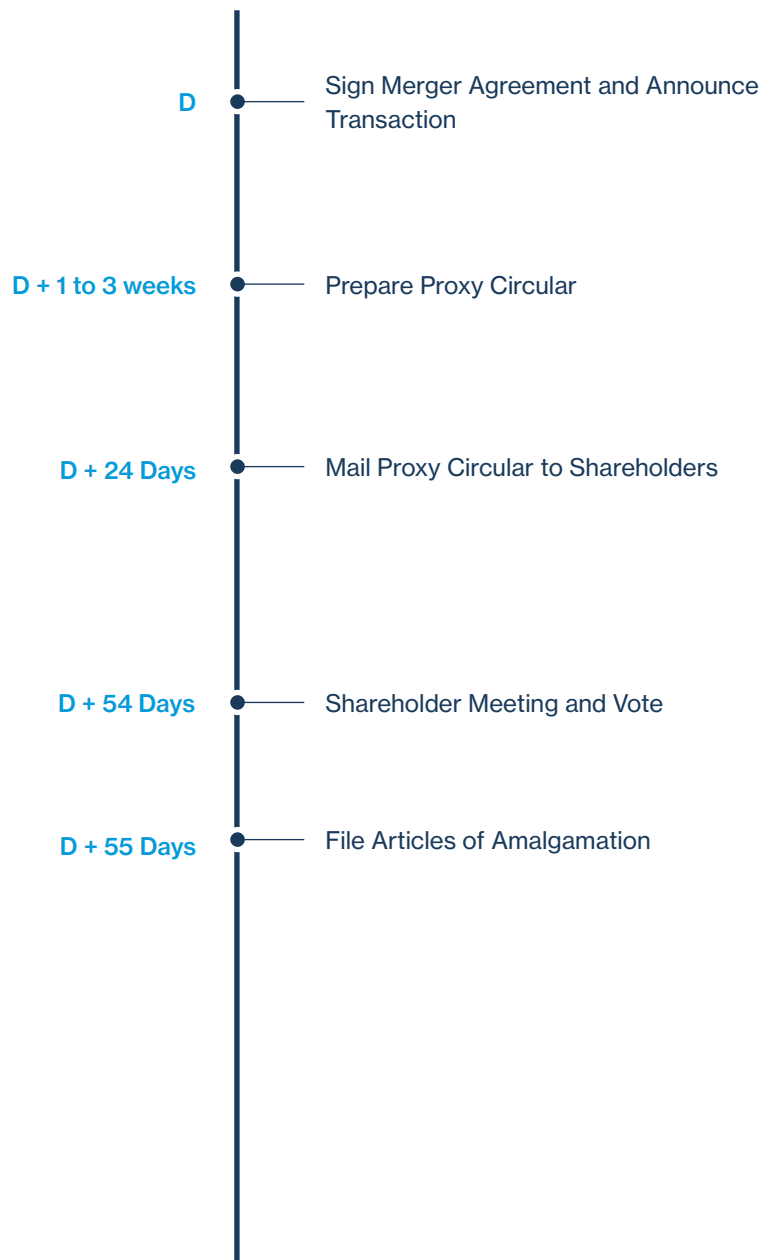


## Plan of Arrangement Timeline



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# Amalgamation Timeline





# Key Contacts

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For assistance with your M&A matters, contact one of our M&A partners below or visit our website at [www.dwpv.com](http://www.dwpv.com).

The information in this publication should not be relied upon as legal advice. We encourage you to contact us directly with any specific questions.

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# About Davies

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Davies is a leading Canadian business law firm focused on high-stakes matters. Tackling our clients' issues with clarity and speed, we are consistently at the heart of their most complex deals and cases. With offices in Toronto, Montréal and New York, we are recognized as a top-tier firm in each of our core practice areas. Visit us at [www.dwpv.com](http://www.dwpv.com).



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