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**DENTONS**

November 15, 2023

# **Five things you need to know about M&A in 2023 and market trends**

Grow | Protect | Operate | Finance

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# Agenda

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Trends in the M&A Market	David Hunter
Shareholder Activism: Contested M&A and Proxy Contests	Jason Saltzman
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United States Outbound Investment Program: Overview and compliance considerations	Jason Silverman

# Trends in the M&A Market

- David Hunter

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# Economic Environment

- Canada's second-quarter GDP contracted for the second time in the past three quarters. Many economists already concede the Canada is in recession.<sup>1</sup>
- Contrast between US and Canadian economies: US Q3 GDP grew at an annualized 4.9%, where growth in Canada flatlined.
- Uncertainty over the length and depth of the anticipated recession; persistent inflation and the resulting rise in interest rates; increasing global instability; and unresolved pandemic supply chain issues, resulting in:
  - increased cost of capital and credit tightening;
  - skittish capital markets; and
  - increased cost and limited availability of capital.

<sup>1</sup> Posthaste: In Canada, the whiff of recession is in the air, Financial Post, 19 September 2023 (<https://financialpost.com/news/canada-recession-may-already-be-here>)

# State of the Market

- Canadian M&A market in 2023 slower than 2022; slowest start since the first half of 2020 in the early days of the COVID-19 pandemic.<sup>2</sup>
- By mid-2023 there were 1,218 deals in Canada with a total value of \$85 billion, down by 17% in terms of volume.
- Total value was up by 10% compared to the first half of 2022, principally due to a few very large deals.<sup>3</sup>
- Early predictions of a bounce back in M&A deal activity from significant decline in 2022 yet to be realized; unfavorable market conditions and pressure on valuations persisted into Q3 of 2023.
- Most active sectors for Canada – US M&A: technology, energy, financial services, and healthcare.

<sup>2</sup> 2023 mid-year Canadian M&A update (<https://www.pwc.com/ca/en/services/deals/trends/mid-year-update.html>)

<sup>3</sup> Ibid footnote 3.

# How to respond?

- Recessions do not hit all sectors equally hard or at the same time; expect buyers to be looking for opportunities in sectors that are not hit as hard and/or rebound more quickly.
- Buyers need to be more prepared and disciplined to secured funding, and in conducting due diligence and risk assessment.
- Potential targets, particularly those facing economic headwinds, need to be on the lookout for an increase in shareholder activism.

# Alternative sources of funding

- Dealmakers pivoting to alternative sources of funding.
- Earn-out, Vendor take-back, sale and leaseback structures.
- Direct support from end users (e.g., an automaker supporting developer of critical EV minerals... Ford Motor's long-term agreement supply agreement with Quebec's Nemaska Lithium.)<sup>4</sup>
- Government funding for critical minerals initiatives for “green economy” projects<sup>5,6</sup>

<sup>4</sup> Nemaska Lithium, 22 May 2023 (<https://nemaskalithium.com/en/ford-and-nemaska-lithium-enter-long-term-lithium-hydroxide-supply-agreement/>)

<sup>5</sup> ISED Government of Canada announces the next projects to be funded by the Mining Innovation Commercialization Accelerator (MICA) Network, 22 June 2022, (<https://www.canada.ca/en/innovation-science-economic-development/news/2023/06/government-of-canada-announces-the-next-projects-to-be-funded-by-the-mining-innovation-commercialization-accelerator-network.html>)

<sup>6</sup> E3 Lithium Ltd., 7 March 2023 (<https://www.e3lithium.ca/newsroom/news-releases/e3-lithium-awarded-35m-in-funding-from--government-of-canada>)



# Flexible deal structures

- Increased use of flexible pricing structures in public deals to address market risk.
- Floating share exchange ratios adjusting the number of shares to be issued based on the market price at closing; couple with a collar imposing upper and/or lower limits.
- A “walk-away” rights based on an agreed upon floor and ceiling for the exchange ratio; deal can be terminated if the market price falls outside of the agreed thresholds.
- Caution: actions to address market volatility create greater closing risk that can bring about increased trading pressure by activist traders.
- Partial purchase structure: buy enough of the target to gain a desired strategic interest without acquiring the target outright.

# Attention to ESG considerations

- Increasing importance of ESG (environmental, social, and corporate governance) considerations; “sustainability sells”.
- ESG factors have changed institutional investors’ decision-making – e.g., banks are factoring ESG issues into their lending decisions, with potential to increase the cost of capital in industries with greater exposure to ESG risk.
- ESG affecting all phases of M&A transaction; assessment of value, due diligence, definitive agreements, and post-closing follow through.
- Attention to ESG issues is carrying over into areas of similar concern; compliance practices, data privacy, sexual/racial discrimination, and cybersecurity.
- Issue specific reps and warranties increasingly appearing in M&A agreements.

# Effective due diligence

- M&A deals tend to be complex and time consuming; risk that the longer it takes to close, the higher the risk of losing value or the entire deal.
- Parties want to close M&A deals more quickly; minimizing risk in an uncertain and volatile market, reduce transaction costs.
- Desire to move quickly needs to be balanced against the need to do more careful due diligence.
- Potential targets can extract value through proactive due diligence preparations - no more disorganized, duplicated, and missing documents.
- Expect to see increasing use of new AI tools to streamline due diligence.<sup>7</sup>
- Increase in purchase of rep and warranty insurance on smaller deals.<sup>8</sup>

<sup>7</sup> Thomson Reuters, Streamline Due Diligence with Document Intelligence, 18 April 2023, (<https://legal.thomsonreuters.com/en/insights/articles/document-intelligence-streamline-m-a-due-diligence-process>)

<sup>8</sup> 2023 SRS Acquiom Inc., 2023 (<https://www.srsacquiom.com/our-insights/rep-warranties-insurance-rwi-fast-facts/>)

# Canadian regulatory environment

- Increasing need to assess implications of Canada's foreign investment and competition laws and policies (timing, feasibility, response to objections) as part of transaction planning.
- Update of *Investment Canada Act* to address evolving national security concerns.
- Expect increasing foreign investment reviews.
- Sectors likely to be impacted include those involving critical minerals and associated supply chains, sensitive technologies (e.g., military, intelligence, AI) and access to sensitive personal data (e.g., healthcare, financial data).
- Recent announcements of proposed amendments to the *Competition Act* in response to concerns market concentration and harm to the public interest in competition:
  - abolishing the efficiencies defence;
  - enhanced information gathering powers to compel production of information in support of market studies; and
  - new rules for restrictive covenants in grocery store leases.

# Shareholder activism: Contested M&A and proxy contests

- Jason Saltzman

# Shareholder activism and contest M&A on the rise in Canada

- After a COVID-19 slump, shareholder activism has significantly picked up
- Over 30 proxy contests have been launched across Canada in 2023
- With valuation gaps, seeing (and hearing) of many more hostile M&A deals

## **Some of the notable issuers targets for hostile bids or shareholder activism include:**

- Magnet Forensics
- Algonquin Power
- Ritchie Bros.
- Tech Resources
- HR REIT
- First Capital

# Trends in contest M&A and proxy contests

## Transactional activism

- Activists challenge a transaction after it has been announced
- Notable examples: Magnet Forensics Ritchie Bros., Canaccord

## Activist swarms

- Multiple shareholders making concurrent, but uncoordinated public demands from issuer
- Challenging to defend as disparate views and objectives
- Notable examples – Richie Bros., First Capital REIT

## ESG based activism

- Sharp increase in ESG based/ESG cloaked activist activity in recent years

# Active/Hostile bidder tactics

## Activists usually have a head start – prior to contact

- Often have engaged legal counsel, proxy advisory firm and financial advisors
- Spoken with other shareholders and acquired a stake in the issuer

## Initial reach out to issuer

- Often a “friendly” reach out that can become more direct and aggressive
- Can lead to a bear-hug letter and/or public statements challenging an announced deal

## More aggressive legal means

- Court and/or stock exchange or securities commissions complaints
- Challenge certain aspects of a deal, such process conflict or disclosure



# Issuer considerations

## Be protective and prepared

- M&A/proxy contest readiness should start long before any action/transaction has commenced
- Know your shareholders, signs a bid may come and rules of the road (relevant laws)

## When announcing a deal

- Robust, independent process – *special committee, separate legal counsel and financial advisors for special committee*
- Consider auction or market check
- Consider all stakeholders and engage with ISS/Glass Lewis if contested

## Defensive strategies if challenge/hostile deal announced

- Engage advisors
- Engage with shareholders
- Challenge or engage with bidder – general best to take the high road
- Find White Knight or other defensive strategy (i.e., rights plan, private placement)

# Key takeaway

## Be prepared

- With challenging markets and valuations, activism and challenged deals are likely to continue
- Be prepared – M&A/proxy contest readiness is a worthwhile investment – will be hard to get up to speed when a contested deal hits

# Cineplex v Cineworld: Lost synergies as M&A damages

- Kimberly Burns
- Matthew Fleming

# Case background

- In *Cineplex v. Cineworld*, 2021 ONSC 8016  
Cineplex (seller) and Cineworld (buyer) agreed to \$2.8 billion share acquisition by plan of arrangement
- As a result of the COVID-19 pandemic, Cineplex closed theatres and Cineworld terminated the agreement arguing it was entitled to do so because Cineplex breached the covenant to operate business in the ordinary course (see [Dentons Business Insights Podcast](#) from November 30.)
- Cineplex alleged breach of contract and claimed “expectation damages” – a party who sustains a loss as a result of breach of contract is entitled to be put in the same position it would have been in had the contract been performed
- Court rejected claim for shareholder loss but awarded damages of \$1.2B for the present value of the loss of synergies Cineplex expected to enjoy as a result of the transaction, based on Cineworld’s own pre-transaction “Synergies Analysis” and expert evidence

# Update and market reaction

## Update

- Appeal in Ontario stayed when USA bankruptcy started,<sup>1</sup> Cineplex announced no anticipated recovery.<sup>2</sup>
- Further litigation uncertain.
- October 31, 2023 decision in [Crispo v. Musk, C. A. 2022-0666-KSJM \(Del. Ch. Oct. 31, 2023\)](#)

## Market Reaction

- Strong and active industry reaction to the decision on MAE and interim covenants.
- Slow and primarily negative reaction to the decision on assessment of damages.
- No visible change in market practice yet.

1. [Cineplex Provides Update on its Claim Against Cineworld \(newswire.ca\)](#)

2. [Cineplex doesn't expect to recoup any material amount of the \\$1.24B owed by Cineworld | CTV News](#)

# How to assess expectation damages

## Synergies or Deal Premium? It's a matter of opinion.

- Industry and academic response is weighted to deal premium / deal value, various excellent resources are available.<sup>3, 4</sup>
- Deal Premium / deal value is a more suitable measure in most cases, and would have been suitable in Cineplex too.
  - Decisions conflate the third party beneficiary issue with the measure of damages choice.
  - Artificial constructs for when shareholders/owners are to be considered as part of the corporation, and when the transacting company is assessed alone, without its owners.
  - Who is the deal really for? Market practice, laws, and court process all push companies to negotiate value based on shareholder premium and deal price.

3. Jonathan Chan and Martin Petrin, Lost Synergies and M&A Damages: Considering *Cineplex v Cineworld*, 2022 100-2 *Canadian Bar Review* 274, 2022 CanLII Docs 3389, <<https://canlii.ca/t/7mz0x>>, retrieved on 2023-11-13

4. Thomas, R. D., & Stair, R. E. (2009). Revisiting "Consolidated Edison"—A Second Look at the Case that Has Many Questioning Traditional Assumptions Regarding the Availability of Shareholder Damages in Public Company Mergers. *The Business Lawyer*, 64(2), 329–357. <http://www.jstor.org/stable/41552793>

# Drafting for expectation damages

What might the market do? (I'm eagerly awaiting)

- **Draft in what you want.**
  - Nothing in Cineplex says that Con-Ed provisions like those in Crispo & Musk<sup>5</sup> won't work.
  - New, challenging, and risky.
- **Do nothing.**
  - An attractive option given the challenges in the market since 2022, the honeymoon effect, and our general preference to delay in cases of uncertainty.
- **Think Ahead.**
  - It's possible all of the 'Do Nothing' deals are doing this.
  - Ensure your deal team is aware of the law and what synergy damages look like for you.

5. [\*Crispo v. Musk\*, C. A. 2022-0666-KSJM \(Del. Ch. Oct. 31, 2023\)](#)

# Thicker Borders: National Security review of foreign investments on the rise

- Sandy Walker



# Increased ICA national security review of foreign investments

- Investment Canada Act (ICA) = foreign investment review law, including national security (NS) review.
- Acquisitions of control and establishment of new Canadian business > require filings; minority investments also subject to NS review but no filing requirement - yet.
- Federal Cabinet can prohibit an investment, authorize it subject to terms and conditions or make an order to remedy the national security concerns arising from an investment that has already occurred (typically a divestiture).
- Marked increase in ICA enforcement: Changed geopolitical landscape, including increased tensions with China, Russia; supply chain vulnerabilities more evident.

# Increased ICA national security review of foreign investments cont'd

- Some stats:
  - In 2022-23 FY, 1,010 filings—all screened for national security by ISED and Canada's national security and intelligence agencies.
  - 32 NS reviews including 22 Cabinet-ordered reviews; compare to 14 average per year in last 5 years.
  - Results for 22 Cabinet-ordered reviews: 10 required no further action under the Act, 8 withdrawn by the investor, 3 divestitures, 1 ongoing.
  - Average review time: 174 days = long time in a transaction timeline.
  - 16/22 Cabinet-ordered reviews from China, 3 from US and 3 from Cyprus, France and Czech Republic.
  - Sectors subject to review: 6 in mining; 7 in computer systems design; 2 scientific R&D

# National Security – Which investors?

## Who is affected?

- All foreign investors establishing new Canadian businesses, acquiring control of or minority interests in Canadian businesses and acquisitions of interests in entities with some connections to Canada.
- **Two considerations in assessing NS risk of a transaction: 1. Investor and 2. Target business sector.**

## What investors?

- Elevated scrutiny and potential prohibitions or restrictions on foreign investment will be focused on investors from “non-likeminded” countries. Think China, Russia, Iran.
- Especially “state-owned enterprises” (SOEs) but also private sector investors judged to be “closely tied to, subject to influence from, or who could be compelled to comply with extrajudicial direction from foreign governments, particularly non-likeminded governments.”
  - Implicates Chinese companies, among others.

# Which targets?

## Which investment targets will receive the most attention?

- Target activities relating to territorial integrity or economic-based security threats. Examples: critical minerals and their supply chains, sensitive technologies e.g., semiconductors, and businesses with access to sensitive personal data.
- **Critical minerals:** building blocks for the green and digital economy, e.g., EV batteries, electric cars, wind turbines and solar panels.
  - October 2022: Government policy statement issued: if an SOE<sup>+</sup> acquires a critical minerals company, national security concerns are substantially amplified.
  - November 2, 2022: three divestitures of minority investments by Chinese entities in public Canadian companies in critical minerals.
- **Sensitive technologies:** military, intelligence or dual military/civilian applications. Multiple fields, including AI, biotechnology, energy generation, storage and transmission and robotics and autonomous systems.
- **Targets with sensitive personal data:** personally identifiable health or genetic; biometric (e.g., fingerprints); financial (e.g., confidential account information, including expenditures and debt); communications; geolocation; or, personal data concerning government officials, including members of the military or intelligence community.

# Recent and proposed changes

Measures to address higher risk investments include:

- Voluntary notification available since August 2022 for non-controlling investments or investments where connection to Canada is more tenuous.
  - Carrot and stick approach: If no objection within 45 days following filing > investor comfort that its investment will not be subject to a national security challenge.
  - If a foreign investor chooses not to make a voluntary filing, the Government challenge for up to five years post-closing.
- Bill C-34 (Third Reading in Parliament): in December 2022, the Government announced it would require pre-closing notifications for certain prescribed business activities. Closing suspended until NS clearance.
  - Ability to impose significant penalties of CA\$500,000 or more for violations.
  - Increase ministerial powers to orders formal national security reviews, to accept undertakings to mitigate risks, and to impose interim conditions during the national security review process > should expedite NS review, avoid binary decision (Yes/No)

# Links

Links related to National Security Review on the Rise

- <https://www.canadaregulatoryreview.com/further-tightening-of-canadas-national-security-review/>
- <https://www.dentons.com/en/insights/newsletters/2023/january/16/global-regulatory-trends-to-watch/dentons-pick-of-canadian-regulatory-trends-to-watch-in-2023/canada-to-batten-down-national-security-hatches>

# United States Outbound Investment Program: Overview and compliance considerations

- Jason Silverman

# Upcoming controls on outbound investment

## Look for new rules and a new program in 2024

- August 9, 2023 Executive Order 14015 (“E.O.”) and August 14, 2023 Advance Notice of Proposed Rulemaking (“ANPRM”)
- E.O. requires Treasury Department to issue rules that will restrict or prohibit **U.S. persons** with respect to investment in a **covered foreign person**
  - **Covered foreign person** means a **person of a country of concern** engaged in **certain activities**
    - **Countries of concern**, currently, are: PRC, Macau, and Hong Kong
    - Covered **activities**, currently, are: sensitive technologies and products in semiconductors, microelectronics, quantum information technology, and artificial intelligence that are critical for military, intelligence, surveillance, or cyber enabled activities of a country of concern.
    - **Person of a country of concern** includes citizens or permanent residents of countries of concern, entities organized in or with a principal place of business of a country of concern, governments of countries of concern, and entities owned by the foregoing.



# Upcoming controls on outbound investment

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  - **U.S. persons** includes citizens, permanent residents, entities organized under the laws of the United States or its states, including foreign branches, and any person in the United States.
  - The relevant **restrictions** or **prohibitions**:
    - Will involve required notification as to certain transactions, and prohibition of others, and include power to nullify or void completed covered transactions after effective date.
    - May require U.S. persons to take steps to prevent foreign persons they control from engaging in transactions and impose related notification requirements.
    - May prohibit U.S. persons from directing transactions by a foreign person that would be prohibited or restricted as to a U.S. person.

# Upcoming controls on outbound investment

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- The ANPRM is not a draft or proposed rule, but identifies the potential scope of the future rules and seeks public comment regarding a range of topics that the Treasury Department is considering as it is drafting those rules. The comment period ended on September 25. Topics and provisions under consideration include:
  - Types of investment that will be covered, including convertible debt financing, greenfield, and JVs
  - How to address indirect transactions (investments through third country entities with knowledge that it will be used for an investment that would otherwise be covered)
  - Excepting certain transactions (publicly traded securities, funds, and *certain* VC/PE funds, subject to certain exclusions)
  - Types of technology covered
  - Including parent entities whose material *subsidiaries* are in a country of concern and engaged in covered activity
  - How the EO’s provisions regarding foreign entities controlled by a U.S. person should be implemented

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# Thank you



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