



# 2011 TRENDS

*Blakes*  
CANADIAN LAWYERS

## MERGERS & ACQUISITIONS

Noteworthy trends that will have an impact on the Canadian mergers and acquisitions landscape in 2011:

### **M&A WILL CONTINUE ITS UPSWING:**

Following a lacklustre 2009 and an uneven 2010, 2011 promises further economic recovery and a gradual increase in M&A activity. Although the stagnant global economy will likely continue to present limited organic growth opportunities, as cash accumulates on balance sheets, companies will pursue strategic acquisitions. Financial buyers will also be in an acquisitive mode as commitments on capital raised in 2006 and 2007 will start to expire. Although mid-market transactions will continue to dominate the Canadian marketplace, having represented approximately 90 per cent of all M&A activity in 2010, mega-deal activity (deals over C\$1-billion) will continue to strengthen. Notwithstanding these positive factors, some buyers will remain cautious given lingering concerns over a possible double-dip recession, the uncertain European economy and high unemployment in the U.S.

### **ASIAN INVESTMENT IN CANADA WILL INCREASE:**

The tremendous Asian demand for commodities is well recognized around the world, as Asian investors have been active in Brazil, India, Russia, and increasingly in Canada. Rapid growth in Asia has also led to concerns over food scarcity. Potash and other Canadian agricultural commodities are increasingly viewed by Asia as vital strategic assets. Among others, China's sovereign wealth fund and a variety of state-owned enterprises can be expected to make strategic investments in Canada's energy, mining and agricultural sectors. These investments will be characterized by creative deal structures, such as partnerships, joint ventures, minority investments and long-term supply arrangements to mitigate ownership risk and address the Canadian government's concerns over foreign control in these sectors.

### **NATURAL RESOURCES ARE DRIVING ACTIVITY:**

Oil and gas and mining M&A will continue to dominate activity in Canada. In our recent third annual *Blakes Canadian Public M&A Deal Study*, we found that over 70 per cent of the 50-largest friendly public deals we canvassed over a 12-month period occurred in these sectors.

### **CANADIANS FOCUS ON INTERNATIONAL ACQUISITIONS:**

In recent years, Canadian businesses have acquired foreign companies at a rate of approximately two for every Canadian company acquired by a foreign company. With the Canadian dollar hovering around par with the U.S. dollar and interest rates remaining low, the value of Canadian outbound M&A transactions has recently been approximately four times that of foreign inbound activity. While Canadian businesses are increasingly looking to expand outside of North America, over 80 per cent of Canadian outbound M&A in 2010 still involved U.S. targets. Canadian financial institutions will be particularly active as they exploit their relative stability and strength to acquire struggling U.S. institutions.

### **HOSTILE DEALS:**

In 2010, hostile M&A activity hit a three-year high as depressed valuations and economic challenges lengthened the strongest buyer's market in decades. Despite signs of financial recovery, the gap between buyers' and sellers' expectations will lead to further unsolicited and opportunistic bids. This increase in hostile M&A signals an improvement in buyer outlook as buyers are willing to pursue challenging transactions.

### **INFORMED SHAREHOLDER APPROVAL OF SHAREHOLDER RIGHTS PLANS:**

While a Canadian board may use a shareholder rights plan, or "poison pill," to delay an unsolicited take-over bid for a reasonable period of time as it seeks out competing offers, in Canada it has always been a question of when, not if, a pill must go. The *Pulse Data* decision of the Alberta Securities Commission and the *Neo* decision of the Ontario Securities Commission (OSC) signaled a limited change in approach and some greater leeway for boards, as both regulators refused to cease-trade a poison pill where the target's shareholders had ratified the pill in the face of the offer. The 2010 decision of the British Columbia Securities Commission in *Lions Gate*, which cease-traded the target's pill, expressed reservations about the reasoning in *Neo* and *Pulse Data*, but the OSC most recently affirmed its view in the *Baffinland* decision that informed shareholder approval of a rights plan in the face of a bid, even in the absence of an ongoing auction, is a significant factor in its analysis as to whether to cease-trade a pill.

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While the situations in which target shareholders will approve a pill in the face of a hostile bid may be few, in those cases where there is a reasonable prospect of such approval (such as where there is a “partial bid” for only a portion of a target’s shares), we expect target boards will consider seeking shareholder approval as a means of keeping a rights plan in place to block the unwelcome bid.

#### GREENTECH TARGETED:

Attractive government incentive programs have prompted developers to undertake new renewable energy projects that are now ripe for consolidation. Programs include the Ontario Power Authority’s Feed-in Tariff (FIT) Program, which provides favourable pricing and guaranteed funding structures that combine stable, competitive prices and long-term contracts for renewable electricity generation. The Ontario Power Authority announced the first tranche of FIT contracts in the spring of 2010, with over 600 contracts awarded to renewable energy developers. The demand for renewable energy assets will continue to rise as participants in carbon-heavy industries seek to pre-empt regulation and reduce their total carbon footprint by acquiring renewable energy and other green assets.

#### SHAREHOLDER ACTIVISM:

Reacting to underperformance in the capital markets, and relying on relatively liberal Canadian laws permitting shareholders to call special meetings and seek to replace directors, institutional shareholders have shown an increased willingness to voice their displeasure with incumbent directors and management. Potential acquirers now recognize a need to negotiate simultaneously with both the board of a target and its key securityholders. Challenges to board decisions by institutional shareholders, such as the recent intervention by the Ontario Teachers’ Pension Plan Board, Canada Pension Plan Investment Board and Ontario Municipal Employees Retirement System in Magna International Inc.’s arrangement to collapse its multiple voting share structure, will continue in the coming year.

#### FOREIGN INVESTMENT UNDER SCRUTINY:

The Canadian government’s decision to block BHP Billiton’s proposed US\$39-billion acquisition of PotashCorp represented only the second time (and first in the resource sector) that a foreign acquisition has been rejected under the *Investment Canada Act*. The deal was blocked despite unparalleled proposed commitments from BHP to both Canada and Saskatchewan, and the action has raised questions as to whether the government of Canada has become protectionist. The Canadian government has promised increased guidance for future foreign investments and a review of the *Investment Canada Act*. While we expect that future reviews will proceed as they have in the past, foreign acquisitions involving “strategic resources”, national security, state-owned enterprises or sovereign wealth funds, or which are particularly large and unsolicited, are likely to receive heightened scrutiny and could be the most challenging to complete.

#### CREDIT BIDDING IN DISTRESSED M&A:

Where a bidder in a competitive sales process is also a secured creditor of the target, the bidder may offer to satisfy the purchase price by having it credited against the debt owed to it. In effect, credit bidding allows a secured creditor to use its debt as acquisition currency and it may “bid” the value of that debt for an amount up to its face value. While the *Companies’ Creditors Arrangement Act* does not expressly provide secured creditors with the right to credit bid as Chapter 11 does in the U.S., the practice has become widely accepted in Canadian insolvency proceedings and played a key role in the recent White Birch Paper and Canwest Publishing transactions. We expect to see credit bidding continue in 2011 as a means of consummating long-term “loan-to-own” strategies and acquiring control of distressed assets with a view to stabilizing a business before pursuing an exit. We also expect to see it incorporated into stalking horse bids to encourage higher offers.

#### INCREASED ANTITRUST SCRUTINY:

The Canadian government adopted a SIR, or second request, process for merger reviews and appointed a new Commissioner of Competition in 2009, and since that time, 10 SIRs have been issued. The Commissioner has indicated her intention to undertake comprehensive examinations of those transactions that could raise serious competition issues and a desire to bring responsible litigation in appropriate cases. However, for those transactions that do not raise any competition issues, the Competition Bureau remains committed to completing its review in a timely manner, and under recently updated guidelines, the Bureau confirmed that it will continue to work towards completing its review of “non-complex” transactions within 14 days.

#### LIBERALIZATION OF TELECOM AND SATELLITE INDUSTRIES:

In June 2010, the Canadian government released a consultation paper inviting submissions on three options it was weighing to liberalize foreign investment restrictions on Canadian telecommunications companies: (i) increase the direct foreign ownership limit on all telecom companies to 49 per cent from the current effective limit of 47 per cent, (ii) remove foreign-ownership restrictions entirely for smaller telecom companies having less than a 10 per cent market share, or (iii) remove foreign-investment restrictions entirely for all telecom companies, regardless of size. Industry Canada is expected to make a decision in mid-2011 regarding which of these three options, if any, it will implement. This potential change follows the recent lifting of foreign-ownership restrictions on Canadian telecom satellites, opening the door to foreign acquisitions of Canadian satellite companies.