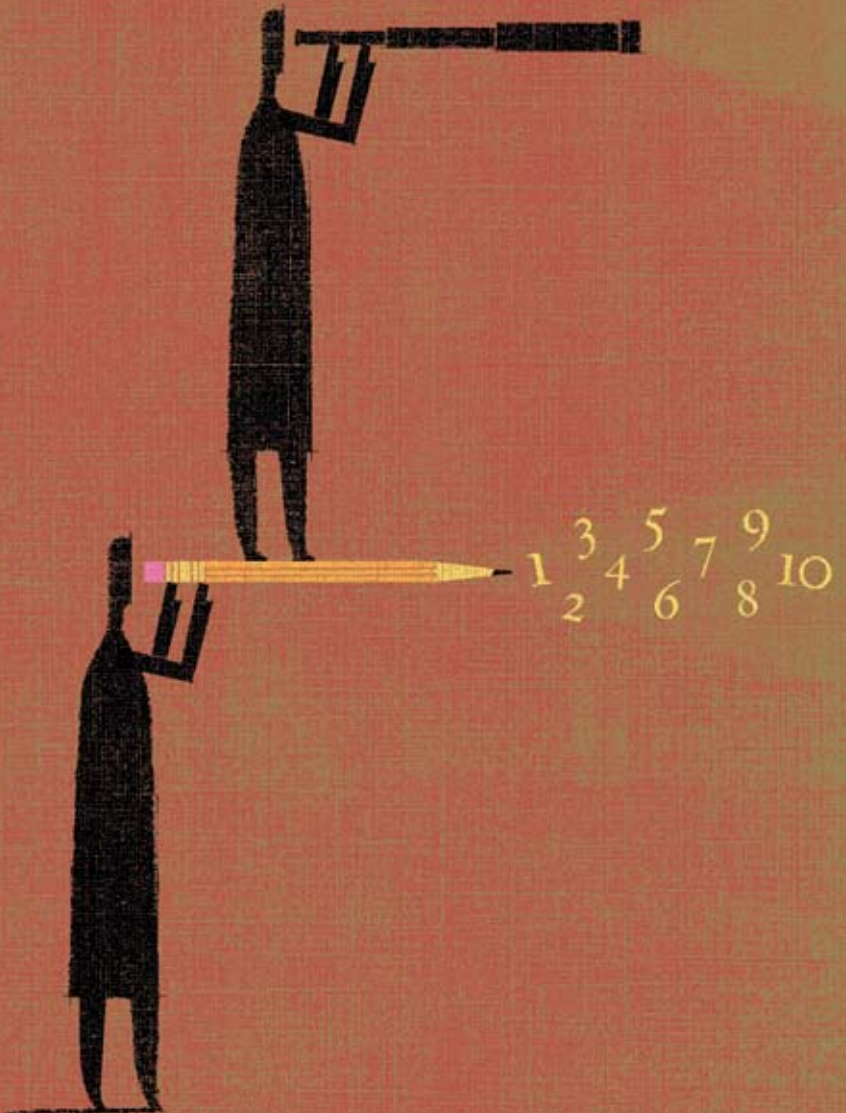


M&A TORYS' TOP 10
TRENDS FOR 2008





TORYS' TOP 10 TRENDS FOR 2008

During the first half of 2007, merger and acquisition activity continued at record levels, fuelled by the availability of financing on favourable terms. However, the “credit crunch” that began in the summer of 2007 ended what had been an unusual string of private equity-led and highly levered mega-deals. The continuing turmoil in the credit markets will be a key factor affecting M&A in 2008.

Torlys' M&A lawyers are looking ahead to 2008, and here's what they see.

- 1** Financing Terms Will Become More Restrictive
- 2** Deal Protection for Sellers Will Be a Key Focus
- 3** Private Equity and Hedge Funds Will Continue to Converge
- 4** Distressed M&A Opportunities Will Increase
- 5** Sale Processes Will Reflect Diminished Leverage of Sellers
- 6** Strategic Buyers Will Be More Competitive
- 7** Canadian Acquirors Will Have More Profile
- 8** Foreign Buyers Will Also Be More Prominent
- 9** Foreign Investment Approval Will Be More Significant in Assessing Deal Risk
- 10** Infrastructure M&A Will Be a Bright Spot

1

Financing Terms Will Become More Restrictive

The first half of 2007 saw credit markets that were highly favourable to borrowers. A frothy M&A market, coupled with extensive liquidity, made for intense competition among lenders. Credit from all sources – banks, commercial lenders, pension funds and others – was available in ever-increasing amounts, at aggressive leverage levels and historically low credit spreads, and on covenant terms that reflected the negotiating leverage of borrowers. Terms such as “covenant light” entered the lexicon as many of the safeguards that lenders typically look to, including financial covenants, were relaxed or jettisoned completely.

The period had the feel of a party that was soon to end, and it did – with the credit crunch that struck over the summer of 2007, precipitated by developments in the U.S. subprime market. In very short order, credit spreads were adjusted, commitments once again had substantial conditions attached and leverage tolerance was reduced dramatically.

We expect that the cautious approach by lenders, together with more restrictive credit terms, will continue through 2008. The full effect of the subprime crisis has yet to be felt in the North American banking industry and, given the market uncertainty, it will take some time for lenders’ risk tolerance to begin to regain some of the ground lost in the latter part of 2007. In particular, these are the patterns we expect to see:

- Credit spreads will continue to settle in at higher levels, reflecting the new risk assessment.
- Overall leverage will decrease and financial investors will be required to make significant equity contributions to transactions – in some recent

transactions this has been as high as 50%. Both these factors will have a significant impact on LBO deal size.

- The most aggressive financing techniques seen in the period leading up to the summer of 2007, such as lenders providing equity bridges, will not reappear in 2008.
- Financing commitments will not be available for many types of riskier deals that were readily underwritten a year ago; moreover, the commitments that are being issued will be subject to conditions, such as “market outs,” that lenders were routinely required to forgo in the first half of 2007.
- In loan documents, borrowers can once again expect to be required to meet maintenance-style financial covenants, such as maximum leverage ratios and fixed-charge coverage ratios, as well as negative covenants of the type that have traditionally protected lenders, such as negative pledges.

In broad terms, we expect to see a continued flight to quality where borrowers with solid fundamentals will still have a ready market for their debt requirements, but on terms that better reflect historical norms.

2

Deal Protection for Sellers Will Be a Key Focus

Buyers caught in the credit market downswing have been carefully examining whether the companies they agreed to purchase have suffered a “material adverse change” in their business. Typical merger agreements contain a closing condition that no material adverse change may occur to the target company’s business during the period between signing the agreement and completion. Though this condition was rarely invoked in the past, in the last few months of 2007, there were a number of cases in which a buyer took the position that a material adverse change had occurred and, accordingly, it was not required to complete the acquisition or would complete it only on renegotiated financial terms. This development will result in greater emphasis on deal protection for the *seller* during 2008 to limit a buyer’s ability to walk away.

In particular, we expect the following to occur:

- Sellers will attempt to further narrow the definitions of “material adverse effect” and “material adverse change” to limit the circumstances under which such an effect or a change will potentially be triggered.
- Sellers will pay greater attention to the quantum of “reverse break fees” and the circumstances in which a buyer can elect to terminate and pay the reverse break fee. Financial sponsors tend to acquire companies through the use of special purpose shell vehicles, rather than putting their investors’ assets directly on the line. However, these sponsors have also in the past agreed to guarantee the obligations of that vehicle up to a specified amount – the reverse break fee. We expect that in 2008, target companies will look to (i) obtain full recourse for the purchase price to eliminate the possibility that a buyer will choose to pay the reverse break fee and walk away; (ii) provide for a specific performance remedy that would allow it to force a closing of the transaction; and/or (iii) negotiate a higher reverse break fee that better reflects the “option” value of a deal with only a limited monetary remedy for a deliberate failure to close.
- Sellers will attempt to address “third-party beneficiary” issues. Current merger agreements provide little scope for shareholders of a target company to sue the buyer directly for lost-transaction premiums because shareholders themselves are not parties. This has been deliberate because the parties generally do not want to create a direct right of action for shareholders that would potentially permit individual shareholders to interfere with the deal. However, it is unclear what damages, other than out-of-pocket transaction expenses, the target company directly suffers in the case of a failed transaction since share premiums are not payable to the target. Third-party beneficiary provisions are intended to allow the target to sue the buyer on behalf of the shareholders for any lost premiums.

3

Private Equity and Hedge Funds Will Continue to Converge



The lines between private equity funds, hedge funds and other sources of financing will continue to blur as asset managers look for alternative ways to put money to work.

As pension funds continue to allocate substantial funds to alternative investments (including private equity and hedge funds), fund managers will look to diversify their range of investments. Private equity funds, traditionally long-term holders of controlling positions in companies, will increasingly consider shorter-term, non-controlling positions in their portfolios (such as KKR's investment in Sun Microsystems). In addition, hedge funds will continue to broaden their activities, taking longer-term positions in private, illiquid companies (such as Cerebus's acquisition of Chrysler). Lastly, tightening of the credit markets may create opportunities for private equity funds and hedge funds to provide debt financing to, or acquire existing debt of, buyout targets.

4

Distressed M&A Opportunities Will Increase

We believe that North America is entering a cyclical upturn in restructurings, which will result in an increased market for distressed M&A activity. As noted above, in the past economic cycle, markets experienced unprecedented growth in the availability of liquidity. The credit markets now appear to be reverting to a normalized historical pattern with lenders seeking a more conservative risk/reward equation, which restricts the availability of refinancing opportunities for a number of companies that borrowed during the liquidity upturn.

As credit markets tighten and the North American economy slows down, it is likely that some companies that have either overleveraged themselves or need to refinance existing covenant-light facilities will be forced to explore strategic alternatives, including restructurings and/or distressed sales of assets. In Canada, these factors will be heightened by the increasing pressure on manufacturers and exporters as a result of the rapid appreciation of the Canadian dollar vis-à-vis the U.S. dollar in an economy where the majority of exports still flow south of the border.

For investors, the cyclical downturn in the economy presents a number of investment opportunities. Involvement in distressed M&A can range across a continuum from early investment in a distressed company to participation in a later stage restructuring as part of a formal court process. Involvement may take the form of investments in convertible debt in companies that require a balance sheet infusion before a formal restructuring; the purchase of assets from a company that requires immediate cash; formal court proceedings to support a solvent company's reorganization through a plan of arrangement in Canada or a Chapter 11 plan of reorganization under the *United States Bankruptcy Code*; or investing in an insolvent company through either a

plan of reorganization under the *Companies' Creditors Arrangement Act* (CCAA) or the Code. In addition, distressed-fund managers and strategic acquirors will find opportunities to purchase assets through a court proceeding such as a CCAA reorganization, a receivership, a section 363 sale under the Code or from a post-confirmation liquidating trust.

In a pre-insolvency situation, we expect that there will be an increased focus on the use of plans of arrangement under Canadian corporate statutes, or plans of reorganization under the Code, for companies with a sound business platform that are facing liquidity issues due to tightening credit conditions or aggressive borrowing in the past economic cycle. These are companies that do not require the type of major operational restructuring that can be accomplished under the CCAA, but may require the use of a plan of arrangement to implement a debt-to-equity conversion or a sale of assets. Although plans of arrangement have not been used frequently in the past few years to implement financial restructurings, we believe that they are well-suited for this purpose.

5

Sale Processes Will Reflect Diminished Leverage of Sellers

In the first half of 2007, the value and number of Canadian and U.S. M&A deals reached record levels, due largely to the activity of private equity funds and the enormous amount of credit available on favourable rates and terms. The reduced availability of leverage has softened M&A deal activity. We believe that the continuing caution in the M&A market will result in fewer buyers and less competitive sale processes. We expect to see fewer auctions, increased use of post-signing market checks and more buyer-friendly terms in merger/support agreements.

We expect that target boards will look more favourably on pre-emptive bids and post-signing market checks (as opposed to auctions) to assist in satisfying their fiduciary obligation to maximize shareholder value. The “bird in the hand” will become more attractive. This impact on the sale process will allow both target companies and potential buyers to avoid the uncertainty and added expense of an auction process.

While Canadian regulators and courts in both the United States and Canada have recognized that auctions are generally the most appropriate way for directors to fulfill their fiduciary duty to maximize shareholder value, courts will typically defer to directors’ reasonable business judgment (including their decisions to solicit alternatives), provided that directors act free of conflicts and with due care in what they honestly believe to be the company’s best interests.

When a target company agrees to a transaction without conducting an auction or a pre-signing market check, target boards will be more likely to require “go-shop” clauses in merger/support agreements as a post-signing market check. Although go-shop clauses have been used less frequently in Canada than in the United States, there have been a number of recent

examples in Canada, including South Coast Partners’ acquisition of Oceanex; Spinrite Acquisition Corp’s acquisition of Spinrite Income Fund; Behringer Harvard REIT’s acquisition of IPC US REIT; OMERS’ acquisition of Golf Town Income Fund; and Algonquin Power Income Fund’s proposed acquisition of Clean Power Income Fund.

A go-shop clause is the opposite of the usual “no-shop” clause (which prevents a target from actively soliciting buyers). The go-shop provides a target with a limited period following the signing of the merger/support agreement to canvass the market for other purchasers. Typically, the target board will agree to pay a smaller-than-usual break fee if a competing transaction is agreed to during the go-shop period. The break fee will usually increase after the go-shop period expires. Provided the target board is comfortable that the go-shop clause would give it a meaningful opportunity to solicit a better offer, such a clause can assist the target’s board in satisfying its fiduciary obligation to maximize shareholder value where there has been only a limited auction or none at all. However, we expect to see more focus on the length of the go-shop period because arranging financing in these markets will take more time.

We also expect that bidders will more frequently demand and be able to secure more buyer-friendly terms, such as financing conditions and “hard” lockup agreements. Although takeover bids in Canada cannot be subject to a financing condition (unlike tender offers in the United States), there are no restrictions on financing conditions for acquisitions of private companies or those completed by way of amalgamation squeeze-out or plan of arrangement. Given the recent tightening of credit, we expect that buyers may be more likely to include financing conditions in private company acquisitions to reduce their exposure in the event that financing is not

available at closing, though they will not likely be found in public company acquisitions.

We expect buyers will place increased importance on obtaining irrevocable or hard lockup agreements to ensure the successful completion of a transaction, especially in jurisdictions such as Canada, where companies with significant shareholders are common.

Hard lockup agreements (whereby the shareholder agrees to sell to the original buyer regardless of any better offer) are currently less common than “soft” lockup agreements (whereby the shareholder is released if the target board exercises its fiduciary out). This is partly because institutional shareholders are cautious about limiting their ability to tender to a better deal in light of their fiduciary responsibilities. However, hard lockup agreements are legally acceptable in Canada and can make the success of a deal a foregone conclusion where a significant shareholder is in a position to block a change-of-control transaction. Parties signing a lockup agreement will want to ensure, however, that they do not trigger the “joint actor” rule under Ontario securities law; otherwise, the selling shareholder’s shares cannot be counted toward the required minority approval of any subsequent squeeze-out transaction, and the target board may have to conduct a formal independent valuation.

Recent decisions have clarified that a joint actor relationship will generally exist with a locked-up shareholder only if the shareholder is involved in the planning or negotiation of the transaction or is an equity investor.



6

Strategic Buyers Will Be More Competitive

In the previous period of favourable credit markets, financial sponsors often significantly leveraged the target company to outbid strategic offerors that were subject to different capital restrictions or that planned to offer their own shares as partial or full consideration. In the current market, we expect strategic bidders to be more competitive for several reasons. Strategic bidders have different considerations in making acquisitions, including transaction synergies and competitive factors, that make them less likely to re-evaluate a transaction on the basis of short-term market developments. Also, strategic bidders can offer shares, may have access to their own stream of cash flow and may have greater access to credit if they have a strong balance sheet. All these factors will allow them to structure offers that are less subject to credit market deterioration. Finally, strategic bidders tend to sign acquisition agreements directly, thereby becoming liable for failure to complete a transaction – unlike financial sponsors, which typically have an acquisition vehicle sign the agreement. Accordingly, offers from strategic bidders may have less risk associated with them, making them relatively more attractive.

More activity by strategic buyers, however, heightens the prospect of competition and antitrust concerns, given the potential for in-market acquisitions to increase market concentration and confer market power; such activity will thus enhance the importance of competition and antitrust considerations in the transaction planning process.

Share-exchange acquisitions by Canadian strategic buyers could also become more complicated if the Toronto Stock Exchange enacts new shareholder approval rules. The TSX is currently considering whether to require shareholder approval in certain circumstances where shares are issued to acquire a public company.



7

Canadian Acquirors Will Have More Profile

We expect an increased number of foreign acquisitions by Canadian businesses, and foreign investments by Canadian pension and private equity funds. An obvious reason for this is the strength of the Canadian dollar. During the third quarter of 2007, for the first time in more than 30 years the Canadian dollar reached, and at times even exceeded, parity with the U.S. dollar. Although exchange rates at any particular moment will not alone drive foreign investment, other factors are also aligned. Sector-specific circumstances are at play in, for example, financial services, where Canadian banks and insurance companies are generally strong relative to potential targets in the United States.

Of particular note is the increased foreign M&A activity that can be expected from Canadian pension plans as they continue to expand their interest in alternative, non-public market investments. Many Canadian pension plans now have investment mandates that allow contributions to be invested in “private equity-type” investments, which include being participants in buyouts. This participation by Canadian pension plans has recently ranged from passive equity co-investor to co-sponsor member of a bidding joint-venture syndicate to outright acquisitions. Investment mandates are not limited to Canadian investments and often expressly contemplate the making of international investments to diversify the particular pension fund’s portfolio. Canadian pension funds constitute some of the largest and fastest growing pools of available investment funds in the world. With available investment capital in the billions of dollars and relatively long-term investment realization horizons, Canadian pension plans are expected to be even more active in M&A in years to come.

8

Foreign Buyers Will Also Be More Prominent

Throughout 2007, strategic buyers from India, the Gulf States, Russia and China have become increasingly prominent in Canadian and international M&A transactions. Spurred on by booming domestic economies and largely unaffected by the credit issues, buyers (state-owned and otherwise) from these countries are likely to be even more prominent in transactions in 2008.

The potential for transactions led by these buyers is not likely to be limited to specific industry sectors, although mining, metals and commodity-related targets in Canada and the United States are likely to continue to draw interest, as will targets in the information technology, life sciences and automotive industries. Last year, buyers from these countries looked increasingly to the financial sector and the investment management industry, with several announced transactions involving banks and private equity and hedge fund managers. This trend too is likely to continue in 2008 through both outright acquisitions and investments by buyers who are seeking strategic alliances as the ultimate goal.



9

Foreign Investment Approval Will Be More Significant in Assessing Deal Risk

Governments in Canada and the United States are tightening controls on foreign investments as they relate to foreign state-owned enterprises and national security. We expect issues relating to foreign investment to continue to occupy the political spotlight in 2008.

In Canada, the government is following through on plans to critically review the application of the *Investment Canada Act* to foreign investment. It placed restrictions on investments by foreign state-owned enterprises, and has announced plans to introduce legislative amendments that would allow investments to be blocked on national security grounds. The government has also struck a Competition Policy Review Panel to engage in a broader review of the key elements of Canada's investment and competition policies to ensure that they are working effectively.

New guidelines clarifying the application of the *Investment Canada Act* to takeovers of Canadian businesses by foreign state-owned enterprises (SOEs) reflect the government's policy that the governance and commercial orientation of SOEs should be taken into account when considering whether their investments would be of net benefit to Canada. Despite some uncertainties about how they will work in practice, the guidelines provide timely and important clarification of the way in which the government may be expected to enforce the Act in an era of active foreign investment by SOEs.

The national security amendments are likely to be more controversial. Previous attempts at legislative change that left key terms such as "national security" and "national interest" undefined were criticized for potentially giving regulators broad and open-ended powers to review a very wide range of investments on

national security grounds. Legislators will need to take particular care to ensure that any amendments are not unclear or overly restrictive such that the benefits of foreign direct investments are lost as foreign companies decide to invest elsewhere.

The work of the Competition Policy Review Panel is well underway and may lead to an overhaul of the *Investment Canada Act*. Among other things, the Panel will consider whether changes to the *Investment Canada Act* are advisable to "address the challenges and complexities of the modern global economy." The Panel report is expected in June 2008.

In the United States, the recently enacted *Foreign Investment and National Security Act of 2007* (FINSA) expanded the scope of foreign investment that is subject to review for national considerations by the Committee on Foreign Investment in the United States. The term "national security" now includes those issues relating to "homeland security," including its application to "critical infrastructure." FINSA also imposes a higher level of scrutiny on foreign government-controlled acquirors, and provides for a more transparent process than in the past.

This increased emphasis on foreign investment means that foreign buyers that are SOEs or that acquire critical infrastructure or other assets that might affect national security will be more focused on these foreign investment approvals when assessing the completion risk and timing of their transactions. We also expect to see provisions in merger or acquisition agreements dealing more explicitly with these risks than has been the case in the past.

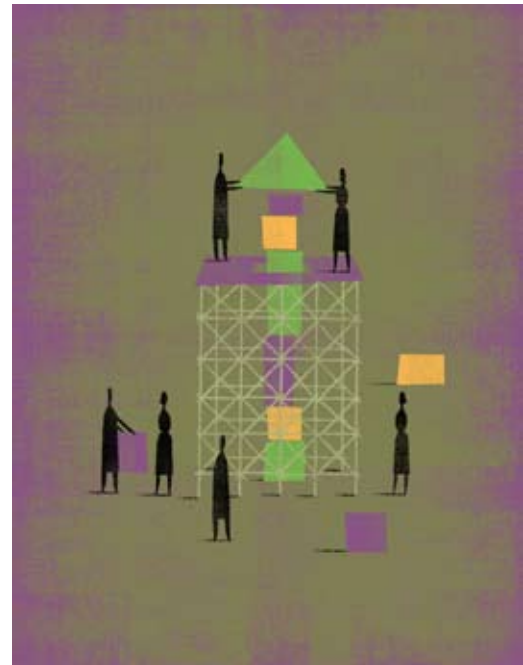
10

Infrastructure M&A Will Be a Bright Spot

Countries all over the world, including Canada and the United States, are experiencing a growing need to replace or expand their infrastructure – roads, railways, bridges, ports, airports, power assets, transmission lines, pipelines, and communications networks. As this demand grows, the need for private sector investment in infrastructure will continue to increase. Facing enormous costs, governments are looking to the private sector for help – and infrastructure funds are responding.

In the past two years, we have seen significant growth in the formation of specialized infrastructure funds to provide private sector investment in infrastructure assets. We expect this trend to continue in 2008 as more investment banks and private equity firms are looking to invest in this unique asset class. Infrastructure funds will, however, face stiff competition for these assets from another class of investor – the pension funds. Infrastructure assets are particularly well-suited for long-term investors such as pension funds, which have corresponding long-term liabilities. The infrastructure asset class offers long-term, inflation-indexed returns, which typically provide stability over time.

As infrastructure and pension funds seek to deploy their capital and as governments become more comfortable with private sector investment in the infrastructure asset class, we expect M&A activity in this sector to increase. In addition, with more funds being raised for the infrastructure sector and competition for infrastructure assets intensifying, infrastructure funds may look beyond the traditional definition of infrastructure to assets that have infrastructure-like characteristics and returns; we also expect that infrastructure funds will look worldwide for opportunities, including in non-OECD countries. Finally, we do not believe that the credit crunch will affect the infrastructure sector as much as other industries. Borrowers with high-quality assets, such as infrastructure businesses, should still have a receptive market for their debt requirements.



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