Canadian Mergers and Acquisitions: Public M&A FAQs

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Blakes Means Business

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Frequently asked questions about Canadian Public M&A

1. Who regulates trading in securities in Canada?

Trading in securities, including in M&A transactions, is largely regulated through securities legislation enacted by each of the provinces and territories. Each provincial or territorial securities act creates and empowers a provincial or territorial securities regulator to enforce such laws. These regulators have enacted a number of national, multilateral and local rules and policies that, among other things, seek to harmonize the application of certain aspects of securities laws across the country, including in relation to M&A transactions. In addition, companies whose securities are listed for trading on a stock exchange in Canada are subject to rules imposed by such stock exchange.

2. How are Canadian public issuers typically acquired?

Canadian public companies are typically acquired by way of either a plan of arrangement or take-over bid. A plan of arrangement is akin to a U.S. merger transaction with the addition of court supervision. "Friendly" M&A transactions are usually structured as plans of arrangement, with take-over bids being principally used for unsupported or "hostile" transactions. We have found that a significant majority of the friendly transactions reviewed in recent years have been completed by way of a plan of arrangement, with the other deals being completed by way of a take-over bid or a non-arrangement shareholder-approved structure, such as an amalgamation.

Plan of Arrangement

A plan of arrangement is a shareholder and court-approved transaction governed by the corporate legislation of the target. An arrangement practically requires the target's involvement and support but is subject to a less prescriptive regulatory regime than a take-over bid. Public company acquisitions which are supported by the target are most often effected via a plan of arrangement instead of a take-over bid.

The parties to a plan of arrangement generally enter into a definitive transaction document known as an "arrangement agreement" setting out the basis for the combination, which is followed by an application to a provincial court for approval of the process for completing the transaction. The court order will require the calling of a target shareholders' meeting (typically held 45 to 90 days after an arrangement agreement is entered into), specify the approval threshold (typically two-thirds of the votes cast at the meeting) and provide for the grant of dissent rights to target shareholders. A meeting circular providing information regarding the transaction will then be sent to target shareholders. Where the offered consideration includes securities of the offeror, the circular must contain prospectus-level disclosure regarding the offeror's business and financial results. The meeting circular is not subject to any regulatory pre-clearance review.

Arrangements have a number of advantages over take-over bids. Most significantly, a plan of arrangement provides for the acquisition of 100 per cent of the target's shares in a single step without the need for a second-step transaction, can facilitate dealing with multiple classes of securities (particularly convertible instruments) as part of the transaction and, if securities of the offeror are to be offered to U.S. shareholders of the target, provides an exemption under U.S. securities laws from the requirement to register such securities.

Take-Over Bid

Unlike plans of arrangement, take-over bids may be made with or without the agreement of the target. If the bid is successful, a "second-step" transaction is required in order to acquire 100 per cent of the target shares (in connection with which dissent rights will be applicable).

Canadian securities legislation contains detailed procedural and substantive requirements applicable to non-exempt take-over bids governing such things as required disclosure, timing, conditionality, share purchases outside of the bid and rules applicable to deposit, withdrawal and take-up. The offeror must prepare a take-over bid circular that sets out prescribed information about the offer and the parties, including securityholdings and past dealings by the offeror and related parties in securities of the target, the nature of any financing relating to the bid and prospectus-level disclosure regarding the offeror if the bid consideration includes offeror securities. Unlike a meeting circular for an arrangement, a take-over bid circular mailed to securityholders in Quebec must also be prepared in the French language. In addition, the board of directors of the target issuer must deliver its own circular to target securityholders in response to the bid.

The take-over bid rules have been harmonized across Canada and, among other things, provide target boards with considerable time and discretion when responding to a take-over bid — bids must remain open for at least 105 days, unless the target board waives that minimum in favour of a shorter period (not less than 35 days) or unless the target enters into certain alternative transactions in response to the bid (in which case the period moves to 35 days).

3. We're considering investing in a Canadian public issuer. At what stage would we have to publicly disclose our investment?

There are two regimes that require disclosure of a holding in a Canadian public issuer: early warning reporting and insider reporting.

Under the early warning regime, the acquisition of, or ability to exercise control or direction over, 10 per cent or more of the voting or equity securities of a Canadian public issuer must be promptly publicly disclosed via press release and regulatory filing. Subsequent acquisitions or dispositions while above the 10 per cent threshold of two per cent or more of voting or equity securities must also be disclosed, including when ownership levels fall below the 10 per cent reporting threshold. However, once below the 10 per cent threshold, subsequent disclosure is required only where an acquisition again results in securityholdings at or above the 10 per cent threshold. Notably, the early warning disclosure threshold is reduced to five per cent for so long as a take-over bid or issuer bid is outstanding. Eligible institutional investors can avail themselves of an alternative reporting regime.

In addition, upon acquiring or obtaining control or direction over 10 per cent or more of the voting securities of a Canadian public issuer, the offeror becomes an "insider" of that issuer. As a result, the offeror is required to report in a publicly searchable database its holding of, as well as any subsequent trades in, securities of the issuer.

Offerors must also be aware of Canadian "pre-bid integration rules," designed to ensure that all of a target's securityholders are treated equally in the context of a take-over bid. The rules "integrate" pre-bid purchases by an offeror (other than qualifying purchases made over a stock exchange) by requiring, among other things, that consideration offered under any subsequent formal bid by the offeror be at least equal to the consideration paid in any such purchases made within the 90 days preceding the formal bid.

4. We're considering increasing our stake in a Canadian public issuer. At what stage would we have to make a public take-over bid?

Any offer to acquire outstanding voting or equity securities made to anyone in Canada that would result in the offeror holding 20 per cent or more of the voting or equity securities of any class of a Canadian public issuer will constitute a take-over bid for Canadian securities law purposes. As a result, unless an exemption from the formal take-over bid requirements is applicable, the offer would be required to be made to all securityholders of the class in Canada on the same terms and conditions.

5. What can we do to avoid triggering the take-over bid requirements?

Exemptions from the take-over bid rules are available in certain circumstances. One of the most commonly used exemptions is the "private agreement" exemption, under which purchases may be made by way of private agreements with five or fewer vendors without complying with the requirement to make an offer to all securityholders of the class). Canadian laws exempt such purchases only if the purchase price (including brokerage fees and commissions) does not exceed 115 per cent of the market price of the securities.

6. If we approach a Canadian public issuer about a possible M&A transaction, when would that transaction need to be publicly disclosed?

Canadian public issuers are required to promptly disclose any "material changes" in their affairs. Material changes are changes in the business, operations or capital of an issuer that would reasonably be expected to have a significant effect on the market price or value of any of its securities. This concept includes a decision by either the board of the issuer to implement such a change or senior management if they believe that approval of the board is probable.

Preliminary discussions and conditional proposals where material terms have not been agreed are not generally viewed as disclosable, and in most cases, public issuers do not announce a transaction until a definitive agreement in respect of the transaction has been entered into. However, any determination of the existence of a material change is highly fact-specific and needs to be carefully considered in the context of a specific transaction.

7. Should we expect the target board to insist on an auction?

A board of a target company is not required to hold an auction before entering into an agreement for the sale of the company and often will enter into such agreements without an auction. However, a target board may determine that conducting an auction or a more limited market check before entering into an M&A transaction is in the best interests of the corporation and proceed on that basis.

8. Are there special protections under Canadian securities laws for minority shareholders in Canadian M&A transactions?

In addition to certain remedies available to minority target shareholders under Canadian corporate laws, securities regulators in some Canadian jurisdictions have adopted specific protections for minority target securityholders in certain categories of M&A transactions that are capable of being abusive or unfair to minority shareholders, such as insider bids and related-party transactions. The protections include enhanced disclosure obligations and, subject to certain prescribed exemptions, requirements to obtain a formal valuation of target shares (and any non-cash consideration to be provided) prepared by an independent valuator and, in the case of shareholder-approved transactions such as arrangements, a separate "majority of the minority" approval by target shareholders. A subset of such categories of transactions that staff of the applicable securities regulators perceive as giving rise to material conflict of interest concerns are subject to enhanced regulatory scrutiny and expectations. This scrutiny includes staff review of such material conflict of interest transactions on a real-time basis to assess compliance. In addition, although it is the responsibility of the target board of directors and any special committee to determine whether a fairness opinion is necessary, where a target board does obtain a fairness opinion for a material conflict of interest transaction, certain additional disclosure is expected by staff, including with respect to the financial adviser's compensation arrangements.

9. Are defences to unsolicited take-over bids available to target boards?

A target facing an unsolicited take-over bid has a number of options available to it in responding to the hostile bid. In fact, the Canadian securities regulators have provided guidance that supports the use of defensive tactics in appropriate circumstances (e.g., where taken by a target board in a genuine attempt to obtain a better bid). That said, Canadian securities regulators are of the view that unrestricted auctions produce the most desirable results in change of control contests. They have also indicated that tactics that could deny or severely limit the ability of target securityholders to decide for themselves whether to accept an offer may result in regulatory action.

Poison Pills

Historically, one of the most common defensive tactics employed by Canadian target boards was a securityholders' rights plan (commonly known as a "poison pill"). Although securities regulators did not generally allow a target's poison pill to remain operative indefinitely, while it remained operative (typically for a period of approximately 60 days following the date of the take-over bid), a poison pill effectively prevented a bidder from acquiring any target shares under its bid without approval of the target. Prior to changes in 2016 to the bid regime that increased the minimum period during which a hostile bid must remain open from 35 days to 105 days, poison pills were used to provide target boards additional time beyond the 35-day minimum period to respond to a hostile bid. The 2016 changes to the bid regime are generally seen as providing target boards sufficient time to identify and explore other value-maximizing alternatives. As such, poison pills have not played a meaningful role in Canada as a defensive tactic in response to hostile bids since 2016.

Private Placements

Another defensive tactic available to a target facing a hostile bid is a "tactical" private placement. As a result of the 2016 changes to the bid rules, a bidder is not permitted to acquire shares under a take-over bid unless more than 50 per cent of all outstanding target shares (other than those held by the offeror and its joint actors) have been tendered to the bid. A significant private placement of target shares to a shareholder friendly to the target, particularly by an issuer with a low market capitalization, can reduce the likelihood that this minimum tender requirement will be satisfied.

Not surprisingly, private placements with material dilutive impact undertaken in the face of hostile bids have been subject to increased scrutiny by Canadian securities regulators. When reviewing such transactions, the regulators consider and balance competing factors, including the extent to which the private placement serves a bona fide corporate objective of the target and the principle of facilitating shareholder choice in an open and even-handed bidding process. When balancing these factors, the regulators will often afford significant deference to the business judgment of target boards. In other words, the mere fact that a substantial private placement is undertaken in the face of a hostile bid will not necessarily result in the securities regulators concluding that the placement is an impermissible defensive tactic.

10. Can a significant securityholder enter into an agreement to agree to vote in favour of our plan of arrangement or tender to our bid? Can we offer any inducements to vote or tender?

Offerors commonly enter into support agreements with significant target securityholders or target management and directors whereby such securityholders agree to support the transaction, including by voting in favour of a plan of arrangement or tendering to the offeror's take-over bid.

In considering support agreements in the context of a take-over bid, it is important to note that Canadian securities laws provide that all holders of a target's securities must be offered identical consideration in a take-over bid and prohibit an offeror from entering into a separate agreement that has the effect of providing to one securityholder greater consideration for its securities than that offered to the other securityholders (subject to certain limited exceptions). Offering non-identical consideration can also introduce additional complexity in the context of a plan of arrangement and would need to be carefully considered in the context of a specific transaction prior to extending any such offers.

11. When a friendly deal has been negotiated, what deal protection measures are commonly used in Canada?

In a public M&A transaction in Canada, a target will generally have the right to terminate the transaction in the event it receives a proposal that is superior, from a financial perspective, to the agreed-upon transaction. There are several deal protection measures commonly used by buyers to reduce the likelihood that the target will terminate the transaction in order to accept a superior proposal, including:

- No shop. Offerors typically obtain a "no-shop" covenant under which the target board is prohibited from soliciting or encouraging competing bids from other buyers.
- Right to match. The offeror is frequently granted an opportunity to match any superior proposal during a limited period after the superior proposal is received by the target.
- Break fees. Break fees payable by a target to a buyer in connection with the target's termination of the transaction with the buyer generally range between two to five per cent of target equity value. Reciprocal or reverse break fees, pursuant to which an offeror is obligated to pay a fee to the target if the transaction fails for specified reasons, are not uncommon in Canada, including in mergers of equals, transactions where significant regulatory issues exist or sponsor-backed deals.

12. What types of M&A transactions are subject to Canada's antitrust law?

Canada's antitrust law is set out in the *Competition Act*, which is administered and enforced by the Competition Bureau, led by the Commissioner of Competition (Commissioner). There are two parts of the *Competition Act* that apply to M&A transactions: the pre-merger notification provisions and the substantive merger review provisions. All transactions are subject to the latter, while only those transactions that exceed certain thresholds are subject to the former.

Because all M&A transactions are subject to the *Competition Act*, it is critical that the parties to a transaction plan early to determine whether competition concerns are raised in order to consider such matters as risk allocation and closing conditions. Completing a transaction that is subject to pre-merger notification is a criminal offence, unless the applicable statutory waiting period has expired, been waived or terminated early.

A transaction is notifiable if each of the following tests for pre-merger notification is exceeded:

- Size of parties test. The parties to the transaction, together with their affiliates, have aggregate assets in Canada with a book value, or aggregate gross revenues from sales in, from or into Canada, in excess of C$400-million.
- Size of transaction test. The aggregate value of the assets in Canada, or aggregate gross revenues from sales in or from Canada generated from the assets in Canada, of the target and its subsidiaries (or, in the case of an asset transaction, from the assets being acquired) exceeds C$93-million (2023). Notably, a separate test applies to an amalgamation, and the target must own or control an operating business in Canada (or, in an asset transaction, the assets being acquired must be from an operating business).
- Equity interest test. The transaction would result in the offeror having more than 20 per cent of the voting shares of a public target (35 per cent in the case of a private entity), provided that, where the offeror already holds in excess of such applicable ownership threshold at launch (but less than a majority), the threshold is whether the contemplated acquisition would result in the offeror having more than 50 per cent of the target's voting shares.

Where a transaction is notifiable and the parties file a formal notification, a waiting period commences and runs for an initial 30 days. At the end of the waiting period, the parties are legally entitled to close their transaction, even if the Commissioner's review is ongoing, unless the Commissioner issues a supplementary information request (SIR) to the parties. A SIR is similar to a second request under the U.S. Hart-Scott-*Rodino Antitrust Improvements Act*, 1976. If a SIR is issued, the parties cannot lawfully close their transaction until 30 days after the day on which both parties have complied with the SIR. A SIR is issued in relatively rare cases involving significant competitive overlap between the parties (approximately 10 per cent of notified transactions). There is a special provision for unsolicited offers, designed to prevent a target from delaying the start of the waiting period, that makes the expiration of the waiting period contingent on the offeror's provision of information rather than both parties.

While the parties to a notifiable transaction are generally free to complete their transaction following the expiry of the statutory waiting period, the Commissioner's review can, and often does, take longer than the statutory waiting period. The Commissioner has the statutory right to review and challenge any M&A transaction within one year after closing, unless an advance ruling certificate is issued. Alternatively, the Commissioner may issue a "no-action" letter, indicating that, at that time, he does not intend to challenge the M&A transaction but retains the right to challenge the transaction at any time before or within one year following its substantial completion. As a practical matter, however, we are not aware of any situation in which the Commissioner has challenged a transaction post-closing after having issued an unqualified no-action letter.

13. If the transaction is subject to Canada's antitrust law review, what is the test for challenging the transaction?

Regardless of whether an M&A transaction is subject to notification or not, the test applicable to any transaction is whether it prevents or lessens, or is likely to prevent or lessen, competition substantially. The analysis has historically taken place in the context of a relevant market that is defined based on product and geographic dimensions. The *Competition Act* provides a non-exhaustive list of factors that may be considered when assessing the competitive impact of an M&A transaction.

The *Competition Act* contains an express efficiency defence — unique to Canada — that allows an M&A transaction to proceed provided it generates gains in efficiency that are greater than, and offset, the anticompetitive effects resulting from the transaction.

14. Does Canada have rules restricting M&A transactions by non-Canadians?

A direct acquisition of control of a Canadian business by a non-Canadian that exceeds the applicable review threshold cannot be completed until the responsible minister under the *Investment Canada Act* has reviewed the investment and declared, or is deemed to have declared, that the investment is likely to be of net benefit to Canada. An acquisition of more than 50 per cent of the voting securities of a corporation or non-corporate entity is deemed to be an acquisition of control. The acquisition of between one-third and one-half of the voting securities of a corporation creates a rebuttable presumption that control has been acquired while, subject to certain exceptions, the acquisition of less than one-third of the votes of a corporation or less than a majority of the votes of a non-corporate entity is deemed not to constitute an acquisition of control for these purposes.

Notwithstanding the above, the *Investment Canada Act* provides that the responsible minister under the Act can determine that control in fact will be or has been acquired, even below the previously noted thresholds, in the following circumstances:

- The acquisition of a Canadian cultural business (as such term is defined)
- The acquisition by a state-owned enterprise (SOE) (as such term is defined)
- Where the acquisition could be injurious to Canada's national security

The direct acquisition of control of a non-cultural Canadian business by an investor ultimately controlled in a World Trade Organization (WTO) member country is subject to review where the Canadian business, along with any businesses that it controls, has (1) for non-SOE investors, an enterprise value of C$1.287 billion (2023) or more, or (2) for SOE investors, a book value of C$512-million (2023) or greater. For non-WTO investor transactions, or where the Canadian business qualifies as a cultural business, the review threshold is exceeded where the Canadian business has a book value of assets of C$5-million or more.

Other than in respect of cultural businesses, if the Canadian business is being acquired indirectly, and the WTO investor rule is met, or if the applicable review threshold is not exceeded, the transaction is subject only to a post-closing notice requirement.

Transactions that are reviewable require the approval of the responsible minister. The initial waiting period is up to 45 days after the investor submits an application for net benefit review, which can be extended by the responsible minister unilaterally by a further 30 days and, thereafter, only with the consent of the responsible minister and investor.

All investments involving a Canadian entity, whether or not the investment is direct or indirect and whether or not control will be acquired, are subject to possible review on grounds of whether an investment is likely to be injurious to national security. There are broad powers under the national security provisions of the *Investment Canada Act* to direct parties not to implement an investment or to implement it with conditions. Where a review takes place after closing, such powers include the right to require the divestiture of control or to impose terms and conditions on the investment.

In addition to the *Investment Canada Act*, other federal statutes regulate and restrict foreign investment, particularly industries and sectors such as transportation, telecommunications, broadcasting, newspapers and financial institutions.