Goodmans LLP

Canadian Acquisition Financing

Canadians companies were involved in a number of large acquisition financings in 2013, and the six major Canadian banks remain active in this area. There are a number of similarities between Canada and the U.S. in terms of key legal and business issues in acquisition financings. However, the Canadian approach is not always consistent with the U.S. approach, and there are some important market-driven and legal differences that are worth outlining in detail.

Certainty of Funds

Acquisitions of Privately Held Companies

As in the U.S., and particularly in a competitive bidding situation, buyers usually cannot include a meaningful financing condition in the underlying purchase agreement. Consequently, buyers seek to minimize the conditions in their financing commitments and ensure that their financing will not fall through in the period between signing and closing, causing them to breach the purchase agreement. For acquisitions of private companies, there is no Canadian statutory requirement for certainty of funds comparable to the public company requirements discussed below. Further, Canadian law-governed financing commitment papers tend to be less detailed and precedent-driven than their U.S. counterparts, in part because the Canadian lending market is narrower and more relationship-driven than in the U.S. However, certain types of provisions could be added to Canadian financing commitment papers and may go some way towards achieving certainty as follows:

- *Limiting Funding Representations and Warranties:* Buyers may seek to limit the representations and warranties that are financing conditions to certain "Specified Representations". Common Specified Representations would be key corporate representations as they relate to the borrower (i.e., existence, power and authority, due authorization, enforceability of loan documents and solvency) plus representations and warranties that relate to the target and mirror those in the purchase agreement, but only if they are material to the lenders and would allow the buyer to terminate the purchase agreement if untrue.
- "*Material Adverse Effect*" - *Target*: Buyers may try to align any "no Material Adverse Effect" condition in the financing commitment to the comparable definition in the purchase agreement and restrict it to the target alone, particularly if the purchase agreement definition excludes market-wide events beyond the borrower's control.
- "*Material Adverse Effect*" - *Borrower*: Buyers, particularly corporate buyers, may resist a standard "no Material Adverse Effect" condition precedent that could result in changes in their own businesses (unrelated to the target) causing the financing to fail.

Buyers are not always successful in negotiating the inclusion of these types of protections in commitment papers in Canada. While it may not be the same as legal protection, Canadian banks may be sensitive to the reputational risk associated with failing to fund a large acquisition when the buyer and seller are otherwise ready to close. In practice, buyers with long-standing banking relationships may factor this into their negotiations.

Public Take-Over Bids

Canadian securities law statutes impose a requirement for "certainty of funds" before commencing a take-over bid for a Canadian public company beyond what would be required in the U.S. The Canadian requirements are not as formal as in other jurisdictions (such as in the UK), but do require that the offeror has made "adequate arrangements" to ensure that funds are available to make payment in full of the cash component under a bid when required.

If the bid is being financed through third party financing arrangements, the offeror will generally satisfy the "adequate arrangements" test only if, at the time the take-over bid is commenced, the offeror reasonably believes it to be a remote possibility that a financing condition will not be satisfied once the conditions to the bid are satisfied or waived. This does not require an offeror to execute a definitive credit agreement with its lenders before commencing a bid and it has been the norm in Canada to commence take-over bids on the basis of binding commitment papers that contain customary conditions. Difficulties sometimes arise because it is not always clear what kind of conditions can be included in the commitment papers within the context of the "adequate arrangements" requirement. Conditions that have been generally permissible are ones that mirror those in favour of the offeror contained in the take-over bid itself or are reasonably easy to satisfy and within the offeror's control (such as completion of a mutually acceptable credit agreement). Conversely, conditions that are largely unworkable in this context are discretionary ones such as "satisfactory due diligence by the lenders" or "satisfaction by the lenders with the capitalization, structure and equity ownership of the target after completion of the transaction". While the objective of the offeror is to try to align all of the conditions in the commitment papers with those in the bid, this objective is not always achievable and there are a number of conditions that are the subject of negotiation between the offeror and its lenders (i.e., no "material adverse change" relating to the offeror).

Market Flex and Syndication

For large acquisition financings being committed to by lenders on a fully-underwritten basis with an intention to syndicate after signing the commitment, "market flex" provisions are commonly added to the commitment papers. These provisions are often the focus of negotiations. Borrowers want to minimize lenders' rights to unilaterally change the credit terms after signing the commitment, whereas lenders want to preserve their ability to change terms to achieve a successful syndication. A key difference in these negotiations in Canada (as compared to the U.S.) results from the fact that there are less syndication options within Canada for lenders. Accordingly, for a borrower that is perceived to be a weaker credit or for very large financings, lenders may negotiate for an ability to change terms to actually replace a Canadian facility with a U.S. "term loan B" financing option and/or a U.S. note offering, if they run out of syndication options in Canada. These flex options will be resisted by borrowers, with varying degrees of success depending on the size of the underwriting and the perceived syndication risk to the lenders who are providing the fully-underwritten commitment.

Currency Considerations

Buyers in Canada often finance the equity and/or debt component of an acquisition with U.S. dollars for a variety of reasons, including the broader lending market in the U.S. and the physical presence of the buyer's equity sponsors in the U.S. This does not create any issues when the acquisition price is denominated in U.S. dollars and the target generates revenue in U.S. dollars. However, where the acquisition price is in Canadian dollars and/or the target's revenues (i.e., the source of repayment) are in Canadian dollars, there is potential for currency fluctuation issues, particularly given the volatility of the Canadian dollar in recent years.

Effective hedging can eliminate this currency risk, although at a cost to the buyer. For instance, one option to minimize currency risk between signing and closing is a "deal-contingent hedging strategy", which is typically used for equity investments and involves the buyer agreeing to purchase Canadian dollars at a fixed exchange rate conditional on closing of the acquisition. This option can work well where there is some certainty on the likelihood and timing of closing. However, as with all currency hedging, the incremental cost and availability should be assessed early to avoid last-minute surprises.

Perfection of Security

Perfection of security in personal property in Canada is governed by different (and potentially more cumbersome) rules than under the *Uniform Commercial Code*. Canada does not have a uniform personal property regime from province to province, and operates under a system where locations of assets and operations is still relevant. The Province of Quebec in particular has a separate and distinct regime for perfection of security that is almost entirely different from the other provinces. This can result in the need to involve multiple sets of counsel in different provinces to ensure perfection of security, and can increase the complexity of the documentation required for an acquisition financing, particularly if the target business has assets spread across Canada.

Goodmans' Banking and Finance Group

The Banking and Finance Group has been involved in many of the largest private equity financings and corporate acquisition financings in recent years in Canada, representing lenders, private equity firms, and local and foreign corporate borrowers.

Goodmans banking practitioners work closely with the firm's top-rated Corporate/M&A Private Equity Group, and together, have developed relationships with some of the leading private equity firms and major lending institutions both inside and outside of Canada.

About Goodmans

Goodmans is internationally recognized as one of Canada's pre-eminent business law firms with market-leading expertise in M&A, corporate and transaction finance, private equity, real estate, tax, restructuring, litigation and other business-related specialities.

The firm represents a broad range of Canadian and foreign clients, from entrepreneurial businesses to multinational corporations, financial institutions, pension funds and governments and has a reputation for handling challenging problems, often international in scope, that demand creative solutions.

At Goodmans, our lawyers excel in their fields to help our clients excel in theirs - ensuring exceptional levels of service and business success. We deliver intelligent results, responsiveness, energy, talent and determination to get the deal done.

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