International

Legal Guides

Featuring contributions from:

Expert Analysis Chapters

1 **2021 and Beyond: Private Equity Outlook for 2022**
Siew Kam Boon, Sarah Kupferman & Sam Whittaker, Dechert LLP

4 **Private Equity Transactions in the UK: the Essential Differences from the U.S. Market**
Nicholas Plant, Stephen Levy, James Davison & Geraint Steyn, Dentons

8 **Defensive Strategies for Sponsors during Periods of Financial Difficulty**
Eleanor Shanks, Bryan Robson, Mark Knight & Matt Anson, Sidley Austin LLP

12 **De-SPAC Transactions in Europe**
Dr. Sebastian Häfele, Kirkland & Ellis

Q&A Chapters

15 **Australia**
Atanaskovic Hartnell: Lawson Jepps & Jia-Lee Lim

26 **Austria**
Schindler Attorneys: Florian Philipp Cvak & Clemens Philipp Schindler

36 **Brazil**
Veirano Advogados: Lior Pinsky & Vitor Rozenthal

44 **Canada**
McMillan LLP: Michael P. Whitcombe & Brett Stewart

52 **Cayman Islands**
Maples Group: Julian Ashworth, Patrick Rosenfeld, Lee Davis & Stef Dimitriou

60 **China**
Grandall Law Firm: Will Fung, Liu Naijin & Lu Hao

72 **France**
Fidal: Gacia Kazandjian, Sally-Anne Mc Mahon, Sabrina Bol & Geoffrey Burrows

80 **Germany**
Kirkland & Ellis: Dr. David Huthmacher

88 **Hungary**
HBK Partners Attorneys at Law: Dr. Márton Kovács & Dr. Áron Kanti

97 **India**
Shardul Amarchand Mangaldas & Co: Iqbal Khan & Ambarish

105 **Italy**
Legance – Avvocati Associati: Marco Gubitosi & Lorenzo De Rosa

117 **Japan**
Oh-Ebashi LPC & Partners: Kazuhiro Kobayashi & Tomomi Fukutomi

125 **Jersey**
Maples Group: Paul Burton

132 **Luxembourg**
Eversheds Sutherland (Luxembourg) LLP: Holger Holle & José Pascual

140 **Nigeria**
Udo Udoma & Belo-Osagie: Folake Elias-Adebowale, Christine Sijuwade & Bond Eke-Opara

148 **Norway**
Aabø-Evensen & Co: Ole Kristian Aabø-Evensen

171 **Poland**
Schoenherr Stangl sp.k.: Krzysztof Pawlak & Paweł Halwa

179 **Portugal**
Morais Leitão, Galvão Teles, Soares da Silva & Associados: Ricardo Andrade Amaro & Pedro Capitão Barbosa

187 **Saudi Arabia**
Hammad & Al-Mehdar Law Firm: Abdulrahman Hammad, Samy Elsheikh & Ghazal Tarabzouni

195 **Singapore**
Oon & Bazul LLP: Ng Yi Wayn

203 **South Africa**
Webber Wentzel: Michael Denenga, Andrew Westwood & Kyle Beilings

213 **Spain**
Garrigues: Ferran Escayola & María Fernández-Picazo

222 **Switzerland**
Bär & Karrer Ltd.: Dr. Christoph Neeracher & Dr. Luca Jagmetti

231 **Taiwan**
Lee and Li, Attorneys-at-Law: James C. C. Huang & Eddie Hsiung

238 **United Kingdom**
Dechert LLP: Robert Darwin & Sam Whittaker

250 **USA**
Dechert LLP: Allie Misner Wasserman, John LaRocca, Dr. Markus P. Bolsinger & Sarah B. Gelb

Canada

Michael P. Whitcombe

Brett Stewart

McMillan LLP

1 Overview

1.1 What are the most common types of private equity transactions in your jurisdiction? What is the current state of the market for these transactions?

Notwithstanding a "pause" in deal activity between March–May 2020 at the onset of the COVID-19 pandemic in North America, the private equity industry proved resilient and quickly adapted to the new order, resulting in Canadian private equity deal activity remaining strong through the end of 2020. This level of activity has continued into the first quarter of 2021. Larger deals (over $1B) decreased in total deal value from $11.6B in 2019 to only $3.7B in 2020. However, middle-market deals continued to be a significant driver in terms of total value invested. The industrial and manufacturing sector and the information communications technology sector continue to capture the largest share of activity measured by both the number of deals and total value.

1.2 What are the most significant factors currently encouraging or inhibiting private equity transactions in your jurisdiction?

At the onset of the COVID-19 pandemic, restrictions on cross-border and inter-provincial travel, in-person meetings, site visits and other activities made it more difficult to perform the investigations necessary to complete appropriate diligence in a timely manner. Implications on representation and warranty insurance underwriting was uncertain. These constraints also caused private equity investors to be concerned about effective post-acquisition integration of acquired businesses. However, the industry quickly adapted and new diligence processes, underwriting protocols and integration procedures were developed.

Private equity firms continue to have high levels of dry powder on hand and acquisition financing is again readily available from third-party lenders.

Continuing economic uncertainty from the COVID-19 pandemic is the greatest single factor currently inhibiting deals, especially traditional buyout activity, as many sectors have taken huge revenue hits. In addition, unprecedented governmental support at both the provincial and federal level and related economic stimulus packages have helped to prop up many Canadian companies, allowing them to survive in the immediate short-term and avoid a distressed sale process. What happens to these companies when these stimulus packages end is, to a great extent, unknown.

From the private equity buyer's perspective, seller's valuation expectations remain high. Valuation multiples in Canada have remained high compared to long-term averages. According to Crosbie & Co., companies with an enterprise value of $100–$250M traded at an average of 8.6X, a premium of 43% to small companies with an enterprise value of $10M–$25M, which traded at an average of 6X. However, valuations remain increasingly difficult to conduct as operations and supply chain disruption are a key focus of risk assessment and investors have to understand the financial risks associated with a target's trading partners, suppliers and customers caused by the pandemic.

The Canadian Government announced a policy that it would increase its scrutiny of transactions subject to review under the Investment Canada Act with respect to investments in health-related sectors as well as sectors involved in the supply of critical goods and services. The lower Canadian dollar continues to make Canadian targets attractive to foreign private equity buyers.

1.3 What are going to be the long-term effects for private equity in your jurisdiction as a result of the COVID-19 pandemic? If there has been government intervention in the economy, how has that influenced private equity activity?

There has been significant government support of the Canadian economy during the COVID-19 pandemic, including wage subsidies, rent subsidies, loans (a portion of which may be forgiveable) and moratoriums on evicting defaulting tenants. These measures have influenced private equity activity by allowing certain companies to remain operating when they would have otherwise needed to shut down, allowing them to be acquired as a going concern by private equity interests.

The short-term impact of these government initiatives on private equity investment has to be factored into the impact on EBIDTA calculations for valuation purposes. EBIDTA will, in many cases, be artificially inflated due to significant costs having been subsidised by the government stimulus programmes. Buyers need to be aware and adjust where appropriate. Sellers are not always willing to accept such adjustments, particularly in a competitive sale process.

In the mid- to longer term, Canada was viewed as a relatively high tax jurisdiction pre-COVID-19 pandemic. Eventually, the cost of the many billions of dollars of government support provided will need to be repaid, with the expectation being that, over time, taxes will need to rise, resulting in Canadian businesses being less attractive as candidates for private equity investment.

1.4 Are you seeing any types of investors other than traditional private equity firms executing private equity-style transactions in your jurisdiction? If so, please explain which investors, and briefly identify any significant points of difference between the deal terms offered, or approach taken, by this type of investor and that of traditional private equity firms.

Family offices and institutional investors, such as pension funds, are becoming more active and independent participants in the private M&A space. If these investors are competing against private equity firms in an auction setting, then they tend to offer private-equity-like transaction terms, including the use of representation and warranty insurance. If it is not a competitive process, then their approach and timelines are often more closely aligned to that of a strategic purchaser. Since these investors generally have the ability to hold an investment indefinitely, they will be more willing to acquire businesses that include real estate assets and will be more willing to consider acquiring manufacturing operations that have "legacy issues".

2 Structuring Matters

2.1 What are the most common acquisition structures adopted for private equity transactions in your jurisdiction?

Privately held Canadian businesses are generally acquired by private equity buyers either through a purchase of assets or a purchase of shares. Private equity investors will typically incorporate a Canadian acquisition corporation and fund it by way of interest-bearing debt and equity on a 1.5:1 basis in order to comply with Canadian thin-capitalisation rules. This acquisition entity then acquires all of the shares/assets of the Canadian target and, in the case of a share acquisition, the acquisition corporation and target are then "amalgamated" under the relevant corporate statute to align the leverage with the operating company. Often, these buyout structures include key management rolling their interest and maintaining their equity stake. The then amalgamated operating company will then typically make add-on transactions by way of direct acquisition whereby the operating company will acquire the share or assets of an add-on target directly. Buyouts remain the preferred form of investment, but minority investments, once only common in smaller growth equity deals, are a continuing and increasingly popular trend.

2.2 What are the main drivers for these acquisition structures?

Whether a Canadian acquisition should be completed by purchasing assets or shares is driven by tax and non-tax considerations. The weight given to these factors will depend on the circumstances of the transaction and the parties' ability to leverage their respective positions. From the point of view of a potential purchaser, the greatest benefits of an asset sale are tax advantages and the ability to pick and choose the assets and liabilities that will be acquired. The majority of "legacy liabilities" can be left with the seller. However, asset sales tend to be significantly more complex in larger transactions and can require more third-party consents for material contracts. In contrast, a share sale is relatively simple from a conveyancing perspective and less likely to trigger third-party consent requirements. From the seller's perspective, tax considerations generally favour share transactions as individual sellers may be able to utilise their $883,384 (as of 2020) lifetime personal capital gains exemptions to shelter a portion of the proceeds. "Hybrid" transactions, which involve the acquisition of both shares and assets of a target entity, providing tax advantages to both buyer and seller, also continue to be popular.

2.3 How is the equity commonly structured in private equity transactions in your jurisdiction (including institutional, management and carried interests)?

Sellers of businesses, including key management, will often rollover equity into a corporate purchaser. The precise terms of the equity interests offered to, or required of, continuing management are often a major point of negotiation in transactions. Typical structures include multiple classes of equity with one class designed to pay out investors, such as the fund and any co-investors (including management), in priority over a second class designed to pay out continuing management only if the business is eventually sold for more than a certain threshold value (incentive equity). Stock options (more tax-effective) or phantom stock options (less tax-effective) are also commonly granted.

2.4 If a private equity investor is taking a minority position, are there different structuring considerations?

Minority positions require private equity firms to consider different structuring issues due to the lack of control. The minority rights stipulated in the shareholders' agreement become of primary concern to ensure private equity firms have veto power (or at least significant influence) over critical decisions. Likewise, put and drag-along provisions are key to ensure the private equity investor has flexibility with regard to their exit strategy. A minority interest is often taken by a private equity investor in the form of convertible preferred shares or a convertible debt instrument.

2.5 In relation to management equity, what is the typical range of equity allocated to the management, and what are the typical vesting and compulsory acquisition provisions?

Allocation to management will vary on a deal-by-deal basis but typically ranges from 10–20%. Aligning the equity interests granted to continuing managers with the continued growth and success of the company is essential. In order to align interests, most stock option plans call for options to vest and become exercisable upon the achievement of certain conditions. Those conditions are typically tied to either continued employment and the passage of time, and/or certain performance/success requirements, such as the achievement of stated financial returns. Generally, management equity is structured to allow for repurchase by the company upon a termination of employment. Options granted to management may vary on whether they are exercisable following termination of employment based on whether the termination was a "good exit" or a "bad exit" or on where the management ultimately lands following the exit. The options granted to management typically vest automatically in the event of a sale of the company by the private equity investor.

2.6 For what reasons is a management equity holder usually treated as a good leaver or a bad leaver in your jurisdiction?

Under Canadian law, the threshold for firing an employee "for cause" is very high and hard to establish. For that reason,

circumstances amounting to an exiting management equity holder leaving as a "bad leaver" are not tied to a causal dismissal but rather to more general grounds of dismissal. Any circumstance where an exiting equity holder is terminated or is acting in competition with the business will be treated as a "bad leaver". Good leavers are usually those leaving due to death, disability or retirement.

3 Governance Matters

3.1 What are the typical governance arrangements for private equity portfolio companies? Are such arrangements required to be made publicly available in your jurisdiction?

Private equity firms utilise their equity positions, or negotiated minority rights, to assign seats on the board of directors to their principals and nominees. As such, they typically have the authority to run the portfolio company for the period of their investment. In Canada, the names and addresses of private companies' boards of directors are publicly available information. However, the names of shareholders of private companies are not currently publicly available. There is pressure being brought by foreign interests on Canadian regulators to bring the disclosure of ownership of Canadian corporations into alignment with other major countries. The Canada Business Corporations Act now requires federally incorporated businesses to maintain a record of beneficial owners in their corporate records. Recent amendments to British Columbia's Business Corporations Act also require private companies to maintain a register of individuals with certain kinds of control over the company. Manitoba, Saskatchewan, Nova Scotia, and Prince Edward Island have also introduced similar amendments to their corporate legislation. While this information will not be public (under currently enacted legislation), it is indicative of a growing trend towards more transparency.

3.2 Do private equity investors and/or their director nominees typically enjoy veto rights over major corporate actions (such as acquisitions and disposals, business plans, related party transactions, etc.)? If a private equity investor takes a minority position, what veto rights would they typically enjoy?

The default dissent rights provided under corporate legislations are typically supplemented through unanimous shareholder agreements ("USAs") that ensure the private equity investor has ultimate control over the portfolio company. Often, such veto rights cease to apply where a private equity investor's equity interest is reduced below a given benchmark. Where a private equity investor holds a minority position, veto rights are still typically enjoyed over critical business matters such as acquisitions, changes to the board and management team, the issuance of new equity or debt and the disposition of key assets.

3.3 Are there any limitations on the effectiveness of veto arrangements: (i) at the shareholder level; and (ii) at the director nominee level? If so, how are these typically addressed?

In order for a shareholder agreement to be automatically enforceable against a subsequent shareholder, which shareholder agreement sets forth veto arrangements, fetters the discretion of the directors or supplants the default provisions of corporate legislation where permitted, it must be unanimous in nature. At the director level, only certain powers of directors can be fettered by a unanimous shareholders' agreement and, most notably, the fiduciary duty owed by the director of a portfolio company to the company itself cannot be restrained.

3.4 Are there any duties owed by a private equity investor to minority shareholders such as management shareholders (or *vice versa*)? If so, how are these typically addressed?

In contrast to some American jurisdictions, controlling shareholders in Canada do not owe a fiduciary duty to minority shareholders.

3.5 Are there any limitations or restrictions on the contents or enforceability of shareholder agreements (including (i) governing law and jurisdiction, and (ii) non-compete and non-solicit provisions)?

A shareholder agreement that is not signed by all of the shareholders of a company is treated as a regular commercial contract and, as such, not automatically enforceable against a subsequent shareholder; it is subject to the articles and by-laws of the corporation and the provisions of the relevant corporate statute. In contrast, a USA is a creature of statute, provided that it is signed by all shareholders. Corporate legislation expressly recognises the ability of shareholders to contract out of certain statutory requirements and fetter certain powers of directors. To the extent a USA restricts the powers of directors to manage the business and affairs of the corporation, shareholders who are given that power inherit the rights, powers, duties and liabilities of a director under corporate statutes or otherwise. Canadian courts will generally not enforce restrictive covenants that unnecessarily restrict an individual's freedom to earn a livelihood. What is reasonably necessary depends on the nature of the business, its geographic reach, and the individual's former role in that business. Canadian courts will not enforce a restrictive covenant that does not contain any time limit.

3.6 Are there any legal restrictions or other requirements that a private equity investor should be aware of in appointing its nominees to boards of portfolio companies? What are the key potential risks and liabilities for (i) directors nominated by private equity investors to portfolio company boards, and (ii) private equity investors that nominate directors to boards of portfolio companies?

Depending on the jurisdiction of incorporation, the board of directors of a Canadian corporation may be subject to certain minimum residency requirements. Notably, boards of directors for companies incorporated under the federal statute must consist of at least 25% resident Canadian directors or include at least one resident of Canada if the board has fewer than four members. Recent changes to the legislation in Ontario and Alberta have removed a similar requirement for resident Canadian directors, thus making those jurisdictions more attractive to foreign-owned private equity firms who want to have the boards of their Canadian portfolio investments aligned in terms of membership with those of their investments held outside of Canada.

In Canada, all directors owe fiduciary duties to the corporation, including a duty to act in the best interest of the corporation. The potential statutory liabilities directors are exposed to can be extensive and the basis for this potential liability varies. Directors may be personally liable for their own wrongdoing

or failure, such as breaching the duties of loyalty and of care, or, in other instances, held personally liable for wrongdoing by the corporation. The statutes that impose liability on directors include those governing: corporate matters; securities compliance; employment and labour protection; taxation; pensions; and bankruptcy and insolvency.

3.7 How do directors nominated by private equity investors deal with actual and potential conflicts of interest arising from (i) their relationship with the party nominating them, and (ii) positions as directors of other portfolio companies?

Directors of a corporation who are nominees of a particular shareholder are subject to fiduciary duties to act in the best interest of the corporation, not the shareholder who nominated them. Canadian corporate statutes require directors to disclose in writing the nature and extent of their interest in a proposed material contract or transaction with the corporation. This provision applies whether the director is a party to the contract or transaction personally or is a director or officer of, or has a material interest in, a party to the contract or transaction. As such, all conflicts or potential conflicts the director has, as a result of their relationship with the nominating party and/or other portfolio companies, must be disclosed. In situations of conflict, the statutes require the director to refrain from voting on any resolution to approve the contract or transaction except in narrow circumstances.

4 Transaction Terms: General

4.1 What are the major issues impacting the timetable for transactions in your jurisdiction, including antitrust, foreign direct investment and other regulatory approval requirements, disclosure obligations and financing issues?

Aside from the typical due diligence process, the timetable for transactions is often governed by the regulatory approval required under the Competition Act and the Investment Canada Act, where applicable. In Canada, certain large transactions trigger advance notice requirements under the Competition Act. Such transactions cannot be completed until the end of a review period. Pre-merger notification filings are required in connection with a proposed acquisition of assets or shares or an amalgamation or other combination to establish a business in Canada where thresholds relating to the "size of the parties", the "size of the transaction" and "shareholding" are exceeded. Recent amendments to the Competition Act may result in more transactions being subject to pre-merger notification as all corporate and non-corporate entities under common direct or indirect control are now treated as "affiliates" and will thus be included in the threshold analysis. This will be especially impactful on traditional private equity funds that are structured as limited partnerships. In addition to competition regulations, under the Investment Canada Act, foreign investments that exceed prescribed values or that relate to a cultural business or involve national security issues are subject to Investment Canada Act approval. This allows the federal government to screen proposed investments to determine whether they will be of "net benefit" to Canada. In response to the COVID-19 pandemic, the Canadian federal government released a policy statement in April 2020 stating that, using existing powers, it will apply enhanced scrutiny under the Investment Canada Act to certain foreign investments, notably foreign direct investment relating to public health or critical goods or services.

4.2 Have there been any discernible trends in transaction terms over recent years?

The increase in foreign investment, typically from the U.S., has influenced transaction terms, which have gradually shifted to become increasingly similar to those in the American market. For example, the size of indemnity caps, while still significantly higher in Canada than in the U.S., continues to trend downwards. The Canadian market has also increasingly seen public-company style "no-indemnity" deals as in the U.S. market. Also, the use of representation and warranty insurance is increasingly being seen as standard in the Canadian private equity market and impacts what terms are "market" in deals using that product. For instance, double materiality scrapes are now very typical in representation-and-warranty-insured Canadian transactions.

5 Transaction Terms: Public Acquisitions

5.1 What particular features and/or challenges apply to private equity investors involved in public-to-private transactions (and their financing) and how are these commonly dealt with?

Canadian takeover bids require that adequate arrangements (an interpreted statement) must be made, with the effect that a bid cannot be conditional on financing. Statutory plans of arrangement, on the other hand, can be conditional in nature and allow more flexibility to provide collateral benefits to managements, etc. Due to this flexibility, most uncontested Canadian privatisation transactions involving private equity investors are completed by a plan of arrangement.

5.2 What deal protections are available to private equity investors in your jurisdiction in relation to public acquisitions?

In friendly acquisitions, break fees are often seen in connection with "no-shop" provisions. The "no-shop clause" is typically subject to a fiduciary out, upon which the break fee becomes payable. The break fee, traditionally in the range of 2–4% of the transaction's value, is now typically based on enterprise value.

6 Transaction Terms: Private Acquisitions

6.1 What consideration structures are typically preferred by private equity investors (i) on the sell-side, and (ii) on the buy-side, in your jurisdiction?

Private equity buyers typically require purchase price adjustments to reflect the financial condition of the target. Typically, these are based on a net working capital adjustment. Earn-out provisions are also often contemplated by private equity buyers in order to link the seller's ultimate consideration to the financial success of the target entity post-closing. Earn-out provisions have become especially popular during the COVID-19 pandemic as a way for transaction parties to account for uncertain future performance without discounting a company's purchase price. The use of "locked box" structures is becoming more common in Canada as a means to limit post-closing price adjustments. Private equity firms generally arrange their own credit facility and invest on a cash-free, debt-free basis. On the sell-side, private equity investors typically prefer simple consideration structures with less variability and that minimise the size and scope of post-closing obligations.

6.2 What is the typical package of warranties / indemnities offered by (i) a private equity seller, and (ii) the management team to a buyer?

Private equity sellers and management teams will try to minimise the representations and warranties and insist on a short survival period for representations given. Private equity sellers will further try to limit their exposure by ensuring they do not include a full disclosure, 10b-5 type representation by liberally using materiality qualifiers and by including an anti-sandbagging provision. Private sellers are also increasingly insisting on public-company style "no-indemnity" exits.

6.3 What is the typical scope of other covenants, undertakings and indemnities provided by a private equity seller and its management team to a buyer?

Private equity sellers generally insist on limiting post-closing exposure as much as possible. As referenced above, they typically limit the length and scope of indemnity provisions as much as possible, as well as other post-closing covenants and undertakings. Public-style exits, in which a private seller's post-closing exposure is limited exclusively to instances of fraud, are becoming increasingly common.

6.4 To what extent is representation & warranty insurance used in your jurisdiction? If so, what are the typical (i) excesses / policy limits, and (ii) carve-outs / exclusions from such insurance policies, and what is the typical cost of such insurance?

Representation and warranty insurance use is not universal, but, as noted above, has become commonplace and is increasingly popular in Canadian private equity transactions. Policy limits typically cap out at 10–20% of the purchase price of a transaction. Available coverage has become broader and, over recent years, the number of typical carve-outs and exclusions from such policies has decreased quite significantly. However, they remain for pre-closing taxes, pension funding, certain environmental matters and other high-risk deal specific terms. Policy premiums for representation and warranty insurance have been steadily declining in recent years and now may range between 2.5–4% of the policy limit. The retention amounts required under these policies have similarly declined. It is now common to see this figure as low as 1% of enterprise value.

6.5 What limitations will typically apply to the liability of a private equity seller and management team under warranties, covenants, indemnities and undertakings?

It is advisable for private equity investors to build restrictions on the scope of representations and warranties that fund investors are required to give on a sale transaction. Representations and covenants as to the portfolio company's operations are more properly given by management shareholders who will have in-depth knowledge in this regard. Private equity investors required to indemnify a purchaser in respect of a breach should do so on a several basis and limitations should be placed on the dollar amount for which private equity investors are responsible. Typically, post-closing indemnification on the sale lasts 12–18 months (with fundamental representations and warranties lasting longer) and negotiated indemnity cap (for non-fundamental representations) often in the range of 5–30% of the sale price. Involvement of foreign participants, especially U.S.-based participants, is often correlated to the lower end of these ranges applying, whereas we see the upper ends of the ranges more commonly on truly domestic Canadian transactions.

6.6 Do (i) private equity sellers provide security (e.g. escrow accounts) for any warranties / liabilities, and (ii) private equity buyers insist on any security for warranties / liabilities (including any obtained from the management team)?

While representation and warranty insurance is becoming more popular, the traditional approach of a seller indemnity coupled with a purchase price holdback or escrow is also still common for both private equity buyers and sellers in Canada. In the event of an earn-out provision, set-off rights against the earn-out payment are also typical.

6.7 How do private equity buyers typically provide comfort as to the availability of (i) debt finance, and (ii) equity finance? What rights of enforcement do sellers typically obtain in the absence of compliance by the buyer (e.g. equity underwrite of debt funding, right to specific performance of obligations under an equity commitment letter, damages, etc.)?

Private equity transactions typically involve equity financing from the private equity investor and debt financing from a third-party lender. Comfort, with respect to the equity financing, is often provided in the acquisition agreement, which generally contains a commitment for the private equity investor to fund and complete the acquisition upon the satisfaction of certain conditions. The acquisition agreement generally contains a representation and warranty that the private equity investor has sufficient funds to provide the funding. A separate equity commitment letter is often provided by the private equity firm. Comfort letters from the third-party lender are typically tabled to provide comfort with respect to the debt financing.

6.8 Are reverse break fees prevalent in private equity transactions to limit private equity buyers' exposure? If so, what terms are typical?

Reverse break fees are becoming more common in Canadian private equity transactions. These fees are typically negotiated as a fixed dollar amount or a percentage of enterprise value. Due to the increased exposure of the target entity to potential damage from a failed deal, reverse break fees are often higher than the negotiated break fee on a transaction, ranging up to 10% of enterprise value.

7 Transaction Terms: IPOs

7.1 What particular features and/or challenges should a private equity seller be aware of in considering an IPO exit?

While traditionally seen as the gold-standard, ideal exit for a private equity seller, IPO exits are not that common in Canada. According to the Canadian Venture Capital and Private Equity Association, in 2020 the exit market saw the highest value of private equity-backed IPOs, being $14B across four IPOs, but the lowest number of IPO exits on record. When considering an IPO exit, private equity sellers should be aware of the costs of preparing for and marketing the IPO, which includes the preparation of a prospectus and a road show. It is also important for

the private equity seller to be aware that an IPO will not allow for an immediate exit of its entire position and that the private equity's final exit will be subject to lock-up provisions, which will limit the investor's abilities to sell their shares for a period of time following the IPO.

7.2 What customary lock-ups would be imposed on private equity sellers on an IPO exit?

Underwriters in an IPO will require these shareholders to enter into a lock-up agreement as a condition to the underwriting to ensure their shares do not enter the public market too soon after the IPO. While the terms of lock-up agreements are subject to negotiation, they typically last 180 days.

7.3 Do private equity sellers generally pursue a dual-track exit process? If so, (i) how late in the process are private equity sellers continuing to run the dual-track, and (ii) were more dual-track deals ultimately realised through a sale or IPO?

Dual-track processes have not typically been popular in Canada. However, given the state of the market before the pandemic and the increased use of these processes in the United States, we expect to see them becoming more common in Canada as buyers continue to seek ways to hedge the risk of a failed attempt to go public while at the same time increasing valuations.

8 Financing

8.1 Please outline the most common sources of debt finance used to fund private equity transactions in your jurisdiction and provide an overview of the current state of the finance market in your jurisdiction for such debt (particularly the market for high yield bonds).

Foreign investors, largely U.S.-based, account for a substantial portion of private equity investment in Canada. U.S. investors often bring their American debt financing with them or obtain Canadian debt financing. Private equity investors utilising U.S. debt sources for Canadian private equity transactions need to develop FX hedging strategies, which are typically only provided by traditional banks and can be costly. Traditional senior secured debt obtained from a domestic Canadian bank, often in the form of a revolving credit facility or term loan, remains the most common source of debt financing in Canadian private equity transactions. At times, senior secured debt is also supplemented by mezzanine financing (usually by way of subordinated debt) through banks or other financial institutions.

8.2 Are there any relevant legal requirements or restrictions impacting the nature or structure of the debt financing (or any particular type of debt financing) of private equity transactions?

There are no relevant legal requirements or restrictions that affect the choice of structure used for debt financing in Canadian private equity transactions. Canadian loans tend to be fully secured against all available collateral.

8.3 What recent trends have there been in the debt financing market in your jurisdiction?

Most private equity firms typically use private lending as part of the financing for their Canadian transactions. According to Crosbie & Co., the average equity portion of the capital structure increased to 49% of all transaction value in 2020, which was a modest increase from 46% in 2019, resulting in a corresponding reduction in leverage employed.

9 Tax Matters

9.1 What are the key tax considerations for private equity investors and transactions in your jurisdiction? Are off-shore structures common?

Many of the common tax considerations in transactions with private equity funds apply equally to transactions with strategic buyers. However, there are several considerations that may take on added importance when transacting with foreign private equity investors in particular. Dividend payments made by Canadian portfolio companies to foreign private equity investors are generally subject to a 25% withholding tax, although this rate is substantially reduced under tax treaties in most instances. Non-resident investors should also familiarise themselves with Canada's thin-cap rules that prohibit Canadian companies from deducting interest on a portion of interest-bearing loans from specified non-residents that exceed one-and-a-half times the tax equity of the "specified non-residents" in the Canadian company. Historically, intermediary entities in tax-favourable jurisdictions such as Luxembourg and the Netherlands have often been utilised by foreign-based private equity funds investing into Canada. However, the Organisation for Economic Cooperation and Development's Base Erosion and Profit Shifting ("BEPS") initiative have significantly affected the usage of such intermediaries.

9.2 What are the key tax-efficient arrangements that are typically considered by management teams in private equity acquisitions (such as growth shares, incentive shares, deferred / vesting arrangements)?

Stock options remain the most popular stock-based compensation tool, due to their favourable treatment (no taxation until exercise and general eligibility for a capital-gains equivalent rate of tax). Other popular stock-based compensation arrangements for management include stock appreciation rights and deferred stock units.

9.3 What are the key tax considerations for management teams that are selling and/or rolling-over part of their investment into a new acquisition structure?

Investors in a Canadian company are generally permitted a tax-free rollover when exchanging their shares in the company for shares of another Canadian company, but not when such shares are exchanged for shares of a non-Canadian company. An effective workaround may be available in the latter circumstances through the use of "exchangeable shares" (i.e., shares of a Canadian company that are exchangeable for, and are economically equivalent in all material respects with, shares in the relevant foreign company).

9.4 Have there been any significant changes in tax legislation or the practices of tax authorities (including in relation to tax rulings or clearances) impacting private equity investors, management teams or private equity transactions and are any anticipated?

As noted above, the Organisation for Economic Cooperation

and Development's BEPS initiative, insofar as anti-treaty-shopping measures are concerned, has significantly decreased foreign-based private equity funds' usage of intermediary entities in favourable jurisdictions (such as Luxembourg and the Netherlands) for their Canadian investments. Amendments to the Excise Tax Act (Canada), enacted in 2018, impose goods and services tax obligations on investment limited partnerships. These changes imposed goods and services tax on management and administrative services provided by the general partner of an investment limited partnership. If the partnership meets the definition of "investment limited partnership", the general partner will be obligated to charge and remit goods and services tax on the fair market value of any management/administrative services provided. The federal government recently implemented, effective July 1, 2021, a $200,000 annual limit on the eligibility of employees of certain businesses to claim a 50% tax deduction for stock option grants. This could affect the compensation packages required to retain and incentivise management.

10 Legal and Regulatory Matters

10.1 Have there been any significant legal and/or regulatory developments over recent years impacting private equity investors or transactions and are any anticipated?

Amendments to the Competition Act (Canada) expanded what is considered "an affiliate" for the purposes of applying the Competition Act thresholds. As amended, the Competition Act now includes non-corporate entities as affiliates. Under these amendments, funds structured as partnerships will now be considered affiliates of both portfolio companies under their control and any other similarly structured sister funds controlled by the same entity. This increases the number of entities that may count towards the "size of the parties" threshold and is expected to result in a greater number of private equity transactions triggering the notice requirements.

10.2 Are private equity investors or particular transactions subject to enhanced regulatory scrutiny in your jurisdiction (e.g. on national security grounds)?

Private equity investors are not subject to specific regulatory scrutiny; however, the amendments to the Competition Act noted above are likely to increase the number of private equity transactions that trigger advance notice requirements under the Competition Act. Foreign investments that constitute an acquisition of "control" of a Canadian business will require approval under the Investment Canada Act if the investment exceeds certain monetary thresholds, involves a cultural business, or has national security implications. Such investments are subject to approval by the federal Ministry of Innovation, Science and Economic Development or the Minister of Canadian Heritage, depending on the nature of the Canadian business being acquired.

10.3 How detailed is the legal due diligence (including compliance) conducted by private equity investors prior to any acquisitions (e.g. typical timeframes, materiality, scope, etc.)?

The majority of private equity investors conduct thorough legal due diligence, reviewing all material legal documents including the target entity's corporate records, materials contracts and employment records. In addition, publicly available searches are also typically conducted in order to identify any registered encumbrances, active legislation, bankruptcy filings and other similar matters. Most legal due diligence is conducted by external counsel and other professionals, such as environmental consultants. The length of the diligence review and materiality threshold applied differs greatly and is often dependent on the nature of the sale process, the risk tolerance of the private equity investor and the industry the target is in.

10.4 Has anti-bribery or anti-corruption legislation impacted private equity investment and/or investors' approach to private equity transactions (e.g. diligence, contractual protection, etc.)?

Canada's Corruption of Foreign Public Officials Act ("CFPOA") was enacted in 1998 to ensure commercial fair dealing, government integrity and accountability, and the efficient and equitable distribution of limited economic resources. CFPOA prohibits the promise, payment or giving of money or anything of value to any foreign official for the purpose of obtaining or retaining business or gaining an improper advantage and concealing bribery in an entity's books and records. Private equity transactions, especially in sensitive industries or which involve a target with material government contracts, typically specify diligence contracts as well as corporate records and policies for compliance with this legislation. In addition, representations and warranties are often obtained from the seller confirming the entity's compliance with the same. While the Foreign Corrupt Practices Act ("FCPA") is an American law, U.S. private equity investors often seek assurances that Canadian target entities are complying with FCPA. If the Canadian target is not currently owned by an American interest, this can be problematic.

10.5 Are there any circumstances in which: (i) a private equity investor may be held liable for the liabilities of the underlying portfolio companies (including due to breach of applicable laws by the portfolio companies); and (ii) one portfolio company may be held liable for the liabilities of another portfolio company?

Typically, Canadian courts are hesitant to pierce the corporate veil and hold shareholders liable for their portfolio companies. However, Canadian courts will pierce the corporate veil where a corporate entity is controlled and used for fraudulent or improper conduct. Likewise, to the extent a shareholder usurps the discretion of a director to manage the business, that shareholder will expose itself to the liabilities of a director of the entity.

11 Other Useful Facts

11.1 What other factors commonly give rise to concerns for private equity investors in your jurisdiction or should such investors otherwise be aware of in considering an investment in your jurisdiction?

Other factors that commonly raise concerns for private equity investors, especially foreign investors, include: that foreign ownership in specified industries such as financial services, broadcasting and telecommunications is limited by certain federal statutes; management and administration fees paid by a Canadian resident to a non-arm's-length non-resident are subject to a 25% withholding tax; and that Canadian employment laws differ fairly significantly from American laws and impose more obligations and potential liabilities on a target corporation.

Michael P. Whitcombe has been recognised as one of Canada's leading business lawyers in *Lexpert's Guide to the Leading 500 Lawyers in Canada*. Michael is Co-Chair of McMillan's Private Equity Group. He principally practises in the areas of negotiated merger and acquisition transactions (domestic and cross-border), private equity investments, strategic alliances, complex commercial arrangements and corporate governance. Michael regularly advises private equity firms along with other medium and large corporations (both domestic and international) and their boards of directors in connection with their operations throughout Canada. He has significant industry experience in the private equity, pharmaceutical, automotive, manufacturing, distribution, service, entertainment, hospitality and tourism sectors. Michael obtained a degree in Business Administration (BBA) in addition to his LL.B. and LL.M. and was called to the Ontario Bar in 1987. Michael is a sessional lecturer in Private Equity Law at Queen's University Law School.

McMillan LLP
181 Bay Street, Suite 4400
Toronto ON, M5J 2T3
Canada

Tel: +1 416 865 7126
Email: michael.whitcombe@mcmillan.ca
URL: www.mcmillan.ca

Brett Stewart is recognised in the *IFLR1000 Financial and Corporate Guide* 2016 and 2018 as a rising star in the areas of Investment Funds and Banking, ranked in *Lexpert's Guide to the Leading U.S./Canada Cross-Border Corporate Lawyers in Canada 2015* as a Corporate Lawyer to Watch in the area of Corporate Commercial Law, and was selected as a *Lexpert®* Rising Star: Leading Lawyer Under 40 for 2014 by *Lexpert® Magazine*. Brett is Co-Chair of McMillan's Private Equity Group. With a focus on assisting domestic and foreign clients with negotiated transactions including mergers and acquisitions, private equity financings, venture capital financings and management buyouts, Brett has represented clients in a number of sectors including agri-food, food manufacturing, aerospace and defence, engineering, pharmaceuticals, tech and clean-tech, manufacturing and transportation.

Brett is Vice-Chair of the Private Equity and Venture Capital Committee of the American Bar Association and the Co-Chair Canadian Women in Private Equity. Brett obtained her J.D. from the University of Toronto and has held the position of Adjunct Faculty Member at Osgoode Hall, York University.

McMillan LLP
181 Bay Street, Suite 4400
Toronto ON, M5J 2T3
Canada

Tel: +1 416 865 7115
Email: brett.stewart@mcmillan.ca
URL: www.mcmillan.ca

McMillan is a leading business law firm serving public, private and not-for-profit clients across key industries in Canada, the United States and internationally.

With recognised expertise and acknowledged leadership in major business sectors, we provide solutions-oriented legal advice through our offices in Vancouver, Calgary, Toronto, Ottawa, Montréal and Hong Kong.

Our firm values – respect, teamwork, commitment, client service and professional excellence – are at the heart of McMillan's commitment to serve our clients, our local communities and the legal profession.

www.mcmillan.ca

mcmillan