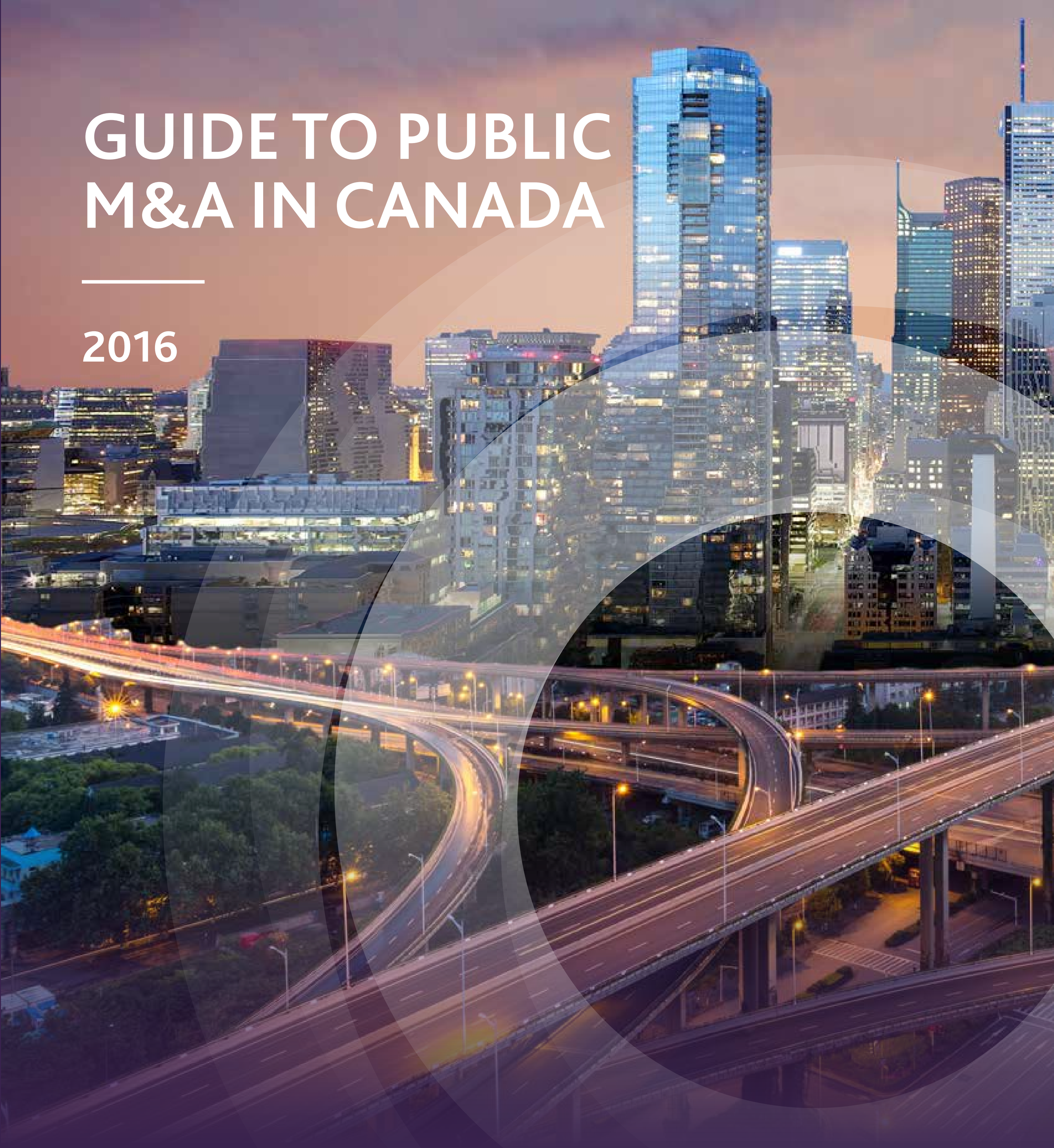
GUIDE TO PUBLIC M&A IN CANADA

2016



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Disclaimer: This guide is current as of September 2016 and is for general information purposes only. It does not constitute a legal opinion or other professional advice. Public M&A transactions in Canada are subject to detailed regulation and should be undertaken only with qualified legal counsel.

All currency references are in Canadian dollars unless otherwise stated.

GOWLING WLG AT A GLANCE

Gowling WLG is an international law firm built on the belief that the best way to serve clients is to be in tune with their world, aligned with their opportunity and ambitious for their success. Around the globe, our 1,400-plus legal professionals and dedicated business support teams do just that. We bring our deep sector expertise to understand and support clients' businesses, and see the world through their eyes.

Gowling WLG clients have access to expertise in key global sectors and a suite of legal services. Combined with our presence in 18 cities worldwide and specialized expertise in countries around the globe, we're positioned to help clients achieve their objectives, wherever their business takes them. We're proud to be recognized as a top employer, and actively encourage diversity and inclusion in our workplaces.

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OUR M&A TEAM

Mergers and acquisitions can be complicated. Getting the right legal advice shouldn't be. At Gowling WLG, our team of top-tier M&A lawyers are at the forefront of their field — in Canada and internationally — with a proven track record of working side-by-side with our clients to get the best deals done. We do this by combining our legal knowledge and strategic acumen with an in-depth understanding of your business and sector. However you define it, your success is our ultimate goal.

INDUSTRY RECOGNITION

Chambers Canada 2017
42 lawyers recognized across 23 practice areas

Busiest Law firm for Canadian M&A 2014, 2013, 2012
Gowling WLG (Canada) has been ranked as the busiest Canadian M&A law firm by Thomson Reuters, advising on more Canadian M&A deals that any other law firm in 2012, 2013 and 2014

Canadian Legal Lexpert Directory 2016
289 rankings across 49 areas of law, including Corporate Finance & Securities, Corporate Mid-Market, M&A and Private Equity

Who's Who Legal: Canada 2016
29 listings across 22 areas of law, including Capital Markets and M&A

INTRODUCTION

This Guide to Public M&A in Canada was developed by Gowling WLG to provide business executives, foreign counsel and investors with a guide to planning and executing their public M&A transactions in Canada.

This guide is current as of September 2016 and is for general information purposes only. It does not constitute a legal opinion or other professional advice.

If you are planning a public M&A transaction in Canada, it is highly recommended that you seek detailed and specific advice from experienced professionals. Public M&A transactions in Canada are subject to detailed regulation and should be undertaken only with qualified legal counsel.

To learn more about public M&A transactions and the range of services that Gowling WLG provides, please visit us at:

gowlingwlg.com/MA-canada

CANADIAN PUBLIC M&A FREQUENTLY ASKED QUESTIONS

This guide answers many frequently asked questions we receive from our international clients as they look at acquiring Canadian public companies or their assets.

Canadian Public M&A is straightforward

- Mergers and acquisitions with Canadian companies can be straightforward and can be accomplished quickly and efficiently.
- Government approvals are limited. If an approval is required, in most cases it is routinely granted.
- Canada is a business-friendly environment and consistently ranks highly as a place to do business.

PLANNING A PUBLIC M&A TRANSACTION

We would like to acquire 100 per cent of a TSX-listed company. Can we buy some of the target's stock in the market (called a "toehold") before we make our approach? How much of a toehold can we acquire?

Yes, acquisition of a toehold is permissible, subject to some limitations. The take-over bid rules (discussed below) do not come into play until the acquirer accumulates 20 per cent or more of the target's voting or equity securities or securities convertible into voting or equity securities (collectively "equity shares"). Acquirers sometimes accumulate a toehold to: (i) lower the overall purchase price for the target (the acquirer avoids paying a premium for shares purchased in advance of a formal offer); (ii) establish an edge against a competitive bidder; and/or (iii) provide a gain if the target is lost to a competitor at a higher price.

Will we have to publicly report our toehold?

Canadian securities laws require "early warning" public disclosure of holdings of 10 per cent or more of any class of the target's equity shares. Additional public disclosure is required for accumulations of 2 per cent or more thereafter. Accumulations of a toehold under 10 per cent would not require disclosure under Canadian laws (unless the target is already the subject of an ongoing take-over bid or sale transaction, in which case the disclosure threshold is reduced to 5 per cent). (Note that U.S. laws, when applicable, always require early warning disclosure at 5 per cent.) Typically, an acquirer may accumulate a toehold that is just below the disclosure level in order to prevent speculation about a possible bid (and possible upward price movement) before it is made.

Are there any disadvantages to acquiring a toehold?

Acquiring toehold stock can potentially impact the bid price. Subject to an exemption for certain normal course purchases through a stock exchange, the highest price that the acquirer pays for the securities of the target within 90 days of launching a take-over bid (including the cash value of any non-cash consideration paid for such securities) sets the floor for the lowest price that the acquirer is permitted to offer to shareholders under a take-over bid (the "pre-bid integration rule"). Similarly, the minimum percentage of outstanding target securities subject to the bid must be equal to the highest percentage of outstanding target securities purchased from any one shareholder in the 90 days prior to a bid.

What is the significance of the 20 per cent threshold? Can we avoid it through affiliates or in side deals?

An acquirer cannot accumulate more than 20 per cent ownership of a class of equity shares unless the offer to acquire securities is made to all of the holders of the class. Outside of an offer made to all of the holders of a class, accumulations in the secondary market over 20 per cent can only be made under limited exceptions (see below). Side deals are not an effective means to avoid crossing the threshold. Canadian securities laws contain anti-avoidance provisions, the effect of which is to include in the calculation of whether the 20 per cent threshold has been met (and whether the 10 per cent threshold for the early warning disclosure mentioned above has been met): shares and convertible securities owned directly, or indirectly, through affiliates or nominees; and shares owned by persons or companies acting jointly or in concert with a bidder under an agreement, commitment or understanding.

How can we find out information on the target or about the target's major shareholders?

Publicly disseminated information about Canadian public companies, including early warning reports filed by shareholders who hold more than 10 per cent of the company's outstanding equity shares, is posted online at www.sedar.com. In addition, insider reports that provide current trading information for large shareholders and other Canadian public company insiders, such as directors and officers, can be found online at www.sedi.ca.

Can we negotiate directly with major shareholders? Can we buy a large stake from a major shareholder group without having to make an offer to all shareholders?

Yes, subject to specific rules, if a target has several large shareholders, it is possible to negotiate a private sale for their shares. In certain circumstances, a "control block" (over 20 per cent) may be purchased by an acquirer without making an offer to all shareholders, thus enabling a large stake to be acquired at one time rather than through a gradual build up in the market. These rules require that there not be more than five sellers, and that the value of consideration paid not exceed 115 per cent of market price (determined as prescribed).

In circumstances where 100 per cent ownership of the target is the objective, an acquirer will often negotiate a "lock-up" agreement with major shareholders and, in a friendly transaction, with the directors and officers of the target. Under a lock-up agreement, the major shareholder(s) agree to tender their securities to the acquirer's offer. In a "hard" lock-up, the shareholders agree to sell their securities to the acquirer no matter what. In a "soft" lock-up, the shareholders may sell their securities to a competing superior offer in certain circumstances. The majority of lock-up agreements in Canada are "soft."

Should we launch a surprise bid ("unsolicited bid") or should we approach the target board of directors in a "friendly" transaction?

Although friendly bids are more common, unsolicited bids are acceptable and cannot, in most circumstances, be blocked indefinitely by a target's board of directors from consideration by the target's shareholders.

An unsolicited bid would typically be made with no access to confidential information (i.e., due diligence has to be based on the public record only). In a friendly transaction, the target will typically allow an acquirer to conduct due diligence prior to launching a bid, but will typically require that the acquirer agree to sign a non-disclosure or confidentiality agreement and to refrain from launching a take-over bid for the target's securities for a lengthy period of time, unless the bid has the support of the target's board (a "standstill" agreement). In a friendly transaction, the parties will also negotiate a support agreement that would typically provide the acquirer with a "break fee" if the target's shares are ultimately purchased by another third party making a superior competing offer.

If we already own a large percentage of the target, are there special rules for acquiring additional securities?

Yes, subject to exceptions. A take-over bid launched by a large shareholder (10 per cent or greater) will be considered to be an "insider bid" and the consideration offered in the bid must be supported by an independent valuation unless an exception applies. The exceptions available include circumstances where the large shareholder has had no management representation or representative directors on the target's board in the last 12 months; where the value of the consideration being offered is accepted and agreed to by certain other large arm's-length shareholders; or where the target is the subject of an active auction (i.e., another takeover bid or sale transaction is ongoing).

Do we need to keep our intentions to make a bid secret?

Yes. Canada regulates insider trading and tipping. Information about a potential take-over bid for a Canadian public company could be used by traders for unfair profit. Further, information leaks of a possible bid tend to lead to trading that drives the stock price up to the disadvantage of the acquirer. It is important to manage the process of a take-over bid to protect against information leaks or improper trading by persons privy to confidential information. Once the decision to pursue a potential acquisition transaction in Canada is made, the acquirer's directors, officers, employees, consultants, professional advisers and affiliates should not trade in the target's securities, or tip or advise others to do so. Only the acquirer itself (or its joint actors) may purchase securities in advance of launching a bid.

> "Canada regulates insider trading and tipping"

EXECUTING A PUBLIC M&A TRANSACTION

How are mergers and acquisitions with Canadian public companies typically structured?

There are three main alternatives for pursuing an acquisition of a Canadian-listed company:

- Take-over bid (an offer made directly to shareholders, not necessarily with agreement of the target)
- Amalgamation (a merger with the target, effective upon a filing with a government ministry for routine processing after approval has been obtained at a special meeting of shareholders)
- Plan of arrangement (a merger with the target or acquisition of its shares, with court approval after the shareholders approve the plan of arrangement at a special meeting)

Features of each alternative are outlined in the chart on the next page. The most suitable process for a transaction will depend on a variety of factors and should be discussed with your legal adviser.

Are there any differences to be aware of if the consideration offered includes securities?

There are several factors to take into consideration when an acquirer is offering its securities as consideration or partial consideration for the target's shares. First, any bid circular or information circular will be required to contain "prospectus-level" disclosure regarding the acquirer. This is often accomplished by "incorporating by reference" the acquirer's existing continuous disclosure record into the bid circular or information circular. It should also be noted that a bid circular may be required to be translated into French if the acquirer's securities are being offered to more than a nominal number of shareholders in Québec.

Second, in a transaction involving a share exchange, the acquirer may inherit the target's reporting issuer status and may become subject to Canadian continuous disclosure requirements upon completion of the transaction. For acquirers in several non-Canadian countries including, among others, the United States, the United Kingdom, France, Germany, Australia, South Africa and Spain, the Canadian continuous disclosure obligations can generally be satisfied by filing in Canada the continuous disclosure reports that are filed with the securities regulator in the acquirer's home jurisdiction.

SAMPLE CANADIAN PUBLIC M&A PROCESSES

	TAKE-OVER BID	AMALGAMATION	PLAN OF ARRANGEMENT
OVERVIEW	Acquirer incorporates a Canadian special purpose company to make an offer to acquire securities directly from shareholders.	Acquirer incorporates a Canadian special purpose company to amalgamate with the target ultimately leaving the acquirer as the sole shareholder.	Acquirer incorporates a Canadian special purpose company to amalgamate with the target or acquire its shares ultimately leaving the acquirer as the sole shareholder.
SHAREHOLDER ACTION	Tender securities to the offer.	Vote at special meeting of shareholders.	
TIME PERIOD	At least 105 days (although in a friendly transaction, the target board may shorten to no less than 35 days). If the terms of the bid are amended or the bid is extended, the acquirer will be required to mail a notice of change or variation and the bid will be required to remain open for at least another 10 days. The bid must be extended for at least an additional 10 days after the minimum tender requirement is met and all other conditions are met or waived.	Approximately 60 days.	Approximately 60-90 days.
OTHER APPROVALS	Any applicable regulatory approvals (i.e., Investment Canada, competition, etc.).	Any applicable regulatory approvals.	Court approval of plan of arrangement, plus any applicable regulatory approvals.
ADVANTAGES	Can be the fastest acquisition process. The only process suitable for unsolicited bids. The process is driven by the acquirer. A one-step process if 90% of the target's securities are tendered to the offer.	One-step process. Fewer rules than take-over bids. May be easiest way to achieve 100% ownership.	One-step process. Fewer rules than take-over bids. Greater flexibility for complex acquisitions and permits U.S. acquirers to issue securities without filing a registration statement. Court has significant discretion to address transaction issues, such as the elimination of out-of-the-money convertible securities or debt.
GETTING TO 100% OWNERSHIP	If 90% of the target's securities are tendered to the offer, the acquirer can quickly compel the sale of the remaining shares. If less than 90% but, typically, more than 66 2/3% of the target's securities are tendered, the acquirer may carry out a second-step "squeeze out" transaction if it wishes to eliminate the remaining minority security holders. This second-step transaction must offer the same consideration. This is usually done by an amalgamation, approved at a shareholder meeting and takes approximately 60 days to complete. See "What level of shareholder acceptance is needed for us to achieve 100% ownership?" on p. 12.	Requires approval at special meeting of shareholders. See "What level of shareholder acceptance is needed for us to achieve 100% ownership?" on p. 12.	
DISADVANTAGES	May require a second-step transaction to gain 100% ownership of the target if less than 90% of the target's securities are tendered to the offer.	Process driven by target (with oversight by acquirer). May take significant time to negotiate and complete.	Process driven by target (with oversight by acquirer). Requires court approvals (which can be an opportunity for objection by special interests). May take significant time to negotiate and complete.
MAIN REQUIRED DOCUMENTATION	Take-over bid circular and directors' circular; notice of change (if required); support agreement (if friendly); lock-up agreements (if applicable); information circular (for second-step, if required).	Amalgamation agreement; voting agreements (if applicable); information circular for special meeting of shareholders.	Arrangement agreement; voting agreements (if applicable); information circular for special meeting of shareholders; various court documents.

Third, the sale of a Canadian share will generally be a taxable event for Canadian shareholders, resulting in a gain or loss that must be reported in the year that the sale occurs. However, if the consideration for the sale includes shares of a Canadian corporation, a tax-deferred rollover may be available. Structuring a transaction to facilitate a tax-deferred rollover may be attractive in circumstances where negative tax consequences of the sale would discourage shareholders' approval or acceptance of the transaction, or in circumstances where the acquirer wishes to motivate significant shareholders to approve or accept the transaction. A non-Canadian acquirer may be able to provide a tax-deferred rollover to Canadian resident shareholders through an exchangeable share structure. Exchangeable shares would be issued by a Canadian subsidiary of the acquirer as consideration and would have attributes that effectively mirror the economic rights of the shares of the acquirer. Over a period of time (often five years, subject to negotiation) Canadian shareholders would be permitted to exchange their exchangeable shares for shares in the acquirer, thereby triggering a taxable disposition at a time of their choosing. The circumstances of each transaction will determine whether the additional complexity and administrative requirements warrant the use of a tax-deferred rollover.

Fourth, it should be noted that in friendly, negotiated acquisitions where the consideration involves the issuance of the securities of a U.S. acquirer, the transaction will almost invariably be structured as a plan of arrangement. This is because there is an exemption from the registration requirements of the U.S. *Securities Act of 1933* in respect of securities issued pursuant to a transaction, the fairness of which has been approved by a court, as is the case in a plan of arrangement. Note that this exemption is not available for a securities exchange take-over bid.

What role does the target's board play in the transaction?

The role of the target's board of directors differs depending on the process followed. In an unsolicited take-over bid, the target's board role is more limited. It will issue a recommendation to shareholders in a "directors' circular" regarding the offer, and it will also likely look for competing bids to maximize shareholder value.

In most cases, the shareholders will ultimately be provided with the opportunity to make the decision to either accept or reject the acquirer's offer.

In a "friendly" transaction, the target's board will typically negotiate and sign a "business combination agreement" or "support agreement" where the target and its board commit, among other things, to facilitate the acquisition transaction, make a positive recommendation to shareholders, hold a shareholder meeting to approve the transaction, if applicable, obtain necessary regulatory approvals and, if applicable, pay a break fee if the transaction fails for specified reasons.

Is the target's board of directors required to conduct an auction?

No. Directors owe a fiduciary duty to act in the best interests of the company. While maximizing shareholder value will be of primary concern to directors when a company finds itself as an acquisition target, it is not necessarily the sole concern. In a change of control situation, directors are required to seek the best value reasonably available to shareholders. While it is not mandatory, when considering the best interests of the company, directors may consider the interests of stakeholders other than shareholders, including employees, customers, suppliers, the community at large and others. Many friendly transactions in Canada are consummated without an auction.

What level of shareholder acceptance is needed for us to achieve 100 per cent ownership?

Under a take-over bid, if shareholders holding 90 per cent of the target's outstanding securities (other than those held by the acquirer) accept the offer, then the remaining securities can be compulsorily acquired at the same price in a matter of a few weeks. If the 90 per cent threshold is close to being reached when the bid expires, the acquirer would typically take up the shares tendered and seek additional tenders to reach the threshold during the required 10 day extension period or further extension periods.

Typically, a bid is structured so that an acquirer can accomplish a second-step "squeeze out" transaction when less than 90 per cent of the target's securities are tendered to the offer. A second-step squeeze out transaction will eliminate the remaining shareholders for the same consideration as the bid. The squeeze-out needs approval by:

i. a "special resolution" passed by, typically, 66⅔ per cent of the shares voted in person or by proxy at the meeting (this can include all of the securities held by the acquirer and its joint actors); and
ii. a resolution approved by a "majority of the minority" (that is, more than 50 per cent of the shares voted in person or by proxy at the meeting, excluding the shares owned by the acquirer and its affiliates and joint actors prior to the bid, but including the shares purchased by the acquirer and its joint actors in the take-over bid).

Since the acquirer can vote the shares it acquires in the bid in the minority approval resolution, this second vote only becomes critical when the acquirer launches its bid with a starting point of more than 33.3 per cent of the outstanding shares of the class. Note that shares excluded from the minority vote have the effect of reducing the denominator (thus potentially benefiting the acquirer).

Note, the "squeeze-out threshold" can be up to 75 per cent for certain provincially incorporated companies.

Any securities acquired prior to the launch of a take-over bid: (i) may not be counted towards the 90 per cent threshold; and (ii) may not be voted by the acquirer in favour of a second-step going-private transaction that may be proposed to squeeze out minority shareholders in the event that less than 90 per cent of the equity shares are tendered to a bid. The size of the toehold acquired in advance of a bid must take into consideration an analysis of the various thresholds and approvals required after a bid is completed in order to ensure that the acquirer can successfully purchase 100 per cent of the target's outstanding securities.

If a plan of arrangement or amalgamation structure is used instead of a take-over bid, the approval threshold is the same as previously discussed for a second-step squeeze-out transaction.

Canada has a dissent process where shareholders being squeezed out can dissent from the transaction and demand to a court to be paid fair value. This process is rarely used effectively.

What is the typical "minimum threshold"? What if we do not get to our minimum threshold? What are other typical bid conditions?

As a result of recent changes to Canada's take-over bid regime, the acquirer must specify a minimum number of shares to be tendered to the offer of more than 50 per cent of the outstanding shares that are subject to the bid (excluding shares held by the acquirer itself or its joint actors). The acquirer is not permitted to purchase any of the target's securities unless this minimum threshold condition is met, nor is it obliged to purchase any of the target's securities unless the other bid conditions are satisfied or waived.

More typically, the minimum tender condition specified is two-thirds of the outstanding shares not held by the acquirer or its joint actors in order to assure that the acquirer can move quickly to a second-step transaction to achieve 100 per cent ownership, as discussed above.

It would be a more aggressive bidder that would set the minimum lower — for example, 50 per cent plus one share — in order to eliminate competition and achieve control, but not necessarily with assurance of getting to 100 per cent. The bidder may then be prepared to attempt to acquire the remainder through bid extensions and other measures.

Other typical conditions include the receipt of required regulatory approvals and no material adverse change.

Often an acquirer will extend the bid and/or raise its consideration to reach a successful conclusion.

The only condition that cannot be included in a take-over bid is a financing condition. Financing must be in place before a bid is launched. If the financing itself is conditional, the acquirer must reasonably believe the possibility to be remote that, if the conditions to the bid are satisfied or waived, the acquirer will be unable to pay for the securities tendered to the bid due to a financing condition not being satisfied.

Can we acquire target shares in the market during a take-over bid?

Yes, up to 5 per cent of the target's shares may be acquired in market purchases during the course of a bid. In addition, commencing on the third day following the launch of the bid, additional shares may be purchased in the market so long as you comply with a number of conditions including (i) stating the intention to acquire shares in the market in the take-over bid circular; and (ii) publicly disclosing daily, by press release, the number of securities acquired in the market and the average price paid. An acquirer cannot sell any target shares during the course of a bid (starting from when the acquirer announces an intention to make a bid).

Can we offer different consideration to different shareholders or "side deals"?

Take-over bid rules require all shareholders to be offered the same consideration or the same choice of consideration, and no collateral benefits or "side deals" are permitted with select shareholders. Plans of arrangement and amalgamations are not as restrictive.

Can we make a take-over bid conditional on regulatory approvals required outside of Canada?

Yes, for international acquirers, typical bid conditions include receipt of approvals in other jurisdictions, such as antitrust approvals in the U.S. and elsewhere.

What happens if another offer comes along to compete with ours? How does deal protection work in Canada?

In a friendly transaction, a target will typically agree to refrain from soliciting other offers and to support the offer made by the acquirer. If a competitive bid does emerge, then typically the target's board can only enter into negotiations with and ultimately support a competing offer if it is "superior." Typically, the acquirer will ask for a matching right and a right to a break fee if it loses to a superior offer. The non-solicitation and superior-offer provisions of a support agreement are highly negotiated, with the acquirer attempting to tightly restrict the target's ability to pursue and accept another offer while permitting the target's directors to discharge their fiduciary duties. The target's board will seek as much flexibility as possible without completely hampering deal certainty.

REGULATORY APPROVALS

What typical regulatory approvals are needed for a non-Canadian acquirer to acquire or invest in a Canadian company?

Acquisitions or investments that exceed certain thresholds are subject to notification or review under the *Investment Canada Act* (foreign investment review) and pre-notification under the *Competition Act*.

How does the foreign investment review process apply to a non-Canadian acquirer?

Foreign investment in Canada is regulated by the federal *Investment Canada Act* (ICA). In general, the acquisition of control of an existing Canadian business by a foreign investor is subject to notification or review. Certain aspects of this regulatory regime are discussed below. For more information, please see gowlingwlg.com/GowlingWLG/media/Canada/Guides/DBIC-2016-REGULATION-FOREIGN-INVESTMENT-J.pdf

Acquisition of Control

The ICA contains detailed and complex provisions relating to the acquisition of control of a Canadian business by a foreign investor. To summarize:

- The acquisition of a majority of a corporation's voting shares is deemed to be an acquisition of control.
- The acquisition of less than a majority, but more than one-third, of a corporation's voting shares is considered an acquisition of control - unless it can be established that the acquiring party will not have control in fact of the corporation. For example, a 40 per cent acquisition would not result in control if another shareholder owned the remaining 60 per cent, and a shareholders' agreement limiting the larger shareholder's rights did not exist.
- The acquisition of less than one-third of a corporation's voting shares is deemed to not be an acquisition of control.

Notification

Notification involves the completion of a prescribed form to provide certain information about the foreign investor, the Canadian business and the vendor. It is not an impediment to the closing of an acquisition – in fact, it can be submitted within 30 days of closing and is usually submitted after closing.

Review

Where review is required, the foreign investor must submit more detailed information about itself and comprehensive plans for the Canadian business before closing. Where review is necessary, the foreign investor may only complete the proposed investment if the minister of industry or the minister of Canadian heritage, as applicable, determines it to be of "net benefit to Canada."

Review Thresholds

Thresholds differ depending on the characteristics of the investor and the investment in question. If the review thresholds are not exceeded, the investment is subject to the notification procedure previously described.

The proposed direct acquisition of control of a non-cultural Canadian business by an investor controlled by residents of a World Trade Organization member state (a WTO investor) that is not a state-owned enterprise (SOE) is reviewable if the enterprise value of the Canadian business exceeds $600 million.[1] In our experience, this is by far the most common permutation of foreign investment.

The proposed direct acquisition of control of a Canadian cultural business is reviewable if the book value of the assets of the Canadian business exceeds $5 million. The same threshold applies if the investor is a non-WTO investor and/or an SOE.

Indirect acquisitions of control by WTO resident investors are not reviewable unless they involve the acquisition of a Canadian cultural business, in which case the $5-million threshold applies. The same applies to WTO investors that are SOEs. It should be noted that structuring a transaction for the purpose of avoiding review — e.g., incorporating a corporation outside of Canada, the sole assets of which are the shares of the Canadian corporation, and then purchasing the shares of the foreign corporation — is not permissible.

Different thresholds apply to non-WTO investors and SOEs. In some cases, it may be difficult to determine whether a foreign investor is an SOE and, by extension, which threshold applies. This is because the ICA's definition of SOE includes an entity that is "controlled or influenced, directly or indirectly," by the government of a foreign state, whether federal, state or local, or an agency of such a government.

Test

Where review is required, the foreign investor must submit an Application for Review and may not complete the proposed investment until the minister of industry and/or minister of Canadian heritage, as applicable, has determined it to be of "net benefit to Canada".

To determine whether the proposed investment is likely to be of net benefit to Canada, the government considers factors such as:

- The effect of the investment on the level and nature of economic activity in Canada, including its effect on employment, resource processing, the utilization of parts, components and services produced in Canada, and exports from Canada.
- The degree and significance of participation by Canadians in the business.
- The effect on productivity, industrial efficiency, technological development, product innovation and product variety in Canada.
- The effect on competition within any industry in Canada.
- Compatibility with national industrial, economic and cultural policies.
- Its contribution to Canada's ability to compete in world markets.

Timing

The ICA provides the minister of industry and/or minister of Canadian heritage, as applicable, with 45 days to determine whether a proposed investment would be of net benefit to Canada, along with a unilateral right to extend the review period by 30 days. Additional extensions require the agreement of the foreign investor - without which the applicable minister would likely reject the investment. In our experience, it is not uncommon for the review of large and complex transactions with significant political overtones to extend beyond 75 days.

Possible Outcomes

The government may either approve the proposed investment or reject it. Almost all proposed investments are ultimately approved based on undertakings negotiated between the investor and the government. Only a handful of high-profile and/or politically controversial transactions have been rejected. For transactions that could raise significant political concerns, foreign investors should not underestimate the importance of an effective government relations strategy.

[1]This threshold will increase to $800 million on April 24, 2017, and will increase to $1 billion on April 24, 2019. Starting on January 1, 2021, it will be adjusted annually based on the growth in Canada's GDP.

What is a "national security review"?

In 2009, the ICA was amended to provide the government with the right to review any investment that "could be injurious to national security." In 2013, and again in 2015, the government amended the national security provisions to provide itself with additional flexibility in relation to national security matters. This right to review applies to minority investments, not just the acquisition of control of existing Canadian businesses. It can also apply to investments in businesses with tenuous links to Canada, as a review can be ordered if "any part" of the business's operations are in Canada.

There is no minimum investment size below which a review on national security grounds may not be ordered. The government has deliberately provided no guidance as to what kind of investment could constitute a threat to national security, affording itself maximum flexibility to take a "we'll know it when we see it approach." The national security provision empowers the government to prohibit any proposed investment, impose conditions on its completion, or require divestiture of a completed investment. A national security review can take up to 200 days.

Although full information on the government's use of the national security powers in the context of particular transactions is not public, it is known that the government has invoked these powers on at least a few occasions.

The biggest risk to foreign investors posed by the national security review powers relates to transactions that do not exceed the applicable mandatory threshold and can therefore be completed before being notified, as it is possible that the government could conduct a review and order divestiture after closing. The government may not commence a national security-related review more than 50 days after receiving an investor's notification — 45 days plus a five-day notice period.

To address this risk (of transactions possibly raising national security-related concerns), due to the nature of the acquired Canadian business and/or the foreign investor, the investor can submit a notification more than 50 days before closing, and include a closing condition in the purchase agreement that either no national security review shall have been commenced, or any such review that is commenced shall have been concluded on terms satisfactory to the investor.

How does competition review apply to Canadian M&A?

The *Competition Act* defines a merger as the acquisition or establishment — whether by purchase or lease of shares or assets, or by amalgamation, combination or otherwise — of control over or a significant interest in all or part of a business.

The Competition Bureau (the Bureau) has adopted an expansive interpretation of this definition. It has indicated that it will generally not consider the acquisition of less than 10 per cent of the voting shares of a corporation to be a merger. It may consider the acquisition of between 10 and 50 per cent to be a merger, depending on whether the facts suggest that the purchaser will acquire the ability to materially influence the economic behaviour of the target. The Bureau has also taken the position that contractual arrangements, such as shareholders' agreements or management agreements, can also be considered mergers, provided they confer control over all or part of a business.

Unless the Bureau issues an advance ruling certificate (discussed later in this section), it has the right to challenge any merger prior to its completion and for one year following its completion. This right applies to all mergers, including those that do not exceed the mandatory pre-notification thresholds (also discussed later in this section). As a result, although this is uncommon, the Bureau has challenged some mergers that did not exceed the pre-notification thresholds.

Certain aspects of this regulatory regime are discussed below. For more information, please see gowlingwlg.com/GowlingWLG/media/Canada/Guides/DBIC-2016-COMPETITION-I.pdf

Notifiable Mergers

Mergers that exceed certain thresholds must be pre-notified to the Bureau and may not be completed until either: (i) the statutory waiting period has expired and the Bureau has not obtained an order prohibiting closing, or (ii) the Bureau has completed its review and rendered a disposition that permits closing.

Thresholds

Notification is required if both of the following thresholds are exceeded:

- **Party size:** The parties, together with their affiliates, have assets in Canada or annual gross revenues from sales from or into Canada (exports and imports) that exceed $400 million.
- **Acquired business size:** The aggregate value of the assets in Canada to be acquired, or the annual gross revenues from sales in or from Canada generated by such assets, exceeds $87 million.[1]

Additional thresholds apply to proposed acquisitions of equity securities or equity interests, specifically:

- The proposed acquisition of voting shares of a publicly traded corporation will not be notifiable unless, following completion of the transaction, the purchaser owns more than 20 per cent of the voting shares (or more than 50 per cent if, prior to the transaction, the purchaser already owned more than 20 per cent).
- The proposed acquisition of voting shares of a private corporation will not be notifiable unless, following completion of the transaction, the purchaser owns more than 35 per cent of the voting shares (or more than 50 per cent if, prior to the transaction, the purchaser already owned more than 35 per cent.

Notification

Notification is required even if the transaction obviously raises no substantive competition law concerns. Failure to comply with the notification provisions can result in a substantial administrative monetary penalty and/or criminal conviction.

Notification can be effected in two ways:

i. the filing of a prescribed notification form by each of the parties, and/or
ii. requesting an advance ruling certificate. It is not uncommon to submit both types of notification.

The submission of complete prescribed notification forms, as determined by the Bureau, triggers a statutory 30-day waiting period. During this time, the parties may not complete the transaction unless the Bureau completes its review and renders a disposition that permits the parties to close. During the initial 30-day period, the Bureau has the right to issue a supplementary information request (SIR). SIRs are generally reserved for transactions that appear to raise significant competition law concerns, and are relatively rare, with only about half a dozen issued per year.

Another way of effecting notification is to request an advance ruling certificate (ARC). An ARC is the best possible outcome for the parties — especially for the purchaser — as it insulates the transaction from subsequent challenge, provided the transaction is completed within one year of issuance of the ARC. Accordingly, the Bureau typically only issues ARCs in respect of transactions that do not raise material substantive concerns. In situations where the information provided in an ARC request is sufficient for the Bureau to complete its review, but the Bureau is neither comfortable enough to issue an ARC nor concerned enough to challenge the transaction, the Bureau will typically issue a no action letter (NAL) and waive the parties' obligation to submit prescribed forms. Essentially, a NAL advises the parties that while the Bureau has no current plans to challenge the transaction, it reserves the right to do so within one year of closing. As a practical matter, parties can take a high degree of comfort from a NAL as it generally indicates that the transaction will not be subsequently challenged. An ARC request does not trigger a statutory waiting period. However, the Bureau has issued guidelines indicating that it will endeavor to complete its review of transactions that it considers to be "non-complex" within 14 days of receiving a complete ARC request, and within 45 days of receiving a complete ARC request for transactions that it considers to be "complex."

Test

The test that the Bureau applies in determining whether to challenge a proposed transaction is whether the transaction would prevent or lessen — or be likely to prevent or lessen — competition substantially. This test, as judicially defined, seeks to determine whether the transaction would give the merged firm the ability to profitably raise prices in the post-merger competitive environment or would create, maintain or enhance the merged entity's ability to exercise market power.

Possible outcomes

The possible outcomes of a merger review can generally be summarized as follows:

- The Bureau renders a disposition that permits the parties to close according to their desired schedule without any changes to the transaction. This occurs in the vast majority of cases.
- The Bureau takes longer than the parties would desire to complete its review. Closing is delayed but ultimately not challenged, and proceeds without any substantive change to the transaction. While not uncommon, this is certainly not typical.
- The Bureau agrees not to challenge the transaction on the basis of concessions made by the parties, such as the divestiture of certain assets. In the relatively rare situations where the proposed merger raises significant competitive concerns, this is a common outcome.
- The Bureau challenges the transaction before the Competition Tribunal (the Tribunal), a specialized quasi-judicial tribunal, by seeking an order to prohibit its completion. If the transaction is already complete, the Bureau seeks an order requiring that the transaction be undone or requiring the purchaser to sell part or all of the acquired business to a third party. This is extremely uncommon.

[1]The figure of $87 million applies in 2016, up from $86 million in 2015. It is adjusted annually based on the change in Canada's GDP.

ASSET ACQUISITIONS

Our target is an asset owned by a Canadian-listed company. We only want the asset and not the whole company. How is an asset acquisition typically structured?

An asset sale involves the negotiated purchase of the assets of a company without acquiring the entity that owns them. This typically happens when only a single property or division is of interest, or the new owner wishes to cap legacy liability exposure.

What approvals are needed for an asset sale?

A sale of all or substantially all of a target's assets requires approval of shareholders at a meeting by special resolution (two-thirds of the shares voted at the meeting). Less significant asset transactions can be approved by the target's board. An asset sale typically involves transfers of title and assignments of contracts, so more approvals and filings are typically required than a sale of the shares of a corporation. See also the previous responses regarding *Competition Act* and *Investment Canada Act*.

How long does the asset sale process typically take?

Sixty to 90 days if a shareholder meeting is required, much less if no shareholder meeting is required, depending on the complexity of the transaction.

INTERNATIONAL ASSETS

Our target is an international asset owned by a Canadian-listed company. How does the process differ from buying a company with a Canadian asset?

Local foreign investment, competition and other approvals may be required. The specific mix of such approvals will vary depending on the jurisdiction and the nature and size of the target's operations in such a jurisdiction. Canadian foreign investment review may not apply, depending on the circumstances.

Can we eliminate the Canadian ownership structure after we buy the company owning the international assets?

Yes, there is full flexibility to eliminate the Canadian ownership structure post-acquisition. However, it is important to focus on this issue early as part of the implementation to optimize tax efficiencies.

> *"there is full flexibility to eliminate the Canadian ownership structure post-acquisition"*

TAX MATTERS

What vehicle should be used for a Canadian acquisition?

Typically, a non-Canadian acquirer would incorporate a Canadian subsidiary to act as the acquisition vehicle. The use of a Canadian subsidiary serves a number of business purposes, including insulating the acquirer from the activities of the target.

Are there any tax advantages to using a Canadian subsidiary?

Yes, a Canadian subsidiary may provide a number of advantages to the acquirer from a Canadian tax perspective. These advantages may include: (i) facilitating the deduction of interest on financing for the acquisition against the income of the Canadian target; (ii) creating high paid-up capital in the shares of the Canadian subsidiary to facilitate repatriation of funds back to the non-Canadian parent corporation free of Canadian withholding tax; and (iii) positioning the acquirer for a possible "bump" in the tax cost of the Canadian target's non-depreciable capital property.

To take advantage of some of these benefits, it may be necessary to carry out a subsequent merger of the Canadian subsidiary and target.

Care is also required in designing the share structure of the Canadian subsidiary and arranging for it to be properly capitalized and financed for the acquisition.

Where assets are being acquired rather than shares, it is even more important to consider using a Canadian subsidiary. If the non-Canadian acquirer buys Canadian business assets directly, it will be liable for debts and liabilities that arise from the operations. It will also be liable for Canadian tax on the income from those assets and will have to file Canadian income tax returns every year, reporting its income from Canadian operations. However, by using a Canadian subsidiary to acquire the assets and to conduct the Canadian operations, the subsidiary becomes responsible for reporting the income and paying tax on the income instead of the non-Canadian parent.

Are there tax advantages to acquiring shares of a target rather than assets?

The acquisition of shares can be more tax efficient for shareholders of the target company compared to an asset purchase. Therefore, the target shareholders may be more inclined to agree to a share purchase than an asset purchase.

In some cases the target company may have advantageous tax pools such as non-capital loss carry forwards, Canadian exploration expenses, Canadian development expenses, scientific research and experimental development credits, net capital losses or other valuable tax attributes. In general, these tax attributes can only benefit the acquirer if it purchases the shares of the target company rather than purchasing assets from the target company.

Where the target company has valuable tax attributes, it is important to structure the acquisition very carefully. This is because the Canadian tax rules contain a number of limitations on using the tax attributes of the target following an acquisition.

Where the target company has no special tax attributes, or where its assets have a very low tax basis compared to the purchase price, it may be advantageous for the acquirer to acquire the assets directly rather than shares of the target. By acquiring the assets, the tax basis for the assets will be equal to the purchase price paid. This creates a high tax basis in the assets for the acquirer, which can result in tax savings to the acquirer in the future. Where assets are purchased, it will be important to allocate the total purchase price between the various assets. Amounts reasonably allocated to inventory or depreciable property can be more tax efficient than amounts allocated to non-depreciable capital property.

How would the Canadian subsidiary be taxed in Canada?

A subsidiary incorporated anywhere in Canada is subject to taxation in Canada on its worldwide income. A Canadian resident corporation is subject to both federal and provincial income tax. Canadian corporate tax rates are comparable to the rates in many other countries.

Often in the early start-up years of a subsidiary's business operating losses may be incurred, in which case there would generally be no income tax payable by the subsidiary. Such business losses can be carried forward for 20 years to offset income earned after the operations become profitable.

Are there situations where a non-Canadian acquirer would carry on the Canadian business directly?

In some situations where a non-Canadian acquirer has other profitable operations, the acquirer may wish to structure the acquisition as an asset purchase and carry on the operations initially as a branch of the acquirer in order to deduct the start-up losses against the earnings from the other profitable operations. Whether this is feasible would also depend on the tax laws of the acquirer's home jurisdiction.

This type of structure is not common and must be implemented very carefully. For example, any non-Canadian acquirer that carries on business in Canada may be required to pay Canadian income tax on any income it earns in Canada, particularly if it carries on that business through a permanent establishment in Canada. Difficult questions can arise in calculating the income that is derived from a Canadian permanent establishment. There are no clear guidelines for the calculations under Canadian law. In addition, the non-Canadian acquirer must pay an additional branch tax based on the profits from the Canadian operation which are not reinvested in Canada. Sales tax, value-added tax, and other indirect taxes may apply to an asset purchase. The non-Canadian acquirer and its directors will also be responsible for Canadian payroll taxes and remittances on any employees who work in Canada. The books and records of the non-Canadian acquirer may be subject to audit by the Canada Revenue Agency. For this reason, the use of fiscally transparent vehicles may be considered by an acquirer that wishes to carry on a Canadian business. Acquirers in the United States may also wish to consider using a Canadian unlimited liability company, which may be viewed as a "disregarded" entity for US tax purposes in certain circumstances. The rules governing these structures are complex and should be reviewed carefully in every case.

What are some of the Canadian withholding taxes that would apply to payments by the Canadian subsidiary to a non-Canadian parent?

Canadian withholding tax will be payable on the gross amount of dividends paid or credited by a Canadian subsidiary to any non-resident shareholder. This tax must be deducted or withheld by the Canadian subsidiary on behalf of its parent corporation. The *Income Tax Act* (Canada) generally imposes a 25 per cent withholding tax rate on dividends, but that rate may be reduced by an applicable tax treaty.

Canadian withholding tax also applies to interest that is paid by a Canadian subsidiary to a non-resident parent or to any other person with whom the subsidiary does not deal at arm's length. The withholding rate on interest is generally 25 per cent, but may also be reduced by an applicable tax treaty.

Are there situations where Canadian withholding tax does not apply?

The withholding tax on dividends only applies to payments that are dividends or similar distributions under corporate law, as well as payments that are deemed to be dividends for Canadian tax purposes. However, a return of capital that is properly made under Canadian corporate law by the Canadian subsidiary to its non-Canadian parent corporation is not generally treated as a dividend for Canadian income tax purposes. As a result, paid-up capital on shares of the Canadian subsidiary can generally be repaid free of Canadian withholding tax. To take advantage of this rule, advance planning is required and suitable share rights and capitalization of the subsidiary is necessary.

As well, interest paid to an arm's-length lender is now free from Canadian withholding tax, as long as it is not participating debt interest. Therefore, interest on loans from banks or other arm's-length parties outside of Canada directly to the Canadian subsidiary can be free of Canadian withholding tax in appropriate circumstances. A recent anti-avoidance rule prevents the use of this withholding tax exemption where there is a back-to-back loan arrangement. As a result, it is important to analyze the overall financing structure to determine whether withholding tax will apply.

Finally, the principal amount of a Canadian dollar loan can be repaid free of Canadian withholding tax. Where a payment includes both interest and principal, the amount of principal should be specified clearly so that withholding tax is not payable on that portion of the payment.

Are there any tax restrictions on how a non-Canadian parent funds the Canadian subsidiary?

One key decision for a non-Canadian acquirer is whether to fund its Canadian subsidiary with debt or equity. A number of tax rules affect this decision. For example, interest is only deductible to the extent it is reasonable. As well, interest paid by a Canadian subsidiary to its parent will be subject to special requirements under Canadian transfer pricing rules. The subsidiary must be able to prove that the interest rate it pays is the same as the interest it would pay to an arm's-length lender, and it must have suitable supporting documents available to show to the Canadian tax authorities if requested.

Under Canadian tax rules, there is a limit on the amount of debt that the Canadian subsidiary should incur from its parent and certain other parties. The limit arises from a restriction on the amount of interest the subsidiary can deduct on debts owing to specified non-residents. In order to have full interest deductibility, the debt-equity ratio of the subsidiary for these debts should not exceed three to two. This restriction is referred to as the thin capitalization rule. Previously, the thin capitalization rule applied only to corporations. Since business trusts are sometimes used in Canada instead of corporations, the rule has been extended to apply to trusts as well. In addition, a recent anti-avoidance rule will extend the restriction on interest deductibility where there is a back-to-back loan arrangement. A non-Canadian acquirer should be mindful of the thin capitalization rule when funding its Canadian subsidiary.

What are some other key tax considerations?

Foreign affiliate dumping: If the Canadian target has foreign subsidiaries, special tax considerations will apply. Where a non-resident acquirer purchases shares of a Canadian target that owns a foreign affiliate, the acquisition may trigger the application of Canada's "foreign affiliate dumping" rules. These rules can result in adverse Canadian tax consequences and therefore may require special structures.

Tax treaty considerations: International acquisitions must take into account the tax rules of all applicable jurisdictions, including the home jurisdiction of the acquirer, not just Canadian tax rules. One important structural consideration for a non-resident acquirer is selecting a suitable foreign jurisdiction through which to invest in the Canadian target. A jurisdiction which has a tax treaty with Canada is often preferable to a jurisdiction with no tax treaty. However, rules exist which are intended to prevent "treaty shopping" and many jurisdictions, including Canada, are proposing additional anti-treaty shopping rules. Therefore, the choice of jurisdiction requires even more careful consideration than in the past.

> **"International acquisitions must take into account the tax rules of all applicable jurisdictions"**

OTHER CONSIDERATIONS

Does Canada have currency controls?

No, Canada has no currency controls.

What process is involved in bringing non-Canadian workers into Canada to work at a Canadian company acquired by a non-Canadian parent?

Canada's immigration programs and rules are designed to facilitate the entry of business people, managers and skilled workers.

Executives, senior managers and technical personnel needed to work in Canada may apply for work permits to allow them to work in Canada on behalf of a foreign business or a related Canadian entity. To be eligible for a work permit, the applicant must qualify under one of Canada's work permit categories. Such workers may sometimes be eligible for intra-company transfer work permits. These are available to eligible managerial-level employees or key specialists who are being transferred from an employer outside of Canada to a related Canadian entity.

Depending on the citizenship and country of residence of the worker, a work permit application may be filed at the port of entry in Canada, or at a Canadian visa office. Citizens of countries that require a temporary resident visa (TRV) must apply at the visa office. When the visa office approves an application, it will issue a TRV and a letter of authorization allowing the worker to fly to Canada. The work permit itself is issued at the port of entry in Canada.

Canada has entered into a number of free trade agreements (FTAs) that contain mobility and entry provisions. Such FTAs include work permit provisions for eligible professional employees and for transferees. FTAs may provide work permit options to citizens of the United States, Mexico, Peru, Chile, Colombia and South Korea.

In some cases where the intra-company transferee or FTA work permit categories are not available, it is necessary to first obtain a Labour Market Impact Assessment (LMIA) from the Canadian government before a work permit application can be made. The LMIA application is filed in Canada. Several criteria must be met. For example, it must usually be shown that qualified Canadian workers are not available. The wage being offered must also meet the prevailing wage rate for the occupation in the location in Canada where the work will be done.

Accompanying spouses of most foreign nationals working in Canada may obtain a work permit under the Spousal Employment Program. Temporary immigration documentation may also be obtained for accompanying children.