CORPORATE FINANCE, MERGERS & ACQUISITIONS AND PRIVATE EQUITY

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CORPORATE FINANCE, MERGERS & ACQUISITIONS AND PRIVATE EQUITY

Corporate Finance

Canada has well-developed and sophisticated capital markets. The main sources of capital are Canadian chartered banks, other financial institutions (including pension funds, mutual funds and insurance companies), public markets, private equity and government agencies. Securities of Canadian and foreign public companies can be listed and traded on one or more of Canada's stock exchanges. Canada's principal stock exchanges are the Toronto Stock Exchange (TSX), the country's largest stock exchange, and the TSX Venture Exchange (TSXV), each with their own listing requirements. Canada also has active over-the-counter markets for a variety of other securities, including, in particular, debt securities. Canadian chartered banks are the principal source of revolving lines of credit and term loans.

SECURITIES LEGISLATION IN CANADA IS LARGELY HARMONIZED THROUGH THE USE OF NATIONAL AND MULTILATERAL INSTRUMENTS ADOPTED BY THE CANADIAN SECURITIES ADMINISTRATORS (CSA), AN UMBRELLA ORGANIZATION COMPRISING ALL OF THE PROVINCIAL SECURITIES REGULATORS, AND IMPLEMENTED AS LAW BY THE PROVINCES.

Public Offerings and Private Placements

In Canada, securities law is currently regulated under provincial jurisdiction and consequently each Canadian province and territory has its own separate securities regulator, as well as its own securities legislation. Nonetheless, securities legislation in Canada is largely harmonized through the use of national and multilateral instruments adopted by the Canadian Securities Administrators (CSA), an umbrella organization comprising all of the provincial securities regulators, and implemented as law by the provinces and territories. Further, the "principal regulator" or "passport" system adopted by each province of Canada (other than Ontario, which is Canada's largest capital market) allows many aspects of securities law to be effectively regulated by only one participating jurisdiction (i.e., the "principal regulator" in the circumstances), in addition to Ontario. These aspects include the review and receipt of prospectuses, compliance with continuous disclosure obligations and obtaining exemptions from various provisions of securities law.

When debt or equity securities are offered to the public in Canada, whether as part of an initial public offering (IPO), a secondary offering or otherwise, generally a prospectus must be filed with the securities regulatory authorities in those provinces and territories where the securities are being offered. The prospectus will be reviewed by the principal regulator under the passport system described above. A copy of the prospectus must also be provided to potential investors and publicly filed. The prospectus must contain full, true and plain disclosure of the nature of the securities being offered and the business of the issuer.

Where securities are being offered in Québec, an English language prospectus must also be translated into and distributed in French.

The requirement to prepare a prospectus can be avoided where securities are offered on basis that is exempt from the prospectus requirements exclusively to institutional or other "accredited investors" by way of a private placement, although in such cases market practice may nonetheless dictate the delivery to investors of an "offering memorandum" containing disclosure that is often substantially equivalent to a prospectus. There are a number of other prospectus exemptions, including for the issue of securities by "private issuers" or to employees, or the issue of short-term commercial paper with an approved rating and bank debt, in which case generally either no disclosure document or an abbreviated one is used. Securities sold on an exempt basis are typically subject to resale or seasoning restrictions.

Shareholders of Canadian public companies are not generally afforded statutory or contractual pre-emptive rights. Accordingly, new equity issues are typically effected by way of public offering or private placement, rather than by way of rights offerings to existing shareholders.

Issuers with equity securities listed on certain Canadian exchanges can take advantage of Canada's short-form prospectus distribution system, which enables capital to be raised in the public markets quickly by preparing and publicly filing a shorter prospectus that incorporates by reference the issuer's most recent financial statements and other continuous disclosure documents. Generally, issuers eligible for this system can clear a prospectus with the provincial securities authorities within four business days of filing a preliminary prospectus. In the case of more senior issuers, it is common for Canadian underwriting syndicates to enter into a "bought deal" arrangement. This constitutes an enforceable agreement by the

underwriters to purchase the securities being offered for sale, even before the filing of a preliminary prospectus, with the result that the syndicate incurs the risk of price fluctuations in the market from the time of signing the "bought deal" letter with the issuer until the closing of the offering. In such cases, a preliminary prospectus must be filed within four business days of the signing of the "bought deal" letter, and the syndicate may begin to solicit purchasers immediately upon the signing of the letter and the issuance of a news release. For issuers that do not qualify under the short-form system, the process to clear a prospectus with the provincial securities authorities can often take from three to six weeks, and sometimes longer.

Canadian securities laws also provide issuers with the ability to file a base shelf prospectus for up to an aggregate dollar amount of securities (which may be unallocated between debt, equity and other securities) for subsequent issuance over a period of up to 25 months. At the time of an actual distribution of securities qualified by the base shelf prospectus — and not later than two business days after the determination of the offering price of the securities — the issuer simply files a relatively brief supplement to the prospectus containing the specific terms of the securities then being offered, as well as any additional information that was not available to the issuer at the time the prospectus was filed. Although there are exceptions (e.g., where innovative, structured or derivative products are being distributed), supplements to the base shelf prospectus are not reviewed by regulators, allowing issuers to act quickly and take advantage of narrow windows of opportunity for financing in the markets.

Continuous Disclosure Obligations

An issuer filing a prospectus, listing its securities on a Canadian stock exchange or acquiring a Canadian reporting issuer through a share exchange transaction, will become a "reporting issuer," and thereby become subject to various continuous and timely disclosure obligations under securities laws. These include the requirement to prepare and file quarterly and annual financial statements and the related management's discussion and analysis, as well as an annual information form and reports with respect to material changes in the affairs of the issuer. Directors, officers and other "insiders" (which include holders of more than 10% of the voting rights attached to the outstanding voting securities) of the issuer will be required to file insider reports with respect to any trading they conduct in securities of the issuer and will be precluded from trading in the issuer's securities if they possess any material non-public information about the issuer. Management information

circulars must be prepared for annual and special shareholder meetings and must contain prescribed disclosure, including comprehensive disclosure on executive compensation in the case of annual general meetings or other meetings where directors will be elected or executive compensation will be voted on.

Foreign issuers that meet certain conditions and have become reporting issuers in Canada, whether by listing on a Canadian exchange or by acquiring a Canadian reporting issuer through a share exchange transaction, may generally satisfy their ongoing continuous disclosure obligations in Canada by filing their home jurisdiction documents.

The CSA has adopted various instruments modelled on U.S. Sarbanes-Oxley legislation. These include a national instrument on auditor oversight, a national instrument requiring CEO and CFO certifications and a national instrument on audit committees. In addition, a national instrument and a national policy have been adopted on corporate governance, which generally provide for a "comply-or-explain" regime. The latter sets out corporate governance best practices in the areas of board and committee independence, board process and policies, diversity and the board's oversight role; the former requires issuers to disclose, on an annual basis, their corporate governance practices.

Canadian and U.S. securities regulatory authorities have implemented a multi-jurisdictional disclosure system (MJDS) that enables securities of large U.S. issuers to be offered to the public in Canada using a U.S. registration statement that has been reviewed only by the U.S. Securities and Exchange Commission (SEC). Corporations with securities listed on a Canadian stock exchange are subject to the rules and regulations of that exchange.

Mergers & Acquisitions

Canada has established corporate and securities laws governing the acquisition of Canadian public companies, which can occur on a negotiated or unsolicited basis. There are two commonly used methods to acquire a public company in Canada: a take-over bid and a plan of arrangement, although in a hostile context typically a take-over bid would be the only practical structure available for an acquiror to effect an acquisition without the support of the target's board.

Take-Over Bids (Tender Offers)

Harmonized provincial and territorial securities laws regulate the conduct of public take-over bids. A public take-over bid is defined generally as an

offer made to a person in a Canadian province or territory to acquire voting or equity securities of a class of securities of a target company which, if accepted, would result in the bidder (together with persons acting jointly and in concert with the bidder) owning 20% or more of the outstanding securities of that class of securities. A take-over bid must offer identical consideration to all shareholders, with no “collateral benefit” to any shareholder permitted. The bid must be open for acceptance for at least 105 days, subject to abridgement to not less than 35 days with the agreement of the target company in a friendly transaction or where another abridged bid or a going-private transaction has been announced. A take-over bid is subject to a mandatory tender condition that a minimum of more than 50% of all outstanding target securities owned or held by persons other than the bidder and its joint actors be tendered and not withdrawn before the bidder can take up any securities under the take-over bid. The take-over bid must also be extended by the bidder for at least an additional 10 days after the bidder achieves the minimum tender condition and all other terms and conditions of the bid have been complied with or waived.

The bidder must provide shareholders of the target company with a take-over bid circular containing prescribed information about the offer, including prospectus level disclosure about the bidder (including pro forma financial statements) if the bidder’s securities form part of the offered consideration. The directors of the target company must respond by sending a directors’ circular to shareholders that includes the board’s recommendation as to whether the shareholders should accept the offer or, if the board declines to make a recommendation, an explanation of why no recommendation has been made. Both the take-over bid circular and the directors’ circular must be translated into French if the take-over bid is being made in Québec (unless a de minimis or other exemption from the translation requirement is obtained in Québec).

Certain take-over bids are exempt from compliance with the foregoing requirements. These include: transactions involving the acquisition of securities from not more than five shareholders of the target company, provided that the price paid does not exceed 115% of the prevailing market price; normal course purchases on an exchange that, when aggregated with other purchases made in a 12-month period, do not exceed 5% of the issuer’s outstanding securities; the acquisition of securities for which there is no published market of a company that is not a reporting issuer and has fewer than 50 shareholders exclusive of current or former employees; and

foreign take-over offers where, among other things, the number of shares held beneficially by Canadian shareholders is reasonably believed to be less than 10% of the total outstanding shares and Canadian shareholders are entitled to participate on terms at least as favourable as other shareholders.

In Canada, unlike in the United States, it is not permissible to make a take-over bid conditional on arranging financing. Before a bidder makes a cash take-over bid, it must have made “adequate arrangements” for its financing. Typically, the bidder will have signed a binding commitment letter with a bank or other source of funds prior to launching its take-over bid. The bidder will seek to have the conditions to the availability of the financing set out in the bank commitment letter as similar as possible to the conditions in the take-over bid circular that is sent to the target company’s shareholders. The law requires that the bidder must be confident that if the conditions to the bid are satisfied, the financing will be available.

Generally, where a bidder successfully acquires 90% or more of the voting shares of a target company (other than shares held by the bidder or its affiliates prior to making the offer) pursuant to a public take-over bid made to all shareholders, the corporate statutes provide that shares held by those who did not tender to the offer can be acquired by the bidder at the same price as under the offer pursuant to a statutory compulsory acquisition procedure. Where this procedure is not available because the 90% threshold has not been reached, but at least 66 ⅔% of the outstanding shares have been acquired under the bid, the shares of the remaining shareholders who did not tender their shares to the offer may also generally be acquired by way of a second step squeeze-out merger/amalgamation at the same price as under the offer.

Plans of Arrangement

The federal and provincial corporate statutes in Canada generally provide that companies can be acquired or merged and their outstanding securities can be exchanged, amended or reorganized through a court-supervised process known as a plan of arrangement. Currently, acquisitions of Canadian public companies are most often completed by way of a plan of arrangement.

The target company will apply ex parte for an initial court order directing the target company to seek the approval of its shareholders and fixing certain procedural requirements for obtaining such approval. A management information circular will be prepared by the target company and mailed to its

shareholders containing prescribed information, including prospectus level disclosure about the acquiror (including pro forma financial statements in certain circumstances) if the acquiror's securities form part of the offered consideration. Unlike with a take-over bid circular and directors' circular, this management information circular is not required to be translated into French, although a French language version is often provided where there are a significant number of shareholders in Québec. Plans of arrangement require both shareholder approval (generally by a special majority vote of not less than two-thirds of votes cast at the shareholder meeting) and final court approval (based on compliance with the initial court order and a determination by the court as to the substantive fairness of the arrangement). A plan of arrangement provides maximum flexibility to implement various structuring aspects of a transaction that might not be possible to implement under a take-over bid and can be accomplished in one step (instead of the two steps required by a take-over bid followed by a statutory compulsory acquisition or squeeze-out merger). A plan of arrangement will generally also enable the issuance of securities of the acquiror to U.S. holders of the target company without requiring such securities to be registered in the U.S.

If the acquiror is a TSX-listed company and is issuing shares under a take-over bid or plan of arrangement that would cause dilution to its shareholders of more than 25%, it will be required by the TSX to seek approval from its own shareholders prior to completing any such transaction.

Related-Party Transactions

The securities laws of certain Canadian provinces contain complex rules governing transactions between a public company and parties that are related to it (i.e., major shareholders, directors and officers) and that are of a certain threshold size — often referred to as "material conflict of interest transactions." These rules are designed to prevent related parties from receiving a benefit from a public company to the detriment of its minority shareholders without their approval and to level the playing field with respect to any informational advantage these related parties may have (or be perceived to have). Such transactions are generally subject to 'real-time review' by the applicable securities regulator and, where deficiencies in the process or disclosure associated with a transaction are identified, regulators have broad remedial powers, and can and will require enhanced disclosure and/or other changes to the transaction to assure the protection of minority securityholders.

A take-over bid made by a related party of the target company (i.e. an "insider bid") will engage these special rules, as will other transaction structures resulting in a "business combination" with a related party. In particular, such transactions typically require an enhanced review and approval process by the target's board, more robust disclosures pertaining to the background leading up to the transaction and, in many cases, may require that a formal valuation of the target company's shares be prepared by an independent valuator under the supervision of an independent committee of the target company's board.

If the acquiror in a plan of arrangement is related to the target company or if a related party is receiving a "collateral benefit," these rules will also generally apply. In particular, approval by a simple majority of the minority shareholders (i.e., shareholders unrelated to the acquiror or any related party who receives a collateral benefit) will generally be required in addition to the shareholder approval required by applicable corporate law. Where the related party is acquiring the target company or is a party to a concurrent "connected transaction" of a certain threshold size, then a formal valuation of the target company shares, prepared by an independent valuator under the supervision of the target company's board or an independent committee of directors, may be required.

In all cases, securities regulators in Canada have the power to intervene to halt a take-over bid or other transaction if it is abusive to the target's shareholders or the capital markets, even if it complies with applicable laws. They also have broad powers to intervene to prevent target boards from undertaking inappropriate 'defensive measures' aimed at thwarting a transaction.

Beneficial Ownership Reporting/Stakebuilding

Shareholders are generally required to publicly notify the market pursuant to "early warning reporting" requirements in the event they acquire beneficial ownership, direction and/or control over equity or voting securities representing 10% or more (5% where a take-over bid has already been made) of a class of securities of a target listed company (including shares beneficially owned or controlled by the shareholder and its joint actors). The investor must give this notice to the market by issuing a press release no later than the opening of trading on the next business day and filing, within two business days, an "early warning" report (EWR) in the prescribed form (which must include disclosure of the purpose for the transaction,

including plans or future intentions the investor may have that relate to or would result in certain enumerated corporate actions with respect to the target company). There is also a cooling-off period that prohibits further purchases until the expiry of one business day after the report is filed, unless the acquiror already owns or controls more than 20% of the outstanding securities of that class. A further press release is required to be issued and an additional report filed if there is a change in a material fact contained in a prior report, upon an increase or decrease in ownership or control of over 2% or more of the class of securities or upon a decrease of ownership or control to less than 10% of the class of securities. There is an exception from the obligation to issue an immediate press release and EWR (and trading moratorium) for shareholders eligible to use the "alternative monthly reporting system;" in that case, an "eligible institutional investor" (i.e., typically financial institutions, mutual funds, pension funds, hedge funds and certain other investment funds) may report within 10 days of the end of the month in which it surpasses the 10% ownership threshold, provided it does not intend to make a take-over bid or other control transaction or to solicit proxies.

Shareholder Activism

Shareholder engagement and activism remains prevalent in Canada, although there is a continuing trend toward behind-the-scenes negotiation between shareholders and boards rather than formal proxy contests. Activism comes in various forms, including by investors submitting shareholder proposals and/or requisitioning a meeting of the target's shareholders, investor "say-on-pay" or "majority voting" votes on compensation and director elections, as well as private engagement with a target's boards and/or full-blown proxy solicitations or contests. It is often suggested that Canadian corporate and securities laws are more investor friendly than, say, in the United States, making activism potentially easier to pursue in Canada, although many of these tools are subject to established rules and guardrails preventing their misuse. Today's boards in Canada, like elsewhere, are becoming increasingly cognizant of shareholder activism and are becoming more receptive to engaging with critical stakeholders to proactively avoid a public contest. For instance, some boards have found it beneficial to consult with activists, while maintaining confidentiality, in board strategy discussions so they can voice their opinions or concerns rather than engaging in subsequent public challenges. Shareholder activism is also a frequent feature in all forms of M&A transactions, requiring both acquirors and targets alike to plan for

potential activism in the context of any potential acquisition or disposition transaction.

Private Equity

Private equity funds are active participants in corporate finance and merger and acquisition transactions in Canada. Set forth below is a brief discussion on some legal topics that are particular to private equity funds.

A private equity fund that proposes to distribute its securities to persons located in Canada must either qualify the distribution pursuant to a prospectus prepared and filed in accordance with applicable Canadian securities regulatory requirements or it must conduct the distribution in reliance upon a prospectus exemption, such as the private-issuer exemption. The private-issuer exemption is available for a distribution of securities by a private issuer to a prescribed class of persons who purchase the securities as principal. By relying on this exemption, a private issuer can raise any amount of capital through any number of financings with no prospectus requirement.

WHEN FORMING A PRIVATE EQUITY FUND IN CANADA, CONSIDERATION SHOULD BE GIVEN TO THE APPLICATION OF DEALER REGISTRATION, ADVISER REGISTRATION AND INVESTMENT FUND MANAGER REGISTRATION REQUIREMENTS TO THE ESTABLISHMENT AND OPERATION OF THE FUND.

When forming a private equity fund in Canada, consideration should be given to the application of dealer registration, adviser registration and investment fund manager registration requirements to the establishment and operation of the fund. A person is required to register as a dealer under Canadian securities laws if it engages in, or holds itself out as engaging in, the business of trading securities. A person is required to register as an adviser if it engages in, or holds itself out as engaging in, the business of advising others as to the investing in, or the buying or selling of, securities. A person is required to register as an investment fund manager if it acts as the manager of an investment fund. Depending on the activities to be undertaken by a private equity fund, it can be structured in a such a manner so that it is exempt from dealer registration, adviser registration and investment fund manager registration requirements.

CORPORATE FINANCE, MERGERS & ACQUISITIONS AND PRIVATE EQUITY

Private equity investments in Canada are similar to traditional mergers and acquisitions. When acquiring public companies, the legal analysis discussed above with respect to take-over bids and plans of arrangement is applicable. As most investments by private equity investors are leveraged with debt, special consideration should be paid to the financing of the acquisition (particularly reducing or removing financing conditions that are incremental to the conditions in the principal purchase agreement). See **Bank Loans and Other Loan Capital.**

Private equity funds may acquire majority or minority interests and therefore shareholder and/or investor rights agreements (or similar operating agreements, such as partnership agreements) become increasingly important for governance, control, capital contributions, distributions and liquidity rights or restrictions (such as tag-along rights, drag-along rights, rights of first refusal, rights of first offer and ownership restrictions). As noted above, public reporting of acquired majority or minority interests may also be triggered under applicable securities laws.

As private equity investments are made for a set time frame, tax structuring is very important to ensure an efficient structure is utilized, particularly for cross-border investments by U.S. private equity funds. Similar to the U.S., there are many exit strategies that can be utilized by private equity funds in Canada. Typical exit strategies exercised in Canada are a sale to: (i) the current management through a management buyout; (ii) other shareholders through share/unit transfer rights set out in the shareholder/partnership agreement; (iii) a third party through either a private sale or a controlled auction; or (iv) the public through an IPO.

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