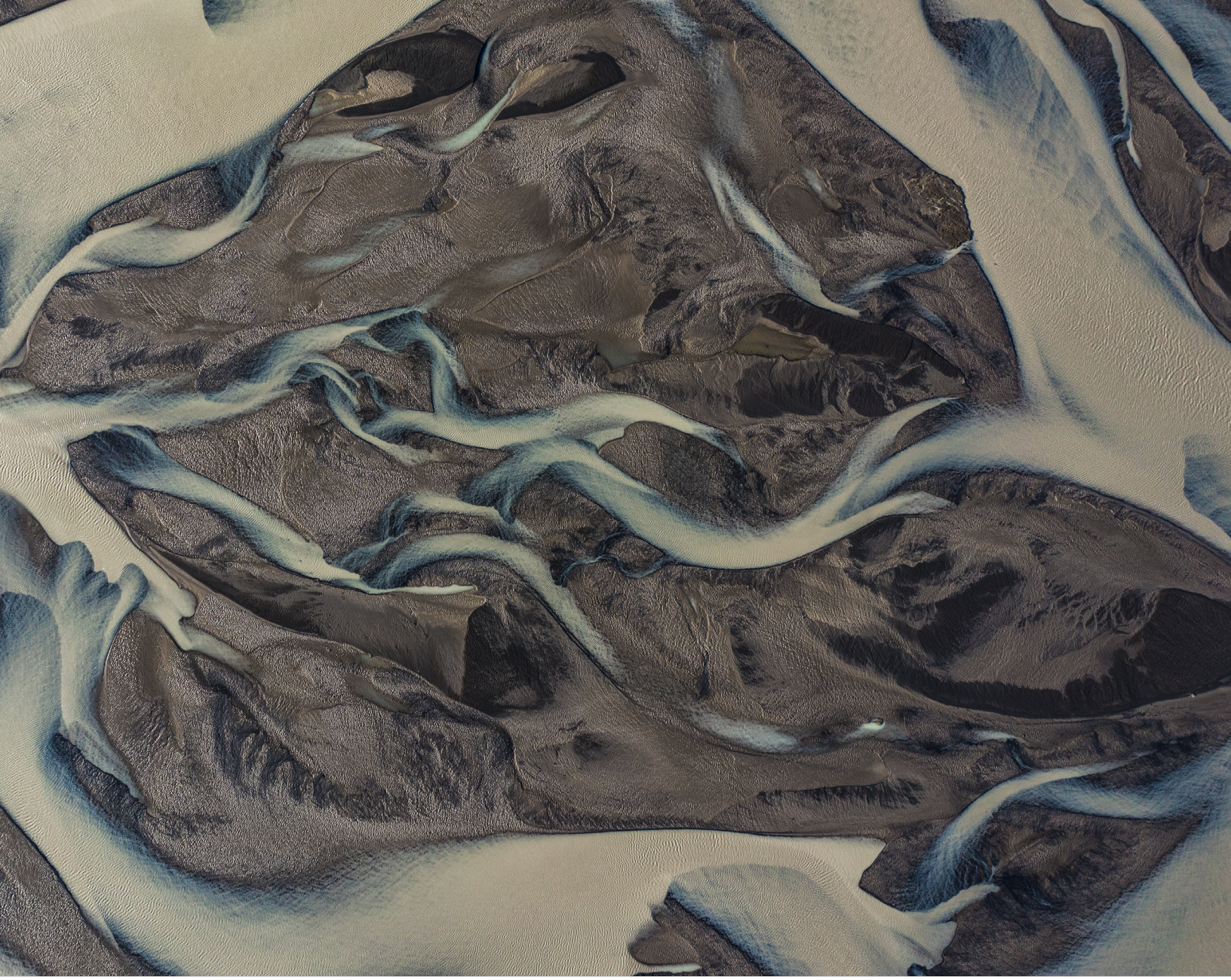
Blakes

# Cross-Border Private M&A in Canada

Blakes Means Business



# Tips for Foreign Acquirers in 2023

As is the case around the globe, the Canadian private M&A market returned to a more traditional pace in 2022 after the record-setting frenzy of deal announcements in 2021. Despite current economic headwinds, there is still significant liquidity in the market. Many financial buyers are looking to put capital to work, and we again expect solid private M&A activity in Canada in 2023 and beyond.

While Canadian M&A takes many cues from the United States and Europe, it is unique in many ways. A successful foreign acquirer advised by Canadian legal counsel will be armed with knowledge about these differences.

## Canadian Structures Are Flexible

Acquisition vehicles can be formed federally or in any province or territory. Canadian businesses are most often operated by corporations with limited liability. Foreign acquirers will sometimes prefer to use unlimited liability corporations, which are treated as corporations for Canadian tax purposes but can achieve flow-through treatment for U.S. tax purposes. Increasingly, investments are made using limited partnerships, which offer governance flexibility and a hybrid of partnership treatment for tax purposes while maintaining limited liability for investors. Many jurisdictions in Canada, most recently Ontario, have removed the requirement for residents of Canada to be included in the board of directors. Canadian entities are relatively simple to form and, in most cases, can be done quickly and electronically.

## What Is Market?

Typical material deal terms in Canada are not just carbon copies of the U.S. or European practice. For example, as compared to the U.S., buyers of Canadian companies are often able to insist on higher caps for indemnification in Canada; survival periods tend to be longer in Canada; anti-sandbagging provisions are often handled differently in Canadian transactions; and legal opinions are much less common in private deals other than in the financial services and venture capital sectors.

## Foreign Investors, Meet the Canadian Federal Government

Canada regulates all foreign investments under the *Investment Canada Act*. Transactions over a certain enterprise-value threshold are subject to review by the federal government, in which case a pre-closing waiting period will apply. All other foreign acquisitions of Canadian businesses are subject to a notification obligation that can be submitted pre- or post-closing. Investments made by state-owned enterprises (SOEs) and investments in cultural businesses are subject to other additional considerations. In addition, all investments by non-Canadians may be subject to a national security review process, including investments where no application for review or notification is required, such as non-controlling or minority investments in Canadian businesses. This aspect of Canada's regulation of foreign investments is becoming increasingly significant, with both the frequency and length of national security reviews rising in recent years.

## Pre-Merger Notification and a Unique Defence

The *Competition Act* (Canada) requires pre-notification merger filings when transaction and party-size thresholds are exceeded, in which case a pre-closing waiting period will apply. All acquisitions, whether pre-notifiable or not, are subject to possible sustantive competition review for up to one year following closing. The parties can obtain substantive comfort from the Competition Bureau (in the form of an advance ruling certificate or no-action letter) in respect of a review. Canada has a unique efficiencies defence to allow mergers where the anticipated efficiencies outweigh the anti-competitive harms.

## Forget Everything You Know About Employment

Unlike the U.S., there is no "at-will" employment in Canada. Absent valid contractual provisions limiting an employee's severance entitlements, an employee is entitled to "reasonable notice" of termination or payment in lieu of such notice. This means that, on an asset transaction, employment of non-unionized employees does not transfer automatically. Employees must be offered employment by the acquirer. Severance entitlements for employees tend to be much higher in Canada than in other jurisdictions. The defined-benefit and defined-contribution pension plans that are used by many Canadian employers to supplement the federal Canada Pension Plan are subject to a web of federal and provincial legislation. Relevant to the acquisition of a Canadian business, these rules govern such things as re cognition of an employee's past service and transfers of plan assets.

## Protect Your Intellectual Property in Canada, Too

Canada's patent system is increasingly similar to that of the United States (e.g., there is a one-year grace period to file after public disclosures made by the applicant). Canadian trademark law elevates the importance of licences, requiring written or implied licences (preferably written), even for wholly owned subsidiaries. As of 2019, applicants can file and renew trademarks without requirement of proof of use. There is no "work made for hire" concept in Canadian law, but a similar concept applies for copyright in the employment context. Transfers of copyright ownership must otherwise be in writing. Moral rights are protected more extensively and apply to all types of works, including software. Intellectual property licences that are silent as to assignability or sublicenseability are generally not assignable or sublicenseable without the licensor's consent.

## Death and Taxes...and More Taxes

Normally, foreign buyers of Canadian shares will want to incorporate a Canadian acquisition company that allows for the pushdown of any acquisition financing and the Canadian tax-efficient repatriation of funds up to the purchase price from Canada without Canadian withholding tax. While Canada does not have entities similar to American limited liability companies (LLCs) to use as acquisition vehicles, Canadian unlimited liability companies afford the opportunity for flow-through tax treatment (for U.S. tax purposes) but must be used with caution given the anti-hybrid rules in the Canada-U.S. tax treaty. Transactions in Canada involving the sale of "taxable Canadian property" (generally, Canadian real property interests) can require clearance from the Canada Revenue Agency or a partial holdback of the purchase price. Canadian thin capitalization rules require that debt owing to related non-resident parties not exceed 1.5 times equity. In asset deals, it is also important to consider sales taxes and whether exemptions are available.

## Being Civil, Quebec Is Distinct

The province of Quebec, un like all other Canadian jurisdictions, is governed by a civil law system derived from the *Napoleonic Code*. Its laws can differ dramatically from the rest of Canada and need to be taken into account when acquiring or selling a business with assets or employees there. In addition, Quebec has legislation that protects the use of the French language.

## No Frivolous Litigation Here

While litigation costs in Canada tend to be lower than in the U.S. due to streamlined rules of civil procedure, frivolous litigation is not common in Canada. This may, in part, be a result of Canada's "loser pays" system. The successful party in Canadian litigation is generally awarded at least part of their costs, and damage awards tend to be lower than in the U.S. Also, punitive damages are extremely rare. Jury trials are extremely rare in Canadian civil matters, except for certain limited types of litigation such as libel or personal injury.

## Who Owns What? Tracking Beneficial Ownership

Corporations incorporated under the federal corporate statute and under many provincial corporate statutes are required to collect and retain specified beneficial ownership information in respect of any "individual with significant control" over the corporation. This is part of the Canadian government's push toward improved corporate transparency and the strengthening of the anti-money laundering and tax evasion regimes. The federal government has also committed to further amendments to implement a public and searchable beneficial ownership registry before the end of 2023. It is intended that the public registry, once launched, will be scalable to allow provinces and territories to participate in a national registry.

## About the Blakes Private M&A Group

Blakes has one of the largest and most active M&A practices in Canada. Thanks to our clients, the Blakes Mergers & Acquisitions group continues to receive awards and top rankings, including a top-tier ranking for Corporate/M&A and Corporate/Commercial in the 2023 edition of *Chambers Canada: Canada's Leading Lawyers for Business*.

A distinguishing factor of the Blakes M&A practice is our Private M&A team, dedicated exclusively to private M&A transactions. We advise both private and public companies and business owners on the acquisition and sale of Canadian and international companies and assets. We also advise buyout funds acquiring or selling a business.

Our Private M&A team leads the market in Canada because we have an industry-focused approach and multidisciplinary specialists covering key industries in each Canadian jurisdiction. For our clients, this means a better understanding of their business, strategic objectives and challenges, including in highly regulated areas such as energy, financial services, insurance, life sciences, food and beverage, power, and gaming, among others.

**For further information, please reach out to a member of our Private M&A group or your usual Blakes contact at any time.**