# In conversation with:

## Norie Campbell

**What past roles have you had within TD or outside of TD? Tell us about your career path.**

I guess you could say that my career started taking shape during law school, when I worked for the member of provincial parliament from my home riding. Working in politics is a really terrific way to start because there are amazing opportunities for young people just starting to figure out the world.

> Working in politics is a really terrific way to start because there are amazing opportunities for young people just starting to figure out the world.

Before joining TD, I trained as a lawyer in the business group at McCarthy Tetrault. I moved to the Bank at a very exciting time – following the Canada Trust acquisition. I have had a number of really interesting roles in our Legal department. I started out representing the Bank as a public company – our share issuances to the public, our disclosures to the market and working with our Board. With the implementation of Sarbanes-Oxley, I did a lot of work in corporate governance and we created the reputational risk policy for structured products. In 2004 and 2005, I had the amazing experience of being Ed's special assistant.

So many exciting things happened at TD in those years – we started our

U.S. expansion with the acquisition of Banknorth, launched the leadership profile and developed our diversity initiative. It was an amazing experience to see it all unfold. Then I went back to the Legal Department supporting business partners like Corporate Development. In the fall of 2011, I was appointed General Counsel and in April 2013 I became a Group Head.

**What was the best advice you ever received?**

I've picked up a few good lessons in my career and in my personal life (many of which apply to work as well). Here are some of my favourites:

- Don't tell me the dog ate your homework – I learned this one while working for Ed. This really aligns with the TD Leadership principle of making an impact. Once you have the respect piece down, the thing that really matters at TD is if you can get things done. Performing really does matter and so do results.

- No one cares more about your career than you do and believe in what others see in you. These may seem contradictory in nature, but I learned them at the same time, and to me they are related. If you wait for someone else to figure it out for you, you could be waiting a long time – in the context of what you want to be and how you will get there.

  That said, listen to what the people you trust say you're capable of, and take their word for it. Don't undermine yourself by setting too low expectations.

**What can our TD pipeline women do to prepare for the next level (can you 'demystify' what is involved with advancing)?**

My advice would be to learn how to get constructive feedback, which involves three things: focusing on your receptivity, engaging people to provide feedback, and taking it up a notch to be a "super sleuth" to get the feedback that matters.

Let's start with receptivity. The absolute key to feedback is that you have to want it. And I don't mean feedback about how great you are; you genuinely have to want to know what people perceive to be your weaknesses. And when you hear it, you can't be defensive. You can disagree, but the fastest way to get someone to clam up is to push back. And it doesn't really matter if it's true at this stage because you're looking for the person's perception.

> "You should always treat feedback like a wonderful gift – busy people will only give constructive feedback because you are worth the effort, they care about you, they believe you can change and get better."

You should always treat feedback like a wonderful gift – busy people will only give constructive feedback because you are worth the effort, they care about you, they believe you can change and get better – it is an endorsement and a vote of confidence.

So now that you're ready to receive, how do you get someone to give feedback? First off, you should target people whose feedback matters to you, who know enough about you for it to be valuable, and who are going to feel like it's worth their while.

Ask specific questions; point out areas you think are your weaknesses; demonstrate your receptivity. Remember, human nature is what it is and people generally don't want to tell you anything that could upset you. You need to create an environment that makes people comfortable enough to give you feedback.

So now how do you to take it up a notch and be a "super sleuth"? Think about the feedback you're getting. Do you always hear that 'you are so detail oriented,' 'you never let a ball drop' or 'you always dot the i's and cross the t's'? Then think about the roles you want to have and if those are the desirable skills? Should you also be hearing things like 'you never miss the big picture' or 'you are a strategic thinker' too? If you think about my core assumption that people want to focus on the positive and don't want to upset you, you should be taking a more active role in listening by saying things like:

- I'm really glad you think I'm detail oriented but sometimes I notice people like that can lose sight of the big picture
- Sounds like I have that skill nailed – what should I work on next, any suggestions?
- Clearly details are important; what else do you think is important?

Listen for themes. If you hear something enough times from enough people, it's worth examining. And watch for cues – sometimes people use humour to subtly express an important view. You should also ask for feedback from the people that are in the roles you want. What are their skills and how do you measure up?

If you wait for someone to tell you what you need to change, or if you believe 'no news is good news' and keep your head down, or if you consistently get terrific feedback (but the exact same feedback every year) then you're likely not developing the skills you need for your next role.

So… be a little suspicious of all good feedback, create a comfortable environment, and try to augment what you are hearing with your own thoughtful insights. And remember, feedback goes both ways. If you're responsible for the development of others, give them the gift of honest feedback. It's just another way to say you believe in them.

**If you didn't become a lawyer, what would you have been?**

I would have been the kindergarten teacher my mom always wished for.

**If you could invite one well-known person to your house for dinner, whom would it be?**

I would invite the parents of our TDCT Scholarship Winners (to get their amazing tips!).

# TD Bank Group Investor Presentation

Q3 2016

# Caution regarding forward-looking statements

From time to time, the Bank (as defined in this document) makes written and/or oral forward-looking statements, including in this document, in other filings with Canadian regulators or the United States (U.S.) Securities and Exchange Commission (SEC), and in other communications. In addition, representatives of the Bank may make forward-looking statements orally to analysts, investors, the media and others. All such statements are made pursuant to the "safe harbour" provisions of, and are intended to be forward-looking statements under, applicable Canadian and U.S. securities legislation, including the U.S. Private Securities Litigation Reform Act of 1995. Forward-looking statements include, but are not limited to, statements made in this document, the Management's Discussion and Analysis ("2015 MD&A") in the Bank's 2015 Annual Report under the heading "Economic Summary and Outlook", for each business segment under headings "Business Outlook and Focus for 2016", and in other statements regarding the Bank's objectives and priorities for 2016 and beyond and strategies to achieve them, the regulatory environment in which the Bank operates, and the Bank's anticipated financial performance. Forward-looking statements are typically identified by words such as "will", "should", "believe", "expect", "anticipate", "intend", "estimate", "plan", "may", and "could".

By their very nature, these forward-looking statements require the Bank to make assumptions and are subject to inherent risks and uncertainties, general and specific. Especially in light of the uncertainty related to the physical, financial, economic, political, and regulatory environments, such risks and uncertainties – many of which are beyond the Bank's control and the effects of which can be difficult to predict – may cause actual results to differ materially from the expectations expressed in the forward-looking statements. Risk factors that could cause, individually or in the aggregate, such differences include: credit, market (including equity, commodity, foreign exchange, and interest rate), liquidity, operational (including technology and infrastructure), reputational, insurance, strategic, regulatory, legal, environmental, capital adequacy, and other risks. Examples of such risk factors include the general business and economic conditions in the regions in which the Bank operates; the ability of the Bank to execute on key priorities, including the successful completion of acquisitions, business retention, and strategic plans and to attract, develop and retain key executives; disruptions in or attacks (including cyber-attacks) on the Bank's information technology, internet, network access or other voice or data communications systems or services; the evolution of various types of fraud or other criminal behaviour to which the Bank is exposed; the failure of third parties to comply with their obligations to the Bank or its affiliates, including relating to the care and control of information; the impact of new and changes to, or application of, current laws and regulations, including without limitation tax laws, risk-based capital guidelines and liquidity regulatory guidance; the overall difficult litigation environment, including in the U.S.; increased competition, including through internet and mobile banking and non-traditional competitors; changes to the Bank's credit ratings; changes in currency and interest rates (including the possibility of negative interest rates); increased funding costs and market volatility due to market illiquidity and competition for funding; critical accounting estimates and changes to accounting standards, policies, and methods used by the Bank; existing and potential international debt crises; and the occurrence of natural and unnatural catastrophic events and claims resulting from such events. The Bank cautions that the preceding list is not exhaustive of all possible risk factors and other factors could also adversely affect the Bank's results. For more detailed information, please refer to the "Risk Factors and Management" section of the 2015 MD&A, as may be updated in subsequently filed quarterly reports to shareholders and news releases (as applicable) related to any transactions or events discussed under the heading "Significant Events" in the relevant MD&A, which applicable releases may be found on www.td.com. All such factors should be considered carefully, as well as other uncertainties and potential events, and the inherent uncertainty of forward-looking statements, when making decisions with respect to the Bank and the Bank cautions readers not to place undue reliance on the Bank's forward-looking statements.

Material economic assumptions underlying the forward-looking statements contained in this document are set out in the 2015 MD&A under the headings "Economic Summary and Outlook", and for each business segment, "Business Outlook and Focus for 2016", each as may be updated in subsequently filed quarterly reports to shareholders.

Any forward-looking statements contained in this document represent the views of management only as of the date hereof and are presented for the purpose of assisting the Bank's shareholders and analysts in understanding the Bank's financial position, objectives and priorities and anticipated financial performance as at and for the periods ended on the dates presented, and may not be appropriate for other purposes. The Bank does not undertake to update any forward-looking statements, whether written or oral, that may be made from time to time by or on its behalf, except as required under applicable securities legislation.

# TD Bank Group – Key Themes

| | | |
|---|---|---|
| 1 | Top 10 North American Bank | *6th largest bank by Total Assets[1]* *6th largest bank by Market Cap[1]* |
| 2 | Proven Performance | *Delivering **top tier** long term shareholder returns* |
| 3 | Strong Balance Sheet and Capital Position | *Highly rated by major credit rating agencies* |
| 4 | Focus on Growth Opportunities | *Targeting 7-10% adjusted EPS growth over the medium term[2]* |

1. See slide 6.
2. See slide 4, footnote 3, for definition of adjusted results.

# TD Snapshot

## Our Businesses

### Canadian Retail

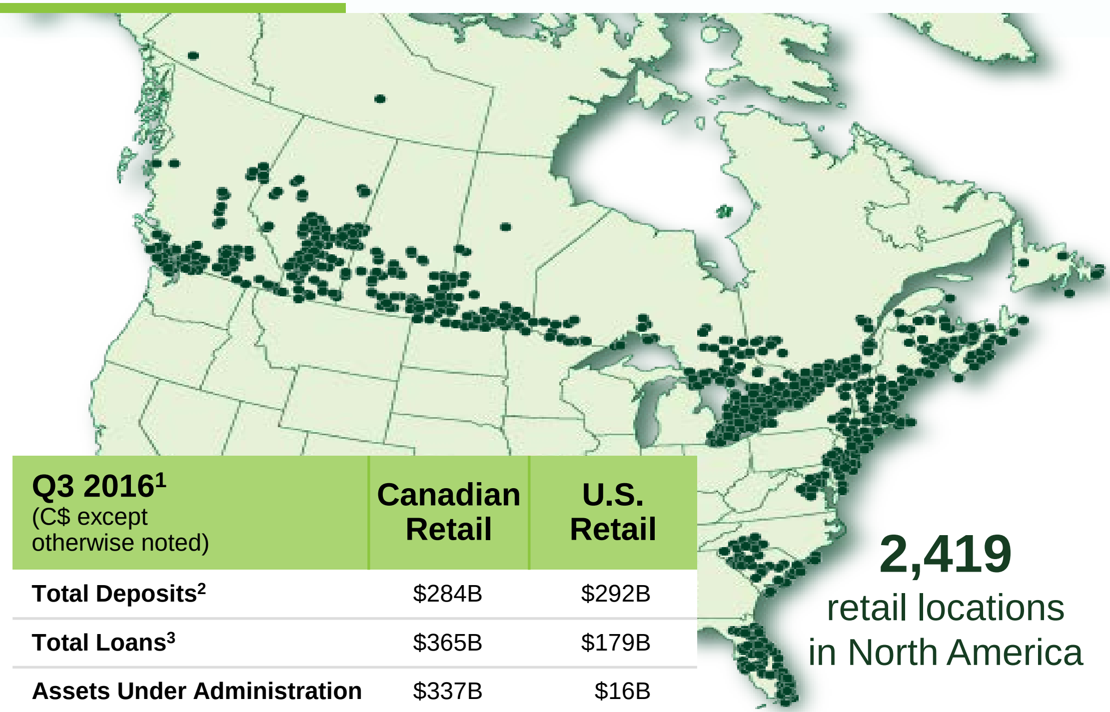
- Personal banking, credit cards and auto finance
- Small business and commercial banking
- Direct investing, advice-based wealth businesses, and asset management
- Property, casualty, life and health insurance

### U.S. Retail

- Personal banking, credit cards and auto finance
- Small business and commercial banking
- Corporate and specialty banking
- Wealth private client services
- Strategic relationship with TD Ameritrade

### Wholesale Banking

- Research, investment banking and capital market services
- Global transaction banking
- Presence in key global financial centres including New York, London and Singapore



| Q3 2016[1] (C$ except otherwise noted) | Canadian Retail | U.S. Retail |
|---|---|---|
| **Total Deposits[2]** | $284B | $292B |
| **Total Loans[3]** | $365B | $179B |
| **Assets Under Administration** | $337B | $16B |
| **Assets Under Management** | $265B | $93B |
| **Reported Earnings[4]** | $6.0B | $2.9B |
| **Adjusted Earnings[4]** | $6.0B | $2.9B |
| **Customers** | ~13MM | ~9MM |
| **Employees[5]** | 38,852 | 25,998 |

**2,419**
retail locations in North America

**TD is a Top 10 North American bank[6]**

1. Q3/16 is the period from May 1 to July 31, 2016.
2. Total Deposits based on total of average personal and business deposits during Q3/16. U.S. Retail deposits include TD Ameritrade Insured Deposit Accounts (IDAs), Canadian Retail deposits include personal, business and wealth deposits.
3. Total Loans based on total of average personal and business loans during Q3/16.
4. For trailing four quarters ended Q3/16. See slide 6, footnote 3 for definition of adjusted results.
5. Average number of full-time equivalent staff in these segments during Q3/16.
6. See slide 6.

# TD Strategy

## To be the Better Bank

### North America

- Top 10 Bank in North America[1]
- One of only a few banks globally to be rated Aa1 by Moody's[2]
- Leverage platform and brand for growth
- Strong employment brand

### Retail Earnings Focus

- Leader in customer service and convenience
- Over 80% of adjusted earnings from retail[3,4]
- Strong organic growth engine
- Better return for risk undertaken[5]

### Franchise Businesses

- Repeatable and growing earnings stream
- Focus on customer-driven products
- Operating a franchise dealer of the future
- Consistently reinvest in our competitive advantages

### Risk Discipline

- Only take risks we understand
- Systematically eliminate tail risk
- Robust capital and liquidity management
- Culture and policies aligned with risk philosophy

**Simple strategy, consistent focus**

1. See slide 6.
2. For long term debt (deposits) of The Toronto-Dominion Bank, as at July 31, 2016. Credit ratings are not recommendations to purchase, sell, or hold a financial obligation inasmuch as they do not comment on market price or suitability for a particular investor. Ratings are subject to revision or withdrawal at any time by the rating organization.
3. The Bank prepares its consolidated financial statements in accordance with International Financial Reporting Standards (IFRS), the current generally accepted accounting principles (GAAP), and refers to results prepared in accordance with IFRS as the "reported" results. The Bank also utilizes non-GAAP financial measures to arrive at "adjusted" results (i.e. reported results excluding "items of note", net of income taxes) to assess each of its businesses and measure overall Bank performance. Please see "How the Bank Reports" in the Q3 2016 Report to Shareholders for further explanation and a reconciliation of the Bank's non-GAAP measures to reported basis results.
4. Retail includes Canadian Retail and U.S. Retail segments. See slide 7 for more detail.
5. Return on risk-weighted assets (RWA) is calculated as adjusted net income available to common shareholders divided by average RWA. As compared to North American Peers (RY, BNS, CM, BMO, C, BAC, JPM, WFC, PNC and USB). Adjusted on a comparable basis to exclude identified non-underlying items. For Canadian peers, based on Q3/16 results ended July 31, 2016. For U.S. Peers, based on Q2/16 results ended June 30, 2016.

# Competing in Attractive Markets

## Country Statistics

- 10th largest economy
- Nominal GDP of C$2.0 trillion
- Population of 36 million

## Canadian Banking System

- Soundest banking system in the world[1]
- Market leadership position held by the "Big 5" Canadian Banks
- Canadian chartered banks account for more than 74% of the residential mortgage market[2]
- Mortgage lenders have recourse to both borrower and property in most provinces

## TD's Canadian Businesses

- Network of 1,152 branches and 2,835 ATMs[6]
- Composite market share of 21%
- Ranked #1 or #2 in market share for most retail products
- Comprehensive wealth offering with significant opportunity to deepen customer relationships
- Top three investment dealer status in Canada

## Country Statistics

- World's largest economy
- Nominal GDP of US$18.0 trillion
- Population of 322 million

## U.S. Banking System

- Over 9,000+ banks with market leadership position held by a few large banks
- The 5 largest banks have assets > 50% of the U.S. economy
- Mortgage lenders have limited recourse in most jurisdictions

## TD's U.S. Businesses

- Network of 1,267 stores and 2,017 ATMs[6]
- Operations in 5 of the top 10 metropolitan statistical areas and 7 of the 10 wealthiest states[3]
- US$1.7 trillion deposits market[4]
- Access to nearly 77 million people within TD's footprint[5]
- Expanding U.S. Wholesale franchise with presence in New York and Houston

**Significant growth opportunities within TD's footprint**

1. World Economic Forum, Global Competitiveness Reports 2008-2015.
2. Includes securitizations. As per Canada Mortgage and Housing Corporation (CMHC).
3. State wealth based on current Market Median Household Income.
4. Deposits capped at $500MM in every county within TD's U.S. banking footprint based on 2015 FDIC Summary of Deposits.
5. Market Population in each of the metropolitan statistical areas within TD's U.S. banking footprint.
6. Total ATMs excludes mobile and TD Branded ATMs.

# TD in North America

| **Q3 2016**<br>**C$ except otherwise noted** | **TD** | **Canadian Ranking[4]** | **North American Ranking[5]** |
|---|---|---|---|
| **Total assets** | $1,182B | 2nd | 6th |
| **Total deposits** | $758B | 1st | 5th |
| **Market capitalization** | $106B | 2nd | 6th |
| **Reported net income *(trailing four quarters)*** | $8.5B | 2nd | 6th |
| **Adjusted net income[1] *(trailing four quarters)*** | $9.1B | n/a | n/a |
| **Common Equity Tier 1 capital ratio[2]** | 10.4% | 5th | 9th |
| **Average number of full-time equivalent staff[3]** | 81,978 | 2nd | 6th |

**TD is a Top 10 North American bank**

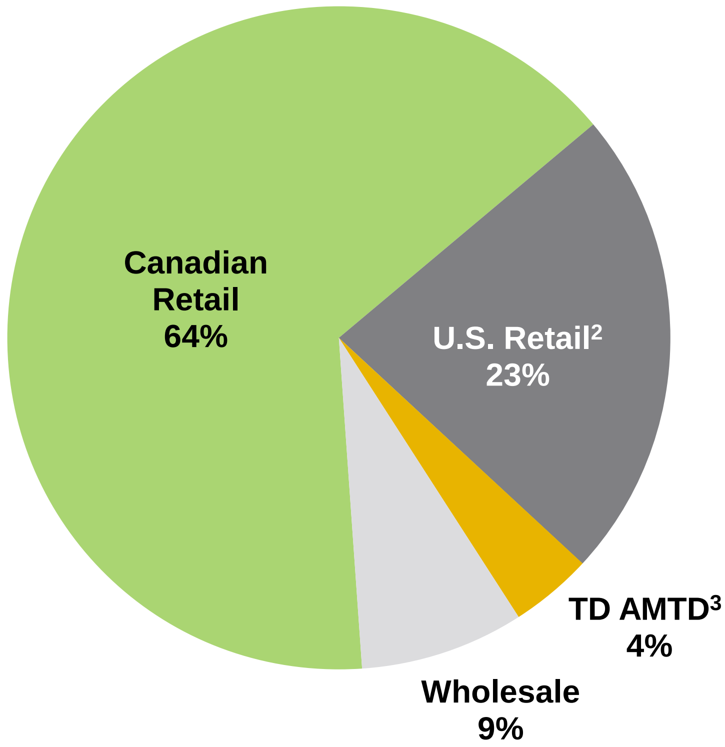
1. See slide 4, footnote 3, for definition of adjusted results.
2. See slide 21, footnote 1.
3. See slide 3, footnote 5 for more information.
4. Canadian Peers – defined as other 4 big banks (RY, BMO, BNS and CM) adjusted on a comparable basis to exclude identified non-underlying items. Based on Q3/16 results ended July 31, 2016.
5. North American Peers – defined as Canadian Peers and U.S. Peers. U.S. Peers – defined as Money Center Banks (C, BAC, JPM) and Top 3 Super-Regional Banks (WFC, PNC, USB). Adjusted on a comparable basis to exclude identified non-underlying items. For U.S. Peers, based on Q2/16 results ended June 30, 2016.

# Composition of Earnings

## Three key business lines

- **Canadian Retail** robust retail banking platform in Canada with proven performance
- **U.S. Retail** top 10 bank[4] in the U.S. with significant organic growth opportunities
- **Wholesale Banking** North American dealer focused on client-driven franchise businesses

### 2015 Reported Earnings Mix[1]




**Building great franchises and delivering value**

1. For the purpose of calculating contribution by each business segment, adjusted earnings from the Corporate segment are excluded.
2. For financial reporting purposes, TD Ameritrade is part of the U.S. Retail business segment, but it is shown separately here for illustrative purposes.
3. TD had a reported investment in TD Ameritrade of 42.35% as at July 31, 2016 (October 31, 2015 – 41.54%).
4. See slide 27, footnote 1.

# Strategic Evolution of TD

**Increasing Retail Focus**

- Acquired 51% of Banknorth
- TD Waterhouse USA / Ameritrade transaction
- Privatized TD Banknorth
- Acquired Commerce Bank
- Commerce Bank integration
- Acquired Riverside & TSFG
- Acquired Chrysler Financial and MBNA credit card portfolio
- Acquired Target credit card portfolio & Epoch; and announced agreement with Aimia and CIBC
- Became primary issuer of Aeroplan Visa; acquired ~50% of CIBC's Aeroplan portfolio
- Completed strategic credit card relationship with Nordstrom

2005 2006 2007 2008 2009 2010 2011 2012 2013 2014 2015 2016

Exited select businesses (structured products, non-franchise credit, proprietary trading)

Partnering with TD Bank, America's Most Convenient Bank to expand U.S. franchise

Achieved Primary Dealer status in the U.S.[1]

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Participated in largest Canadian IPO in 14 years and one of the largest bond placements in Canadian history[2]

Expanded product offering to U.S. clients and grew our energy sector presence in Houston

**From Traditional Dealer To Franchise Dealer**

**Lower-risk retail focused bank with a franchise dealer**

1. Primary dealers serve as trading counterparties of the New York Fed in its implementation of monetary policy. For more information please visit https://www.newyorkfed.org/
2. Nalcor Energy Muskrat Falls Project (C$5 billion bond placement) and PrairieSky Royalty (C$1.7 billion initial public offering). Please see "Business Highlights" in the Wholesale Banking Business Segment Analysis of the Bank's 2014 Annual Report.

# Risk Management Framework

## Our Risk Appetite

**We take risks required to build our business, but only if those risks:**

- Fit our business strategy and can be understood and managed
- Do not expose the enterprise to any significant single loss events; we don't "bet the bank" on any single acquisition, business or product
- Do not risk harming the TD brand

**Proactive and disciplined risk management practices**

# TD Bank Group – Key Themes

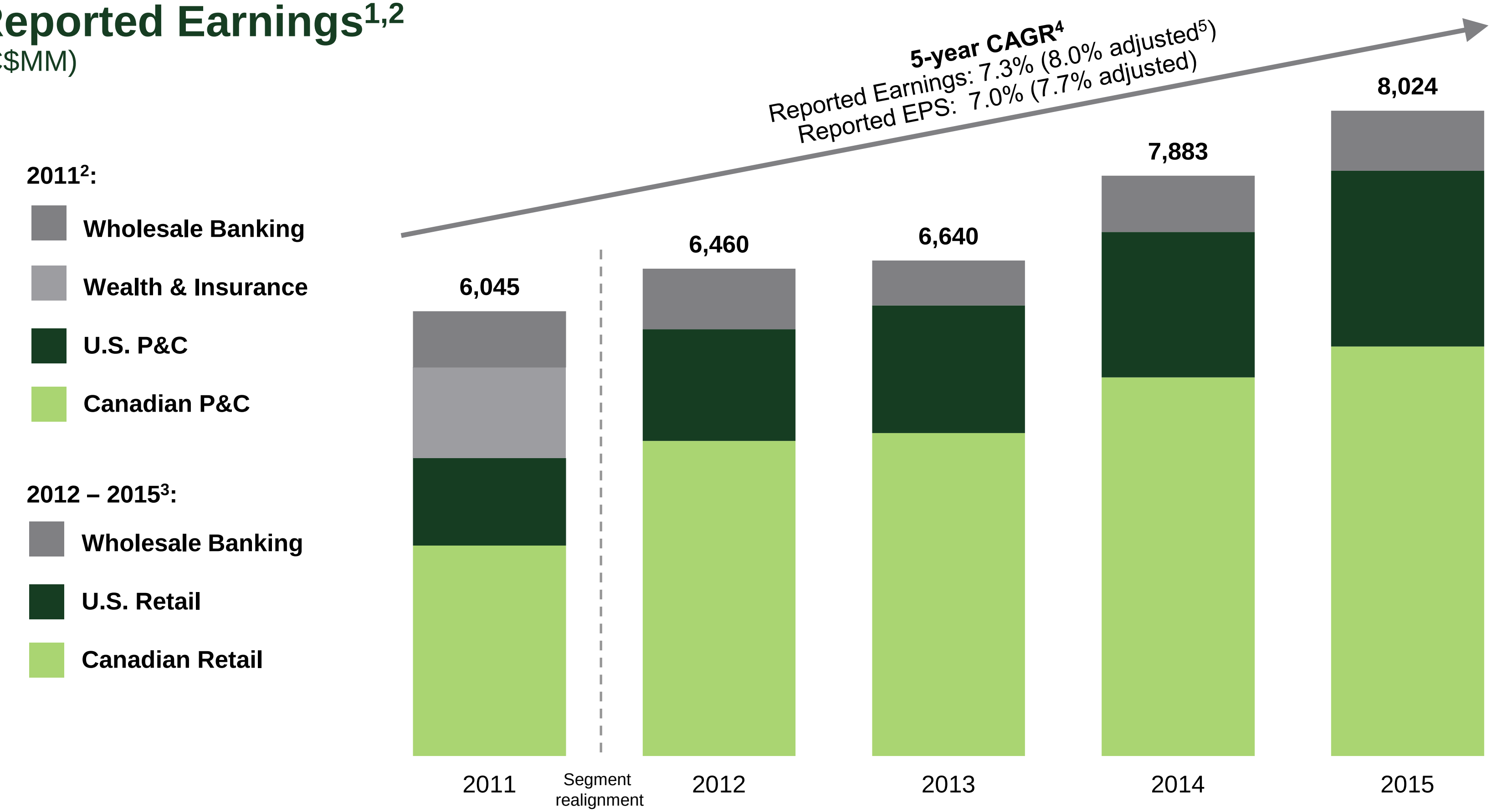
| | | |
|---|---|---|
| 1 | Top 10 North American Bank | *6th largest bank by Total Assets[1]* *6th largest bank by Market Cap[1]* |
| 2 | Proven Performance | *Delivering **top tier** long term shareholder returns* |
| 3 | Strong Balance Sheet and Capital Position | ***Highly rated** by major credit rating agencies* |
| 4 | Focus on Growth Opportunities | *Targeting **7-10%** adjusted EPS growth over the medium term[2]* |

1. See slide 6.
2. See slide 4, footnote 3, for definition of adjusted results.

# Stable Earnings Growth

## Reported Earnings[1,2]

(C$MM)



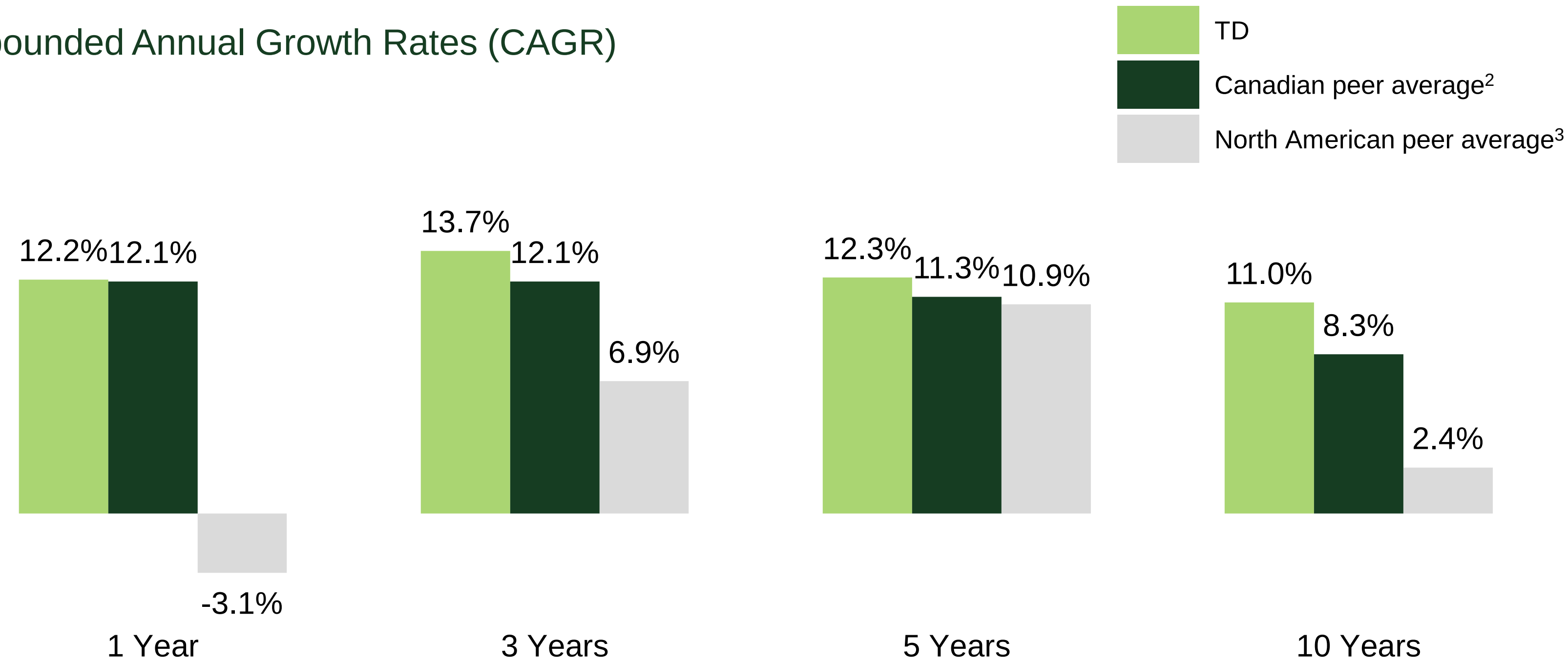

**Targeting 7-10% adjusted EPS growth[5] over the medium term**

1. For the purpose of calculating contribution by each business segment, adjusted earnings from the Corporate segment are excluded.
2. Effective July 4, 2011, executive responsibilities for TD Insurance were moved from Group Head Canadian P&C Segment to Group Head Wealth Segment. Results are updated for segment reporting purposes effective Q1 2012. These changes were applied retroactively to 2011 for comparative purposes.
3. Effective Q1 2014, retail segments were realigned into Canadian Retail and U.S. Retail. For details of the retail segments, see slides 3 and 7. The segment realignment along with implementation of new IFRS standard and amendments, and impact of the stock dividend announced on December 5, 2013 were applied retroactively to 2012 and 2013 results.
4. Compound annual growth rate for the five-year period ended October 31, 2015.
5. See slide 4 footnote 3 for definition of adjusted results.

# Solid Total Shareholder Returns

## Total Shareholder Return[1]

Compounded Annual Growth Rates (CAGR)

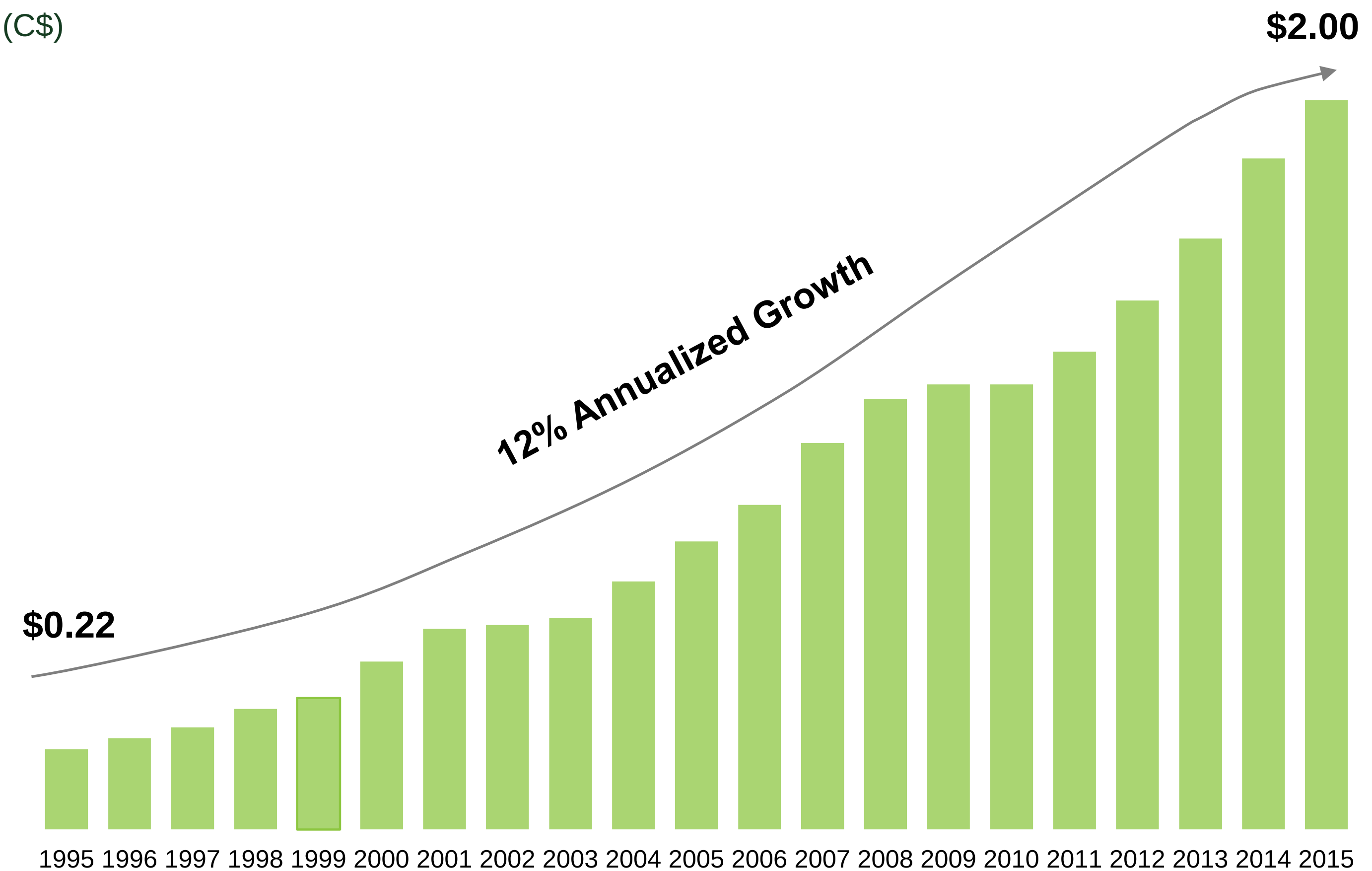



**Delivering top tier long-term shareholder returns**

1. TSR is calculated based on share price movement and dividends reinvested over the trailing one-, three-, five- and ten-year periods as of July 31, 2016. Source: Bloomberg.
2. Canadian Peers – defined as other 4 big banks (RY, BMO, BNS and CM).
3. North American Peers – defined as Canadian and U.S. Peers. U.S. Peers – defined as Money Center Banks (C, BAC, JPM) and Top 3 Super-Regional Banks (WFC, PNC, USB).

# Strong, Consistent Dividend History

## Dividends Per Share
(C$)




**Q1/16:**
**Announced $0.04 dividend increase**

**Dividend yield:**
**3.8%[1]**

**Q3/12:**
**Increased target payout range to 40%-50%[2]**

**Dividend has grown over time**

1. Dividend yield based on dividend declared per share for Q3/16 divided by average of high and low common share prices for the period.
2. In Q3/12, the Bank's target payout range was changed to 40-50% of adjusted earnings (see slide 4, footnote 3 for the definition of adjusted results).

# Q3 2016 Highlights

## Total Bank Reported Results (YoY)

**Earnings up 4% (6% adjusted[1])**

**EPS up 4% (6% adjusted)**

**Revenue up 9%**

- Up 5% ex FX and acquisitions[2]

**Expenses up 8% (7% adjusted)**

- Up 2% ex FX and acquisitions[2]

**PCL down 5% QoQ**

## Financial Highlights $MM

| Reported | Q3/16 | Q2/16 | Q3/15 |
|---|---|---|---|
| Revenue | 8,701 | 8,259 | 8,006 |
| PCL | 556 | 584 | 437 |
| Expenses | 4,640 | 4,736 | 4,292 |
| **Net Income** | **2,358** | **2,052** | **2,266** |
| **Diluted EPS ($)** | **1.24** | **1.07** | **1.19** |

| Adjusted[1] | Q3/16 | Q2/16 | Q3/15 |
|---|---|---|---|
| Net Income | **2,416** | **2,282** | **2,285** |
| Diluted EPS ($) | **1.27** | **1.20** | **1.20** |

## Segment Reported Results (YoY)

**Canadian Retail earnings down 3%**

**U.S. Retail earnings up 17% (21% adjusted)**

**Wholesale earnings up 26%**

## Segment Earnings $MM

| Q3/16 | Reported | Adjusted |
|---|---|---|
| Retail[3] | 2,297 | 2,297 |
| *Canadian Retail* | *1,509* | *1,509* |
| *U.S. Retail* | *788* | *788* |
| Wholesale | 302 | 302 |
| Corporate | (241) | (183) |

1. See slide 4, footnote 3, for definition of adjusted results.
2. For the purpose of this presentation, revenue and expense growth excluding FX and acquisitions is calculated using adjusted figures. Adjusted revenues were $7,985MM and $8,701MM in Q3 2015 and Q3 2016, respectively. Adjusted expenses were $4,261MM and $4,577MM in Q3 2015 and Q3 2016, respectively. Adjusted revenue growth YoY is equal to reported revenue growth YoY.
3. See slide 4, footnote 4, for definition of Retail.

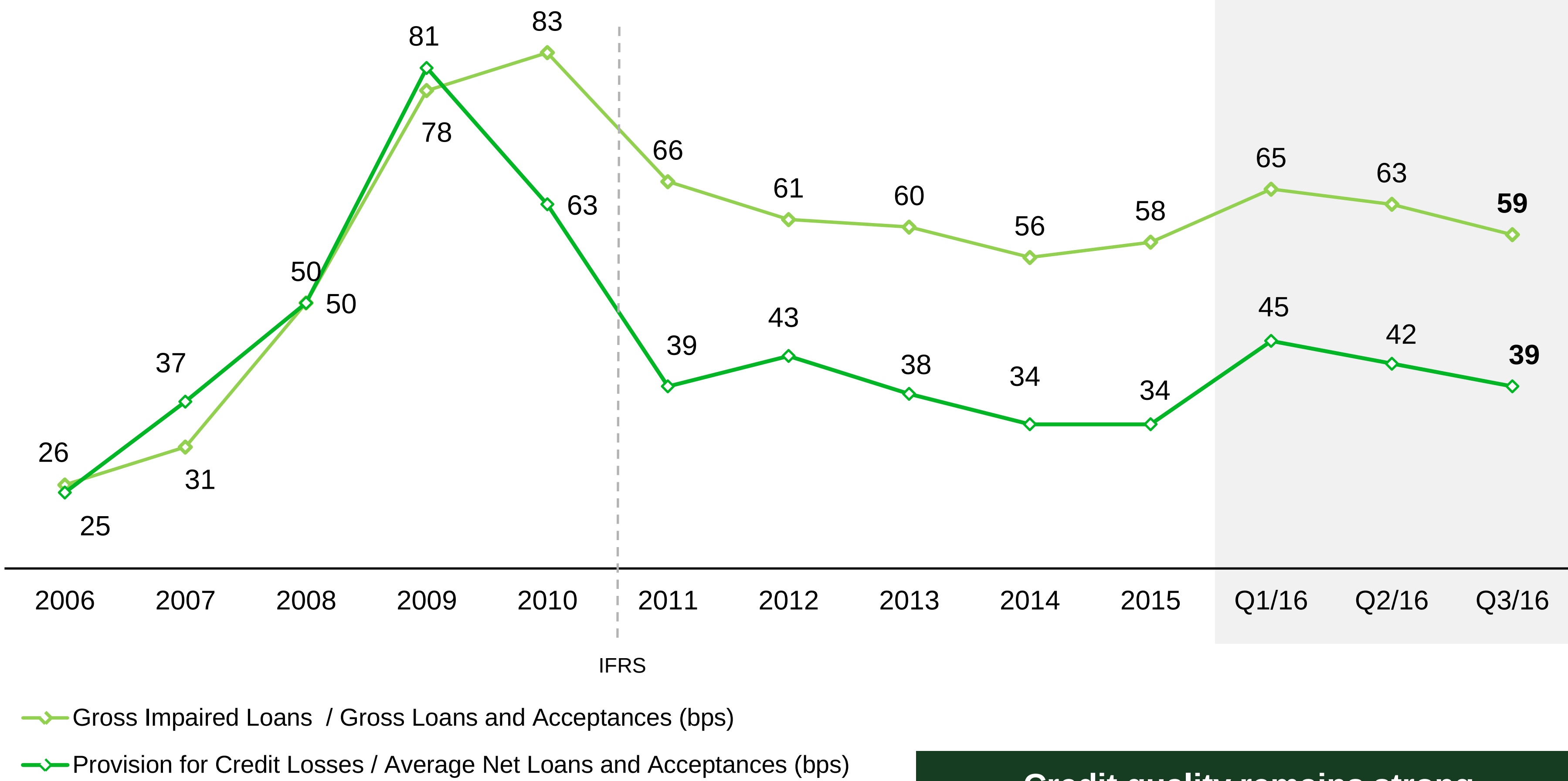
# Q3 2016 Segment Results Highlights

| | |
|---|---|
| **Canadian Retail** | ▪ Net income down 3% YoY. Revenue growth of 3% was more than offset by higher insurance claims and a higher effective tax rate in the quarter<br>▪ PCL down 2% QoQ, primarily reflecting lower delinquencies in personal banking.<br>▪ Expenses up 1% YoY |
| **U.S. Retail** | ▪ In U.S. Dollar terms, U.S. Retail reported net income up 12% YoY (16% adjusted[1]), reflecting higher loan and deposit volumes, positive operating leverage and good credit quality<br>▪ PCL up 6% QoQ primarily due to growth in the commercial banking portfolio<br>▪ Reported expenses up 6% YoY (3% adjusted) |
| **Wholesale Banking** | ▪ Net income up 26% YoY<br>▪ Revenue up 12% YoY, reflecting increased origination activity from debt and equity capital markets, higher corporate lending fees and higher trading-related revenue<br>▪ Expenses up 1% YoY |

1. See slide 4, footnote 3, for definition of adjusted results.

# Strong Credit Quality

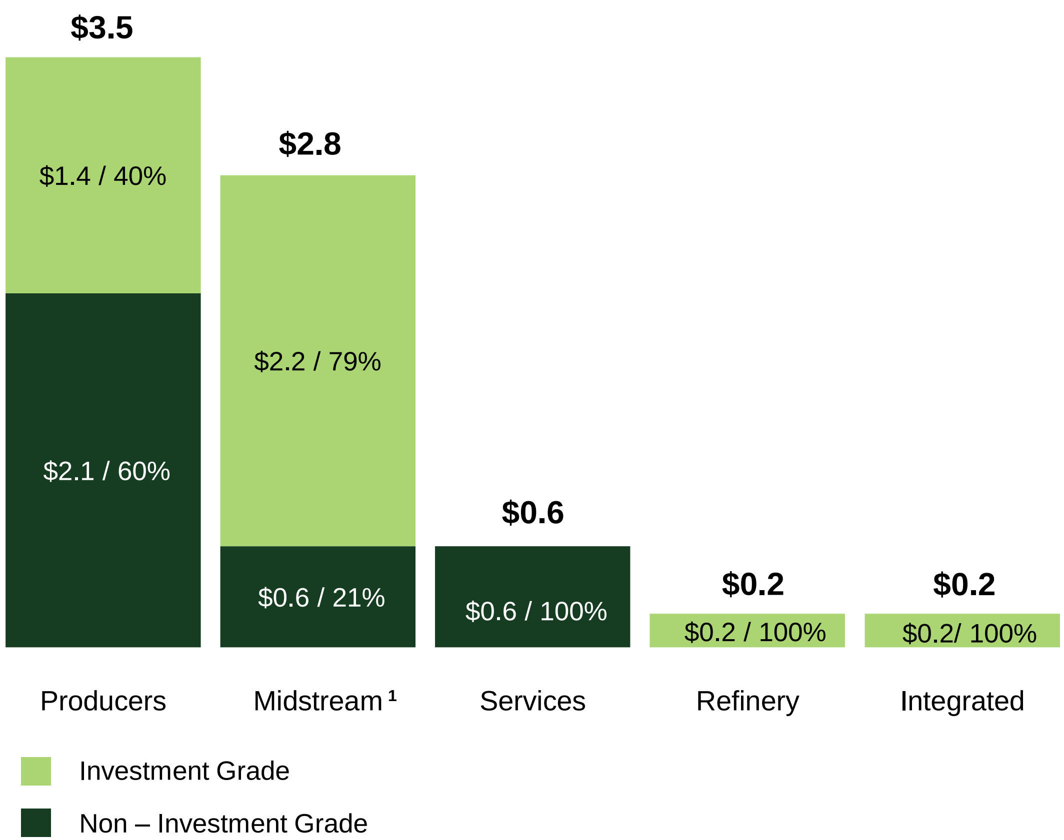
## GIL and PCL Ratios (bps)




**Credit quality remains strong**

# Oil and Gas Exposure

## Corporate and Commercial Outstandings by Sector ($B):




## Highlights

- Oil and Gas Producers and Services outstandings reduced $300MM and remain less than 1% of total gross loans and acceptances
- 65% of undrawn Oil & Gas exposure is investment grade
- Excluding real estate secured lending, consumer lending and small business banking exposure in the impacted provinces[2] represents 2% of total gross loans and acceptances

1. Midstream includes pipelines, transportation and storage.
2. Oil and Gas impacted Provinces include Alberta, Saskatchewan and Newfoundland and Labrador.

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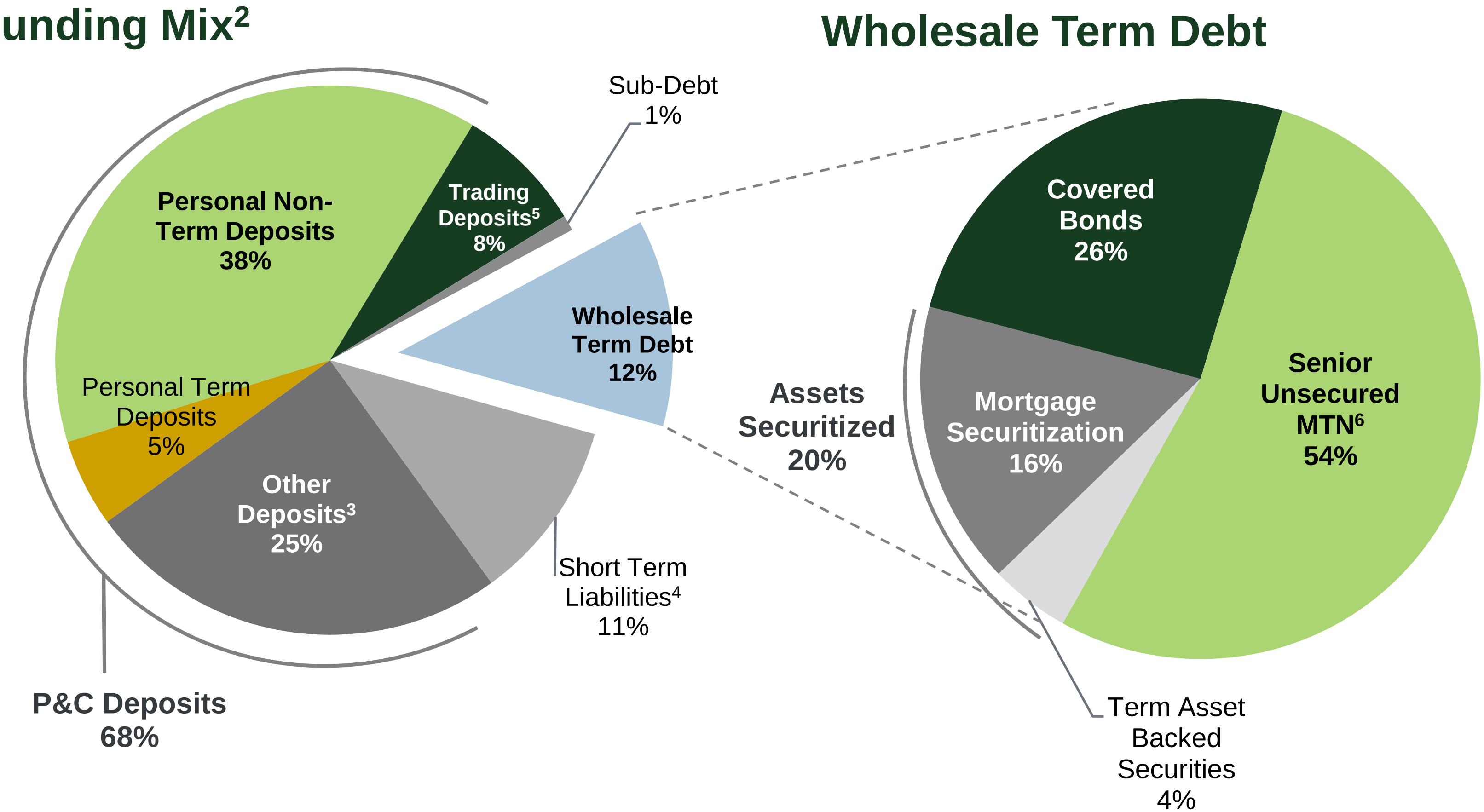
2. See slide 4, footnote 3, for definition of adjusted results.

# Attractive Balance Sheet Composition[1]




**Personal and commercial deposits are primary sources of funds**

1. As of July 31. 2016.
2. Excludes certain liabilities which do not create funding which are: acceptances, trading derivatives, other liabilities, wholesale mortgage aggregation business, non-controlling interest and certain equity capital: common equity and other capital instruments.
3. Bank, Business & Government Deposits less covered bonds and senior MTN notes.
4. Obligations related to securities sold short and sold under repurchase agreements.
5. Consists primarily of bearer deposit notes, certificates of deposit and commercial paper.
6. Includes certain private placement notes.

# Gross Lending Portfolio

## Balances

| | Q3/16 |
|---|---|
| **Canadian Retail Portfolio** | **$ 368.4** |
| **Personal** | **$ 306.0** |
| Residential Mortgages | 187.7 |
| Home Equity Lines of Credit (HELOC) | 63.9 |
| Indirect Auto | 20.4 |
| Unsecured Lines of Credit | 9.8 |
| Credit Cards | 17.9 |
| Other Personal | 6.3 |
| **Commercial Banking (including Small Business Banking)** | **$ 62.4** |
| **U.S. Retail Portfolio** (all amounts in US$) | **US$ 138.5** |
| **Personal** | **US$ 61.7** |
| Residential Mortgages | 20.4 |
| Home Equity Lines of Credit (HELOC)[1] | 9.9 |
| Indirect Auto | 20.8 |
| Credit Cards | 10.1 |
| Other Personal | 0.5 |
| **Commercial Banking** | **US$ 76.8** |
| Non-residential Real Estate | 15.7 |
| Residential Real Estate | 5.1 |
| Commercial & Industrial (C&I) | 56.0 |
| **FX on U.S. Personal & Commercial Portfolio** | $ 42.2 |
| **U.S. Retail Portfolio** (C$) | **$ 180.7** |
| **Wholesale Portfolio**[2] | **$ 38.9** |
| **Other**[3] | **$ 1.5** |
| **Total** | **$ 589.4** |

## Highlights

### Canadian Portfolio

- Real estate secured lending gross loans outstanding up 4% YoY
  - $252 billion portfolio (51% insured)
  - Uninsured residential mortgage current LTV[4] of 58%
- Personal lending up 4% YoY
- Business loans and acceptances up 10% YoY

### U.S. Portfolio

- Excluding the acquisition in the strategic cards portfolio loan volumes increased 11% YoY
- Personal loans increased 4% YoY
- Business loans increased 17% YoY

1. U.S. HELOC includes Home Equity Lines of Credit and Home Equity Loans
2. Wholesale portfolio includes corporate lending and other Wholesale gross loans and acceptances
3. Other includes Corporate Segment Loans.
4. Current LTV is the combination of each individual mortgage LTV weighted by the mortgage balance

Note: Some amounts may not total due to rounding.
Excludes Debt securities classified as loans

# Capital & Liquidity

## Highlights

**Common Equity Tier 1 ratio of 10.4%**

**Leverage ratio of 3.8%**

**Liquidity coverage ratio of 132%**

## Common Equity Tier 1[1]

| | |
|---|---|
| **Q2 2016 CET1 Ratio** | **10.1%** |
| Internal capital generation | 33 bps |
| Actuarial loss on employee pension plans | (9) bps |
| RWA increase and other | 1 bps |
| **Q3 2016 CET1 Ratio** | **10.4%** |

1. Amounts are calculated in accordance with the Basel III regulatory framework, excluding Credit Valuation Adjustment (CVA) capital in accordance with OSFI guidance and are presented based on the "all-in" methodology. The CVA capital charge is phased in over a five year period based on an approach whereby a CVA capital charge of 64% applies in 2015 and 2016, 72% in 2017, 80% in 2018 and 100% in 2019.

# Strong Focus on Risk-Adjusted Return

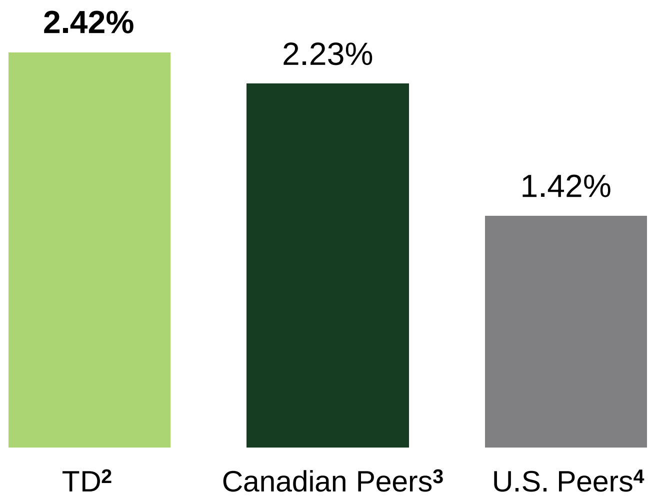
## Accolades

- **"Safest Bank in North America & One of the World's 50 Safest Banks"**
  *– Global Finance Magazine*
- **"Best Big Bank in America"**
  *– Money® Magazine*
- **"Best Bank in Canada"**
  *– Euromoney Magazine*

## Ratings[5]

| | Moody's | S&P | DBRS |
|---|---|---|---|
| **Rating** | Aa1 | AA- | AA |
| **Outlook** | Negative | Stable | Negative |

## Q3 2016 Adjusted Return on Risk-Weighted Assets[1]




**Highly rated franchise**

1. Return on Risk-Weighted Assets (RWA) is adjusted net income available to common shareholders divided by average RWA. Adjusted results are defined on slide 4, footnote 3. See slide 21, footnote 1.
2. TD based on Q3/16 adjusted results as defined on slide 4, footnote 3.
3. Canadian Peers – defined as the other big 4 banks (RY, BMO, BNS, and CM). Based on Q3/16 adjusted results ended July 31, 2016.
4. U.S. Peers – defined as Money Center Banks (C, BAC, JPM) and Top 3 Super-Regional Banks (WFC, PNC, USB). Based on Q2/16 adjusted results ending June 30, 2016.
5. See footnote 2 on slide 4 for more information on credit ratings.

# TD Bank Group – Key Themes

| | | |
|---|---|---|
| 1 | **Top 10 North American Bank** | ***6th** largest bank by Total Assets[1]*<br>***6th** largest bank by Market Cap[1]* |
| 2 | **Proven Performance** | *Delivering **top tier** long term shareholder returns* |
| 3 | **Strong Balance Sheet and Capital Position** | ***Highly rated** by major credit rating agencies* |
| 4 | **Focus on Growth Opportunities** | *Targeting **7-10%** adjusted EPS growth over the medium term[2]* |

1. See slide 6.
2. See slide 4, footnote 3, for definition of adjusted results.

# Canadian Retail

## Consistent Strategy

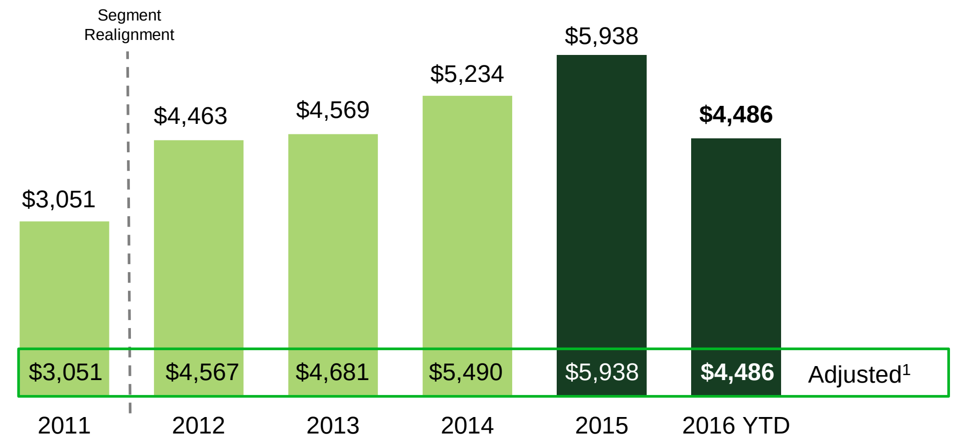
### How we compete

- Legendary customer service and convenience
- Relentless commitment to operational excellence
- The power of One TD
- Winning culture and team

**+7% adjusted earnings growth[1] target over the medium term**

## Reported Net Income

(C$MM)




### Q3 2016 Highlights

| | | | |
|---|---|---|---|
| **Total Deposits[2]** | C$284B | **Employees[4]** | 38,852 |
| **Total Loans[2]** | C$365B | **Customers** | ~13MM |
| **Assets Under Administration** | C$337B | **Mobile Users[5]** | 3.4MM |
| **Assets Under Management** | C$265B | **Branches** | 1,152 |
| **Gross Insurance Premiums[3]** | C$4.0B | **ATMs[5]** | 2,835 |
| **Earnings[3]** | C$6.0B | | |

1. See slide 4, footnote 3 for definition of adjusted results. See slide 11 for information on segment realignment. Reported earnings for 2012 were C$4,463MM, 2013 were C$4,569MM and 2014 were C$5,234MM. Reported earnings equal adjusted earnings for 2011, 2015 and 2016 YTD.
2. Total Deposits based on total of average personal, business and wealth deposits during Q3/16. Total Loans based on total of average personal and business loans during Q3/16.
3. For trailing four quarters ending Q3/16.
4. Average number of full-time equivalent staff during Q3/16.
5. Active mobile users are defined as TD customers who have logged in using the Canadian mobile or tablet apps (applications) within the last 90 days. Total ATMs excludes Mobile and TD Branded ATMs.
6. Rated #1 among Canada's five major banks for "Overall quality of customer service" by independent market research firm Ipsos (formerly Synovate) from 2005 to 2015.

# Canadian Retail

## Personal Banking

- #1 or #2 market share in most retail products[1]
- On average 44% longer branch hours than peers[2] with 431 branches offering Sunday banking
- Mobile banking leadership in Canada with the highest number of mobile unique visitors accessing financial services[3]

## Business Banking

- #2 Business Bank in Canada in both credit and deposit market share[1]
- Customized Commercial Banking and Floor Plan Financing solutions delivered through 50 branches
- Largest number of small business customers compared to peers5 and over 500 dedicated Small Business Bankers in Retail branches

## Credit Cards

- #1 card issuer in Canada measured by outstanding card loan balances
- Dual card issuer of high value brands, including suite of TD Aeroplan Visa, TD First Class Visa and MBNA cards
- North American operational scale and professional expertise

## Wealth

- Market leadership in direct investing with 1.2 million clients
- #1 Pension Fund Manager for the 5$^{th}$ consecutive year[6]
- Leverage world class retail bank to accelerate growth in our advice businesses

## Insurance

- Personal lines products in Canada, including Home & Auto, Life & Health, Creditor and Travel insurance
- #1 direct-to-consumer insurer and #1 affinity insurer[7]

**Robust retail banking foundation in Canada with proven performance**

1. Sources: CBA, OSFI and IFIC as at May 2016 Market Share Summary (internally produced report).
2. As at April 30, 2016. Canadian Peers are defined as RY, BNS, BMO and CM.
3. Comscore reporting current as of April 30, 2016.
4. Source CBA, as at July 31, 2015. Canadian Peers are defined as RY, BNS, BMO and CM.
5. Based on assets as of December 31, 2015 (Source: 2016 Top 40 Money Managers Report by Benefits Canada).
6. Ranks based on data available from OSFI, Insurers, Insurance Bureau of Canada, and Provincial Regulators, as at December 31, 2014. Peer group top 10: Intact, Desjardins, Aviva, RSA, Wawanesa, The Co-Operators, Allstate, Economical and Travelers.

# U.S. Retail

## Consistent Strategy

### How we compete

- Legendary service and convenience
- Grow and deepen customer relationships
- Differentiated brand as the "human" bank
- Productivity initiatives that enhance both the employee and customer experience
- Conservative risk appetite
- Unique employee culture

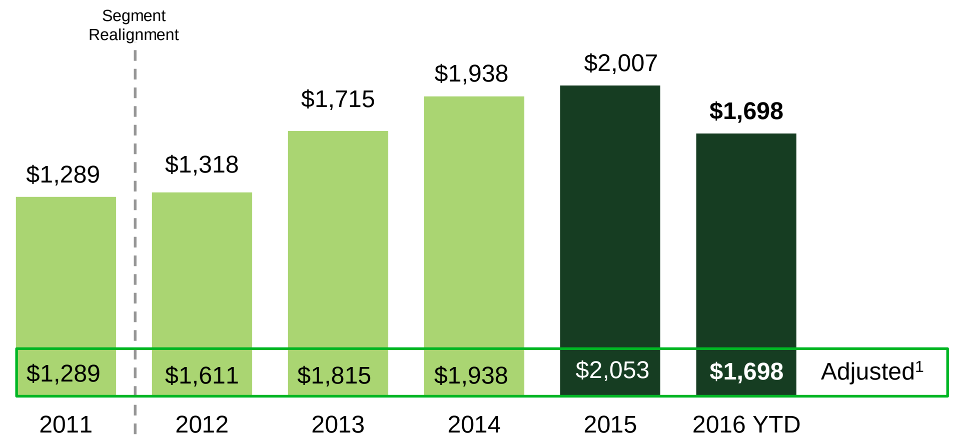
**Named "Best Big Bank" in Money®'s "Best Banks 2015" Issue[6]**

**Ranked Among Top 50 Companies for Diversity and Inclusion**

**Expecting earnings growth in the absence of rate increases**

## Reported Net Income[1]

(US$MM)




### Q3 2016 Highlights

| | C$ | US$ | | |
|---|---|---|---|---|
| **Total Deposits[2]** | $292B | $225B | **Employees[4]** | 25,998 |
| **Total Loans[2]** | $179B | $138B | **Customers** | ~9MM |
| **Assets Under Administration** | $16B | $13B | **Mobile Users[5]** | 2.2MM |
| **Assets Under Management** | $93B | $71B | **Stores** | 1,267 |
| **Reported Earnings[3]** | $2.9B | $2.2B | **ATMs[5]** | 2,017 |
| **Adjusted Earnings[3]** | $2.9B | $2.2B | | |

1. See slide 4, footnote 3 for definition of adjusted results. See slide 11for information on segment realignment. Reported earnings for 2011 were C$1,188MM (US$1,205MM), for 2012 were C$1,325MM (US$1,318MM), for 2013 were C$1,752MM (US$1,715MM), and for 2015 were C$2,488MM (US$2,007MM). Reported earnings equal adjusted earnings for 2014 and YTD 2016.
2. Total Deposits based on total of average personal deposits, business deposits and TD Ameritrade Insured Deposit Accounts (IDAs) during Q3/16. Total Loans based on total of average personal and business loans during Q3/16.
3. For trailing four quarters ending Q3/16. See slide 4, footnote 3 for definition of adjusted results.
4. Average number of full-time equivalent staff during Q3/16.
5. Active mobile users are defined as TD customers who have logged in using the U.S. mobile app (application) within the last 90 days. Total ATMs excludes Mobile and TD Branded ATMs.
6. MONEY is a registered trademark of Time Inc. and is used under license. From MONEY® Magazine, November, 2015 © 2015 Time Inc. MONEY and Time Inc. are not affiliated with and do not endorse products or services of TD Bank, N.A. or TD Bank Group.

# U.S. Retail

## Personal & Commercial Banking

- Top 10 bank[1] with ~9MM customers, operating retail stores in 15 states and the District of Columbia
- Open longer than the competition, including Sunday banking in most markets
- #3 market share in NYC[2] and targeting top 5 market share in all of our major markets, with significant opportunity to target key customer segments and deepen customer relationships
- Solid commercial growth opportunities across our Maine-to-Florida footprint
- "Highest in Customer Satisfaction with Retail Banking in Florida"[3] and "Highest in Customer Satisfaction with Small Business Banking in the Northeast Region"[4] by J.D. Power

## Credit Cards

- Exclusive issuer of Target-branded Visa and private label consumer credit cards to Target's U.S. customers
- Primary issuer of Nordstrom credit cards in the U.S.
- North American operational scale and professional expertise

## Auto Lending

- Prime indirect lending to dealers in each of the 50 states and the District of Columbia
- Comprehensive banking solutions for our dealers, including floor plan, commercial banking and wealth management across the TD Bank footprint
- Focused on strategic dealer partnerships where our value proposition best aligns with dealers' needs and priorities

## Wealth

- Building U.S. wealth capability in the high net worth and private banking space
- Acquired in 2013, Epoch Investment Partners expands overall product capabilities in the U.S. and Canada

## TD Ameritrade

- Strategic relationship drives mutually beneficial customer referrals and growth
- Market leadership in trading in the U.S.[5]
- Ranked Best in Class in the U.S. by StockBrokers.com for the fifth straight year[6]

**Top 10 bank in the U.S. with significant growth opportunities**

1. Based on total deposits as of September 30, 2015. Source: SNL Financial, Largest Banks and Thrifts in the U.S. by total deposits.
2. Active branch count in New York City's five boroughs as of October 31, 2015, based on SNL Financial.
3. TD Bank received the highest numerical score among retail banks in Florida in the J.D. Power 2016 Retail Banking Satisfaction Study, based on 76,233 responses from 10 banks, measuring opinions of consumers with their primary banking provider, surveyed April 2015-February 2016. Your experiences may vary. Visit jdpower.com
4. TD Bank, N.A. received the highest numerical score in the northeast in the proprietary J.D. Power 2015 Small Business Banking Satisfaction Study℠. Study based on 8,086 total responses, measuring 8 financial institutions in the northeast (Connecticut, Maine, Massachusetts, New Hampshire, New Jersey, New York, Pennsylvania, Rhode Island, Vermont) and measures opinions of small business customers with annual revenues from $100,000 to $10 million. Proprietary study results are based on experiences and perceptions of customers surveyed in July-August 2015. Your results may vary. Visit www.jdpower.com.
5. Internally estimated daily average revenue client trades (DARTS) based on last twelve months publicly available reports for E*TRADE Financial and Charles Schwab as of March 31, 2015.
6. TD Ameritrade was ranked #2 overall in 2016 and #1 in 2012 to 2015 out of 15 online brokers evaluated in the StockBrokers.com Online Broker Review 2016. TD Ameritrade was also rated #1 or Best in Class (within top 5) in several categories, including "Offering of Investments" (2nd year in a row), "Platforms & Tools" (5th year in a row), "Customer Service" (3rd year in a row), "Investor Education" (4th year in a row), "New Investors" (4th year in a row), "Research" (5th year in a row), "Mobile Trading" (4th year in a row), "Options Trading" (6th year in a row), and "Active Trading" (6th year in a row). TD Ameritrade also received awards for #1 Tablet App, # Desktop Platform, #1 Trader Community, and #1 New Tool.

# Wholesale Banking

## Consistent Strategy

### How we compete

**Canada**

- Be a top-ranked integrated investment dealer
- Fully aligned with TD Bank Group partners
- Provide superior advice and execution

**U.S.**

- Extend the Canadian franchise's goals into the U.S.
- Build the U.S. franchise with our North American clients and in partnership with TD Bank, America's Most Convenient Bank

**Outside North America**

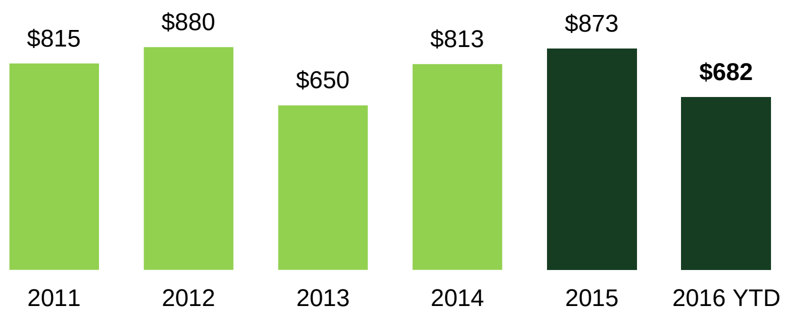
- Be a focused player in franchise/client-driven businesses (e.g. Supranational, Sovereign and Agencies, fixed income, foreign exchange)

**Top 3 in**

- ✓ **Equity Underwriting[4]**
- ✓ **Corporate Debt Underwriting[5]**
- ✓ **Government Debt Underwriting[6]**

## Net Income

(C$MM)




| Q3 2016 Highlights | |
|---|---|
| **Gross Drawn[1]** | C$21B |
| **Trading-related Income[2]** | C$1.6B |
| **Earnings[2]** | C$878MM |
| **Employees[3]** | 3,808 |

**Targeting 15-20% ROE with franchise focus**

1. Includes gross loans and bankers' acceptances, excluding letters of credit and before any cash collateral, credit default swaps (CDS) and reserves for the corporate lending business.
2. For trailing four quarters ending Q3/16.
3. Average number of full-time equivalent staff during Q3/16.
4. For Equity Underwriting deals in Canada for calendar year-to-date as of July 31, 2016. Source: Bloomberg
5. For Corporate Debt Underwriting deals in Canada for calendar year-to-date July 31,2016. Excludes self-led domestic bank deals and credit card deals. Bonus credit to lead. Source: Bloomberg.
6. For Government Debt Underwriting deals in Canada for calendar year-to-date July 31,2016. Source: Bloomberg.

# Wholesale Banking

## Focus on client-driven franchise businesses

- Diversified business mix with a North American focus
- Presence in key global financial centres
- Extend our client-centric franchise model through superior advice and execution

## A North American dealer aligned with our TD partners

- Focus on integrating the strength of the TD brand and alignment with our enterprise partners

## Solid returns without going out the risk curve

- Disciplined and proactive risk management by focusing on franchise clients, counterparties, and products
- Delivered strong business results while exiting proprietary-type businesses

## Well positioned for growth

- Grow organically by broadening and deepening client relationships
- Be a top ranked integrated investment dealer in Canada by increasing our origination footprint and competitive advantage with Canadian clients[1]
- Expand the U.S. franchise by growing our service offerings to North American clients and partnering with U.S. retail
- Grow foreign exchange, commodities and metals businesses globally

**A client-centric wholesale franchise**

1. Ranked #2 Equity Block Trading and #1 Equity Options Block Trading (Block trades by value on all Canadian exchanges. Source: IRESS); #3 Government Debt Underwriting (Source: Bloomberg); # 2 Corporate Debt Underwriting (Excludes self-led domestic bank deals and credit card deals. Bonus credit to lead. Source: Bloomberg); #2 in Equity Underwriting (excludes self-led offerings, preferred share deals and retail structured products. Source: Bloomberg); #3 in M&A announced (Based on rolling 12 month period. Source : Bloomberg); and #2 in Canadian Syndicated Loans (Deal volume awarded proportionately to the Lead Arrangers. Based on rolling 4-quarter calendar period. Source: Bloomberg). All rankings are calendar year-to-date as of July 31, 2016 unless otherwise stated.

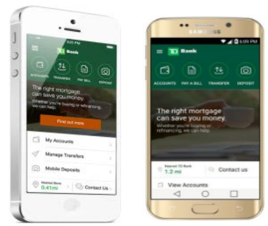
# Omni Comfort and Convenience

## Consistent Strategy

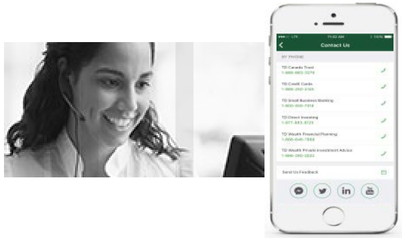
### How we compete

- Customer-centricity allows customers to choose how, when and where they bank
- An Omni experience is an interaction between a customer and the entire organization; it seamlessly spans products, devices, channels and/or borders in order to meet or exceed customer expectations across all moments of contact
- Our North American structure leverages technology and capabilities to drive customer adoption and innovation for our Canadian and U.S. Retail businesses

## Digital Enhancements



**Completely redesigned TD Bank app for iOS and Android devices with more than 20 new features, including improved navigation and self-service options, greater money movement flexibility and a secured messaging capability.**
(U.S.)



**New Omni-Dial capability will provide a seamless, and authenticated transition from our TD app directly to our call centre. Customers will spend less time upfront explaining what they're calling about and our phone agents will have more relevant information to support customers as soon as they take the call.**
(Canada)

TD Live Chat

**TD Live Chat gives customers the option to connect online with banking specialists. Available in English and French**
(Canada)

Text us at TDHELP

**First major bank in Canada to offer customer service support via text message**
(Canada)

**Bank, trade and make payments from almost anywhere with the TD app**
(Canada)

Make small purchases with a tap of your Android™ smartphone[3] using TD Mobile Payment, and check your account balance at a glance with Quick Access on your Apple Watch™

1. Apple, the Apple logo and the Apple Watch are trademarks of Apple Inc., registered in the U.S. and other countries.
2. TM Android is a trade-mark of Google Inc.
3. Selected Android mobile devices are eligible for TD Mobile Payment.

# Corporate & Social Responsibility

## Highlights

- Ranked 54th on the **Global 100 Most Sustainable Corporations in the World** by Corporate Knights
- Included on the **Dow Jones Sustainability World Index**
- Named to the **Climate Disclosure Leadership Index** – the highest ranking Canadian financial institution by CDP
- Among the best places to work for LGBT equality in the U.S. with a perfect score on **Human Rights Campaign's Equality Index** for 7th straight year
- TD Bank, America's Most Convenient Bank, named among the **Top 50 Companies for Diversity** by Diversity Inc. for the 3rd year in a row
- Named **Best Green Bank – North America 2015** by U.K. based capital Finance International
- **Donated C$92.5 million in 2015** to not-for-profit groups in Canada, the U.S., the U.K., and Asia Pacific

- TD Friends of the Environment Foundation celebrates 25 years with over **C$76 million in funds disbursed** in support of more than 24,000 local environmental projects
- More than **235,000 trees planted through TD Tree Days**, TD's flagship volunteer program – with 50,000 more to be planted in 2016
- In 2014, TD was the **first commercial bank in Canada to issue a $500 million green bond** to support the low-carbon economy
- TD Securities continues to support the green bond market by underwriting climate bonds:
  - C$1 billion issued by the European Investment Bank (syndicate)
  - C$750 million bond for the Government of Ontario
  - US$700 million bond for International Finance Corporation
- TD Asset Management is **a signatory to United Nations Principles for Responsible Investment**
- TD Insurance is **a signatory to United Nations Principles for Sustainable Insurance**
- **Recognized by sustainability indices:**
  - Dow Jones Sustainability Index (World and North American Index)
  - Ethibel Sustainability Index Global
  - Jantzi Social Index
  - FTSE4Good Index
  - MSCI Global Sustainability Indexes
  - Nasdaq OMX CRD Global Sustainability Index
  - STOXX ESG Leaders Indices
  - Euronext Vigeo, World 120 index

**Making positive impacts on customers, workplace, environment, and community**

For further information about Corporate Responsibility, please visit http://www.td.com/corporateresponsibility/.

# A Principled Approach

## Leadership Profile

- **Make an Impact and Value Speed**
- **Build for the Future**
- **Inspire the Will to Win**
- **Act Decisively while Working Effectively in Teams**
- **Live Transparency and Respect Different Views**
- **Show Excellent Judgment**
- **Demonstrate Unwavering Integrity**

## Guiding Principles

- Deliver Legendary Customer Experiences
- Be an Extraordinary Place to Work
- Operate with Excellence
- Understand Our Business
- Take Only Risks We Understand and Can Manage
- Enhance Our Brand
- Increase Shareholder Value

**Living TD principles to be The Better Bank**

# TD Model Has Proven Its Resilience

## Simple Strategy
## Consistent Focus

- Lead with service and convenience
- Leverage TD brand across all segments
- Continue to invest while driving efficiencies
- Focus on organic growth

## Headwinds

Slowing loan growth in Canada

Low interest rate environment

Demanding regulatory environment

## Vision:
## To be The Better Bank

- One of the World's Most Admired Companies[1]
- One of Canada's most valuable brands[2]
- One of Canada's Most Responsible Companies[3]

**Targeting 7-10% adjusted EPS growth[4] over the medium term**

1. By Fortune magazine in 2015.
2. By Brand Finance in 2012, 2013, 2014 and 2015.
3. By Macleans magazine and Sustainalytics in 2012, 2013, 2014 and 2015.
4. See slide 4, footnote 3 for definition of adjusted results.

# Investor Relations Contacts

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**Website:**
www.td.com/investor

IR magazine
Award winner
Canada 2016

**Best Investor Relations by Sector:** Financial Services

**Best Corporate Governance**

# TD Bank Group Investor Presentation

Q3 2016

GLOBAL LEGAL INSIGHTS

# Banking Regulation

Second Edition

Contributing Editors: Peter Hsu & Rashid Bahar
Published by Global Legal Group

# CONTENTS

# Canada

Blair W. Keefe & Eli Monas
Torys LLP

## Introduction

The banking industry in Canada is one of the safest and most efficient banking systems in the world. For seven years in a row, the World Economic Forum has recognised Canada's banking system as the soundest in the world.[1] Canada's banking industry is composed of domestically owned banks, foreign bank subsidiaries, full-service foreign bank branches, foreign bank lending branches (which cannot take deposits and can only fund themselves on the interbank market) and foreign bank representative offices. As of March 2015, the banking industry in Canada comprised 28 domestic banks, 24 foreign bank subsidiaries, 26 full-service foreign bank branches, 3 foreign bank lending branches and 25 foreign bank representatives offices.[2]

Canadian banks are regulated by the Office of the Superintendent of Financial Institutions (OSFI), which is generally regarded as one of the most conservative banking regulators in the world. OSFI is a strong proponent of meeting international best practices and has publicly announced its intention to fully implement Basel III well in advance of 2019. This conservative approach has served the Canadian banking sector well, enabling Canadian banks to weather the financial crisis much better than most of their international competitors (the Canadian government did not have to bail out any financial institutions in Canada).

## Regulatory architecture: overview of banking regulators and key regulations

### General overview

The *Bank Act*, a federal statute enacted by the Parliament of Canada, is the primary statute governing the banking industry in Canada. The Canadian Constitution gives the federal government exclusive jurisdiction to incorporate banks, establish their business and investment powers, and impose capital and other requirements regulating the business and affairs of banks. While Canadian provincial governments may incorporate and regulate certain deposit-taking institutions, such as credit unions, only institutions incorporated under the *Bank Act* may refer to themselves as banks.

The *Bank Act* has been supplemented by numerous regulations, guidelines, advisories and regulatory rulings that elaborate upon the principles and rules established therein.

Canada believes that there should be a separation between the financial services sector and the commercial sector of the economy. Therefore, government policy is to restrict the ability of banks to engage in or own interests in entities that carry on non-financial services business.

### Office of the Superintendent of Financial Institutions

The *Office of the Superintendent of Financial Institutions Act* was enacted by the federal government in order to establish one consolidated regulator for the banking and insurance sectors in Canada. OSFI is the principal agency responsible for overseeing banks and administering the *Bank Act* on behalf of the Minister of Finance. It was created to contribute to the public confidence in the Canadian financial system. As part of its role, OSFI publishes guidelines and advisories in respect of the sector and provides interpretive rulings on a case-by-case basis. Among the key guidelines established by OSFI are those that set out the adequate levels of capital and liquidity to be maintained by banks. The

Capital Adequacy Requirements Guideline, which was revised in January 2013[3] to incorporate new requirements contained in Basel III, is the key guideline in this regard.

Financial Consumer Agency of Canada

The Financial Consumer Agency of Canada (FCAC) was established in 2001 to administer the consumer provisions of the *Bank Act*, including disclosure requirements regarding borrowing costs and deposit account terms. The FCAC does not have any authority to grant redress to consumers, but can impose penalties on banks for failing to comply with the requirements of the *Bank Act* and the regulations.

Canadian Deposit Insurance Corporation

The Canadian Deposit Insurance Corporation (CDIC) was established to ensure the safety of small deposits and to assist in maintaining the public confidence and stability in the financial system by providing deposit insurance for bank depositors. Although the CDIC relies upon the examination reports of the Superintendent as its vehicle for monitoring the performance of a particular insured bank, it has the authority to request that it be appointed as receiver of a troubled bank in certain circumstances if it perceives that a bank is in danger of becoming insolvent and the CDIC is likely to be called upon to make insurance payments to the depositors of the bank.

## Recent regulatory themes and key regulatory developments in Canada

In general, Canadian banks weathered the financial crisis much better than most of their international competitors. However, Canada recognises that remaining stagnant is not an option, and is therefore a strong proponent of continuing to meet international best practices, including with respect to capital and corporate governance.

Capital

Canada announced its intention to fully implement Basel III capital requirements on all Canadian banks well in advance of 2019 (with the majority of the requirements already being imposed by January 2013). In particular, OSFI mandated (i) that all non-common capital instruments issued after January 1, 2013 contain features that require them to automatically convert into common shares of the bank if the bank ever becomes non-viable, and (ii) that all existing non-common capital instruments without such features be amortised over a 10-year period on a straight line basis.

The Financial Stability Board released its October 2011 paper titled "Key Attributes of Effective Resolution Regimes for Financial Institutions", which recommends that all resolution authorities should have the ability to "bail in" senior debt of a failing bank before taxpayers are exposed to losses. On August 1, 2014, the Canadian federal government published a consultation paper outlining a proposed design for a bail-in regime for Canada's domestic systemically important banks (D-SIBs). The proposed regime is aimed at ensuring that (a) taxpayers are protected from having to bail out a D-SIB in the highly unlikely event of such an institution running into difficulty, and (b) Canada's financial system remains strong by clarifying that banks' shareholders and creditors are responsible for bearing losses, thereby giving them stronger incentives to monitor the bank's risk-taking activities. In order to be able to achieve each of the policy objectives set forth in the consultation paper, the bail-in regime would be incorporated into Canada's existing resolution framework for banks. The federal government has undertaken a review of these existing resolution tools to determine how best to integrate the conversion power described in the consultation paper.

In its 2013 Budget Plan, the Canadian federal government introduced plans to impose a higher capital requirement on D-SIBs (as determined by OSFI). OSFI released an advisory in March 2013 describing considerations used to designate D-SIBs and establishing a risk-weighted capital ratio requirement equalling a 1 per cent common equity surcharge for banks so designated. The Canadian banks designated as D-SIBs are Bank of Montreal, The Bank of Nova Scotia, Canadian Imperial Bank of Commerce, National Bank of Canada, Royal Bank of Canada and The Toronto-Dominion Bank. These banks are expected to meet the additional risk capital ratio requirement of 1 per cent by January 1, 2016.

Corporate governance

Another key development in Canada since the financial crisis in 2008 is the renewed focus on corporate governance. In 2010, OSFI created a dedicated corporate governance unit to conduct a cross-sector review of governance at larger financial institutions. This information was later used to update OSFI's guideline on corporate governance, which will be discussed in greater detail below under the heading "Bank Governance and Internal Controls". As a result of its review, OSFI has developed a greater focus on risk governance and risk appetite at banks. In particular, banks should have an enterprise-wide, board-approved risk-appetite framework that guides the risk-taking activities of a bank and that is well understood throughout the organisation. The risk-appetite framework should set basic goals, limits and benchmarks pertaining to the amount of risk a bank is willing to accept.

## Bank governance and internal controls

The *Bank Act* sets out the required composition of banks' boards of directors and mandates the establishment of certain board committees, including an audit committee and a conduct review committee. Under the *Bank Act*, Canadian banks must consist of, at a minimum, seven directors (at least half of whom must be Canadian residents). In addition, the CEO of a Canadian bank must be a resident of Canada and a director of the bank. Each director and officer of a bank in Canada must discharge his or her duties honestly and in good faith with a view to the best interests of the bank, and is required to exercise the care, diligence and skill set that a reasonably prudent person would exercise in comparable circumstances. While there is currently no law or regulation in Canada on bonus payments to management and employees of banks, OSFI requires Canadian banks to implement the Basel Committee's compensation principles on an annual basis, in addition to other international best practices.

In addition to the *Bank Act* provisions regulating the governance of banks, in January 2013 OSFI issued a best practice guideline (the Guideline), which was updated from a previous guideline that was published in 2003, setting out its expectations regarding corporate governance of banks (as well as of other federally regulated financial institutions, such as trust and loan companies and insurance companies). The Guideline aims to promote industry best practices in corporate governance and address international standards as articulated by organisations such as the Financial Stability Board, the Organisation for Economic Co-operation and Development, the Basel Committee for Banking Supervision and the International Association of Insurance Supervisors. OSFI also articulates its expectations with respect to corporate governance through its *Supervisory Framework* and *Assessment Criteria*, which are available on OSFI's website.

Banks are expected to conduct self-assessments of compliance with the Guideline, which are to be made available to OSFI upon request. In addition to complying with the Guideline, boards and senior management of banks are expected to be proactive and aware of corporate governance best practices that are applicable to their institution and, where appropriate, to adopt these best practices. It is important to note that the Guideline is not intended to apply uniformly to all organisations, but is to be applied flexibly depending on the nature, scope and size of the bank.

OSFI has noted that it will take a number of approaches to assess the effectiveness of a bank's corporate governance processes, including discussions with boards, board committees, senior management and oversight functions, and it will seek evidence that processes exist and are operating effectively.

<u>Board and board responsibilities</u>

The Guideline creates a critical distinction between the responsibilities of a bank's board of directors and the responsibilities of its senior management. While the board is responsible for setting the direction and general oversight of the management and operations of an entire bank, senior management is accountable for implementing the board's decisions and is responsible for directing and overseeing the operations of the bank.

At a minimum, the main focus of the board's attention and activities should be to approve the bank's (i) short-term and long-term enterprise-wide business objectives, strategy and plans, (ii) significant strategic initiatives or transactions, (iii) internal control framework, (iv) appointment, performance review and compensation of the CEO and, where appropriate, other members of senior management, (v) succession plans with respect to the board, CEO and, where appropriate, other members of senior management, (vi) mandate, resources and budgets for the oversight functions, and (vii) external audit plan, including audit fees and scope of engagement.

Senior management, on the other hand, should be responsible for reviewing and discussing the bank's (i) significant operational and business policies, (ii) business and financial performance in terms of the board-approved strategy, (iii) compensation policy for all human resources, (iv) implementation of internal controls, (v) organisational structure, and (vi) compliance with applicable laws, regulations and guidelines. However, the Guideline also notes that the board has a critical role in providing high-level guidance to senior management through review and discussion of the matters listed above. The board should also seek assurances from senior management that decisions are consistent with the board-approved strategy and risk appetite.

The Guideline identifies a number of attributes of an effective board, including: sound judgement when making decisions (taking into consideration the business objective and risk appetite of the bank); initiative (exercising responsibilities in a proactive manner with a readiness to probe and challenge); responsiveness to issues or deficiencies identified by senior management, regulators or the board itself; and operational excellence (permitting open debate and discussion and advance consideration of important matters). It also suggests that the board of a bank regularly conduct a self-assessment of the effectiveness of the board and board committee practices, occasionally with the assistance of independent external advisers (although the board has discretion in establishing the scope and frequency of such external input).

An effective board should provide objective and thoughtful guidance to, and oversight of, senior management and should collectively bring a balance of expertise, skills, experience, perspectives and competencies. The Guideline suggests that boards and board committees have reasonable representation of individuals with financial industry and risk-management expertise and that boards implement a skills and competency evaluation process that is reviewed annually and updated as appropriate. However, the Guideline does not specifically identify an optimal number of board members.

The Guideline requires that boards be independent from senior management. However, beyond the separation of the chair and CEO, OSFI does not view any single board structure as guaranteeing independence. Further, the board should document and approve an independent-director policy, taking into account the specific ownership structure of the institution and, where appropriate, direct tenure. In keeping with the idea that board independence should be maintained, the Guideline also suggests that the role of the chair be separate from the role of CEO. The chair is expected to have frequent dialogue with, and a high level of influence among, other board members and senior management, in addition to direct and ongoing dialogue with regulators.

For the board to fulfil its duties and role of oversight of the bank's operations, OSFI expects banks to establish oversight functions that are independent from operational management through an appropriate committee, such as an Audit Committee or Risk Committee. The heads of the oversight functions should have unfettered access and a direct reporting line to the board and its relevant committees. Boards should approve the mandate, resources and budgets of the oversight functions and, where appropriate, approve the appointment, performance review and compensation of the heads of these functions. More specifically, boards should review and discuss findings and reports produced by the oversight functions and follow up with concerns or findings that are raised by the oversight functions.

Given the different size and complexity of various banks, the scope and sophistication of such oversight functions may vary among institutions. For example, instead of establishing specific oversight functions, boards and senior management of smaller, less complex banks will ensure that other internal or external functions or processes provide the required level of controls and independent enterprise-wide oversight. In addition, the board should regularly assess the effectiveness of the bank's oversight functions and should occasionally, with the assistance of independent external advisers, conduct a benchmarking analysis of those functions or their processes. The board has discretion to establish the scope and frequency of such external input.

<u>Risk governance</u>

Risk governance is another key area that has been identified by OSFI. As mentioned above, the Guideline states that banks should have an enterprise-wide, board-approved Risk Appetite Framework

(RAF) that guides the risk-taking activities of the bank and that is tailored to its domestic and international business activities. The RAF should be well-understood throughout the organisation, and all operational, financial and corporate policies, practices and procedures of the bank should support the RAF. The RAF should set basic benchmarks, goals and limits of the amount of risk the bank is willing to accept. The RAF is intended to be forward-looking and should consider the material risks to the bank, in addition to the bank's reputation.

Depending on the size and nature of a bank, the board should establish a dedicated Risk Committee to oversee risk management on an enterprise-wide basis. The Risk Committee should consist of members that are non-executives of the bank, and members of the committee should have sufficient knowledge in risk management of financial institutions. Through assurances from the Chief Risk Officer, the Risk Committee should ensure that risk-management activities are independent from operational management, are adequately resourced and have appropriate visibility throughout the organisation. The Risk Committee should receive reports on significant risks of the bank and exposures relative to the bank's risk appetite (including approved risk limits) and should provide input on the approval of material changes to a bank's strategy and corresponding risk appetite. Banks should also have a senior officer who is responsible for identifying, measuring, monitoring and reporting on the risks of the bank on an enterprise-wide level, and who has unfettered access and a direct reporting line to the board or Risk Committee. This officer should provide regular reports to the board, the Risk Committee and senior management, including reporting on whether the bank is operating within the RAF. In addition, the board and Risk Committee should periodically seek assurances from the Chief Risk Officer that any risk information or analysis provided by business lines is objective. The Guideline also specifies that the Chief Risk Officer and risk-management function should not be directly involved in revenue-generation or in the management and financial performance of any business line or product of the bank, and that the Chief Risk Officer's compensation should not be linked to the performance of specific business lines of the bank.

Audit Committee

Under the *Bank Act*, banks are required to establish an Audit Committee comprising non-employee directors, a majority of whom are "non-affiliated" with the institution. Duties of the Audit Committee include reviewing annual statements and evaluating and approving internal control procedures.

The Guideline stipulates that the Audit Committee, not senior management, should be responsible for recommending to shareholders the appointment, reappointment, removal and remuneration of the external auditor; the Audit Committee should agree to the scope and terms of the audit engagement and approve the engagement letter. The Audit Committee should also establish criteria for the types of non-audit services that the external auditor can and cannot provide to the bank and should be satisfied with the content of the auditor's engagement letter before it is signed. The Audit Committee should also assess whether any change to the external auditor's materiality level and/or proposed scope continues to ensure a quality audit. Annually, the Audit Committee should report to the board on the effectiveness of the external auditor.

OSFI also expects an Audit Committee to discuss the overall results of an audit and any related concerns raised by the external auditor with both senior management and the external auditor, including key areas of risk for material misstatement of financial statements, areas of significant auditor judgment (including accounting policies and estimates), significant unusual transactions, difficult or contentious matters noted during the audit, changes in the audit scope or strategy, internal control deficiencies identified during the course of the audit and areas of financial statement disclosures that could be improved.

## Bank capital requirements

Regulatory capital of a bank in Canada consists of Tier 1 capital (which comprises Common Equity Tier 1 capital and Additional Tier 1 capital) and Tier 2 capital.[4] The *Bank Act* requires that banks maintain adequate capital and liquidity, and authorises the Superintendent to establish guidelines on these issues. The Superintendent has issued guidelines for both capital and liquidity.

The current capital adequacy guideline was revised in January 2013 to reflect the changes to capital requirements contained in Basel III.[5] Canada is a strong supporter of the work of the Basel Committee and firmly believes that Canadian banks should meet international best practices for capital. The intention is, therefore, for all Canadian banks to fully implement the Basel III requirements well in advance of 2019. In that regard, OSFI has required *all* financial institutions (regardless of the size of the institution or whether it is publicly traded) since the beginning of Q3 2013 to adhere to the new composition of capital public disclosure requirements set forth in the Basel Committee on Banking Supervision Disclosure Rules (the BCBS Disclosure Rules).[6]

Prior to 2015, Canada required that the ratio of a bank's assets to its capital not exceed an assigned leverage ratio (the maximum leverage ratio that could be assigned to an institution by the Superintendent was 23 times total capital, but most institutions would have had a much lower multiple). However, beginning in Q1 2015, Canada adopted the Basel III leverage ratio and disclosure requirements. As such, Canadian banks are now expected to maintain a leverage ratio that meets or exceeds 3% at all times. The Superintendent will also prescribe authorised leverage ratio requirements for individual institutions (and we would expect that many institutions will have been assigned a more restrictive leverage ratio than 3%). The authorised leverage ratio for each institution is confidential and not publicly disclosed. The authorised leverage ratio is assigned by the Superintendent on the basis of a number of factors, including the potential impact of the change in the leverage ratio on the institution's risk-based capital ratios compared to internal targets and OSFI targets, the adequacy of capital and liquidity management processes and procedures and the institution's risk profile and business lines (including diversification of exposures).

One of the principal activities of bank supervisors is to monitor compliance with the capital requirements established under the capital adequacy guideline. Supervisors receive quarterly capital returns from banks, and, when trends begin to develop that suggest that a bank's capital adequacy ratios are reducing, supervisors will require that bank to establish a plan to address these trends. The Superintendent has also published an advisory describing its supervisory intervention programme. Under the advisory, as capital deteriorates, a bank will be assigned escalating stages of intervention. Depending on the stage assigned, additional reporting will be required and other restrictions on the business of the bank may be imposed, including a requirement to cease all dividends paid to shareholders.

If the Superintendent believes that a bank is undercapitalised, it has the authority to direct a bank to increase its capital, and if the Superintendent believes the situation has deteriorated to the point that there is a material risk to depositors and other creditors, it may take control of the assets of the bank to protect them from erosion (or, if that is not sufficient, take control of the bank).

## Rules governing banks' relationships with their customers and other third parties

Investment powers

Under the *Bank Act*, banks are prohibited from engaging in or carrying on any business other than the business of banking, except as permitted thereunder. Banks can provide, among other services, any financial services, investment counselling services and portfolio management services; act as a financial agent; and issue and operate payment, credit or charge card plans. Banks may also invest in securities, but are limited in making "substantial investments" or in controlling certain types of entities. A substantial investment will arise through direct or indirect beneficial ownership of voting shares carrying more than 10 per cent of the voting rights attached to all outstanding voting shares of a corporation, shares representing more than 25 per cent of the shareholders' equity in a corporation, or interests representing more than 25 per cent of the ownership interests in any unincorporated entity.

Banks may, however, make controlling and, in certain circumstances, non-controlling substantial investments in Canadian banks, trust or loan companies, insurance companies, cooperative credit societies and entities primarily engaged in dealing in securities; in foreign regulated entities that are primarily engaged outside Canada in a business that if carried on in Canada would be the business of banking, the business of a cooperative credit society, the business of insurance, the business of providing fiduciary services or the business of dealing in securities; and in factoring, finance, financial leasing, specialised financing and financial holding entities. Certain substantial investments may be made only with the prior approval of the Minister of Finance or the Superintendent of Financial Institutions.

Confidentiality and privacy

All banks in Canada have a common law duty of confidentiality in their dealings with customers and in customer identification. In addition, Canadian banks must comply with Canadian privacy laws, including the federal *Personal Information Protection and Electronics Documents Act* (PIPEDA). PIPEDA applies to all organisations in respect of personal information used, collected or disclosed by an organisation in the context of commercial transactions, and requires that organisations obtain an individual's consent prior to using such personal information. A positive duty to safeguard personal information that has been collected is imposed on organisations, and certain limits on the retention of personal information are also set out in PIPEDA.

Consumer protection

The *Bank Act* contains a number of regulations that focus on consumer protection issues, including requirements for the disclosure of the cost of borrowing and disclosure of interest rates. As mentioned above, the FCAC was established to administer the consumer provisions of the *Bank Act* (in addition to strengthening oversight of consumer issues and expanding consumer education in the financial sector). In particular, the FCAC's mandate, which derives from the *Financial Consumer Agency of Canada Act*, includes the following: (i) to supervise federally regulated financial institutions to ensure that they comply with federal consumer protection measures that apply to them, with undertakings relating to the protection of customers as defined in legislation, and with directions from the Minister of Finance; (ii) to promote the adoption by financial institutions of policies and procedures designed to implement consumer protection measures, voluntary codes of conduct and financial institutions' public commitments designed to protect the interests of customers; (iii) to monitor federally regulated financial institutions to ensure that they comply with voluntary codes of conduct and respect the public commitments they have made to protect the interests of consumers and merchants; (iv) to promote consumer awareness of the obligations of financial institutions to financial consumers and of all matters related to protecting consumers of financial products and services; (v) to foster consumer understanding of financial services and related issues in cooperation with government bodies, financial institutions, consumer groups and other organisations; (vi) to collaborate and coordinate its activities with stakeholders to contribute to and support initiatives to strengthen the financial literacy of Canadians; (vii) to monitor and evaluate trends and emerging issues that may have an impact on consumers of financial products and services; (viii) to supervise payment card network operators to determine whether they are in compliance with the provisions of the *Payment Card Networks Act* and its regulations; (ix) to promote adoption by payment card network operators of policies and procedures designed to implement provisions of the *Payment Card Networks Act* and its regulations; (x) to monitor implementation of voluntary codes of conduct adopted by payment card network operators and any public commitments they make regarding their commercial practices relating to payment card networks; and (xi) to promote public awareness about the obligations of payment card network operators under a voluntary code of conduct or the *Payment Card Networks Act*.

In cases of contravention or non-compliance with legislation, the FCAC will notify a bank of such violation and may also seek a commitment from the bank to remedy the issues within a short time, impose a monetary penalty, impose criminal sanctions or take other actions as are necessary.

With respect to protection of customers' deposits, the CDIC was established to ensure the safety of small deposits and to assist in maintaining stability and public confidence in the financial system by providing deposit insurance for the banks' depositors. CDIC member institutions fund deposit insurance through premiums paid on the insured deposits that they hold. Deposit insurance is automatic for certain eligible Canadian dollar-denominated deposits (including savings accounts, chequing accounts and term deposits with an original term to maturity of five years or less)[7] up to $100,000 per depositor per institution.

* * *

**Endnotes**

1. World Economic Forum, Global Competitiveness Report, 2008, 2009, 2010, 2011, 2012, 2013 and 2014.

2. http://www.osfi-bsif.gc.ca.
3. The Capital Adequacy Requirements Guideline has most recently been further updated effective January 2015.
4. Common Equity Tier 1 capital includes common shares. Additional Tier 1 capital includes preferred shares. Tier 2 capital includes subordinated debentures.
5. The Capital Adequacy Requirements Guideline has most recently been revised effective January 2015.
6. See the Basel Committee on Banking Supervision's publication titled Composition of Capital Disclosure Requirements: Rules Text, June 26, 2012, for more details on these capital ratios.
7. Products not insured by CDIC include mutual funds, stocks, bonds and term deposits with a date to maturity of more than five years.

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# THE CANADIAN P3 EXPERIENCE

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# Infrastructure Investment
# The Global Challenge

# Infrastructure Investment

– **Drives Jobs**
– **Drives Growth + Prosperity**
– **Drives Global Competitiveness**

**But some realities....**

# Infrastructure Challenge

Infrastructure Deficit

+ Fiscal Reality

= Innovative Approaches

# Canadian P3 Market

- Canada started to implement P3s over twenty years ago with the Confederation Bridge toll project linking the Province of Prince Edward Island to the mainland
- There is today broad public approval and acceptance (CCPPP survey 2014, 62% of Canadians open to using P3s)
- Some public sector unions remain opposed, however, private sector construction unions are supporters and some are direct equity investors in P3s
- Public sector pension funds are major investors

# Canadian P3 Overview

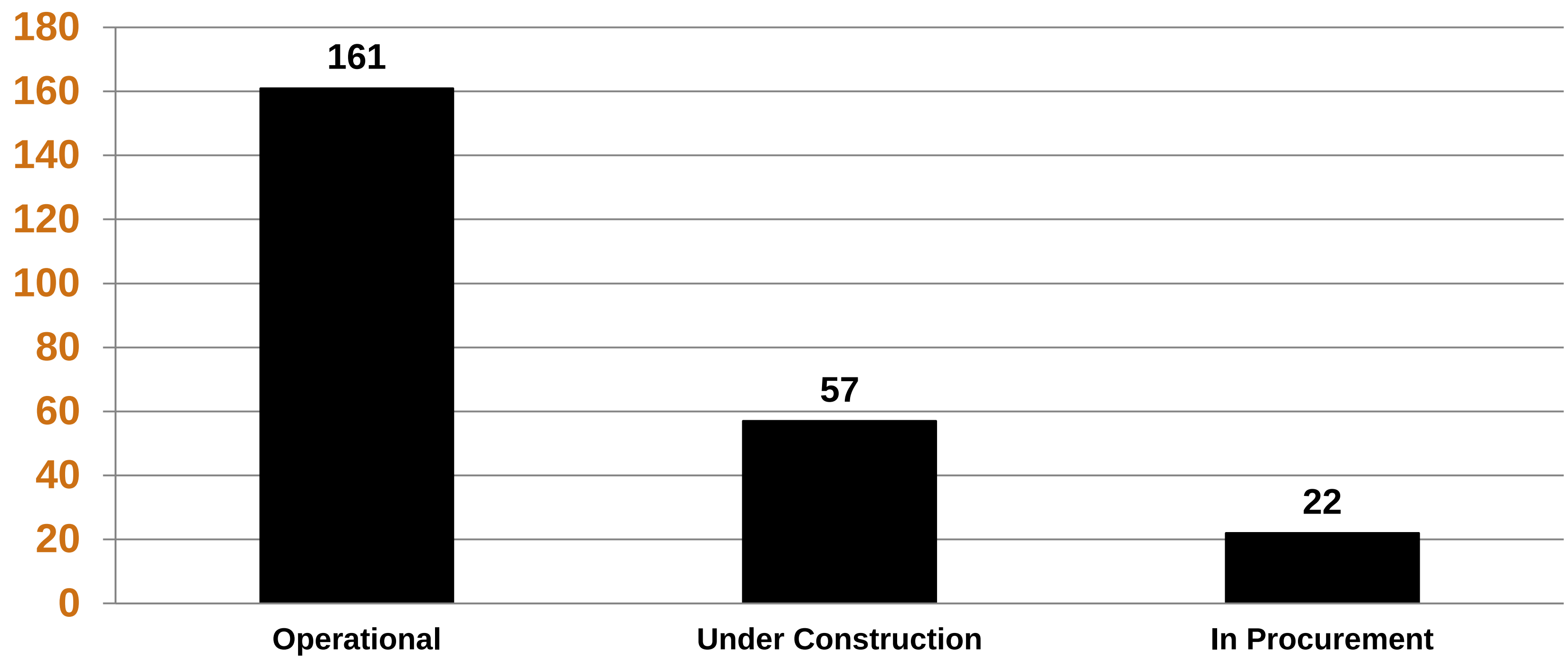
- 23 year history
- 240 projects
- $115+ Billion
- Best suited to projects with opportunity for material risk transfer

# PPP Projects by Sector

| Sector | Number | Value ($B) * |
|---|---|---|
| Transportation | 56 | 50.8 |
| Energy | 11 | 26.0 |
| Hospitals & Healthcare | 91 | 25.3 |
| Justice/Corrections | 19 | 5.4 |
| Education | 14 | 2.6 |
| Accommodations | 7 | 2.5 |
| Recreation & Culture | 16 | 1.3 |
| Government Services | 4 | 1.0 |
| Water & Wastewater | 18 | 1.0 |
| Information Technology | 4 | 0.8 |
| **Total** | **240** | **116.8** |

*Includes only costs of projects where costs have been finalized and released
*Data from CCPPP Website as of August 30, 2016*

# PPP Projects by Status




*Data from CCPPP Website as of August 30, 2016*

# Canada’s P3 Model

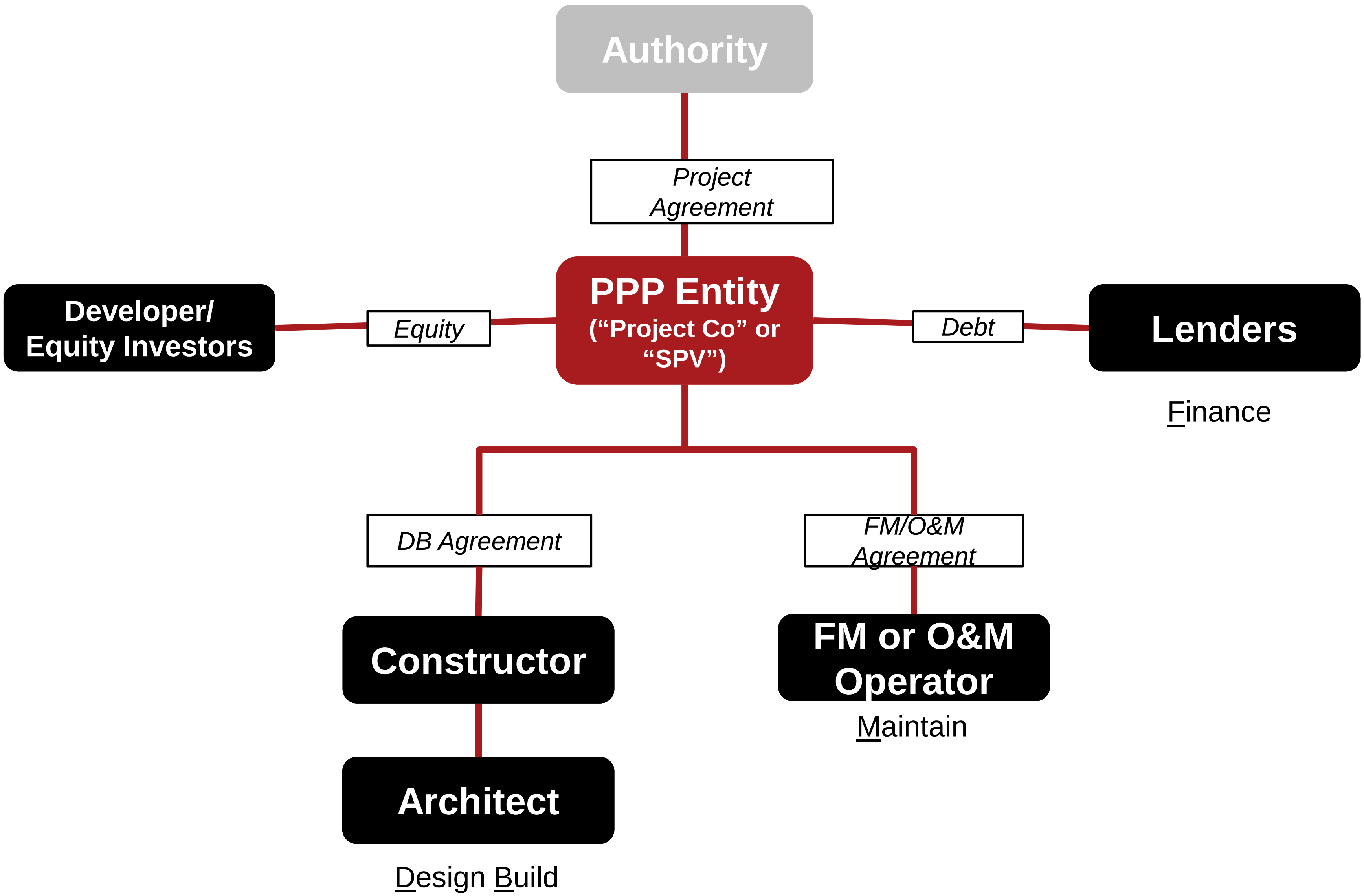
# Canadian P3 Agencies

- **The use of government procurement agencies is key, the agency model allows for more streamlined and innovative procurement focused on P3 best practices without losing ultimate government accountability**

- **Provincial**
  - **Infrastructure Ontario (*www.infrastructureontario.ca*)**
  - **Partnerships BC (*www.partnershipsbc.ca*)**
  - **Alberta Infrastructure (*www.infrastructure.alberta.ca*)**
  - **Infrastructure Québec (*www.sqi.gouv.qc.ca*)**
  - **Partnerships New Brunswick**
  - **SaskBuilds (*www.saskbuilds.ca*)**

- **Federal**
  - **PPP Canada (*www.p3canada.ca*)**

# Sample P3 Structure for DBFM Model



# Sample Procurement Time Line

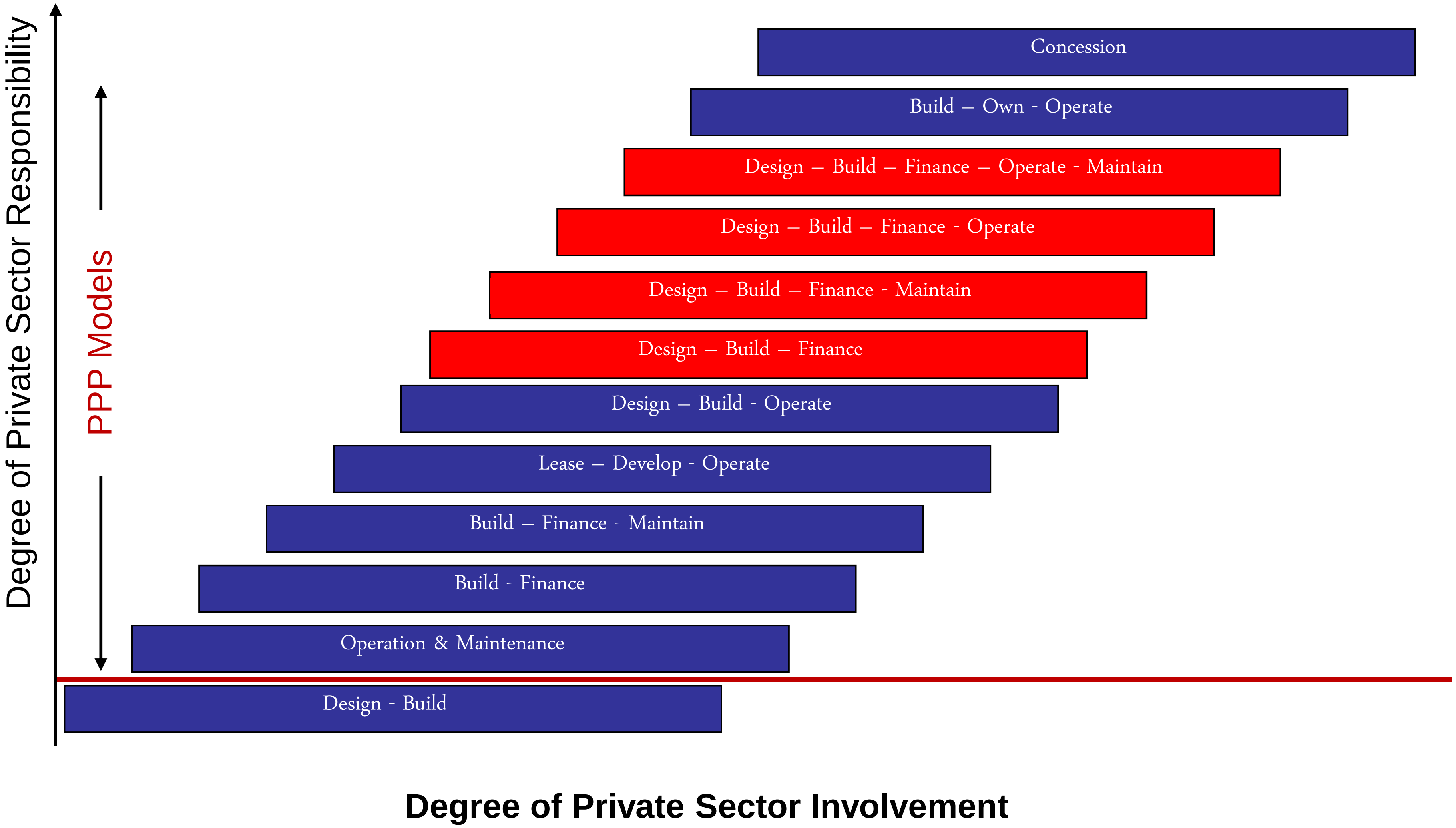
- RFQ Released
- RFP Released
- RFP Closed
- Evaluation & Selection
- Commercial and Financial Close

| Assignment of Project to Agency | Pre-transaction Phase Approx 6 months | 5-7 months | 6 -7 months | 3-4 months | 1-2 months | Construction Phase |
|---|---|---|---|---|---|---|

Approximately 15-20 months

Source: Infrastructure Ontario

# Models of PPP in Canada



# P3 Market: Deal Structures

| Project | Number |
|---|---|
| Build Finance (BF) | 36 |
| Design Build Finance (DBF) | 22 |
| Design Build Finance Maintain (DBFM) | 77 |
| Design Build Finance Maintain Operate (DBFMO) | 63 |
| Design Build Finance Operate (DBFO) | 19 |
| Other | 23 |
| **Total** | **240** |

*Data from CCPPP Website as of August 30, 2016*

# Canadian P3 Results

- **On Time**
- **On Budget**

**Economic Impact (2003 - 2012)**

- **290,680 Direct Jobs**
- **$25.1B Contribution to Direct GDP**
- **$9.9B Cost Savings**
- **$7.5B Tax Revenue**

# Success Factors: Canadian P3 Model

- Committed Governments
  - P3 Champions – Political will, policy direction
  - Consistent Deal Flow
- Public Ownership and Public Interest Preserved
- Expertise in public sector
  - Institutionalized through dedicated agencies
  - Standardized Documentation and Processes drive completion and excellence
    - Technical, financial and budget due diligence must be done up front
    - Use of templates for procurements and contracts, and project pipeline matter to the market
    - Private sector experience in architecture, engineering, law, finance, procurement, facility management, or communications and construction/operations added to public sector team

# Success Factors: Canadian P3 Model

- **Value for Money**
  - **Performance-based Contracts**
  - **Appropriate Risk Transfer and Performance Security in place**
  - **Built-in Lifecycle Maintenance**
  - **Alignment of interests, negotiating leverage**
  - **Private sector equity at risk**
- **Financing is not funding; confidence in budget commitments must be firm**
- **Performance risk born by equity and project lenders**
- **Deep Financing Markets**
- **Procurement**
  - **Competitive**
  - **Efficient**
  - **Transparent and fair**
  - **Selection of good partners**

## Model Drives Excellence in Design, Construction, Financing, Operating and Life Cycle Performance

- P3 Agency works with clients to drive high quality design innovation through use of performance-based output specifications
  - P3 balances design-technical merit and cost; in 80% of IO projects, the winning team has both the highest ranking financial submission and one of the top two design-technical scores

- Bidders can differentiate their bid proposals through innovative solutions that drive value, resulting in significant capital and life cycle cost savings

- A whole life-cycle approach to the building design and facilities systems maintenance, repair, replacement and operation increases opportunities for improved life-cycle operating performance, and owner satisfaction

# P3 Track Record for Province of Ontario

- Infrastructure Ontario (IO) is the Province's procurement agency for P3s known in Ontario as AFP (Alternative Finance and Procurement)

- Third-party assessment of IO's performance for the first 45 AFP projects to reach substantial completion since 2005
  - 45 AFP Projects had reached substantial completion by March 31, 2015, with an approximate capital value of $12 billion
  - 98% were completed on budget (within the contract award plus post-contract contingency)
  - 73% were completed on time or within one month of their scheduled completion date

## Key Infrastructure Opportunities and Challenges

- Accelerated infrastructure spending
  - Commitment to infrastructure at all levels of government is an exciting opportunity – but creates capacity challenges (financial capacity; project oversight capabilities; supply of skilled trades)
- Shift to linear infrastructure
  - Transit projects through urban environments have significantly different public interaction and risk profile than other types of infrastructure
  - Sponsors need to ensure all approvals provided for and expropriation of required lands is or will be completed in time for construction
- Increasing project and partnering complexities
  - Larger and more complex projects result in more complex structures for both project companies (e.g., multi-party joint ventures with asymmetric risks) and funders(equity/sub-debt/bank/bank-bond/bond/syndications)
  - Ongoing need to balance risk transfer between authority and consortium
  - risk identification and assignment of risk critical to optimizing value for money in a P3 project

# Range of Challenges in the US

1. Need for authorizing State legislation
2. Commitment of governments to infrastructure renewal
3. Governments at state and municipal level require in-house expertise to identify a pipeline of potential P3 projects, establish appropriate procurement agencies
4. Lenders and equity providers need to develop P3 risk assessment tools and funding mechanisms

# Range of Challenges in the US

4. Ability to act within budget authority: need for annual appropriations and limited agreement/authority for States to sign multi-year contracts to deliver projects
5. Public Support:

   – in Canada assets remain public and core operations are performed by the public entity

   – successful projects and the creation of needed courthouses, hospitals, roads, transit fosters that public support

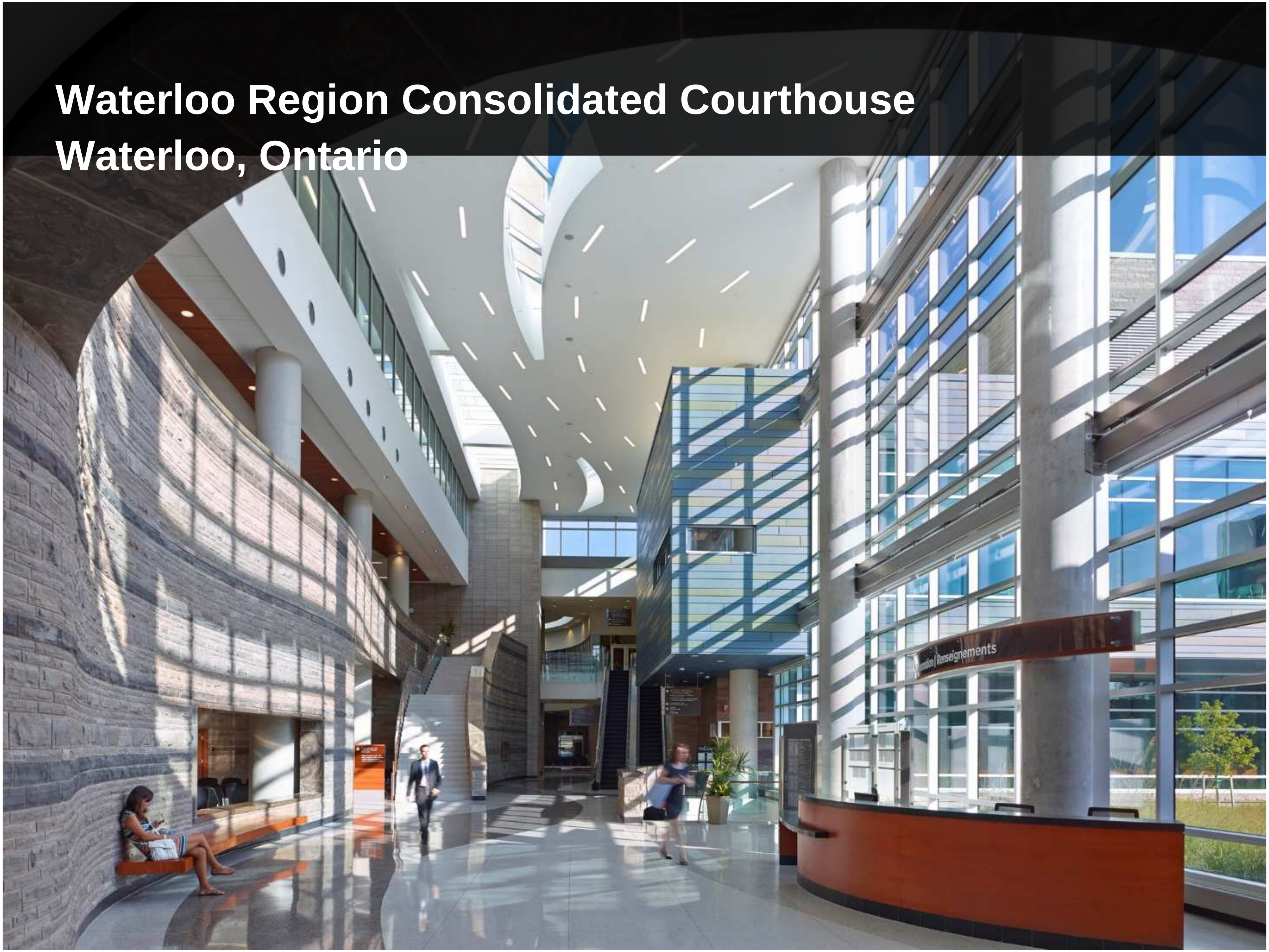
# Canadian P3 Projects

**[Please see how P3 Projects can deliver excellence in design. Many Canadian P3 projects have garnered international architectural awards]**

# Canada Line
# Vancouver, BC

# Bridgepoint Health
# Toronto, Ontario

# Waterloo Region Consolidated Courthouse
## Waterloo, Ontario



# Forensic Services and Coroner’s Complex
# Toronto, Ontario

# Goderich Water & Wastewater System Ontario

# Montréal Concert Hall –
# Maison Symphonique, Québec

# Pan Am Athletes’ Village
# Toronto, Ontario

# Viva Bus Rapid Transit Expansion
# York Region, Ontario

# St. Michael’s Hospital Expansion
# Toronto, Ontario

# Next Generation of P3s
# Canada and Beyond

# The Next Generation of P3 in Canada

**Players**

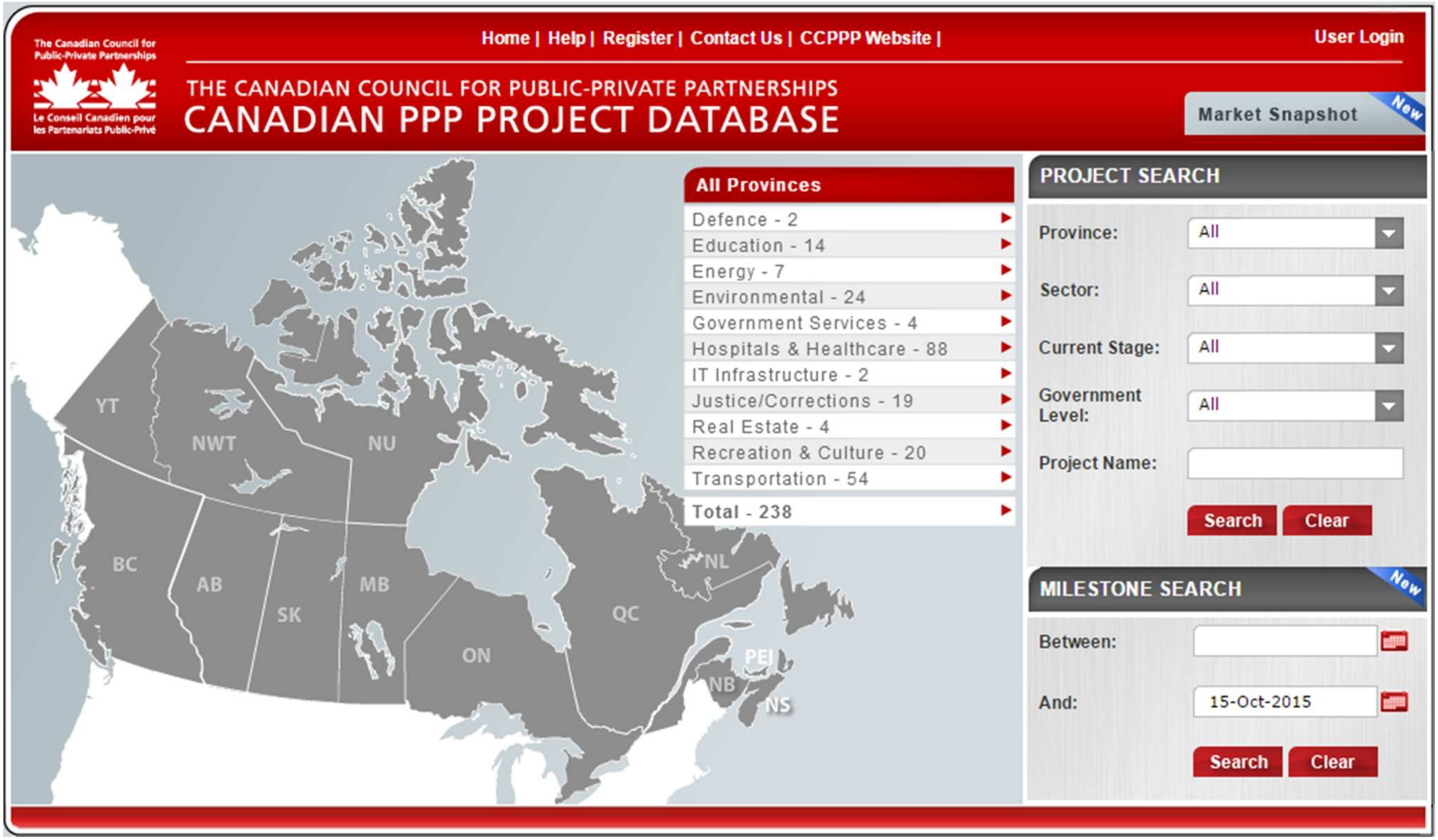
- Federal government
- Territories
- Municipalities
- First Nations
- Provinces

# The Next Generation of P3 in Canada

**Sectors**

- **Urban Transit**
- **Water/Wastewater**
- **Social Housing**
- **Green Energy**
- **Broadband**
- **Government Services**

# CCPPP Canadian Project Database-an excellent source on Canadian P3s at *www.pppcouncil.ca*



M&A | Top Trends 2016

TORYS LLP

# Torys looks ahead to the 10 trends that will shape M&A.

# OVERVIEW

Appetite for deals is set to define many of the trends in M&A in the year 2016. We see dealmakers pursuing novel ways to source investment opportunities, solve governance issues and close their transactions.

Investors are looking for new opportunities to use their capital, and the emergence in Canada of the special purpose acquisition company or "SPAC" is one example of this trend. Creative business collaborations are also driving deal activity: we expect more businesses will join forces with local investors, strategic partners and competitors to advance their strategic objectives.

M&A initiatives will continue to encourage the growth of Canadian investment outside Canada alongside emerging opportunities for foreign investors in Canadian assets. Attractive domestic targets will include distressed businesses in the oil and gas sector as the steep drop in oil prices and tightening of capital markets begin to take their toll.

Infrastructure is also drawing interest from investors. We expect competition in this space to increase among traditional infrastructure investors and private equity investors, who are both allocating capital to a broader scope of infrastructure investments, including businesses that support core infrastructure assets. Electricity businesses are especially drawing the attention of investors, as governments look to consolidate assets in this sector.

The changing corporate governance landscape is influencing dealmaking as activists and management increasingly collaborate on improving shareholder value. This trend toward discussion, negotiation and agreement on business strategy will forestall hostile, formal proxy contests, resulting in more "wins" for shareholders.

Evolving governance practices can also be seen in executive compensation arrangements in M&A transactions as public scrutiny continues to grow. We predict that the focus of compensation practices in the deal context will shift from severance to retention and the long-term best interests of the company.

Other steps are also being taken to ensure the success of new business combinations. Early planning on tech-related issues and assets "in the cloud" is helping dealmakers close transactions successfully. More parties may also opt to resolve regulatory intervention on their transactions through litigation in order to get deals done.

Torys' M&A lawyers are looking ahead to 2016, and this is what they see.

# OUR EXPERTISE

We have a decades-long history of being considered among the best M&A practices in Canada, with a strong presence in public and private markets across the country, in the U.S. and around the world. We specialize in sophisticated, complex and innovative transactions, both public and private. Among our long-standing clients are major corporations, entrepreneurial and growth-oriented companies in all major sectors, investment funds, pension funds and all levels of government.

## GETTING DEALS DONE

Our M&A team works across practices, industries and borders to get deals done for our clients. Our experience and commercially minded approach allow us to run deals of any level of complexity or profile smoothly. We draw from the firm's sector expertise to run deals efficiently across virtually every sector, including REITs, mining, oil and gas, power, infrastructure, pharma, life sciences, and technology and media.

**#1**

Ranked Band 1 by Chambers and Partners

**OVER $175 BILLION**

Value of deals from 2014-present

**+141 DEALS**

Across 16 industries

# TORYS' M&A PRACTICE

A SELECTION OF OUR RECENT DEALS

CINVEN

**US$3.5B**

SALE OF AMDIPHARM MERCURY LIMITED TO CONCORDIA HEALTHCARE CORP.

ALAMOS GOLD

**US$1.5B**

MERGER WITH AURICO GOLD INC.

ROGERS COMMUNICATIONS JOINT VENTURE ARRANGEMENTS WITH BCE INC. TO ACQUIRE A

**50%**

STAKE IN GLENTEL INC.

BROOKFIELD PROPERTY PARTNERS

**US$5.5B**

BID TO ACQUIRE THE REMAINING INTEREST IN BROOKFIELD OFFICE PROPERTIES INC.

LOBLAW

**C$12.4B**

ACQUISITION OF SHOPPERS DRUG MART CORP., ONE OF CANADA'S MOST RECOGNIZED RETAIL BRANDS

CANADIAN PENSION PLAN INVESTMENT BOARD

**US$12B**

ACQUISITION OF ANTARES CAPITAL, GE CAPITAL CORP.'S PRIVATE EQUITY LENDING UNIT

# CONTENTS

1

# SHAREHOLDER ACTIVISM: WHO IS WINNING NOW?

James D. Scarlett, James C. Tory, Karrin Powys-Lybbe

Shareholder activism continues to develop and expand in Canada. We are seeing continued growth in activity and influence from activists coupled with a decline in activist initiatives that reach the point of publicly disclosed proxy contests. This is due to the increased willingness of directors and activists to engage constructively with each other rather than view their interactions as a “contest” in which either management or the activist “wins” with the other being the “loser.” Such constructive engagement is increasingly becoming the price that activists and incumbent boards must pay to win the support of traditionally passive institutional investors who are becoming more and more engaged in their portfolio companies and whose support will often be decisive to the success or failure of an activist campaign. The result should be more “wins” for shareholders.

While the number of formal proxy contests has been declining in Canada since a high point in 2012, shareholder activism is now a familiar part of the capital markets in Canada. And there is no sign that the pressure on boards will abate: FTI Consulting recently conducted a survey of 24 activist firms that found that 96% of activists believe that this activity will continue to increase, with primarily activist funds holding assets of US$169 billion and partially focused funds having an additional US$173 billion.[1]

**A recent survey by FTI Consulting reports the following:**

86%

of the activists surveyed expect to raise more capital in the next 12 months.

70%

of the activists surveyed expect to increase partnerships with institutional investors and pension funds.

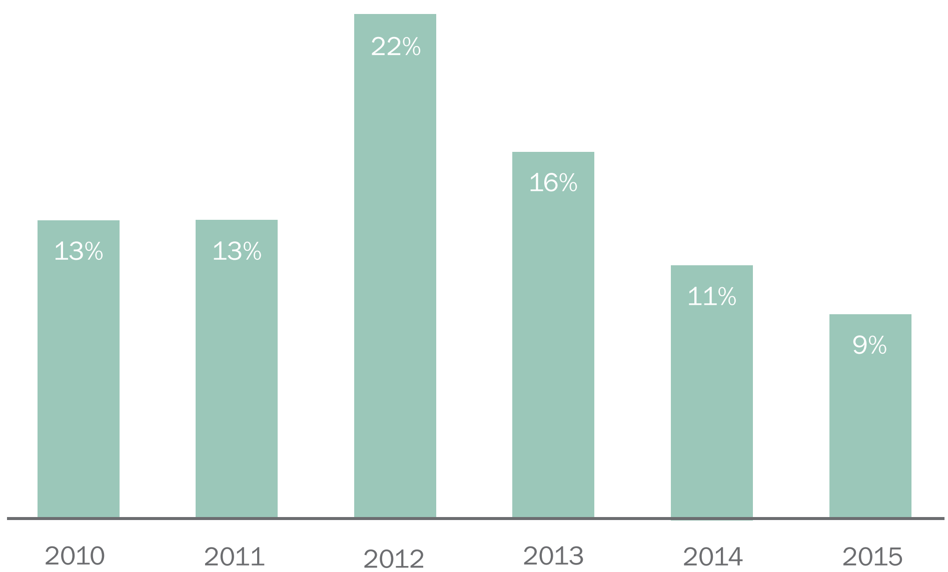
as competition grows in the U.S. market, activists will look more closely at Canadian and European targets.

[1] Source: *The Shareholder Activists’ View 2015*, FTI Consulting. Available at: http://www.fticonsulting.com/~/media/Files/us-files/insights/reports/shareholder-activism-parti.pdf

The tactics of activists vary—some pursue “winner-take-all” control challenges and others work toward change through agreements with incumbent boards—but in each case there is a challenge to the status quo.

So who is “winning” this war these days, and what does the future hold? That depends on how you define success. There has been a decline in the number of formal proxy contests in Canada from 2012 to 2015 and it appears as if management has been able to hold its ground more often in the last two years. In addition, challenges are increasingly transactional—initiatives proposing operational change or implementation of specific transactions—rather than board/proxy control contests. There are also more instances of activist shareholders reaching a settlement with their target before getting to the stage of a formal proxy contest.

### Figure 1. Decline in Formal Proxy Contests in Canada




Percentage of activist campaigns (2010-2015) that resulted in a formal proxy contest, based on a review of SEDAR filings. 2015 data as of November 1, 2015.

This could be interpreted as management starting to win. But those statistics only tell part of the story. Behind the statistics, the trend we are seeing is for management and boards to recast the battle, seeing this as an opportunity to engage in productive discussions with shareholders as the directors discharge their fiduciary duties. An activist’s agenda may reflect “short termism” of a kind that no responsible board could support, but not always. Activists are often well informed and may be able to provide insights on strategy, market or other factors that the board and management should be considering. By engaging with such activists with a view to the best interests of the company, boards are able to settle disputes before they become formal proxy contests, contributing to the decline we saw in the number of publicly announced proxy contests in 2015.

Constructive board engagement with shareholders is increasingly important in the changing corporate governance landscape in which managements' traditional shareholder relations approach risks falling short of the governance expectations of institutional shareholders. Prudential institutional investors are abandoning their passive approach to their portfolio companies in favour of greater engagement, looking to maximize the value of their investments by focusing on improved corporate governance. The support of institutional investors requires boards to demonstrate their expertise, independence and willingness to engage constructively with shareholders, including activists who are pursuing shareholder-friendly agendas.

This approach was seen in Trian Fund Management, L.P.'s campaign to gain four seats on the board of E.I. du Pont de Nemours & Co (DuPont) earlier this year. DuPont succeeded in defending against Trian's campaign, and its success was reportedly due to its active engagement with investors, strong communication and execution of the company's strategic plan, and effective responses to criticisms made by Trian. DuPont's directors and senior management team were directly engaged in these initiatives, helping gain support of shareholders for a persuasive plan to grow shareholder value.

Where does this leave us when looking ahead to 2016? We think shareholder activism and increased engagement of institutional shareholders will continue. We also think we will see a continuing trend toward discussion, negotiation and agreement on business strategy, involving management, activists and other shareholders, forestalling hostile, formal proxy contests. The result will be more "wins" for shareholders.

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2

# THE M&A CLOCK IS TICKING FOR SPACS IN CANADA

John Emanoilidis, Rima Ramchandani, Mile T. Kurta

A special purpose acquisition company, or SPAC, is a publicly traded shell company created with the commitment to purchase an unidentified future target. Long popular in the United States, this novel way to finance an M&A transaction has broken ground in Canadian IPO markets. So far, the Canadian variety is modelled closely after the U.S. SPAC, sharing a number of investor-friendly characteristics and among them, a defined timeline to source an acquisition. The future of SPACs in Canada—including the success that the country's early adopters will have in investing approximately C$1 billion of raised capital—is a trend being followed closely by market participants.

## How Does a SPAC Work?

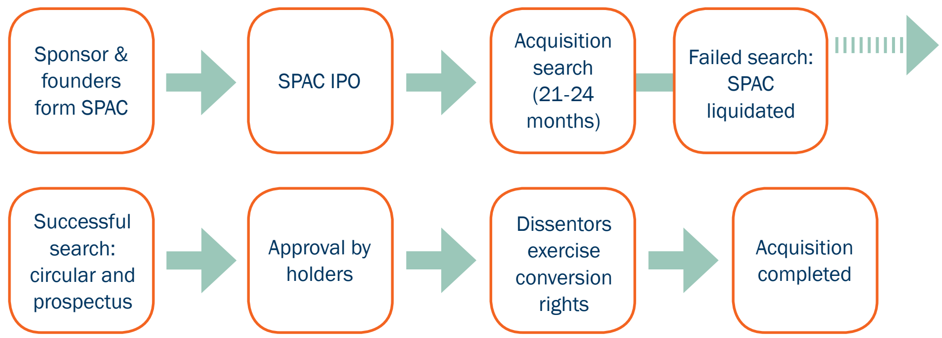
A SPAC is a shell that raises capital through an IPO to investors. IPO proceeds are placed in escrow to fund the future acquisition of one or several businesses or companies (a "qualifying acquisition"). At the IPO stage, the SPAC has no revenue, assets or operating history, but is backed by a sponsor and proven management team or founders with the relevant knowledge and contact base to source the prospective transaction. It is on the strength of the founders' expertise that investors are willing to invest in a SPAC.

Units offered to investors typically comprise one share and a half purchase warrant exercisable at a premium to the IPO unit price following completion of the qualifying acquisition. If the acquisition is not completed by the set date—typically 21 to 24 months after the launch of the IPO—the SPAC is liquidated and escrowed proceeds are distributed to investors. The founders, who normally hold a 20% equity stake in the SPAC, cannot participate in the liquidation and lose their initial investment.

A qualifying acquisition cannot be completed without approval from investors by a majority vote. Under current practice, sponsors are entitled to vote their equity stake on a proposed acquisition, which facilitates meeting the shareholder approval requirement. Shareholders may also exercise conversion rights entitling them to receive their pro rata portion of the escrowed proceeds, regardless of whether and how such shareholders vote on the proposed acquisition. Current practice limits the exercise of these conversion rights by prohibiting a SPAC shareholder and its affiliates and joint actors from converting more than a total of 15% of the number of SPAC shares issued and outstanding following closing of the IPO.

Newer U.S. SPACs dispense with the shareholder approval requirement, thereby removing a degree of uncertainty; rather, shareholders are given the right to have their interest redeemed for cash without a shareholder vote (unless otherwise required by law or stock exchange rules). In addition, the JOBS Act has made it simpler and more cost-effective for SPACs to go public in the U.S. by reducing some public company reporting requirements.

## SPAC Process




## Who Might be Interested in a SPAC?

SPACs are intended to provide an opportunity for the public to invest in companies that normally attract investment from private equity firms, with the benefit of significant investor protections, including the right for investors to vote on the qualifying acquisition, exercise their conversion rights described above or recover their pro rata portion of the escrowed fund if the SPAC fails to complete a deal within the specified timeline.

For target companies, the SPAC presents an alternative to a traditional IPO: the seller can cash out with the possibility of retaining an equity stake in a publicly traded vehicle that has immediate access to a strong and reputable board of directors and management team. As a listed shell company with no operating history, the SPAC also gives targets access to the capital markets in a process potentially less costly than undertaking a reverse takeover of an existing public company.

## What Makes a SPAC Successful?

The key driver in a SPAC IPO's success is the strength and credibility of the founders selecting the target acquisition. And unlike traditional PE funds that may have investment restrictions, the SPACs that have gone public to date generally permit their founders to focus on the target, geography and sector of their choice. However, as the Canadian SPAC market matures, we would expect to see SPACs with a more clearly defined sector or geographic focus.

Founders face a relatively short deadline to source a quality target in a competitive environment, seek shareholders' majority approval (including preparing and filing an information circular and prospectus on the proposed acquisition) and consummate the transaction—and if they fail to meet the deadline, the founders must forfeit their investment in the SPAC. It may also be challenging for SPACs to compete in hot auctions where other prospective buyers may not be subject to similar restrictions.

Success also depends on the extent to which shareholders exercise their conversion rights. The withdrawal by some dissenting shareholders of their relevant portion of the escrowed proceeds in the face of a proposed acquisition has the ability to influence the amount of funds readily available to complete the transaction. This may require the SPAC to raise additional financing, adding another layer of complexity and timing to the process. While a proposed acquisition will also be conditioned on conversion rights not being exercised beyond a set threshold, uncertainty around shareholder response contributes to the overall risk profile of the SPAC.

Recent U.S. SPACs have introduced a number of workarounds to address conversion risk. For example, third parties and sponsor-related parties have made equity investments in the SPAC prior to completion of the acquisition, or committed to do so in the event of a capital shortfall. Proceeds have helped secure SPAC cash levels while also demonstrating investors' backing of the proposed acquisition. SPACs have also raised capital through private placement offerings timed simultaneously with the acquisition closing.

The success of the SPAC in Canada will be measured in a few years' time, when the race to beat the clock and complete a qualifying acquisition has been decided.

On the flipside, a successful SPAC has the potential to make significant gains for founders with a 20% stake (which they acquired for nominal value on the SPAC's formation) in the post-acquisition vehicle, though U.S. practice shows that these sponsor promotes have been reduced as part of the agreement reached to complete a qualifying acquisition. It remains to be seen whether the size of sponsor promotes will equally decrease in Canada as the SPAC market here evolves.

### SPACs in Canada so Far

Currently, the structure of the Canadian SPAC is largely influenced by the U.S. model described above. TSX rules require that SPACs complete a qualifying acquisition within 36 months of their IPO, though all recent Canadian SPACs have been structured to complete their acquisitions within a more competitive 21 to 24 months (unless shareholders and the TSX approve an extension to 36 months).

The Canadian SPAC IPOs launched this year have largely drawn interest from both Canadian and U.S. institutional investors, with the type of retail investors often seen investing in SPACs in the U.S. not yet forming a significant portion of the Canadian investor pool. The founders of these SPACs include some of Canada's most experienced and successful business players, who are expected to extend their access to vast networks and potential acquisition opportunities to the SPACs they have helped found. Long term, the success of the SPAC in Canada hinges on whether the SPACs that have gone public will complete qualifying acquisitions within their tight timeframes.

### Is the Canadian SPAC Here to Stay?

Like other IPOs, SPACs are subject to market conditions. Their emergence in Canada comes at a time when investors are looking for ways to commit their capital. Ultimately, players hoping to engage in a SPAC in Canada should view the opportunity not only alongside their broader assessments of the marketplace, but also with the understanding that a SPAC's ultimate success will be measured in a few years' time, when the race to beat the clock and complete a qualifying acquisition has been decided.

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3

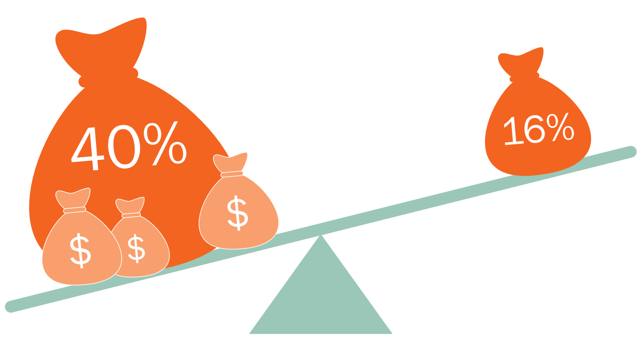
# NEW INVESTORS, NEW SCOPE: INFRASTRUCTURE INVESTING IS BROADENING

Mark W.S. Bain, Matthew W. Cockburn, Tara A. Mackay

Significant capital expenditure will be required in the years ahead to improve infrastructure worldwide. As governments look to private capital to play a role in this push, competition among investors for infrastructure assets is growing rapidly. Private equity funds are increasingly looking to invest in infrastructure-like assets. At the same time, traditional infrastructure investors are broadening the scope of their investment mandate: they are shifting their focus from direct investments in core infrastructure to related businesses and operations that support them. This is leading to an overlap of infrastructure investors and private equity investors in this space. We expect this trend will continue.

## The Appeal of the Infrastructure Asset Class

Investors are increasingly allocating capital to infrastructure investing. The growing appeal of the asset class can be attributed to a number of factors: it offers some protection against economic cycles and inflation; it is less volatile than traditional private market investments; and it provides steady cash flow returns. Infrastructure investing also matches well with the investment profile of investors with longer-term liabilities, such as pension funds.




In a report by Preqin, over 40% of investors surveyed intended to increase infrastructure investing in 2015. Only 16% planned to allocate less funds.[1]

[1] Source: *2015 Preqin Global Infrastructure Report.* Available at https://www.preqin.com/item/2015-preqin-global-infrastructure-report/4/10606.

In the private equity space, investors are establishing investment funds with longer investment horizons to pursue infrastructure deals. They are also dedicating more capital to the sector. For example, KKR recently raised a US$3.1 billion global fund focused on infrastructure investments. Domestically, Canada Pension Plan Investment Board also recently announced the formation of an investment vehicle with allocated funds in excess of C$1 billion targeting investments in midstream energy infrastructure in the Western Canadian basin.

It follows that investor demand for core infrastructure assets is high and competition is driving up prices. As a result, infrastructure investors are now looking beyond core assets for opportunities to invest in businesses that support or manage infrastructure such as transportation assets, water utilities, power generation and social institutions. For infrastructure investors, these businesses share many of the attributes of the underlying assets—because they relate to essential services with steady, long-term consumer demand, they too present lower commercial risk and often benefit from long-term contracts guaranteeing stable revenue streams. However, these businesses can benefit from improved efficiencies and present opportunities to realize enhanced returns, thereby also appealing to private equity investors.

## Private Equity in Infrastructure: What are the Challenges?

Alongside infrastructure investors, we are increasingly seeing private equity players pursue investments in infrastructure-related businesses where prospects to maximize value present a compelling business case. However, unlike conventional investing in the private markets, deals in infrastructure present unique challenges that private equity investors must face.

### Regulation

These businesses are heavily regulated, either as a result of the regulatory framework that applies to the infrastructure asset and/or the longer-term contracts that govern it. Government-led sales processes are also highly regulated, making them more challenging than typical private company auctions. Investors will need to make important concessions about transparency, both in relation to the sales process and the business once it has changed hands.

### Operations

Complex businesses may require deep industry knowledge and expertise. And while day-to-day control may reside with the investor, the investor will nevertheless face overarching operational restrictions under the relevant contractual framework or concession agreement.

### Governance

Investments in these businesses may require partnering with the public sector. The government entity will have certain control rights over investment decisions and the exercise of those rights will not always be driven by business considerations; social, political and economic considerations may have equal, or even more important, weight in decision-making processes. These rights will ultimately constrain what the investor can do with the business, particularly on exit.

## Transparency will need to be considered when making investments in highly regulated businesses in the infrastructure space.

Despite these challenges, we predict that the overlap between private equity and infrastructure investing will keep expanding. This is especially the case as governments and institutions turn their attention more and more to addressing infrastructure needs. In Canada, the platform of the newly elected federal government contemplates significant investment in infrastructure assets along with other strategies, including a federal infrastructure bank[2] to help provincial and municipal governments finance projects.[3]

Time will tell how these plans unfold in Canada as governments around the world focus on projects to develop, refurbish and upgrade infrastructure. And as private investors venture into the infrastructure space, they may need to adjust their traditional perceptions about, and approach to, dealmaking in order to tap into this growing sector.

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[2] Source: Liberal Party of Canada. Available at: http://www.liberal.ca/realchange/canada-infrastructure-bank/.

[3] Source: Liberal Party of Canada. Available at: https://www.liberal.ca/trudeau-commits-to-largest-infrastructure-investment-in-canadian-history/.

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4

# CONSOLIDATION IN THE REGULATED ELECTRICITY SECTOR IS ACCELERATING

Sharon C. Geraghty, Charles Keizer, Aaron S. Emes

Circumstances are converging to encourage consolidation in the electricity sector. Electricity businesses are gaining attention from investors as attractive M&A targets. Particularly on the transmission and distribution side, these highly regulated businesses tend to deliver predictable returns that are attractive in low-interest-rate markets.

Concurrently, many electricity businesses are owned by governments that face growing pressure to find efficiencies and new sources of money to fund infrastructure spending, increasing the likelihood that the businesses will become available for acquisition. The combined influence of these factors is starting to be felt.

## Investor Demand

Electricity transmission and distribution businesses are gaining in popularity as targets for acquisition. Fortis Inc., an integrated electricity utility company that had its beginnings as a Newfoundland transmission and distribution business, acquired CH Energy Group in 2013 and UNS Energy in 2014, which operate regulated electricity and gas distribution businesses in the United States. In 2014, Berkshire Hathaway purchased AltaLink from SNC Lavalin in a transaction that placed a higher value than expected on the Alberta transmission assets, demonstrating the attractive prices that the private sector is prepared to pay for these assets. And recent transactions are also demonstrating the potential that these businesses have to grow: in September 2015, Nova Scotia-based energy company Emera Inc. announced its intention to acquire TECO Energy, a U.S. power generation business.

## Appetite to Consolidate

Governments looking to dispose electricity-sector assets are also generating M&A activity. Many government-owned electricity distributors lack the capital and other resources necessary to adapt to change and increase efficiency—and in some regions, the government is creating incentives to accelerate the consolidation process. In the spring of 2015, the Province of New South Wales in Australia obtained a mandate to lease a 49% stake in its transmission and distribution network to fund new investment in infrastructure. The government is rumoured to have received interest from a number of pension and other offshore investors.

The Canadian electricity landscape is also seeing movement toward consolidation. In 2014, the Ontario provincial government struck the Premier's Advisory Council on Government Assets, chaired by Ed Clark, which recommended a number of changes to generate funds for infrastructure development and spur consolidation in the electricity distribution sector. Following those recommendations, on November 5, 2015, the Province of Ontario in Canada sold a 15% interest in its transmission and distribution business by way of an initial public offering of the shares of Hydro One Limited to fund infrastructure investment.

## M&A in the Regulated Electricity Sector: What are the Challenges?

As is the case in many other highly regulated sectors, M&A in this sector poses unique tax, regulatory and other challenges (see Trend 3, "New Investors, New Scope: Infrastructure Investing is Broadening," p.15). For example, Ontario's payment-in-lieu tax provisions for municipally owned utilities have generally discouraged consolidation. To address this concern, the government has temporarily reduced various tax components to further foster consolidation.

Where the assets are owned by municipalities or other governments, the political approval process may introduce uncertainty and timing challenges. Also, because electricity transmission and distribution businesses are largely rate-regulated, parties must pay careful attention to the impact of the transaction on ratepayers. The rate-setting process is critical to value, and the ability of an acquiror to retain the benefit of synergies, harmonize rates and grow the rate base can have a significant effect on the economics of the deal. In many cases the acquisition itself may also require approval by the rate regulator. As well (as was the case for Berkshire Hathaway's acquisition of AltaLink), foreign investment and anti-trust approvals may be necessary. The regulatory approval processes in Canada, the United States and elsewhere can be prolonged, requiring careful negotiation of terms to facilitate the approval process and fairly allocate between the parties the risk of a failed approval or unacceptable terms being imposed by a regulator.

## Conclusion

The growing number of investors amenable to taking on the regulatory challenges of businesses in the electricity sector speaks to the appealing characteristics of these assets, such as stable long-term returns. In the year ahead, we expect to see factors unique to regulated regimes continue to converge with investor interest to fuel M&A activity in this space.

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# ED CLARK ON WHAT'S AHEAD IN 2016

Sharon C. Geraghty, Sophia Tolias, Konata T. Lake

The breadth of Ed Clark's distinguished career, including serving as former President and CEO of TD Bank Group and his current position as Business Advisor to the Premier of Ontario, affords him unique insight into the private and public sectors. Torys lawyers Sharon Geraghty, Sophia Tolias and Konata Lake had the opportunity to interview Mr. Clark for his thoughts on Ontario business and the economy in the year ahead.

Photographer: Jonathan Pushnik

**Q. Tell us about your new role as business advisor to the Premier of Ontario.**

**A.** I do two things. First, I am an economist by training and have been involved in the economy through my experience running a large financial institution. This has allowed me to give the Premier my views on what works and what doesn't work economically in Ontario. I can bring business perspective to how businesses will react to different initiatives.

Second, I play a project management-type role on files with heavy private sector content. As someone from that community, I can help the Premier understand where they are coming from and how they may respond to an issue. I can also help the business community understand the political scene and how their voices can best be heard in that context.

**Q. What are your top recommendations for Ontario business and the economy in the years ahead?**

**A.** In the years ahead, we need to do two things. We have to work on making our existing economy more competitive, and as a country we must recognize how dramatically the world is changing. We need to shift our focus from manufacturing goods to innovation and services and become an exporter of innovative service products.

**Q. You recommend an "outcome-based approach" to regulation. Can you tell us more about that?**

**A.** To make our economy more competitive, we should address regulatory burden for businesses. Practically, an outcome-based approach involves government mobilizing the business community for input on what they are trying to accomplish, and then drafting rules to achieve that outcome at the lowest possible cost. This may involve looking at how other jurisdictions achieve highly desired outcomes through less burdensome regulation.

**Q. What advice do you have for investors interested in highly regulated sectors?**

**A.** If an investor interested in a highly regulated sector is choosing not to invest, it's important that they engage with government to explain what is impeding the investment and challenge us to solve the problem. The business community needs to work with government to increase this type of interaction and tell us what we need to do to improve productivity and achieve overall business growth.

**Q. Can you comment on the relationship between the private and public sectors?**

**A.** Dynamics between the private and public sectors are changing. There is recognition in government that its resources are limited at the implementation phase. Governments should partner with the business sector where the business sector can deliver on a government priority more efficiently than the public sector. For example, Ontario has become a world leader in public-private partnerships—the PPP model helps dramatically reduce costs, allows projects to be delivered on time and leaves implementation to the private sector.

The bottom line is that the public and private sectors should play to their strengths: the private sector should focus on *doing* things, while the government should retain its public policy role deciding what *should be done*.

5

# CREATIVE COLLABORATIONS ARE GAINING GROUND

Cornell C.V. Wright, Joseph J. Romagnoli, Derek Flaman, David Cuschieri

New collaborations are starting to change the M&A landscape. In recent years we have seen corporations and financial sponsors engage in joint ventures and other innovative collaborations to pursue their business objectives. The gathering momentum of this trend demonstrates the appetite for dealmaking amid the current global economic environment. Below we discuss the reasons why these new unions are gaining ground.

## Access to Financing

With markets currently in flux, businesses with exceptional prospective assets and ambitious development goals, particularly in the areas of oil and gas and mining, are experiencing internal and external challenges to obtaining financing through traditional private debt and capital markets. To gain access to capital, they are turning to creative business combinations that might have historically not been considered. Businesses are joining forces with financial investors (including foreign and domestic private equity firms and sovereign wealth funds) who are seizing the opportunity to invest directly in projects on flexible terms designed to support sharing in the upside of successes while protecting capital returns.

This approach was effectively used by Harvest Operations Corp. (an Alberta corporation wholly-owned by the Korean National Oil Company) in its joint venture arrangements with KERR Canada Co. Ltd., the subsidiary of a Korean investment fund, in connection with the exploration, development and production of certain oil and gas assets in the Deep Basin area in northwest Alberta.

## Access to Markets

The increasingly global scale of doing business is driving competition and costs. Many businesses are looking for opportunities in new markets. These markets may be closed to direct foreign investment or ownership, or otherwise be challenging from a regulatory, political or risk perspective to pursue without a domestic counterpart. Businesses are therefore seeking local partners to carry out these foreign investments—and potentially provide a gateway to further business initiatives in those locations.

A successful example of this approach is Alberta-based Husky Energy's entrance into a 50-50 contractual joint venture with CNOOC to jointly develop the US$9 billion Liwan subsea gas development project in the South China Sea.

We have also seen dealmakers use creative structuring with tax inversion transactions where the parties have effectively relocated their jurisdiction of incorporation with a view to reducing their overall tax rate.

## Joint Ventures Between Competitors

In other instances, businesses are choosing to advance their strategic objectives by partnering with competitors. These arrangements are collaborative in nature and may be used to increase collective purchasing power, pursue research and development, or jointly distribute parties' respective products. For example, Rogers Communications Inc. recently formed a joint venture with BCE Inc. under which the two companies will own the Canadian retail distribution outlets of GLENTEL Inc. At the international level, digital music service provider Spotify has entered into strategic partnerships with mobile carriers around the world to offer its music streaming services to data service subscribers.

Collaborative arrangements are also especially prevalent in the pharmaceutical sector and are growing in number. Large pharmaceutical companies are increasingly pursuing alliances with smaller biotechnology companies as they search to bring new products to market. They are also partnering with academic institutions for similar purposes.

Strategic collaborations with competitors may, however, be complex from an antitrust perspective. Care must be taken to ensure that they do not contravene provisions in the *Competition Act* or *Sherman Act* that regulate competitor collaborations. Alliances that are structural in nature could also be subject to long and complex merger notification and review processes that could affect deal timing.

## Access to Strategic Partners

A corporation needs technical expertise and experience, sufficient capital for development, and a strong reputation. Corporations that excel in only one or two of these areas may find that missing elements have caused opportunities to be left on the table. These gaps in business profile are being addressed with increased willingness from buyers to seek out the perfect union with an entity or investor that has compatible strengths and business objectives to create a more competitive and balanced business vehicle benefiting both parties.

We saw this in the M&A context when Pershing Square teamed up with Valeant Pharmaceuticals International in a bid to acquire Allergan Inc. In Canada, Canadian Tire and Scotiabank entered into a strategic partnership whereby Scotiabank acquired a 20% interest in Canadian Tire's financial services business—their co-marketing agreement has resulted in new business growth opportunities for both companies.

KKR's establishment of the Veresen Midstream Limited Partnership with Veresen Inc. is another example of this type of collaboration. The partnership made a C$760 million acquisition of certain natural gas gathering and compression assets from Encana Corporation and the Cutbank Ridge Partnership (CRP) and negotiated a related 30-year fee-for-service arrangement following its commitment to fund up to C$5 billion of new midstream infrastructure. KKR's combined business acumen, access to capital and long-standing reputation represented an ideal match for Veresen's industry expertise and highly reputable business profile.

Gaps in business profile are increasingly being addressed through strategic unions with entities or investors with compatible strengths and business objectives.

## Creative Collaborations to Get Deals Done

Parties are also structuring transactions creatively in order to get their M&A deals done, in many cases by dealing upfront with certain assets to avoid extended regulatory reviews or opposition. For example, to secure *Competition Act* approval, building and construction materials makers Holcim and Lafarge decided to sell all of Holcim's Canadian operations and all associated assets to ensure that their US$47 billion merger would pass muster in Canada. Similarly, in connection with Anheuser-Busch InBev's US$106 billion offer to acquire SABMiller, InBev plans to sell SABMiller's interest in the MillerCoors U.S. venture to help secure regulatory approval.

Foreign investors under the *Investment Canada Act* have adopted the same sort of strategy, perhaps most famously when Glencore agreed up front to sell certain Viterra business units to Canadian companies Agrium and Richardson International to secure a "net benefit" approval. Some parties are even opting to litigate in order to resolve regulatory reviews (see Trend 6, "More Regulatory Reviews Will Be Resolved With Litigation," p.33).

## Considerations

The nature, structure and scope of these new collaborations will vary greatly according to the commercial goals and financial, technical, geographic or political restrictions or limitations of the parties. These arrangements—and the necessary contractual framework required to implement them—can be complex due to the combination of typical joint venture concepts with more traditional financing or acquisition models.

Determining and executing appropriate engagement, risk, downside protection, and upside sharing should be approached on a case-by-case basis with sensitivity to the parties' goals.

M&A's new collaborations offer various benefits that appeal to a wide range of businesses and investors. The presence of these innovative unions seems set to expand as corporations and sponsors alike seek new ways to satisfy complex business objectives in global markets.

## COMMON JOINT VENTURE ISSUES FOR INTERNATIONAL STRUCTURES

- Foreign direct investment restrictions
- Currency control and foreign exchange
- Repatriation of profits
- Double taxation and investment protection treaties
- Licensing requirements
- *Foreign Corrupt Practices Act*

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6

# MORE REGULATORY REVIEWS WILL BE RESOLVED WITH LITIGATION

Omar Wakil, Dany H. Assaf, Linda M. Plumpton

In recent years we have observed that merger reviews under the *Competition Act* are becoming more complex and that regulatory intervention under the *Investment Canada Act* is increasing, particularly in connection with small, non-reportable transactions. A consequence of this trend is that some parties are opting to litigate, and we expect this to continue in 2016.

## Recent Regulatory Disputes in Canada

In 2015, its ruling in the Tervita case marked the Supreme Court of Canada's first merger decision under the *Competition Act* since 1997. The transaction involved the acquisition of a waste landfill site with a value of only C$6 million, falling well below the notification threshold for mandatory merger review under the *Competition Act*. In allowing the merger, the Court resolved a matter that had begun in 2010, when the deal was originally challenged by the Competition Bureau. The case involved complex litigation proceedings before the Competition Tribunal and Federal Court of Appeal.

Last year, the Competition Bureau also challenged the acquisition by Parkland Industries of 17 Pioneer gas stations or supply contracts to non-corporate stations. The Commissioner of Competition alleged that the transaction would result in a substantial lessening of competition in 14 communities in Ontario and Manitoba. Following an application by the Commissioner, the Competition Tribunal granted an interim injunction requiring Parkland Industries to preserve and "hold separate" six gas stations and eight supply agreements that it acquired from Pioneer pending the outcome of the contested proceedings. The litigation is ongoing.

Similarly, Industry Canada reviews of foreign investments under the "net benefit" and "national security" provisions of the *Investment Canada Act* (ICA) have been on the rise, with numerous transactions being blocked or restructured. Last spring, the government used the national security provisions of the ICA to block a Chinese state-owned enterprise from establishing a new business in Canada. The Chinese investor, Beida Jade Bird, planned to build a C$30-million fire alarm manufacturing facility in Saint-Bruno de Montarville, Québec. The investment was reportedly prohibited because the site was located close to facilities operated by the Canadian Space Agency.

In August 2015, O-Net Communications, a Hong Kong-based investor, sought judicial review of a Privy Council national security order requiring O-Net to divest itself of a Québec-based company called ITF Technologies, which it acquired in 2014. The case is notable because it involves a post-closing "national security" review and divestiture order. As in the Beida Jade Bird matter, the investment was not initially subject to the normal-course "net benefit" review, in this case because of its small size. The litigation is ongoing.

## NATIONAL SECURITY REVIEWS SINCE 2009

### 2009

GEORGE FORREST + FORSYS

Outcome: terminated

### 2012

BEIJING NAVINFO

Outcome: non-approval

### 2013

VIMPELCOM + WIND MOBILE

Outcome: non-approval

### 2013

ACCELERO + ALLSTREAM

Outcome: non-approval

### 2013

BLACKBERRY

Outcome: government concern

### 2014-15

CASES INVOLVING RUSSIAN INVESTORS

Outcome: non-approvals

### 2015

BEIDA JADE BIRD (MAPLE ARMOUR)

Outcome: conditional approval

### 2015

ITF + O-NET COMMUNICATIONS

Outcome: non-approval

## M&A and Regulatory Scrutiny

At a minimum, these cases illustrate an interventionist government and parties willing, at least in some circumstances, to litigate transactions important to them rather than settle regulatory proceedings. The prospect of litigation has and will continue to impact M&A transactions in a number of important ways:

1. Regulatory risk assessments should be part of any transaction, regardless of size. Enforcement actions have been taken in numerous small, non-reportable mergers in recent years.

2. Parties should consider structuring transactions to minimize the likelihood of lengthy or complex regulatory reviews that could lead to litigation. This could include offering upfront "hold-separate" commitments or, in the case of foreign investment reviews, carving out sensitive assets or business lines, or avoiding establishing businesses in the proximity of sensitive government facilities.

3. Also in the case of foreign investment reviews, parties should consider early, confidential pre-consultations with relevant government agencies. Investors will not get informal "green-lights," but might be given advance warning of potential problems. Vendors and targets should consider similar approaches.

4. Parties should ensure their M&A agreements reflect due consideration of risks and potential outcomes pre- and post-closing. This could include requirements to seek early "national security" clearance, indemnification provisions for vendors in case they get swept into a post-closing review or even litigation, long outside dates to permit time for extended reviews, or reverse break fees to compensate for uncompleted deals.

Aside from taking these steps, as regulatory intervention in M&A increases, M&A players should recognize litigation as an option if regulatory outcomes are not commercially satisfactory, and strategize accordingly with "eyes wide open."

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7

# DISTRESSED M&A OPPORTUNITIES ARE EMERGING

Scott R. Cochlan, David Bish, Tony DeMarinis

Canadian distressed M&A activity seems poised to rise, as low commodity prices and tight capital markets spur a re-examination of business models and balance sheets built for better times. Investment capital is readying itself for upcoming distressed opportunities, and restructuring laws are conducive to facilitating these deals. Some investors and strategic buyers have shied away from distressed opportunities in the past because they see them as being especially risky, complicated and contentious. While there is some truth to this, savvy investors know that this field also comes with unique benefits and potentially outsized returns.

## What is Distressed M&A?

Distressed M&A typically refers to deals completed when the target company is facing insolvency or is already insolvent. The *Companies' Creditors Arrangement Act* (CCAA) is a popular proceeding for larger insolvent companies, while receiverships are more common for smaller companies. Solvent companies have increasingly used the plan of arrangement provisions under the *Canada Business Corporations Act* or its provincial counterparts to de-lever balance sheets by way of securities exchanges. Most restructuring proceedings now involve a competitive sales process, equity subscription, debt-to-equity conversion, or other M&A component.

## Benefits and Considerations

Court oversight and the involvement of a CCAA monitor or a receiver can significantly reduce acquisition risks. These independent eyes add rigour to the disclosure process and a dealmaking orientation. A court's powers can also simplify the process. For example, a court can stay the exercise of contractual remedies by counterparties and override restrictions against assignment or other actions. For asset purchases, a court can vest title free and clear of liens and other interests to achieve a level of title certainty rarely equalled by even the most comprehensive (and costly) legal due diligence exercises. Meanwhile, judicial oversight and approvals reduce liability exposure for boards of directors.

There can also be extraordinary opportunities to re-model the target business. In addition to debt reduction, uneconomic contracts can be terminated or left behind. A purchaser can also "cherry pick" attractive parts of a business with more ease than in the ordinary course.

There are, however, unique considerations. Even in "debtor-in-possession" CCAA proceedings, it is not always clear that a company's management and board are firmly in control. Lenders, bondholders, employee groups and other key stakeholders are often heavily involved and can strongly influence outcomes. Confidentiality can also be challenging. Generally, the transparency and multi-party nature of most insolvency proceedings promotes leaks and disclosure. And asset sales may deliver "cleansed" assets, but they can also leave behind valuable tax attributes (although share transaction alternatives exist). Restructuring processes can also be notoriously fluid and unpredictable.

Some distressed M&A opportunities allow buyers to "cherry pick" parts of a business with more ease than in the ordinary course.

## Sector Opportunities

Perhaps topping the sights of distressed investors presently is the oil and gas sector. A steep drop in oil prices, tightening of the capital markets, and other factors are taking their toll. The sector has already seen insolvency filings for companies like Laricina Energy and Southern Pacific, and it is still uncertain where we sit in the cycle.

Elsewhere, players in the mining and retail sectors are also looking to generate distressed M&A opportunities. With investment options across a number of sectors, those prepared to enter distressed M&A waters may find attractive opportunities in the coming year.

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8

# GO WITH THE (CAPITAL) FLOW IN CROSS-BORDER M&A

Jared Fontaine, Ian Arellano, Neville Jugnauth

Global M&A has risen substantially in 2015, with the total value of deals internationally surpassing US$3 trillion.[1] Amid this period of growth, Canadian M&A has experienced an overall decline in the aggregate deal value of domestic Canadian M&A activity alongside significant growth in outbound investments, with Canadian investors seeking high-quality investment opportunities on a global level. In 2016, we expect Canadian buyers to follow the flow of capital both abroad and domestically: globally, domestic buyers will continue to be active with large-scale acquisitions in foreign markets; and in Canada, investors will look to capitalize on opportunities emerging from recent weakness in the Canadian economy.

## Growing Outbound M&A Activity

Transactions involving Canadian buyers and foreign targets dominated Canadian M&A activity in 2015. This year, M&A transactions in excess of C$96 billion were outbound deals (see Figure 1, p.44) including Canada Pension Plan Investment Board's (CPPIB) C$14.8 billion acquisition of Antares Capital, the U.S.-based mid-market PE sponsor financing solutions provider, from General Electric, and Borealis Infrastructure's C$8.9 billion acquisition of Fortum Distribution in Sweden.

Canadian institutional investors have been the principal drivers of the growth of outbound investment activity. Some of the largest deals in 2015 involved a financial sponsor or investor. For example, Canadian pension funds, Onex and Brookfield Asset Management all actively engaged in foreign M&A activity in 2015. In addition to the CPPIB and Borealis acquisitions, notable examples of this trend include CPPIB's co-sponsorship of the C$6.7 billion U.S. acquisition of Informatica, the Caisse de dépôt et placement du Québec's US$1.1 billion acquisition with Hermes Infrastructure of a stake in Eurostar, and the joint AIMCo/OMERS acquisition of UK-based Environmental Resources Management for US$1.7 billion.

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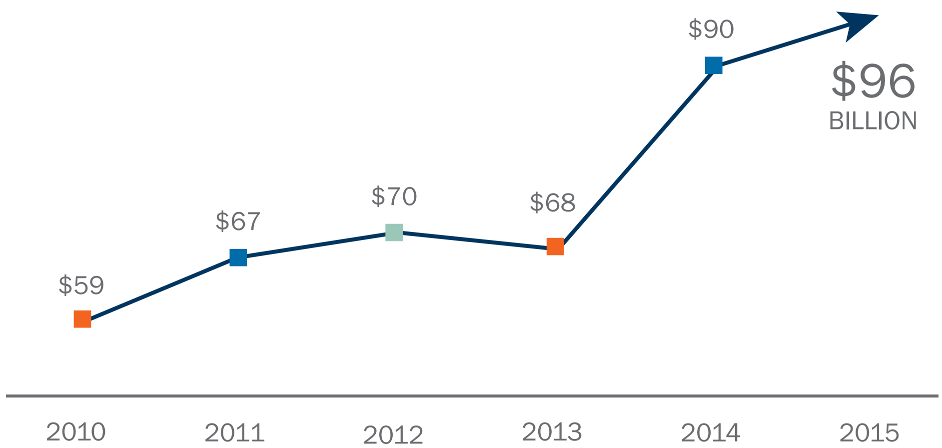
[1] Source: *Thomson Reuters' M&A Review Q3 2015*. Available at: http://dmi.thomsonreuters.com/Content/Files/3Q2015_Global_MandA_Financial_Advisory_Review.pdf

While RBC's US$3.2 billion acquisition of City National in the U.S. demonstrates that this trend is not limited to private equity, we expect that Canadian pension funds and private equity groups will continue to dominate outbound M&A activity from Canada.

### Figure 1. M&A Activity Outside Canada by Canadian Buyers

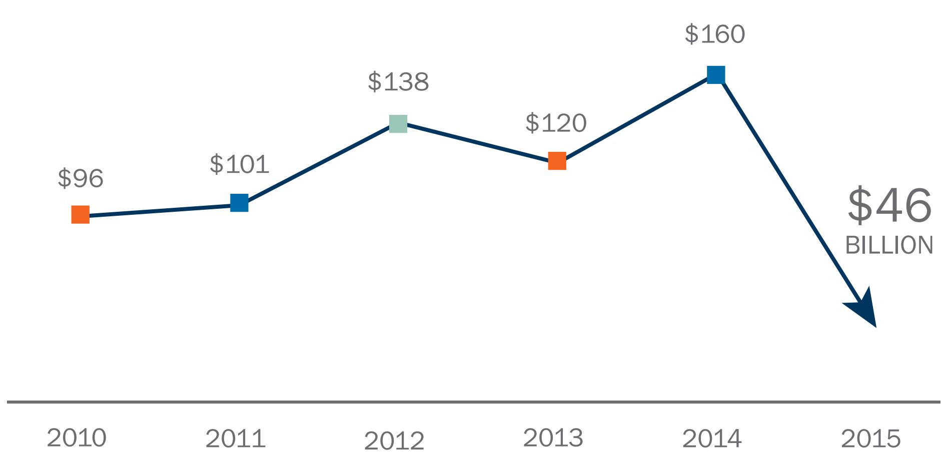



Total Deal Values in C$ (Billions)
Source: Capital IQ. Deal values based on closed transactions. 2015 data as of November 1, 2015.

## Domestic Revival

The total value of deals involving a Canadian target fell to C$46 billion in 2015, from C$160 billion in 2014 (see Figure 2). We expect that this recent decline in domestic M&A in Canada will not last and that macroeconomic factors will create favourable opportunities for both foreign and domestic strategic buyers in 2016.

### Figure 2. M&A Activity Involving Canadian Targets




Total Deal Values in C$ (Billions)
Source: Capital IQ. Deal values based on closed transactions. 2015 data as of November 1, 2015.

Current market conditions have forced some Canadian companies to consider divestitures of non-core assets to improve balance sheets. We also see distressed M&A opportunities developing, particularly in the oil and gas, mining and retail sectors (see Trend 7, "Distressed M&A Opportunities are Emerging," p.39). Competitors with strong balance sheets and access to financing are well positioned to take advantage of these opportunities to make strategic acquisitions as is illustrated by Crescent Point's C$1.5 billion acquisition of Legacy Oil and Gas.

A relatively weak Canadian dollar is likely to drive an increase in inbound acquisitions of Canadian targets by foreign buyers. U.S. companies in particular, given moderate returns at home and a strong U.S. dollar, will be encouraged to look to foreign markets, including Canada.

## Rules Changes on the Horizon

As foreign investors turn their focus to Canada, they should expect M&A targets to wield more leverage than in the past to negotiate deals. Canadian takeover bid rules are changing to empower boards and redefine bid dynamics between targets and hostile bidders. Under Canada's proposed new takeover bid regime, all non-exempt takeover bids will have to stay open for acceptance for a minimum duration of 120 days (subject to a target board's ability to shorten the timeframe to as little as 35 days in certain cases). The proposed bid rules will also allow a hostile bidder to shorten its bid period if the target enters into a white knight transaction.

## Energy: A Sector to Watch

Despite a significant decline in the number of energy-sector M&A deals in 2015 due to weak industry fundamentals, the value of completed deals remained relatively high as both strategic and financial buyers looked to take advantage of discounted assets—a trend that appears to be set to increase in the year ahead.

Some of the largest domestic M&A deals in 2015 included energy-sector transactions such as Cenovus' sale of its interest in Heritage Royalty to Ontario Teachers' Pension Plan Board for C$3.3 billion, Apache's sale of Quadrant Energy to Brookfield Asset Management and Macquarie Capital for C$2.6 billion and the previously mentioned C$1.5 billion acquisition by Crescent Point of Legacy Oil & Gas. With continuing depressed commodity prices in 2016, additional divestitures of attractively priced assets will drive greater M&A activity in this sector.

## Conclusion

Domestic investors show no sign of slowing their activity in international investments for the year ahead, and we are starting to see opportunities for consolidation of Canadian energy targets increasingly attracting strategic investors and financial buyers looking to deploy capital in Canada. We anticipate that growth, both in outbound deals and renewed vigor in domestic activity, will help define Canadian M&A in 2016.

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9

# TECH ISSUES IN M&A WILL KEEP DEALMAKERS IN THE CLOUD

Adam S. Armstrong, David A. Chaikof, Joel Ramsey

“Every company is now a tech company.” This phrase is heard more and more in the business community, from commentators to CEOs of multinational corporations. With few exceptions, every business today relies on information technology to survive. In every sector of the economy, from banks to retailers to energy companies, businesses depend on IT to manage their most important assets: their information and their customers.

If every company is a tech company, then every M&A deal is a tech deal—and to ensure the success of an M&A deal, companies must recognize that solving the IT puzzle should be a central pillar of their M&A strategy. While this has been true for the better part of two decades, the way in which IT has evolved has made defining what is being bought or sold more difficult than ever in recent years.

## Enter the Cloud

The emergence of cloud computing as a preferred model of IT is largely responsible for this shift. The term “cloud computing” has been used to describe a variety of service models, but here we use it to refer to IT services that, broadly speaking, are delivered using computing resources that are:

- distributed (i.e., not centralized); and/or
- shared, whether with other companies (public cloud) or other internal businesses or functions—which may or may not be part of an M&A deal (private cloud).

Advances in software development and the proliferation of high-speed telecommunications networks have allowed servers and data centres to be “virtualized” across the globe, replacing more traditional IT models that rely more heavily on local, customized infrastructure.

Cloud computing is appealing to businesses because, among other reasons, it requires little capital investment by the service recipient and is adaptable to changing business needs while promising a stable common platform across numerous user groups. As a result, cloud-based platforms are increasingly favoured by CIOs seeking cost-savings and more agile resources. But it is called "cloud" computing for a reason: it is not easy to define what and where, exactly, your company's systems are.

## M&A in the Cloud

Solving the IT puzzle and determining which pieces are being purchased (or sold), and which pieces will have to be purchased separately to fill the gaps, are critical to realizing value from the M&A deal. This issue goes directly to the heart of an M&A transaction where the target's IT is central to its value. If the target is a heavy user of cloud-based technology provided by third-party service providers or affiliates, then what, exactly, is being sold and how is it to be valued? And once identified, how do you ensure that technology is seamlessly transitioned to the buyer?

**The success of a deal will depend now more than ever on successfully untangling and integrating buyer and seller IT systems.**

The negotiation of the transition services agreement (TSA) for acquisitions becomes critical, but perhaps more critical is technology due diligence that must be performed before a TSA can be drafted. The acquiror will need to identify and untangle the target's IT, which may be spread across multiple shared systems, and potentially across the globe. The success of the M&A deal will depend now more than ever on the success of this untangling and integration of the target's IT with the acquiror's IT (or on the acquiror learning to run the target's IT)—essential steps for the buyer to effectively run the acquired business.

## Planning Ahead for Success

### Buyers

- Start the tech due diligence process early and enlist the assistance of your integration team to plan the integration well before signing. Seek their input on the cost and timeline, which could greatly affect the overall economics of the deal.

- Study the target's IT, not just as a supporting asset, but as part of the value proposition of the company. Has the target developed systems and processes that enhance the value of the company, or has the target simply made use of a standard cloud computing service in a way that fits its business needs?

- Have an IT procurement strategy that anticipates M&A scenarios. Make sure your IT service providers are obligated to assist you in tech due diligence, and that there is a mechanism in your service agreements to support the operations of the target.

### Sellers

- Ensure your cloud pricing model allows spin-offs without triggering minimum commitments that will burden you or the buyer after the sale.

- Protect your IP. Check that your cloud provider cannot claim to own your patentable systems or processes that were incorporated into the cloud platform.

- Plan early. Understand what will be sold as part of the M&A deal and what transition assistance you are willing to prioritize, taking into consideration confidentiality issues and your resourcing requirements.

Anticipating tech-related issues and establishing good strategies early on to address them can work to ensure the success of M&A opportunities when they arise. Cloud computing, too, will inevitably evolve, but the days of M&A deals without a meaningful tech component are over.

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10

# SHOULD THEY STAY OR SHOULD THEY GO? EXECUTIVES IN M&A

Mitch Frazer, Lynne Lacoursière, Jennifer Lennon

Executive compensation arrangements in the context of M&A transactions are receiving more attention from investors, management teams and boards, and are increasingly subject to public scrutiny. Consider the recent example involving Chubb Corp., where its shareholders voted overwhelmingly in favour of its proposed merger with Ace Ltd. but voted over 60% against the non-binding advisory vote on the company's executive pay package. As a result, compensation arrangements are evolving from being primarily focused on severance to being focused on retention and the long-term best interests of the company.

## Single-Trigger to Double-Trigger

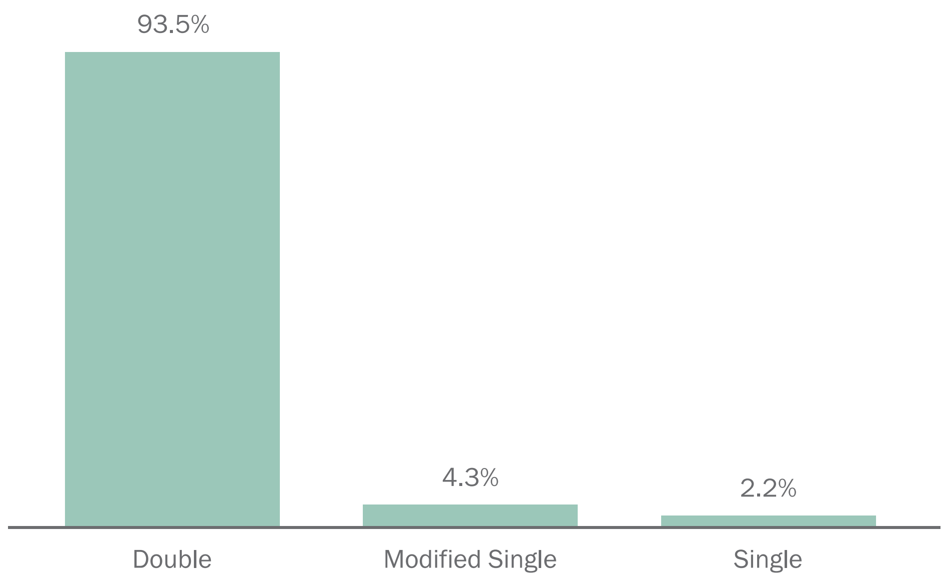
To the delight of proxy advisory firms and institutional investors, a large proportion of public issuers have amended their long-term incentive plans and severance arrangements in recent years to provide for "double-trigger" change-of-control provisions (see Figure 1, p.56). Rather than severance payments and accelerated vesting of equity awards being automatically triggered on a change of control of the target company (a "single-trigger"), "double-trigger" arrangements are only triggered if there is both a change of control and an involuntary termination of employment.

"Double-trigger" arrangements would typically pay out if an executive is terminated without cause or is constructively dismissed within a specified period of time post-closing of the M&A transaction (typically 12-24 months). Stock options and other equity-based awards are exchanged for comparable awards of the acquiror or merged company and continue on the same terms and conditions post-closing.

"Modified single trigger" change-of-control arrangements are triggered if the executive resigns (without being constructively dismissed) within a specified period following the change of control.

“Double-trigger” arrangements are preferable from a corporate governance perspective as they ensure executives are neutral with respect to a change of control and are motivated to act in the best interests of the company. These arrangements also serve as a retention tool and provide greater flexibility for bidders to structure transactions without triggering massive cash outlays on closing. Strategic buyers and those with less cash on hand typically favour the rollover of equity-based awards. However, buyers may choose to cash out equity awards on closing despite the rollover ability.

### Figure 1. TSX 60 Companies – Change of Control Severance Triggers




Source: Hugessen Consulting Inc. Information excludes TSX 60 Companies with no policy or no disclosure.

While the treatment of stock options and other time-based awards on a rollover is straight forward, performance-based awards present particular challenges. For example, if a performance share unit pays out based on the achievement of a financial metric or strategic goal of the target, how should that performance goal be assessed with respect to the merged entity post-closing? As compensation plans weigh more heavily toward performance-based awards, targets and bidders must pay careful attention to how these awards will be treated and valued on a change of control.

## Severance Pay to Retention Pay

There is a growing trend for severance arrangements to be the subject of negotiation in the context of M&A deals. Where a bidder is looking to retain the target’s executives for the long term or for a transition period, it may negotiate with the executives to forgo their severance pay for an enhanced retention package provided the executive remains with the company for a specified period post-closing. Retention bonuses can be structured as cash payments or special equity awards.

Retention bonuses may be viewed as a problematic pay practice if they are implemented before or in anticipation of a change of control as they may be seen to be entrenching management and may deter potential bidders. As a result, retention bonuses are typically negotiated pre-closing in consultation with the purchaser. The agreements seek to align the interests of the target and the purchaser and encourage the retention of key members of senior management.

### Transaction Awards

Special awards granted in the context of an acquisition may be desirable as a retention mechanism or as an incentive to achieve the strategic goals or expected synergies following the transaction. These awards can be structured as cash payments or special equity awards. Awards that are subject to performance conditions post-closing would typically only be granted to senior management in operational roles or to those whose performance could impact the particular performance goal. Transaction awards may also be used to ensure that compensation of the new executive team is similarly structured on a go forward basis.

Transaction awards may also be implemented by the target to retain key people until the transaction closes. Any such arrangements would generally be subject to the company's conduct of business covenants in the purchase agreement or would require consent of the purchaser.

## As compensation plans weigh more heavily toward performance-based awards, targets and bidders must pay careful attention to how these awards will be treated and valued on a change of control.

### Evolving Compensation Practices

The corporate governance landscape in Canada is changing. This is not only influencing how corporations are engaging with their shareholders (see Trend 1, "Shareholder Activism: Who is Winning Now?," p.3), but also how executive compensation arrangements are being structured. As the value of human capital in the pursuit of corporate strategy comes increasingly into focus for dealmakers, we expect that executive compensation practices will continue to evolve, with more attention on retaining key executives and rewarding achievement of long-term business goals.

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Torys’ M&A Practice is highly regarded for its experience in sophisticated, complex and innovative mergers and acquisitions. We are involved in high-profile transactions, both public and private, for companies of all sizes. On cross-border and global M&A transactions, we provide seamless service to clients in the United States, Canada and internationally.

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Torys LLP is a respected international business law firm with a reputation for quality, creativity and teamwork. The firm's record of experience combined with the insight and imagination we bring to our work has made us our clients' choice for their large and complex transactions, projects and major disputes on both sides of the Canada-U.S. border and internationally.

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# Canadian Regulators Adopt 105-Day Minimum Bid Period and Enhance Early Warning Rules

February 25, 2016
John Emanoilidis | Sophia Tolias

Torys Business Law Guide

The Canadian Securities Administrators (CSA) have announced that they are adopting amendments to the country's takeover bid regime that will extend the current 35-day minimum bid period for takeover bids to 105 days, rather than the previously proposed 120-day period for tendering to a takeover bid in Canada.

Along with this change, the CSA are also adopting new early warning rules that will require, among other things, disclosure of decreases in ownership of public company securities of 2% or more and when ownership levels fall below the 10% reporting threshold.

The regulators' switch from a 120-day to 105-day minimum bid period was driven by the need to ensure that the new takeover bid period does not conflict with compulsory acquisition provisions in Canadian corporate statutes—these statutes generally allow a bidder to squeeze out minority shareholders if at least 90% of the target's shares have been tendered within 120 days of the date of the bid. Aside from the new 105-day period, the CSA's draft rules on Canada's proposed new takeover bid regime, released in March 2015, remain largely unchanged.[1] CSA National Policy 62-202 governing defensive tactics is also unaffected.

The new takeover bid and early warning rules are expected to take effect on May 9, 2016.

## What You Need To Know

### New Takeover Bid Regime

- All non-exempt takeover bids will be open for shareholders to deposit their shares for a minimum duration of 105 days, which the target board can shorten to as little as 35 days in certain cases.

- Non-exempt takeover bids will be subject to a mandatory minimum tender condition of over 50% of outstanding shares, other than shares held by the bidder and its joint actors. The deposit period must be extended by 10 days once the minimum tender requirement has been met and all other bid terms and conditions are satisfied or waived.

- The new 105-day period will increase deal uncertainty for hostile bidders, exposing them, for example, to interloper risk for an extended period of time. This will strengthen target boards' negotiating leverage. We anticipate that hostile bidders will perceive the benefit of engaging more with target boards who will have the ability to reduce the minimum tender period for friendly transactions.

- Target boards will continue to see the advantage of adopting a poison pill to regulate exempt purchases of target securities through creeping acquisitions and private agreement purchases, and to prevent irrevocable lock-up agreements. However, absent unique circumstances, we expect that the regulators would not generally permit a target board to implement a poison pill for the purpose of delaying a bid beyond 105 days, if the bid has been accepted by a majority of disinterested shareholders and otherwise complies with the new rules.

## Enhanced Early Warning

- The new rules clarify that early warning news releases must be issued by the opening of trading on the next business day.
- Disclosure will be required of decreases in ownership of public company securities of 2% or more and when ownership levels fall below the 10% reporting threshold.
- Eligible institutional investors will be prevented from using the Alternative Monthly Reporting System if they solicit proxies to
    - contest a director election or
    - support an M&A transaction that is not supported by management or oppose an M&A transaction that is recommended by management.
- Enhanced disclosure in early warning reports will be required in respect of
    - the acquiror's plans or future intentions with respect to the reporting issuer and involving, for example, a corporate transaction, board or management change, or a solicitation of proxies, among other actions, and
    - the acquiror's interest in related financial instruments, securities lending arrangements and other arrangements in respect of the securities.
- Lenders and borrowers will, in some cases, be exempt from including the securities lent or borrowed for the purposes of determining the early warning reporting threshold trigger.[2]

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[1] For background details on the CSA's proposed takeover bid rules, see Torys' bulletin on Torys.com.

2 For background details on the CSA's proposed early warning rule changes, see Torys' bulletin on Torys.com.

*To discuss these issues, please contact the author(s).*

*This publication is a general discussion of certain legal and related developments and should not be relied upon as legal advice. If you require legal advice, we would be pleased to discuss the issues in this publication with you, in the context of your particular circumstances.*

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# Legal Year in Review

Osler's insights on key developments in 2015 and their implications for Canadian business.


OSLER

# Table of Contents

# Introduction

As 2015 comes to a close, we want to share with our clients and friends our observations about what we believe to be some of the most significant legal developments affecting Canadian business over the past year and their implications for 2016 and beyond.

Recently elected governments at both the federal and provincial levels had a major impact on Canadian business in 2015, introducing a number of important new policies and legal initiatives.

With a view to generating revenue and improving service delivery, Premier Kathleen Wynne's Ontario government sold a partial interest in Hydro One through the largest initial public offering in Canada in 15 years. The Ontario government also materially altered the model for retail distribution and sales of beer in Ontario, opening the delivery model to new private participants, while preserving the existing low cost delivery and public-revenue-generating features. Finally, Ontario renewed its modernization initiatives in the gaming sector, seeking to promote increased private sector involvement in the industry, while streamlining government oversight and maintaining government revenues.

The financing of public pension plans – and the need to improve pension coverage for all Canadians – was also top-of-mind for governments. The Ontario government announced the new Ontario Retirement Pension Plan (ORPP). Whether the new federal Liberal government will follow with an amendment to the Canada Pension Plan and how this will affect the ORPP remains to be seen.

In the energy sector, the new NDP government in Alberta announced a robust climate change leadership plan. Meanwhile, the new federal government promised to beef up the regulatory process for the approval of energy projects. The energy industry is also grappling with the implications of the U.S. refusal to authorize the Keystone XL Pipeline Project.

On the tax front, the new federal government has promised to increase taxes for high-earning individuals and to limit the tax benefits afforded to employee stock options. The latter measure may have unintended consequences in the cash-strapped tech start-up sector, where employee stock options are a key tool for attracting top talent.

This past year was more evolutionary than revolutionary in securities law. A number of initiatives continued to move forward – including the push to create a common securities regulator, as well as the CSA's review of the systems and practices surrounding proxy solicitation. We also saw new crowdfunding rules and changes to the way in which prospectus-exempt financings are conducted across the country.

Significant proposed changes to the take-over bid regime were published in March 2015 that would result in a 120-day permitted bid regime. If these rules come into effect, the Alberta Securities Commission's order that Canadian Oil Sands Limited's shareholder rights plan be cease traded 91 days after Suncor Energy Inc. formally commenced its $4.3 billion hostile take-over bid may be the last "poison pill" hearing of its kind.

The wave of special purpose acquisition corporation (SPAC) offerings was arguably the biggest development in Canada's capital markets. The first Canadian SPAC offering was completed in April 2015, rapidly followed by four others. Whether we will see more SPACs will likely depend on whether any of the existing SPACs completes a successful qualifying acquisition.

As for governance, board composition – particularly representation of women on boards and in executive officer positions – remained a focus. Executive compensation was also the subject of considerable attention in light of the loss of "say on pay" votes by three large Canadian issuers.

In its ongoing efforts to enforce insider trading laws, the Ontario Securities Commission (OSC) had a notable success in the *Finkelstein* case. The evidentiary standard applied in *Finkelstein*, together with the OSC's proposed new Whistleblower Program and the ability to enter no-contest settlements, has added to the regulators' enforcement toolkit.

In a landmark year for privacy and data security laws, the courts demonstrated an increased willingness to allow plaintiffs to use class proceedings as a vehicle for protecting their personal information. The federal government continued its enforcement of its anti-spam legislation and passed significant amendments to PIPEDA, including security breach notification requirements.

A number of appellate decisions – several involving privacy issues – grappled with whether and how Canadian courts should adjudicate on matters involving foreign elements. The multi-national operations of major companies, including internet-based businesses like Facebook and Google, challenged the Canadian courts to define the limits of their jurisdiction and their judicial resources.

In another important litigation development, the Québec Superior Court's unprecedented award in two Québec class proceedings brought against tobacco manufacturers for smoking-related injuries has the potential to change the future course of class proceedings. The $15 billion award (which is currently under appeal) was made in the absence of any evidence from individual class members, raising important questions about the applicable evidentiary rules in the class actions context.

The past year also saw significant changes in international trade, foreign investment and anti-corruption measures.

Concluded in late 2015, the *Trans-Pacific Partnership* (TPP) is the largest and most far-reaching international trade agreement Canada has entered into in over 20 years. If ratified and implemented, the TPP (as well as the *Canada-EU Comprehensive Economic Trade Agreement* (CETA), entered into in late 2014) will address numerous subjects of paramount importance to Canadian business, including reduction of tariff and non-tariff barriers, intellectual property, electronic commerce, cybersecurity, anti-corruption and others.

Meanwhile, in relation to foreign in-bound investment, the *Investment Canada Act* "net benefit" review thresholds were amended. A higher monetary threshold, together with a change to "enterprise value" (as opposed to the former "book value") as the calculation method, means that some transactions that were previously subject to review will no longer be. On the other hand, a number of other transactions will now be reviewable.

Canada's efforts to fight corruption and improve transparency continued in 2015 with the laying of charges against SNC-Lavalin in relation to its overseas business activities and with the passage of the *Extractive Measures Transparency Act* (ESTMA). The ESTMA applies to businesses in the extractive sector, imposing new disclosure and transparency measures in relation to their dealings with both domestic and foreign governments.

In November 2015, Prime Minister Trudeau and the other G20 Leaders endorsed the OECD's package of measures released as part of the base erosion and profit shifting (BEPS) project. The BEPS project is designed to address concerns about tax-planning strategies that exploit differences in domestic and international tax rules to shift profits to low tax jurisdictions. If the recommendations are adopted, they could have a significant impact on cross-border trade and the competitiveness of Canadian businesses.

As we monitor these and other legal developments in 2016, we would be happy to discuss them with you.

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# Hydro One IPO and the Beer Store restructuring: Ontario gets down to business

Like many other provincial governments in Canada, Premier Kathleen Wynne's Ontario government is struggling to find ways to deal with mounting debt and fund its "activist agenda," including its efforts to address Ontario's infrastructure deficit, in the face of a soft economy. Part of Premier Wynne's approach has been to turn to innovative individuals and strategies for guidance and solutions.

## PREMIER'S ADVISORY COUNCIL ON GOVERNMENT ASSETS

In 2014, Premier Wynne enlisted a unique ally in her endeavours when she appointed Ed Clark – a seasoned business executive who was about to retire as CEO of TD Bank and who also has a solid grounding in public policy – as the Chair of her newly formed Premier's Advisory Council on Government Assets. More recently, she expanded Mr. Clark's role by appointing him as her special Business Advisor.

The Council's brief was to advise the government on how to wring more revenue from its assets, to help reduce Ontario's deficit and support the Government's ambitious program of infrastructure investment. The Council's initial focus was to review the Liquor Control Board of Ontario (LCBO), Hydro One and Ontario Power Generation (OPG).

## THE PRELIMINARY REPORT

The Council released a preliminary report late in 2014. In it, the Council rejected privatizing the LCBO in favour of other recommendations that would improve its profitability while introducing incremental improvements to customer experience and competition. The Council also suggested a broader examination of beverage alcohol distribution in Ontario, focusing on the privately owned quasi-monopolies of the Beer Store (owned by Labatt, Molson and Sleeman, each of which is foreign controlled) and off-site winery retail stores, with a view to adding selective competition and ensuring that the public gets its fair share of the profits from these channels.

In its preliminary report, the Council also considered opportunities for operational improvements in Hydro One's businesses. The Council suggested, among other things, that the government dilute its interest in Hydro One's distribution business by bringing in private capital to facilitate more efficient electricity distribution.

## ELECTRICITY SECTOR REPORT

In April 2015, the Council issued its final electricity sector report, "Striking the Right Balance: Improving Performance and Unlocking Value in the Electricity Sector in Ontario." The Council recommended, among other things, that

- the Province should proceed with a partial sale of its interest in Hydro One to create a growth-oriented company centred in Ontario;
- the partial sale should occur by way of a public offering, with approximately 15% of the shares of Hydro One offered to the market initially; and
- the Province should indicate its intention to retain its remaining shares after selling down to 40% ownership, and that the balance should be widely held with no other individual shareholder having more than a 10% holding.

On November 5, 2015, Hydro One and the Province completed the initial public offering of 81,100,000 common shares of Hydro One Limited by way of secondary offering by the Province at a price of $20.50 per common share. The underwriters for the offering exercised their option to purchase 8,150,000 additional common shares from the Province at the initial offering price on November 12, 2015. The offering resulted in total gross proceeds to the Province of approximately $1.83 billion, making it not only the largest IPO in Canada in 2015 but also the largest in the last 15 years. The Province has retained 84% of the Company's issued and outstanding common shares but, further to the Council's recommendations, it has indicated that it intends to sell additional common shares over time, until it holds approximately 40% of Hydro One Limited.

The offering resulted in total gross proceeds to the Province of approximately $1.83 billion, making it not only the largest IPO in Canada in 2015 but also the largest in the last 15 years.

## BEER RETAILING AND DISTRIBUTION REPORT

In April 2015, the Council issued a further report, "Striking the Right Balance: Modernizing Beer Retailing and Distribution in Ontario." The Report attached a term sheet, or "Framework of Key Principles" (Framework), that the Council had negotiated with the Beer Store and its owners. That Framework formed the basis for further negotiations with the Beer Store and its owners, culminating in a series of agreements that were signed and announced in September (the New Beer Agreements).

The New Beer Agreements, when fully implemented, will make a number of changes to the way that beer is retailed and distributed in Ontario:

- Ownership of the Beer Store will be opened up to all brewers with Ontario facilities that sell beer through the Beer Store.

- Governance of the Beer Store will be more transparent and accountable – smaller brewers will have board representation, and four independent directors (selected jointly by the Province and the original owners of the Beer Store) will represent the broader public interest.
- The Beer Store will be operated on a cost-recovery basis, with all brewers paying a fair share.
- The Beer Store will invest $100 million in capital expenditures to improve customer experience.
- 12-packs will be piloted in LCBO stores.
- Beer will be available for sale in up to 450 grocery stores in Ontario.

These changes represent a typically Canadian compromise: They preserve the benefits of Ontario's current retail and distribution regime – relatively low costs, and a good balance of public revenue and lower consumer prices when compared to other Canadian jurisdictions – while making the system more fair for all participants and providing some enhancements to consumer convenience.

Hydro One
**$1.83 billion IPO**

*Beer soon in up to*
**450**
*stores*

## THE PREMIER'S BUSINESS ADVISOR: ONTARIO NOW HAS A CHIEF DEVELOPMENT OFFICER

In his ongoing role as the Premier's Business Advisor, Ed Clark is lending his considerable reputation within the North American business community (he has been twice named by *Barron's* as one of the world's top 30 CEOs) to Premier Wynne's agenda. He has recently signalled some of the initiatives that he feels are needed for Ontario to overcome its complacency and build upon its strengths (such as its public health and education systems, its open and tolerant society and its world-competitive tax system):

- becoming a leader in "smart" manufacturing and innovation
- helping small businesses to become more export-oriented, so they can achieve scale and focus on continued growth rather than selling out
- reducing unnecessary red tape by taking an outcome-based approach to regulation – with the goal of making government a source of competitive advantage
- shifting the Ontario economy to one that is knowledge-based and focused on the export of services
- opening up Ontario's excellent hospitals and linking them more closely with the private sector, turning them into exporters of health services
- focusing on competing in industries where people are paid more, not less – such as advanced manufacturing, health, universities and consulting
- better capitalizing on Ontario's huge innovation base in Ottawa, Toronto and Kitchener-Waterloo

These initiatives, if successful, could have a fundamental impact on the economy of Ontario, and Canada as a whole.

## OTHER PROVINCES

Other provinces are struggling with comparable issues – or their own unique challenges – but not many of them will have an Ed Clark ready to help. We can expect to see other provinces looking at some of the initiatives that Ontario will be pursuing and asking similar questions: What government assets may help fund needed infrastructure investments? How can governments attract and grow businesses by easing their regulatory burden? How can their economies pivot from old industries to new? We will continue to monitor the situation across the country to determine the success of the initiatives that will undoubtedly be implemented in the months and years ahead.

*Note: Osler acted for Hydro One on its IPO and for the Premier's Advisory Council on Government Assets with respect to its work with the Beer Store.*

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# The politics of energy: Big changes in the oil patch

## POLITICAL AND COMMERCIAL CLIMATE IN 2015

Unprecedented political, legal and market developments during 2015 posed significant challenges to the energy industry.

The extraordinary election of a New Democratic Party (NDP) majority in Alberta followed by a Liberal Party majority in Ottawa set in motion potentially significant changes in government policy affecting the energy industry, many of which are still under development. Provincially, corporations paid 2% more in income taxes immediately, and faced economic uncertainty from future royalty review and climate change initiatives. Federally, reform to the environmental assessment process and climate change regulation is expected, while promises to phase out fossil fuel subsidies, a pending moratorium on oil tanker traffic off B.C.'s North Coast and efforts to improve the duty to consult and accommodate First Nations also factor high on the federal government's agenda. U.S. President Obama's move to deny the presidential permit to build Keystone XL dealt a further blow to an industry whose global competitiveness requires export options.

From a market perspective, crude oil prices seesawed downward, with one month's gains being erased by the next month's losses. Energy companies slashed budgets, removing $31 billion from the economy. Job losses in the sector exceeded 35,000 and the "lower for longer" pricing reference became the new reality. OPEC maintained rather than curtailed production rates as Saudi Arabia ceased being the swing producer – perhaps in an attempt to slow the United States's fracking boom and Canadian oil sands development, to create economic hardship for Russia, to secure relationships with European and Chinese buyers in a lower price environment, or some combination of these.

Significant oversupply dominated the year as onshore storage space dwindled and commercial tankers holding 100 million barrels sat anchored outside numerous ports in China, Malaysia, Indonesia and the Gulf of Mexico. Devastating terrorism attacks in Paris, mere weeks before the UN climate change conference there, added to the global pressures and uncertainty affecting the energy industry.

## KEY LEGAL DEVELOPMENTS

### (a) Taxes and Royalties

In June 2015, the Alberta government passed Bill 2 – *An Act to Restore Fairness in Public Revenue*, which received Royal Assent on June 29, 2015. Under this Bill, effective July 1, 2015, the corporate tax rate was increased from 10% to 12%. For 2015, corporate income tax will be prorated based on the number of days in the corporation's taxation year that are before July 1, to which the prior 10% rate will apply, and the number of days after and including July 1, to which the new 12% rate will apply. In 2016, the 12% rate will apply for the full year.

Federally, the Liberal Party platform includes a promise to phase out fossil fuel subsidies. Full details on what this means are not currently known as the platform indicates that the Department of Finance will be instructed to conduct a detailed analysis of all fossil fuel subsidies. It is estimated that the phase-out will increase federal revenue by approximately $250 million by 2018.

Unprecedented political, legal and market developments during 2015 posed significant challenges to the energy industry.

A significant focal point of the provincial NDP platform was a promise to review the current oil and gas royalty regime and recommend changes to "ensure a full and fair return to the people of Alberta for their energy resources." The government has appointed a four-person advisory panel, which began its review and public consultation process in late August 2015. With the process ongoing, the nature and scope of the changes to the royalty structure are uncertain. However, the panel's mandate is to finish its review process by December 2015, with the current structure to remain in place until the end of 2016.

The Canadian Association of Petroleum Producers (CAPP) submitted a set of 60 recommendations to the Alberta government regarding the royalty review (CAPP Submission). The CAPP Submission stressed that for Alberta to remain competitive with other jurisdictions in attracting investment, the royalty review panel and the government must consider the full cost of doing business in Alberta. In addition to royalties, this would include municipal taxes, provincial corporate taxes at the new 12% rate, mineral rights and fees, carbon pricing policies and other costs.

### (b) Regulatory Reform

The previous federal Conservative government attempted to streamline the process for approval of energy projects through an overhaul of the *Canadian Environmental Assessment Act*. The incoming Liberal government has promised further changes to the regulatory process, which will likely include repealing many of the changes made by the Conservatives. The framework and guiding principles for these changes are to: restore oversight and thorough environmental assessments under areas of federal jurisdiction; ensure decisions are based on science and evidence, which will include consideration of upstream carbon emissions in the assessment process; ensure that decisions serve the public interest; and provide ways for interested Canadians to express their views and for experts to meaningfully participate in assessments. Based on its platform, it is clear that the Liberal government intends to pay particular attention to the role of Aboriginal peoples in the assessment process, promising to undertake a full review to ensure that the federal Crown is discharging its consultation, accommodation and consent obligations in regulatory processes.

The NDP government has stated its intent to resolve what it sees as the "conflicting mandate" of the Alberta Energy Regulator (AER) as both promoter and regulator of the energy industry. The AER was established by the provincial Progressive Conservatives to try to streamline the regulatory process by having one agency responsible for all environmental legislation and regulations. The AER is currently responsible for the *Public Lands Act*, the *Environmental Protection and Enhancement Act* and the *Water Act*. It is not clear what the restructured regulatory bodies would be responsible for, nor how they would interact to ensure consistency and efficiency.

### (c) Climate Change

Both the Alberta NDP and federal Liberal Party have pledged to take steps to address climate change. However, policy development at both levels is in the early stages. The Liberal platform promises a collaborative approach between the federal, provincial and territorial governments to establish emissions reduction targets and ensure that the provinces receive federal funding while retaining flexibility to meet these targets through their own policies and pricing strategies.

Big changes in the —*oil*— *patch*

The Alberta NDP announced a robust climate change leadership plan on November 22, 2015. It is based on the recommendations of the province's Climate Change Advisory Panel, whose report was released concurrently with the provincial government's press conference. Although it is unclear which aspects of the Panel's detailed recommendations will be adopted into law, the cornerstones of the new plan are: (1) an accelerated phase-out of coal, (2) an economy-wide carbon levy, (3) an absolute cap on oil sands emissions and (4) a methane gas emissions reduction plan.

The first prong of the new strategy will be to accelerate the phase-out of coal-fired power production by 2030. In its place, natural gas-fired power production is expected to provide the base load reliability while renewable power is expected to fill two-thirds of the new capacity. The province is expected to provide limited long-term fixed price emission offset credit contracts to renewable project developers to mitigate some of the merchant power pricing risk that has historically stymied renewable project financing in Alberta. However, both natural gas and renewable power producers will have to contend with merchant power pricing risk when securing financing, and coal plant operators spurned by the new plan may refuse to make the capital investments to smoothly transition the balance of power sources in Alberta.

The second prong of the new strategy is a carbon price applicable to the wider economy. In addition to the increased carbon levy of $30 per tonne to be paid by large industrial emitters, announced in June 2015, Albertans will be subject to an economy-wide carbon tax of $20 per tonne effective January 2017, growing to $30 per tonne by January 2018. The Climate Change Advisory Panel also recommended an annual escalator of 2% more than inflation, but it is not clear whether the government will adopt that recommendation. The broader economy-wide carbon price is expected to touch 78–90% of all emissions in the province, the largest proportion in Canada. A key feature of the proposal is the pledge that all proceeds of the broader carbon tax would remain in and be put to work within provincial borders, through investment in green infrastructure (such as public transit), energy-efficiency programs, renewable energy research, development and investment (including the payment of emission offset contracts to be offered at auction for renewable power projects), and an adjustment fund. This fund would be used to help lower-income Albertans offset the cost increases of carbon pricing and to provide financial support to small businesses, First Nations and those working in coal facilities subject to the accelerated phase-out of coal-fired power production.

The third prong of the new plan is an absolute limit on oil sands emissions of 100 megatonnes (Mt) per year, with provisions for new upgrading and cogeneration. This announcement was largely unexpected and of great significance, since oil sands production in the province is currently responsible for approximately 70 Mt of annual emissions. For new projects with top-quartile or better potential emissions performance, the new treatment may provide significant advantages, but for those with high prospective emissions intensities (or significant risk of such an outcome), the policy will magnify risks and may make such projects less attractive. An absolute cap on oil sands emissions is a significant departure from the previous intensity-based cap and risks stymying the development of future oil sands projects. Given that the industry currently emits 70% of its new capped emissions allotment – and additional approved, but not yet operational, projects will contribute to such emissions – unless there are significant efficiency-based emissions reductions from existing projects, new projects will have to compete for the remaining capacity in order to come online. Companies may have incentives to seek regulatory approval for new projects before the absolute cap is reached. An absolute cap without the opportunity to buy or trade emissions capacity could also stifle the development of new projects.

As the fourth prong of the new plan, a methane gas emissions reduction strategy is intended to reduce emissions from Alberta's oil and gas operations by 45% of 2014 levels by 2025. The details of this strategy are expected to unfold in early 2016.

### (d) Transparency Legislation

In June 2015, the *Extractive Sector Transparency Measures Act* was proclaimed into force by the previous Conservative government in furtherance of its international anti-corruption and transparency commitments. This legislation requires extractive sector businesses operating in Canada to make public and report payments made to domestic and foreign governments in relation to the commercial development of oil, gas or minerals. For further analysis of the legislation please see the article entitled "Continuing crackdown on foreign corruption and new transparency measures."

### (e) Oil Pipeline Projects

On November 6, 2015, President Obama officially denied the presidential permit required to build the Keystone XL Pipeline Project (KXL). This decision will place greater importance on the other proposed pipeline projects to export oil from Canada: Trans Mountain Expansion Project, proposed by Kinder

Morgan; Energy East Pipeline, proposed by TransCanada PipeLines; and Northern Gateway, proposed by Enbridge. Each of these projects will face uncertain regulatory regimes, as the Liberal Party has promised significant changes to the assessment and approval process for such projects. Within weeks of being elected, Prime Minister Trudeau instructed federal Transport Minister Garneau to "formalize a moratorium on crude oil traffic on British Columbia's North Coast, working in collaboration with the Minister of Fisheries, Oceans and the Canadian Coast Guard, the Minister of Natural Resources and the Minister of Environment and Climate Change to develop an approach," signalling another blow to Canada's pipeline industry's ability to export crude oil.

Both the NDP and Liberal Party expressed disappointment at President Obama's decision and offered support for the idea that Canada's energy resources need improved access to global markets. However, they have also been circumspect in providing support for the remaining proposed projects. The Liberal Party has stated that each of the projects will have to undergo thorough regulatory review, and declined to pre-judge the outcome of the review. However, the Liberal Party has been clear in its position regarding Northern Gateway, promising to reverse the decision of the Conservative government to approve the project, citing concerns that the review process did not adequately consult with local communities and Aboriginal peoples.

## CONCLUSION

How Canada's energy industry will weather the challenges presented by such profound political and market developments remains to be seen, but one thing is clear. Our clients are entrepreneurial, responsible leaders in an industry the world depends on, and have made unparalleled contributions to the Canadian economy. As conventional oil supplies dwindle, let's hope that when undertaking regulatory reforms on the royalty, climate change, duty to consult, and pipeline fronts, our politicians heed CAPP's advice: before *any* value can be captured from such initiatives, resources need to be developed and development is expensive. Hopefully the result of such reforms will continue to motivate energy companies to invest the billions of dollars they invest annually in the very risky economics of an industry whose geopolitical and economic volatility created more barriers than opportunities in 2015.

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# Betting on the future: The rise of the gaming industry

In 2015, the Ontario government's ambitious plan to modernize the delivery of gambling entertainment options was reinvigorated after overcoming a number of challenges and delays. This Modernization Plan is yet another example – along with the Hydro One IPO and the restructuring of beer retail sales channels in the province – of Ontario's desire to optimize assets and raise money for priorities such as transit and infrastructure. The revitalization of the gaming industry is opening up opportunities for expansion and growth across the province.

### THE LEAD-UP TO MODERNIZATION

By many measures, Ontario Lottery and Gaming Corporation (OLG), the Crown corporation responsible for the conduct and management of commercial gaming in Ontario, is one of the biggest gaming organizations in North America. With over 30 gaming sites and 10,0000 lottery points of sale, OLG's revenues total nearly $7 billion annually, with contributions of approximately $2 billion of net profits to the province to support government priorities like healthcare, education and infrastructure. In addition, host municipalities receive just under $100 million in the aggregate from gaming revenues every year.

Recognizing the need to increase net profits to the province and optimize the delivery of land-based gaming, the government began its ambitious modernization initiative in 2012. At that time, OLG's land-based gaming offering included over 23,000 slots and 500 table games. Nearly all gaming venues were owned and operated by OLG, with day-to-day operational services being provided by private sector operators for only a handful of facilities. OLG employed just under 18,000 people across Ontario. The cost of all of these properties and employees was borne by the public purse. With minor exceptions, all capital improvements also fully relied on public funding.

Conceding that this model was not sustainable in the long term, OLG undertook a strategic business review, consultations with stakeholders and comparative analyses of gaming in multiple jurisdictions. After obtaining government approval, OLG launched its Modernization Plan. From the very beginning, one of the primary drivers behind the modernization was to lessen the burden of capital costs on the public purse and maximize the opportunity for private sector investment. Another key driver was the recognition that private sector expertise can and should be leveraged better, not only to spur development and investment but also to provide enhanced, customer-focused operational services within a heavily regulated model. With forecasted new private sector capital investment of $3 billion expected to stimulate economic activity, the original projections were that all modernization initiatives combined would result in additional annual net profit to the province of $1.3 billion by 2017, along with over 2,300 net new gaming jobs and over 4,000 service sector jobs in related fields such as hospitality.

The province's vision has always been to have new or redeveloped "casino gaming" facilities in Ontario, with the capital and operational risks borne by the private sector as opposed to the public, with a streamlined OLG providing operational "conduct and management" oversight. A parallel initiative to modernize the charitable bingo gaming sector by converting participating existing bingo halls to electronic bingo centres was also expected to generate more than $475 million for charitable organizations over its implementation period.

## CHALLENGES AND ROADBLOCKS

Despite the best of intentions, the implementation of the modernization initiative has faced delays. The reasons for the delays include

- backlash to the province's decision to cancel the program to fund the horse racing industry by means of slot machines at racetracks
- the subsequent decision to continue funding the horse racing industry and integrate horse racing with gaming
- the development of a new host community funding formula
- decisions by some municipalities to reject new facilities or the relocation of existing facilities
- leadership change, including the OLG's CEO and the Board of Directors
- change in the Ontario government's leadership, including the Premier and Minister of Finance
- the OLG's procurement process taking longer than originally anticipated

## OVERCOMING DELAYS TO MODERNIZATION

In 2015, gaming modernization picked up momentum with a number of key developments:

- the appointment of Stephen Rigby, the former National Security Advisor to the Prime Minister of Canada, as the new President and CEO of OLG

- the closing of seven RFPQs, including for the Greater Toronto Area, as part of the procurement process to increase private sector involvement
- the approval by Toronto City Council, after many heated debates and lengthy consultations, of the expansion of gaming at Woodbine Racetrack with a view to developing an integrated casino entertainment complex
- Ontario's renewed commitment to integrating horse racing with casino gaming
- the awarding of the first Gaming Bundle (the Ontario "East" Bundle, consisting of Belleville, Peterborough, and Thousand Islands sites) to Great Canadian Gaming Corporation, nearly three years after commencement of the procurement process

Although the original implementation plan and projections have been revised because of the evolving nature of modernization, the initiative continues to draw considerable interest from world-class gaming operators, developers and financiers. With the upswing in activity over the last year, and the anticipated release of multiple RFPs in the coming weeks and months, the province is poised to transition to a more modern oversight model that is based on a renewed partnership with the private sector. The overall goal is to spur economic activity, develop sustainable, modern and efficient operations, and provide Ontarians and visitors to Ontario with innovative entertainment options in a socially responsible way that will optimize funding for good causes.

The province's vision has always been to have new or redeveloped "casino gaming" facilities in Ontario, with the capital and operational risks borne by the private sector as opposed to the public.

## THE GLOBAL M&A PICTURE

While OLG has been focusing on modernization, the global gaming industry has been experiencing a wave of mergers and acquisitions, triggered in large part by the significant growth of mobile and online platforms, the introduction of new taxation measures and the increased regulation that followed suit. The requirement to meet more onerous regulatory requirements, as well as the increased need to promote products in a competitive landscape, has increased compliance-related costs and operating expenses for industry players. The economies of scale under such circumstances have resulted in increased M&A activity.

The number and scale of transactions in 2015 made it the biggest year yet for M&A in this sector. We witnessed three proposed mega-deals: the £2.3 billion tie-up between Ladbrokes and Gala Coral in July 2015, a £6 billion merger between Betfair and Paddy Power in August 2015, and GVC's £1.1 billion acquisition of Bwin.party in September 2015.

These deals came on the heels of the mega M&A transaction in Canada that took place in the summer of 2014, when Montreal-based Amaya Inc. (Amaya), represented by Osler, purchased privately held Oldford Group, then owner and operator of PokerStars and Full Tilt, for US$4.9 billion (the Oldford Group Acquisition). Prior to and following the completion of the Oldford Group Acquisition, Amaya went on a divestiture spree by unloading its land-based gaming assets and other non-core assets. These divestitures contributed to the initial public offering of three new issuers: The Intertain Group Ltd. (TSX: IT), NYX Gaming Group Ltd. (TSXV: NYX) and Innova Gaming Group Inc. (TSX: IGG).

As a result of these transactions and others in the market, Canada is quickly being recognized as one of the world-leading jurisdictions for gaming companies.

Our European counterparts saw a great deal of action as well, including the acquisition of IGT for £3.591 billion by Gtech in July 2014, followed by the purchase of Bally Technologies for £3.04 billion by Scientific Games in November 2014.

It is worth noting that some of the world's largest and most well-known private equity firms participated in financing the recent M&A activity, fuelling expectations that M&A activity in the Canadian and global gaming industry will continue to grow in 2016. Combined with the anticipated awarding by OLG of multiple Gaming Bundles, and all of the concomitant transitional, operational and development activity, the gaming industry in Canada is poised for significant activity in 2016.

*Note: In 2015, Osler launched its Gaming Specialty Group.*

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# Pension reform: The new Ontario Retirement Pension Plan, an expanded Canadian Pension Plan?

Recently, there has been significant debate and discussion regarding retirement savings adequacy and coverage in Canada. Are we saving enough? Should there be expanded mandatory government sponsored plans, such as the Canada Pension Plan (CPP)? What role should employers and/or governments play in improving pension coverage in Canada? These important social questions have thrust pensions into the media and political spotlight. Consequently, politicians are now paying attention to pension matters – so much so that pensions have become an election issue – with the result that legislators are introducing new laws across the country that will affect employers and the Canadian retirement income system in general.

This renewed focus on pensions has led to ongoing reforms to pension standards legislation, including the creation of new innovative plan designs like Pooled Registered Pension Plans, Voluntary Retirement Savings Plans and Target Benefit Plans. However, perhaps the most significant and innovative development yet is the Ontario government's proposal to implement the Ontario Retirement Pension Plan (ORPP), which will cover all employers/employees in Ontario who are not in a comparable workplace pension plan. While there is considerable uncertainty at this time regarding any potential CPP expansion at the federal level, we do know that the Ontario government is currently proceeding with the ORPP.

## WHAT IS THE ORPP?

The ORPP is intended to close the retirement savings gap for Ontarians without a secure workplace pension plan. Because of the unwillingness of the former federal government to consider mandatory expansion of the CPP, the Ontario government has taken steps to implement the ORPP and has passed two bills providing certain details regarding the ORPP thus far.

The ORPP is intended to be supplemental to the CPP. The plan aims to provide a predictable source of retirement income based on an employee/employer contribution rate of up to 1.9% each. The Ontario government is committed to ensuring that by 2020 every employer will participate in the ORPP or a comparable workplace pension plan for all employees in Ontario.

## WHO WILL THE ORPP COVER AND WHO IS EXEMPT?

As discussed in more detail below, the ORPP will be phased in to apply to employers that do not provide a comparable workplace pension plan to all their employees. In 2016, employers will be canvassed to determine whether they provide a registered pension plan and to establish their phase-in timing for participation in the ORPP where applicable.

The Ontario government defines a comparable workplace pension plan as a registered pension plan that meets certain minimum thresholds. Defined benefit (DB) pension plans will be comparable plans where the plan provides a minimum annual benefit accrual rate of 0.5%. Defined contribution (DC) pension plans must have a minimum annual contribution rate of 8% of pay and require at least 50% of that minimum to be contributions by the employer to be considered a comparable plan. It is important to note that only "registered pension plans" may qualify. Accordingly, a group RRSP or deferred profit-sharing plan (DPSP) would not qualify as a comparable workplace pension plan, regardless of the contribution rates.

## PHASE-IN SCHEDULE FOR THE ORPP

The Ontario government plans to phase in the ORPP in four waves, with the first wave being in January 2017. Employers first need to determine what wave they fall within. If the employer does not currently offer a registered pension plan, the employer will fall within wave 1, 2 or 3, depending on the size of the employer. Employers that do offer a registered pension plan will fall within wave 4.

- **Wave 1**: Large employers (500 or more employees) without registered workplace pension plans – ORPP contributions to start January 1, 2017
- **Wave 2**: Medium employers (50–499 employees) without registered workplace pension plans – ORPP contributions to start January 1, 2018
- **Wave 3**: Small employers (49 or fewer employees) without registered workplace pension plans – ORPP contributions to start January 1, 2019
- **Wave 4**: Employers with non-comparable registered workplace pension plans or comparable workplace pension plans that do not apply to all Ontario employees – ORPP contributions to start January 1, 2020

Wave 4 employers will have until 2020 to determine whether to amend their registered pension plan to cover all employees in a comparable plan or to participate in the ORPP for employees who are not so covered. By 2020, employers of all sizes will be required to provide a comparable workplace pension plan or participate in the ORPP. Where all employees of an employer participate in a comparable workplace pension plan, the employer will not be required to participate in the ORPP.

For the first three waves, the contribution rate for both employers and employees will start at 0.8% for the first year and 1.6% for the second year, and will reach the fully phased-in rate of 1.9% each by 2019, 2020 and 2021, respectively. The fourth wave will start at the fully phased-in contribution rate of 1.9% in 2020. By 2021, the fully phased-in contribution rate will be 3.8% split equally between the employer and the employee.

## WHAT SHOULD EMPLOYERS BE DOING NOW?

The ORPP will be implemented in Ontario effective January 1, 2017. Accordingly, employers need to get ready for the change.

Employers need to examine their existing workforce, pension and retirement savings plans to determine if they will be subject to the ORPP. If an employer currently has a registered pension plan in place that would not be a comparable plan, the employer should consider whether it is advisable to change its plan to a comparable plan. If an employer currently sponsors a group RRSP or DPSP or does not have any retirement plan in place, the employer should consider whether to implement or commence participation in a new comparable plan. Any employer considering plan amendments to make their plan comparable for purposes of the ORPP or establishing a new comparable plan should seek legal advice on the implementation of the plan amendment or new registered pension plan.

Employers also need to examine their existing employment contracts and collective agreements. An employer that will participate in the ORPP may wish to consult labour counsel and potentially take this into consideration in collective bargaining, as it will be an additional benefit cost for the employer. It will also come into account in total projected compensation costs, unless the employer makes other benefits or compensation changes. Again, any such proposed changes should be discussed with legal counsel.

## WHAT ABOUT CPP EXPANSION?

The recent federal election created uncertainty surrounding pension reform in Canada at both the federal and provincial levels. Will there be CPP expansion? How would it impact the ORPP? With the recent change of the federal government, the Ontario government has stated that Premier Kathleen Wynne and Prime Minister Justin Trudeau will be "active partners" in a national discussion regarding pension enhancement, including the CPP and the ORPP.

With the recent change of the federal government, the Ontario government has stated that Premier Kathleen Wynne and Prime Minister Justin Trudeau will be "active partners" in a national discussion regarding pension enhancement, including the CPP and the ORPP.

The CPP is a joint pension program between the federal government and the provinces, and CPP expansion would therefore require the support of the federal government, as well as two-thirds of the provinces, representing two-thirds of citizens. Accordingly, a key component of any CPP expansion would be strong federal backing, as well as obtaining the requisite support of the provinces, which is potentially daunting.

At this stage, whether CPP expansion will proceed and what any such expansion would look like is unclear. If the CPP were to be sufficiently expanded it is possible that the ORPP would be incorporated in some manner into the CPP expansion. What remains clear is that some mandatory expansion of public plans will occur to improve the pension plight of Ontarians, and perhaps Canadians, and employers will have to determine how to change their plan designs so as to integrate with these plans.

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# Taxation and innovation: Striking the right balance

A new Liberal majority government was elected federally in 2015 following a campaign that included a pledge to finance certain campaign commitments, in part by increasing taxes for the wealthiest Canadian individuals. A key challenge for the government will be to strike a fair balance between increasing revenues and redistributing income, on the one hand, and creating appropriate and effective incentives for innovation and productivity on the other.

The Liberals' campaign included two key tax commitments – a promise to increase taxes on individuals with incomes in excess of $200,000 with a new top federal marginal tax rate of 33% and a promise to reduce the ability of high income individuals to obtain tax-preferred stock option benefits by imposing a cap that would apply to employees with over $100,000 in annual stock option gains.

Stock option rules in Canada currently compare favourably with those in our largest neighbour (and competitor for tech talent), the United States. Under existing Canadian tax rules, an employee who acquires shares upon the exercise of an employment stock option is allowed a tax deduction of 50% of the employment benefit (this benefit is calculated as the difference between the fair market value of the share acquired over the exercise price paid by the employee to acquire the share), provided that certain other conditions are met. The effect of this deduction is to tax the stock option benefit at the rate applicable to capital gains – which is one-half of the rate that would otherwise apply to ordinary employment income.

The new Liberal government proposes to change these rules. Although the government's November 20, 2015 "Update of Economics and Fiscal Projections" did not provide any formal guidance or proposal, the Honourable Bill Morneau, Minister of Finance, stated that details of the proposal remain to be developed "in the next few months." He did provide some comfort, however, that any

> The new government should carefully consider the potential impact of the proposed changes to the taxation of stock options on tech companies' ability to attract and retain the best talent.

changes to the tax rules relating to employment stock options would only affect stock options granted after the government has settled upon a course of action in this regard. Employment stock options granted prior to that time will remain subject to the current taxation regime and should not be affected by the government's proposal.

Employee stock options are frequently used as part of a compensation package in the technology sector, particularly in start-up companies that are cash-constrained and might otherwise struggle to attract the top talent they need to advance their business. The new government should carefully consider the potential impact of the proposed changes to the taxation of stock options on tech companies' ability to attract and retain the best talent.

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# Securities law developments in 2015: Evolutionary not revolutionary

This past year was marked by a few major developments in Canadian securities laws that could lead to significant changes in practice, such as the proposed reform of Canada's take-over bid regime. For the most part, however, 2015 saw more evolutionary developments such as the introduction of several new prospectus exemptions and the imposition of stricter investor protections for individuals. Here is our list of the year's most notable developments:

## CCMRS – A MARCH TOWARDS A NATIONAL SECURITIES REGULATOR?

The push by a number of the provinces and the federal government to create a common securities regulatory regime (the Cooperative Capital Markets Regulatory System) continued to move forward in 2015. In particular, updated draft legislation for the uniform *Capital Markets Act*, draft initial regulations and related materials were published for comment on August 25, 2015, with the comment period remaining open until December 23, 2015. It remains to be seen how much political priority will be given to the initiative by the recently elected federal Liberal government, given that the initiative was previously backed by the prior Conservative government at the federal level.

## NEW TAKEOVER BID REGIME – HIGHER HURDLES FOR BIDDERS

Following years of debate among market participants regarding the role of defensive tactics and the use of shareholder rights plans in particular, in March 2015 the CSA published for comment significant proposed changes to the takeover bid regime in Canada. The changes will effectively give the target of a hostile bid 120 days to respond, as it will require the bid to remain open for at least 120 days unless the target's board agrees to a shorter period (of not less than 35 days) or unless the target enters into an alternative transaction. The new rules will also require a mandatory 10-day extension of a bid following the satisfaction or waiver of all conditions, including the minimum tender requirement. All bids will be subject to a mandatory minimum tender requirement of more than 50% of the outstanding securities not already held by the bidder or its joint actors. The new take-over bid regime, if implemented as currently proposed, will likely result in the end of shareholder rights plan or "poison pill" hearings by regulators in most cases, since it is expected that securities regulators will cease trade rights plans after 120-day bids, absent unusual circumstances. Please refer to the article entitled "The swan song of poison pill hearings?" for more information.

## CROWDFUNDING COMES TO CANADA

Given the rapid growth of crowdfunding as a means for early-stage companies to access capital, it was only a matter of time before securities regulators established a legal framework for the practice. The CSA has created a crowdfunding prospectus exemption that will come into force on January 25, 2016. Under this regime, issuers will be required to prepare an offering document containing all information that investors should know about their business; investors will be subject to an investment limit on each individual investment and overall annual limits that vary depending on the investor's accreditation status; investors will be required to sign a prescribed risk acknowledgement form confirming they are aware of the risks of the investment; and issuers will be required to continue to make annual financial statements and certain other information available to investors on an ongoing basis, even if they are not subject to public company reporting obligations. The securities may only be sold through a registered "funding portal" meeting prescribed requirements, and there will be a prohibition on advertising and general solicitation of the securities.

> The push by a number of the provinces and the federal government to create a common securities regulatory regime continued to move forward in 2015.

## REFORMS TO THE EXEMPT MARKET SYSTEM FOR CAPITAL RAISING

A number of other important revisions to the exempt market system in Canada will have a significant impact on the way in which prospectus-exempt financings are conducted across the country. Two of these initiatives reflect in part the constrained financing environment for certain smaller issuers. The first is the introduction of a new exemption aimed at allowing exempt issuances to be made to existing securityholders, and the second is a revised rights offering regime designed to streamline the rights offering process and facilitate the (relatively rare) usage of the exemption. Other developments in 2015 include a series of amendments in Ontario designed to harmonize exemptions relating to offering memorandums and family, friends and business associates with other jurisdictions. Finally, a number of amendments designed to enhance investor protections in the context of exempt offerings were introduced or published in draft form, including the introduction of a risk acknowledgement form for accredited investors that do not meet financial asset requirements and a new substantially expanded form of exempt trade report.

## OSC WHISTLEBLOWER INITIATIVE

The Ontario Securities Commission (OSC) has unveiled a proposed Whistleblower Program, which would be the first program of its kind in Canada. Though it is modelled on the SEC's whistleblower program in the United States, the OSC's proposal seeks to avoid some of the more egregious aspects of that program, which resulted in 120 whistleblower award claims in 2015 alone, and in one case resulted in a payment of over $30 million to a single individual. Further details regarding the OSC's proposed Whistleblower Program are set out in the article entitled "Securities enforcement: Big win and broader tools for regulators."

## PROXY VOTING INFRASTRUCTURE – THE LONG AND WINDING ROAD CONTINUES

The CSA has been engaged in a review of the Canadian voting infrastructure since August 2013, in the wake of various concerns expressed by market participants regarding the integrity and reliability of the network of organizations, systems, legal rules and market practices that support the solicitation, collection, submission and tabulation of proxy votes for shareholder meetings in the context of the Canadian beneficial share ownership system. CSA staff issued a report in January 2015 that discussed the progress made to date in their review and outlined next steps. The progress report confirmed that the CSA believes the current system to be fragmented and requiring modernization and improvement, and identified a number of specific improvements that must be made in the vote reconciliation process. We expect this review process to continue in 2016 and beyond. In the spring of 2015, the CSA also chose not to regulate proxy advisory firms such as ISS and Glass Lewis, opting instead to issue guidance on best practices that proxy advisory firms should follow.

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# The swan song of poison pill hearings?

In what may be the last major rights plan decision prior to the implementation of proposed amendments to the take-over bid regime (Proposed Amendments) that will give target issuers 120 days to respond to a hostile take-over bid, on November 30, 2015 the Alberta Securities Commission (ASC) ordered that Canadian Oil Sands Limited's (COS) shareholder rights plan would be cease traded 91 days after Suncor Energy Inc. (Suncor) formally commenced its $4.3 billion hostile bid for COS.

The largest hostile bid in Canada this year, Suncor's offer commenced on October 5, 2015 and was intended to be structured as a 60-day "permitted bid" under COS's rights plan in effect at that time. Suncor made its offer after the release of the Proposed Amendments – the most significant changes to the take-over bid regime in 15 years – but before they have come into force.

Under the Proposed Amendments, all non-exempt take-over bids (including partial bids) will be subject to the following new requirements:

- 50% Minimum Tender Requirement – Bids will be subject to a mandatory minimum tender requirement of more than 50% of the outstanding securities of the class that are subject to the bid, excluding those beneficially owned, or over which control or direction is exercised, by the bidder and its joint actors.
- 10-Day Extension Requirement – Following the satisfaction of the Minimum Tender Requirement and the satisfaction or waiver of all other terms and conditions, bids will be required to be extended for an additional 10-day period.
- 120-Day Bid Period – Bids will be required to remain open for a minimum of 120 days, subject to two exceptions. First, the target issuer's board of directors may issue a "deposit period news release" in respect of a proposed or commenced take-over bid providing for an initial bid period that is shorter than 120 days but not less than 35 days. If so, then all other outstanding or subsequent bids

will also be entitled to the shorter minimum deposit period counted from the date that other bid is made. Second, if an issuer issues a news release that it has entered into an "alternative transaction" – effectively a friendly change of control transaction, such as an arrangement – then all other outstanding or subsequent bids will be entitled to a minimum 35-day deposit period counted from the date that other bid is made.

(For more information, refer to our Update entitled "It's about time – CSA proposes amended take-over bid regime" on osler.com.)

Against this regulatory backdrop, and having regard to what the COS board concluded was an opportunistic bid by Suncor made in unique and volatile market circumstances and timed to expire just after the release of critical budget information, COS's board authorized the adoption of a second tactical rights plan that provided for a 120-day permitted bid. The Suncor bid was not a permitted bid for purposes of this second rights plan.

In explaining its order, the ASC noted that the Proposed Amendments are not yet in force and applied the factors set out in the previous *Royal Host* and *Regal* decisions in determining not whether but when it was time for the pill to go. The ASC found that although COS did not obtain shareholder approval of the second rights plan, this fact was not determinative. The ASC concluded there was still a real and substantial possibility that COS could surface a superior alternative if its value-maximizing process was given more time to unfold. Accordingly, the ASC concluded that a total of 91 days was appropriate, and ordered the rights plan to be cease traded at 6:00 p.m. (Calgary time) on January 4, 2016. At the time of publication, formal written reasons for the ASC's decision had not yet been released.

It is unclear when the Proposed Amendments will be implemented, and if there will be any changes to them in the wake of comments received by the Canadian Securities Administrators (CSA). It is possible they will be adopted in the first half of 2016.

Pending their implementation, the ASC's decision is highly relevant to hostile take-over bids made during this transition period. The ASC's decision is a welcome acknowledgement that target companies with existing rights plans that have 60-day permitted bids may legitimately require more than 60 days to respond effectively to a hostile bid and that circumstances can and often will change between the time of initial board and shareholder approval of a 60-day permitted bid rights plan and the time of an actual hostile bid.

The ASC's decision is a welcome acknowledgement that target companies with existing rights plans that have 60-day permitted bids may legitimately require more than 60 days to respond effectively to a hostile bid and that circumstances can and often will change between the time of initial board and shareholder approval of a 60-day permitted bid rights plan and the time of an actual hostile bid.

A notable omission from the Proposed Amendments is how rights plans will ultimately be treated following their adoption. This is of particular interest considering that the Proposed Amendments arose out of competing proposals from the CSA and Autorité des marchés financiers of Québec (AMF) on rights plans and defensive tactics more generally. The AMF and the balance of the CSA's members have previously aired different perspectives on the most appropriate approach to the regulation of defensive tactics, which may account for the Proposed Amendments' silence on this issue.

If implemented in their current form, we anticipate that the Proposed Amendments will have the following effects on Canadian rights plans:

- Rights plans will be waived by targets or cease traded by securities regulators after a 120-day formal bid, absent unusual circumstances, and therefore securities regulators will be called upon much less frequently to hold hearings as to when "the pill must go." This will result in greater regulatory certainty as to timing of bids than under the current regime.
- Since the Proposed Amendments will give a target issuer 120 days to respond to a hostile bid, in many cases target issuers may conclude that they have sufficient time to respond to a hostile bid without needing to adopt a rights plan. Accordingly, we would expect that there will be less of an incentive for issuers to adopt rights plans either "strategically" at their annual meetings or "tactically" in the face of a bid.
- As the Proposed Amendments do not apply to exempt bids, there will still be a role for rights plans in protecting target issuers against "creeping bids," such as bids made through the normal course purchase and private agreement exemptions. We therefore expect issuers that are concerned about the possibility of creeping bids to continue to adopt rights plans.

We would encourage the CSA to provide guidance on their proposed approach to rights plans if and when the Proposed Amendments are implemented. As the COS rights plan litigation has illustrated, the current regime results in uncertainty as to how much time target issuers have to respond to a bid. The CSA should make the rules and timelines as clear as possible in the circumstances.

*Note: Osler is acting for COS in response to Suncor's hostile bid and represented COS before the ASC.*

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# Special Purpose Acquisition Corporation (SPAC) offerings: Will we see more?

The wave of special purpose acquisition corporation (SPAC) offerings was arguably the biggest development in Canada's capital markets in 2015. Although the TSX adopted SPAC rules in 2008, the first Canadian SPAC offering was only completed in April 2015. Four other deals followed in quick succession, raising over $1.1 billion in capital.

| SPAC | Capital Raised |
|---|---|
| Dundee Acquisition Ltd. | $112.3 MM |
| INFOR Acquisition Corp. | $230.0 MM |
| Alignvest Acquisition Corporation | $258.8 MM |
| Acasta Enterprises Inc. | $402.5 MM |
| Gibraltar Growth Corporation | $104.5 MM |

## HOW SPAC OFFERINGS ARE STRUCTURED

A SPAC is a publicly traded shell corporation that is formed to complete a "qualifying acquisition" of an operating business within 24 months (with the potential of an extension to 36 months if approved by investors). If a deal is not completed, investors get their money back with interest.

In all SPAC deals to date, the public has acquired Class A units, consisting of a Class A restricted voting share and 1/2 of a Class B share purchase warrant (one full warrant in the Gibraltar deal), at a price of $10 per share. Each warrant is exercisable for one Class B voting share at a price of $11.50 per share, and the warrants expire five years after completion of a qualifying acquisition. Each Class A restricted voting share automatically converts into a Class B voting share upon completion of a qualifying acquisition. The gross proceeds of the issuance of Class A units are held in escrow pending completion of a qualifying acquisition and are invested in short-term Canadian government securities with a maturity of 180 days or less.

The founders of the SPAC – a sponsoring entity and certain directors and officers – provide seed financing to the SPAC by purchasing Class B units, consisting of a Class B voting share and 1/2 of a Class B share purchase warrant (one full warrant in the Gibraltar deal), also at a price of $10 per unit. The seed financing covers underwriting fees and legal and other fees in connection with the IPO and qualifying acquisition.

Before the IPO, the founders also acquire initial shareholdings that constitute 20% of the Class B shares for nominal consideration. These "founders' shares" compensate the founders for the risk they have assumed with their seed capital, for their efforts in organizing the SPAC and for their ability to source and execute a successful qualifying acquisition. As a result, the average cost of the Class B shares for the founders (including the founders' shares and the Class B shares underlying the Class B units) has been in the range of $1.22 to $1.33 per share, as compared to $10 per Class A share for the public. The founders' shares cannot be traded until the earlier of one year following the closing of a qualifying acquisition and the date on which the closing price of the Class B shares equals or exceeds $12 per share for 20 trading days within a 30-day trading period. In addition, 25% of the founders' shares are subject to forfeiture unless the closing price of the Class B shares exceeds $13 for 20 trading days within a 30-day trading period in the five years following the qualifying acquisition.

A qualifying acquisition (or combination of related acquisitions) must have a fair market value of not less than 80% of the assets held in escrow and must be approved at a shareholders' meeting by a majority of votes cast by Class A and Class B shareholders voting together as a single class. If the qualifying acquisition is approved by shareholders, the SPAC uses the escrowed funds to complete the acquisition (most likely with additional debt financing and the issuance of equity to the owners of the target business).

If the qualifying acquisition is not approved by shareholders and no qualifying acquisition is completed within the permitted timeline, escrowed funds are returned to the shareholders.

Class A shareholders have the right to exercise redemption rights in connection with the shareholders' meeting to vote on a qualifying acquisition – regardless of whether they vote for or against or do not vote at all on the qualifying acquisition. However, in the deals to date, no single shareholder (together with any joint actors) can redeem more than 15% of the outstanding Class A shares. In addition, Class A shareholders have the right to keep their purchase warrants after they have redeemed their Class A shares.

Whether SPACs will continue to be a viable asset class will likely depend on the current group of SPACs completing successful qualifying acquisitions.

## WILL SPACs CONTINUE TO BE A VIABLE ASSET CLASS?

A SPAC presents a potentially favourable investment opportunity to shareholders. They are effectively assured of a T-Bill return over a 24-month period, with the potential of further upside on their equity participation if a qualifying acquisition is completed.

In 2015, SPACs represented a new and attractive investment option. Whether SPACs will continue to be a viable asset class will likely depend on the current group of SPACs completing successful qualifying acquisitions.

SPACs are potentially attractive for certain kinds of businesses that are considering either an IPO or a sale. A SPAC transaction may be the most desirable option where the owners of the business would like to remain in control but monetize a sizable stake, want a pre-established shareholder base, can benefit from the SPAC's existing management team and experience, or where the IPO or M&A market may otherwise be closed.

However, SPACs also have certain limitations. With respect to a sale transaction, a SPAC must obtain shareholder approval before completing a deal. Other bidders aren't typically subject to the same completion risk. Even if shareholder approval is obtained, shareholders may redeem too many shares, which could deplete the available cash and result in the SPAC being unable to complete the qualifying acquisition. Furthermore, without additional financing, SPACs are unable to provide deposits or pay break fees if deals are not completed, since their cash is escrowed.

Going public through a SPAC is also not suitable for everyone. While marketing risk is avoided, it is replaced by the risk of having to obtain shareholder approval, as in a sale transaction. In addition, many issuers that go public prefer to do so directly rather than through a pre-existing publicly traded vehicle.

The United States has a fairly robust SPAC market, with some notable successes. Data from the United States from 2003 through September 2015 show that 228 SPACs completed IPOs, raising US$29 billion. Of these, 56% completed an acquisition, 1% announced an acquisition that has not yet been completed, 33% liquidated and 10% are still looking for an acquisition. See "SPAC 2.0 – A Lightning Start, What's Next?", industry report by 4Front Capital Partners Inc., dated September 28, 2015.

Until one or more of the current group of Canadian SPACs completes a qualifying acquisition, it may be that the market window for new SPAC offerings is closed (although two SPACs – Avingstone Acquisition Corporation and Kew Media Group Inc. – have filed preliminary prospectuses). SPACs have become a permanent feature of the U.S. capital markets and there is no reason to think that a similar market in Canada won't also emerge. Time will tell how big a long-term market exists and whether 2015's initial wave of transactions will spawn more in the future.

*Note: Osler acted for the underwriters on the Alignvest Acquisition Corporation SPAC offering.*

SPACs raised over **$1.1 billion** in capital in 2015

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# Governance: Board composition and compensation in the spotlight

Board composition and recruitment were key governance issues in 2015 as a result of changes to corporate governance disclosure requirements and initiatives by institutional investors to promote proxy access in the United States and Canada. Compensation also remained a major focus, as institutional shareholders expressed their displeasure by saying "nay" on pay at three large Canadian issuers, and the Securities and Exchange Commission advanced several compensation-related regulatory initiatives.

## BOARD COMPOSITION

*Board Diversity Disclosure* – Effective December 31, 2014, most Canadian issuers (other than TSX Venture Exchange issuers and investment funds) became subject to disclosure requirements regarding the representation of women on boards and in executive officer positions. Our survey of disclosure by TSX-listed issuers provided a snapshot of current practices – and the picture is disappointing. We noted significant areas of non-compliance, low representation of women on boards and executive officer positions, few issuers with board policies or goals to improve gender diversity on boards and virtually no issuers with targets for women in senior executive positions. Canadian boards should be considering ways to enhance board and executive officer diversity. The extent to which Canadian issuers make progress in increasing the representation of women in leadership positions will drive the corporate governance agenda in 2016.

(For more information, refer to our report entitled "Diversity Disclosure Practices" on osler.com.)

*Board Renewal* – Issuers subject to gender diversity disclosure requirements are also required to disclose any term limits for board service or other board renewal mechanisms, or explain why they do not have such mechanisms. Earlier this year, the Institute of Corporate Directors (ICD) issued its report concluding that term limits can be a supporting mechanism, but should not be the only process used for board renewal and may even be counterproductive. Instead, the ICD recommended that board renewal be based on performance management within a culture that demands accountability of directors and focuses on the future needs of the board.

A review of corporate governance disclosure practices to July 31, 2015 by the Canadian Securities Administrators (CSA) staff showed that only 19% of the issuers reviewed had adopted some combination of service term limits and/or age limits. Of these, over half (53%) adopted only age limits, 24% adopted only service term limits and 23% adopted both. The vast majority of issuers, however, have no formal mechanism for board renewal beyond their director assessment process. Canadian boards continue to discuss the utility of adopting various formal mechanisms for board renewal.

*Proxy Access* – "Proxy access" refers to proposals to enable qualified shareholders to submit nominations for directors to be included in the issuer's proxy materials. SEC proposed rules to implement proxy access were struck down in court, prompting institutional shareholders to submit shareholder proposals for proxy access to U.S. corporations through by-law amendments. The SEC has permitted these to be presented despite objections from U.S. issuers, with the result that an increasing number of U.S. issuers have adopted proxy access.

Consistent with the original SEC proposed rule, proxy access in the United States permits shareholder(s) collectively holding at least 3% of the outstanding shares who have been shareholders for at least three years to nominate up to 25% of the positions on the board and have their nominees included in the issuer's proxy circular. In some cases, issuers have either limited (to 10 or to 20) the number of shareholders that may collectively make such a nomination or have retained the ability to exclude nominations if the issuer has received notice of an intention to nominate directors pursuant to the issuer's advance notice provisions for director nominations.

Most Canadian corporate statutes already permit shareholders to make a shareholder proposal that includes nominees to replace up to 100% of the positions on the board and to have that proposal included in the company's proxy circular, provided that the submitting shareholder(s) hold a prescribed minimum number of shares and have been a shareholder for a prescribed period before making the submission.

The Canadian Coalition for Good Governance (CCGG) is promoting a version of proxy access that differs both from the Canadian statutory provisions and the version adopted in the United States. The CCGG proposal is to permit shareholder(s) collectively holding at least 3% of the outstanding shares (5% for smaller companies) to nominate up to 25% of the positions on the board and have their nominees included in the issuer's proxy circular, without any pre-submission shareholding requirement. The absence of any shareholding requirement is somewhat surprising given recent criticism of "short-termism" by leading investors, including members of the CCGG. In light of the existing corporate statutory provisions for proxy access in Canada, and especially since these are more shareholder-friendly than proxy access proposals in the United States, Canadian corporations are unlikely to voluntarily adopt either the U.S. version of proxy access or the CCGG's proposal.

The extent to which Canadian issuers make progress in increasing the representation of women in leadership positions will drive the corporate governance agenda in 2016.

*Overboarded Directors* – In its most recent update to its proxy voting guidelines, Institutional Shareholder Services (ISS) adopted a new stricter standard for determining when a director is "overboarded." Now a director who is the CEO is considered to be overboarded if he or she sits on more than one public company board in addition to his or her employer's board (previously more than two). A non-CEO director is overboarded if he or she sits on more than four public company boards in total (previously more than six).

## COMPENSATION

*Say on Pay* – Failed say on pay votes this year at Barrick Gold Corporation (73.4% against), Yamana Gold Inc. (62.73% against) and Canadian Imperial Bank of Commerce (56.84% against) demonstrated that executive compensation disclosure continues to be subject to close scrutiny by shareholders and the media. This was Barrick's second failed say on pay vote, having received both the lowest level of shareholder support on a say on pay vote in Canada (14.8% in 2013) as well as the second lowest (26.6% in 2015). In some cases, shareholders also expressed their dissatisfaction by withholding from voting for the compensation committee chair and, in the case of Barrick, the compensation committee members.

(For more information, refer to our Update entitled "Say on pay votes come back in a big way: Three failed votes in one week" on osler.com.)

Say on pay is voluntary in Canada and adoption rates continue to increase, although very slowly. This summer, the CCGG sent letters to issuers to encourage those who have yet to do so to adopt say on pay. However, this year's vote results are an important reminder that issuers must carefully consider disclosure implications when making pay decisions, should be transparent about the rationale for their decisions – especially when making decisions that may be unpopular – and should avoid surprising their shareholders.

*Pay Ratio Disclosure* – The SEC issued final rules for disclosure of the ratio of CEO pay to pay of the median compensated employee, which will require such disclosure effective in 2018. Canadian issuers that are foreign private issuers in the United States will not be required to comply with this requirement unless they choose to satisfy Canadian executive compensation disclosure requirements by providing disclosure in accordance with U.S. rules. As noted by the SEC, neither the *Dodd-Frank Act*, which requires the SEC to adopt such rules, nor its legislative history states what objectives or benefits the requirement is intended to provide. Canadian issuers are unlikely to provide such disclosure, although they may find it interesting for internal purposes to estimate what their ratio would be.

*Pay for Performance* – The SEC issued proposed rules on pay for performance disclosure in April 2015. Again, Canadian issuers that are foreign private issuers in the United States will not be required to comply with this requirement unless they choose to satisfy Canadian executive compensation disclosure requirements by providing disclosure in accordance with U.S. rules. In anticipation of such rules and in response to demands from institutional shareholders to better demonstrate the relationship of corporate performance to CEO compensation, several U.S. and Canadian public companies have taken a variety of different approaches to provide supplemental information regarding the CEO's realized or realizable pay over a period of three to five years.

The SEC's proposed rule takes a different approach, prescribing a manner for calculating compensation that requires disclosure in comparison to total shareholder return (TSR), and requiring disclosure not only with respect to the CEO but also with respect to all other named executive officers as a group. If the SEC adopts a final rule in line with the proposal, it may further reinforce use of TSR as a performance metric and increase company and investor focus on short-term stock price movements.

(For more information, refer to our Update entitled "SEC proposes pay-versus-performance disclosure rules" on osler.com.)

*Compensation Clawbacks* – In the summer, the SEC issued proposed rules to require issuers of securities listed on U.S. stock exchanges to adopt, disclose and enforce incentive-based compensation clawback policies to recover excess incentive-based compensation received in the three-year period preceding the date the issuer is required to restate previously issued financial statements due to an error. Whether or not the executive officer engaged in misconduct or otherwise shared any responsibility for the error prompting the financial misstatement is irrelevant to determining both whether the executive officer is affected and the amount to be clawed back.

All issuers listed on a U.S. stock exchange, including Canadian companies that are foreign private issuers, would be subject to the proposed clawback requirements. Foreign private issuers would be permitted to forgo recovery in very limited circumstances if recovery would violate their home country law. A significant number of Canadian issuers, including Canadian issuers not listed on a U.S. stock exchange, have adopted compensation clawback arrangements. Most of these contemplate a double-trigger, involving both a financial restatement and misconduct on the part of the executive contributing to the restatement. However, some Canadian issuers have a "no fault" standard where the absence of misconduct by the executive is not relevant. The SEC's proposal is likely to accelerate clawback arrangement adoption rates in Canada and increase the number of arrangements triggered by a financial restatement even in the absence of misconduct.

(For more information, refer to our Update entitled "SEC proposes listing standards for clawback of erroneously awarded incentive-based compensation" on osler.com.)

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# Securities enforcement: Big win and broader tools for regulators

From 2012 to 2014, Canadian securities regulators commenced 27.5% fewer proceedings and concluded 22.2% fewer cases. Given this backdrop, developments in 2015 – including the highly anticipated decision in *Finkelstein*, along with the Ontario Securities Commission's (OSC) proposed Whistleblower Program and the recent availability of "no-contest" settlements – could mark a change for securities enforcement in Canada.

## EVIDENTIARY STANDARD FOR INSIDER TRADING AND TIPPING

After an extended period of mixed success by Canadian securities regulators in prosecuting capital markets wrongdoing, including setbacks in 2014 in *Re Jowdat Waheed and Bruce Walter* and *Walton v. Alberta (Securities Commission)*, the OSC scored a significant victory in 2015 in the *Finkelstein* decision. Although it is now under appeal, the ruling holds promise for regulators launching future administrative proceedings against persons alleged to have engaged in insider trading and tipping.

In *Finkelstein*, an OSC panel found that Toronto lawyer Mitchell Finkelstein and four investment advisors breached Ontario's *Securities Act* by engaging in insider trading and tipping. In its decision, the panel highlighted that Finkelstein's position as a lawyer put him in a special relationship with the reporting issuers. As a partner in a Bay Street law firm, he misused his crucial gatekeeping role by disclosing confidential information.

In many insider trading and tipping cases, only the offenders themselves will have actual knowledge of the relevant communications. This makes direct evidence for tipping and trading offences rare and successful prosecutions difficult. The OSC panel in *Finkelstein* overcame this difficulty by relying on circumstantial evidence to draw inferences that material non-public information had been shared and received, allowing them to conclude on a balance of probabilities that violations of the *Securities Act* had occurred. This lower evidentiary standard allowed OSC staff to secure convictions in *Finkelstein*, but underscores the regulators' need to be cautious in pursuing administrative proceedings and ensuring sufficient procedural safeguards during the proceeding itself.

The OSC has had some success in other administrative – as opposed to criminal – settings by relying on circumstantial evidence, as it did in *Finkelstein*. A similar finding was made in *Re Agueci et al.*, which is also under appeal (Osler represents one of the appellants). However, there are mixed views in Canadian securities law generally on the extent to which and situations in which circumstantial evidence can be used.

After an extended period of mixed success by Canadian securities regulators in prosecuting capital markets wrong-doing…the OSC scored a significant victory in 2015 in the *Finkelstein* decision.

For example, the Alberta Court of Appeal's 2014 decision in *Walton*, from which the Supreme Court of Canada refused to grant leave to appeal, suggests that something more than mere circumstantial evidence is needed to meet the evidentiary standard to secure a conviction. This decision is directionally more consistent with recent experience in the United States. While downstream tippees in *Finkelstein* were found liable for insider trading, those in *United States v. Newman and Chiasson* were not, as the Court in *Newman* seems to have imposed an increased burden on prosecutors to demonstrate that the tippees had knowledge that the tipper received an impermissible personal benefit, and not merely that the tipper disclosed material non-public information. The Supreme Court of the United States recently refused to hear the federal government's challenge of the decision in *Newman*. The possible sea change resulting from *Newman* and the mixed record in Canada suggest that there is room for appellate review and clarification.

## PROPOSED WHISTLEBLOWER PROGRAM'S IMPLICATIONS FOR CULTURE OF COMPLIANCE

The OSC hopes that its enforcement efforts will be enhanced with its proposed Whistleblower Program, which seeks to motivate reporting of securities law violations by offering monetary awards to whistleblowers. The current proposal, which is still in its draft form, reflects changes that the regulator made in light of public comments on its earlier proposal.

While the OSC's proposed program would be the first in Canada, the United States already has a program for whistleblowing that was created by the *Dodd-Frank Act*. In fiscal year 2015, the SEC received a total of almost 4,000 tips from whistleblowers, a 30% increase since fiscal year 2012. Tips received from abroad, however, declined slightly; the SEC received 421 tips in fiscal year 2015, a 6% decrease since fiscal 2014. Of the tips received from abroad in fiscal 2015, 49 were from Canada, the second-highest foreign source of whistleblowing tips to the SEC after the United Kingdom.

Eligibility for financial rewards under the OSC's proposed program would require that whistleblowers have credible and detailed information that the regulator currently does not have, and the information provided must lead to the commencement of an OSC proceeding. The new proposal also extends eligibility to culpable whistleblowers and in certain circumstances to employees involved in compliance, oversight and audit roles – for example, 120 days after they first reported the information through the proper internal channel.

If the information provided by a whistleblower leads to monetary sanctions or voluntary payments in excess of $1 million, then the whistleblower would be entitled to an award between 5% and 15% of the total sanctions or payments, for an award up to $5 million. This award cap was raised from $1.5 million following public comments, but is contrasted with the American model where there is no cap on the total reward that may be payable. In the fiscal year 2015, the SEC paid more than US$37 million in rewards to eight whistleblowers, for an average reward of over US$4.6 million. In one of those cases, the SEC paid more than US$30 million to a single whistleblower. The OSC's proposed program seeks to avoid payments of this magnitude by introducing a proportionally smaller reward scale and the maximum reward cap.

While whistleblowing awards could create incentives for persons with inside knowledge of securities violations to come forward, tying reward amounts to penalties awarded potentially poses problems in that it reflects and perpetuates a misalignment in the traditional functions of Canadian securities regulators, which is to prevent and protect capital markets from misconduct. The focus of the Whistleblower Program should be to drive the behaviour of registrants towards increased compliance, which respects the core tenets of the OSC's traditional enforcement mandate, instead of punishing bad behaviour.

4,000 tips from **whistle-blowers** in 2015, up 30%

Concern has also been expressed that the program may undermine businesses' internal reporting and compliance programs by giving incentives to employees to bypass these channels entirely and go straight to the OSC in the hope of pocketing a significant monetary award. While the OSC says that it will encourage reporting internally, there is still no requirement that employees first use available internal channels – or provide proof as to why there were good reasons not to – before they are eligible for a whistleblowing reward. In our view, imposing this condition is vital if the OSC wants to encourage a corporate culture of compliance, and the absence of such a requirement could undermine the essential role of internal compliance and complaint procedures in ensuring robust compliance with securities law.

Confidentiality risks also pose a unique challenge to the proposed Whistleblower Program. While the OSC intends to use all reasonable efforts to keep confidential the identities of whistleblowers, there are certain permitted exceptions for disclosure, such as when it would be necessary to allow a person charged with a securities law violation to make full answer and defence or to advance the goals of securities legislation. These categories are extremely broad and vague. Disclosure may advance prosecutorial goals in certain proceedings, but the risk that a whistleblower's identity could be disclosed may correspondingly deter the whistleblower from coming forward.

## NO-CONTEST SETTLEMENTS – A FURTHER ADDITION TO THE ENFORCEMENT TOOLKIT

The proposed Whistleblower Program comes after the OSC made "no-contest" settlements available in 2014, and is part of a recent trend of expanding the OSC's enforcement toolkit. Aimed at improving the regulator's enforcement capability, no-contest settlements allow the alleged wrongdoer in administrative proceedings to settle without admitting to an offence. Last November, the OSC approved a significant $13.5 million no-contest settlement with entities related to TD Waterhouse regarding excess client fees that the TD entities themselves had discovered and reported. The TD settlement underscores the need for market registrants to maintain strong internal systems to comply with securities law, and showcases the OSC's role in protecting investors and facilitating fair and efficient capital markets.

The outcome of the appeal in *Finkelstein* and the final shape of the proposed Whistleblower Program could have significant ramifications for the enforcement of securities law in Canada. While this may improve enforcement capabilities and the success of prosecutions, Canadian regulators should still be wary of overstepping their traditional enforcement mandate in favour of a more punitive approach towards securities violators.

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# Cybersecurity: Heightened legal, regulatory and reputational risks

In 2015, there was a flurry of legal and regulatory developments in the Canadian privacy and data management arena, highlighted by privacy class actions, Canadian anti-spam law (CASL) enforcement activity, and key amendments to Canada's private sector privacy legislation, the *Personal Information Protection and Electronic Documents Act* (PIPEDA). Collectively, these developments have heightened the need for Canadian organizations to enhance their data governance programs to mitigate an expanding array of legal, regulatory and adverse publicity risks.

We expect 2015 will be viewed as a watershed year in Canadian privacy law. The willingness of the courts to provide an expansive view on the availability of class proceedings to privacy-related matters, the commencement of new class proceedings involving privacy breaches (including proceedings related to the much-publicized data breach involving the Ashley Madison website), the imposition of significant monetary penalties under CASL, and the enactment of PIPEDA's security breach notification requirement (which will come into effect once regulations are passed, likely in 2016) have significantly altered the Canadian privacy and data management landscape.

## PRIVACY CLASS ACTIONS

There are private remedies in Canada under statute and at common law to recover damages for invasions of privacy, and in 2015, the courts in Canada issued a number of noteworthy judicial decisions that appear to have created a favourable environment for class proceedings.

In particular, the courts have granted class certification in a number of important privacy cases, and the courts have also found the existence of a broad jurisdiction to grant extra-territorial remedies over online businesses. In light of these and other developments, it has now become commonplace for a business that has experienced a data breach to face multiple and parallel class proceedings in Canada and the United States that seek an aggregate award of damages.

The following developments from 2015 will have considerable risk management implications for domestic and foreign companies that are in the possession or control of personal information of Canadian residents:

- In 2015, the courts in Canada certified a number of significant class proceedings in respect of data breaches. In *Condon v. Canada*, the Federal Court of Appeal upheld the certification of a class action against the federal government relating to the loss of a hard drive by Human Resources and Skills Development Canada. In *John Doe and Suzie Jones v. Canada*, the Federal Court also certified a class proceeding against the federal government relating to disclosures of the identities of participants in the federal government's medical marijuana program. The outcome of these cases suggests that under the right circumstances, the court will certify classes and authorize collective relief for damages against organizations (including governments) that are allegedly reckless in maintaining and safeguarding personal information.
- On the heels of their success in arguing class certification in these and other cases, the plaintiffs' bar in Canada launched a number of new class actions in 2015, including class actions in respect of data breaches caused by third-party hackers (such as the class action against Avid Media for the data breach of the Ashley Madison website), as well as for the alleged misuse of customer data by companies themselves (such as the $750 million class action against Bell for its relevant ads program). The plaintiffs' bar has become more active and competitive in light of their recent successes, and we can expect further new filings in 2016.
- In 2015, the Ontario Court of Appeal released a significant decision that removed a major barrier to private class action litigation in the health care sector. More specifically, in *Hopkins v. Kay*, the Ontario Court of Appeal rejected an argument that the Ontario *Personal Health Information Protection Act* (PHIPA) was a comprehensive code that precluded tort claims for invasion of privacy. The Supreme Court of Canada denied leave to appeal this decision. As a result, it is now open for individual and class plaintiffs to pursue claims and to seek damages beyond the limited restitutionary provisions in PHIPA.
- In a decision that stands in sharp contrast to *Hopkins v. Kay*, the B.C. Court of Appeal released an important decision (*Ari v. Insurance Corporation of British Columbia*) that limited the scope of common law remedies for the invasion of privacy in the province of British Columbia. In particular, on a motion to strike part of a class action involving alleged unauthorized access to and use of personal information by a "rogue" employee, the B.C. Court of Appeal held that the *Freedom of Information and Protection of Privacy Act* is a comprehensive statute, and there is no cause of action in negligence for

We expect 2015 will be viewed as a watershed year in Canadian privacy law.

breach of the statute. However, the Court refused to strike a claim under the B.C. *Privacy Act* for vicarious liability against the employer, ICBC, for the actions of its employee.

- In its certification decision in *John Doe and Suzie Jones v. Canada*, the Federal Court held that there was viable cause of action for the novel tort of "publicity given to private life." This particular tort is recognized in numerous U.S. states, but it has not yet been widely recognized in Canada. In addition, in a departure from the usual rules of civil litigation, the Court authorized the use of pseudonyms to protect the privacy of representative plaintiffs in privacy cases to facilitate access to justice.
- In *Equustek Solutions Inc. v. Google Inc.*, the B.C. Court of Appeal upheld an extraordinary injunction against the world's leading online search engine. Further details regarding this case are provided in the article entitled "Canadian courts' jurisdiction: How long is the "long arm of the law"?"
- Finally, in *Douez v. Facebook, Inc.*, the B.C. Court of Appeal dismissed a proposed privacy class action against Facebook by enforcing a forum selection clause in favour of the courts of California. Further details regarding this case are provided in the article entitled "Canadian courts' jurisdiction: How long is the "long arm of the law"?"

## CASL ENFORCEMENT ACTIVITY

CASL is perhaps the most stringent anti-spam legislation in the world. Phase 2 of CASL, which imposes strict consent and notice rules covering the installation of computer programs, came into effect on January 15, 2015. The first phase of CASL, which came into force on July 1, 2014, imposed similar requirements in respect of the sending of commercial electronic messages (CEMs).

The penalties for non-compliance are potentially severe: Organizations can be subject to administrative penalties of up to $10 million and a private right of action for damages of up to $200 per contravention of the legislation. This private right of action is scheduled to come into force on July 1, 2017.

The Canadian Radio-television and Telecommunications Commission (CRTC) announced a number of enforcement proceedings in 2015. The CRTC issued a Notice of Violation, including a penalty of $1.1 million, against Compu-Finder for sending CEMs without the recipients' consent and without a properly functioning "unsubscribe" mechanism. In addition, Plenty of Fish agreed to pay $48,000 and Porter Airlines Inc. agreed to pay $150,000 as part of separate undertakings with the CRTC for alleged violations of CASL's CEM rules. Most recently, Rogers Media agreed to pay $200,000 as part of an undertaking to the CRTC on the basis that the company had allegedly sent CEMs to customers that contained an "unsubscribe" mechanism that did not function properly.

Enforcement of CASL by the CRTC will continue through 2016 and beyond.

We also expect CASL compliance efforts to increase in 2016, as companies seek to mitigate the class action risk associated with the private right of action under the legislation.

*CASL non-compliance can result in*

**$10 million in penalties**

## AMENDMENTS TO PIPEDA

Amendments to PIPEDA came into effect in June 2015. Among other things, the amendments include

- a security breach notification requirement, which mandates notification to the Office of the Privacy Commissioner of Canada, affected individuals and other organizations in the wake of a security incident involving a "real risk of significant harm" to affected individuals
- offences related to the contravention of the security breach notification requirements
- a concept of "valid consent" for the collection, use and disclosure of personal information
- exceptions to the consent requirement, including for administering the employment relationship, and for certain investigations
- new powers for the Privacy Commissioner to enter into compliance agreements

In response to these privacy law developments of the past year, Canadian organizations should enhance their data governance programs in 2016 to mitigate the legal, regulatory and adverse publicity risks associated with this evolving landscape.

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# Canadian courts' jurisdiction: How long is the "long arm of the law"?

In 2015, Canadian courts continued to consider their role in adjudicating disputes that have significant foreign elements. This issue arises with increasing frequency as global commercial activity expands and takes new forms, making it critical for both local and foreign entities to appreciate the ramifications of the courts' decisions.

Cases confronting Canadian courts in the past year grapple with "big picture" questions such as: Should Canada's laws extend to companies with no physical presence in Canada? What are or should be the limits on Canada's willingness to defer to foreign legal systems? To what extent should Canada extend legal assistance to litigants who experience the impact of foreign business activity in Canada? When should Canadian courts decline to become involved in matters that are best addressed in a foreign court or that may place undue strain on Canadian judicial resources?

Key cases decided in 2015 show how Canadian courts are also faced with the need to adapt traditional legal concepts to non-traditional facts – such as Internet search engines with only a cyber-presence in Canada and social media sites with potentially onerous terms of use that may or may not be read by users.

## THE MOST INFLUENTIAL CASES OF 2015

Some of the leading cases exploring these issues in 2015 include

- *Equustek Solutions Inc. v. Google Inc.* – In this case, the British Columbia Court of Appeal upheld an injunction requiring Google to remove an entire website from its world-wide global search index – not just search results found through Google.ca. The decision was in aid of the plaintiff's ongoing litigation in B.C. against the defendant for misuse of confidential information and unlawful use of trade secrets. Google was not a party to this litigation. The Canadian court asserted jurisdiction over the global search giant, even though Google did not maintain any physical presence in B.C., on the basis that Google carried on business in B.C. The Court relied on facts such as Google selling advertising to B.C. residents, including the defendants, and indexing websites located in B.C. and/or owned by B.C. residents.

The case is potentially good news for businesses seeking to expand the arsenal of remedies against unfair competition from counterfeit goods or illegally copied content sold or distributed online by individuals that are seeking to evade court orders.

But the case also sounds a cautionary note for companies that provide Internet technical or business infrastructure, even if they have no physical place of business in Canada. The extent of activity in Canada that may justify the assumption of jurisdiction by a Canadian court and the scope of the available remedies against an Internet business will no doubt be explored in future cases. (For more information, refer to our Update entitled "B.C. court of appeal upholds injunction over global search results.")

- *Douez v. Facebook, Inc.* – By contrast, the British Columbia Court of Appeal declined to take jurisdiction over a proposed class proceeding commenced against Facebook by B.C. residents. These residents alleged that the appearance of their names or photographs in a Facebook advertising feature was in violation of British Columbia's *Privacy Act*. However, Facebook's terms of use required all disputes to be adjudicated in the courts of California.

  The Court of Appeal held that this forum selection clause was clear and enforceable, despite provisions of the B.C. *Privacy Act* stating that actions under the legislation were to be heard in the B.C. Supreme Court. This provision of B.C. law could not bind the California courts, nor could it take away jurisdiction from a foreign court that the foreign court would otherwise have under its own laws. The California court would therefore have to consider the effect of this provision under its own law.

  Although the Court of Appeal would have considered evidence from the plaintiffs of "strong cause" not to enforce the forum selection clause, the plaintiffs did not adduce any such evidence.

  This case confirms that Canadian legislatures are limited in their ability to reserve to Canadian courts the right to adjudicate on matters arising out of their own legislation. However, participants in online commerce, including social media, may be reassured that terms of use that are clear will be given effect, even if they require a Canadian resident to litigate a dispute in a foreign jurisdiction such as California. (For more information, refer to our Update entitled "B.C. court of appeal stays a proposed privacy class action against Facebook based on a forum selection clause" on osler.com.)

- *Kaynes v. BP plc* – On March 26, 2015, the Supreme Court of Canada denied leave to appeal from the Ontario Court of Appeal's determination that a securities class action should not be litigated in Ontario.

  The plaintiffs were Canadian residents who purchased securities of BP on the NYSE and European exchanges. BP had ceased to be a reporting issuer under Ontario securities laws, but remained under an obligation to provide investor documents to securityholders in Canada. The plaintiffs alleged that some of these documents contained certain misrepresentations made before and after the Deep Water Horizon oil spill in the Gulf of Mexico that affected the price of their shares. A similar class proceeding had been commenced in the United States by those who purchased their shares on the NYSE.

The Ontario Court of Appeal confirmed that there were sufficient connecting factors to Ontario (i.e., the fact that the plaintiffs received disclosure from BP in Canada) to permit the Ontario Court to assume jurisdiction over the class action. However, the Ontario Court of Appeal agreed with BP that Ontario was not the preferable forum (*forum non conveniens*) to determine the plaintiffs' claims, thereby confirming that even when the Ontario court could adjudicate a particular dispute involving foreign elements, there is an additional question as to whether it should assume carriage of the dispute.

The United States and Europe were clearly more appropriate forums for a number of reasons. The U.S. class action covered a similar time period and applied to all BP shareholders, including the plaintiffs, who purchased their shares on the NYSE. U.S. securities laws conferred exclusive jurisdiction on U.S. courts to adjudicate secondary market misrepresentation claims involving trades on a U.S. securities exchange. Given that the plaintiffs' claim related to a large degree to U.S. securities law disclosure requirements (BP was no longer a reporting issuer in Ontario), it was appropriate for the Canadian court to defer to this jurisdiction as a matter of comity. By the same token, Canadian residents who purchased shares on the London or German stock exchanges had a reasonable expectation that any claims they had would be governed by the securities laws of those jurisdictions.

Finally, the Court was motivated by a concern to avoid a multiplicity of proceedings in more than one jurisdiction over the same claims of the same parties. This decision, therefore, not only promoted order and fairness but also economic use of Canadian judicial resources.

- *Chevron Corp. v. Yaiguaje* – The plaintiffs seek recognition and enforcement in Canada of what the Southern District of New York (SDNY) called a "fraudulent judgment" in the amount of approximately US$9 billion. The plaintiffs obtained this judgment in Ecuador for purported environmental damage allegedly caused by a corporate predecessor of Chevron Corporation. On September 4, 2015, the Supreme Court of Canada determined that a plaintiff who has obtained a judgment in a foreign jurisdiction does not have to demonstrate that the foreign defendant (in this case, Chevron Corporation) has any connection to Ontario – either through its presence or owning assets in Ontario – in order for an Ontario court to consider whether the foreign judgment should be recognized and enforced in Ontario.

  The Supreme Court of Canada decision only allowed the plaintiffs to "get in the door." It permits the Canadian court to assume jurisdiction over the dispute as to whether Canada should recognize and enforce the judgment. The judgment has been found after a lengthy trial in the SDNY to have been obtained through a massive fraud, including by bribing and threatening Ecuadorian judges. The SDNY held that the plaintiffs' lawyers violated the federal *Racketeer Influenced and Corrupt Organizations Act* (RICO),

As business activity takes on an increasingly global character and becomes less anchored in physical territory… the limits of traditional concepts such as "juris-diction" and "convenient forum" will continue to be tested.

committing extortion, money laundering, wire fraud, *Foreign Corrupt Practices Act* violations, witness tampering and obstruction of justice in obtaining the Ecuadorian judgment and in trying to cover up their crimes.

The next chapters in the Chevron story in Canada remain to be told. At least some part of this story will come before the courts in 2016.

These cases suggest that, as business activity takes on an increasingly global character and becomes less anchored in physical territory, courts will continue to be faced with new and complex situations. The limits of traditional concepts such as "jurisdiction" and "convenient forum" will continue to be tested. This will have consequences for everyone involved. In particular, businesses with only a "cyber presence" in Canada will need to pay close attention to legal developments in this area to assess when the Canadian legal system may be brought to bear on their activities.

*Note: Osler acts for Facebook, BP and Chevron.*

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# The tobacco decision: Mega trials and the limits of class actions?

One of the most significant decisions of the past year has the potential to change the way class actions in Canada are argued and adjudicated. On May 27, 2015, the Québec Superior Court rendered judgment in two of the largest class actions in Canadian history. The proceedings were commenced in 1998 on behalf of two disparate classes of smokers and former smokers. With a total class membership in excess of 1 million Québec residents, each of whom was alleged to suffer from either a smoking-related disease or a tobacco-related addiction, the two actions sought collective recovery from the three Canadian tobacco manufacturers for alleged civil faults arising from conduct dating back to 1950.

Notably, the action sought recovery of "moral damages" (akin to damages for "pain and suffering" in common law jurisdictions) in an amount exceeding $15 billion, as well as punitive damages, solely on the basis of a common issues trial (and to the exclusion of any subsequent individual trials). The plaintiffs did not tender evidence on their own behalf or on behalf of a single member of either class. Rather, plaintiffs' counsel relied exclusively on expert evidence and certain statutory mechanisms that they claimed were sufficient to provide the court with a reasonable basis to make class-wide determinations of fault, causation and injury in respect of each and every class member.

> If the courts permit issues such as causation and injury...to be addressed in the aggregate, how will they ensure that the fundamental principles of procedural fairness and access to justice are preserved for class action defendants?

## QUESTIONS RAISED IN LANDMARK RULING

Although the trial judge ultimately dismissed most of the allegations advanced against the three defendant tobacco manufacturers, he concluded that there was a class-wide fault in respect of the defendants' failure to adequately inform of product risks (a finding that is now under appeal to the Québec Court of

Appeal). Accordingly, he awarded in excess of $15 billion in aggregated moral and punitive damages. Although he also ordered provisional execution of a portion of the total award, in the amount of $1 billion – payable within 60 days of judgment – this latter order was subsequently overturned by the Québec Court of Appeal.

The case represents a landmark ruling, not only by virtue of its unprecedented scope but also as a result of the novel legal questions raised. It is the first product liability class proceeding in Canadian history in which compensatory damages were awarded in the aggregate on the basis of a common issues trial and in the absence of class member evidence. Accordingly, it may presage the use in future of class actions procedures and related statutory mechanisms – including those contemplated by provincial consumer protection legislation – to impose liability and damages on defendants in a context where the plaintiff class members are effectively sheltered from individual scrutiny.

As the courts have repeatedly affirmed, class actions are intended to be purely procedural mechanisms that bring together commonly situated individuals who share a legal interest. They are not intended to alter the parties' fundamental legal rights, nor expose parties to liability that would not otherwise exist in the context of an individual action. If the courts permit issues such as causation and injury – which have traditionally been characterized as inherently "individualistic," particularly in the product liability context – to be addressed in the aggregate, how will they ensure that the fundamental principles of procedural fairness and access to justice are preserved for class action defendants? Moreover, if this "aggregated" approach is indeed going to be applied going forward, will the courts adopt a more stringent approach to certification of class proceedings to ensure that "commonality" across the class truly exists in all material respects?

Alternatively, the courts may ultimately consider this judgment an opportunity to reiterate and reaffirm the purely procedural nature of the class actions regime, with a view to highlighting the potential hazards of aggregating differently situated class members with disparate claims. The decision is under appeal, and it is likely that many of these questions will be addressed by the appellate court in 2016 and beyond as the proceedings continue to unfold.

*Note: Osler acts for Imperial Tobacco Canada Ltd.*

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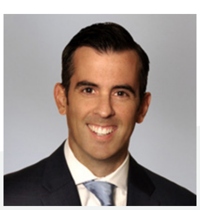

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# TPP and CETA: Landmark trade deals that Canadian businesses need to understand

In November 2015, Canada entered into the *Trans-Pacific Partnership* (TPP). The TPP will be the largest and most far-reaching international trade agreement that Canada will implement since the *North American Free Trade Agreement* (NAFTA) in 1994 and the *World Trade Organization (WTO) Agreements* in 1995. Together with the *Canada-EU Comprehensive Economic and Trade Agreement* (CETA), which was entered into in 2014, these initiatives were part of the previous federal government's Global Market Action Plan to diversify Canada's international trade and investment relationships by providing new, improved and preferential access to foreign markets for Canadian businesses.

## LENGTHY, COMPLEX NEGOTIATIONS LEAD TO AGREEMENTS

In early November 2015, the Canadian government publicly released the TPP – an agreement among Canada and 11 other Pacific Rim countries representing 40% of the global economy. The agreement is a result of seven years of negotiations and comprises 30 chapters plus schedules, annexes and side letters, totalling thousands of pages. In addition to Canada, the members of the TPP are Australia, Brunei Darussalam, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, the United States and Vietnam.

A year before the TPP legal text was issued, the Canadian government and the European Union released the text of the CETA, which took over four years to negotiate. As the name suggests, this comprehensive agreement goes beyond the template of previous international trade agreements and consists of 34 chapters as well as various annexes and declarations.

These state-of-the-art international trade agreements cover subject areas previously addressed by other international trade and investment agreements, such as the reduction of tariff and non-tariff barriers, cross-border services trade (including financial services), temporary entry of business persons, intellectual property, investment protection (including investor-state arbitration), trade remedies, public procurement and dispute resolution. However, they also cover subjects not previously considered as standard features of international trade and investment agreements. For example, the TPP deals with anti-corruption, electronic commerce, rules on transfer of data and cybersecurity.

The TPP and CETA will add to the intricate web of critical trade and investment rules that Canadian businesses will need to analyze and take into account in the formulation of their business strategies. Canadian businesses should ensure they are taking advantage of all benefits available to them under Canada's free trade initiatives and that they are also able to respond to the competitive challenges from other businesses that will be doing the same. Both the TPP and CETA can be expected to effect fundamental shifts in the flow of goods, services and investments both from Canada and into Canada.

With the TPP negotiations concluded, the parties must now begin the process of ratification and implementation at the domestic level. Since 2008, the federal government has followed the process of tabling treaties in the House of Commons before ratification. There have been calls within Canada for the agreement to be reopened as it was negotiated by the previous government without full consultation with the Canadian public. However, this appears to be unlikely given the years of complex negotiations and balancing of competing interests required to complete the TPP.

In the case of the CETA, while the negotiations between Canada and the EU were completed in November 2014, the ratification process has been held up because of concerns raised by certain EU members, particularly Germany, in relation to the investment chapter and the investor-state arbitration mechanism within CETA. These concerns, together with the ongoing U.S. negotiations of investment standards in the context of the *Transatlantic Trade and Investment Partnership* (TTIP), may create pressure to modify the CETA before it receives ratification from Canada and the EU.

Here is a very high level review of the TPP and CETA:

**Tariff Elimination:** A key aim of both the TPP and the CETA, like any free trade agreement, is to reduce and ultimately eliminate tariffs to improve market access opportunities abroad for domestic producers. Not surprisingly, the agreements set out detailed tariff liberalization obligations. For instance, both the TPP and the CETA include specific provisions for the agriculture sector. Under the TPP, parties are prohibited from using export subsidies in TPP markets and must work together to discipline the use of export credits at the WTO. Under the CETA, EU tariffs on products like maple syrup, fruit, vegetables, processed pulses and grains, and sugar confectionary will be eliminated immediately upon the agreement coming into effect. Other products, like pork and beef, will be duty-free but quota-limited. The Canadian market will also be significantly liberalized with 93.6% of agricultural tariff lines set at 0% immediately on entry into force of the CETA, subject to notable exclusions for products such as poultry and eggs.

A significant change for the automotive sector is the reduction in the required level of regional value content for auto parts and light duty vehicles to benefit from the TPP tariff reduction. The TPP provides for minimum regional value content of 45% for finished vehicles and between 35% and 45% for auto parts. This is a reduction from the 62.5% regional value content provided for in NAFTA. Whether these regional value content percentages within the two agreements are directly comparable is a matter of some debate because of the different formulas for calculating regional value content under the two agreements. Nevertheless, industry experts are concerned that this reduction could be harmful to Canada's steel sector and to automotive manufacturers and suppliers.

Both the TPP and CETA can be expected to effect fundamental shifts in the flow of goods, services and investments both from Canada and into Canada.

**Trade in Services:** Like NAFTA, the TPP and the CETA adopt a "negative list" approach (in contrast to the WTO "positive list" approach) to liberalization of services. Under the TPP and CETA, all service sectors should benefit from non-discriminatory treatment and market access, except for those expressly excluded. The TPP and CETA also include chapters focused on financial services trade – one of the largest service sectors in Canada. These chapters provide for enhanced market access commitments for Canadian financial services firms from TPP parties and the EU. They also provide protections for financial investors and a special dispute resolution framework tailored to the financial services sector. However, like other financial services trade agreements, the TPP and CETA preserve the broad discretion of financial regulators to take measures to promote financial stability and maintain the integrity of their financial systems.

**Intellectual Property:** Both the TPP and CETA introduce additional protection for patented inventions, particularly in the pharmaceutical field. Within the CETA, unreasonable delays in approving a pharmaceutical product will lead to additional protection for up to two years following patent expiry. The TPP further provides that unreasonable delays at the Patent Office will lead to extended patent terms. Canada's eight-year market protection for biologics has now become an international standard, with flexibility in how it is achieved. New safeguards will ensure transparency in national pharmaceutical reimbursement and removal of technical barriers in pharmaceutical review and inspection. Other important changes arising from the TPP include an increase in the copyright term from 50 to 70 years, the application of trade secrets law to state-owned enterprises and the criminalization of certain misuses of trade secrets. Furthermore, under CETA, Canada committed to introduce a geographic indication protection system and to protect over 170 marks covering various foods and beer, with limitations to protect existing public domain uses.

**Investment:** The TPP and the CETA investment chapters include what are now considered standard guarantees prohibiting expropriation without prompt and adequate compensation, and requiring investors from each of the parties to be treated in a fair and equitable manner. Both the TPP and the CETA will ensure investors are accorded both "national treatment" and "most-favoured-nation treatment," meaning that foreign investors cannot be treated in a less advantageous manner than domestic investors or investors of any other country. The investment provisions also include access to international investor-state mechanisms for dispute settlement, enabling foreign investors to enforce their rights against the host-state of the investment in an independent international arbitration proceeding. At the same time, the TPP and the CETA preserve the right of governments to legislate and regulate in the public interest. In particular, they preserve Canada's ability to review certain foreign investments pursuant to the *Investment Canada Act*. However, under both agreements, the review threshold will be raised to $1.5 billion in enterprise value for investors from the EU and original signatories to the TPP. State-owned enterprises will not be eligible for the higher threshold.

**Public Procurement:** Subject to certain exclusions and exceptions, the TPP and the CETA will expand the ability of businesses to compete in the national and sub-national public procurement markets.

**Transparency and Anti-Corruption:** Under the TPP's Transparency heading, parties will have to ensure developments affecting other signatories are published or disclosed, including legislative updates and administrative rulings and proceedings. The TPP also requires each party to adopt legislation criminalizing the offering of an undue advantage to a domestic or foreign public official. Among other obligations, parties will also be required to ensure corporations are held liable for corruption offences and adopt measures regarding books and records, whistleblower protection and integrity of officials.

The parties to the TPP and the CETA must now complete the process of ratifying and implementing the agreements at the domestic level.

Running a business domestically and abroad without knowing the fundamental rules of international trade and investment can lead to surprises, which are more often than not unfavourable. Canada's current free trade arrangements present many opportunities that are either not fully understood or incorporated into the strategic business plans of many Canadian enterprises. Often, businesses make critical investment decisions without fully comprehending the potential threats that exist when competing organizations are taking or can take advantage of market liberalization initiatives.

The TPP and CETA add to an already complex web of critical trade and investment rules that Canadian businesses need to understand and integrate into their business strategies in order to remain competitive.

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# Significant changes to Canadian foreign investment review

There were several significant developments in foreign investment law in Canada in 2015. Chief among these was the change to the size of transactions that are now subject to the "net benefit" review test under the *Investment Canada Act* (ICA). Not only did the monetary threshold increase but also the basis on which the threshold is calculated changed from "book value" to "enterprise value." As a result, certain transactions that were previously subject to review will no longer be reviewable, while at the same time, some that were not subject to review under the old threshold will now be subject to ICA scrutiny. Proposed increases to the review threshold are also contemplated under new trade agreements.

In addition, the regulatory burden on investments has increased, including more extensive information disclosure requirements for foreign investors in relation to non-reviewable acquisitions of control of Canadian businesses.

One of the most significant events in 2015 was the election of the new Liberal government. It remains to be seen whether this political shift will cause corresponding policy changes in the area of foreign investment regulation in 2016 and beyond.

## THE CHANGES TO THE REVIEW THRESHOLD

Effective April 24, 2015, the threshold for determining whether net benefit review under the ICA is required for acquisitions or dispositions by entities owned by nationals of a World Trade Organization member state is $600 million based on enterprise value of the target business, rather than the former threshold of $369 million in book value of the assets of the target business. The threshold will increase to $800 million in 2017, then to $1 billion in 2019, after which it will be indexed annually. If the Canada-European Union Comprehensive Economic and Trade Agreement (CETA) or the Trans-Pacific Partnership (TPP) trade agreement comes into force within the next year or so, eligible investors will only be subject to investment review at a threshold of $1.5 billion – almost double the threshold that would otherwise apply ($800 million in 2017).

The enterprise value threshold is calculated differently depending on the type of target business:

- **Direct acquisition of a publicly traded entity** – $600 million or more in enterprise value, based on the target's market capitalization plus its total liabilities (excluding its operating liabilities), minus its cash and cash equivalents.
- **Direct acquisition of a privately held entity** – $600 million or more in enterprise value, based on the total acquisition value plus its total liabilities (excluding its operating liabilities), minus its cash and cash equivalents. If the investor is acquiring 100% of the voting interests, total acquisition value is the total consideration payable. Where the investor is acquiring less than 100% of the voting interests, total acquisition value is the aggregate of the consideration payable by the investor, the consideration payable by any other investors and the fair market value of any portion of the voting interests that are not being acquired.
- **Acquisition of assets** – $600 million or more in enterprise value, based on the total consideration payable, plus the liabilities that are assumed by the investor (other than operating liabilities), minus the cash and cash equivalents that are transferred to the investor.

However, a state-owned enterprise (SOE) investor is still subject to review based on the threshold of book value of assets of the Canadian business at $369 million (indexed annually). All cultural investments will continue to be reviewable if the book value of assets of the Canadian business exceeds $5 million.

## IMPLICATIONS OF THE MOVE TO ENTERPRISE VALUE

The change from an asset-based threshold to an enterprise value threshold has a number of important implications for foreign investors contemplating direct acquisitions of control of Canadian businesses:

- **Review of transactions involving targets with large enterprise value but low book value** – acquisitions of some businesses that would not have been subject to review based on the former threshold of $369 million in book value of assets may be reviewable because they exceed the $600 million enterprise value threshold.
- **Enterprise value can be tactically determined to affect reviewability of a transaction** – in private transactions the purchase price will be the key factor and could be structured with a view to reducing the enterprise value. In public transactions, a purchaser may be able to carefully time its offer to coincide with a low market capitalization that results in an enterprise value below $600 million.
- **Different treatment of SOEs and private investors** – a possible unintended consequence of the amendments is that a private sector investor may trigger a review as a result of the target's enterprise value exceeding the $600 million threshold, but a SOE investor would not trigger a review if the book value of the target's assets is below the $369 million asset value threshold that applies to SOE investors.

## NEW TRADE AGREEMENTS WITH IMPLICATIONS FOR THE ICA REVIEW THRESHOLDS

The TPP trade agreement concluded in October 2015 proposes an increase in the ICA review threshold to $1.5 billion in enterprise value. Only investors who are nationals of an original signatory to the TPP, or entities controlled by nationals of those TPP parties, may benefit from the higher review threshold. SOE investors are not eligible for the higher threshold.

The $1.5 billion threshold will match the increase in the threshold proposed under the CETA concluded in 2014, which is still not yet in force. The higher threshold in CETA will apply to an acquisition of a Canadian enterprise by an EU investor that is not an SOE. The determination of whether the acquirer is an EU investor would be based on whether an EU national controls the acquirer in law, or in the absence of a majority ownership, whether EU nationals control the acquirer in fact such as through the ownership of voting interests or the nationality of members of the board of directors. Moreover, EU enterprises that are controlled by nationals from Canada's existing free trade agreement partners (e.g., the United States) would also benefit from the higher threshold.

At this time, no in-force dates have been set for the TPP or CETA. Of the two, CETA is expected to be in force sooner.

One of the most significant events in 2015 was the election of the new Liberal government. It remains to be seen whether this political shift will cause corresponding policy changes in the area of foreign investment regulation in 2016 and beyond.

## NEW INFORMATION BURDEN

In addition to changes to the review thresholds, the new regulations impose revised disclosure requirements. A foreign investor is now required to provide significantly more information to the federal government regarding the investor, its business activities and shareholders than was previously the case. This information burden applies to notifications required to be filed for all acquisitions of control of Canadian businesses by non-Canadians that are not reviewable.

## EXTENDED TIMELINE FOR NATIONAL SECURITY REVIEWS

Independent of the ICA net benefit review process, the ICA national security regime allows the federal government to review a broad range of foreign investments, including minority investments, on the basis that such investments could be "injurious to national security." Effective March 25, 2015, the government's maximum review period extended from 130 days to 200 days (or possibly longer upon the consent of the investor). There are still no published criteria for what kind of investment might be "injurious to national security," nor are there publicly available statistics on enforcement of this aspect of the ICA. Anecdotally, national security issues seemed to arise with greater frequency in the last couple of years of the Conservative government.

## REVIEW STATISTICS

The number of transactions subject to ministerial review and approval under the ICA remains small. For the year ended March 31, 2015, excluding national security reviews, 15 applications were reviewed and approved, up from 11 in 2013–14. The average review time was 75.3 days, up from 71.5 days in 2013–14.

These investments totalled $21.78 billion in asset value, an increase of 41.2% compared to 2013–14. The number of national security reviews is unknown, but they are not uncommon.

## NEW LIBERAL GOVERNMENT

The new Minister of Innovation, Science and Economic Development, the Honourable Navdeep Singh Bains, is responsible for approving large investments under the ICA and administering the ICA's national security regime. The new minister has both academic and business experience. He was a visiting professor at Ryerson University's Ted Rogers School of Management and holds an MBA with a specialization in Finance. He also holds a Certified Management Accountant qualification and worked for several years in accounting and financial analysis for the Ford Motor Company of Canada.

Will the new minister and the Liberal government adopt a different attitude to foreign investment?

Foreign investment was not a campaign issue during the 2015 federal election. The Liberal Party did not advocate changes to the ICA. The last Liberal government routinely allowed large takeovers even in the face of some populist concern at the time about the "hollowing out" of Canadian-controlled industries. Based on this track record, it is difficult to imagine this Liberal government being *more* critical of foreign investment than the former Conservative government, which turned down some high-profile proposals on "net benefit to Canada" and national security grounds. Indeed, given the weakness of the Canadian economy, the new government may be inclined to more quickly approve foreign investment that promises significant employment and capital investment.

It is too early to say what approach the Liberals will take. Will they administer the national security regime differently? How will they deal with the ICA policies that put investments by SOEs through the additional hurdles of demonstrating transparency and commercial orientation while all but prohibiting them from acquiring control of oil sands businesses?

The way these legislative and regulatory changes are put into practice over the years ahead will certainly have an impact on the foreign investment climate in Canada, though the extent and tenor of that impact remain to be seen.

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# Continuing crackdown on foreign corruption and new transparency measures

Recent efforts to crack down on foreign corruption and increase transparency in dealings between Canadian businesses and governments continued in 2015 with two key legal developments. The first was the laying of charges against SNC-Lavalin in relation to alleged corruption in its overseas activities. The second was the enactment of the *Extractive Sector Transparency Measures Act* (ESTMA). The ESTMA imposes new disclosure and reporting measures on participants in the extractive sectors, with the objective of enhancing transparency and deterring corruption. With the enforcement tools under the ESTMA and the *Corruption of Foreign Public Officials Act* (CFPOA), the Canadian government now has one of the world's more robust anti-corruption enforcement regimes.

## CORRUPTION CHARGES BROUGHT AGAINST SNC-LAVALIN

In last year's "Legal Year in Review," we discussed the RCMP's three-year criminal investigation into the overseas operations of SNC-Lavalin to determine the existence of corruption. On February 19, 2015, the RCMP National Division brought charges against the SNC-Lavalin Group Inc., its division SNC-Lavalin Construction Inc. and its subsidiary SNC-Lavalin International Inc. (together, SNC-Lavalin). Each entity was charged with one count of corruption under the CFPOA and one count of fraud under the *Criminal Code*.

The laying of charges against this leading – and respected – Canadian public company confirms that the government is intent on rooting out corruption on the part of Canadian companies, regardless of their reputation and size. The prosecution of these criminal charges will unfold in the months to come, with the first court appearance by the accused currently scheduled for February 2016.

The prosecution of SNC-Lavalin for foreign bribery and fraud is a direct message from the federal government that officers and directors of Canadian corporations should be carefully monitoring the activities of their overseas businesses, including those of their agents, as well as their record-keeping and internal controls. We expect that this will lead to the implementation of risk-based robust anti-corruption compliance programs for those Canadian companies operating overseas that have not yet heeded several prior wake-up calls.

## THE ESTMA COMES INTO FORCE

As of June 1, 2015, Canadian businesses involved in resource extraction either within Canada or overseas need to comply with the transparency obligations of the ESTMA. The legislation requires Canadian businesses involved in resource extraction to file and make publicly available reports on certain types of payments made to both domestic and foreign governments.

The ESTMA will apply to any corporation, trust, partnership or other unincorporated organization "engaged in the commercial development of oil, gas or minerals in Canada or elsewhere" or any such entity that "controls a corporation or a trust, partnership or other unincorporated organization that is engaged in the commercial development of oil, gas or minerals in Canada or elsewhere."

The ESTMA applies to all publicly listed companies in Canada if they are engaged in the commercial development of oil, gas or minerals in Canada or elsewhere. Private companies engaged in the commercial development of oil, gas or minerals will also be subject to the ESTMA, if the company has a place of business in Canada, does business in Canada or has assets in Canada, and meets at least two of the following conditions in any one of its two most recent financial years:

a. owns $20 million or more in assets

b. generated at least $40 million in revenue

c. employs an average of at least 250 employees

The ESTMA requires the annual reporting of all payments made to any domestic or foreign government or trust, board, commission, corporation, body or authority if the total amount paid within a prescribed payment category and made to the same payee in a financial year exceeds $100,000. The definition of "payee" in the ESTMA is broad and likely will capture any Indian, Inuit or Métis government or "council of the band" under the *Indian Act*.

Reports must be filed annually within 150 days of the end of each reporting entity's financial year. Reporting is not required for the financial year in progress on June 1, 2015, or for any prior financial year. A reporting entity with a financial year end of December 31 will, for example, be required to begin reporting payments made in 2016 and to file its report no later than May 30, 2017. The requirement to report payments made to First Nations groups in Canada, however, is deferred for two years.

With the enactment of the ESTMA, Canada has moved to the forefront of resource extraction transparency regimes which, when coupled with the more rigorous enforcement under the CFPOA, should cause Canadian companies to take a hard look at their internal anti-corruption and transparency compliance programs.

The term "payment" is broadly defined and includes "a payment – whether monetary or in kind – that is made to a payee in relation to the commercial development of oil, gas or mineral" and falls within one of the following categories:

a. taxes (other than consumption taxes and personal income taxes)

b. royalties

c. fees, including rental fees, entry fees and regulatory charges as well as fees or other consideration for licences, permits or concessions

d. production entitlements

e. bonuses, including signature, discovery and production bonuses

f. dividends other than those paid as ordinary shareholders

g. infrastructure improvement payments

If the reporting requirements of another jurisdiction achieve the purposes of the ESTMA, the Minister of Natural Resources may determine that a report filed pursuant to the requirements of that jurisdiction is an acceptable substitute for a report filed under the ESTMA. The Department of Natural Resources Canada (NRCan) has made this determination in relation to reports submitted pursuant to the rules of EU member states that have implemented the EU Accounting and Transparency Directives at a national level. It is expected that NRCan will make a similar determination in relation to reports filed under the U.S. rules following their reissuance by the U.S. Securities and Exchange Commission, as well as in relation to Québec's recently enacted transparency legislation.

The ESTMA makes the provision of misleading information or a failure to comply with reporting requirements an offence, subject to the defence of due diligence. Fines of up to $250,000 can be levied for each day that the offence is continuing.

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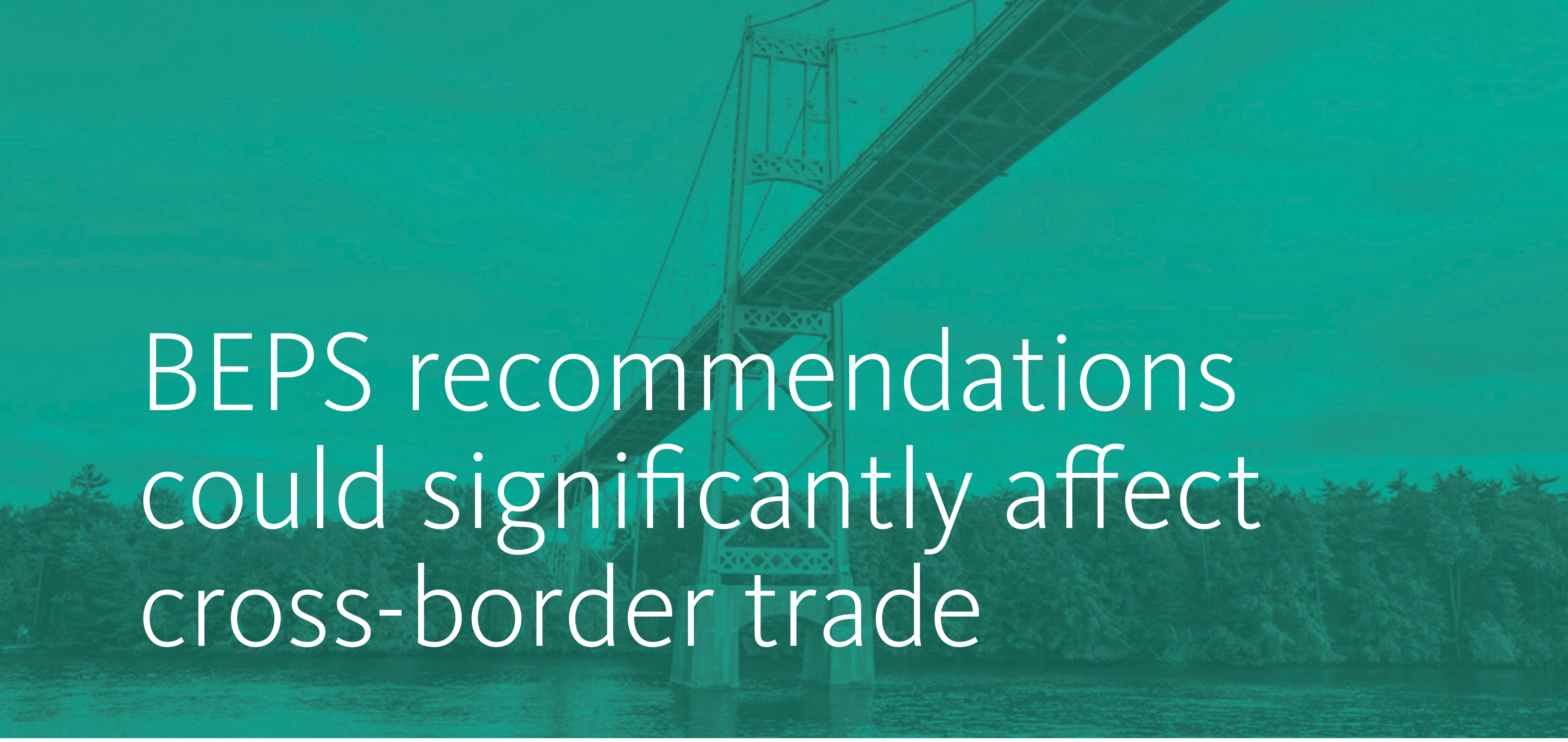

# BEPS recommendations could significantly affect cross-border trade

In November 2015, Prime Minister Trudeau and the other G20 Leaders endorsed the OECD's package of measures released as part of the base erosion and profit shifting (BEPS) project. The BEPS project, an ambitious plan undertaken jointly by the OECD and G20 to overhaul the global international tax system, culminated this year in hundreds of pages of recommendations that, if adopted, could have a significant impact on cross-border trade and the competitiveness of Canadian businesses.

The OECD's final report on the OECD/G20 BEPS project (the Final Report) was released in 2015. The Final Report represents the culmination of the OECD's multi-year project aimed at improving the coherence, substance and transparency of the international tax system. The project was initiated at the request of the G20, in response to growing public concern about BEPS. BEPS generally refers to tax-planning strategies that exploit differences in domestic and international tax rules to shift profits to low tax jurisdictions. The BEPS project has received unprecedented attention from governments and the private sector.

The Final Report outlines the OECD's recommendations and the participant countries' consensus for addressing BEPS. It was approved by the G20 Finance Ministers on October 8, 2015 at their meeting in Lima, Peru, and endorsed by the G20 Leaders on November 16, 2015 at their meeting in Antalya, Turkey.

The Final Report represents the consensus views of 44 countries that make up about 90% of the global economy. As a result, if the recommendations in the reports are adopted into tax treaties and domestic law, they could have a significant impact on cross-border trade and investment around the world. The Final Report includes recommendations on the digital economy, the use of hybrids, designing controlled foreign corporation rules, limiting interest deductibility, limiting the use of patent boxes and certain other harmful tax

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practices; preventing abusive treaty shopping, preventing artificial avoidance of "permanent establishment" status, aligning transfer pricing outcomes with value creation, measuring and monitoring BEPS, mandatory disclosure rules, transfer pricing documentation and country-by-country reporting, making dispute resolution mechanisms more effective, and developing a multilateral instrument to modify bilateral tax treaties.

At the time of writing it is not yet known whether, and the extent to which, the new federal government may seek to adopt the various BEPS recommendations.

The consensus nature of the Final Report results, in many cases, in ambiguous recommendations. Combined with broad access to financial data, such rules will undoubtedly result in many countries seeking to raise additional corporate tax revenues, and may lead to an escalation in international tax disputes and compliance costs in Canada and around the world. By avoiding discussion of difficult issues (such as the allocation of taxing revenue between source and residence countries), the consensus in the Final Report may mask significant differences in views between countries as to who will collect more tax revenue as a result of the proposals.

In Canada's case, we hope that the new government will remain mindful of the need to ensure that tax treaty provisions and domestic rules protect the competitiveness of Canadian businesses and encourage investment in Canada.

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