M&A | Top Trends 2016

TORYS LLP

# Torys looks ahead to the 10 trends that will shape M&A.

# OVERVIEW

Appetite for deals is set to define many of the trends in M&A in the year 2016. We see dealmakers pursuing novel ways to source investment opportunities, solve governance issues and close their transactions.

Investors are looking for new opportunities to use their capital, and the emergence in Canada of the special purpose acquisition company or "SPAC" is one example of this trend. Creative business collaborations are also driving deal activity: we expect more businesses will join forces with local investors, strategic partners and competitors to advance their strategic objectives.

M&A initiatives will continue to encourage the growth of Canadian investment outside Canada alongside emerging opportunities for foreign investors in Canadian assets. Attractive domestic targets will include distressed businesses in the oil and gas sector as the steep drop in oil prices and tightening of capital markets begin to take their toll.

Infrastructure is also drawing interest from investors. We expect competition in this space to increase among traditional infrastructure investors and private equity investors, who are both allocating capital to a broader scope of infrastructure investments, including businesses that support core infrastructure assets. Electricity businesses are especially drawing the attention of investors, as governments look to consolidate assets in this sector.

The changing corporate governance landscape is influencing dealmaking as activists and management increasingly collaborate on improving shareholder value. This trend toward discussion, negotiation and agreement on business strategy will forestall hostile, formal proxy contests, resulting in more "wins" for shareholders.

Evolving governance practices can also be seen in executive compensation arrangements in M&A transactions as public scrutiny continues to grow. We predict that the focus of compensation practices in the deal context will shift from severance to retention and the long-term best interests of the company.

Other steps are also being taken to ensure the success of new business combinations. Early planning on tech-related issues and assets "in the cloud" is helping dealmakers close transactions successfully. More parties may also opt to resolve regulatory intervention on their transactions through litigation in order to get deals done.

Torys' M&A lawyers are looking ahead to 2016, and this is what they see.

# OUR EXPERTISE

We have a decades-long history of being considered among the best M&A practices in Canada, with a strong presence in public and private markets across the country, in the U.S. and around the world. We specialize in sophisticated, complex and innovative transactions, both public and private. Among our long-standing clients are major corporations, entrepreneurial and growth-oriented companies in all major sectors, investment funds, pension funds and all levels of government.

## GETTING DEALS DONE

Our M&A team works across practices, industries and borders to get deals done for our clients. Our experience and commercially minded approach allow us to run deals of any level of complexity or profile smoothly. We draw from the firm's sector expertise to run deals efficiently across virtually every sector, including REITs, mining, oil and gas, power, infrastructure, pharma, life sciences, and technology and media.

**#1**

Ranked Band 1 by Chambers and Partners

**OVER $175 BILLION**

Value of deals from 2014-present

**+141 DEALS**

Across 16 industries

# TORYS' M&A PRACTICE

A SELECTION OF OUR RECENT DEALS

CINVEN

**US$3.5B**

SALE OF AMDIPHARM MERCURY LIMITED TO CONCORDIA HEALTHCARE CORP.

ALAMOS GOLD

**US$1.5B**

MERGER WITH AURICO GOLD INC.

ROGERS COMMUNICATIONS JOINT VENTURE ARRANGEMENTS WITH BCE INC. TO ACQUIRE A

**50%**

STAKE IN GLENTEL INC.

BROOKFIELD PROPERTY PARTNERS

**US$5.5B**

BID TO ACQUIRE THE REMAINING INTEREST IN BROOKFIELD OFFICE PROPERTIES INC.

LOBLAW

**C$12.4B**

ACQUISITION OF SHOPPERS DRUG MART CORP., ONE OF CANADA'S MOST RECOGNIZED RETAIL BRANDS

CANADIAN PENSION PLAN INVESTMENT BOARD

**US$12B**

ACQUISITION OF ANTARES CAPITAL, GE CAPITAL CORP.'S PRIVATE EQUITY LENDING UNIT

# CONTENTS

1

# SHAREHOLDER ACTIVISM: WHO IS WINNING NOW?

James D. Scarlett, James C. Tory, Karrin Powys-Lybbe

Shareholder activism continues to develop and expand in Canada. We are seeing continued growth in activity and influence from activists coupled with a decline in activist initiatives that reach the point of publicly disclosed proxy contests. This is due to the increased willingness of directors and activists to engage constructively with each other rather than view their interactions as a "contest" in which either management or the activist "wins" with the other being the "loser." Such constructive engagement is increasingly becoming the price that activists and incumbent boards must pay to win the support of traditionally passive institutional investors who are becoming more and more engaged in their portfolio companies and whose support will often be decisive to the success or failure of an activist campaign. The result should be more "wins" for shareholders.

While the number of formal proxy contests has been declining in Canada since a high point in 2012, shareholder activism is now a familiar part of the capital markets in Canada. And there is no sign that the pressure on boards will abate: FTI Consulting recently conducted a survey of 24 activist firms that found that 96% of activists believe that this activity will continue to increase, with primarily activist funds holding assets of US$169 billion and partially focused funds having an additional US$173 billion.[1]

**A recent survey by FTI Consulting reports the following:**

**86%** of the activists surveyed expect to raise more capital in the next 12 months.

**70%** of the activists surveyed expect to increase partnerships with institutional investors and pension funds.

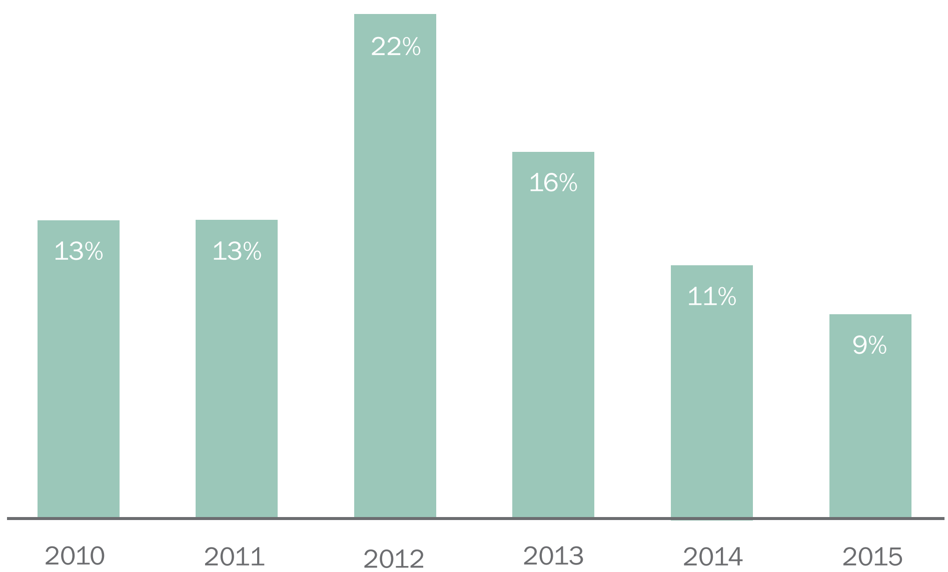
as competition grows in the U.S. market, activists will look more closely at Canadian and European targets.

[1] Source: *The Shareholder Activists' View 2015*, FTI Consulting. Available at: http://www.fticonsulting.com/~/media/Files/us-files/insights/reports/shareholder-activism-parti.pdf

The tactics of activists vary—some pursue “winner-take-all” control challenges and others work toward change through agreements with incumbent boards—but in each case there is a challenge to the status quo.

So who is “winning” this war these days, and what does the future hold? That depends on how you define success. There has been a decline in the number of formal proxy contests in Canada from 2012 to 2015 and it appears as if management has been able to hold its ground more often in the last two years. In addition, challenges are increasingly transactional—initiatives proposing operational change or implementation of specific transactions—rather than board/proxy control contests. There are also more instances of activist shareholders reaching a settlement with their target before getting to the stage of a formal proxy contest.

### Figure 1. Decline in Formal Proxy Contests in Canada




Percentage of activist campaigns (2010-2015) that resulted in a formal proxy contest, based on a review of SEDAR filings. 2015 data as of November 1, 2015.

This could be interpreted as management starting to win. But those statistics only tell part of the story. Behind the statistics, the trend we are seeing is for management and boards to recast the battle, seeing this as an opportunity to engage in productive discussions with shareholders as the directors discharge their fiduciary duties. An activist’s agenda may reflect “short termism” of a kind that no responsible board could support, but not always. Activists are often well informed and may be able to provide insights on strategy, market or other factors that the board and management should be considering. By engaging with such activists with a view to the best interests of the company, boards are able to settle disputes before they become formal proxy contests, contributing to the decline we saw in the number of publicly announced proxy contests in 2015.

Constructive board engagement with shareholders is increasingly important in the changing corporate governance landscape in which managements' traditional shareholder relations approach risks falling short of the governance expectations of institutional shareholders. Prudential institutional investors are abandoning their passive approach to their portfolio companies in favour of greater engagement, looking to maximize the value of their investments by focusing on improved corporate governance. The support of institutional investors requires boards to demonstrate their expertise, independence and willingness to engage constructively with shareholders, including activists who are pursuing shareholder-friendly agendas.

This approach was seen in Trian Fund Management, L.P.'s campaign to gain four seats on the board of E.I. du Pont de Nemours & Co (DuPont) earlier this year. DuPont succeeded in defending against Trian's campaign, and its success was reportedly due to its active engagement with investors, strong communication and execution of the company's strategic plan, and effective responses to criticisms made by Trian. DuPont's directors and senior management team were directly engaged in these initiatives, helping gain support of shareholders for a persuasive plan to grow shareholder value.

Where does this leave us when looking ahead to 2016? We think shareholder activism and increased engagement of institutional shareholders will continue. We also think we will see a continuing trend toward discussion, negotiation and agreement on business strategy, involving management, activists and other shareholders, forestalling hostile, formal proxy contests. The result will be more "wins" for shareholders.

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2

# THE M&A CLOCK IS TICKING FOR SPACS IN CANADA

John Emanoilidis, Rima Ramchandani, Mile T. Kurta

A special purpose acquisition company, or SPAC, is a publicly traded shell company created with the commitment to purchase an unidentified future target. Long popular in the United States, this novel way to finance an M&A transaction has broken ground in Canadian IPO markets. So far, the Canadian variety is modelled closely after the U.S. SPAC, sharing a number of investor-friendly characteristics and among them, a defined timeline to source an acquisition. The future of SPACs in Canada—including the success that the country's early adopters will have in investing approximately C$1 billion of raised capital—is a trend being followed closely by market participants.

## How Does a SPAC Work?

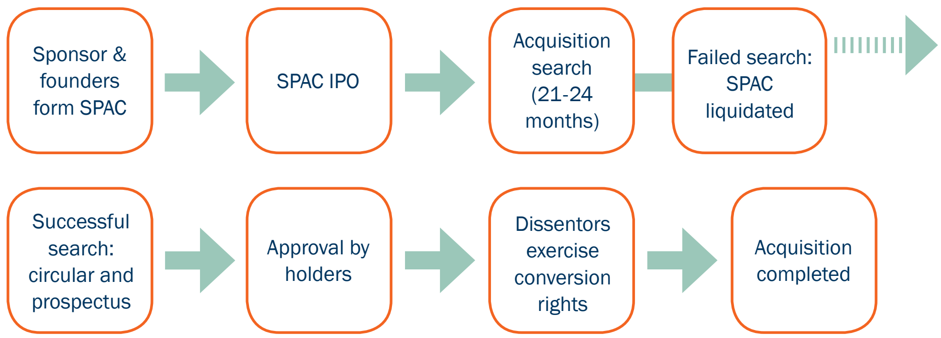
A SPAC is a shell that raises capital through an IPO to investors. IPO proceeds are placed in escrow to fund the future acquisition of one or several businesses or companies (a "qualifying acquisition"). At the IPO stage, the SPAC has no revenue, assets or operating history, but is backed by a sponsor and proven management team or founders with the relevant knowledge and contact base to source the prospective transaction. It is on the strength of the founders' expertise that investors are willing to invest in a SPAC.

Units offered to investors typically comprise one share and a half purchase warrant exercisable at a premium to the IPO unit price following completion of the qualifying acquisition. If the acquisition is not completed by the set date—typically 21 to 24 months after the launch of the IPO—the SPAC is liquidated and escrowed proceeds are distributed to investors. The founders, who normally hold a 20% equity stake in the SPAC, cannot participate in the liquidation and lose their initial investment.

A qualifying acquisition cannot be completed without approval from investors by a majority vote. Under current practice, sponsors are entitled to vote their equity stake on a proposed acquisition, which facilitates meeting the shareholder approval requirement. Shareholders may also exercise conversion rights entitling them to receive their pro rata portion of the escrowed proceeds, regardless of whether and how such shareholders vote on the proposed acquisition. Current practice limits the exercise of these conversion rights by prohibiting a SPAC shareholder and its affiliates and joint actors from converting more than a total of 15% of the number of SPAC shares issued and outstanding following closing of the IPO.

Newer U.S. SPACs dispense with the shareholder approval requirement, thereby removing a degree of uncertainty; rather, shareholders are given the right to have their interest redeemed for cash without a shareholder vote (unless otherwise required by law or stock exchange rules). In addition, the JOBS Act has made it simpler and more cost-effective for SPACs to go public in the U.S. by reducing some public company reporting requirements.

## SPAC Process




## Who Might be Interested in a SPAC?

SPACs are intended to provide an opportunity for the public to invest in companies that normally attract investment from private equity firms, with the benefit of significant investor protections, including the right for investors to vote on the qualifying acquisition, exercise their conversion rights described above or recover their pro rata portion of the escrowed fund if the SPAC fails to complete a deal within the specified timeline.

For target companies, the SPAC presents an alternative to a traditional IPO: the seller can cash out with the possibility of retaining an equity stake in a publicly traded vehicle that has immediate access to a strong and reputable board of directors and management team. As a listed shell company with no operating history, the SPAC also gives targets access to the capital markets in a process potentially less costly than undertaking a reverse takeover of an existing public company.

## What Makes a SPAC Successful?

The key driver in a SPAC IPO's success is the strength and credibility of the founders selecting the target acquisition. And unlike traditional PE funds that may have investment restrictions, the SPACs that have gone public to date generally permit their founders to focus on the target, geography and sector of their choice. However, as the Canadian SPAC market matures, we would expect to see SPACs with a more clearly defined sector or geographic focus.

Founders face a relatively short deadline to source a quality target in a competitive environment, seek shareholders' majority approval (including preparing and filing an information circular and prospectus on the proposed acquisition) and consummate the transaction—and if they fail to meet the deadline, the founders must forfeit their investment in the SPAC. It may also be challenging for SPACs to compete in hot auctions where other prospective buyers may not be subject to similar restrictions.

Success also depends on the extent to which shareholders exercise their conversion rights. The withdrawal by some dissenting shareholders of their relevant portion of the escrowed proceeds in the face of a proposed acquisition has the ability to influence the amount of funds readily available to complete the transaction. This may require the SPAC to raise additional financing, adding another layer of complexity and timing to the process. While a proposed acquisition will also be conditioned on conversion rights not being exercised beyond a set threshold, uncertainty around shareholder response contributes to the overall risk profile of the SPAC.

Recent U.S. SPACs have introduced a number of workarounds to address conversion risk. For example, third parties and sponsor-related parties have made equity investments in the SPAC prior to completion of the acquisition, or committed to do so in the event of a capital shortfall. Proceeds have helped secure SPAC cash levels while also demonstrating investors' backing of the proposed acquisition. SPACs have also raised capital through private placement offerings timed simultaneously with the acquisition closing.

The success of the SPAC in Canada will be measured in a few years' time, when the race to beat the clock and complete a qualifying acquisition has been decided.

On the flipside, a successful SPAC has the potential to make significant gains for founders with a 20% stake (which they acquired for nominal value on the SPAC's formation) in the post-acquisition vehicle, though U.S. practice shows that these sponsor promotes have been reduced as part of the agreement reached to complete a qualifying acquisition. It remains to be seen whether the size of sponsor promotes will equally decrease in Canada as the SPAC market here evolves.

## SPACs in Canada so Far

Currently, the structure of the Canadian SPAC is largely influenced by the U.S. model described above. TSX rules require that SPACs complete a qualifying acquisition within 36 months of their IPO, though all recent Canadian SPACs have been structured to complete their acquisitions within a more competitive 21 to 24 months (unless shareholders and the TSX approve an extension to 36 months).

The Canadian SPAC IPOs launched this year have largely drawn interest from both Canadian and U.S. institutional investors, with the type of retail investors often seen investing in SPACs in the U.S. not yet forming a significant portion of the Canadian investor pool. The founders of these SPACs include some of Canada's most experienced and successful business players, who are expected to extend their access to vast networks and potential acquisition opportunities to the SPACs they have helped found. Long term, the success of the SPAC in Canada hinges on whether the SPACs that have gone public will complete qualifying acquisitions within their tight timeframes.

## Is the Canadian SPAC Here to Stay?

Like other IPOs, SPACs are subject to market conditions. Their emergence in Canada comes at a time when investors are looking for ways to commit their capital. Ultimately, players hoping to engage in a SPAC in Canada should view the opportunity not only alongside their broader assessments of the marketplace, but also with the understanding that a SPAC's ultimate success will be measured in a few years' time, when the race to beat the clock and complete a qualifying acquisition has been decided.

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3

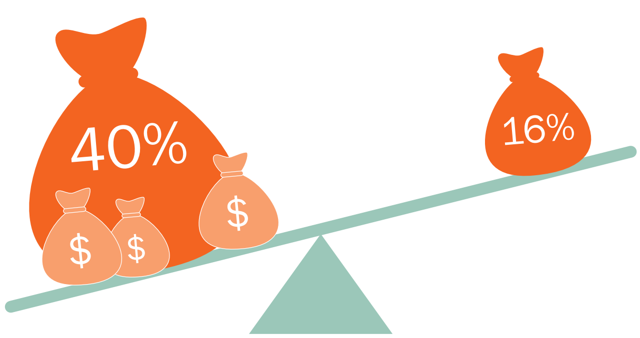
# NEW INVESTORS, NEW SCOPE: INFRASTRUCTURE INVESTING IS BROADENING

Mark W.S. Bain, Matthew W. Cockburn, Tara A. Mackay

Significant capital expenditure will be required in the years ahead to improve infrastructure worldwide. As governments look to private capital to play a role in this push, competition among investors for infrastructure assets is growing rapidly. Private equity funds are increasingly looking to invest in infrastructure-like assets. At the same time, traditional infrastructure investors are broadening the scope of their investment mandate: they are shifting their focus from direct investments in core infrastructure to related businesses and operations that support them. This is leading to an overlap of infrastructure investors and private equity investors in this space. We expect this trend will continue.

## The Appeal of the Infrastructure Asset Class

Investors are increasingly allocating capital to infrastructure investing. The growing appeal of the asset class can be attributed to a number of factors: it offers some protection against economic cycles and inflation; it is less volatile than traditional private market investments; and it provides steady cash flow returns. Infrastructure investing also matches well with the investment profile of investors with longer-term liabilities, such as pension funds.




In a report by Preqin, over 40% of investors surveyed intended to increase infrastructure investing in 2015. Only 16% planned to allocate less funds.[1]

[1] Source: *2015 Preqin Global Infrastructure Report.* Available at https://www.preqin.com/item/2015-preqin-global-infrastructure-report/4/10606.

In the private equity space, investors are establishing investment funds with longer investment horizons to pursue infrastructure deals. They are also dedicating more capital to the sector. For example, KKR recently raised a US$3.1 billion global fund focused on infrastructure investments. Domestically, Canada Pension Plan Investment Board also recently announced the formation of an investment vehicle with allocated funds in excess of C$1 billion targeting investments in midstream energy infrastructure in the Western Canadian basin.

It follows that investor demand for core infrastructure assets is high and competition is driving up prices. As a result, infrastructure investors are now looking beyond core assets for opportunities to invest in businesses that support or manage infrastructure such as transportation assets, water utilities, power generation and social institutions. For infrastructure investors, these businesses share many of the attributes of the underlying assets—because they relate to essential services with steady, long-term consumer demand, they too present lower commercial risk and often benefit from long-term contracts guaranteeing stable revenue streams. However, these businesses can benefit from improved efficiencies and present opportunities to realize enhanced returns, thereby also appealing to private equity investors.

## Private Equity in Infrastructure: What are the Challenges?

Alongside infrastructure investors, we are increasingly seeing private equity players pursue investments in infrastructure-related businesses where prospects to maximize value present a compelling business case. However, unlike conventional investing in the private markets, deals in infrastructure present unique challenges that private equity investors must face.

### Regulation

These businesses are heavily regulated, either as a result of the regulatory framework that applies to the infrastructure asset and/or the longer-term contracts that govern it. Government-led sales processes are also highly regulated, making them more challenging than typical private company auctions. Investors will need to make important concessions about transparency, both in relation to the sales process and the business once it has changed hands.

### Operations

Complex businesses may require deep industry knowledge and expertise. And while day-to-day control may reside with the investor, the investor will nevertheless face overarching operational restrictions under the relevant contractual framework or concession agreement.

### Governance

Investments in these businesses may require partnering with the public sector. The government entity will have certain control rights over investment decisions and the exercise of those rights will not always be driven by business considerations; social, political and economic considerations may have equal, or even more important, weight in decision-making processes. These rights will ultimately constrain what the investor can do with the business, particularly on exit.

## Transparency will need to be considered when making investments in highly regulated businesses in the infrastructure space.

Despite these challenges, we predict that the overlap between private equity and infrastructure investing will keep expanding. This is especially the case as governments and institutions turn their attention more and more to addressing infrastructure needs. In Canada, the platform of the newly elected federal government contemplates significant investment in infrastructure assets along with other strategies, including a federal infrastructure bank[2] to help provincial and municipal governments finance projects.[3]

Time will tell how these plans unfold in Canada as governments around the world focus on projects to develop, refurbish and upgrade infrastructure. And as private investors venture into the infrastructure space, they may need to adjust their traditional perceptions about, and approach to, dealmaking in order to tap into this growing sector.

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[2] Source: Liberal Party of Canada. Available at: http://www.liberal.ca/realchange/canada-infrastructure-bank/.

[3] Source: Liberal Party of Canada. Available at: https://www.liberal.ca/trudeau-commits-to-largest-infrastructure-investment-in-canadian-history/.

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4

# CONSOLIDATION IN THE REGULATED ELECTRICITY SECTOR IS ACCELERATING

Sharon C. Geraghty, Charles Keizer, Aaron S. Emes

Circumstances are converging to encourage consolidation in the electricity sector. Electricity businesses are gaining attention from investors as attractive M&A targets. Particularly on the transmission and distribution side, these highly regulated businesses tend to deliver predictable returns that are attractive in low-interest-rate markets.

Concurrently, many electricity businesses are owned by governments that face growing pressure to find efficiencies and new sources of money to fund infrastructure spending, increasing the likelihood that the businesses will become available for acquisition. The combined influence of these factors is starting to be felt.

## Investor Demand

Electricity transmission and distribution businesses are gaining in popularity as targets for acquisition. Fortis Inc., an integrated electricity utility company that had its beginnings as a Newfoundland transmission and distribution business, acquired CH Energy Group in 2013 and UNS Energy in 2014, which operate regulated electricity and gas distribution businesses in the United States. In 2014, Berkshire Hathaway purchased AltaLink from SNC Lavalin in a transaction that placed a higher value than expected on the Alberta transmission assets, demonstrating the attractive prices that the private sector is prepared to pay for these assets. And recent transactions are also demonstrating the potential that these businesses have to grow: in September 2015, Nova Scotia-based energy company Emera Inc. announced its intention to acquire TECO Energy, a U.S. power generation business.

## Appetite to Consolidate

Governments looking to dispose electricity-sector assets are also generating M&A activity. Many government-owned electricity distributors lack the capital and other resources necessary to adapt to change and increase efficiency—and in some regions, the government is creating incentives to accelerate the consolidation process. In the spring of 2015, the Province of New South Wales in Australia obtained a mandate to lease a 49% stake in its transmission and distribution network to fund new investment in infrastructure. The government is rumoured to have received interest from a number of pension and other offshore investors.

The Canadian electricity landscape is also seeing movement toward consolidation. In 2014, the Ontario provincial government struck the Premier's Advisory Council on Government Assets, chaired by Ed Clark, which recommended a number of changes to generate funds for infrastructure development and spur consolidation in the electricity distribution sector. Following those recommendations, on November 5, 2015, the Province of Ontario in Canada sold a 15% interest in its transmission and distribution business by way of an initial public offering of the shares of Hydro One Limited to fund infrastructure investment.

## M&A in the Regulated Electricity Sector: What are the Challenges?

As is the case in many other highly regulated sectors, M&A in this sector poses unique tax, regulatory and other challenges (see Trend 3, "New Investors, New Scope: Infrastructure Investing is Broadening," p.15). For example, Ontario's payment-in-lieu tax provisions for municipally owned utilities have generally discouraged consolidation. To address this concern, the government has temporarily reduced various tax components to further foster consolidation.

Where the assets are owned by municipalities or other governments, the political approval process may introduce uncertainty and timing challenges. Also, because electricity transmission and distribution businesses are largely rate-regulated, parties must pay careful attention to the impact of the transaction on ratepayers. The rate-setting process is critical to value, and the ability of an acquiror to retain the benefit of synergies, harmonize rates and grow the rate base can have a significant effect on the economics of the deal. In many cases the acquisition itself may also require approval by the rate regulator. As well (as was the case for Berkshire Hathaway's acquisition of AltaLink), foreign investment and anti-trust approvals may be necessary. The regulatory approval processes in Canada, the United States and elsewhere can be prolonged, requiring careful negotiation of terms to facilitate the approval process and fairly allocate between the parties the risk of a failed approval or unacceptable terms being imposed by a regulator.

## Conclusion

The growing number of investors amenable to taking on the regulatory challenges of businesses in the electricity sector speaks to the appealing characteristics of these assets, such as stable long-term returns. In the year ahead, we expect to see factors unique to regulated regimes continue to converge with investor interest to fuel M&A activity in this space.

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Special Feature

# ED CLARK ON WHAT'S AHEAD IN 2016

Sharon C. Geraghty, Sophia Tolias, Konata T. Lake

The breadth of Ed Clark's distinguished career, including serving as former President and CEO of TD Bank Group and his current position as Business Advisor to the Premier of Ontario, affords him unique insight into the private and public sectors. Torys lawyers Sharon Geraghty, Sophia Tolias and Konata Lake had the opportunity to interview Mr. Clark for his thoughts on Ontario business and the economy in the year ahead.

Photographer: Jonathan Pushnik

**Q. Tell us about your new role as business advisor to the Premier of Ontario.**

**A.** I do two things. First, I am an economist by training and have been involved in the economy through my experience running a large financial institution. This has allowed me to give the Premier my views on what works and what doesn't work economically in Ontario. I can bring business perspective to how businesses will react to different initiatives.

Second, I play a project management-type role on files with heavy private sector content. As someone from that community, I can help the Premier understand where they are coming from and how they may respond to an issue. I can also help the business community understand the political scene and how their voices can best be heard in that context.

**Q. What are your top recommendations for Ontario business and the economy in the years ahead?**

**A.** In the years ahead, we need to do two things. We have to work on making our existing economy more competitive, and as a country we must recognize how dramatically the world is changing. We need to shift our focus from manufacturing goods to innovation and services and become an exporter of innovative service products.

**Q. You recommend an "outcome-based approach" to regulation. Can you tell us more about that?**

**A.** To make our economy more competitive, we should address regulatory burden for businesses. Practically, an outcome-based approach involves government mobilizing the business community for input on what they are trying to accomplish, and then drafting rules to achieve that outcome at the lowest possible cost. This may involve looking at how other jurisdictions achieve highly desired outcomes through less burdensome regulation.

**Q. What advice do you have for investors interested in highly regulated sectors?**

**A.** If an investor interested in a highly regulated sector is choosing not to invest, it's important that they engage with government to explain what is impeding the investment and challenge us to solve the problem. The business community needs to work with government to increase this type of interaction and tell us what we need to do to improve productivity and achieve overall business growth.

**Q. Can you comment on the relationship between the private and public sectors?**

**A.** Dynamics between the private and public sectors are changing. There is recognition in government that its resources are limited at the implementation phase. Governments should partner with the business sector where the business sector can deliver on a government priority more efficiently than the public sector. For example, Ontario has become a world leader in public-private partnerships—the PPP model helps dramatically reduce costs, allows projects to be delivered on time and leaves implementation to the private sector.

The bottom line is that the public and private sectors should play to their strengths: the private sector should focus on *doing* things, while the government should retain its public policy role deciding what *should be done*.

5

# CREATIVE COLLABORATIONS ARE GAINING GROUND

Cornell C.V. Wright, Joseph J. Romagnoli, Derek Flaman, David Cuschieri

New collaborations are starting to change the M&A landscape. In recent years we have seen corporations and financial sponsors engage in joint ventures and other innovative collaborations to pursue their business objectives. The gathering momentum of this trend demonstrates the appetite for dealmaking amid the current global economic environment. Below we discuss the reasons why these new unions are gaining ground.

## Access to Financing

With markets currently in flux, businesses with exceptional prospective assets and ambitious development goals, particularly in the areas of oil and gas and mining, are experiencing internal and external challenges to obtaining financing through traditional private debt and capital markets. To gain access to capital, they are turning to creative business combinations that might have historically not been considered. Businesses are joining forces with financial investors (including foreign and domestic private equity firms and sovereign wealth funds) who are seizing the opportunity to invest directly in projects on flexible terms designed to support sharing in the upside of successes while protecting capital returns.

This approach was effectively used by Harvest Operations Corp. (an Alberta corporation wholly-owned by the Korean National Oil Company) in its joint venture arrangements with KERR Canada Co. Ltd., the subsidiary of a Korean investment fund, in connection with the exploration, development and production of certain oil and gas assets in the Deep Basin area in northwest Alberta.

## Access to Markets

The increasingly global scale of doing business is driving competition and costs. Many businesses are looking for opportunities in new markets. These markets may be closed to direct foreign investment or ownership, or otherwise be challenging from a regulatory, political or risk perspective to pursue without a domestic counterpart. Businesses are therefore seeking local partners to carry out these foreign investments—and potentially provide a gateway to further business initiatives in those locations.

A successful example of this approach is Alberta-based Husky Energy's entrance into a 50-50 contractual joint venture with CNOOC to jointly develop the US$9 billion Liwan subsea gas development project in the South China Sea.

We have also seen dealmakers use creative structuring with tax inversion transactions where the parties have effectively relocated their jurisdiction of incorporation with a view to reducing their overall tax rate.

## Joint Ventures Between Competitors

In other instances, businesses are choosing to advance their strategic objectives by partnering with competitors. These arrangements are collaborative in nature and may be used to increase collective purchasing power, pursue research and development, or jointly distribute parties' respective products. For example, Rogers Communications Inc. recently formed a joint venture with BCE Inc. under which the two companies will own the Canadian retail distribution outlets of GLENTEL Inc. At the international level, digital music service provider Spotify has entered into strategic partnerships with mobile carriers around the world to offer its music streaming services to data service subscribers.

Collaborative arrangements are also especially prevalent in the pharmaceutical sector and are growing in number. Large pharmaceutical companies are increasingly pursuing alliances with smaller biotechnology companies as they search to bring new products to market. They are also partnering with academic institutions for similar purposes.

Strategic collaborations with competitors may, however, be complex from an antitrust perspective. Care must be taken to ensure that they do not contravene provisions in the *Competition Act* or *Sherman Act* that regulate competitor collaborations. Alliances that are structural in nature could also be subject to long and complex merger notification and review processes that could affect deal timing.

## Access to Strategic Partners

A corporation needs technical expertise and experience, sufficient capital for development, and a strong reputation. Corporations that excel in only one or two of these areas may find that missing elements have caused opportunities to be left on the table. These gaps in business profile are being addressed with increased willingness from buyers to seek out the perfect union with an entity or investor that has compatible strengths and business objectives to create a more competitive and balanced business vehicle benefiting both parties.

We saw this in the M&A context when Pershing Square teamed up with Valeant Pharmaceuticals International in a bid to acquire Allergan Inc. In Canada, Canadian Tire and Scotiabank entered into a strategic partnership whereby Scotiabank acquired a 20% interest in Canadian Tire's financial services business—their co-marketing agreement has resulted in new business growth opportunities for both companies.

KKR's establishment of the Veresen Midstream Limited Partnership with Veresen Inc. is another example of this type of collaboration. The partnership made a C$760 million acquisition of certain natural gas gathering and compression assets from Encana Corporation and the Cutbank Ridge Partnership (CRP) and negotiated a related 30-year fee-for-service arrangement following its commitment to fund up to C$5 billion of new midstream infrastructure. KKR's combined business acumen, access to capital and long-standing reputation represented an ideal match for Veresen's industry expertise and highly reputable business profile.

Gaps in business profile are increasingly being addressed through strategic unions with entities or investors with compatible strengths and business objectives.

## Creative Collaborations to Get Deals Done

Parties are also structuring transactions creatively in order to get their M&A deals done, in many cases by dealing upfront with certain assets to avoid extended regulatory reviews or opposition. For example, to secure *Competition Act* approval, building and construction materials makers Holcim and Lafarge decided to sell all of Holcim's Canadian operations and all associated assets to ensure that their US$47 billion merger would pass muster in Canada. Similarly, in connection with Anheuser-Busch InBev's US$106 billion offer to acquire SABMiller, InBev plans to sell SABMiller's interest in the MillerCoors U.S. venture to help secure regulatory approval.

Foreign investors under the *Investment Canada Act* have adopted the same sort of strategy, perhaps most famously when Glencore agreed up front to sell certain Viterra business units to Canadian companies Agrium and Richardson International to secure a "net benefit" approval. Some parties are even opting to litigate in order to resolve regulatory reviews (see Trend 6, "More Regulatory Reviews Will Be Resolved With Litigation," p.33).

## Considerations

The nature, structure and scope of these new collaborations will vary greatly according to the commercial goals and financial, technical, geographic or political restrictions or limitations of the parties. These arrangements—and the necessary contractual framework required to implement them—can be complex due to the combination of typical joint venture concepts with more traditional financing or acquisition models.

Determining and executing appropriate engagement, risk, downside protection, and upside sharing should be approached on a case-by-case basis with sensitivity to the parties' goals.

M&A's new collaborations offer various benefits that appeal to a wide range of businesses and investors. The presence of these innovative unions seems set to expand as corporations and sponsors alike seek new ways to satisfy complex business objectives in global markets.

## COMMON JOINT VENTURE ISSUES FOR INTERNATIONAL STRUCTURES

- Foreign direct investment restrictions
- Currency control and foreign exchange
- Repatriation of profits
- Double taxation and investment protection treaties
- Licensing requirements
- *Foreign Corrupt Practices Act*

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6

# MORE REGULATORY REVIEWS WILL BE RESOLVED WITH LITIGATION

Omar Wakil, Dany H. Assaf, Linda M. Plumpton

In recent years we have observed that merger reviews under the *Competition Act* are becoming more complex and that regulatory intervention under the *Investment Canada Act* is increasing, particularly in connection with small, non-reportable transactions. A consequence of this trend is that some parties are opting to litigate, and we expect this to continue in 2016.

## Recent Regulatory Disputes in Canada

In 2015, its ruling in the Tervita case marked the Supreme Court of Canada's first merger decision under the *Competition Act* since 1997. The transaction involved the acquisition of a waste landfill site with a value of only C$6 million, falling well below the notification threshold for mandatory merger review under the *Competition Act*. In allowing the merger, the Court resolved a matter that had begun in 2010, when the deal was originally challenged by the Competition Bureau. The case involved complex litigation proceedings before the Competition Tribunal and Federal Court of Appeal.

Last year, the Competition Bureau also challenged the acquisition by Parkland Industries of 17 Pioneer gas stations or supply contracts to non-corporate stations. The Commissioner of Competition alleged that the transaction would result in a substantial lessening of competition in 14 communities in Ontario and Manitoba. Following an application by the Commissioner, the Competition Tribunal granted an interim injunction requiring Parkland Industries to preserve and "hold separate" six gas stations and eight supply agreements that it acquired from Pioneer pending the outcome of the contested proceedings. The litigation is ongoing.

Similarly, Industry Canada reviews of foreign investments under the "net benefit" and "national security" provisions of the *Investment Canada Act* (ICA) have been on the rise, with numerous transactions being blocked or restructured. Last spring, the government used the national security provisions of the ICA to block a Chinese state-owned enterprise from establishing a new business in Canada. The Chinese investor, Beida Jade Bird, planned to build a C$30-million fire alarm manufacturing facility in Saint-Bruno de Montarville, Québec. The investment was reportedly prohibited because the site was located close to facilities operated by the Canadian Space Agency.

In August 2015, O-Net Communications, a Hong Kong-based investor, sought judicial review of a Privy Council national security order requiring O-Net to divest itself of a Québec-based company called ITF Technologies, which it acquired in 2014. The case is notable because it involves a post-closing "national security" review and divestiture order. As in the Beida Jade Bird matter, the investment was not initially subject to the normal-course "net benefit" review, in this case because of its small size. The litigation is ongoing.

## NATIONAL SECURITY REVIEWS SINCE 2009

### 2009

GEORGE FORREST + FORSYS

Outcome: terminated

### 2012

BEIJING NAVINFO

Outcome: non-approval

### 2013

VIMPELCOM + WIND MOBILE

Outcome: non-approval

### 2013

ACCELERO + ALLSTREAM

Outcome: non-approval

### 2013

BLACKBERRY

Outcome: government concern

### 2014-15

CASES INVOLVING RUSSIAN INVESTORS

Outcome: non-approvals

### 2015

BEIDA JADE BIRD (MAPLE ARMOUR)

Outcome: conditional approval

### 2015

ITF + O-NET COMMUNICATIONS

Outcome: non-approval

## M&A and Regulatory Scrutiny

At a minimum, these cases illustrate an interventionist government and parties willing, at least in some circumstances, to litigate transactions important to them rather than settle regulatory proceedings. The prospect of litigation has and will continue to impact M&A transactions in a number of important ways:

1. Regulatory risk assessments should be part of any transaction, regardless of size. Enforcement actions have been taken in numerous small, non-reportable mergers in recent years.

2. Parties should consider structuring transactions to minimize the likelihood of lengthy or complex regulatory reviews that could lead to litigation. This could include offering upfront "hold-separate" commitments or, in the case of foreign investment reviews, carving out sensitive assets or business lines, or avoiding establishing businesses in the proximity of sensitive government facilities.

3. Also in the case of foreign investment reviews, parties should consider early, confidential pre-consultations with relevant government agencies. Investors will not get informal "green-lights," but might be given advance warning of potential problems. Vendors and targets should consider similar approaches.

4. Parties should ensure their M&A agreements reflect due consideration of risks and potential outcomes pre- and post-closing. This could include requirements to seek early "national security" clearance, indemnification provisions for vendors in case they get swept into a post-closing review or even litigation, long outside dates to permit time for extended reviews, or reverse break fees to compensate for uncompleted deals.

Aside from taking these steps, as regulatory intervention in M&A increases, M&A players should recognize litigation as an option if regulatory outcomes are not commercially satisfactory, and strategize accordingly with "eyes wide open."

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7

# DISTRESSED M&A OPPORTUNITIES ARE EMERGING

Scott R. Cochlan, David Bish, Tony DeMarinis

Canadian distressed M&A activity seems poised to rise, as low commodity prices and tight capital markets spur a re-examination of business models and balance sheets built for better times. Investment capital is readying itself for upcoming distressed opportunities, and restructuring laws are conducive to facilitating these deals. Some investors and strategic buyers have shied away from distressed opportunities in the past because they see them as being especially risky, complicated and contentious. While there is some truth to this, savvy investors know that this field also comes with unique benefits and potentially outsized returns.

## What is Distressed M&A?

Distressed M&A typically refers to deals completed when the target company is facing insolvency or is already insolvent. The *Companies' Creditors Arrangement Act* (CCAA) is a popular proceeding for larger insolvent companies, while receiverships are more common for smaller companies. Solvent companies have increasingly used the plan of arrangement provisions under the *Canada Business Corporations Act* or its provincial counterparts to de-lever balance sheets by way of securities exchanges. Most restructuring proceedings now involve a competitive sales process, equity subscription, debt-to-equity conversion, or other M&A component.

## Benefits and Considerations

Court oversight and the involvement of a CCAA monitor or a receiver can significantly reduce acquisition risks. These independent eyes add rigour to the disclosure process and a dealmaking orientation. A court's powers can also simplify the process. For example, a court can stay the exercise of contractual remedies by counterparties and override restrictions against assignment or other actions. For asset purchases, a court can vest title free and clear of liens and other interests to achieve a level of title certainty rarely equalled by even the most comprehensive (and costly) legal due diligence exercises. Meanwhile, judicial oversight and approvals reduce liability exposure for boards of directors.

There can also be extraordinary opportunities to re-model the target business. In addition to debt reduction, uneconomic contracts can be terminated or left behind. A purchaser can also "cherry pick" attractive parts of a business with more ease than in the ordinary course.

There are, however, unique considerations. Even in "debtor-in-possession" CCAA proceedings, it is not always clear that a company's management and board are firmly in control. Lenders, bondholders, employee groups and other key stakeholders are often heavily involved and can strongly influence outcomes. Confidentiality can also be challenging. Generally, the transparency and multi-party nature of most insolvency proceedings promotes leaks and disclosure. And asset sales may deliver "cleansed" assets, but they can also leave behind valuable tax attributes (although share transaction alternatives exist). Restructuring processes can also be notoriously fluid and unpredictable.

Some distressed M&A opportunities allow buyers to "cherry pick" parts of a business with more ease than in the ordinary course.

## Sector Opportunities

Perhaps topping the sights of distressed investors presently is the oil and gas sector. A steep drop in oil prices, tightening of the capital markets, and other factors are taking their toll. The sector has already seen insolvency filings for companies like Laricina Energy and Southern Pacific, and it is still uncertain where we sit in the cycle.

Elsewhere, players in the mining and retail sectors are also looking to generate distressed M&A opportunities. With investment options across a number of sectors, those prepared to enter distressed M&A waters may find attractive opportunities in the coming year.

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8

# GO WITH THE (CAPITAL) FLOW IN CROSS-BORDER M&A

Jared Fontaine, Ian Arellano, Neville Jugnauth

Global M&A has risen substantially in 2015, with the total value of deals internationally surpassing US$3 trillion.[1] Amid this period of growth, Canadian M&A has experienced an overall decline in the aggregate deal value of domestic Canadian M&A activity alongside significant growth in outbound investments, with Canadian investors seeking high-quality investment opportunities on a global level. In 2016, we expect Canadian buyers to follow the flow of capital both abroad and domestically: globally, domestic buyers will continue to be active with large-scale acquisitions in foreign markets; and in Canada, investors will look to capitalize on opportunities emerging from recent weakness in the Canadian economy.

## Growing Outbound M&A Activity

Transactions involving Canadian buyers and foreign targets dominated Canadian M&A activity in 2015. This year, M&A transactions in excess of C$96 billion were outbound deals (see Figure 1, p.44) including Canada Pension Plan Investment Board's (CPPIB) C$14.8 billion acquisition of Antares Capital, the U.S.-based mid-market PE sponsor financing solutions provider, from General Electric, and Borealis Infrastructure's C$8.9 billion acquisition of Fortum Distribution in Sweden.

Canadian institutional investors have been the principal drivers of the growth of outbound investment activity. Some of the largest deals in 2015 involved a financial sponsor or investor. For example, Canadian pension funds, Onex and Brookfield Asset Management all actively engaged in foreign M&A activity in 2015. In addition to the CPPIB and Borealis acquisitions, notable examples of this trend include CPPIB's co-sponsorship of the C$6.7 billion U.S. acquisition of Informatica, the Caisse de dépôt et placement du Québec's US$1.1 billion acquisition with Hermes Infrastructure of a stake in Eurostar, and the joint AIMCo/OMERS acquisition of UK-based Environmental Resources Management for US$1.7 billion.

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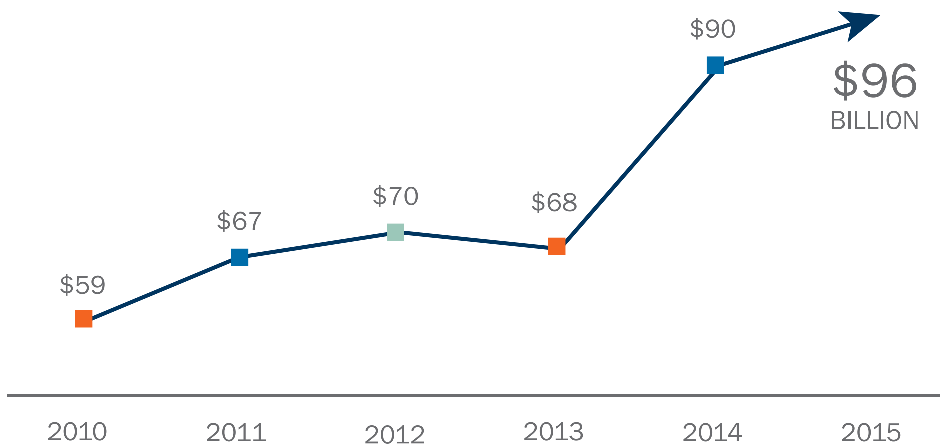
[1] Source: *Thomson Reuters' M&A Review Q3 2015*. Available at: http://dmi.thomsonreuters.com/Content/Files/3Q2015_Global_MandA_Financial_Advisory_Review.pdf

While RBC's US$3.2 billion acquisition of City National in the U.S. demonstrates that this trend is not limited to private equity, we expect that Canadian pension funds and private equity groups will continue to dominate outbound M&A activity from Canada.

Figure 1.  M&A Activity Outside Canada by Canadian Buyers

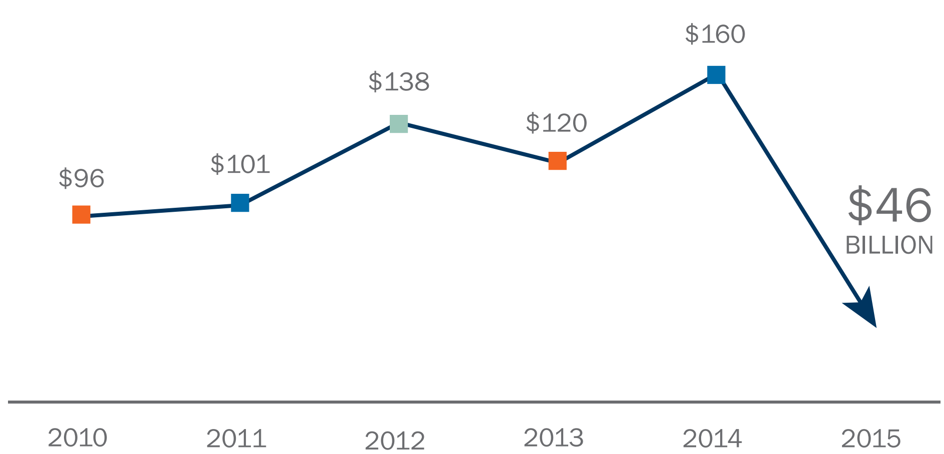



Total Deal Values in C$ (Billions)
Source: Capital IQ. Deal values based on closed transactions. 2015 data as of November 1, 2015.

## Domestic Revival

The total value of deals involving a Canadian target fell to C$46 billion in 2015, from C$160 billion in 2014 (see Figure 2). We expect that this recent decline in domestic M&A in Canada will not last and that macroeconomic factors will create favourable opportunities for both foreign and domestic strategic buyers in 2016.

Figure 2.  M&A Activity Involving Canadian Targets




Total Deal Values in C$ (Billions)
Source: Capital IQ. Deal values based on closed transactions. 2015 data as of November 1, 2015.

Current market conditions have forced some Canadian companies to consider divestitures of non-core assets to improve balance sheets. We also see distressed M&A opportunities developing, particularly in the oil and gas, mining and retail sectors (see Trend 7, "Distressed M&A Opportunities are Emerging," p.39). Competitors with strong balance sheets and access to financing are well positioned to take advantage of these opportunities to make strategic acquisitions as is illustrated by Crescent Point's C$1.5 billion acquisition of Legacy Oil and Gas.

A relatively weak Canadian dollar is likely to drive an increase in inbound acquisitions of Canadian targets by foreign buyers. U.S. companies in particular, given moderate returns at home and a strong U.S. dollar, will be encouraged to look to foreign markets, including Canada.

## Rules Changes on the Horizon

As foreign investors turn their focus to Canada, they should expect M&A targets to wield more leverage than in the past to negotiate deals. Canadian takeover bid rules are changing to empower boards and redefine bid dynamics between targets and hostile bidders. Under Canada's proposed new takeover bid regime, all non-exempt takeover bids will have to stay open for acceptance for a minimum duration of 120 days (subject to a target board's ability to shorten the timeframe to as little as 35 days in certain cases). The proposed bid rules will also allow a hostile bidder to shorten its bid period if the target enters into a white knight transaction.

## Energy: A Sector to Watch

Despite a significant decline in the number of energy-sector M&A deals in 2015 due to weak industry fundamentals, the value of completed deals remained relatively high as both strategic and financial buyers looked to take advantage of discounted assets—a trend that appears to be set to increase in the year ahead.

Some of the largest domestic M&A deals in 2015 included energy-sector transactions such as Cenovus' sale of its interest in Heritage Royalty to Ontario Teachers' Pension Plan Board for C$3.3 billion, Apache's sale of Quadrant Energy to Brookfield Asset Management and Macquarie Capital for C$2.6 billion and the previously mentioned C$1.5 billion acquisition by Crescent Point of Legacy Oil & Gas. With continuing depressed commodity prices in 2016, additional divestitures of attractively priced assets will drive greater M&A activity in this sector.

## Conclusion

Domestic investors show no sign of slowing their activity in international investments for the year ahead, and we are starting to see opportunities for consolidation of Canadian energy targets increasingly attracting strategic investors and financial buyers looking to deploy capital in Canada. We anticipate that growth, both in outbound deals and renewed vigor in domestic activity, will help define Canadian M&A in 2016.

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9

# TECH ISSUES IN M&A WILL KEEP DEALMAKERS IN THE CLOUD

Adam S. Armstrong, David A. Chaikof, Joel Ramsey

"Every company is now a tech company." This phrase is heard more and more in the business community, from commentators to CEOs of multinational corporations. With few exceptions, every business today relies on information technology to survive. In every sector of the economy, from banks to retailers to energy companies, businesses depend on IT to manage their most important assets: their information and their customers.

If every company is a tech company, then every M&A deal is a tech deal—and to ensure the success of an M&A deal, companies must recognize that solving the IT puzzle should be a central pillar of their M&A strategy. While this has been true for the better part of two decades, the way in which IT has evolved has made defining what is being bought or sold more difficult than ever in recent years.

## Enter the Cloud

The emergence of cloud computing as a preferred model of IT is largely responsible for this shift. The term "cloud computing" has been used to describe a variety of service models, but here we use it to refer to IT services that, broadly speaking, are delivered using computing resources that are:

- distributed (i.e., not centralized); and/or
- shared, whether with other companies (public cloud) or other internal businesses or functions—which may or may not be part of an M&A deal (private cloud).

Advances in software development and the proliferation of high-speed telecommunications networks have allowed servers and data centres to be "virtualized" across the globe, replacing more traditional IT models that rely more heavily on local, customized infrastructure.

Cloud computing is appealing to businesses because, among other reasons, it requires little capital investment by the service recipient and is adaptable to changing business needs while promising a stable common platform across numerous user groups. As a result, cloud-based platforms are increasingly favoured by CIOs seeking cost-savings and more agile resources. But it is called “cloud” computing for a reason: it is not easy to define what and where, exactly, your company’s systems are.

## M&A in the Cloud

Solving the IT puzzle and determining which pieces are being purchased (or sold), and which pieces will have to be purchased separately to fill the gaps, are critical to realizing value from the M&A deal. This issue goes directly to the heart of an M&A transaction where the target’s IT is central to its value. If the target is a heavy user of cloud-based technology provided by third-party service providers or affiliates, then what, exactly, is being sold and how is it to be valued? And once identified, how do you ensure that technology is seamlessly transitioned to the buyer?

> The success of a deal will depend now more than ever on successfully untangling and integrating buyer and seller IT systems.

The negotiation of the transition services agreement (TSA) for acquisitions becomes critical, but perhaps more critical is technology due diligence that must be performed before a TSA can be drafted. The acquiror will need to identify and untangle the target’s IT, which may be spread across multiple shared systems, and potentially across the globe. The success of the M&A deal will depend now more than ever on the success of this untangling and integration of the target’s IT with the acquiror’s IT (or on the acquiror learning to run the target’s IT)—essential steps for the buyer to effectively run the acquired business.

## Planning Ahead for Success

### Buyers

- Start the tech due diligence process early and enlist the assistance of your integration team to plan the integration well before signing. Seek their input on the cost and timeline, which could greatly affect the overall economics of the deal.

- Study the target’s IT, not just as a supporting asset, but as part of the value proposition of the company. Has the target developed systems and processes that enhance the value of the company, or has the target simply made use of a standard cloud computing service in a way that fits its business needs?

- Have an IT procurement strategy that anticipates M&A scenarios. Make sure your IT service providers are obligated to assist you in tech due diligence, and that there is a mechanism in your service agreements to support the operations of the target.

### Sellers

- Ensure your cloud pricing model allows spin-offs without triggering minimum commitments that will burden you or the buyer after the sale.

- Protect your IP. Check that your cloud provider cannot claim to own your patentable systems or processes that were incorporated into the cloud platform.

- Plan early. Understand what will be sold as part of the M&A deal and what transition assistance you are willing to prioritize, taking into consideration confidentiality issues and your resourcing requirements.

Anticipating tech-related issues and establishing good strategies early on to address them can work to ensure the success of M&A opportunities when they arise. Cloud computing, too, will inevitably evolve, but the days of M&A deals without a meaningful tech component are over.

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10

# SHOULD THEY STAY OR SHOULD THEY GO? EXECUTIVES IN M&A

Mitch Frazer, Lynne Lacoursière, Jennifer Lennon

Executive compensation arrangements in the context of M&A transactions are receiving more attention from investors, management teams and boards, and are increasingly subject to public scrutiny. Consider the recent example involving Chubb Corp., where its shareholders voted overwhelmingly in favour of its proposed merger with Ace Ltd. but voted over 60% against the non-binding advisory vote on the company's executive pay package. As a result, compensation arrangements are evolving from being primarily focused on severance to being focused on retention and the long-term best interests of the company.

## Single-Trigger to Double-Trigger

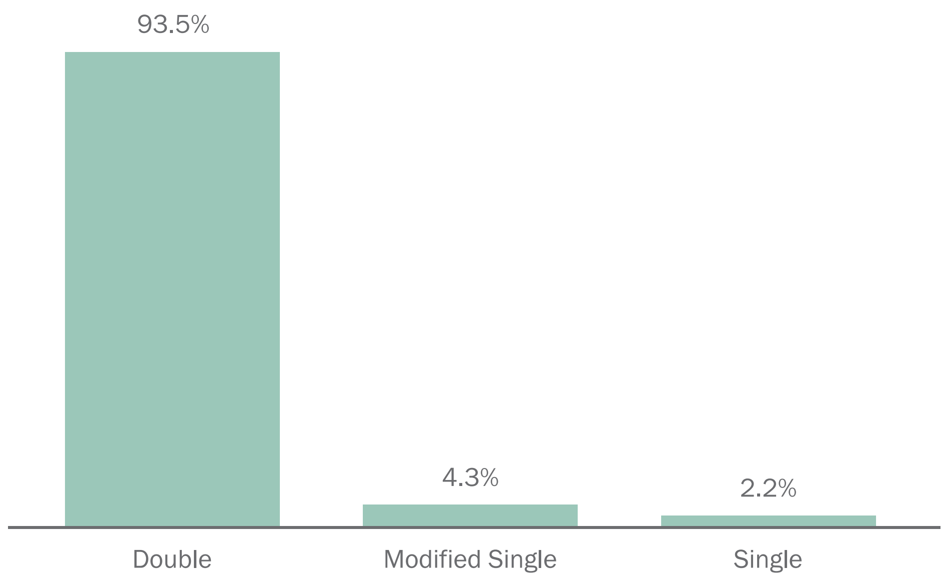
To the delight of proxy advisory firms and institutional investors, a large proportion of public issuers have amended their long-term incentive plans and severance arrangements in recent years to provide for "double-trigger" change-of-control provisions (see Figure 1, p.56). Rather than severance payments and accelerated vesting of equity awards being automatically triggered on a change of control of the target company (a "single-trigger"), "double-trigger" arrangements are only triggered if there is both a change of control and an involuntary termination of employment.

"Double-trigger" arrangements would typically pay out if an executive is terminated without cause or is constructively dismissed within a specified period of time post-closing of the M&A transaction (typically 12-24 months). Stock options and other equity-based awards are exchanged for comparable awards of the acquiror or merged company and continue on the same terms and conditions post-closing.

"Modified single trigger" change-of-control arrangements are triggered if the executive resigns (without being constructively dismissed) within a specified period following the change of control.

"Double-trigger" arrangements are preferable from a corporate governance perspective as they ensure executives are neutral with respect to a change of control and are motivated to act in the best interests of the company. These arrangements also serve as a retention tool and provide greater flexibility for bidders to structure transactions without triggering massive cash outlays on closing. Strategic buyers and those with less cash on hand typically favour the rollover of equity-based awards. However, buyers may choose to cash out equity awards on closing despite the rollover ability.

### Figure 1. TSX 60 Companies – Change of Control Severance Triggers




Source: Hugessen Consulting Inc. Information excludes TSX 60 Companies with no policy or no disclosure.

While the treatment of stock options and other time-based awards on a rollover is straight forward, performance-based awards present particular challenges. For example, if a performance share unit pays out based on the achievement of a financial metric or strategic goal of the target, how should that performance goal be assessed with respect to the merged entity post-closing? As compensation plans weigh more heavily toward performance-based awards, targets and bidders must pay careful attention to how these awards will be treated and valued on a change of control.

## Severance Pay to Retention Pay

There is a growing trend for severance arrangements to be the subject of negotiation in the context of M&A deals. Where a bidder is looking to retain the target's executives for the long term or for a transition period, it may negotiate with the executives to forgo their severance pay for an enhanced retention package provided the executive remains with the company for a specified period post-closing. Retention bonuses can be structured as cash payments or special equity awards.

Retention bonuses may be viewed as a problematic pay practice if they are implemented before or in anticipation of a change of control as they may be seen to be entrenching management and may deter potential bidders. As a result, retention bonuses are typically negotiated pre-closing in consultation with the purchaser. The agreements seek to align the interests of the target and the purchaser and encourage the retention of key members of senior management.

### Transaction Awards

Special awards granted in the context of an acquisition may be desirable as a retention mechanism or as an incentive to achieve the strategic goals or expected synergies following the transaction. These awards can be structured as cash payments or special equity awards. Awards that are subject to performance conditions post-closing would typically only be granted to senior management in operational roles or to those whose performance could impact the particular performance goal. Transaction awards may also be used to ensure that compensation of the new executive team is similarly structured on a go forward basis.

Transaction awards may also be implemented by the target to retain key people until the transaction closes. Any such arrangements would generally be subject to the company's conduct of business covenants in the purchase agreement or would require consent of the purchaser.

As compensation plans weigh more heavily toward performance-based awards, targets and bidders must pay careful attention to how these awards will be treated and valued on a change of control.

### Evolving Compensation Practices

The corporate governance landscape in Canada is changing. This is not only influencing how corporations are engaging with their shareholders (see Trend 1, "Shareholder Activism: Who is Winning Now?," p.3), but also how executive compensation arrangements are being structured. As the value of human capital in the pursuit of corporate strategy comes increasingly into focus for dealmakers, we expect that executive compensation practices will continue to evolve, with more attention on retaining key executives and rewarding achievement of long-term business goals.

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