Private M&A 2022

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LEXOLOGY
Getting The Deal Through

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Davis Polk & Wardwell LLP

Lexology Getting The Deal Through is delighted to publish the fifth edition of *Private M&A*, which is available in print and online at www.lexology.com/gtdt.

Lexology Getting The Deal Through provides international expert analysis in key areas of law, practice and regulation for corporate counsel, cross-border legal practitioners, and company directors and officers.

Throughout this edition, and following the unique Lexology Getting The Deal Through format, the same key questions are answered by leading practitioners in each of the jurisdictions featured. Our coverage this year includes new chapters on Latvia and Spain.

Lexology Getting The Deal Through titles are published annually in print. Please ensure you are referring to the latest edition or to the online version at www.lexology.com/gtdt.

Every effort has been made to cover all matters of concern to readers. However, specific legal advice should always be sought from experienced local advisers.

Lexology Getting The Deal Through gratefully acknowledges the efforts of all the contributors to this volume, who were chosen for their recognised expertise. We also extend special thanks to the contributing editors, Will Pearce and Louis L Goldberg of Davis Polk & Wardwell LLP, for their continued assistance with this volume.

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STRUCTURE AND PROCESS, LEGAL REGULATION AND CONSENTS

Structure

1 How are acquisitions and disposals of privately owned companies, businesses or assets structured in your jurisdiction? What might a typical transaction process involve and how long does it usually take?

Generally, a purchase and sale agreement is entered into to govern the acquisition or disposition of privately owned companies, businesses or assets. The sale of a business is commonly accomplished by way of a sale of shares or assets. Sellers often prefer share sales because of lower applicable tax rates on gains. Buyers often favour asset purchases because of the possibility of achieving tax benefits and excluding unwanted liabilities. Sellers of smaller 'Canadian-controlled private corporations' may also be able to utilise a (limited) lifetime capital gains exemption on a share sale in addition to the other benefits of a clean exit by way of a sale of shares and, as a result, typically prefer share transactions.

Companies may also be combined by way of an amalgamation pursuant to the relevant corporate statute. Amalgamations must be approved by a super-majority vote of shareholders (generally two-thirds of the shares in attendance at a meeting).

A typical transaction process would involve signing a confidentiality agreement, developing a term sheet, a due diligence review, negotiation of transaction documentation and a closing. Companies at times utilise auctions to solicit a broad range of potential buyers.

The length of time to complete a transaction will depend on the complexity of the business, the number of interested parties, any special arrangements among the sellers and other factors, but two to four months is common.

Legal regulation

2 Which laws regulate private acquisitions and disposals in your jurisdiction? Must the acquisition of shares in a company, a business or assets be governed by local law?

Canada is a federal state with one federal, 10 provincial and three territorial governments. Each jurisdiction has its own laws governing acquisitions and dispositions of companies, businesses and assets. Most provinces in Canada have private legal systems based on English common law and legal precedents, while in Quebec matters of private law (ie, contract, family and property matters) continue to be governed by the Civil Code. Although there are important differences in law among these jurisdictions, particularly in Quebec, most corporate and business laws and practices across Canada share common features.

Businesses in Canada are most commonly formed as corporations under one of the business corporation statutes that exist in each province, territory and under federal law (eg, the Canada Business Corporations Act). The incorporating statute will govern the transfer of shares or assets. Banks, insurance companies and trust and loan companies are governed by specialised federal statutes.

A number of other statutes may be relevant, depending on the nature and location of the business. Federal and provincial governments each have their own power to legislate on certain subjects, and share jurisdiction over some subjects. The range of statutes and regulations that may need to be considered will often include laws on employment, privacy, tax, pensions, securities, competition, foreign investment and specific regulatory regimes governing a company's business.

Other than local mandatory laws, there is no constraint on the law that may be chosen by the parties to govern the transaction, but parties often elect the governing law based on the location of the seller, company or buyer.

Legal title

3 What legal title to shares in a company, a business or assets does a buyer acquire? Is this legal title prescribed by law or can the level of assurance be negotiated by a buyer? Does legal title to shares in a company, a business or assets transfer automatically by operation of law? Is there a difference between legal and beneficial title?

The buyer will acquire the same title that the seller had in the shares or assets, and will commonly negotiate for certain representations and warranties regarding ownership, ability to transfer and absence of encumbrances.

Legal title to shares or assets transfers upon the exchange of consideration, subject to satisfying agreed terms and conditions, and upon the transfer being recorded in the company's securities register. Share transfers may be subject to conditions or restrictions in the company's constating documents or in a shareholders' agreement. For most private companies, the board of directors must approve all share transfers.

A distinction is recognised between legal and beneficial title. A person holding legal title to shares will be listed in the company's share register as the registered holder, but may hold the shares on behalf of an unnamed beneficial holder. Federal companies, and some provincial companies as well, are required to maintain a register of individuals with significant control – including beneficial owners. Beneficial interests in property may be transferred distinct from the interests of the legal, or registered, holder. Beneficial title would transfer automatically by operation of law upon the exchange of consideration and subject to satisfying agreed terms and conditions.

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Multiple sellers

4 Specifically in relation to the acquisition or disposal of shares in a company, where there are multiple sellers, must everyone agree to sell for the buyer to acquire all shares? If not, how can minority sellers that refuse to sell be squeezed out or dragged along by a buyer?

While it is often the practice, and is certainly preferred by buyers, that all sellers be party to one or a series of purchase agreements, it is possible to acquire all of the shares of a private company without agreement from all shareholders. Many private companies have shareholder agreements that provide significant shareholders with the ability to 'drag' non-consenting shareholders into a transaction. In the absence of such an agreement, minority shareholders can also be squeezed out or dragged into a transaction by way of an amalgamation, plan of arrangement or similar shareholder vote-based transaction approved by a supermajority vote of the shareholders (typically two-thirds of the shares represented at a meeting).

Exclusion of assets or liabilities

5 Specifically in relation to the acquisition or disposal of a business, are there any assets or liabilities that cannot be excluded from the transaction by agreement between the parties? Are there any consents commonly required to be obtained or notifications to be made in order to effect the transfer of assets or liabilities in a business transfer?

Unlike in share transactions, a buyer of assets is generally free to choose which assets and liabilities will be transferred. Depending on the assets and liabilities being acquired, government and third-party consents may be required.

If the target's operations are unionised, the buyer will be deemed to be a successor employer under applicable labour relations legislation and will 'step into the shoes' of the seller for the purposes of the collective bargaining agreement. Most Canadian provinces have employment standards legislation that deems continuity of employment if employees of the business accept or continue employment with the buyer. Similarly, workers' compensation legislation in most Canadian provinces will deem the buyer of assets to be a successor and liable for unpaid premiums of the seller. In non-arm's-length transactions, tax authorities may have the ability to trace the transfer of the assets in order to pursue the payment of tax liabilities.

Contracts will often have assignment provisions detailing whether consent or notice is required to assign the contract. If the contract is silent, it is generally assignable subject to any statutory and common law limitations. A third party may assume obligations, but an assignment of obligations will not relieve the assignor of liability without the counterparty's consent.

Consents

6 Are there any legal, regulatory or governmental restrictions on the transfer of shares in a company, a business or assets in your jurisdiction? Do transactions in particular industries require consent from specific regulators or a governmental body? Are transactions commonly subject to any public or national interest considerations?

The Investment Canada Act (ICA) governs the acquisition of control of Canadian businesses by non-Canadians. Investments governed by the ICA are either notifiable or reviewable depending on the size of the target, the structure of the transaction, the identity of the parties and the nature of the target's business. The test for approval of a reviewable transaction under the ICA is whether the investment is likely to be of net benefit to Canada, and approval may be conditioned on undertakings made by the foreign investor regarding employment, capital expenditures, Canadian management participation, R&D activity, production and exports over a three- to five-year period after closing.

The ICA allows the government to review, prohibit or impose conditions on a broad range of investments by non-Canadians on the basis of national security concerns.

There are also restrictions on foreign ownership and sector-specific review regimes in a number of industry sectors, including commercial aviation, telecommunications, financial services, fishing, and certain other sectors, and some provinces have restrictions on foreign ownership of land.

7 Are any other third-party consents commonly required?

Any sale by a company of all or substantially all of its assets must be approved by a supermajority (typically two-thirds) vote of the shareholders. Shareholders' agreements may impose additional requirements.

Third-party consents may be required to assign contracts. Shares and assets may be subject to third-party security interests, in which case the secured party must provide a release or no interest letter in respect of the transfer to convey title free of encumbrances.

A private company's articles of incorporation or similar constating documents will typically restrict transfer of the shares of a company without approval by the company's board of directors.

Regulatory filings

8 Must regulatory filings be made or registration (or other official) fees paid to acquire shares in a company, a business or assets in your jurisdiction?

Generally, no regulatory filings are required to be made or registration fees paid in share or asset transactions. Certain transactions may also be notifiable or reviewable under the ICA. If a transaction engages the notification provisions under the Competition Act, based on factors including the size of the transaction and the size of the parties to the transaction, an application is required to be made, with an application fee, and approval must be obtained before completion. The acquisition of real property will typically require registration, with payment of a nominal fee, and may require payment of land transfer taxes.

ADVISERS, NEGOTIATION AND DOCUMENTATION

Appointed advisers

9 In addition to external lawyers, which advisers might a buyer or a seller customarily appoint to assist with a transaction? Are there any typical terms of appointment of such advisers?

Both buyers and sellers often engage accountants and financial advisers or brokers to assist in the structuring, valuation, due diligence, negotiation and execution of transactions.

Financial advisers or brokers are often provided with a 'success fee', which is dependent on the closing of the transaction and the price paid. When negotiating engagement terms with advisers, attention should be paid to the calculation of the success fee (usually based on a percentage of the transaction value or purchase price), any other fees involved, the timing of the payment of fees, the scope of services being provided, the payment trigger and tail periods.

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Duty of good faith

10 | Is there a duty to negotiate in good faith? Are the parties subject to any other duties when negotiating a transaction?

As Canadian courts have not recognised a general duty to negotiate in good faith, parties are generally free to pursue their own self-interest. However, a duty to negotiate in good faith may arise in cases where there is a 'special relationship' between the parties based on the presence of dependence, influence, vulnerability, trust and confidence, which would not typically exist in an arm's-length commercial relationship, or where the parties have specifically agreed to negotiate in good faith.

Directors of Canadian corporations have two primary duties: their fiduciary duty (duty of loyalty) and their duty of care. The fiduciary duty requires that directors 'act honestly and in good faith with a view to the best interests of the corporation' and the duty of care requires that directors 'exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances'. Directors must comply with both of these duties when considering, negotiating and consummating any transaction.

Courts in Canada have also recognised a duty of honesty in contractual performance. This duty of honesty requires that parties do not lie or knowingly mislead each other about matters directly linked to the performance of a contract.

Documentation

11 | What documentation do buyers and sellers customarily enter into when acquiring shares or a business or assets? Are there differences between the documents used for acquiring shares as opposed to a business or assets?

While the form of agreement used in a share and asset purchase may differ, most fundamental provisions are similar (eg, purchase and sale mechanics, representations and warranties, covenants and indemnities). Typically, a share sale is less complex than an asset sale, because in a share sale the company's assets, employees, contracts, etc, remain with the company.

The specific ancillary documents to be exchanged at or before closing of a share or asset purchase are similar, and may include such documents as confidentiality agreements, letters of intent, non-competition agreements, employment or consulting agreements, escrow agreements, disclosure letters, leases, unanimous shareholders' agreements or other similar documents. Asset purchases will require general and specific conveyances, and may require assignment or assumption agreements and transition services agreements.

12 | Are there formalities for executing documents? Are digital signatures enforceable?

An individual executing a document on behalf of an entity (eg, a corporation, partnership or trust) must have legal authority to bind that particular entity (or the partners thereof). This authority may arise from such individual's capacity as officer, director, general partner, manager, agent, trustee or otherwise. Typically, the legal authority to bind an entity is found in the entity's constating documents. Corporate law does not require that corporate seals be affixed to documents, and they are rarely used.

Canadian law recognises the ability to sign most documents with an 'electronic signature'. However, certain types of documents may require original signatures (such as land transfer documents). Certain documents may need to be signed in front of a notary, commissioner of oaths or a lawyer (such as affidavits or statutory declarations).

DUE DILIGENCE AND DISCLOSURE

Scope of due diligence

13 | What is the typical scope of due diligence in your jurisdiction? Do sellers usually provide due diligence reports to prospective buyers? Can buyers usually rely on due diligence reports produced for the seller?

Due diligence conducted by buyers often includes investigation into financial, tax, legal, organisational, operational, environmental and intellectual property matters. Legal counsel is often engaged to conduct due diligence on legal title to, and liens registered against, shares or assets, compliance with laws, legal structure, material legal risks, financial and other obligations, employment or labour matters, litigation, contract review, third-party consents, government approvals, and tax and transaction structuring matters.

It is not typical for sellers to prepare legal due diligence reports to share with prospective buyers, but it is becoming more common for sellers to prepare financial due diligence reports in auctions. Sellers may conduct some level of internal due diligence in advance of a transaction with a view to curing significant deficiencies. Sellers or their advisers will usually establish physical or digital data rooms to allow buyers to conduct their own due diligence investigations.

Liability for statements

14 | Can a seller be liable for pre-contractual or misleading statements? Can any such liability be excluded by agreement between the parties?

A seller may be liable for pre-contractual or misleading statements that were made negligently or fraudulently, or if he or she induced the buyer to enter into the transaction or agreement. However, parties typically agree to an 'entire agreement' or exclusionary clause that excludes representations or warranties other than those set out in the transaction agreement. Such clauses are enforceable, absent fraud.

Publicly available information

15 | What information is publicly available on private companies and their assets? What searches of such information might a buyer customarily carry out before entering into an agreement?

Private companies are generally required to file with a corporate registry limited information about directors and, in some cases, shareholders, all of which is publicly available. Other public searches that a buyer would typically conduct on a private company include lien, litigation, workers' compensation, bankruptcy, tax, employment, intellectual property, real property and environmental searches. Some searches require the consent of the target company, and the types of searches and information available may differ across jurisdictions.

Impact of deemed or actual knowledge

16 | What impact might a buyer's actual or deemed knowledge have on claims it may seek to bring against a seller relating to a transaction?

In the absence of specific agreement by the buyer and seller, there is no definitive answer. A buyer's knowledge may adversely affect its ability to make claim for breach of contract relating to such knowledge and, if the buyer fails to use such knowledge to mitigate damages, may reduce the damages a buyer is able to collect.

Because of the uncertainty, buyers often seek to include in the transaction agreement language to the effect that it can rely on the

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representations and warranties in the agreement, notwithstanding any actual or deemed knowledge of a breach or potential breach, whereas sellers may seek an 'anti-sandbagging' clause prohibiting the buyer from making claims if it knew of the breach.

PRICING, CONSIDERATION AND FINANCING

Determining pricing

17 How is pricing customarily determined? Is the use of closing accounts or a locked-box structure more common?

In share transactions, pricing is typically a function of a company's enterprise value, calculated on a debt-free, cash-free basis and assuming a normalised level of working capital, which in turn is used to determine the equity value for shareholders. For mature companies, enterprise value is frequently expressed as a multiple of the company's earnings before interest, taxes, depreciation and amortisation. Companies that operate in specialised sectors, such as technology and oil and gas, may be valued using industry-specific methodologies. Pricing in asset-based transactions will depend on the nature (and underlying cost base) of the assets acquired; where the assets constitute an entire operating business, the same valuation methodologies may apply as for share sales.

Closing accounts – known in Canada as purchase price adjustments – are used in a majority of private M&A transactions, and often include adjustments for working capital and any cash and debt on the balance sheet at closing. Locked-box structures are used less frequently.

Form of consideration

18 What form does consideration normally take? Is there any overriding obligation to pay multiple sellers the same consideration?

The form of consideration is negotiable but a majority of private M&A transactions would be all-cash. Where the buyer has limitations on cash financing, alternative and creative methods of seller financing are used, including 'rolled equity' and vendor take-back notes. The terms and conditions of any non-cash consideration are frequently the subject of meaningful negotiation. Share-based transactions may permit a seller to defer tax on any capital gain realised on the sale.

In general, the rights of shareholders of the same class of securities (eg, common or preferred shares) would be set forth in the articles of a company or other constating documents, and shareholders would customarily be entitled to receive the same consideration as other shareholders in the same class. However, economic entitlements can be modified contractually through the use of shareholder agreements or other arrangements.

Recently, partnerships have been used with increased frequency as acquisition vehicles to provide a buyer and other investors (including management) with flexibility to allocate returns in accordance with priorities and preferences that they negotiate among themselves.

Earn-outs, deposits and escrows

19 Are earn-outs, deposits and escrows used?

Third-party escrows and buyer holdbacks are often used as security for purchase price adjustments and indemnification claims. Earn-outs are commonly used to bridge significant valuation gaps between a buyer and seller, where they would typically be paid out over a one- to three-year period based on the financial performance of the acquired business. Deposits are not common, but can be found routinely in some industries, such as oil and gas asset transactions.

Financing

20 How are acquisitions financed? How is assurance provided that financing will be available?

Bank financing is the most common form of acquisition debt financing in Canada, often consisting of secured credit facilities provided by a domestic or foreign bank or syndicate. Other sources include second lien credit facilities, unsecured credit facilities, mezzanine debt and, growing in importance in Canada, high-yield debt. Private debt provided by pension funds and other non-bank financial institutions such as insurance companies has recently become more widely available.

Assurance of the availability of debt financing may be provided through a commitment letter or term sheet agreed by the buyer and its lender, which the buyer may be asked to deliver as part of an auction process or upon signing the purchase agreement. The lender's commitment may be subject to conditions, which parties seek to limit as much as possible. Financing conditions in acquisition agreements are infrequent.

For private equity-led transactions, lenders will generally require the private equity fund to commit to a certain level of equity financing in an equity commitment letter or limited guarantee, or both, from the fund.

Limitations on financing structure

21 Are there any limitations that impact the financing structure? Is a seller restricted from giving financial assistance to a buyer in connection with a transaction?

There are no outright restrictions on financial assistance, and in several provinces it is permitted without condition. In some provinces, there may be disclosure or other requirements.

CONDITIONS, PRE-CLOSING COVENANTS AND TERMINATION RIGHTS

Closing conditions

22 Are transactions normally subject to closing conditions? Describe those closing conditions that are customarily acceptable to a seller and any other conditions a buyer may seek to include in the agreement.

Transactions are normally subject to closing conditions, although signing and closing of transactions may occur simultaneously in the absence of regulatory or other conditions.

Most transactions include conditions regarding the accuracy of the seller's representations and warranties at closing and the seller's compliance with its covenants. Other customary conditions include regulatory approvals, material third-party consents, the absence of material legal actions or proceedings, and the absence of any material adverse effect.

23 What typical obligations are placed on a buyer or a seller to satisfy closing conditions? Does the strength of these obligations customarily vary depending on the subject matter of the condition?

All parties will customarily agree to use 'commercially reasonable efforts' to satisfy closing conditions. The level of efforts required is subject to negotiation and the parties may agree to a higher standard, including 'best efforts'. Unlike the 'commercially reasonable efforts' standard, which allows the promisor to exercise business judgment and consider its own financial interests, 'best efforts' is more onerous and can require the party making the covenant to take all reasonable steps to achieve the objective, including the expenditure of money, but is not an absolute obligation.

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The 'efforts' standard for obtaining regulatory approvals often differs from general obligations to satisfy closing conditions. A seller will typically seek to require the buyer to take whatever steps may be necessary to obtain the applicable regulatory approvals, which may include disposing of parts of the buyer's or the seller's business and commencing litigation.

Pre-closing covenants

24 Are pre-closing covenants normally agreed by parties? If so, what is the usual scope of those covenants and the remedy for any breach?

With the exception of transactions where signing and closing occur simultaneously, the parties will normally agree to pre-closing covenants governing the conduct of the business between signing and closing. Sellers will usually agree to operate the business in the ordinary course consistent with past practices. Pre-closing covenants typically limit the ability of the seller to impair the value of, or otherwise materially affect, the business or the assets.

In addition, the parties typically agree to maintain confidentiality of the transaction and obtain the other party's consent to any public announcements.

A material breach of a pre-closing covenant may entitle the buyer to terminate the agreement, subject to an agreed-upon cure period, or to specific performance of the agreement if damages are not an adequate remedy. The buyer may also have a claim for indemnification after closing.

Termination rights

25 Can the parties typically terminate the transaction after signing? If so, in what circumstances?

Parties customarily negotiate rights to terminate an agreement after signing. Common termination rights include:

- mutual agreement: permits termination by mutual consent;
- breach of representation or failure to perform covenant: permits termination for a breach by the other party of its representations and warranties or covenants (typically subject to materiality and cure periods);
- 'outside date': permits termination if closing conditions have not been satisfied by the agreed-upon date; and
- termination due to legal impediment: permits termination if any law or order of a governmental authority restrains or prohibits the transaction.

26 Are break-up fees and reverse break-up fees common in your jurisdiction? If so, what are the typical terms? Are there any applicable restrictions on paying break-up fees?

Break-up fees are not common for closely held private companies. Where break-up fees are included, the seller typically agrees to pay a fee to the buyer as compensation if the seller or target company terminates the agreement before closing to accept an offer from another suitor.

Deal protection measures such as break-up fees are not specifically regulated. However, the use of such measures can be challenged as a breach of the directors' fiduciary duties. Directors must be satisfied that the break-up fee or other deal protection measure is consistent with their fiduciary duties, including that the fee is in the best interests of the company and the amount is reasonable in the circumstances.

Reverse break-up fees are becoming more common as a method of compensating sellers for the failure of a transaction to close for reasons specific to the buyer, such as rejection of the transaction by the buyer's shareholders and failure to satisfy regulatory conditions. Reverse break-up fees are not regulated and typically do not give rise to the same fiduciary concerns as break-up fees.

REPRESENTATIONS, WARRANTIES, INDEMNITIES AND POST-CLOSING COVENANTS

Scope of representations, warranties and indemnities

27 Does a seller typically give representations, warranties and indemnities to a buyer? If so, what is the usual scope of those representations, warranties and indemnities? Are there legal distinctions between representations, warranties and indemnities?

Sellers typically give representations, warranties and indemnities. Their scope varies based on transaction structure and size, market dynamics and relative bargaining strength.

Normally, representations and warranties cover ownership of shares and assets, condition of assets, financial statements, business operations, compliance with laws, and outstanding claims and liabilities. The technical differences between representations and warranties are minor and it is common practice to refer to both.

Indemnities afford broader protection than representations and warranties. While the principles of remoteness of damage, causation, reliance and mitigation apply to an action for breach of representations and warranties, they do not apply to indemnity claims (unless otherwise negotiated). Buyers can negotiate a broader class of beneficiaries and definition of losses and include business risks and liabilities that may not otherwise be covered by representations and warranties.

Limitations on liability

28 What are the customary limitations on a seller's liability under a sale and purchase agreement?

Limitations on a seller's liability typically include liability caps, de minimis claim amounts, baskets (thresholds or deductibles), survival periods on representations and warranties and excluded liabilities.

Liability caps can be as low as 1 to 15 per cent in competitive deals. Baskets are most commonly structured as tipping thresholds (as opposed to straight deductibles) and represent typically up to 1 per cent of the transaction value. Survival periods commonly range between 12 and 24 months from closing, with longer periods for tax, title and fraud. Sellers will negotiate the exclusion of certain damages from recoverable losses, including special damages and punitive damages, and less frequently, consequential damages. Other limitations include materiality and knowledge qualifications, disclosure of exceptions and offsetting insurance proceeds.

Where transaction insurance is used, liability caps, thresholds and survival periods tend to be lower and shorter, often lining up with policy terms. The presence of transaction insurance also commonly results in the parties being silent on the availability of consequential damages and including a materiality scrape in the purchase agreement.

Transaction insurance

29 Is transaction insurance in respect of representation, warranty and indemnity claims common in your jurisdiction? If so, does a buyer or a seller customarily put the insurance in place and what are the customary terms?

Transaction insurance is becoming common practice in Canada in competitive transactions. Buy-side policies are more common than sell-side policies. Costs typically range from 2 to 4 per cent of the policy coverage amount, which includes a C$25,000 to C$50,000 underwriting fee. The retention or deductible is typically 1 per cent of the purchase

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price and is often shared between buyers and sellers. The policy term is normally three years for general representations and six years for tax and fundamental representations. Non-binding quotes can take up to a week to obtain, and the underwriting process and policy negotiations can take up to two weeks.

Exclusions from policy coverage vary but typically include actual knowledge of breach, specific claims, liabilities and issues disclosed in the purchase agreement or identified in due diligence, financial statement provisions, underfunded pension obligations, working capital adjustments, asbestos and polychlorinated biphenyls, forward-looking statements, interim period breaches and fraud.

Post-closing covenants

30 Do parties typically agree to post-closing covenants? If so, what is the usual scope of such covenants?

Parties typically negotiate post-closing covenants, which often address such matters as use and disclosure of personal information, access to and preservation of books and records, filing of tax returns, cooperation with tax matters, access and use of privileged communications, and non-disclosure of confidential information. Buyers will often require sellers not to compete against the target business for a period after closing, typically between three and five years, and not to solicit employees, customers and suppliers.

TAX

Transfer taxes

31 Are transfer taxes payable on the transfers of shares in a company, a business or assets? If so, what is the rate of such transfer tax and which party customarily bears the cost?

Canada does not impose a stamp tax on the transfer of shares or other business assets. A land transfer tax (or registration fee) is generally payable by the buyer of land in all provinces in Canada. The rate and basis of taxation varies in each province, and may vary by municipality.

Corporate and other taxes

32 Are corporate taxes or other taxes payable on transactions involving the transfers of shares in a company, a business or assets? If so, what is the rate of such transfer tax and which party customarily bears the cost?

A Canadian taxpayer who disposes of or is deemed to dispose of shares held as capital property will generally realise a capital gain (or loss) to the extent that such taxpayer's proceeds of disposition, net of any reasonable costs of disposition, exceed (or are less than) the adjusted cost base of such shares. Generally, one-half of any capital gain realised in a taxation year will be included in computing the taxpayer's income in that taxation year as a taxable capital gain and, generally, half of any capital loss realised in a taxation year must be deducted from the taxable capital gains realised by the Canadian taxpayer in the same taxation year. The rate and basis of taxation vary by province and whether the taxpayer is an individual or a corporation.

The corporate income tax consequences applicable to the disposition of business assets by a Canadian taxpayer will depend on the type and tax attributes of such asset, including whether such taxpayer has previously claimed depreciation for income tax purposes on such asset.

Canada levies a 5 per cent value-added tax (good and services tax (GST)) on the supply of most goods and services in Canada. Generally, GST paid in the course of commercial activities is recoverable through input tax credits, which are applied against the GST collected. Some provinces impose additional provincial sales tax, which applies to supplies of goods in services in those provinces and varies in rate from 6 to 10 per cent. In other provinces, the GST has been harmonised with the provincial sales tax component so that a single value-added sales tax (harmonised sales tax) is imposed on essentially the same base as GST, at aggregate rates ranging from 13 to 15 per cent. There is no provincial sales tax in Alberta.

Sales taxes do not apply to a sale of shares, but do apply to a sale of assets. Parties may be able to elect to exempt the sale of a business from GST if the buyer acquires all or substantially all of the assets necessary to carry on the business.

EMPLOYEES, PENSIONS AND BENEFITS

Transfer of employees

33 Are the employees of a target company automatically transferred when a buyer acquires the shares in the target company? Is the same true when a buyer acquires a business or assets from the target company?

Employees of a company are automatically acquired when the buyer acquires the company's shares. When a buyer acquires assets, the employment of any transferred employees is terminated by the seller at common law, giving rise to an obligation on the seller to provide reasonable notice or pay in lieu of notice. Therefore, the seller will normally require the buyer to offer employment to all affected employees on substantially the same terms and conditions. In the case of unionised employees, a buyer will be required to assume the applicable collective agreement.

Notification and consultation of employees

34 Are there obligations to notify or consult with employees or employee representatives in connection with an acquisition of shares in a company, a business or assets?

Normally, in the context of a sale of shares or assets, there is no obligation to notify or consult with employees, subject to complying with any such requirement in a collective agreement. In a sale of assets, the seller usually provides notice that the employment relationship will cease, and the buyer would normally provide offers of employment to the affected employees to ensure the continuation of their employment. In some Canadian jurisdictions, notice of mass termination may be required to be given to the applicable regulatory body. Notice to or consent from individuals to whom certain personal information relates may be required.

Transfer of pensions and benefits

35 Do pensions and other benefits automatically transfer with the employees of a target company? Must filings be made or consent obtained relating to employee benefits where there is the acquisition of a company or business?

In the case of unionised employees, a buyer must provide those employees with the benefits set out in the collective agreement, regardless of transaction structure. Non-unionised employees in a share purchase would normally continue to be entitled to the same pension and benefits as they were before closing.

In an asset purchase, pensions and benefits do not automatically transfer with the employees. Instead, sellers will commonly require buyers to provide equivalent benefits post-closing to reduce exposure to severance claims.

With respect to pension plans, notifications and approvals are obtained where required under the terms of a collective agreement, a new pension plan is established or assets and liabilities are transferred between plans, or changes are made to an existing pension plan.

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UPDATE AND TRENDS

Key developments

36 What are the most significant legal, regulatory and market practice developments and trends in private M&A transactions during the past 12 months in your jurisdiction?

Canadian M&A activity hit record highs during the first half of 2021, continuing a trend seen during the latter half of 2020, and following global trends in dealmaking. This activity resulted from an improved economic outlook and low interest rates, along with a backlog of dormant and delayed transactions from 2020, which are expected to proceed as markets stabilise and economies recover.

With government subsidies winding down, distressed companies across a number of sectors will present attractive targets for opportunistic and well-funded buyers. Additionally, with unprecedented levels of private equity dry powder, the trend of private equity transactions representing an ever-increasing portion of Canadian M&A deals is expected to continue.

Sectors that had particularly strong deal value and volume during 2020 and the first part of 2021 include the financial sector, real estate, materials and information technology. Furthermore, certain business sectors, such as healthcare and technology, and innovated businesses poised to benefit from a permanent shift in societal behaviour, such as e-commerce and remote working and learning, have drawn increased investor attention in Canada. Technology in particular has seen a large increase in M&A activity in Canada, being at the forefront of private equity investment.

Consolidation in various sectors is expected to drive substantial deal activity during the remainder of 2021, as certain competitors are unable to weather the current challenging environment. Parties are expected to increasingly avail themselves of the 'failing-firm defence' in an attempt to consummate consolidation transactions that may have previously been restricted as being anticompetitive. The argument that a transaction does not substantially reduce competition because the target firm would have otherwise failed may be considered by the Competition Bureau in deciding whether to allow a seemingly anticompetitive M&A transaction to proceed, among other factors. With the economy attempting to stabilise post-pandemic, regulators may prefer to see those assets productive, even in the hands of a competitor.

Environmental, social and governance (ESG) factors have become a fixed reality in the private M&A and private equity market, with sound ESG practices linked to stronger operational performance, valuations and higher returns. Investors are increasingly using ESG criteria and performance in the evaluation of a target's operations.

As expected, the turmoil caused by the covid-19 pandemic has seen increasing use or threatened use of material adverse effect (MAE) conditions to terminate M&A transactions. Canadian case law on this issue continues to be sparse, but there is recent case law concluding that the pandemic could constitute an MAE, depending on the definition and carve-outs. It is expected that the interpretation and treatment of MAE clauses will continue to receive attention from Canadian courts over the coming months and years, and will have a lasting impact on the negotiation and drafting of such provisions going forward.

There has also been recent Canadian case law that suggests that 'ordinary course' operation of a business during periods of external shock does not mean the unwavering operation of the business in a routine manner, which may be impossible under the circumstances. Rather, such ordinary course operation may be consistent with prior responses of the target to comparable economic circumstances or shocks.

Canada has seen escalating use of earn-out provisions in private M&A transactions, which allows buyers and sellers to share in the future uncertainty associated with the acquired business. Earn-outs are historically common during times of economic uncertainty, suggesting increased use of the provision throughout 2021 and potentially beyond.

The accelerated adoption of technology to facilitate M&A transactions is expected to survive the pandemic. Changes to due diligence processes, such as virtual site visits, drone footage and electronic data rooms, and the remote negotiation and closing of transactions, without the need for travel or face-to-face meetings, appear to be permanent.

Lastly, Canadian M&A may face new challenges and considerations with the new US Biden administration, with the cancelation of the Keystone XL pipeline resulting from a focused effort on environmental welfare being a prime example. US politics continue to have significant effects on Canadian M&A dealmaking and require ongoing monitoring in Canada.

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Coronavirus

37 What emergency legislation, relief programmes and other initiatives specific to your practice area has your state implemented to address the pandemic? Have any existing government programmes, laws or regulations been amended to address these concerns? What best practices are advisable for clients?

After the onset of the covid-19 pandemic and the resulting economic challenges, the federal government, along with most provincial and territorial governments, were quick to introduce various relief and stimulus programmes. The year 2021 has seen many of those programmes being slowly rolled back. The extra time to file and pay income taxes as well as deferral of sales tax remittance and customs duty payments were not extended into 2021. Many of the current programmes have upcoming completion dates; however, there have been proposed extensions for several major subsidies.

Several key programmes remain in place during 2021.

- The Canada Emergency Wage Subsidy (which covers a portion of an employee's wages for eligible employees), remains available, with a possible extension in the proposed budget on 19 April 2021.
- The Canada Emergency Rent Subsidy (covering part of the commercial rent for eligible businesses) was scheduled to conclude in July 2021, but an extension was also proposed in the budget.
- An additional C$20,000 has been approved for the Canada Emergency Business Account (an interest-free loan for struggling small businesses) in addition to the $C40,000 originally available. Businesses that repay the loan before 31 December 2022 will have 33 per cent of the loan forgiven (up to C$20,000).
- The Business Credit Availability Program is still in place, pursuant to which Export Development Canada guarantees certain amounts to be borrowed by businesses. This increases those businesses' access to credit from financial institutions.

Owing to the evolving nature of those programmes and other initiatives, clients should frequently seek advice and updates from their legal and accounting advisers.

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