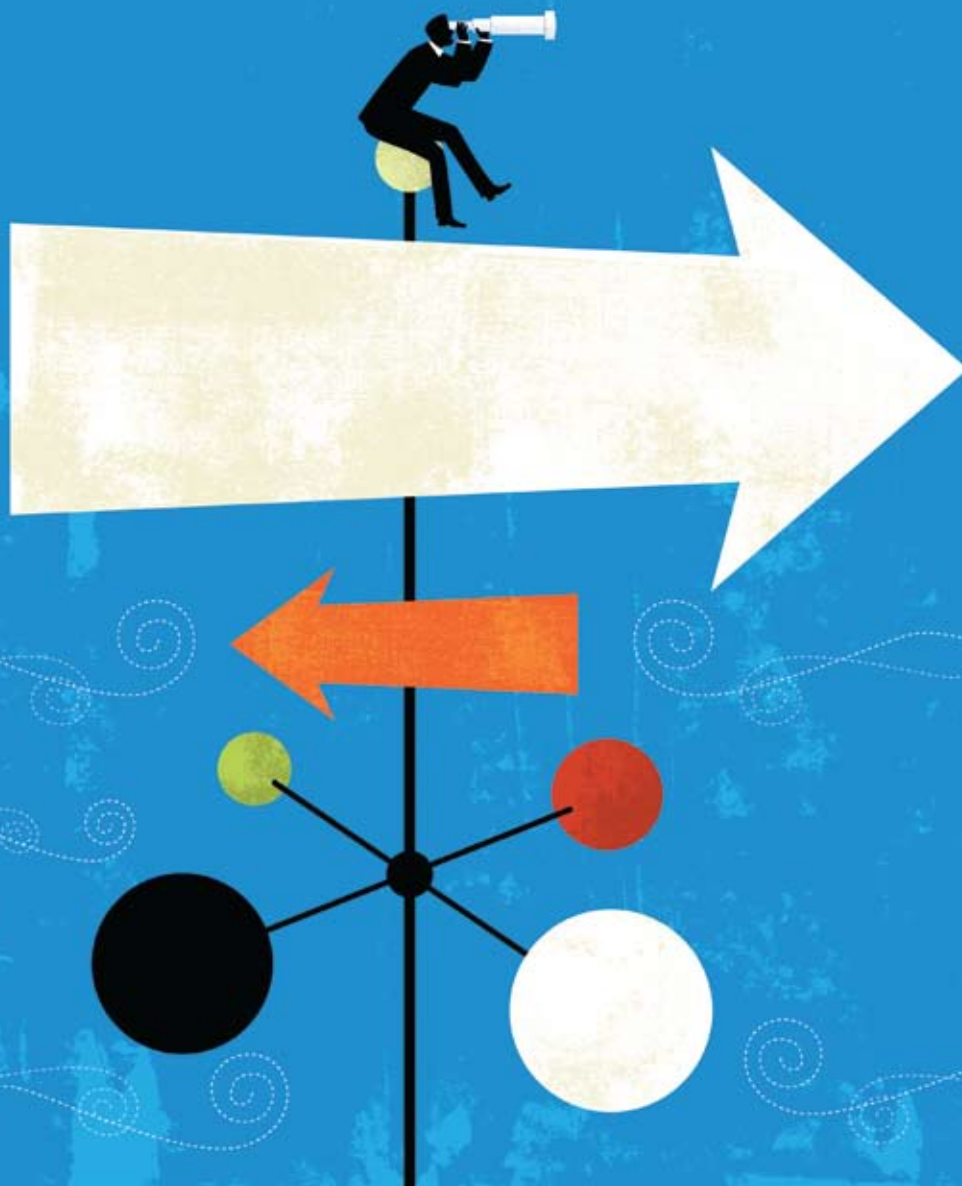


M&A TORYS' TOP 10 TRENDS FOR 2009





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The year 2008 brought a global credit crisis that adversely affected financial institutions and their clients, and thrust a new world on the business community and its advisers. In many cases, those financial institutions were driven into the hands of suitors, often government-backed, with breathtaking speed. The credit crisis also sounded the death knell for easily accessed capital to fund acquisitions, a tightening that had started in mid-2007. In the wake of this crisis, we are seeing the development of a wide array of bold strategies and tactics to navigate this new world.

In 2009, we expect to see these strategies and tactics enhanced and refined as the marketplace and courts redefine acceptable sale terms and conditions. The shortage of credit will favour strategic buyers with strong balance sheets and sovereign wealth funds with greater access to financing. Private equity will lean toward mid-market going-private transactions that contain more equity than in the past. Finally, we will see more activity in the infrastructure sector as governments seek to provide much-needed stimulus to the economy.

Torlys' M&A lawyers are looking ahead to 2009 and this is what they see.

- 1** A Buyers' Market Is Emerging
- 2** Strategic Investing Will Command Favourable Terms
- 3** Parties Will Focus on Dispute Resolution Procedures and Remedy Provisions
- 4** Sellers Will Be More Willing to Negotiate on an Exclusive Basis
- 5** Infrastructure Will Continue to Be a Key Sector
- 6** Going-Private Transactions Will Be More Prevalent
- 7** Using Derivatives to Acquire Toeholds Will Face Greater Regulatory Scrutiny
- 8** Sovereign Wealth Funds Will Rely on the Santiago Principles to Allay Regulatory Concerns
- 9** Distressed M&A Will Increase
- 10** Foreign Investment Will Undergo Enhanced Review in Canada

1

A Buyers' Market Is Emerging

By Joris Hogan and James Scarlett

The credit crisis has brought significant changes to the bargaining power of buyers and sellers as financial buyers fade and strategic buyers looking for favourable deals take their place. In this context, emerging trends we see in 2009 include the following:

- **Expanded material adverse effect clauses.** Buyers will push to expand the scope of traditional material adverse effect (MAE) outs to cover matters that go beyond seller-specific changes to include more general industry disruptions. Buyers will also continue to craft special termination provisions to augment traditional MAE provisions.
- **Financial market MAE clauses.** Lenders to buyers have begun to include financial market MAE clauses as conditions to lending. As a result, buyers will require equivalent clauses in purchase agreements, thereby shifting financial market risk to sellers.
- **Baked credit.** Purchasers can control their exposure to funding risk from their lenders by insisting on executing both a definitive purchase agreement and the definitive loan documentation concurrently. In the past, purchasers in North American deals would typically sign a purchase agreement on the strength of signed commitment letters from a lending group. However, in some recent deals, we have seen – and expect to continue seeing – purchasers insist on a longer negotiation period, during which time both the purchase agreement and the loan documentation can be finalized.
- **Enhanced deal protections.** Purchasers are increasingly looking for ironclad deal-protection terms that make it problematic for a third party to top a deal with a higher offer. These terms include requirements that the seller enforce all existing standstill arrangements under confidentiality agreements signed during the auction process or similar market canvassing. Enforcing a pre-existing standstill with a third party that does not automatically fall away with the announcement of a transaction largely prevents that third party from coming forward with a better offer after the deal has been announced.
- **More aggressive lockups.** We expect to see more asset lockups like the one given by Bear Stearns to JPM Chase as well as share option lockups of up to 20% of a seller's outstanding shares and, in distress situations, in which the listing exchange's shareholder approval requirements are more flexible, potentially larger share options.

2

Strategic Investing Will Command Favourable Terms *By David Chaikof and Tom Yeo*

In September 2008, while many shied away from the financial sector, Warren Buffett's Berkshire Hathaway injected US\$5 billion into Goldman Sachs. In return, Buffett got perpetual preferred stock with a 10% dividend rate, plus warrants to purchase another US\$5 billion of Goldman Sachs's common shares. Buffett also made similar investments, including a US\$3 billion investment in General Electric, and there will most likely be many more to come from him and others. With incredibly tight credit markets and companies facing a downturn in their business, more issuers are looking to strategic investors. In turn, investors will have plenty of opportunities to make investments on favourable terms – and with considerable upside potential.

These investments, known as “private investment in public equity,” or “PIPEs,” often take the form of debt or preferred stock combined with warrants to purchase common shares or a right to convert the debt or stock into common shares. The conversion right gives the investor the chance to participate in the business's success through a future conversion or warrant exercise while still having a fixed return on its investment and downside protection through the debt or preferred stock. An investor can also seek other protections, including representation on the board of directors, veto rights over certain transactions and pre-emptive rights to preserve its ownership interest in the event of future equity issuances.

The number of shares to be issued under conversion or warrant rights in these deals can be significant, resulting in potential dilution to existing shareholders that far exceeds the limits imposed by stock exchanges. Accordingly, many issuers must obtain shareholder approval for these transactions or rely on financial-hardship exemptions from the relevant stock exchanges. The financial-hardship exemption is often relied on when the investment is a key component of a broader recapitalization plan involving the company's existing creditors, such as Fairfax Financial Holdings Limited's US\$350 million investment in convertible debentures of AbitibiBowater.

As more companies get squeezed by the effect of declining financial results, depressed equity markets or reluctant lending institutions, we expect to see more issuers looking for a cash infusion through a convertible debt or preferred stock placement.



3

Parties Will Focus on Dispute Resolution Procedures and Remedy Provisions *By Ian Goldrich and James Tory*

In 2008, we saw a number of acquisitions, both strategic and financial, collapse in the wake of the economic downturn. The parties to these transactions often wound up in court litigating the buyer's right to walk away from the deal (and at what price) versus the seller's right to compel closing. Buyers and sellers would be well-advised to ensure that their selected legal counsel has extensive expertise in commercial litigation.

In several instances, courts held that the buyer's contractual outs trumped the seller's right to require the buyer to complete the acquisition. For example, in *United Rentals*, the Delaware Chancery Court held that the seller's sole remedy upon the buyer's refusal to close was to pay a US\$100 million reverse break fee. In other cases, the sellers commenced litigation but had to settle for reduced pricing (for example, Clear Channel's sale of its television assets to Providence Equity).

However, buyers who relied on material adverse effect (MAE) provisions to avoid closings were less successful. In two closely watched cases, *Genesco* (in Tennessee and New York) and *Hexion* (in Delaware), the courts rejected the buyers' claims that the sellers had been materially and adversely affected by developments. These decisions reiterated the high threshold to be met (in terms of both financial quantum and length of time) to trigger an MAE provision.

In 2009, we expect that buyers and sellers will negotiate more vigorously the specifics of the dispute resolution terms in a merger agreement, including choice-of-law and choice-of-forum provisions. For example, since Delaware courts have never found an MAE to have occurred in the context of a merger agreement, buyers who are concerned about enforcing an MAE clause may push for an alternative venue.

Buyers and sellers will also focus on removing any ambiguity in the remedy and walk-away provisions that resulted in much of the litigation described above. For example, parties will more clearly define the circumstances in which a buyer can be compelled to complete a transaction versus circumstances in which the buyer can walk away after paying a fee.



4

Sellers Will Be More Willing to Negotiate on an Exclusive Basis *By Aaron Emes and Sharon Geraghty*

Sellers face significant challenges when they run a sale process in today's market. When buyers and financing were plentiful, sellers were generally advised to conduct a robust auction, canvassing for the best deal before locking in to negotiate with any single party. Exceptions to this rule arose only in unique circumstances or where a buyer had made a pre-emptive bid (in other words, a bid with a premium at the highest end of what the market would expect for a control premium).

However, this has changed. Buyers are cautious, debt financing is scarce and market valuations are moving targets. The risk of a failed process is much greater than before, so sellers will be even more concerned about the potential publicity and disruption involved in conducting a more active auction.

In this environment, we expect sellers to balance their priorities differently. Price is still critical, but speed of execution, confidentiality, certainty of financing and locking down a deal have become important criteria in assessing competing proposals. These imperatives are increasingly going to drive targets to deal exclusively with one party – a potential buyer that is interested, credible and able to complete diligence and arrange financing quickly. If a buyer meets those criteria and offers a meaningful control premium, a seller will be more prepared to enter into exclusive negotiations than before.

The tradeoff for exclusivity will generally be a lower break fee and possibly a go-shop provision that will allow the target to solicit a higher price for a limited time after signing (usually with an even lower break fee applicable during the go-shop period). Sellers will want to keep the exclusivity period short (typically weeks, not months), so that they can quickly identify whether the deal would be likely to proceed and whether financing would be available.

5

Infrastructure Will Continue to Be a Key Sector

By Krista Hill and Phil Symmonds

In September 2008, Abertis Infraestructuras and Citigroup withdrew their US\$12.8 billion offer to operate the 537-mile Pennsylvania Turnpike after state lawmakers delayed a decision on the legislation required for the transaction to proceed. Even though the governor of Pennsylvania was strongly in favour, legislators opposed leasing the turnpike. Since then, we have seen governments coming under enormous fiscal pressure – resulting from both declining revenues and the need to provide a fiscal stimulus to mitigate the current financial crisis. If the decision to lease an asset such as the Pennsylvania Turnpike were to come before legislators in 2009, we think that the outcome may be different. We expect that balance sheet stress will prompt governments to be more favourably inclined to lease or divest infrastructure assets, either to raise proceeds or to avoid the required capital expenditures. For example, in November 2008, Canadian finance minister Jim Flaherty indicated that the federal government is considering selling off some Crown assets to avoid a deficit.

The need for stimulus should also result in an acceleration of infrastructure projects and investment, and reduced time for approvals. In December 2008, president-elect Barack Obama indicated that he intended to implement the biggest investment in public infrastructure in the United States since the federal highways program in the 1950s. We should also see increased government interest in private finance initiatives and public-private sector partnerships as governments look to the private sector to provide financing and assume risk for infrastructure initiatives. Moreover, given their cash flow profiles, long lives and monopoly-like characteristics, infrastructure assets will continue to be attractive targets in uncertain times for pension funds, infrastructure funds and sovereign wealth funds. All of this points to an active period for infrastructure M&A in 2009.



6

Going-Private Transactions Will Be More Prevalent *By Philip Brown and Karrin Powys-Lybbe*

Relatively few going-private transactions took place in 2008, but we expect the number to increase in 2009 and into 2010. In a going-private transaction, a public company is transformed into a private company, often with private equity as the acquiror, and with management and/or major shareholders participating on an ongoing basis.

These types of transactions will be precipitated by a number of factors. First, dramatically reduced share prices will begin to rectify the long-held disconnect between buyers' views on price and sellers' views on value. Target companies will become more attractive to buyers as a result, and sellers are likely to accept a lower price than they would have a year ago. The realignment of valuation perception is likely to be the most dramatic we have seen in years.

To the extent that target boards decide to defer sales until share prices recover, we expect to see more hostile transactions, potentially involving management working with acquirors and at odds with the board. Historically, hostile transactions have been more prevalent when share prices are depressed and boards are reluctant to sell until values again appreciate.

Second, although doing transactions is very difficult in an extremely tight credit market, some credit does appear to be available in Canada's mid-market, which includes many target companies of private equity. There also appears to be a trend that private equity buyers are prepared to put more equity into attractive acquisitions and thereby reduce the debt required to complete a transaction.

Third, as 2011 approaches, the remaining Canadian income trusts that have not been sold or converted to a corporation will put themselves up for sale or take themselves private. The depressed share prices for income trusts will make them more affordable and, with the advantageous tax benefits of trusts expiring in 2011, should accelerate income trusts going private in 2009.



7

Using Derivatives to Acquire Toeholds Will Face Greater Regulatory Scrutiny *By Andrew Beck and Pat Koval*

In recent years, hedge funds and other activist investors have relied increasingly on equity derivative strategies to accumulate economic interests in potential takeover or proxy contest targets. Typically, these strategies involve cash-settled total return equity swaps or similar vehicles. In these contracts, while no actual purchase or sale of underlying securities occurs between the purchaser of the swap (the “long” party) and the counterparty, the counterparty will typically hedge its risk by purchasing the underlying securities. The long party will not receive the power to vote the underlying securities or to compel the counterparty to dispose of them. As a practical matter, however, the swap may be “closed out” and “converted” into a direct holding by the long party by cash-settling the swap and using the proceeds to acquire the securities from the counterparty.

Under Canadian and U.S. securities laws, the prevailing view of cash-settled total return swaps has historically been that, absent specific evidence to the contrary, such swaps do not provide the long party with actual or beneficial ownership of, or control or direction over, the underlying securities. Therefore, a party acquiring an economic interest under an equity swap in 10% or more of the outstanding equity or voting securities of a class of a Canadian target issuer has not typically filed an early-warning report or an insider report relating to that interest (although a party who is already an insider as a result of beneficial ownership of such securities is required to disclose its acquisition of an additional economic interest). Similarly, in the United States, a long party would not typically file a report under section 13(d) of the *Securities Exchange Act of 1934* after acquiring an economic interest under a total return swap in 5% or more of the common stock of an issuer.

In 2006, the Ontario Securities Commission indicated in the *Sears* decision that the use of swaps to deliberately “park” securities and avoid reporting obligations in the context of a takeover bid could constitute abusive conduct. In 2008, the much-reported court decision in a proxy contest for CSX Corporation has focused attention on the fact that regulators and courts may consider the use of equity derivatives to be abusive if they are perceived to be used to avoid disclosure obligations.

In *CSX*, the U.S. District Court for the Southern District of New York found that two hedge funds used cash-settled total return swaps and other arrangements to obtain significant economic power over CSX, without disclosure, before launching a proxy contest for seats on the CSX board of directors. While the Court declined to go so far as to say that a typical cash-settled total return swap creates beneficial ownership, it found that the hedge funds had entered into these arrangements to avoid their disclosure obligations. On appeal, the U.S. Court of Appeals for the Second Circuit issued a summary order affirming the lower court's decision, but without reasons. The summary order states that an opinion will follow, but it is unclear whether that opinion will discuss the issues raised by the lower court.

We expect cases like *CSX*, along with increased scrutiny of these issues by U.K. and other international securities regulators, to cause increased regulatory scrutiny of the use of equity swaps in contests for corporate control. Canadian securities regulators may also revisit the early-warning and insider reporting rules in this context.



8

Sovereign Wealth Funds Will Rely on the Santiago Principles to Allay Regulatory Concerns *By Michael Akkawi and Steve Donovan*

The impact of the credit crisis on the leveraged buyout model leads us to expect a much bigger role for well-funded sovereign wealth funds (SWFs) in the M&A market. SWFs are loosely defined as state-owned investment funds. We see SWFs being more active as direct buyers in North America over the next few years, particularly in the mega-deal space. Although the recent financial turmoil has affected SWF returns, and lower commodity prices may have some SWFs worried about future sources of funds, other factors will override these issues. First, the decline in equity values will make acquisition opportunities difficult to pass up. Second, many SWFs have a mandate to invest internationally and have the funds to pursue this mandate. Third, many SWFs are able to take a long-term view of their investments and therefore ride out business cycles.

SWFs that seek to become more active in direct investment in North America, particularly through high-profile transactions, will need to mitigate political concerns regarding foreign investment. Both the *Investment Canada Act* and the U.S. *Foreign Investment and National Security Act of 2007* could apply to the review of investments by SWFs. We believe that the “Santiago Principles,” if properly used, may provide a framework to respond to these regulatory concerns.

In October 2008, the International Working Group of Sovereign Wealth Funds (IWG) published the Santiago Principles, 24 generally accepted principles and practices to reflect the investment practices and objectives of SWFs. The guiding objectives of these principles are, among others, (i) to base investments on the considerations of economic and financial risks and returns, and (ii) to have in place a transparent and sound governance structure that provides for adequate operational controls, risk management and accountability.

Although complying with the Santiago Principles is voluntary, we expect SWFs to provide undertakings to comply with some or all of the principles as a strategy for allaying regulatory concerns regarding transparency, corporate governance, commercial objectives and financial disclosure.



9

Distressed M&A Will Increase

By Scott Bomhof and William Gray

The liquidity crisis and broad recessionary pressures are expected to create significant opportunities for distressed M&A activity in the United States and Canada.

Historically, the U.S. restructuring process has been characterized by policies protecting existing management while the debtor develops a confirmable Chapter 11 plan approved by its creditors. Debtor-in-possession (DIP) financing had been readily available to fuel the reorganizing business during this typically year-long or longer process. But 2009 promises to be different because traditional DIP lenders are unlikely to have the liquidity or willingness to provide financing.

The dearth of DIP financing will make it difficult for troubled companies to sustain operations during an extended Chapter 11 plan process. As a result, distressed companies will most likely engage in expedited sales of non-core assets or sell all their troubled business under section 363 of the U.S. Bankruptcy Code. A section 363 sale can often be achieved within 45 to 90 days and – although subject to an auction and court approval – does not require a disclosure statement or confirmation by a creditors' vote.

“Pre-negotiated sales” may become commonplace because they promise the benefits of Chapter 11 without its concomitant cost and delay. The pre-negotiated sale process allows a buyer and a distressed seller to enter into an M&A agreement pre-petition and file it on the first day of the bankruptcy case. The proposed first-day orders are usually accompanied by a proposal to establish the procedures for the bankruptcy auction, including various bid protections (such as break fees) for the proposed buyer – the “stalking horse” bidder. Court approval is sought immediately so that an auction and final sale can be achieved within 45 to 90 days.

The downsides of the process – the public nature of the proposed transaction, the possibility of higher and better bids and court scrutiny of the auction and sale – are compensated for by the benefits of quickly emerging from bankruptcy with a bankruptcy court order transferring the assets free and clear of claims. Stalking horse bidders are successful in the vast majority of cases, usually without competing bids.

The Canadian landscape in distressed M&A is experiencing a similar pattern. Companies are turning to the *Companies' Creditors Arrangement Act* to facilitate expedited sales processes within compressed time frames, with similar benefits and downsides as noted above. While Canadian sale proceedings tend to favour a more typical receivership-type sale process involving the submission of confidential bids, there is a growing trend of U.S.-type stalking horse sale proceedings being used to provide greater certainty and to allow for pre-negotiated sales to be presented to the judge at the commencement of the proceedings.

10

Foreign Investment Will Undergo Enhanced Review in Canada *By Phil Mohtadi and Omar Wakil*

In November 2008, the Canadian government announced that it would enact legislation to modernize Canada's investment laws. Although legislation had not been introduced at the time of writing, the government has outlined the broad scope of its proposed amendments to the *Investment Canada Act*.

Thresholds for the review of foreign investments are likely to increase, thus reducing the number of M&A transactions subject to the *Investment Canada Act*. The Competition Policy Review Panel recommended that the standard review threshold be increased from C\$295 million in assets to C\$1 billion in enterprise value. The government's aim is to cut the number of reviewable transactions annually by roughly one-half.

The government is also planning to establish a new national security review mechanism in the *Investment Canada Act* to ensure that foreign investments do not jeopardize Canada's national security. This amendment will bring Canada in line with its major trading partners, including the United States, which already allows for the review of foreign investments on national security grounds. Although it is unlikely that many transactions will be reviewed – much less blocked – on national security grounds, the recent government rejection of the proposed acquisition by Alliant Techsystems Inc., a U.S. firm, of a portion of the business of Canadian firm MacDonald, Dettwiler and Associates Ltd. may signal a trend toward increasing regulatory scrutiny of foreign acquisitions in industries that present national security concerns, even though no legislative amendments have yet been enacted.



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