

SECURITIES BULLETIN

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M&A DEVELOPMENTS IN CANADA IN 2007

The following is a brief review of M&A developments in Canada in 2007.

INTRODUCTION

M&A activity in Canada is regulated under:

- *Corporate Laws.* Canadian corporations may be incorporated under the federal Canada Business Corporations Act or one of the similar provincial or territorial business corporations acts. These statutes regulate a variety of ordinary and extraordinary (eg, statutory amalgamations and plans of arrangement) corporate transactions. Extraordinary corporate transactions must be approved by a special resolution of shareholders (typically two-thirds of the votes cast). Shareholders generally have the right to dissent from extraordinary corporate transactions and demand payment of the “fair value” of their shares (as determined by a court if necessary). Canadian courts have broad remedial powers under these statutes to intervene in respect of transactions that are oppressive or unfairly prejudicial to, or that unfairly disregard the interests of, shareholders.
- *Securities Laws.* Securities regulation in Canada is the responsibility of the provinces and territories. Each province and territory has its own legislation and securities regulatory authority that regulates, among other things, take-over bids. The Provinces of Ontario and Quebec have additional rules (including approval by a majority of the minority shareholders and independent valuation of the subject matter of the transaction) designed to ensure fair treatment of minority shareholders in connection with certain types of transactions involving a corporation and its “related parties” (which include shareholders owning 10% or more of the voting securities of the corporation).

The provincial and territorial securities regulatory authorities coordinate their activities through the Canadian Securities Administrators (CSA), a forum for developing a harmonized approach to securities regulation across the country. The CSA has developed a system of mutual reliance pursuant to which one securities regulatory authority acts as the lead authority for reviewing regulatory filings of “reporting issuers”.

The Ontario Securities Commission (OSC) is generally regarded as the lead securities regulatory authority in Canada.

- *Stock Exchange Rules.* The two principal stock exchanges in Canada are the Toronto Stock Exchange (TSX) (senior market) and the TSX Venture Exchange (junior market). These exchanges regulate selected aspects of M&A activity.
- *Competition Law.* The Canada Competition Act confers upon the Commissioner of Competition and the Competition Tribunal the ability to review mergers to determine whether they will or are likely to prevent or lessen competition substantially. Mandatory pre-merger notification of certain large mergers is also required.
- *Investment Canada Act and foreign ownership restrictions.* Transactions involving the acquisition by a non-Canadian of “control” of a Canadian business with assets that exceed prescribed monetary thresholds are reviewable under the Investment Canada Act and subject to approval by the federal Minister of Industry or, in the case of a cultural business, the federal Minister of Canadian Heritage. Other Canadian statutes limit foreign ownership in specified industries (eg, financial services, broadcasting and communications).

M&A ACTIVITY AND TRENDS

M&A activity remained strong in 2007 (in spite of credit concerns which emerged during the second half of the year), buoyed by a strong Canadian economy, low interest rates, high energy and commodity prices and continued cross-border activity. Based on industry information, the number of completed deals exceeded 2,000 for the first time (2,098 transactions were completed with an aggregate deal value of U.S.\$270 billion).

M&A trends in 2007 included: involvement by private equity funds, Chinese participation, large cross-border transactions, increased willingness of acquirors to launch hostile and competing bids, increased institutional shareholder activism and growing recognition of national security interests.

M&A DEVELOPMENTS

There were several significant M&A court and regulatory decisions in 2007.

Standstill Agreements - Sunrise REIT and Osprey Decisions

Ventas, Inc. v. Sunrise Senior Living Real Estate Investment Trust (Sunrise REIT Decision)

In its Sunrise REIT decision, the Ontario Court of Appeal upheld a lower court decision that required Sunrise Senior Living Real Estate Investment Trust (Sunrise REIT) to perform the covenant given by it in its purchase agreement with Ventas, Inc. (Ventas) to enforce existing confidentiality agreements, including those entered into by losing bidders in an auction process carried out by Sunrise REIT.

Background

In September 2006, Sunrise REIT commenced a two-stage, targeted auction process.

In the first stage of the process, potential bidders were required to enter into confidentiality agreements with Sunrise REIT that contained a standstill covenant (ie, a covenant undertaking not to make an unsolicited take-over bid for Sunrise REIT) and were invited to submit non-binding bid proposals. In the second stage of the process, some of the potential bidders which participated in the first stage were permitted to carry out further due diligence and were invited to submit final bid proposals.

Two rival bidders emerged after completion of the first stage of the process: Ventas and Health Care Property Investors, Inc. (HCP), each of whom had entered into a confidentiality agreement with Sunrise REIT. The two confidentiality agreements were similar, except that the standstill covenant in the Ventas confidentiality agreement ceased to apply if Sunrise REIT entered into an agreement to sell more than 20% of its units or assets to a third party whereas the standstill covenant in the HCP confidentiality agreement did not.

Only Ventas submitted a final bid proposal.

In January 2007, Ventas and Sunrise REIT entered into a purchase agreement pursuant to which Ventas agreed to acquire all of the units of Sunrise REIT at a price of C\$15 per unit. The transaction was subject to the approval of the unitholders of Sunrise REIT. The purchase agreement contained provisions which restricted Sunrise REIT from soliciting alternative proposals (“no shop” provisions) and required Sunrise REIT to enforce existing confidentiality agreements, including those entered into by losing bidders (“enforcement” provisions) and provisions which permitted the trustees of Sunrise REIT to respond to and accept superior alternative proposals in specified circumstances (“fiduciary out” provisions). Unlike the “no shop” provisions, the “enforcement” provisions were not expressly qualified by reference to the “fiduciary out” provisions.

In February 2007, HCP submitted a bid proposal to the trustees of Sunrise REIT offering to acquire all of the units of Sunrise REIT on the same terms as had been agreed to by Ventas except that the price was C\$18 per unit. Shortly thereafter, Sunrise REIT applied to the Ontario Superior Court of Justice for a ruling on whether, under the purchase

agreement, it was permitted to consider the HCP bid proposal. This application was followed by a separate application by Ventas for a declaration that Sunrise REIT was required to perform the “enforcement” provisions of the purchase agreement.

Court Decisions

In early March 2007, the Superior Court ruled that Sunrise REIT was required to perform the “enforcement” provisions of the purchase agreement and could not consider the HCP bid proposal. In its decision, the Superior Court:

- 1) accepted Ventas’ argument that the “enforcement” provisions were a negotiated and reasonable form of deal protection and one of the benefits of having won the auction process initiated by Sunrise REIT;
- 2) ruled that, because HCP had breached its confidentiality agreement, the HCP bid proposal did not constitute a “bona fide unsolicited acquisition proposal” which the trustees of Sunrise REIT could consider pursuant to the “fiduciary out” provisions of the merger agreement; and
- 3) noted that the parties were sophisticated and had experienced advisors and that, if Sunrise REIT had intended to prevent the “enforcement” provisions from interfering with the “fiduciary out” provisions, it should have so provided.

The Superior Court decision was appealed to the Ontario Court of Appeal. In late March 2007, the Court of Appeal upheld the Superior Court decision. In its decision, the Court of Appeal:

- 1) noted that, although the “fiduciary out” provisions only permitted Sunrise REIT to consider superior offers from parties who had not bound themselves to a standstill covenant as part of the auction process or who had not been part of the auction process, this was not inconsistent with the Sunrise REIT trustees’ fiduciary obligations to maximize unitholder value; and
- 2) commented that it was “not necessary – nor would it be wise” to adopt in Canada “the principle gleaned from some American authorities that a target can place no limits on the directors’ right to consider superior offers and that any provision to the contrary is invalid and unenforceable” and added that the Sunrise REIT trustees had:

“... not contract[ed] away their fiduciary obligations. Rather, they complied with them by setting up an auction process ... that was designed to maximize the unit price obtained for Sunrise REIT’s assets ... by requiring bidders to come up with their best price in the second round subject to a fiduciary out clause that allowed [the trustees] to consider superior offers from anyone save those who had bound themselves by a Standstill Agreement in the auction process not to make such a bid.”

After the Court of Appeal rendered its decision, in response to unitholder pressure, Ventas increased its offer price to C\$16.50 per unit and completed its acquisition of Sunrise REIT.

Quebecor Media Inc. v Osprey Media Income Fund (Osprey Media Decision)

In the Osprey Media decision, the Ontario Superior Court of Justice distinguished the facts before it from those before the same court in the Sunrise REIT decision and refused to prevent Osprey Media Income Fund (Osprey) from considering and accepting a superior proposal from Black Press Ltd. (Black Press).

Background

In March 2007, Osprey announced that it had initiated a strategic review process to identify and consider strategic alternatives. As part of that process, interested parties were required to execute confidentiality agreements. Quebecor Media Inc. (QMI), Torstar Corporation (Torstar) and Black Press and others entered into confidentiality agreements with Osprey, all of which contained a standstill covenant. Unlike the Sunrise REIT situation, however, the standstill covenants contained “springs” which provided that the standstill covenant would cease to apply upon a public announcement of

“an offer from a third party not affiliated, or acting jointly or in concert, with [the interested party] to acquire” 20% or more of Osprey’s outstanding securities or all or substantially all of Osprey’s assets.

Black Press is owned by the Black family (81%) and Torstar (19%). Under the terms of a shareholders agreement between the Black family and Torstar, Torstar has agreed that it will not compete against Black Press in Western Canada and Black Press has agreed that it will not compete against Torstar in Ontario.

QMI and Torstar each submitted bid proposals. Black Press did not.

The trustees of Osprey determined that the QMI bid proposal was superior and, in late May 2007, entered into an acquisition agreement with QMI pursuant to which QMI agreed to make a take-over bid for all of the Osprey units at a price of C\$7.25 per unit.

In June 2007, Black Press submitted a bid proposal to the trustees of Osprey offering to acquire all of the units of Osprey at a price of C\$8.25 per unit. Prior to submitting its bid proposal, Black Press obtained the consent of Torstar required under the terms of the shareholders agreement.

In late June 2007, the trustees of Osprey determined that the Black Press proposal was superior to the QMI offer contained in the acquisition agreement. This determination started a five business day period during which QMI had the right to match the Black Press bid proposal. The next day, QMI applied to the Ontario Superior Court of Justice for an order preventing Osprey from dealing with or entering into definitive agreements with Black Press.

Court Decision

In early July 2007, the Superior Court dismissed QMI’s application. In its decision, the Superior Court:

- 1) noted that the Osprey facts were different from the Sunrise REIT facts in several important ways:
 - (a) the HCP confidentiality agreement did not have a “spring” provision like the Black Press confidentiality agreement; and
 - (b) the Osprey acquisition agreement did not contain “enforcement” provisions like the Sunrise REIT purchase agreement;
- 2) concluded that QMI had not negotiated for and was not entitled to protection against its competitors in the auction process; and
- 3) noted that:

“The intent of the parties was that Osprey would be unencumbered in entering a second round of bidding once the QMI offer was accepted. It was for this reason that QMI negotiated for, and received entitlement to, the enormous termination fee of C\$15 million.”

The Superior Court did not provide any support for its conclusion that the termination fee was “enormous”. The equity value of the QMI offer was C\$355.5 million.

After the Superior Court decision, QMI increased its offer price to C\$8.45 per unit and completed its acquisition of Osprey.

Observations with respect to the Sunrise REIT and Osprey Decisions

We have the following observations with respect to the Sunrise REIT and Osprey decisions:

- 1) Before commencing an auction process, targets should consider whether standstill covenants should cease to apply once a transaction is announced between target and one of the parties to an auction process. They should also use their best efforts to ensure that all confidentiality agreements entered into by potential acquirors are consistent.

- 2) Potential acquirors should consider whether they will require a “spring” in their confidentiality agreements before agreeing to participate in an auction process. As an alternative to a “spring” (which a target may not be prepared to give in competitive bidding situations), potential acquirors should insist that their confidentiality agreements contain “most favoured nations” clauses (ie, a clause that would give them the same favourable treatment given to others involved in the auction process).
- 3) Targets should ensure that the “fiduciary out” provisions are explicit if they are intended to permit auction participants to make competing bids notwithstanding any standstill covenant in their confidentiality agreements.
- 4) Before agreeing to contractual provisions similar to those contained in the Sunrise REIT purchase agreement, trustees/directors will need to demonstrate that those contractual provisions were part of a deliberate process or negotiation that was designed to ensure that they received the highest and best price.

Disclosure – AiT Decision

Secondary Market Liability

Effective January 2006, Ontario amended the Ontario Securities Act to provide that persons who buy or sell securities of a public company that has a real and substantial connection with Ontario when the public company’s continuous disclosure record is incorrect or incomplete will, depending on the circumstances, have a right of action for damages against, among others, the directors of the public company.

As a result of these amendments, directors of public company targets considering or carrying out an auction/sale process are required to consider whether and when they should disclose negotiations, particularly in circumstances where the target has entered into a non-binding letter of intent as part of the negotiations. A recent decision of the OSC on January 14, 2008 in the matter of AiT Advanced Information Technologies Corporation (AiT) has helped clarify the situation by supporting the established practice of disclosing transactions only upon the signing of a binding agreement between the acquiror and the target (subject to prior disclosure should unusual trading activity occur as a result of leaks).

Background

In February 2002, AiT and 3M Company (3M) commenced discussions with respect to a possible acquisition of AiT by 3M. After initial discussions, 3M indicated to AiT that it was prepared to consider acquiring AiT at a specified price.

At a meeting held on April 25, 2002, the AiT board allegedly approved the price put forward by 3M and decided, subject to receiving an acceptable fairness opinion and being satisfied with all of the other elements of the transaction, to recommend the transaction to its shareholders. The next day, AiT and 3M signed a non-binding letter of intent which contained “no shop”, “exclusivity” and “fiduciary out” provisions and was subject to customary conditions, including 3M being satisfied with its due diligence and the parties negotiating and entering into a definitive acquisition agreement.

On May 9, 2002, after having received enquiries from the TSX with respect to unusual trading in its shares, AiT issued a press release stating that it was exploring strategic alternatives but did not mention its negotiations with 3M or the price which its board had allegedly approved and recommended the transaction. After completion of 3M’s due diligence and further negotiations, the AiT board received a fairness opinion from its financial advisor, and on May 23, 2002 the parties executed a definitive agreement and issued a press release announcing the transaction.

In February 2007, the OSC commenced proceedings against AiT, its chief executive officer and one of its directors. In its submissions, OSC staff alleged that a “material change” in the business, operations or capital of AiT had occurred during the “relevant period” (ie, the period immediately after the April 25, 2002 board meeting and the subsequent period up to May 9, 2002) as a result of the AiT board meeting of April 25, 2002, the negotiation and signing of the letter of intent on April 26, 2002, the ongoing discussions between 3M and AiT and the completion of the on-site due diligence review undertaken by 3M on May 7, 2002 to May 9, 2002.

AiT Decision

In its decision, the OSC concluded that there had not been a material change in the business and operations of AiT before AiT and 3M signed the definitive acquisition agreement and that AiT was not required to disclose the fact or status of its negotiations with 3M before that time. In its decision, the OSC:

- 1) confirmed that the assessment of whether a material change has occurred depends on the facts and circumstances of each situation (ie, there is no “bright-line” test for such determination) and that, where a transaction is speculative, contingent and surrounded by uncertainties, a commitment from one party to proceed with a transaction is not sufficient to constitute a material change;
- 2) concluded that:

“In our view, in the context of whether a board decision constitutes a material change, [a target’s] disclosure obligations arise not when a potential transaction is identified and discussed with the board, but instead, when the decision by the board to implement the potential transaction is based on its understanding of a sufficient commitment from the parties to proceed and the substantial likelihood that the transaction will be completed.”;
- 3) disagreed with OSC staff’s allegation that the AiT board had made a decision to implement the transaction at its April 25, 2002 board meeting, stating that there was insufficient evidence available at that time to determine that:
 - (a) 3M was committed to proceed with a transaction; and
 - (b) there was a substantial likelihood that the transaction being discussed would be completed; and
- (4) determined that the signing of the letter of intent did not constitute a material change in the business and operations of AiT because the letter of intent was non-binding and did not contain a firm commitment on price, the “no shop” and “exclusivity” provisions were granted as an inducement to 3M to continue its evaluation of a potential transaction and most of the conditions necessary to be satisfied before 3M would commit to the transaction were beyond the ability of AiT to resolve.

The foregoing provides only an overview. Readers are cautioned against making any decisions based on this material alone. Rather, a qualified lawyer should be consulted.

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