Q4 | Torys Quarterly

CANADIAN SECTOR REPORT

Get our analysis on the latest trends and developments facing sectors in Canada.

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Contents

Executive summary

Canadian sector report

In this issue of the *Torys Quarterly*, we turn our focus to sectors in Canada: what kind of deal activity are they experiencing, what marketplace and regulatory challenges are they facing—and what does it mean for Canadian business as we move toward 2020?

Some of Canada's emerging and fast-growing sectors have been busy managing new realities as they continue to develop. Canada's technology sector is maturing, with acqui-hires and other investment coming into the country's tech hubs. Canada's tech sector has become a particularly attractive sector for U.S. buyers—including large buyers—which is influencing the Canadian tech ecosystem in important ways, from how deals are getting done to domestic VC funding.

Canada's financial institutions are experiencing points of transition, including in response to new regulation and increased scrutiny and enforcement. Operationally, the sector is working to keep up with consumer demand for fintech, and FIs are looking to make use of cloud-based solutions and digital innovation, while navigating compliance risks associated with fintech and new consumer protection legislation.

Headlines in Canada throughout 2019 have been dominated by developments in the oil and gas sector. In Canada's oilsands, legal, regulatory and political woes continue to add strain to the sector. Those in the still-evolving North American cannabis sector also face headwinds with tightening financing conditions, and the cannabis market continues to find its legs amid ongoing regulatory developments that have significant implications for the future of the sector.

Other Canadian sectors are addressing investment challenges. Mining participants are seeking creative financing alternatives in the face of constrained investment from institutional and generalist investors. The power sector is working to balance ratepayers' prices with the need to source greater investment in aging infrastructure assets. And in light of the federal government's mandate to ensure universal access to broadband internet in Canada, project proponents in the public and private sectors are contemplating creative project models to fulfil this objective. Meanwhile a new environmental impact assessment regime for large projects has been introduced, which will influence how project proponents pursue new opportunities across the country.

The real estate sector is seeing shifts in both investor type and investment strategy. Private equity and other institutional investors looking for stable returns are increasing their investments in real estate. Urban intensification outside of the traditional office and multi-family asset classes is being extended to also include seniors housing. And transit-oriented development—where developers are paying to develop public infrastructure as part of urban intensification—is influencing the industry.

Read more on these sector trends and developments in the *Q4 Torys Quarterly*.

U.S. tech looks north of the border

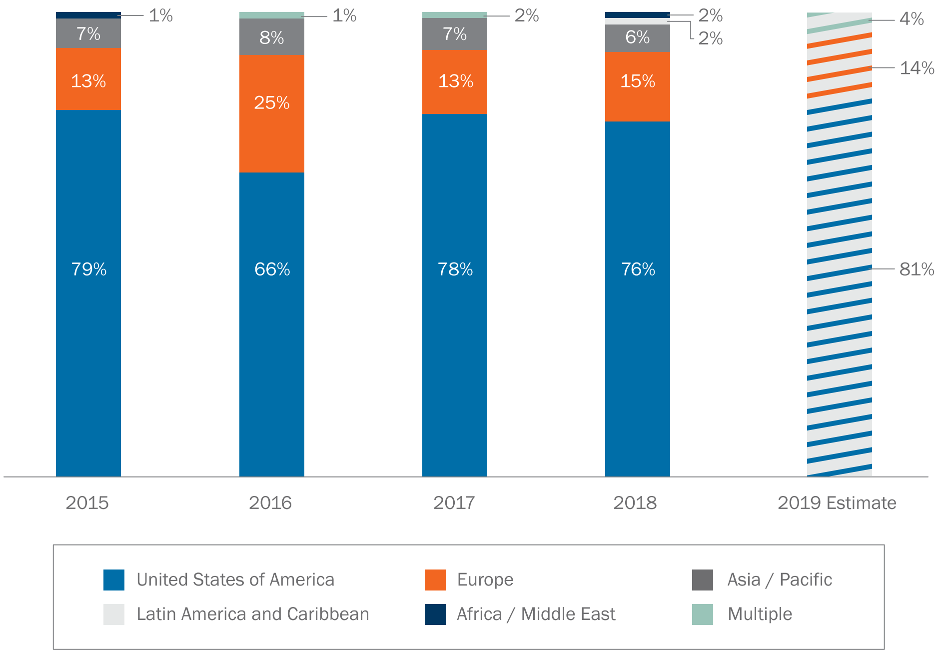
By John Emanoilidis, Kristine Di Bacco, Konata Lake, Matthew Atkey, Marko Trivun

The technology sector in Canada has experienced significant activity and change in recent years. With ongoing, substantial investment from U.S. technology companies in both Canadian startups as well as Canadian tech talent, it is becoming increasingly important for players on both sides of the border to understand the nuances of these Canada-U.S. cross-border transactions and what they may say about where the Canadian tech space is headed.

Influx of U.S. inbound investment

U.S. investment continues to dominate inbound activity in Canada's tech sector (Figure 1), averaging 76% of all inbound M&A activity between 2015-2018. Current 2019 estimates put the share of U.S. investors representing over 80% of all M&A deals this year. U.S. tech investors, including from some of the largest players in the United States, are coming into Canada as acquirors, requiring all parties involved to focus on cross-border issues such as tax structuring related to entering Canada.

Figure 1: Inbound investment activity in Canada



Source: S&P Capital IQ. Announced transactions to October 1, 2019 involving a Canadian target in the tech sector. Cancelled transactions are excluded.

Rise of acqui-hires

For many U.S. tech companies looking north for acquisitions, the acqui-hire has proven a popular transaction type in a sector that is seeking top development, design, engineering and other specialized talent for a competitive advantage. Acqui-hires are acquisitions that are focused primarily on the hiring of a target's talent (and sometimes its IP assets) as opposed to the product or service of the target company.

A number of hot markets for tech talent in Canada that have been notably attractive targets for U.S. investors include the Kitchener-Waterloo corridor, Toronto, Montréal and Vancouver. Both parties in an acqui-hire scenario will need to carefully think through various considerations involved in this type of transaction, one of the most notable of which is which party bears the responsibility for the historical employment obligations of the employees that are the subject of an acqui-hire transaction.

Legal considerations for Canada-U.S. tech M&A

Plans of arrangement

One difference U.S. buyers will notice is frequent use of the court-ordered "plan of arrangement" process available under most Canadian corporate statutes which can be very advantageous in its flexibility. In addition to its traditional role in public company transactions, this helpful tool is also increasingly used in more complex private deals (e.g., where the interests of larger numbers of stakeholders need to be addressed to implement a clean exit). Tech companies that have undergone multiple rounds of financing can often have an expansive shareholder base, making a plan of arrangement an attractive option in a purchase and sale transaction.

Tax

U.S. companies intending to offer share consideration to the shareholders of a Canadian target will need to carefully consider the Canadian tax implications and consider strategies such as the use of an exchangeable share structure. U.S. buyers will also need to consider Canadian tax implications for the ongoing operations of the Canadian target; e.g., Canadian tech targets will frequently be entitled to scientific research and experimental development (SR&ED) investment tax credits that can be affected by changes in control. Employee stock options are also typically subject to special Canadian tax rules beneficial to Canadian employees, making it important for transaction structures to preserve these benefits. Similarly, the holders of shares of certain qualified small business corporations may be entitled to tax breaks if a sale is structured appropriately.

Employment issues

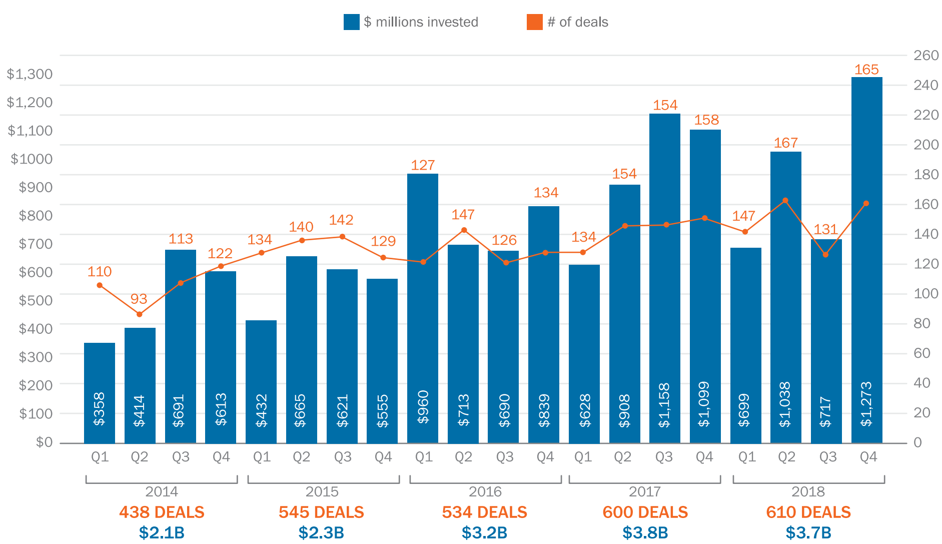
Understanding distinctions in Canadian employment law will also be very important for U.S. buyers. There is no concept of "at-will" employment in Canada, and termination without cause or notice will typically trigger significant financial obligations for the employer.

The role of venture capital

Canada is considered to have a healthy VC ecosystem, with a VC sector that has grown steadily in recent years. Canada ranks second place among all OECD countries (as of 2017) in absolute dollar amounts available for VC investments (and ranks third when calculating VC investments as a percentage of GDP among OECD countries).[1]

In 2018, Canada saw 610 venture deals with an aggregate value of $3.7B and average deal size of $6.1M (Figure 2). While these data points are in line with 2017 numbers, it's a large increase from recent years: in 2014 for example, there were 438 deals with an aggregate value of $2.1B. A CVCA report states that 2019 numbers for Canadian VC activity are on track to exceed 2018 numbers.[2]

Figure 2: Quarter-over-quarter VC investment activity



Source: Canadian Venture Capital and Private Equity Association, VC & PE Canadian Market Overview, Q4 2018

U.S. funds as a source of capital

A recent report shows that a prevalence of foreign VC funds, particularly U.S. funds, in Canada, is helping fill the funding gap in Canada both at the seed and growth stages. In a review of 257 single investments made by a VC in one fundraising round

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[1] "Canadian Venture Capital Sufficiency", Narwhal Project.

[2] CVCA Report, Q4 2018, p.8

of a Canadian company, the study found that Canadian VCs invested in 100 rounds, while U.S. and other international VCs invested in 86 and 36 rounds, respectively. In other words, U.S. investors participated in almost as many rounds as Canadians VCs. This trend in the VC world is familiar, as we see the same U.S. influence in inbound tech M&A (as discussed above).

U.S. and other international funds are also investing more money per deal: Canadian startups that only raise from Canadian VCs raise on average $4.4M in a Series A round, while Canadian startups that only raise from U.S. and/or other foreign funds raise on average $11.9M in a Series A round. One reason for this may be that the pool of available money in Canada is fragmented across too many funds, and that while Canada has many funds, since they're each relatively small, they operate with more constraints.[3]

Canada also faces challenges in terms of startup investment: despite the availability of venture capital in Canada, Canada has not produced a proportionate number of startups with a valuation of US$1B or more—so-called "unicorns".

While there remains good reason for excitement around the growth in Canadian tech, the data show that it is still very early days. Larger venture capital funds, and U.S. investment more broadly, will likely remain necessary, at least in the short term, to help fund and accelerate more successful companies, including future unicorns.

[3] "Canadian Venture Capital Sufficiency", p.11

How can Canada’s banks stay ahead of the cloud curve?

By Joel Ramsey

Since mainstream cloud computing services entered the financial sector several years ago, financial institutions (FIs) in Canada have viewed cloud computing as a tool to revolutionize the way they operate and do business. Many FIs have undergone cloud transformations in recent years as solutions on the market have reached new levels of maturity for the sector.

This enthusiasm has been tempered by efforts to satisfy ever-increasing regulatory scrutiny on FIs' operations and outsourcing arrangements. Tensions remain between the use of cloud-based solutions and developing regulatory requirements, requiring those in the sector to think carefully about how to strike a balance between risk and reward, and how to stay adaptive to ongoing change from both regulators and the available technologies themselves (for more on regulatory developments in the financial services space, see "Financial institutions should expect more enforcement".) We expect these competing pressures will remain an ongoing focal point in the financial services sector in the years ahead.

Current trends in FI cloud services

As certain cloud providers have proactively embraced compliance with regulatory requirements, such as the B-10 Outsourcing Guidelines issued by OSFI, FIs have become more comfortable hosting important workloads on IaaS (infrastructure-as-a-service) and PaaS (platform-as-a-service) services, while also replacing local software installations with SaaS (software-as-a-service) platforms. These new products often: provide faster performance and sleeker user interfaces; come equipped with ready-made algorithms that analyze and report on data in new ways; and better position FIs to satisfy consumers who have come to expect the simplicity and ease of a wide variety of apps that leverage the "as-a-service" model, from ride-sharing to grocery shopping to home maintenance.

Most cloud solutions offered to FIs have "out of the box" functionality, allowing an FI to select its configurations without making wholesale changes to the underlying technology itself. They are built on shared software, hardware and networks and use shared resources located at shared service locations. Cloud providers often will not allow any customers (even their largest ones) to have direct access to or approval rights over any of these solutions.

Financial institutions in Canada are working to make the most of what the cloud has to offer while mitigating regulatory risk at the same time.

There are upsides and downsides to these standardized offerings. The former include a more stable technology base that is consistent for all of the cloud provider's customers, lower capital and maintenance costs, and scalability to respond to changes in usage patterns. The latter include a lower degree of direct oversight and control over the product, its security and continuity, and the inability to approve (or prevent) changes.

Without sufficient oversight and control, an FI may put its operations at risk and run afoul of regulators' guidance. The core principle of this regulatory guidance is that outsourcing an internal function (or procuring an important service) does not excuse the FI from a failure to perform that function or service. As the B-10 Outsourcing Guidelines state, federally-regulated entities "retain ultimate accountability for all outsourced activities". So how does an FI address this risk while making the most of what the cloud as to offer? The key is to ask questions, demand answers and hold cloud providers accountable for them.

Important questions for cloud service providers

Below are some of the questions that FIs should ask about any potential cloud solution.

- How do the FI and its regulator exercise their rights to audit the services and the service provider when the service provider prohibits direct access to its shared environment?
- How does the FI ensure its data is:
    - protected using industry leading security controls?
    - appropriately segregated and accessible to the FI?
    - not processed or accessed by the FI or its subcontractors except as necessary to provide the services?
    - backed up with acceptable regularity?
    - not accessed, processed or stored in jurisdictions that present unacceptable risks to the FI?
- How does the FI reconcile the differences between its incident management processes and those of the service provider?
- How does the FI ensure the FI has appropriate controls over its subcontractors?
- How does the FI understand whether the algorithms or machine learning that may be included in the cloud solution make calculations that are legally compliant and meet the FI's business requirements?

Sometimes, the cloud provider's response to many of these questions is: "trust us", pointing to the hundreds or more sophisticated FIs who all receive the same services and have the same contract terms. This answer will not satisfy a financial regulator. While financial services are an industry built on trust, that trust must be earned through information and accountability.

Below are some strategies to help ensure an FI can satisfy its compliance obligations when contemplating a cloud-based opportunity:

- Ask for and review the service provider's policies and standards carefully. They are often presented as a substitute for the FI's standards (e.g., information and physical security, incident management, business continuity planning, personnel background checks), but they may be written more like aspirational or non-specific statements.
- To the extent the cloud provider cannot or will not permit the FI to directly

access sensitive information or environments, utilize trusted third parties that both parties agree to in order to verify the service provider's standards (i.e., independent auditors).

- If the service provider will not agree to be compliant with the FI's standards, refer to acceptable industry standards (e.g., ISO or NIST for security).
- Carefully assess whether the FI needs to retain internal functions that are not captured by the cloud offering, which may affect the business case for outsourcing to the cloud in the first place.

Whatever information and answers are uncovered in this process, the cloud provider should make contractual commitments to the standards and processes it discloses to the FI. Ultimately, FIs that ask the right questions, perform appropriate diligence and prepare well for adapting to and integrating cloud-based services will reap the benefits of their new capabilities faster and with greater ease.

Consumer protection in the digital era

By Brigitte Goulard, Eli Monas and Peter Aziz

“All banking customer groups now prefer digital channels”, concludes the October 2019 McKinsey report, “Inflection point: Seven transformative shifts in US retail banking”. Rising consumer expectations for digital banking convenience are requiring banks and financial technology companies (fintechs) to explore ways to improve customer service in the digital era. However, one of the biggest stumbling blocks to achieving this goal is legislation, and particularly, consumer protection requirements which are mainly based on disclosure obligations.

As a result, banks and fintechs focused on digitally engaging with consumers would benefit from understanding the legislative frameworks governing consumer protection, and the impediments they may represent to innovation.

As noted by authors Thomas A. Durkin and Gregory Elliehausen, "The common element of the federal government's consumer-protection measures for financial services in the United States is the requirement that institutions disclose designated information to consumers in specified formats at required times. Disclosures are so central to the purpose of some financial consumer protections that we might properly call them "information protections".[1]

Although referring to the US legislative regime, the authors' statement could just as well apply to the Canadian landscape where disclosure is the cornerstone of consumer protection. Unfortunately, disclosure, and especially prescriptive requirements, do not encourage innovative, digitally-friendly consumer interactions.

Even international best practices in consumer protection fail to recognize the need for—and advantages of—flexibility in the digital age. The G20/OECD guidance on effective approaches to implementing the G20 High Level Principles on Financial Consumer Protection does not adequately recognize the growth of the digital distribution platform in financial services.[2] The use of terms such as "documentation", "material", "information leaflets" and "glossaries" present a dated picture of how financial institutions disseminate information. In addition, several of the G20/OECD recommended approaches emphasize the use of standardized forms as useful tools to achieve the transfer of essential information: "Standardized forms with essential information are used to reflect the nature, key features, risks and costs of the products and services offered, how such products and services may be paid for and the key information of the financial services provider, so that the consumer can easily compare products and providers".

The G20/OECD's recommendation that information for complex products be shared via standardized forms is even more difficult to achieve in a digital format: "Enhanced disclosure requirements are established for more complex products that highlight specific costs and risks involved for the consumer. These requirements include the provision of a clear, concise and easily understandable standardized form that contains information enabling the consumer to comprehend the key features and risks of the product and is prepared in a format that facilitates comparison with other products".

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[1] "The Impact of Public Policy on Consumer", edited by Thomas A. Durkin and Michael E. Staten Credit, chapter 5, Disclosure as a Consumer Protection, authored by Thomas A. Durkin and Gregory Elliehausen.

[2] "Update Report on the work to Support the Implementation of the G20 High-Level Principles on Financial Consumer Protection", G20/OECD Task Force on Financial Consumer Protection, September 2013.

Active internationally, and a member of the OECD Task Force on Financial Consumer Protection, it is not surprising that the Canadian federal government looked to the OECD's principles and guidance when revising its financial consumer protection legislative framework. Introduced in December 2018 (but not yet in force), the *Bank Act* amendments consolidated the various existing consumer provisions therein and introduced several new requirements. However, many of the new *Bank Act* consumer protection provisions would not be considered digital-friendly.

For example, the new consumer protection framework includes a general catch-all provision requiring banks to disclose a product's or service's features, the list of charges and penalties, and the particulars of a person's rights and obligations in respect of the product or service.[3] In addition, the bank must provide the customer with a copy of the bank's complaint management procedures, the name of its external complaint body and the Financial Consumer Agency of Canada's contact information. It is unreasonable to expect a customer to read this amount of information, particularly if he or she is reviewing it on a telephone or a smart phone.[4]

Although the Canadian federal government looked to the OECD's latest guidance when revising its financial consumer protection legislative framework, many of the new proposed provisions would not be considered digital-friendly.

In *Bank 4.0: Banking Everywhere, Never at a Bank*, authors Brett King and Jo Ann Barefoot make the case for a complete overhaul of the regulatory model, "We need to create a whole new model for the digital age, in order to both to regulate digital-markets and to deploy new technology in the regulatory process".[5]

Unfortunately, the new *Bank Act* consumer protection framework fails to achieve this objective, and banks and fintechs alike that wish to operate in the banking sector will need to comply with regulatory requirements that are digital-unfriendly for the foreseeable future.

[3] Section 627.59 of the *Bank Act* (new provision not yet in force). This provision applies to all products and services for which there are no other disclosure specific provisions in the Act.

[4] Under the Canadian framework, the External Complaint Body is the independent OmbudService with whom the bank must register to deal with customer complaints.

[5] The book *Bank 4.0: Banking Everywhere, Never at a Bank* was authored by Brett King but the chapter 2, The Regulator's Dilemma was co-authored by Brett King and Jo Ann Barefoot.

Financial institutions should expect more enforcement

By Brigitte Goulard, Gillian Dingle and Marissa Daniels

The financial services sector has been in a state of change in Canada with respect to regulatory scrutiny. With a number of recent initiatives and activities coming from the Financial Consumer Agency of Canada (FCAC), we believe enforcement activity is poised to increase, including in both issuing more Notices of Violations as well as naming those institutions that do receive such notices. As a result, we recommend that financial institutions pay greater attention to their communications with the FCAC.

Background

The FCAC's Supervision Framework Guide states that its enforcement team investigates potential breaches of market conduct obligations and, depending on the severity of the breach, may, following the investigation, issue a Notice of Breach level 1, 2 or 3. However, not all Notices of Breach result in a Notice of Violation. Where FCAC determines that a breach is low in terms of severity, it may choose to address outstanding issues with tools such as actions plans or compliance reports.

Historically, few breaches have resulted in a Notice of Violation. To give some perspective, although FCAC does not reveal the number of breaches it investigates, its annual reports do disclose how many breaches have resulted in Notices of Decision.[1] In 2017-18, four Notices of Decision were published addressing nine violations, and in 2016-17, three Notices of Decision were published.

However, as we describe below, recent regulatory changes suggest a shift in FCAC's enforcement activity.

1. New FCAC definition of a reportable compliance issue

In April 2019, the FCAC adopted a new definition of a reportable compliance issue. Under the previous definition, financial institutions were required to report to the FCAC a material or systemic compliance deficiency that would normally have been reported to the institution's compliance division. The interpretation of "material or systemic" was left to each institution.

Now, institutions must report to the FCAC breaches of a market conduct obligation that would normally be reported to the institution's compliance division if the breach meets, at a minimum, one of the following:

- once detected by the institution, the breach took longer or will take longer than 120 calendar days to fix and remediate;
- the breach affected or affects more than 250 consumers; or
- the breach was or is ongoing for more than 1 year before the institution detected it.

It is expected that this more onerous reporting requirement will result in an increase in FCAC reporting as breaches not previously considered "material or systemic" may now meet the above reporting threshold.

2. FCAC's growth in supervision and enforcement resources

FCAC's 2019-20 Business Plan notes that in order to effectively implement and operationalize its supervision initiatives, including the implementations of the

[1] A Notice of Decision is the manner in which the Commissioner's decision on a Notice of Breach is communicated.

Government's new financial consumer protection framework, the FCAC will continue "to build its capacity to discharge its oversight and enforcement responsibilities".

As result, the FCAC's supervision and enforcement team is expected to grow 130% over a three-year period from 27 persons in 2017-18 to 60 in 2020-2021.[2]

It is logical to assume that additional resources will lead to an increase in supervisory activities, and as a result, to more enforcement.

3. A new regulatory framework

The *Budget Implementation Act*, No. 2 2018, which received royal assent from Parliament in December 2018, introduced a new federal financial consumer protection legislative framework.

The framework expanded FCAC's oversight of banks' internal business processes and procedures including ensuring that a bank's product and service offerings are appropriate for, and take into consideration, the customer's needs and circumstances. The FCAC will also have the right to ensure that remuneration paid to bank staff, including benefits, do not impede any policies and procedures implemented to ensure the "appropriateness" of offered products or services.

The framework also now allows the Commissioner to direct banks to refund any charges incorrectly collected from consumers, and to impose interest as part of the refund. The Commissioner will also be permitted to direct banks to comply with a provision, or a compliance agreement, and to "perform any act that in the opinion of the Commissioner is necessary to do so".

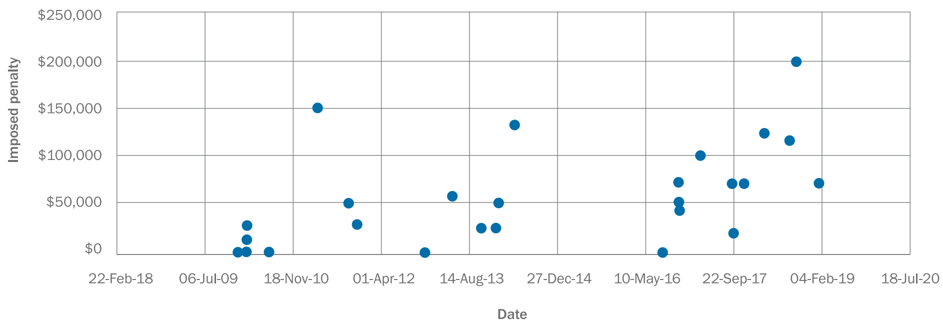
FCAC's expanded scope of oversight combined with additional powers and tools, will, without a doubt, lead to an increase in FCAC supervisory oversight.

4. FCAC's steady increase in administrative penalty amounts

As the graph on p. 20 demonstrates, the administrative monetary penalties amounts associated with FCAC Notices of Violation have gradually increased over the past 10 years. It is likely that the industry will now see a considerable jump in the quantum of administrative monetary penalties imposed, as recent amendments to the *Financial Consumer Agency Act of Canada (Act)* will increase the maximum penalty amount from $50,000 to $1,000,000 for individuals and from $1,000,000 to $10,000,000 for financial institutions.

[2] FCAC 2018-19 Business Plan

Figure 1: Mean FCAC penalty per violation



**This data includes FCAC decisions where banks were held in breach of a Bank Act consumer provision other than in breach of section 459.2 of the Bank Act for failure to comply with the branch closure requirements. In instances where a single penalty was imposed for multiple breaches, data points reflect the mean penalty per breach.*

5. New leadership under the FCAC

Also significant to FCAC's approach to enforcement, is the arrival of a new Commissioner, Judith Robertson, in August 2019. Ms. Robertson's extensive experience in the financial sector and her experience as a Commissioner for the Ontario Securities Commission may influence the agency's enforcement approach. In particular, we are mindful that publishing a respondent's name is common practice in securities regulatory enforcement proceedings. Though "naming" is not yet mandatory under the Act, particularly given the Commissioner's securities industry background, it is possible that she may decide to exercise the discretion that currently exists in the Act to publicly disclose the names of institutions subject to a Notice of Violation even before the coming into force of the new mandatory naming provisions.

6. Backlog in FCAC communications

We also believe that there is a significant amount of FCAC investigations and communications which were on hold pending the appointment of the new Commissioner and the finalization of an internal categorization tool for violations at the FCAC. Recently, we have been retained by clients who have received proposed notices of violations and we expect more are likely be received later this year.

Key trends in Canadian real estate investment

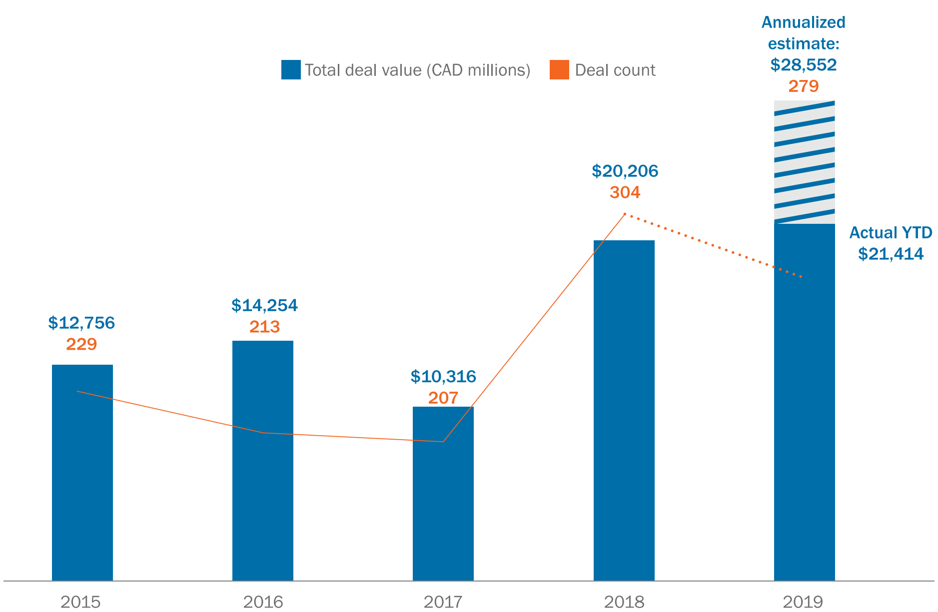
By Sabrina Gherbaz, Simon Knowling and Graham Rawlinson

Divestitures of non-core assets, rising institutional investment and multi-use, urban intensification investments are just some of the trends that are shaping Canada's real estate sector. We anticipate that strong investment in the asset class is poised to continue, with investor confidence in a low-interest-rate environment likely to drive robust activity in the sector in the coming months.

Trend 1: Disposals of non-core assets by public companies

Although in the last couple of years we had seen a disconnect between public real estate company stock prices and the net asset values of the underlying public company real estate portfolios, that has largely subsided in 2019 (the S&P/TSX Capped REIT Index is up about 20% year to date). We have, however, seen public companies adjust portfolios by shedding non-core assets, including so as to re-cycle capital into their real estate portfolios, particularly in urban centres. Deal activity in the Canadian real estate market has consequently remained strong, particularly in the Toronto, Vancouver and Montréal markets. Based on current trends and our own discussions with leading players, we expect 2019 to be on par with the four-year high of deal values and trading volumes recorded for 2018 (see Figure 1, below, and Trend 3, p. 24).

Figure 1: YTD real estate M&A deal value and volume



Source (Figures 1 and 2): S&P Capital IQ. Announced transactions to October 1, 2019 involving a Canadian target in the real estate sector. Cancelled transactions are excluded.

Trend 2: Rise in institutional investment

More and more, Canadian real estate assets are being acquired by financial buyers—pension plan, private equity, and other institutional capital funds—who are making up much of the investor pool in Canadian real estate transactions (see Figure 2). As interest rates have remained at historic lows, our financial buyer clients are continuing to seek cash-flow generating hard assets. Many of these funds also have the investment muscle and patience, with longer term investment horizons than typical public company investors, to meet sellers' price expectations.

The recently announced acquisition by Blackstone of Dream Global, adding to Blackstone's growing portfolio of logistics assets, is a notable demonstration of this trend, removing another publicly-traded investment option from the Canadian marketplace. Another example is the recent acquisition by Axium Infrastructure of a 75% interest in a portfolio of government-funded long-term care homes in four provinces, in partnership with a private Canadian real estate development and seniors housing operating company. Torys acted for Axium Infrastructure.[1] The rise of institutional investment is being felt across all sector types, including office, retail, multi-family and seniors housing, leading to continued downward pressure on capitalization rates.

Case study: Pension funds are pursuing direct investments

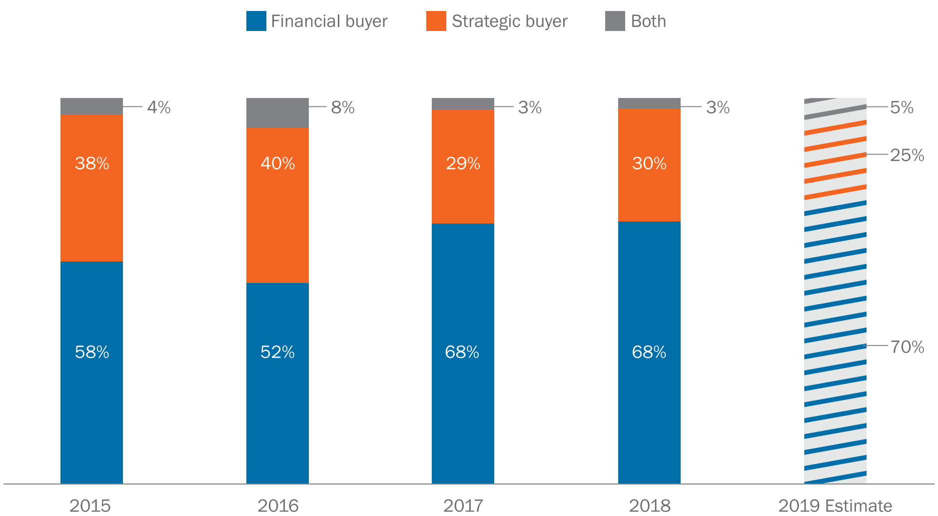
The above trend can be illustrated by two current examples of pension funds making direct investments in Canadian real estate assets. Investment Management Corporation of Ontario (IMCO), as the asset manager for Ontario Pension Board, recently co-invested along with Cadillac Fairview in 160 Front Street in Toronto, Ontario. According to Brian Whibbs, Managing Director of Real Estate, IMCO: "Investing in real estate is an integral part of IMCO's investment strategy because it is well-aligned to Ontario Pension Board's return objectives."[2] Another example is the partnership investment by OPTrust, along with Great-West Life Real Estate Fund, London Life Real Estate Fund and I.G. Investment Management, Ltd., in a complex of office buildings located at the southeast corner of Yonge and Adelaide in Toronto's financial district. Rob Douglas, Managing Director of Real Estate Investments, OPTrust, noted the importance of finding "income-generating assets that align with OPTrust members' requirements of providing Plan sustainability and security."[3] Torys advised IMCO and OPTrust on each of these transactions.

[1] See press release by Axium Infrastructure.

[2] See press release by Cadillac Fairview.

[3] See press release by OPTrust.

Figure 2: Investor type



Trend 3: Intensifying existing investments

Increasingly, our Canadian real estate investor clients are intensifying their existing investments by pursuing high-density developments, which continues to be a key driver of both public and private market real estate activity in Canada. We have seen urban intensification outside of the traditional office and multi-family asset classes to now also include seniors housing, as well as transit-oriented development where developers are paying to develop public infrastructure as part of urban intensification.

Case study: New GO Station at Woodbine

Earlier this year the Ontario Government announced that it, together with Metrolinx, had partnered with Woodbine Entertainment to build a new GO station at Woodbine, at no cost to taxpayers.[4] Woodbine

[4] See press release by the Government of Ontario.

Entertainment will fund the capital costs of the new build, estimated to be between $75 million and $90 million. Torys is advising Metrolinx.

Especially in the core Canadian urban markets, multi-use, intensification investments are becoming more frequent, as residential and commercial uses share space at high-value locations. These developments are presenting investors with particular challenges, since the skill set required to succeed in mixed-use development is unique, requiring strong project management capabilities to address permitting, planning and capital challenges. Increasing construction costs, including as a result of several large-scale government-backed infrastructure projects and tariffs on building materials, are continuing to put pressure on development budgets.

Conclusion

We anticipate that investors who focus on building out their development capabilities and relationships will remain ahead of the curve in the current dealmaking environment, and vigorous investment in the real estate asset class should continue. Previous concerns about the risks of rising interest rates are also dampening, and the current perception of a low-interest-rate environment should further encourage deal activity in the near term.

Solving the broadband infrastructure gap

By Mark Bain, Josh Van Deurzen

Today, access to broadband internet is largely considered an essential service akin to utilities such as electricity or public highways, as it is critical to participation in the modern economy. Despite this fact, many rural and remote communities have limited or no broadband connectivity due to lack of the consumer density required to support economically viable private sector broadband infrastructure projects.

As of 2017, only 37% of rural households in Canada had access to speeds of at least 50 megabits per second (Mbps) download and 10 Mbps upload, compared with 97% of urban homes.[1] Major urban areas are, in contrast, well supported with multiple internet service providers (ISPs) providing high-speed reliable service and economic pricing, and require no government financial or capacity support.

To eliminate this gap, governments at all levels are creating policy objectives, encouraging public-private hybrid delivery models. They are also allocating funding to broadband projects in support of expanding access. For example, in its Budget 2019, the Government of Canada established the $1.7 billion Universal Broadband Fund, which, together with the CRTC's previously announced $750 million Broadband Fund, will be deployed on various broadband development projects in furtherance of the CRTC's universal service objective that 100% of Canadian homes should have access to speeds of at least 50 Mbps download and 10 Mbps upload by 2030.[2] However, those charged with implementing such policies need to navigate several challenges in structuring, funding and financing broadband projects in a way that will achieve the announced goals.

Leveraging government funds

Governments struggling to balance their budgets cannot solve the broadband infrastructure gap alone—simply put, there's not enough money. In 2016, Innovation, Science and Economic Development Canada estimated the cost of connecting all Canadians with 50/10 Mbps service at between $6.5 billion and $50 billion, depending on the technologies used.[3]

To make taxpayer dollars go further, governments should encourage ISPs to invest in broadband infrastructure in rural and remote communities by sponsoring public-private hybrid/shared responsibility approaches or providing the minimum funding required to make otherwise uneconomic projects financially viable. However, determining the right type of project support and the right amount of funding requires deep industry knowledge and expertise which government entities may not have.

We see three models of broadband solutions evolving in the market: a pure private solution in major urban centres; a pure public model in remote communities with low demand but high political support; and a spectrum of mixed public-private models in situations where there is some reasonable level of demand, but not enough for a pure private solution to be viable.

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[1] Government of Canada, "High-Speed Access for All: Canada's Connectivity Strategy"

[2] Federal Budget 2019: Building a Better Canada: Universal High Speed Internet

[3] Office of the Auditor General, Connectivity in Rural and Remote Areas, Report 1 of the 2018 Fall Reports of the Auditor General of Canada

Avoiding overbuild

Unlike traditional forms of infrastructure such as hospitals or highways where the government is not competing with private interests, with broadband network infrastructure, governments building new and standalone broadband systems may potentially be in competition with one or more incumbent ISPs. Building broadband network infrastructure in an area where a broadband network already exists is not an effective use of government funds, assuming that the open access rules are honoured in practice. But in many cases the location of existing privately owned broadband network infrastructure is unknown to governments.

Operating governance

While day-to-day operations and control of government-owned or government-funded broadband infrastructure naturally resides with ISPs, government entities will want to impose operational requirements upon the ISPs regarding open access, minimum performance standards and pricing. Where government-owned or government-funded broadband infrastructure is operated by an ISP as part of its broader network, such operational requirements must be crafted to be compatible with the applicable ISP's existing business processes and systems. These will vary across ISPs bidding on government funding for projects.

Recent broadband projects in Canada reflect various approaches being taken to address these challenges. We also see a similar mix of approaches taken to such projects in the U.S. and internationally.

Case study: Northwest Territories' Mackenzie Valley Fibre Link

The Mackenzie Valley Fibre Link (MVFL) spans over 1,400 km along the Mackenzie Valley corridor in the Northwest Territories, connecting Northern communities, resource industries, Arctic research institutions and the Inuvik Satellite Station Facility to an existing fibre system at Checkpoint Junction, in southern Northwest Territories, and from there interconnecting to high-speed fibre optic networks in southern Canada. Following the completion of the all-weather Inuvik-Tuk highway, an additional 140 km of fibre cable will potentially be added to extend the MVFL to Tuktoyaktuk, located on the shores of the Arctic Ocean, at the uppermost edge of Canada.

The Government of the Northwest Territories (GNWT) procured the MVFL as a public-private partnership, selecting Northern Lights GP—a consortium comprised of Ledcor Developments and Northwestel (a wholly-owned subsidiary of BCE)—to design, build and finance the MVFL and, following construction completion, to operate and maintain the MVFL for 20 years. GNWT retained ownership of the MVFL and, accordingly, will repay in full the private financing arranged by Northern Lights GP to construct the MVFL over the 20-year operational term of the project. GNWT avoided overbuild by securing an indefeasible right of use on existing, Northwestel-owned fibre to connect the southern terminus of the newly constructed fibre in Checkpoint Junction to available long haul southern carriers in High Level, Alberta. Northwestel will operate the MVFL over the operational term on an open-access basis pursuant to a performance-based contract with financial incentives tied to key performance metrics.

GNWT required that end users of the MVFL backbone would receive fair market pricing, set at no more than a 25% premium to southern Canada rates, and agreed to vary backbone access pricing such that the spur lines and last mile connections would be reasonably profitable to the ISPs while protecting overall customer pricing.

Torys acted as counsel to the Government of the Northwest Territories.

Case study: SWIFT

Southwestern Integrated Fibre Technology (SWIFT) is a not-for-profit regional broadband development program initiated by the Western Ontario Wardens' Caucus and delivered in partnership with member municipalities and the governments of Ontario and Canada to subsidize the construction of an open-access, high-speed broadband network in Southwestern Ontario, Caledon and the Niagara region. The project is expected to provide broadband connectivity to approximately 300 underserved communities across 500,000 square km of mostly rural territory. The region currently features different service levels across urban, ex-urban and remote communities.

The SWIFT program involves a multi-stage procurement process whereby ISPs must first be pre-qualified by SWIFT to participate in the program through a request for pre-qualification (RFPQ) process which requires respondents to share information about their business structure and financial capabilities, as well as the location of their existing broadband infrastructure and known service gaps. Through this RFPQ process, more than 40 ISPs have been pre-qualified to participate in a series of requests for proposals (RFPs) to be issued by SWIFT for multiple broadband infrastructure projects across Southwestern Ontario, Caledon and Niagara.

Through these RFPs, SWIFT will direct provincial and federal government funding to subsidize a portion of the construction costs for new or upgraded broadband infrastructure assets in low density rural and remote areas. Communities that already have access to 50/10 Mbps service are not eligible for funding, thus ensuring geographical expansion of existing broadband network infrastructure. The subsidy level for each project will be determined on a case-by-case basis through the competitive RFP processes, subject to a maximum specified proportion of the construction costs for each project that will be eligible for subsidy. The project will be constructed, owned and operated by ISPs, with SWIFT retaining a 51% ownership interest in all funded broadband infrastructure for the first 7 years following construction completion.

SWIFT has mitigated against overbuild by compiling information provided by ISPs during the RFPQ process regarding the location of existing infrastructure and known service gaps to generate an internet service map setting out geographic areas that already have access to 50/10 Mbps service and are therefore ineligible for SWIFT funding. SWIFT also used information gathered from ISPs through the RFPQ process to establish critical network standards and performance criteria to align with ISPs' existing business frameworks.

Torys is acting as counsel to SWIFT.

Conclusion

Those are just two examples of different approaches government entities have adopted to expand or to economically support expanded access to broadband infrastructure to rural and remote communities in Canada. We predict that the existing approaches to developing these types of projects, particularly the combined public-private projects, will continue to evolve and new models will emerge as the demand for more and better internet access approaches a near-universal social issue. It also seems probable that different regions will always require tailored approaches to address their unique needs, which means further attention, collaboration and creative thinking will be required from all parties involved to solve this important public policy challenge.

Pipeline problems persist in Canadian oil and gas

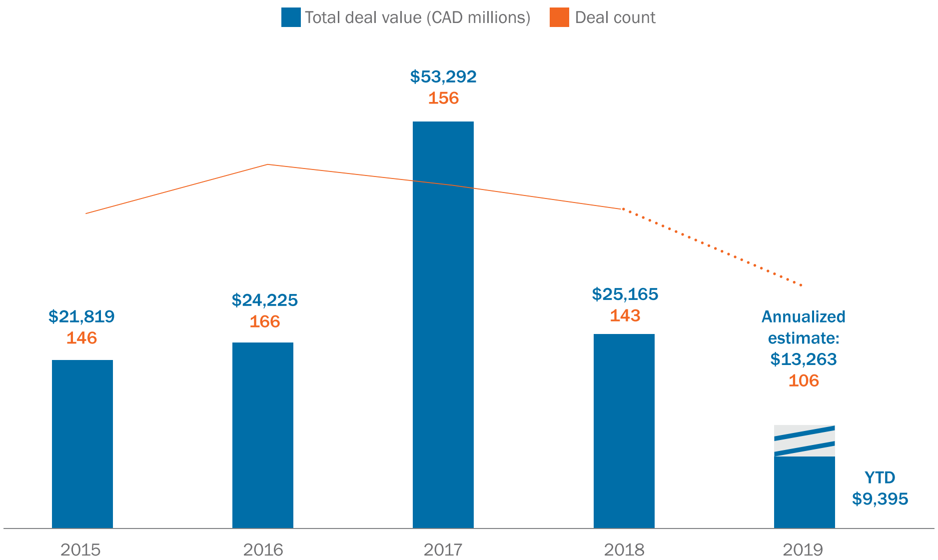
By Stephanie Stimpson and Derek Flaman

It has been a long and difficult stretch for Canadian oil and gas, with legal challenges, political decisions and takeaway capacity issues all serving to put pressure on an already stymied industry. A confluence of challenges—including, most prominently, persisting uncertainty around the Trans Mountain Pipeline—continue to negatively affect the sector in Canada. On the heels of the federal election, we must now wait to see whether further barriers will be created by the Liberals' minority government, notwithstanding the goverment's vow that the Trans Mountain Pipeline will be built.

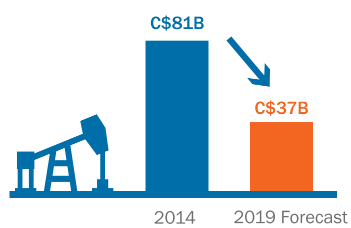
Oil and gas in 2019

M&A activity in oil and gas has been on a downward trend since 2016 (see Figure 1), with both volume and total deal value on the decline. A projected 106 deals at a total value of $13B expected for 2019 would represent the lowest activity in oil and gas M&A in five years.

Figure 1: YTD oil and gas M&A deal value and volume



The government of Alberta mandated production curtailment from January 1 to December 31 2019, indicating that a lack of sufficient pipeline and rail takeaway capacity, as well as storage facilities being at near capacity, was costing the Canadian economy more than C$80M per day.[1] The negative impact such lack of capacity has had on investment in Canada's oil and gas sector is undeniable. The Canadian Association of Petroleum Producers (CAPP) has forecasted that capital investment across Canada's oil and natural gas sector will have fallen by 54% over the last five years.



Canadian Association of Petroleum Producers forecast that capital investment across Canada's oil and natural gas sector will fall to C$37B in 2019.

[1] https://www.alberta.ca/release.cfm?xID=621526E3935AA-08A2-6F45-72145AEBDF115BDF

This lack of capital and negative investor sentiment has negatively impacted stock prices of the oil and gas producers and service companies, some of which have recently been removed from the S&P/TSX Composite Index, resulting in certain funds being required to sell off shares.[2]

Very low stock prices may cause speculation around greater potential for hostile bids; however we have not seen any hostile activity since Husky Energy's C$2.8 billion proposed hostile takeover of MEG Energy, a bid which it ultimately elected not to extend (Husky cited curtailment and lack of progress on pipelines in Canada as the reason for its withdrawal). Some of the small to mid-size producers (such as Obsidian, Pengrowth, Strategic and Bellatrix) have announced strategic reviews and restructurings in 2019, but there is no certainty on the appetite of suitors in the current environment.

Midstream activity on the rise

Some areas of the sector are experiencing more activity than others: M&A activity for midstream assets, including pipeline and other midstream infrastructure, continues to be a focal point for investors. Institutional investors in particular are gravitating to midstream assets for their reliable cash flow and targeted rates of return. Recent examples include KKR's Q1 partnership with SemGroup Corp to create a new midstream platform in connection with the acquisition of Meritage Midstream from Riverstone Holdings,[3] AIMCo's acquisition of an 85% equity stake in the Northern Courier Pipeline from TC Energy Corporation, and Northleaf Capital Partners' acquisition of CSV Midstream Solutions Corp., a Calgary-based midstream natural gas and liquids infrastructure company, from Apollo Global Management, LLC. In the public M&A space, Pembina announced its agreement in Q3 to purchase Kinder Morgan Canada Inc.—the second stage of Kinder Morgan's exit from Canada following its sale of the Trans Mountain Pipeline to the Government of Canada in 2018. AltaGas Ltd., which targeted asset sales of up to C$2 billion for 2019, has announced deals exceeding that amount, most recently with the C$870 million disposition of its interest in the Central Penn Pipeline in the US. And earlier this month Husky Energy announced its sale of the Prince George Refinery in British Columbia to Tidewater Midstream and Infrastructure Ltd., including a five-year offtake agreement for 90% of the nameplate capacity on diesel and gasoline volumes produced at the facility.

Impact from regulators and courts

A number of regulatory and legal developments over the last several years have had direct and significant effects on the oil and gas sector, contributing to the

[2] Calgary Herald: Varcoe: Oilpatch paying 'penalty' as drillers, producers dropped from stock index

[3] Torys acted for KKR.

overall uncertainty in the industry and downward pressure on investment, including a number of country exits by foreign companies. A few of these key developments are summarized below:

- **Bill C-69**. The federal Liberal government introduced Bill C-69 to overhaul how major infrastructure projects, including interprovincial pipelines, are reviewed and approved in Canada. An amended version of Bill C-69 cleared the final hurdle to becoming law and received royal assent in June and was proclaimed into law in August. Concerns around Bill C-69 include that it will make the regulatory and environmental review process more onerous, raise the risk of litigation and generally have a chilling effect on foreign investment to Canada. The government of Alberta recently launched a constitutional challenge against Bill C-69 in the Alberta Court of Appeal. In "Getting projects built under Canada's new assessment regime", we discuss how the proponents can navigate the new environmental assessment regime.

- **Bill C-48**. This bill (dubbed the Oil Tanker Moratorium Act) was introduced by the federal Liberal government in 2017 and also received royal assent in June. This bill seeks to protect a portion of BC's northern coast and is expected to impair the ability to export crude oil to global markets.

- **BC reference case**. In May, the BC Court of Appeal unanimously ruled against the BC government's proposed regulations which would require a hazardous substance permit be obtained to transport any increased amount of heavy oil through BC.[4] This was a further action by the BC government to stymie the Trans Mountain Pipeline, and the BC government has indicated its intent to appeal the decision to the Supreme Court of Canada.

- ***Redwater***. The Supreme Court's decision in the *Redwater* insolvency case has had the effect of increased uncertainty around license transfers with the Alberta Energy Regulator as well as a negative impact on debt facilities and issuers' ability to raise capital.[5] The AER has been criticized for its management of the regulatory framework in Alberta and the board of the AER was recently replaced by the UCP government.

- **Carbon tax**. Carbon legislation remains a political and regulatory issue in Canada. In June, Alberta's newly elected UCP government repealed the provincial carbon tax previously adopted by the NDP government. This means that Alberta may be subject to the federal carbon tax, similar to other provinces that have not adopted their own carbon pricing regime.

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[4] Reference re Environmental Management Act (British Columbia), 2019 BCCA 181 (BCCA)

[5] Read more in our bulletin, "SCC says orphan wells cannot be ignored".

- **Trans Mountain nearing construction**. In mid-June, the federal government re-approved TMX. TMX has stated that construction will commence this fall. The latest decisions around TMX have been considered wins for the project moving ahead. In September, the Federal Court of Appeal permitted only half of the legal challenges to proceed, allowing expedited court proceedings on the quality of the Indigenous consultation with certain groups and dismissing the claims based on environmental concerns. This case illustrates the signficant challenges for companies satisfying consultation rights in the context of a linear project extending over a thousand kilometres and impacting numerous communities and stakeholders in contrast to localized projects where consultation involves a finite set of communities and stakeholders.

Conclusion

Years of pressure have taken their toll on Canada's oil and gas industry. It will take time for investors to rebuild their confidence in the Canadian regulatory and political climate such that we see capital spend flowing to the sector, and there is no imminent improvement expected following the recent federal election. Industry and the government of Alberta have reacted to these concerns by launching public relations campaigns intended to educate the public regarding the strong safety and environmental stewardship supported by the industry in Canada and the critical impact of the oil and gas sector to the Canadian economy. The hope is that some middle ground will be achieved on these highly political and polarizing issues to promote investment and allow development of our country's resources in an environmentally and fiscally responsible manner.

The federal government has maintaining its commitment to build the Trans Mountain Pipeline and potential relief may lie ahead with the pipeline's re-approval and if outstanding approvals are granted to the Line 3 Replacement Project or Keystone XL. With more certainty around pipeline access for Canadian oil and gas on the horizon, the sector may at last have renewed cause for optimism.

Investment in Canada's power sector

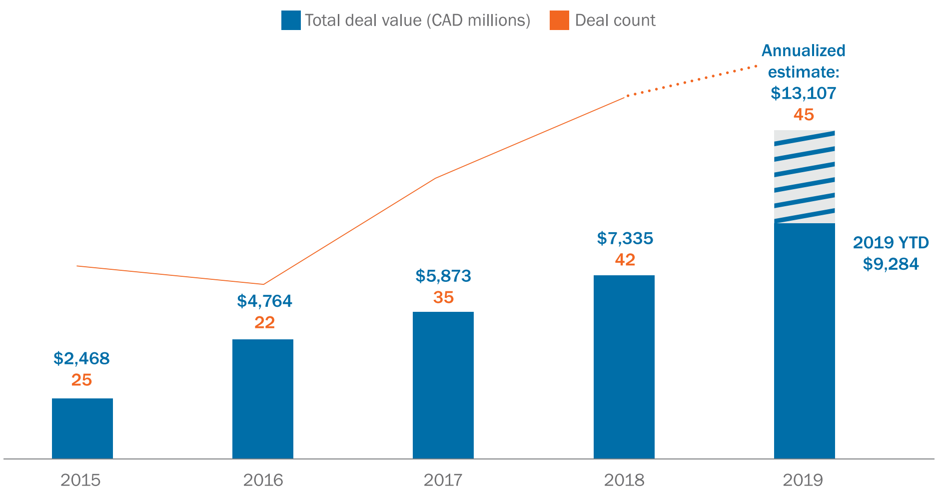
By Krista Hill, Charles Keizer

Canada's power sector today is at the intersection of a number of challenges and opportunities. Interest from investors in power sector assets, especially financial investors and Indigenous communities in Canada, is higher than ever. At the same time, the sector is working to balance regulatory and citizen concerns around consumer pricing for utilities which need capital investment in essential upgrades to keep the sector well positioned for the future.

Move from development to the secondary market

During the last 15 years, the energy space in Canada has been dominated by project development work in the generation sector, with significant renewable and gas-fired projects undertaken as various provincial governments worked to manage their supply mix. The result was a substantial addition of capacity across the country in power generation assets, including renewable assets like wind and solar. In recent years, we have seen many of those assets change hands, with Canadian domestic deal activity in the power sector rising steadily since 2016 (Figure 1). The majority of power transactions have involved Canadian targets which are independent power producers and electric and gas utilities (Figure 2). Since 2015, these transactions have mostly involved asset sales (Figure 3). Many sellers are looking to free up capital to deploy elsewhere.

Figure 1: YTD power M&A deal value and volume



Source (Figures 1 to 5): S&P Capital IQ. Announced transactions to October 1, 2019 involving a Canadian target in the power sector (comprising electric and gas utilities, multi-utilities, and independent power & renewable electricity producers). Cancelled transactions are excluded.

These transactions have been attracting investment from institutional investors, particularly pension funds, and financial investor interest in the sector has increased significantly in the last few years (Figure 4). Power assets are particularly well suited for long-term investors, such as pension funds, which have corresponding long-term liabilities. The asset class offers long-term, inflation-indexed returns, which typically provide stability over time.

As institutional investors look for investment opportunities in this asset class, competition for power assets is intensifying and as a result, we are seeing Canadian institutional investors increasingly look both domestically and worldwide for opportunities in the sector, with strong outbound activity particularly in 2018 (Figure 5).

Figure 2: Industry breakdown

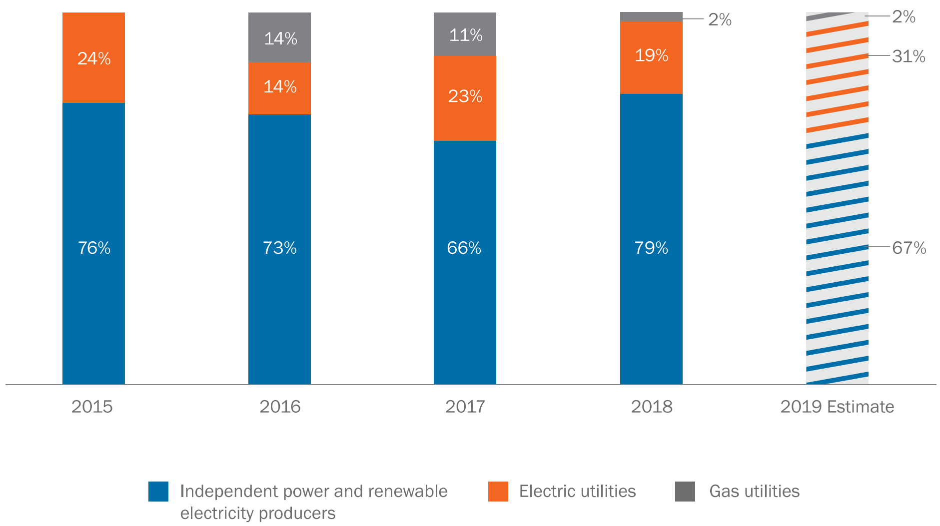
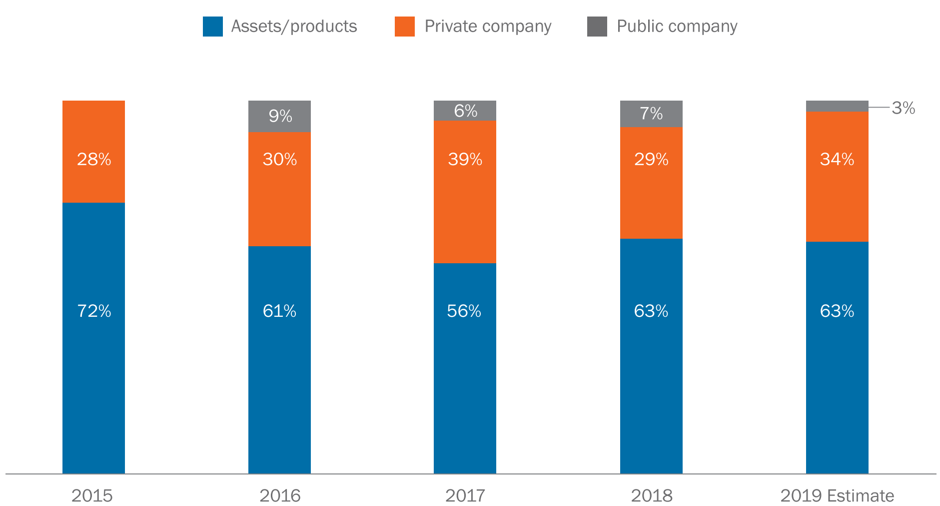


Figure 3: Target type



Addressing aging infrastructure and preparing for the future

After substantial investment in Canadian power infrastructure assets that commenced in the mid-20th century, utilities are in need of additional capital investments in a now-aging fleet of assets used to deliver electricity. Utilities are also looking to augment existing infrastructure to meet demand through localized generation, to integrate battery storage and to address the demand implications of electric vehicles.

In Ontario, applications are being made by utilities before the Ontario Energy Board to secure authorization for planned capital reinvestment, with ongoing rate applications being made to adjust distribution and transmission rates in order reflect mounting capital expenditures. Coincident with the industry's need to reinvest is the public policy objective to reduce charges for ratepayers. The future success in the sector—supported by a reliable system that seizes upon technological and other advances at a reasonable consumer cost—will depend on how adept the regulator is at balancing the priorities of utilities, ratepayers and the policy makers.

Figure 4: Investor type (as a % of deal count)

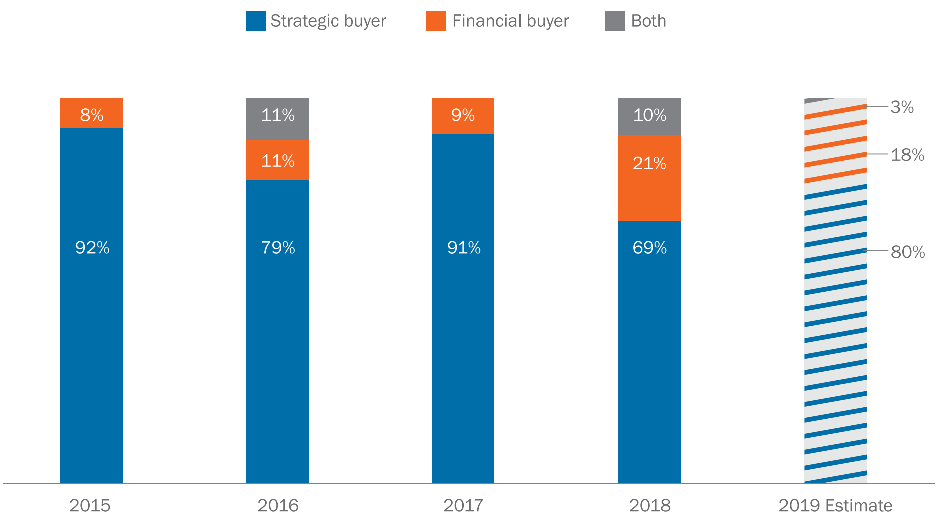
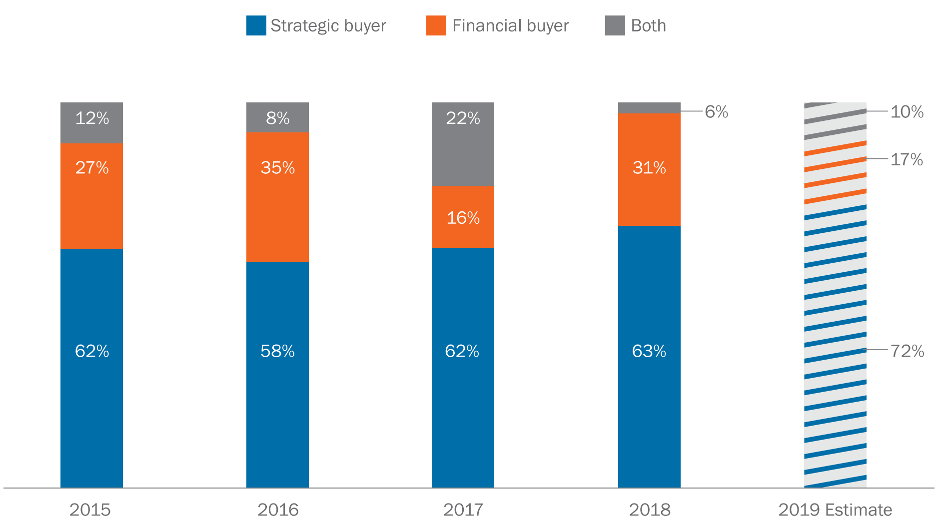


Figure 5: Outbound investor type



Indigenous involvement in power projects

Another development in the power space that we are seeing in Canada is the involvement of Indigenous peoples in power projects. Successful projects in Canada today must include meaningful involvement of Indigenous communities (learn more about Indigenous engagement in projects in "Getting new projects built under Canada's new assessment regime"); increasingly, Indigenous communities are seeking greater control over the projects in their territories, at every level of engagement, including equity ownership. We expect this will be a trend that will continue within the power sector and beyond for projects in Canada.

Mining transactions proceed at measured pace and with need for creativity

By Michael Amm and Michael Pickersgill

At the beginning of 2019, conditions seemed right for a significant new wave of M&A activity in the mining sector, with high expectations focused in particular on gold, copper and battery metals. However, in the nine months ending September 30, 2019, global transaction activity by value is down approximately 40% from the same period in 2018. By way of contrast, deal value during the comparable period in 2011 being the most recent peak period for M&A in the sector, was approximately four times higher.[1]

A cautious M&A environment

M&A enthusiasm has been dampened by growing concerns around the US-China trade dispute, Brexit and the overall health of the global economy. The price of copper, often seen as leading indicator of global economic activity, has declined from a high of US$2.97 per lb in April 2019 to US$2.56 per lb in October 2019, despite the widely expected medium-term supply side shortage. In the gold space, the wave of consolidation that was expected to be triggered by the Barrick/Randgold and Newmont/Goldcorp mergers, their stated intention to divest significant non-core assets and the industry-wide need to replenish resources and reserves, has resulted in only limited increased M&A activity.

The much-lauded battery metals space (encompassing cobalt, lithium and more recently nickel) has been characterized by volatile swings in metals prices and perceptions of future demand and supply. At the same time, activity involving Chinese acquirors has slowed as concerns have increased over the political effects of the US-China trade tensions and the increasingly challenging nature of foreign investment approvals. We expect that many of these headwinds will continue into 2020.

Overlaying these developments has been greater shareholder sensitivity and activism focused on the impact of transactions on shareholder value, both on the acquiror and target side. In this environment, M&A transactions have generally been disciplined, carefully structured and driven largely by key strategic imperatives and opportunities arising from market dislocations in certain sectors.

The recently completed C$515 million acquisition of Cobalt 27 by Pala Investments exemplifies of many of these themes. By June 2019, when the transaction was entered into, cobalt prices had fallen 66% from their 2018 peak. Cobalt 27's share price performance had fully matched the decline. These factors and their adverse impact on the outlook for Cobalt 27's business in the short and medium term opened a unique strategic opportunity for an acquiror who believed in the strength of demand for cobalt over the longer term.

The transaction was creatively structured to provide for a spin-out to Cobalt 27 shareholders of the company's assets, other than its physical cobalt inventory and its stream on Vale's Voisey's Bay nickel project. Conic Metals, the new listed company spun out to shareholders, holds a minority joint venture interest in the Ramu nickel project in Papua New Guinea and more than 10 royalties on earlier-stage nickel and cobalt projects. This structure was designed to allow Pala to focus on the key strategic assets of interest to it while giving shareholders continued exposure to other nickel and cobalt interests.

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[1] Source: Mergermarket

However, following announcement, the transaction became subject to criticism from some shareholders on value and governance grounds, culminating in a public campaign led by an activist shareholder opposing the transaction. An interloper also made a competing proposal for a transaction, although the interest of that party ultimately fell away. The leading independent proxy advisory firms issued contradictory recommendations, with ISS recommending in favour of the deal and Glass Lewis against. Shareholder activism of this type in the mining sector has increased in recent years as reflected in the high-profile campaigns involving HudBay and Detour Gold.

The Cobalt 27 transaction was ultimately approved by shareholders (and recommended by both proxy advisory firms) following a significant cash price increase and a sustained process of committed engagement with the company's shareholder base. We believe that this type of sustained and committed shareholder engagement will become increasingly important to the success of public M&A deals in the mining sector—focused on both shareholders of the target company and shareholders of the acquiror. Shareholders have become increasingly skeptical of M&A transactions and therefore often require an enhanced level of engagement to allow them to understand the merits and strategic rationale.[2]

Challenging public markets—and success with creative alternatives

The first three quarters of 2019 saw a continued positive trend for gold and precious metals, and a corresponding positive trend for gold equities on the TSX: the S&P TSX Global Gold Index was up almost 15% in Q3 2019 and approximately 33% over the first three quarters of 2019. In contrast, public financing activity on the TSX has remained difficult. In the first three quarters of 2019, the TSX and TSX Venture Exchange have seen drops in new issuer listings and capital raising in the sector compared with the same period in 2018.

Financing activity has remained constrained as institutional and generalist investors have been slow to come back into the sector notwithstanding positive future supply and demand dynamics and some ongoing capital markets challenges arising for issuers in the cannabis and technology sectors. While some mining issuers have successfully accessed the markets through public equity offerings, those transactions have generally been difficult to complete. A significant portion of equity financing by Canadian mining companies has been conducted through private placements, strategic or otherwise.

The result has been a continued emphasis on creative dealmaking in the capital markets sector. One example was the successful bought deal secondary offering by Osisko Gold Royalties of shares owned by Orion Mine Finance. As consideration for

[2] Torys advised Pala Investments on the transaction.

the sale of Orion's initial stream and royalty portfolio to Osisko, an affiliate of Orion's initial fund, received cash and a significant equity stake in Osisko. Orion wished to monetize this equity position at an opportune time and Osisko was interested in ways to structure such a sale in a manner that would benefit Osisko.

The result was a creative transaction for Orion and Osisko. Osisko successfully completed a secondary offering of approximately 9 million shares held by the Orion affiliate for proceeds of approximately C$110 million.[3] At the same time, Osisko repurchased just over 12 million of its shares from the Orion affiliate at the same price as the secondary offering for aggregate proceeds equal to approximately C$175 million payable in cash and the exchange of certain of the equity interests held by Osisko in other mining companies. The cash portion was funded by the sale by Osisko of its remaining interest in Dalradian Resources and its significant interest in Victoria Gold to another investment fund managed by Orion which had existing investments in Dalradian and Victoria. The result of the transaction was a reduction of Orion's interest in Osisko from 19.5% to 6.2% and a rationalization of both parties' equity investment portfolios.

Financing activity has remained constrained as institutional and generalist investors have been slow to come back into the sector. The result has been a continued emphasis on creative dealmaking in the capital markets sector.

The extent to which royalty and streaming companies continue to play a leading role in the sector is another result of the continuation of difficult public capital markets in the face of stronger precious metal prices. Their business model provides investors with access and exposure to precious metals (and in some cases other minerals and oil and gas) prices and production increases through a portfolio of investments, without the operating and capital costs risks faced by miners. In contrast to the mining sector in general, this approach has remained popular with many large institutional and other generalist investors.

Franco-Nevada, the largest royalty and streaming company by market capitalization, in July 2019 announced the implementation of a US$200 Million "At-the-Market" (ATM) equity offering.[4] An ATM is a low cost, flexible equity offering structure that permits equity to be sold directly into the market over a stock exchange at prevailing market prices. Sales occur at the issuer's discretion periodically over the life of the

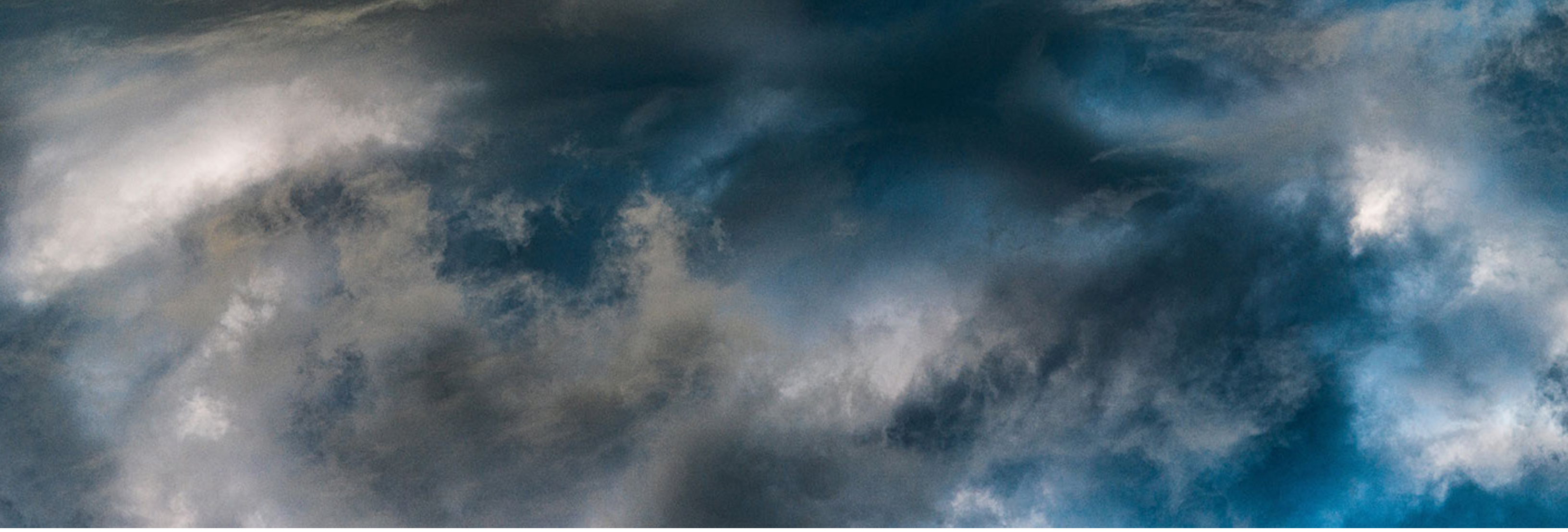
[3] Torys advised Osisko on the transaction.

[4] Torys advised Franco-Nevada on the equity offering.

program. While these structures have been a longstanding feature of the US capital markets, they have more recently become adopted in Canada, primarily for cross listed issuers such as Franco-Nevada. We expect that the ATM structure will be increasingly employed by mining companies while the environment for traditional public equity offerings remains challenged.

Alternative finance, and royalty and streaming finance in particular, continues to play a key role as a critical component for the funding of project development. A recent example was Triple Flag Mining's US$100 million stream investment in Continental Gold to support the construction of the Buritica project in Colombia.[5] The lack of large, new development projects in recent years has resulted in fewer large financing opportunities for royalty and streaming companies. As a result of the inevitable need to move new projects toward development to satisfy growing demand and declining output from existing mines, we expect that royalty and streaming financing will continue its key position in the overall mining finance toolkit.

[5] Torys advised Triple Flag Mining on the investment.



Getting projects built under Canada's new assessment regime

By Dennis Mahony and Michael Fortier

Canada's environmental sector is evolving. A new regulatory regime has been introduced by the federal government to assess the impact of large projects on the environment, with a wide-ranging scope of focus that encompasses climate change, broad socio-economic benefits, and greater collaboration with stakeholders and Indigenous groups. We believe that proponents who invest the time and effort in the early stages to carefully prepare for the assessment process will reap substantial benefits in their pursuit of new opportunities across Canada.

Broader assessments in Canada

For decades, federal environmental assessment has been a major part of the development of large projects across Canada, including pipelines, ports, railway yards, mines and nuclear facilities. The regime was substantially changed this past August when the new *Impact Assessment Act (IAA)* came into force, replacing the *Canadian Environmental Assessment Act, 2012 (CEAA 2012)*. Key changes include: introducing a new Impact Assessment Agency; a new litmus test, based on a wide range of "public interest" factors; more emphasis on greater stakeholder and Indigenous participation; and an important new planning phase. The new regime's broader scope has a stronger focus on the assessment of a project's potential economic and social impacts, as well some entirely new considerations, like the positive—not just adverse—impacts of a project, sustainability, certain climate impacts and the intersection of sex and gender with other identity factors.

Elements of the new regime have been controversial (see our article "Pipeline problems persist in Canadian oil and gas"), posing genuine uncertainty for new (and transitioning) large projects across Canada—but there also appears to be a path for developing projects faster and with more stakeholder support. Project proponents that carefully manage the process from the outset may well gain a substantial competitive advantage.

Efficiency through early planning

A common reaction to substantial change of this kind is to assume that the early period of uncertainty is likely to result in administrative wheels grinding slower, in this case, leading to industry concerns that it will take even more time under the IAA to get projects built. Fortunately, the new regime contains a variety of provisions which could result in the opposite.

Most notable among them is a new, initial phase, which mandates early engagement with stakeholders and detailed planning for the assessment process to come, including clarification of expected timelines. While many experienced project proponents have always made that kind of effort unilaterally, institutionalizing it through the IAA means that it is now on the Agency to implement a "measure-twice, cut once" philosophy. Even for those projects where substantial stakeholder consensus is not possible, there should be more clarity up front about the nature and extent of the assessment, which in turn will help reduce the frequency of credible later-stage claims of surprise (and the assertion that the proponent should start over on a particular subject or step).

Consistent with that spirit, the IAA also reduces the legislated default maximum timelines for a review from 365 to 300 days for Agency assessments and from 730 to 600 days for (the much more involved) panel reviews. More importantly, it eliminates the previous regime's "clock-stopping" mechanism—in which time would regularly not count against the legislated limit—which made the default timelines illusory.

Figure 1: Duration of completed review panels under CEAA 2012

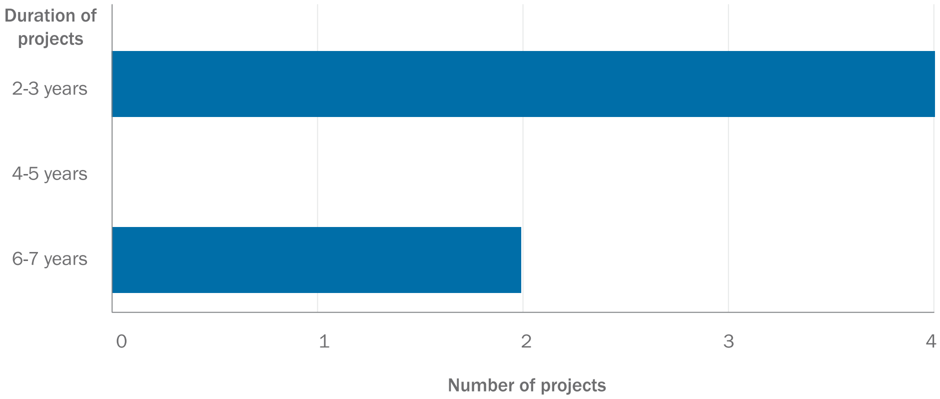
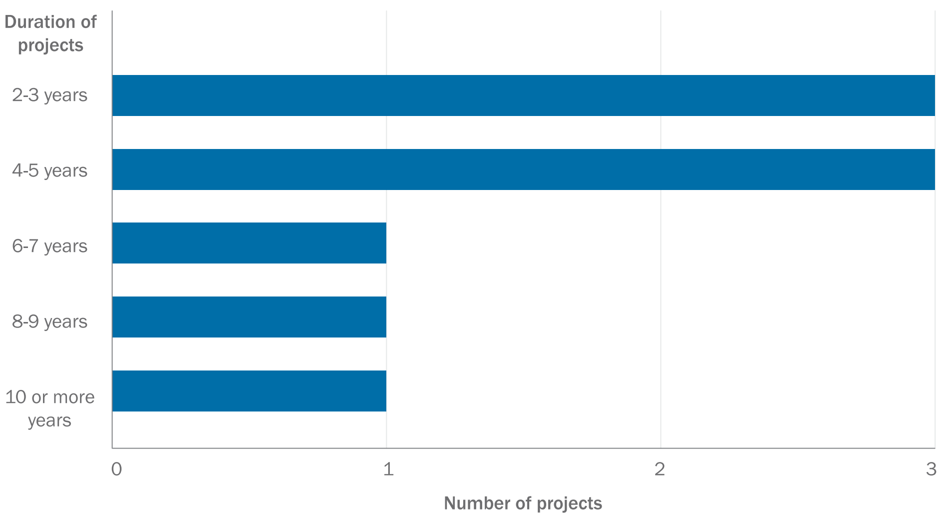


Figure 2: Duration of ongoing review panels under CEAA 2012

(Prior to the IAA coming into force)



As noted in Figures 1 and 2 above, the timelines in practice for panel reviews under the old regime routinely took at least several years.

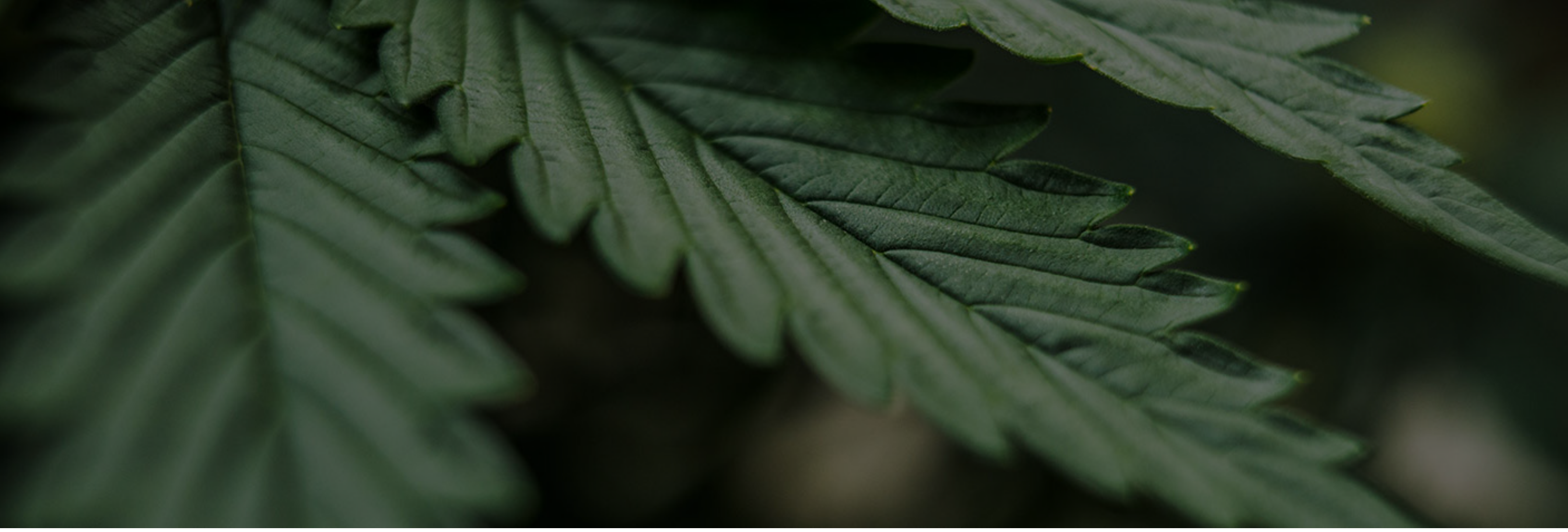
While the IAA does contain mechanisms for time extensions and suspensions, they are not automatic (as was the clock stopper) and they are balanced by mechanisms for shortening the schedule. If properly utilized in practice, those changes could make a very big difference in how quickly a project can be assessed.

Building better support

An obvious potential benefit of the earlier engagement mandated by the new regime is enhanced opportunity to engender a more collaborative relationship with stakeholders, including Indigenous groups—which in turn can facilitate better understanding and ultimately more project support. You can read more on Indigenous engagement with projects in Canada in "Investment in Canada's power sector". But even in those cases where stakeholder and/or Indigenous collaboration is ultimately illusive, the IAA's express focus on the positive impacts of the project could be a game-changer. In the past, there have been very limited opportunities for proponents to deliver a more balanced overall assessment, and, correspondingly, limited potential for a more balanced reception by the public. Proponents who are conscious of that opportunity will make sure that the benefits-story now forms a central part of the narrative from the very outset, which should help give these projects a distinct advantage.

Outlook

Canadian businesses that operate internationally are constantly reminded that our regulators need to get better at making good decisions faster. Canada's new IAA—if carefully navigated—could prove to be a step in the right direction.



The state of play in North American cannabis investment

By Cheryl Reicin, Eileen McMahon and Frazer House

The North American cannabis markets continue to mature against the backdrop of challenges unique to this sector. Through the second and third quarters of 2019, we've seen difficult financing conditions in the cannabis capital markets. However, this tightening of the capital markets is occurring against the backdrop of a continually improving legal landscape for the cannabis industry in Canada, the U.S. and abroad. These and other key developments in the cannabis space are discussed in this article.

Legal and regulatory developments

In Canada, the *Cannabis Act* is now in effect and published edibles regulations are also in force (October 2019). Provincial rollout of retailing has been bumpy, especially in some provinces such as Ontario, but is slowly settling into place. In the U.S., Congress gave overwhelming bipartisan approval to the SAFE Act, legislation intended to protect financial institutions from liability related to money laundering and proceeds of crime when servicing the state-legal, federally illegal U.S. cannabis industry. The legislation faces an uncertain reception in the Senate, although some commentators have expressed optimism. More and more states, such as Illinois, have legalized recreational cannabis and others, such as Pennsylvania and New Jersey, may be in the process of doing so. Meanwhile, pressure continues to be put on the FDA (and, conversely, by the FDA back on Congress) to develop an approach to CBD that will permit and regulate edible Cannabidiol (CBD). Although speculative, it's even possible that more sweeping legal developments could occur south of the Canadian border, with all current Democratic nominee contenders supporting full federal legalization (except Joe Biden, who supports decriminalization), and strong support in some wings of the Republican party for a form of legalization—perhaps a "states' rights" approach.

Financing and deal activity

With an improving legal landscape for the sector, we expect to see more normalization in cannabis financing markets. These trends are very important for industry participants, as many players, especially licensed producers, continue to have significant financing needs in order to execute their business plans, and the sector's volatile capital markets landscape is no longer favourable for financing.

The initial exuberance and hyperactive financing environment of the cannabis industry has until recently relied heavily on the support of retail investors. As we move through 2019, we have seen a marked cooling off in this market—likely attributable to many factors including non-compliance with applicable laws, resulting in the suspension (and, in one case, revocation) of licenses issued by Health Canada; licensed producers not meeting sales projections; and high-profile crises, such as at CannTrust's alleged use of fake walls to conceal from Health Canada unlicensed cultivation at its cultivation facility. As markets normalize and institutional investors become more significantly involved, we expect to see improved compliance, fewer crises and a more rational market.

In M&A and other strategic transactions, we expect to see interest not just in the companies themselves but also in their assets, including through sales and leasebacks of cultivation facilities to REITs. Investment firms (public or private) have to date mostly sat on the sidelines of the cannabis industry, making up less than 6% of all M&A purchasers in the market, but as valuations start to normalize and as the scope of legalization widens, this is expected to change. Now that the cannabis commercial market is real, investment decisions are becoming less driven by projections and speculation and more driven by traditional financing metrics.

Among the well-capitalized investors, a number of strategics in the alcohol, tobacco, consumer packaged goods and pharmaceutical industries are increasingly active. Debt finance is also playing a bigger role as it becomes more readily available to maturing companies with effective discipline regarding capital allocation and burn rates. We continue to expect consolidation, especially among the cultivators, with others going out of business altogether.

All in all, the path of cannabis financing and M&A markets has been similar to the path of other new and emerging markets (such as the dot com market of the 1990's, among others) where initial exuberance is eventually confronted by reality, and finally, normalization. Companies that are able to differentiate themselves through finely timed execution, branding, intellectual property, technology and alliances, tax-advantaged structures and/or size will be the survivors, and anchor the cannabis industry going forward.

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