

DOND 2017



DEAL OR NO DEAL:
EPISODE VII – THE LAST CONTRACT

Session 3: 10:20-11:20

Presented by Fasken
Martineau DuMoulin

Title:

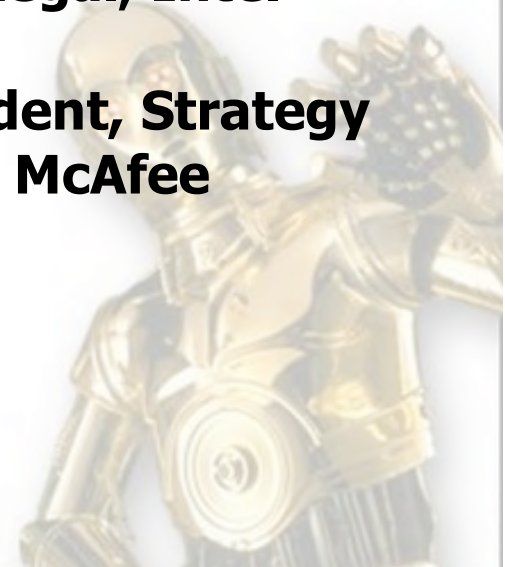
***Overview of Canadian M&A
Considerations and Legal Issues in
Acquiring and Operating Businesses in
Canada***

Speakers:

**Jay Lefton – Partner, Fasken Martineau
DuMoulin LLP**

**Dan Vaughn - Director, M&A Legal, Intel
Capital**

**Tom Fountain - Senior Vice President, Strategy
and Corporate Development, McAfee**



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Jay Lefton focuses his practice on corporate and securities law, including public and private financings, mergers, acquisitions and takeover bids, private equity, strategic alliances, and technology transfer and licensing, with an emphasis on technology and life sciences companies. Recognized as a leading lawyer in these areas of law by the foremost legal rankings publications, Jay represents and advises issuers (both publicly and privately owned), advisers, venture capitalists, institutional investors and private equity funds. He also advises universities, hospitals, research institutions and researchers at various stages in the commercialization of their discoveries. He has advised acquirors and target companies and their boards of directors in connection with negotiated transactions and unsolicited takeover bids, many of which were multi-jurisdictional in nature.

Jay is a former member of the Ontario Securities Commission's Securities Advisory Committee, which advises the Commission on various matters, including legislative and policy initiatives.

Presentations

- "Recent Developments and Trends in Technology M&A", Conference of the International Bar Association's Corporate and M&A Law Committee and the Technology Law Committee entitled "M&A in the Technology Sector", Tel Aviv, Israel, October 2016
- "Overview of Canadian M&A Considerations and Legal Issues in Acquiring and Operating Businesses in Canada", Bar Association of Metropolitan St. Louis, June 2016

Areas of Practice

- Mergers & Acquisitions (M&A)
- Corporate Finance
- Corporate/Commercial
- Private Equity & Venture Capital
- Start-Up and Emerging Company Services
- Life Sciences

Education

- LL.B, 1981, University of Toronto
- B.Comm, 1978, University of Toronto

Year of Call/Admission

- Ontario, 1983

- "Overview of Canadian M&A Considerations and Legal Issues in Acquiring and Operating Businesses in Canada", M&A Subcommittee of the Colorado Bar Association, November 2015
- "Overview of Canadian M&A Considerations and Legal Issues in Acquiring and Operating Businesses in Canada", Business Law Section of the Connecticut Bar Association, Toronto, Ontario, October 2015
- "Doing Business in Canada and Related Cross-Border M&A Issues", International Law Section of the Austin Bar Association, March 2014
- "Top 20 Legal Mistakes Start-Ups Make", University of Ontario Institute of Technology, Entrepreneurship Café, February 2014
- "Top 20 Legal Mistakes Start-Ups Make", Ryerson University, Digital Media Zone, February 2014
- "Top 20 Legal Mistakes Start-Ups Make", McMaster University, Joint Presentation of the School of Graduate Studies and McMaster Industry Liaison Office, November 2013
- "Getting Academic Research into the Marketplace", School of Graduate Studies Best Practices Luncheon, McMaster University, November 2013
- "International M&A in the High Tech and Energy Sectors", Joint Conference of the Israel Bar Association and the International Law Section of the American Bar Association, Eilat, May 2013
- "Mergers and Acquisitions in the Transportation and Logistics Industries", TransCore Link Logistics Subscriber Conference, July 2012
- "Private Enterprises and Growth Capital", International Bar Association Annual Meeting, Dubai, November 2011
- "Key Canadian Considerations in Public M&A Transactions", American Bar Association Subcommittee on Public Company Acquisitions, August 2011
- "Commercialization 101: Lessons from the Trenches", Strategic Planning Day, Michael G. DeGroot Institute for Infectious Disease Research, June 2011
- "Getting Academic Research Into the Marketplace: Tech Transfer and Structuring Issues for Licensing Transactions and Spin-Out Companies", University of Toronto Faculty of Medicine Innovation & Commercialization Seminar Series, March 2011
- "Mergers & Acquisitions of Life Science and Technology Companies", 2nd Joint Conference of the International Bar Association and the Israel Bar Association, Tel Aviv, February 2011
- "Collaborations between Industry and Higher Education: What Works and What Doesn't", Alliance for the Commercialization of Canadian Technologies (ACCT) Canada, Directors' Forum, September 2010

- "Structuring for Success: Technology Transfer and Commercialization Issues for the Academic Researcher", University of Toronto Faculty of Medicine Innovation and Commercialization Seminar Series, April 2010
- "Options and Other Equity-Based Incentives for Employees and Other Service Providers: Tax, Corporate and Securities Issues" and "Confidentiality, Non-Competition and Non-Solicitation Agreements: Recent Developments", Thunder Bay Law Association Annual Continuing Legal Education Conference, October 2009
- "Technology Transfer: From Conception to Commercialization", Thunder Bay Regional Research Institute, November 2008
- "Alternative Financing Strategies in Canada: SPACs, CPCs and Stock Exchange Listings", October 2008
- "M&A Considerations in Acquiring Privately Held Companies: Market Trends, Key Provisions, Traps and Pitfalls", Thunder Bay Law Association Annual Continuing Legal Education Conference, October 2008
- "The Pitfalls and Perils of Drafting Contracts", BioPharma CFO Roundtable sponsored by KPMG LLP, April 2006
- "A Practical Guide to Starting a Business and Raising Capital in Ontario: 75 Tips in 75 Minutes", Northwestern Ontario Technology Centre, October 2005
- "Incorporating Companies, Issuing Shares and Raising Capital in Ontario – Keeping up with the New Rules: an Overview of National Instrument 45-106", Thunder Bay Law Association Annual Continuing Legal Education Conference, October 2005
- "Fundamentals of Licensing Agreements for the General Practitioner", Thunder Bay Law Association Annual Continuing Legal Education Conference, October 2005
- "Do's and Don'ts in Global Biotech Fundraising", Annual International Convention of the Biotechnology Industry Organization, Philadelphia, Pennsylvania, June 2005
- "Accessing the North American Capital Markets: The Canadian Perspective", 2nd Annual Corporate Counsel Conference, October 2004
- "Technology Tango: Strategic Alliances and Partnering for Leverage and Growth", Canadian Institute Conference entitled "The Art and Science of Financing High Techs, 2000
- "Anatomy of a Licensing Agreement: Legal and Business Considerations in Drafting Licence Agreements and Negotiating Financial Provisions", BioCatalyst Yorkton Biotech Conference, 1999
- "Legal Considerations in the IPO Process", Institute for International Research Conference entitled "Going Public: Winning IPO Strategies, 1999

- "A Review of Securities Law Implications of Accessing the Canadian Capital Markets", Bio '98 Conference, Biotechnology Industry Organization, 1998
- "Overview of the Capital Markets and Financing of Biotechnology Companies", Symposium sponsored by the Cuban government, 1997
- "Public and Private Financings of Biotech Companies: A Legal Perspective", Canadian Institute Conference, 1997
- "Medical Device Companies: A Non-Regulatory Overview of Doing Business in Canada", The BioEast '96 Conference, 1996
- "Strategic Alliances and Innovative Financings in the Bio/Pharm Industry: Motivation, Financial Trends and Techniques", Institute for International Research Conference, 1995

Publications

- "Takeover Guides: Canada, Multinational Takeover Bids Task Force", *Securities Law Committee, International Bar Association*, June 1, 2017
- "Toronto and Tel Aviv Exchanges Sign MOU: Is Dual-Listing on the Horizon?", *Canadian Securities Law News*, April 1, 2010
- "The Lawyer's Role in Canadian Mid-market Mergers & Acquisitions", *The Lexpert®/American Lawyer Guide to the Leading 500 Lawyers in Canada*, January 1, 2005
- "Ontario Leaves Limitation Questions Unanswered", *International Financial Law Review*, January 1, 2004
- "Acquisitions of Canadian Corporations Using Plans of Arrangement", *International Business Lawyer*, December 1, 2003
- "Use of Voting Support Agreements in Canadian M&A Transactions", *Federated Press Corporate Financing Journal*, January 1, 2003
- "Exempt Securities Distributions", *Canadian Tax Highlights*, February 1, 2002
- "Canada, Takeovers Practice Manual", *Practical Law Company*, January 1, 2002
- "Use of Exchangeable Shares in the Acquisition of Canadian Corporations", *US Bancorp Piper Jaffray M&A Monitor*, January 1, 2001
- "A Guide to the Use of Exchangeable Shares in the Acquisition of Canadian Companies", *Tax Notes International*, February 1, 2000

Community Involvement

- Member, Board of Governors, University of Ontario Institute of Technology and Mount Sinai Hospital

- Member, Board of Directors, Ontario Genomics Institute
- Member, Board of Directors, Thunder Bay Regional Health Research Institute
- Former Chair, Cell Therapy Advisory Board of Princess Margaret Hospital (Toronto)
- Former Member, Canadian Friends of the Hebrew University of Jerusalem and former member, Canadian Friends of the Tel Aviv Foundation
- Former Member, Board of Directors, University of Toronto Innovations Foundation, whose mandate was to commercialize technologies developed at the University
- Former Member, Board of Directors, ThinkFirst Foundation of Canada (Former Chair); former member; and former member, the Ontario Neurotrauma Foundation
- Former Member, Adjudication Panel of the Premier's Catalyst Awards Program, sponsored by the Ontario Ministry of Research and Innovation

Rankings and Awards

- Recognized in the 2017 edition of Chambers Global – The World's Leading Lawyers for Business (Corporate/M&A – Canada (Foreign Expertise – Israel) and Corporate/M&A – Israel (Expertise Based Abroad)):"described by sources as a 'very experienced and versatile attorney'"
- Recognized in the 2016 edition (and since 2013) of Who's Who Legal (Global) for Mergers & Acquisitions: "excels at cross-border M&A transactions and is highly praised by clients for his 'business-oriented thinking'"
- Recognized in the 2016 edition (and since 2014) of Who's Who Legal Global for Life Sciences, Transactional: "advises a significant number of clients in the life sciences sector on their financings, strategic alliances, mergers and acquisitions, technology transfer and licensing. Clients praise his ability to 'effectively manage risk and allow transactions to proceed smoothly'"
- Selected by peers for inclusion in the 2017 edition (and since 2010) of The Best Lawyers in Canada® (Mergers & Acquisitions Law, Securities Law, Biotechnology Law)
- Recognized in the 2016, 2015, 2014 and 2013 editions of The Lexpert®/American Lawyer Guide to the Leading 500 Lawyers in Canada (Corporate Mid-Market) and the 2016, 2015, 2014 and 2013 editions of The Canadian Legal Lexpert® Directory (Corporate Commercial Law, Corporate Mid-Market, Private Equity)
- Recognized in the 2016 edition of The Canadian Legal Lexpert® Directory (Corporate Commercial Law)
- Martindale-Hubbell® AV® Preeminent™ 5 out of 5 Peer Review Rated

Memberships and Affiliations

- Member, Mergers and Acquisitions Committee, American Bar Association, Business Law Section
- Member, International Bar Association and Canadian Bar Association
- Former Adjunct Faculty Member, Osgoode Hall Law School; has also instructed at the University of Toronto's Rotman School of Management
- Delegate, Ontario trade missions to Israel and the West Bank led by the Premier of Ontario (2010; 2016); Chair, Canadian Organizing Committee for Nanolsrael (2010)
- Member, Toronto Academic Health Sciences Council Subcommittee on Intellectual Property and Technology Transfer (2000-05)
- Member, Biotechnology Council of Ontario (which provided guidance to the Government of Ontario on the development of Ontario's strategy for this sector) (1999-2001)

SPEAKER BIOS: SESSION 3

Thomas D. Fountain
Senior Vice President, Strategy & Corporate Development
McAfee, LLC

Tom Fountain is senior vice president for strategy and corporate development at McAfee. He is responsible for defining the company's strategy, building its technology partner program, and spearheading the company's strategic alliance efforts.

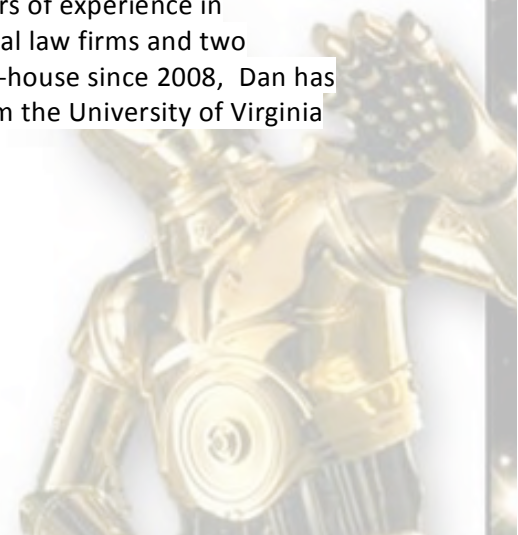
Tom joined McAfee in 2013 from Juniper Networks, where he served as vice president and general manager of the content and media business unit. As general manager, Tom managed product development, product management, technical marketing, and support, and oversaw product marketing and sales for the content business. Before assuming leadership for one of Juniper's network software businesses, Tom was vice president of corporate strategy with responsibility for setting the company's strategic agenda, managing the strategy planning process, and leading competitive intelligence.

Earlier in his career, Tom was a venture capitalist with Mayfield Fund, where he focused on infrastructure investments; a co-founder of Ingrian Networks (later acquired by SafeNet) in the network and database security market; the founder and chief executive officer of an outsource software development firm; and a faculty member at Stanford University, where he taught in the electrical engineering and computer science departments.

Tom was a PhD student in electrical engineering at Stanford University, where he earned an MBA with distinction as an Arjay Miller Scholar, a second master's degree in electrical engineering, a third master's degree in Computer Science, and a bachelor's degree in computer systems engineering.

Dan Vaughn
Director, M&A Legal
Intel Corporation

Dan Vaughn is a Director, M&A legal for Intel. Dan has over 20 years of experience in corporate, M&A and securities law. He has worked for multinational law firms and two multinational corporations over the course of his career. Working in-house since 2008, Dan has lead over 25 acquisitions during that period. He earned a J.D. from the University of Virginia School of Law in 1995.



Overview of M&A Considerations and Legal Issues in Acquiring and Operating Businesses in Canada



Presentation to
“Deal or No Deal” Conference

Sponsored by the

Association of Corporate Counsel

(Bay Area Chapter)

November 9, 2017

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Today's Presentation



- **Overview of the Canadian regime**
- **Methods of Conducting Acquisitions**
 - Asset
 - Share
 - Take-over bid
 - Private Share Purchase
 - Amalgamation
 - “Plan of Arrangement”
- **Tax Issues**
 - Exchangeable Shares
 - Earn-outs
- **Plan of Arrangement**
- ***Investment Canada Act***
- ***Competition Act***
- **Restrictive Covenants**
- **Employment-Related Considerations**
- **IP-Related Issues**
- **Privacy Legislation**
- **Canadian Anti-Spam Legislation**
- **Quebec Considerations**



- **10 provinces + 3 territories**
- **All jurisdictions are common law other than Quebec, which is civil law**
 - Today's presentation generally considers the Ontario perspective
- **Each jurisdiction has similar, but separate:**
 - Securities and corporate legislation
 - Securities regulatory body
 - Trend towards securities law harmonization
- **Each jurisdiction has its own corporate legislation**
 - In addition, there is a federal corporate statute
 - *Canada Business Corporations Act*
 - Some corporate statutes contemplate an "unlimited liability company" ("ULC")
 - Only established if there are US tax reasons to do so
 - No LLCs
 - Most (not all) corporate statutes require some (generally 25%) of the directors to be "resident Canadian"

➤ Resolutions

- Any shareholders' or directors' resolution must:
 - Be passed at a duly called meeting, or
 - Be signed by all shareholders (or, if applicable, directors) entitled to vote thereon
- Some fundamental matters (e.g. amendment of articles, amalgamations, sale of all or substantially all the assets) require approval by way of a "special resolution":
 - Which generally is a resolution:
 - Passed at a meeting by not less than $\frac{2}{3}$ of the votes cast by shareholders who voted in respect of the resolution, or
 - Signed by all shareholders entitled to vote thereon
 - Gives rise to dissenting shareholder rights
 - Entitling dissenting shareholders to be paid the "fair value" for their shares calculated as of the day prior to passing the resolution

➤ **Passing Resolutions**

- No concept of calculation based upon outstanding share capital, as long as quorum requirements are met
 - cf Delaware voting requirements

➤ **Unanimous Shareholders' Agreement**

- Has the status at law of articles and by-laws

Principal Methods of Conducting Business Acquisitions



- **Purchase of Assets**
- **Purchase of Shares**
- **Statutory Amalgamation**
- **Hybrid Structure**
 - Combination of shares/assets

- **Plan of Arrangement**
 - A Plan of Arrangement is not a “structure” per se
 - A court-approved "process" by which the foregoing (or variations) may be implemented



- **ABA Market Trends Subcommittee has both "Canadian" and "U.S." M&A Market Trends reports**
 - There is nothing fundamentally different between the U.S. and Canadian deal regimes
 - *Generally speaking:*
 - The U.S. Market Trends Studies should apply, and
 - U.S. deal terms should generally be able to prevail
 - In some cases, Canadian deal terms are more favorable to buyers
 - e.g.:
 - Survival periods tend to be longer
 - 39% had survival periods of >18 months (compared to 18% in U.S.)
 - Indemnification caps tend to be higher
 - 74% are >15% (compared to 19% being >15% in the U.S.)
 - Indemnification Baskets
 - No basket: 9% (compared to 2% in US)
 - Deductible: 41% (compared to 65% in the US)
 - First Dollar: 45% (compared to 26% in the US)

Where Canadian Acquisition Agreements Differ



- **Canadianization of a U.S. form of acquisition agreement includes:**
 - conforming the representations and warranties relating to:
 - Labor/employment/pension/benefits
 - Tax
 - Privacy
 - Anti-spam
 - *Investment Canada Act*
 - *Competition Act* (anti-trust)
 - Environmental
 - Structuring earn-out clauses to address Canadian tax issues
 - Issues relating to currency (as courts only enforce judgments in Canadian dollars and presume "\$" means "Cdn\$")
 - Dispute resolution
 - Governing law is a matter of negotiation



Principal Methods of Conducting Business Acquisitions: Asset Purchase



- **Generally preferred from the Buyer's point of view, as it:**
 - Has the potential to increase the cost base for tax purposes, and
 - Generally avoids hidden liabilities arising in a share purchase context
- **Considerations relating to the need for third party consent for assignments are similar to those in the U.S.**
- **Must be approved by a "special resolution" if the sale is of "all or substantially all of the assets"**



Principal Methods of Conducting Business Acquisitions: Share Purchase



- **Take-over bid**
 - Provincial jurisdiction
 - Offer to acquire outstanding voting or equity securities of a class made to one or more persons, any of whom is in the particular Canadian jurisdiction, where the securities subject to the offer to acquire (together with “offeror’s securities”) constitute in the aggregate 20% or more of the outstanding securities of that class
 - Concept applies to **both** public and private acquisitions
 - For a more detailed discussion, see <http://bit.ly/iba-guide>
 - Take-over bid for public companies
 - Canadian equivalent of a “tender offer”
 - Take-over bids which are not exempt from the general rules are referred to as “formal take-over bids” or “formal bids”
- **Direct acquisition of shares**
 - Share purchase agreement for private companies (if exempt from formal take-over bid rules) (see slide 11)



Take-Over Bids: Exemptions from the Formal Bid Requirements



- **The securities legislation contains various situations where a take-over bid is exempt from the formal requirements of the securities legislation, including:**
 - Acquisitions of private company, if:
 - The target is not a “reporting issuer” (i.e. not a registrant);
 - No published market in the securities; and
 - Number of holders of securities of the class is not more than 50 (excluding current or former employees of issuer and affiliates)



Principal Methods of Conducting Business Acquisitions: Amalgamation



- **More similar to a U.S. form of "consolidation"**
- **Two (or more) corporations *existing under the same corporate legislation* may "amalgamate" by filing the Articles of Amalgamation**
 - No concept of a "surviving" corporation
 - Amalgamated entity has all the rights and obligations of the predecessor corporations
 - Assets and rights not considered to be disposed of, so generally no contractual consents required *unless* otherwise specified in contract



Principal Methods of Conducting Business Acquisitions: Amalgamations



- **Generally tax neutral to the corporation, but it triggers a tax year-end for all amalgamating corporations**
- **Cannot take back non-share consideration on a tax-free amalgamation, so "cash-out" transactions are done using redeemable, retractable preferred shares**
- **Frequently amalgamations are not tax efficient for the shareholders, so acquisitions where a share purchase agreement is not practical are frequently done by Plans of Arrangement**
 - see slide 24 ff
- **Approved by Special Resolution**



Principal Methods of Conducting Business Acquisitions: Tax Issues



➤ Hybrid Structure

➤ Combination of:

- First step: sale of certain assets (e.g. IP assets) to a non-Canadian affiliate of acquiror
- Second step: distribution of sale proceeds to Target shareholders
- Final step: purchase by acquiror of Target shares

➤ This structure could be used, for example, if:

- Virtually all of the shares are held by Canadians
- The assets being purchased will generate tax deductions in the foreign jurisdiction whose value exceeds any incremental Canadian tax created by the partial asset sale
- The acquiror maintains all of its assets of a certain type (e.g. IP) in a specified jurisdiction
- The Target has non-Canadian operations/subsidiaries
 - Prefer to have these acquired by a non-Canadian entity to avoid having funds cross multiple borders in the future



Canadian Acquisition Structure: Tax Issues



- **Income, Dividends, capital gains: taxed differently**
 - Frequently it will depend on the nature of the recipient (corporation/individual/non-resident, etc.)
 - Canadian inter-company dividends frequently are tax-free
 - Tax rates for individuals are graduated
 - Ontario top rate is 53.53% (income in excess of (Cdn.)\$220,000)
 - Highest individual tax rates on eligible dividends from Canadian companies range from ±30% to about 43% (depending on province)
 - Highest individual tax rates on capital gains range from ±24% to 27% (depending on province)
 - Corporate tax rates (combined federal and provincial) range from 26% to 31%
- **(Cdn.)\$835,716* lifetime capital gains exemption on sale of "qualified small business corporation" shares**
 - Often makes a share sale preferred to an asset sale for sellers

* 2017 amount; indexed annually



Canadian Acquisition Structure: Tax Issues (Share Purchase)



- In *almost* all cases, a foreign acquiror ("AcquireCo") incorporates a Canadian subsidiary (or uses an existing Canadian entity) ("CanAcquireCo") to complete a purchase (other than of assets)
 - Unless, for example, the purchase is being done at a valuation below the price at which prior financings were done
 - Is the gross purchase price below the aggregate price that all shareholders have previously paid for all their shares?
 - Can amalgamate the two entities to simplify the Canadian structure post-closing
- Objective is to ensure that "paid-up capital" ("PUC") of CanAcquireCo is as high as possible
 - Ability to repatriate cash post-closing to foreign jurisdiction (up to amount of PUC) without Canadian withholding taxes



Exchangeable Shares: Structure to Take into Account Tax Considerations for Canadian Shareholders



- **If non-Canadian AcquireCo (incorporated in the US or otherwise: "USCo") wishes to acquire shares of Canadian Target company ("CanCo") in exchange for stock of USCo:**
 - No Canadian rollover (deferral) for tax purposes
 - Disposition for tax purposes
 - Resulting obligation to pay capital gains tax

Exchangeable Share Structure



- Achieves tax deferral for Canadian shareholders
- USCo establishes Canadian subsidiary which issues shares which *mirror*, and are exchangeable into, stock of USCo
 - Issue "exchangeable shares" to the CanCo shareholders
 - The economic equivalent of holding shares of USCo directly
- **Typically not undertaken if there is sufficient cash consideration to permit the Target shareholders to pay their capital gains tax**
- **Consider:**
 - Plan of Arrangement considerations in the U.S. (e.g. slide 26)



Exchangeable Share Attributes



- **Non-voting in the Canadian subsidiary (except where required by law)**
 - Provisions may include economic disincentive for negative votes
- **Right to receive Canadian dollar dividends from issuer of exchangeable shares economically equivalent to dividends paid by USCo to holders of its stock**
 - Canadian shareholders are treated "as if" the exchangeable shares had been exchanged
- **Exchangeable at the option of the holder at any time for one share of USCo (plus accrued and unpaid dividends)**



Exchangeable Share Attributes



- **Generally provides for mandatory exchange, e.g.:**
 - After the negotiated "sunset" period (frequently 5-10 years, although this can be shorter or longer);
 - Acquiror wants as short a period as possible: see slide 26
 - The number of outstanding exchangeable shares falls below a specified threshold; or
 - M&A event at the USCo level
- **Voting Rights in USCo**
 - The need for voting rights depends, in part, on whether the shareholders of the Target think that voting rights are meaningful
 - If so, typically use "blank cheque preferred shares" to create a special voting share which is *non-participating* but which is entitled to a number of votes (fluctuating from time to time) equal to the number of shares of common stock of USCo into which the exchangeable shares are then exchangeable
 - Held and voted by the Target shareholders (through a voting trust) or by a third party trustee (e.g. Computershare)



Tax Implications of Earn-Outs



- **Earn-outs occur where shares of a corporation are sold under an agreement whereby the proceeds of disposition are at least partially determined by reference to future events, including earnings generated by the underlying business**
- **For Canadian tax purposes, payments based on the use of or production from property, including as an installment of the sale price, are generally treated as income and not as capital gains to the seller**
 - Characterization of the proceeds of disposition as income is generally quite negative for the seller of the target shares, because:
 - only 50% of capital gains are included in income;
 - only capital gains can benefit from the Qualified Small Business Corporation share exemption;
 - non-residents (who are usually exempt from Canadian capital gains tax) are subject to withholding tax on income
- **This characterization does not affect the tax position of the buyer**



Methods to Avoid Tax Implications of Earn-Outs



➤ **Canada Revenue Agency (“CRA”) Administrative Policy:**

- The CRA allows the seller to use the “cost recovery method” to report sale proceeds
 - Under the cost recovery method:
 - the seller reduces its adjusted cost base of the shares as amounts on account of the sale price become determinable; and
 - no capital gain is realized until the amount of the sale price that can be calculated with certainty exceeds the seller’s cost base.
- Several conditions must be met in order for the seller to use the cost recovery method, including that:
 - It must be reasonable to assume that the earn-out feature relates to underlying goodwill of the business which cannot reasonably be agreed upon at the date of sale; and
 - earn-out period cannot extend beyond 5 years



Methods to Avoid Tax Implications of Earn-Outs



➤ Reverse Earn-Outs:

- A “reverse earn-out” is frequently used to avoid the classification of earn-outs as income (and in circumstances where the CRA’s Administrative Policy is not clearly available)
- In a reverse earn-out:
 - the purchase price is structured as a *maximum amount*; and
 - the maximum price set is subject to reduction if the particular future events/milestones are not met
- In connection with reverse earn-outs:
 - the seller’s proceeds of disposition and the buyer’s cost basis will be recorded as the maximum amount, with the seller reporting the resulting capital gain; and
 - where the future events/milestones are not achieved, the sale price (and therefore the seller’s proceeds of disposition and the buyer’s cost basis) are reduced accordingly (with a corresponding decrease in the capital gain reported by the seller), and the seller will re-file its tax return for prior years
- Post-closing adjustments to the buyer’s cost basis can be troublesome if the buyer sells the target shares before the completion of the adjustment period



Plan of Arrangement



- **A statutory *mechanism* in most Canadian corporate statutes**
- **Consider it a court-supervised "*process*", as opposed to a "*structure*"**
 - Virtually any type of acquisition structure can be implemented using a Plan of Arrangement
 - Most are structured as share purchases or hybrid transactions
- **Key Benefits**
 - **Flexibility**
 - Court-approved process allows implementation of acquisition structures, and using methods, that would not necessarily be provided for in the corporate statutes
 - **Third Parties Bound**
 - Can effect changes which can be binding on third parties, such as
 - Option holders or warrant holders
 - Stockholders (other than those which dissent)



Plan of Arrangement



➤ Implementation Steps

- Application to the Court for an "interim order"
 - Court makes procedural determinations relating to the holding of the meeting, including the requirement to grant dissenters' rights
- Holding a shareholders' meeting to consider and vote on the plan of arrangement (and the transaction contemplated therein)
 - Generally the target board will obtain a "fairness opinion"
- Application to the Court for a "final order" approving the plan of arrangement
- Implementation of the Arrangement
 - May include filing "articles of arrangement" under applicable corporate legislation to effect the arrangement



Plan of Arrangement



➤ U.S. Considerations:

➤ Original issuance of shares is exempt under section 3(a)(10) of the U.S. *Securities Act* of 1933

- If the issuance has been approved by a court of competent jurisdiction after a hearing on the fairness of the terms and conditions of issuance, of which all holders of the target's securities receive notice, and have an opportunity to attend and be heard
- *In the case of an exchangeable share structure*, the issuance of common stock on exchange of the exchangeable shares requires a registration statement
- AcquireCo can generally only commit to provide freely tradable stock if AcquireCo is eligible to rely upon S-3, S-4 or equivalent "F" forms
- As a result, AcquireCo wants to collapse the exchangeable share structure as soon as possible in order to avoid the requirements of keeping a registration statement current



Investment Canada Act



- **Applies to *both*:**
 - Establishments of a new Canadian business by non-Canadians, and
 - Acquisitions of control of a Canadian business
- **Some transactions only require post-closing notification**
 - Others require review/approval prior to closing
- **For those transactions requiring approval, government will consider the "net benefit to Canada"**
 - Not specifically defined
 - Assessed according to six categories of factors (primarily economic)



Review Thresholds for non-Cultural WTO (Non-TA) Transactions (non-SOEs)



➤ Direct acquisitions:

- Current threshold: require *only* a post-closing notification (not prior review and approval) if:
 - (a) The "Enterprise Value"* of the Target does not equal or exceed (Cdn.)\$1 billion**,
 - (b) Acquired by Non-Canadian investors which are World Trade Organization (WTO) investors (i.e. investors controlled by citizens or permanent residents of countries that are members of the WTO) and are not state-owned (and state-controlled) enterprises ("SOEs"), ***and***
 - (c) Target is not involved in a culturally-sensitive industry

* asset-based test replaced in April 2015

** increased annually based upon Canadian GDP



Review Thresholds for non-Cultural TA Transactions (non-SOEs)



➤ Direct acquisitions:

- Effective September 21, 2017: require *only* a post-closing notification (not prior review and approval) if:
 - (a) The "Enterprise Value" of the Target does not equal or exceed (Cdn.)\$1.5 billion*,
 - (b) (i) Acquired by "Trade Agreement Investors" (i.e. citizens or permanent residents of any CETA** country or another bilateral free trade agreement country, *including the USA*) which are not SOEs; **or**
(ii) the entity being acquired is controlled by a trade agreement investor (other than an SOE), **and**
 - (c) Target is not involved in a culturally-sensitive industry

* increased annually based upon Canadian GDP

** Canada-European Union Comprehensive Economic and Trade Agreement



Review Thresholds for non-Cultural Transactions (non-SOEs)



- **"Enterprise Value" (for a share purchase) is:**
 - Total consideration paid, *plus*
 - Target's liabilities, *minus*
 - Target's cash (or cash equivalents)

Review Thresholds for Other Transactions



➤ Direct acquisitions:

- The previously-existing (Cdn.)\$369 million book value* threshold (subject to annual indexing based upon Canadian GDP**) continues to apply to acquisitions by SOEs
- The lower book value* threshold of (Cdn.)\$5 million continues to apply to acquisitions:
 - by non-WTO Investors, and/or
 - of "cultural businesses"

* book value of assets controlled directly or indirectly by CanCo

** (Cdn.)\$379 million in 2017



Review Thresholds: Non-Cultural (and non-SOE)



- **WTO + direct: \geq the Enterprise Value review threshold***
- **WTO + indirect: no review**
- **Non-WTO + direct: \geq (Cdn.)\$5 million****
- **Non-WTO +**
 - Indirect, where the book value of the assets of the CanCo is less than or equal to 50% of total book value of global assets acquired in the transaction: \geq (Cdn.)\$50 million**; or
 - Indirect, where the book value of the assets of CanCo is $>$ 50% of total book value of global assets acquired in the transaction: \geq (Cdn.)\$5 million**
- **Post-closing notification is still required if below the review threshold**

* subject to adjustment

** book value of assets controlled directly or indirectly by CanCo



"Cultural" Sectors



- **Industries identified as relevant to Canada's national identity and cultural heritage, including:**
 - Book, newspaper and magazine
 - Film
 - Video and music
 - Radio communications; radio, TV, cable



Review Thresholds: Cultural



- **Direct: \geq (Cdn.)\$5 million*, and can't close without a review (prior approval) above that threshold**
- **Indirect:**
 - Where the book value of Canadian assets is less than or equal to 50% of total book value of global assets acquired in the transaction: (Cdn.)\$50 million*; or
 - Where the book value of Canadian assets is $>$ 50% of total book value of global assets acquired in the transaction: \geq (Cdn.)\$5 million*
 - In both cases, can close without a review, but subject to a post-closing notification (and potential review) if below the monetary threshold
 - Subject to review if \geq monetary threshold

* of book value of assets controlled directly or indirectly by CanCo



➤ **Canadian equivalent of CFIUS**

- A review may be ordered if investment by a non-Canadian is potentially "injurious to Canada's national security"
 - No definition of "national security"
 - Triggered even if the investment does not involve the acquisition of control of a Canadian business

➤ **Investor can be ordered to divest**

- Can also be allowed to keep what they have invested in, in return for negotiated undertakings

Merger Review: *Competition Act* Notification Thresholds



- **Canadian equivalent of HSR criteria**
 - Substantive test under Canadian competition laws is very similar to that under U.S. antitrust law (although there are important differences)
- **Pre-merger notification required if two financial thresholds met:**
 - (1) Size of Parties Test: Parties, together with affiliates, have:
 - Assets in Canada with gross book value, or
 - Gross annual revenues from sales in, from or into Canada
 - Exceeding (Cdn.)\$400 million*; and
 - (2) Size of Transaction Test **: Target, together with subsidiaries, have:
 - Gross book value of assets in Canada, or
 - Gross annual revenues generated in or from CanadaExceeding (Cdn.)\$88 million*

* 2017 thresholds; subject to periodic adjustment

** For share transactions; similar thresholds for other structures



Merger Review: *Competition Act*



- **Even if a deal is not notifiable, the Competition Bureau has jurisdiction to challenge a deal if it raises significant substantive concerns**
 - Some may choose to seek an "Advance Ruling Certificate" or "No Action Letter"



Merger Review: *Competition Act* Notification Thresholds



- **For a share purchase acquisition, there is an additional threshold relating to the proportion of shares acquired:**
 - 20% of voting shares of a public company (or 50% if the purchaser already owns 20% or more)
 - 35% of the voting shares of a private company (or 50% if the purchaser already owns 35% or more)



M&A Related Restrictive Covenants



- **Non-competition and non-solicitation covenants interpreted more liberally in an M&A context, although:**
 - Reasonableness is based upon:
 - Duration
 - Geography, and
 - Scope
 - No "blue pencilling" allowed
 - Restrictive covenant is lawful *unless* it can be established (on a balance of probabilities) that its scope is unreasonable having regard to the context

Employment-Related Considerations



- **No Canadian jurisdiction is an "at-will" jurisdiction**
- **Applicable employment laws**
 - Employment law is regulated provincially having regard to the location of the employee (not the employer)
 - Employment relationship (including the employer's obligations relating to termination of employment) is based upon a combination of:
 - Common law (or Quebec Civil Code, if applicable) and
 - Employment standards legislation
 - The "basic" statutory termination obligations may increase (in certain provinces), resulting in implications for:
 - Severance pay
 - "Mass termination"



Employment-Related Considerations



➤ Common law:

- Cannot terminate employment without "reasonable notice" or pay in lieu of reasonable notice unless terminated for cause
 - Termination for cause is a high standard
 - Unfounded claims can result in incremental damages on the basis that the employer acted in bad faith
- Notwithstanding the above, in common law jurisdictions, an enforceable contract can "cap" the employer's liability to the statutory minimum
 - In Quebec, the Civil Code states that an employee must receive reasonable notice in advance of termination
 - Agreements in Quebec frequently contemplate permitting pay in lieu
- Considerations for reasonable notice include:
 - Age
 - Salary
 - Period of service
 - Position
 - Ability to find alternate work
 - Inducement
- With certain provincial exceptions, option vesting continues during the notice period unless otherwise expressly stated



Employment-Related Considerations in M&A



- **Sale of a Business (Shares)**
 - Inherit employment relationships in a share purchase scenario
 - Cannot unilaterally change employment terms (since not "at will")
 - A unilateral change may constitute "constructive dismissal"
- **Sale of a Business (Assets)**
 - Offers of employment are generally optional in an asset purchase scenario
 - If made, inherit the "period of service" with the predecessor
 - Vendor will typically require offers be made on same terms
 - In Quebec, employees (excluding senior managers) who are not retained by the buyer may be able to challenge their termination or the fact that they have not been hired by the buyer if they have at least two years of continuous service at the time of the transaction and if the selection is not based upon "objective criteria"



Employment-Related Restrictive Covenants



- **When creating covenants, consider that:**
 - Only limit what is reasonably required to protect rights that are entitled to protection, where reasonableness is based upon:
 - Duration
 - Geography
 - Scope of activities
 - No "blue pencilling" allowed
 - Non-competition covenants are particularly difficult to enforce in some jurisdictions
 - In Ontario, the courts consider non-competition covenants generally unenforceable:
 - Non-solicitation covenants to suffice
 - Non-solicit does not have to have a geographic limitation
 - The Quebec Civil Code recognizes non-competition covenants
 - Onus is on the employer to prove reasonableness



- **"Work made for hire" does *not* have an equivalent concept in Canada**
- **Without an agreement to assign, inventions created by employees, contractors, or consultants, paid by a business organization, may not necessarily be beneficially owned by the business organization**
 - It is important to review employment agreements for critical employees, as well as service/consultancy contracts, to provide greater certainty as to invention ownership and moral rights
 - Works done by employees under a contract of service, *within the course of scope of employment*, are owned by the employer (unless the agreement provides otherwise)
 - Still need waiver of moral rights

- **Canada is expected to implement the Madrid Protocol for international registration of trademarks in 2019**
 - Until then, trademark registrations can only be effected through a Canadian application
 - A U.S. trademark does not assist a Canadian situation except in the case of allegations of "common law infringement" or "passing off"
 - For protective purposes, it may be prudent to file for Canadian trademark protection in anticipation of expanding into Canada
- **To register a ".ca" web domain:**
 - must meet "Canadian Presence Requirements"

- **Personal Information Protection and Electronic Documents Act ("PIPEDA"), federal legislation which applies unless there is provincial legislation**
- **PIPEDA requires compliance with 10 "fair information management principles" regulating, generally, collection, use and disclosure of personal information**
- **Implications for outsourcing of services from Canada and due diligence**
- **Only British Columbia, Alberta and Quebec have their own private sector privacy laws**
 - **Manitoba's legislation is pending**

Canada's Anti-Spam Law ("CASL") in force July 1, 2014



- **Not just email**
 - "commercial electronic message" (CEM) – any electronic message with a commercial purpose (includes email and text messages)
- **Not just individuals**
 - Applies to emails sent to individuals and businesses
- **Not just mass emails**
 - Technically a single email can be “spam” (because it’s a CEM)
- **Computer Programs**
 - Cannot install or update a "computer program" or cause an electronic message to be sent from another person’s computer, without express consent
- **Not just in Canada**
 - Applies to emails sent from Canada, or to recipients in Canada



Canadian Anti-Spam Legislation



	CAN SPAM	CASL
messages	electronic mail only	electronic message (email, text, sound, voice, image) to electronic address (email, IM, telephone, or similar account)
definition of spam	primary purpose commercial	<u>one</u> of its purposes is commercial
territorial scope	not stated	computer system in Canada used to send or receive CEM
consent	express opt-out	opt-in express consent; limited forms of implied consent / exceptions; cannot use CEM to request consent (since an electronic message to request consent is itself CEM)
formalities	prescribed content	similar but different content
secondary liability	not stated	directors, officers, agents of corporations employers of employees
private action	affected ISPs	the coming into force of the private right of action under CASL has been suspended (indefinitely)



Canadian Anti-Spam Legislation: Basic Requirements



- **Prohibits sending a *commercial electronic message* to an *electronic address* unless:**
 - The recipient has given express or implied consent (a consent requirement); ***and***
 - The message contains certain information about the sender and an unsubscribe mechanism (a content requirement)
- **CASL contemplates prescribed exceptions to consent**
- **An *opt-in* regime (unlike U.S. CAN-SPAM)**
 - Except where relying on implied consent or exceptions (requires opt-out)



Canadian Anti-Spam Legislation: Basic Requirements



➤ **Consequences for breach:**

- Up to (Cdn.)\$10 million fine for organizations
 - March 5, 2015: CRTC levied its first Notice of Violation to a high profile Canadian company, with a (Cdn.)\$1.1 million administrative penalty, for "flagrant" violation of CASL on four occasions
- Up to (Cdn.)\$1 million fine for individuals
- Private right of action for damages of up to (Cdn.)\$1 million per day of violation (originally expected to be in force July 1, 2017) has been suspended indefinitely
- CASL also amended certain provisions of the Competition Act to include reviewable practices relating to e-marketing



Canadian Anti-Spam Legislation: Amendments Effective January 15, 2015



➤ Installation of Computer Program Rules

- Cannot install or update a "computer program" on another person's "computer system" in the course of a business activity, or cause an electronic message to be sent from another person's computer, without *express consent* of owner or authorized user of computer system
 - Broad definition of "computer program"
 - "Computer system" includes laptop, smartphone, desktop
- Exceptions for self-installed software
- Also prohibits causing software to be installed without consent – when installation of one program causes automatic installation of other software that owner does not expect (including but not limited to malware)
- Deemed consent in certain circumstances for certain types of programs, like cookies or JavaScript or HTML code
- Rules apply if the computer system is located in Canada or if the person causing the installation is in Canada



- **Charter of the French Language:**
 - French is the official language of Quebec
 - Consumers have a right to be informed and served in French
 - Workers have a right to carry on their activities in French
 - Inscriptions on products sold in Quebec must be drafted in French (and another language, subject to restrictions), subject to limited exceptions
 - Commercial publications distributed in Quebec must be drafted in French (and another language, subject to restrictions), subject to limited exceptions
 - Websites must be in French if the firm has an establishment in Quebec *and* offers its products/services in Quebec
 - "English language" clause recommended in most contracts concluded with persons in Quebec
 - Obligation to register and to generalize the use of French throughout their business if >50 employees in Quebec



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