

M&A TORYS' TOP 10
TRENDS FOR 2010





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We predict that 2010 will be remembered as a comeback year with significant M&A activity. While 2009 was a slow year in the M&A space, in 2010 the pickup in M&A activity will be considerable.

We expect activity to include acquisitions in the “green” and media and telecom sectors. Life sciences will continue to be robust though mid-market focused. Well-run Canadian pension funds and banks will also take advantage of their relative strength to make international acquisitions. Large conglomerates, including financial institutions, will carve out their non-core assets. Private equity is also showing signs of renewed interest in acquisitions.

Although foreign buyers will face some scrutiny from the Canadian government when national security issues are triggered, “national security” will not be viewed as broadly as was once feared. Canadian M&A deals may also face more lengthy and onerous antitrust reviews.

In 2010, shareholders will continue their unprecedented level of activism, which began in 2009. Canadian directors may experiment by trying to “just say no” to unsolicited offers, while recent developments suggest that U.S. directors may tread more cautiously on this front.

Torlys' M&A lawyers are looking ahead to 2010, and this is what they see.

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“Buying Green” Will Grow By Krista Hill and Michael Pickersgill

On November 3, 2009, power generator TransAlta Corporation announced the completion of its C\$1.6 billion acquisition of Canadian Hydro Developers, which develops renewable energy projects and has an existing operating portfolio of wind, hydro and biomass facilities located across Canada. At the time of announcing the offer for Canadian Hydro, TransAlta CEO Steve Snyder described the transaction as a continuation of a strategy to expand the firm’s renewable energy portfolio and noted that the resulting company would be “well-positioned to succeed in a world in which both capital and carbon are constrained.”

We foresee demand for renewable energy assets continuing to grow in both Canada and the United States in 2010 and beyond for a number of reasons. First, large industrial emitters, such as TransAlta, will be under continuing pressure to reduce their carbon footprint or otherwise to prepare for the impending regulation, in some form, of greenhouse gas emissions. One strategic way for emitters to address the impending regulatory burden in a carbon-constrained environment will be to own renewable energy or other “green” assets.

Second, to increase installed capacity of renewable energy, many jurisdictions have introduced programs to assist in the development and financing of renewable energy projects. A good example of such a program is the feed-in tariff (FIT Program) that the Ontario Power Authority introduced under the *Green Energy and Green Economy Act, 2009* (Ontario). The FIT Program provides guaranteed and favourable pricing for many forms of renewable electricity generation. We expect the FIT Program to ultimately result in thousands of new megawatts of renewable energy capacity being

connected to the Ontario grid. However, large amounts of capital investment will be needed to construct these renewable energy projects, many of which are currently being developed by smaller developers that do not necessarily have access to the capital ultimately required. Accordingly, in a capital-constrained environment, we expect that developers will seek partners to finance projects or that the developers will try to sell development projects to larger operators.

This combination of strategic demand for renewable energy assets and the financing requirements for developing new projects points to an active period in renewable energy M&A in 2010 and beyond.



2

“Just Saying No” May Get Easier in Canada and Harder in the United States By Joris Hogan and James C. Tory

The decision of the Ontario Securities Commission in *Neo Material Technologies* (described below) and the musings of Vice Chancellor Leo Strine, Jr., of the Delaware Chancery Court, have revived the debate on both sides of the border on whether and when a target board may rely on a poison pill to “just say no” to a hostile takeover bid, pre-empting target shareholders from determining the outcome of the bid. Until the uncertainty created in Canada by *Neo* is clarified through further decisions, there is the prospect of more contested securities regulatory hearings in Canada on the use of poison pills as a defensive tactic.

The legal position on pills in Canada before *Neo* was well-settled. Whether or not the target corporation was in sale mode, securities regulators would not permit the target board to use a poison pill to prevent target shareholders from gaining access to an unsolicited offer and determining the outcome of the bid. At most, a target board could delay target-shareholder access to an offer in order to provide time for the board to seek out a better bid. But the only question was *when* – not *whether* – the pill would be cease-traded by securities regulators.

In *Neo*, the OSC signalled a possible change in approach. The OSC declined to cease-trade a pill deployed in the face of what the target board considered an undervalued and opportunistic bid in circumstances in which the target board was not seeking out a better offer and target shareholders had ratified the continued deployment of the pill. The OSC said that a pill can be maintained in the face of an unsolicited bid as long as it continued to serve the purpose of allowing the target board to fulfill its fiduciary duty to protect the long-term best interests of the target corporation. *Neo* raises at least the possibility that a target board may be permitted to “just say no” to an unsolicited bid that it considers, on reasonable grounds, a threat to the long-term best interests of the

corporation – at least when, as in *Neo*, the continued deployment of the pill has been ratified by shareholders.

An interesting counterpoint to the possible expanded scope for pills in Canada occurred in Delaware. There, Vice Chancellor Strine, in a chambers appearance in the takeover battle between Broadcom Corporation and Emulex, appeared to be inviting a challenge to the use of a poison pill as a defensive tactic when coupled with a supermajority by-law provision relating to the calling of a special meeting.

Delaware courts, after showing some early hostility to poison pills, have taken a generally deferential approach since the late 1980s to the use of pills to “just say no” to unsolicited offers if the target corporation was not for sale. This deferential approach appears to have been premised, in part, on the ballot box being open to target shareholders, making a proxy fight possible to replace a recalcitrant board. Vice Chancellor Strine, with reference to Emulex’s adoption of a supermajority by-law, seems to be saying that if it can be shown that the ballot box is not open, “just say no” would not be allowed under Delaware law, and the Delaware court may order the target’s poison pill to be redeemed. Accordingly, U.S. target boards may be more cautious in 2010 about the active steps they take to discourage an unsolicited offer.

3

Canadians Will Go Shopping *By Ian Arellano and Blair Keefe*

There is an increasing trend for leading Canadian companies, pension funds and other investors to seek growth opportunities outside Canada. This is largely driven by Canadian demographics (as the population ages, consumption in many sectors of the economy decreases), low GDP growth rates and the relatively mature nature of the Canadian marketplace. For many industries, these factors lead to low domestic growth rates. In addition, the strong Canadian dollar, relative to the U.S. dollar, is helpful, particularly with respect to U.S. acquisitions.

Canadian financial institutions are currently well-positioned to purchase foreign assets. These institutions were fortunate to have suffered relatively fewer losses than many of their international peers during the financial crisis and have strong balance sheets and capital ratios. In fact, many of their international competitors will be sellers rather than buyers of international assets in order to de-lever their balance sheets and repatriate capital to their domestic operations. This is particularly true for institutions that now have a government as a major shareholder. Further, international institutions exiting a jurisdiction often have an inherent bias to sell to another international institution as a result of the “soft” M&A considerations, such as treatment of employees, customers and other local stakeholders.

Many Canadian pension funds still collect more than they pay out, so these funds have an inherent need to increase their investment activities. Further, their investment groups have been bolstered by excellent new talent that has become available as a result of the financial crisis. Their continuing cash inflow and increasing internal investment capabilities bode well for increased investment and M&A activity. Given relative growth rates, and the pension funds’ desire for return, we expect that their international M&A activities will continue to grow.



4

Carving Out Assets Will Get Messy *By Jay Romagnoli and Richard Willoughby*

The financial and economic crisis will continue to feed the spinoff market as distressed companies and oversized conglomerates seek to sell non-core assets and thereby enhance their balance sheets.

A spinoff transaction requires that a parent carve out a currently integrated business as a stand-alone. The issues involved in a carve-out include how to split assets and liabilities, how much debt the spun-out entity will take on and how much debt will remain with the parent, and what type of working relationships should be put in place between the parent and the spun-out entity. These issues are more difficult to resolve when, as is often the case in the current crisis, the transaction is born of necessity and little groundwork has been laid to prepare the spun-out entity to operate on a stand-alone basis.

As an example, the parent and the spun-out entity will usually need to enter into agreements that provide for the sharing of intellectual property. In the case of trademarks that are associated with the parent, the parent will usually want to limit use to a short transitional period. In the case of other intellectual property, a co-ownership arrangement or perpetual licence is often appropriate. The parent may seek to limit the business or geographic scope of these rights to help preserve the value of its similar businesses in other jurisdictions. The limitations can cause issues for the spun-out entity later if the business evolves beyond the permitted scope and the restricted intellectual property is not easily excised from operations (as is often the case with, for example, custom software).

In addition, the parent will often be required to provide transitional services until the spun-out entity assembles its own information technology and other support systems and services; the parent may then need to participate in the migration of these services to the spun-out entity. These arrangements can be difficult to negotiate, not only because the spun-out entity often requires a wide range of services over an extended period of time but also because of the inherent tension in the arrangement: the spun-out entity seeks an outsourcing operation with the highest standards of performance for mission-critical functions, whereas the parent is not in the outsourcing business and is therefore ill-equipped to provide the service. A long-term relationship may also be desirable in some operational areas – for example, supply and distribution functions.

These dynamics complicate not only the terms of the transaction itself but also the sale process. In the case of an auction, it is unlikely that all bidders would have the same transitional needs and expectations for ongoing relationships. This makes the job of comparing bids difficult and can require the simultaneous negotiation of these arrangements with multiple bidders before the preferred bid can be determined. The current auction process involving assets of Nortel Networks highlights many of the complicating elements that splitting off an integrated business can create.

If the spinoff is achieved by way of an IPO, the underwriters would be subject to additional pressure to ensure that the spun-out entity has the tools that it needs to succeed.

5

Power to the People: Heightened Shareholder Activism Will Continue *By Patricia Koval and Patrice Walsh-Watson*

The economic crisis and corporate social responsibility agendas spurred shareholders into unprecedented action in 2009. Shareholder activism intensified and the strategies became more aggressive as shareholders found that forcing their own economic agendas in this manner could be easier, cheaper and more effective than acquiring additional voting equity to earn board representation or assume control. In 2009, more often than in the past, companies dealt with a proactive and organized block of shareholders who did not agree with directors and management, and wanted a say themselves.

Shareholders of all sizes pushed companies (and their boards) not only to enhance value through strategic transactions but often to unlock value for shareholders by selling non-strategic assets or freeing up cash reserves for dividends. This was done through proactive communications with management that pushed for shareholder votes on significant corporate decisions; proxy contests directed at changing boards, effecting specific approvals or changing control itself; and requisitioned meetings or shareholder proposals to force decisions on special interest matters. At the same time, shareholder advocates used a variety of techniques, some new, to promote maximum shareholder participation and enfranchisement.

We see this activism increasing in 2010.

In North America, regulators are facilitating increased shareholder involvement in response to activist shareholders who say the current rules are not allowing them to make their voices heard effectively. In the United States, in 2009 both the NYSE and the SEC made changes to proxy rules that are intended to make them more shareholder-friendly. Canadian regulators and shareholders are paying attention to these developments, and changes to the Canadian proxy rules may follow. The TSX recently enacted a rule change that will require a listed company to obtain shareholder approval when acquiring another public company if the transaction involves issuing securities in excess of 25% of the acquiring company's outstanding securities (on a non-diluted basis). Although this requirement is consistent with that of many stock exchanges outside Canada, it is a big change for the Canadian M&A landscape and we are already seeing its impact on deal structuring and risk allocation.

Several recent Ontario court and regulatory decisions have also demonstrated that tactics taken by management to interfere with shareholders' democratic rights will not be tolerated. In its decision in *Hudbay Minerals*, the OSC focused on Hudbay's governance practices in connection with shareholders' meetings, including a requisitioned meeting to change its board; the OSC sent a strong message against using tactical scheduling to frustrate the ability of shareholders to vote on a major matter. An Ontario court sent a similar message concerning management's use of technical tactical challenges in the recent proxy battle for control of management of the Citadel Group of Funds.

In 2010, equity holders, large and small, will continue their demands to formally exercise their democratic rights to have a say in corporate decisions. Companies should be ready to hear from their shareholders and proactively communicate the company's strategies. We think investor relations groups and proxy contest advisers will be busier than ever in 2010.



6

Private Equity: Baby-Stepping Its Way Back to the M&A Table

By Stephen Donovan and Cameron Koziskie

Private equity financial buyers on both sides of the border are poised to emerge from their long slumber. Financial buyers have been forced to the sidelines in the last two years, largely as a result of the scarcity of debt financing. There are strong signs that the Canadian and U.S. debt markets are back, and private equity players have begun to secure loans for their portfolio company acquisitions. Rates are higher and the quantity of debt may be reduced, but debt is now available to facilitate completion of deals. Given the more pronounced easing of credit conditions in Canada, coupled with the relatively stable state of the Canadian economy, we expect that Canadian targets will be of particular interest to both Canadian and U.S. private equity buyers in 2010.

Against this positive backdrop, the private equity buyout market continues to face headwinds. For many companies that don't need to sell, there remains a disconnect between seller and buyer on the most important deal term: valuation. Sellers regard the recent stock market and economic rebound as a sign that the "good ol' days" are back and have used that performance to convince themselves that their businesses should now command premiums near those available in 2007 (the top of the cycle). Private equity buyers are taking a more cautious approach and are very concerned about earnings visibility; they don't want to buy an earnings stream that is fraught with uncertainties, and they are particularly worried that the current recovery may be transitory. This disconnect could either result in the use of mechanisms (such as earnouts, multiple-stage closings or guaranteed exit mechanisms) to bridge the gap or slow the re-emergence of private equity buyers until convincing evidence appears to resolve the debate.



7

Media and Telecom Assets Will Change Hands

By Paul Cowling and Sharon Geraghty

The market is ripe for merger and acquisition activity in the media and telecom sectors. The recession, declining advertising revenues and increasing competition from the Internet and other non-traditional media continue to put financial pressure on conventional over-the-air broadcasters. They have been particularly vocal about the impact of these factors on their profitability and competitiveness as the Canadian Radio-television and Telecommunications Commission (CRTC) considers a possible new compensation regime for the broadcasters' over-the-air signals and as the 2011 deadline for transitioning to digital television approaches.

We expect these pressures and ongoing changes in the demand for media to put individual assets or groups of assets into play. We also see these pressures prompting some media companies to streamline their activities and shore up their capital structures by exiting non-core or unprofitable businesses. The recent closures and sales of local television stations may signal this trend.

Structural changes in the wireless market will also likely lead to asset movement. The Canadian government has been clear that it wants to see enhanced competition in this market. Several new entrants that emerged from the 2008 AWS spectrum auction are in the process of launching or will launch in 2010, with incumbents responding by upgrading their networks and adjusting their offerings. The Canadian government will also auction off the 700 MHz spectrum that will be made available from the transition to digital television, thereby also potentially creating opportunities for new entrants. We expect that these changes and developments will likely result in increased M&A activity and strategic partnerships among new entrants and incumbents alike.

In December 2009, the federal Cabinet overturned the CRTC's decision that Globalive, a new entrant that emerged from the 2008 spectrum auction, does not meet Canadian ownership rules. Globalive immediately became eligible to begin operations following the Cabinet decision, but some industry analysts have indicated that incumbents or other new entrants may decide to challenge the decision in the courts. The ultimate outcome will be closely watched by industry participants and potential investors who are thinking ahead to the next spectrum auction or considering acquisition and financing opportunities in the meantime.



8

More BioPharma M&A in 2010, but Healthy or Distressed? *By Cheryl Reicin*

As blockbuster drugs began to come off patent, big pharmas – fearing loss of revenue share – rushed to couple with their counterparts in 2009. The big pharmas are hungrily looking for additional products and innovation to fill their sagging pipelines and in 2010, they will refocus and continue to look to small and mid-sized biotech companies for licence, partnership and acquisition transactions.

The liquidity crunch in the venture capital community and capital markets has created an environment in which small and mid-sized biotech companies need to consider a pharma deal earlier than they may ideally desire. In addition, although licensing deals have traditionally been pharmas' preferred route of engaging with early-stage biotech companies, depressed valuations of public biotech companies are making acquisitions more attractive and, ironically, even cheaper than licensing deals. At the same time, the licensing deals continue to be increasingly complex financial deals, which are precursors to follow-up acquisition.

In 2009, distressed biotech merger and acquisition transactions often took the form of tax-loss deals and reverse mergers. In Canada, the tax-loss deals were fuelled in large part by Canadian income trust conversions, which led the income trusts to search for shelter for their revenues.

Mergers and acquisitions will continue to be strong in 2010 since pharmas' needs are unquenchable. The real question is whether the deals will involve healthy or distressed entities. The answer will depend largely on how wide the capital markets will open as well as the

alternatives available to potential targets. In the last half of 2009, U.S. biotech public markets were busy with registered direct offerings; the issue is whether the window will stay open and whether it will widen for larger traditional public offerings. The Canadian biotech public markets are still in slumber mode, but we see signs of movement. Another factor will be whether the competition for biotech deals among pharmas will increase or decrease with fewer players in the market.

Medical device mergers will also continue at a healthy pace, although the acquirors will be more deliberate and the valuations more rational than in the past.



9

Not a Pandora's Box: National Security Reviews of Foreign Investment in Canada Will Be Limited By Phil Mohtadi and Sue-Anne Fox

Recent changes to the *Investment Canada Act* allow the Canadian government to review foreign investments on national security grounds, regardless of the size of the target or of the investment. Accordingly, foreign buyers potentially face a new hurdle when investing in Canada.

“National security” is not defined, but we believe that an appropriate starting point will be whether the Canadian business has strategic or military importance. And although there is limited experience with the new process, we can identify three emerging trends, each of which tends to limit the scope of a possible review of foreign investment on national security grounds:

- **Investments in natural resources will not generally trigger national security reviews.** In 2009, neither China Investment Corporation’s minority investment in Teck Resources nor China-based Jilin Jien Nickel Industry’s acquisition of Canadian Royalties triggered a national security review. However, transactions involving the acquisition of strategic natural resources, such as uranium, may well trigger a review.
- **“National security” is not intended to encompass “national interest.”** Despite intense media coverage, political scrutiny and popular opinion that Ericsson’s acquisition of Nortel’s North American wireless business was not in Canada’s national interest, the government declined to review the transaction, a positive early indication that the national security process will not become politicized.
- **Enforcement staff will not presume that an investment by a state-owned enterprise or sovereign wealth fund will give rise to national security issues.** The United Arab Emirates’ International Petroleum Investment Corporation’s acquisition of NOVA Chemicals Corporation in 2009 did not involve a national security review. This result supports the view that the process will not be triggered solely because the investor is a state-owned enterprise or sovereign wealth fund.

10

Are We There Yet? Expect a Longer, Bumpier Ride in Canadian Merger Reviews *By Jay Holsten and Omar Wakil*

Canada's new merger review regime, enacted in March 2009, allows the Commissioner of Competition to "stop the clock" during her review of a merger by issuing a supplemental information request (SIR) before the expiry of an initial 30-day pre-merger waiting period. Since the issuance of an SIR extends the waiting period until 30 days after the parties have complied with its terms, the Commissioner is not under the same pressure to limit the scope of SIRs that she was with production orders under the prior regime. Before March 2009, a requirement for court approval and a fixed waiting period of 42 days imposed practical limits on document production and review. These constraints – which limited the time available both for parties to collect documents and for the Commissioner and her staff to review them – have now been removed.

In recent public statements, the Commissioner has attempted to assure the business community that the application of Canada's new review process will not mirror the much-criticized U.S. process on which it is based, and that she will be more "surgical" than her American counterparts in targeting document production. Nevertheless, parties to complex mergers should expect to receive broader and more demanding document production orders, which will affect review timing and increase compliance costs. This is a trend we have already begun to see.

The SIR process also provides the Commissioner with much more control over the timing of the review process than was previously the case.

In these circumstances, antitrust considerations take on greater strategic significance – particularly in complex cases in which timing is an issue – and reinforce the need to involve experienced antitrust counsel in the early stages of merger planning.



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