

The buyout binge

Contrary to talk of the “hollowing out” of Canadian industry, M&A lawyers think the current spate of foreign acquisitions of Canadian companies is a sign of economic health. But there’s still room for improvement, and there are numerous traps to avoid.

By Pablo Fuchs

Despite a loonie surging ahead of the dollar and a generally booming economy, Canada’s national identity still seems to struggle with an inferiority complex when it comes to business. For the most recent example, read the media reports nationwide about foreign multinationals snapping up Canadian companies all over the place.

Canadians have watched foreign buyouts of domestic firms take place for decades. But this latest batch represents the elite of corporate Canada across a broad spectrum of sectors:

- Hudson’s Bay Co. (retail);
- Inco Ltd. and Falconbridge Ltd. (mining)
- Fairmont Hotels & Resorts and Four Seasons Hotels and Resorts (hospitality)
- Dofasco Inc. and Stelco Inc. (steel)
- Alcan Inc. (aluminum)
- Sleeman Breweries Ltd. and Vincor International Inc. (wine and spirits);
- Terasen Inc. (energy)
- ATI Technologies ULC (high-tech)

The list of seemingly never-ending buyouts has led everyone from journalists and politicians to Tim Horton’s regulars to suggest that Canadian industry is being “hollowed out.” Canada, they say, risks



Brock Gibson

Blake, Cassels & Graydon LLP, Calgary

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becoming nothing more than a wholly-owned subsidiary of the rest of the world, especially the United States.

But a closer look at the facts presents a more nuanced picture. “The reaction to the loss of Canadian icons such as Inco and Alcan is understandable,” says Derek Burney, a senior strategic advisor with Ogilvy Renault LLP in Ottawa and a former ambassador to the United States. “But what people forget is that there are Canadian companies out there that are just as active on the foreign acquisition trail.”

Consider these examples:

- Waterloo, Ont.-based Manulife Financial Corp. bought out U.S. life insurer John Hancock Financial Services Inc. for more than \$10 billion in 2004.
- Toronto-based Thomson Corp. bought out Reuters Group PLC earlier this year for \$17.2 billion, creating the leading provider of news and data for professional markets in the world.
- More recently, Royal Bank Financial Group became the

latest in a long list of Canadian banks to move into Latin and Central America with its \$2.2 billion acquisition of RBTT Financial Group.

- And in early October, TD Bank Financial Group became the seventh-largest bank in North America after its acquisition of Commerce Bancorp Inc. for \$8.5 billion — this following its acquisition of Banknorth Group Inc. in 2005.

In addition, two separate reports issued this year suggest that the purported “hollowing out” crisis is a myth. According to a March study from the Toronto-based Institute for Competitiveness & Prosperity (*Report on Canada: Agenda for Canada’s Prosperity*), Canada now has 72 companies that are considered global leaders in their areas of business — more than twice the number in 1985.

In addition, Canada’s current global leaders are almost twice as large as the 1985 leaders when defined by sales revenue in constant dollars. “We simply are not being hollowed



Edward Waitzer
Stikeman Elliott, Toronto

“The reality is that Canada, for better or worse, lacks global scale and its capital markets lack global depth.”

out,” the report says. “We are thickening up.”

As well, in a C.D. Howe Institute study released in August (*Canada is Missing Out on Global Capital Market Integration*), Canada ranks just 46th out of 73 industrialized and major developing countries in terms of net inflow of foreign direct investment (FDI) as a percentage of overall GDP from 2001-05. But we rank 13th on the list in terms of net outflow of FDI. Canadian businesses have spent \$60 billion on foreign takeovers of their own during that time.

Global realities

What all this activity represents is a new reality in the global economy, in which capital markets are becoming increasingly integrated. Accordingly, Canada must improve its access to international capital markets while taking the necessary measures to ensure that our own champions of industry flourish both domestically and internationally. Merger and acquisition (M&A) activity will therefore continue to become a cross-border affair.

“There’s a worldwide trend toward the globalization of economies,” says Brock Gibson, a partner with Blake, Cassels & Graydon LLP in Calgary whose practice focuses on M&A, corporate finance and energy transactions. Companies needing to compete on a global level will search for foreign M&A partners just as fervently as if they were looking to expand their businesses domestically.

“There’s a global trend in consolidation in many different industries for different reasons, but [at the heart of it], it’s

the big buying the weak,” says M&A lawyer Norman Steinberg, co-chair of Ogilvy Renault LLP in Montreal. Gibson adds: “We’re a part of this, and it’s inevitable that we’ll have Canadian companies bought out. Hopefully, we’ll also have Canadian companies making acquisitions in the reverse order.”

Globalization’s forebear, at least on this continent, was the creation of a North American economy, catalyzed first by the 1989 Free Trade Agreement between Canada and the U.S. and later by the 1994 North American Free Trade Agreement, forming the world’s largest free trade area.

“Once Canada got into a free trade agreement with the U.S., what it created was a common, single North American economy with two — three, if you include Mexico — states that share it,” says Don Ross, managing partner of Osler, Hoskin & Harcourt LLP’s New York office and chair of the firm’s cross-border practice.

“So overall, there are two underlying forces” creating this era of mergers between companies in different international jurisdictions, he says: “NAFTA, and more generally, globalization interact around the world in a way they never used to, which is causing big companies to get in a race to get bigger in order to be more profitable.”

Canada’s position

As a result, U.S. and international companies looking for an M&A partner turn to Canada, for a variety of reasons. Canada can boast “great companies, their great

Péril en la demeure?

Les avocats spécialisés en fusions et acquisitions considèrent l'avalanche d'acquisitions étrangères de compagnies canadiennes comme un signe de prospérité économique.

Bien que le dollar canadien soit devenu plus vigoureux que le dollar américain, le blason de l'identité canadienne n'a pas été redoré pour autant. Un complexe d'infériorité relativement aux affaires semble encore planer sur le pays. Si vous n'en êtes pas convaincus, lisez les rapports des médias au sujet du spectre de « l'engloutissement » des compagnies canadiennes par des multinationales étrangères.

Les plus récentes acquisitions publicisées sont : Hudson's Bay Co, Inco Lté et Falconbridge Lté.; Fairmont Hotels & Resorts and Four Seasons Hotels and Resorts; Dofasco inc. et Stelco inc.; Alcan inc.; Sleeman Breweries Ltd. et Vincor International inc., Terason inc. et ATI Technologies ULC.

La liste croissante des acquisitions a conduit bien des journalistes et des citoyens à penser que l'industrie canadienne est littéralement dépouillée de ses richesses. La crainte soulevée est que le Canada risque d'être réduit à une simple filiale possédée par le reste du monde, notamment les États-Unis.

Et pourtant, les compagnies canadiennes ne chôment pas en matière d'acquisitions de compagnies étrangères non plus. Waterloo a acquis la compagnie américaine John Hancock Financial Services Inc. en 2004. Thomson Corp. s'est emparée de Reuters Group PLC plus tôt en 2007, Royal Bank Financial Group a pénétré les marchés d'Amérique latine et centrale en acquérant RBTT Financial Group. En octobre dernier, TD Bank Financial Group a acheté Commerce Bancorp Inc.

Les données chiffrées récentes indiquent que les acquisitions par des compagnies étrangères sont loin de constituer une tragédie pour notre pays. En effet, la valeur des acquisitions effectuées par les entreprises canadiennes à l'extérieur est supérieure d'environ 20 G\$ à celle des entreprises canadiennes obtenues par des étrangers. De plus, c'est l'Europe qui a fait l'acquisition du plus grand nombre de compagnies cana-

diennes plutôt que les sociétés américaines.

La position canadienne dans le cadre de la mondialisation

Toute cette activité est représentative de la mondialisation bien réelle de l'économie dans laquelle les marchés financiers deviennent de plus en plus intégrés. Par conséquent, le Canada doit améliorer son accès aux marchés internationaux tout en prenant les mesures nécessaires pour que nos propres champions des affaires puissent prospérer à l'échelle nationale et internationale.

Le Canada attire les fusions et acquisitions, en raison de « ses compagnies, sa gestion et son environnement de travail qui sont extraordinaires », déclare Norman Steinberg, avocat en fusions et acquisitions et coprésident chez Ogilvy Renault s.r.l. à Montréal.

De plus, les règles relatives aux reprises de compagnies penchent en faveur des acquéreurs, ce qui encourage les compagnies étrangères à percevoir notre pays comme une terre remplie d'occasions d'acquisitions.

S'ouvrir ou se fermer, voilà la question!

Aux dires d'Edward Waitzer, associé chez Stikeman Elliott s.r.l. à Toronto, plusieurs pays comme Hong-Kong, Singapour et l'Islande ont grandement bénéficié de leur ouverture aux investissements étrangers directs (IED). Et si Londres est devenu le nouveau centre global de finance, c'est dû en grande partie à l'accueil favorable réservé aux IED par le Royaume-Uni. « Un autre argument est que [l'ouverture] attire une technologie, des connaissances et une innovation d'envergure mondiale », ajoute-t-il. Sans compter qu'il s'agit d'un « moyen de garder au Canada les usines et les emplois », renchérit Don Ross, associé directeur au bureau new-yorkais d'Osler, Hoskin & Harcourt s.r.l.

Compte tenu des gains substantiels en emplois, certains avocats jugent les consi-

dérations sur la nature du pays où se trouve le siège social d'une compagnie trivial, tandis que d'autres sont préoccupés, au contraire, par le fait que les décisions soient prises à l'extérieur du Canada.

Face à cette inquiétude, certains politiciens et experts recommandent de mettre en place des mesures protectionnistes pour sauvegarder les intérêts canadiens vitaux contre une mainmise étrangère, de la même façon que pour les secteurs relatifs aux services financiers, aux télécommunications, aux médias et aux transports qui sont à l'abri des forces du marché.

Faisant écho à ces préoccupations, le gouvernement canadien actuel a mis en place en juillet dernier un Groupe d'étude chargé d'examiner l'efficacité de la politique canadienne en matière de concurrence et d'investissement afin de s'assurer qu'elle encourage les placements à l'étranger et qu'elle favorise la création d'emplois meilleurs et plus nombreux pour les Canadiens. Le Groupe d'étude procédera ainsi à l'examen de la *Loi sur la concurrence* et de la *Loi sur l'investissement Canada*. Des recommandations seront émises le 30 juin 2008 à cet égard.

Le libre-échange pour toujours

Tous les avocats interrogés par *National* s'opposent sans réserve à la création de frontières destinées à empêcher l'entrée de compagnies étrangères.

« Nous devons plutôt garantir que les champions de l'industrie soient en position de force pour effectuer des acquisitions, suggère Maryse Bertrand, une associée chez Davies Ward Phillips & Vineberg s.r.l. à Montréal. Or, nos compagnies ne disposent pas des outils visant à garantir leur réussite ». Elle considère que la clé d'un tel succès consiste à réformer le système canadien de taxes corporatives. Et Me Steinberg de renchérit : « les gouvernements fédéral et provincial ne réduisent pas les taxes autant que les pays étrangers à travers le monde ».

En conclusion, un pays traditionnellement ouvert au libre-échange comme le Canada devrait continuer à générer bien des acquisitions et des fusions, et ce, peu importe que l'on y soit favorable ou non. ■

— Yasmina El Jamaï



Al Hudec

Davis LLP, Vancouver

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management and the great environment in which to operate,” Steinberg says. He compares the ease and stability of acquiring Canadian oil and natural resource companies to the notorious difficulties encountered in less stable jurisdictions like Nigeria, Russia or Venezuela.

At the same time, however, Canadian companies are also easier to acquire than those in other industrialized nations. “The reality is that Canada, for better or worse, lacks global scale and its capital markets lack global depth,” says Edward Waitzer, a partner with Stikeman Elliott LLP in Toronto with significant M&A experience who served as chair of the Ontario Securities Commission from 1993 to 1996.

Combine that with an environment in which takeover rules are tilted towards acquirers, and you get an atmosphere that encourages foreign entities to look to Canada for acquisition targets. “Securities regulators have frowned on the use of defensive tactics, [to the point] where Canada has gained a reputation that buyers will make enough noise that the target will get sold,” he says.

Although many people worry when major Canadian firms fall under the control of foreign entities, the fact is these moves can benefit the Canadian economy. Waitzer suggests that many countries have benefited greatly from openness to FDI, including Hong Kong, Singapore and Iceland. London became, by many accounts, the new centre of global finance thanks in large part to the U.K.’s welcoming approach to FDI.

“Openness to foreign investment implies a discipline on management and a real discipline in the markets,” Waitzer says, noting that companies operating in a market open to FDI are held to the highest standards. “Another argument is that it attracts world-scale technology, knowledge and innovation.”

As well, the acquisition of Canadian firms by foreign multinationals presents “a way of ensuring business and realizing economies of scale [that] equal more efficiency in the economy,” says Al Hudec, a senior securities practitioner with Davis LLP in Vancouver. “It’s a way to keep plants and

jobs in Canada,” adds Ross, who points to the US\$1.1 billion (plus assumed debt) buyout in late August of Stelco by his client, United States Steel Corp.

Stelco, Canada’s largest steel company, restructured because it was losing money. When the restructuring was over, 76 percent of the shares were owned by three private equity investors, but despite their best efforts, the company still lost money. That led to the U.S. Steel buyout, and “as a result,” says Ross, “all of Stelco’s operations will continue and the people working in Hamilton will continue to have their jobs.”

The focus should be “all about the economic impact on Canada,” and not on whether the company is owned by Canadians or foreigners, agrees Jay Holsten, chair of Torys LLP’s antitrust and competition group in Toronto. “Does it matter whether a company’s head office and its executives are in Canada, or whether a company with major decision-makers in another place ... hires thousands of Canadians?” he asks rhetorically. “The net result is the same, so how is that a bad thing?”

Given these circumstances, Ross considers the term “hollowing out” a pejorative one. Instead, he believes Canadians should be using the phrase “maintaining vital corporate operations,” because some major M&A deals ensure that companies will remain active in the Canadian context.

Takeover backlash

Not everyone is in complete agreement on that point, however. Even though the operations of a purchased Canadian firm could remain in Canada, the “loss of head offices is a major issue,” says Hudec. Steinberg agrees: “It presents concerns on many different levels. We lose decision-makers, service providers, the charitable donations — there are many different facets” to consider.

Throw regional perspectives into the mix as well, and the complexity of the debate only grows. “The hollowing-out effect certainly appears to be happening from the Quebec point of view, where there [already] are few head offices and a number of them have been purchased or are in the process of being purchased,” says Maryse Bertrand, a partner with Davies Ward Phillips & Vineberg LLP in Montreal who specializes in corporate and securities law. “This leaves you wondering what it means for the city and the province in the long term.”

What could be done to allay such concerns? Some politicians and pundits recommend that more barriers to entry be erected to protect vital Canadian interests from falling into foreign hands. They point to some barriers already in place for the financial services, telecommunications, media and transportation sectors that some have considered to be successful.

Holsten is not a proponent of protectionist policies, but he does note that “some areas, such as broadcast, telecom and banking, are key to the health of the Canadian economy ... I



Maryse Bertrand

Davies Ward Phillips & Vineberg, Montreal

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see a need for [such barriers] from a Canadian identity perspective.” Moreover, he adds, “the financial services sector would be very different today if the federal government had allowed banks to merge or had allowed foreign takeovers,” citing Canadian banks’ success in expanding to the U.S. and building their insurance and brokerage businesses.

Ross adds: “If you don’t have a financial services sector that you can regulate, you can’t have an effective monetary policy. These barriers allow the Bank of Canada to set monetary policy through Canadian banks, and it’s not easy to run a country if you don’t have an effective monetary policy.”

These sentiments were joined by a larger public outcry against the “hollowing out” of corporate Canada, which led the Harper government to announce in the 2007-08 budget a review of key elements of national competition and investment policies. The Competition Policy Review Panel (CPRP) was formed on July 12 — fittingly, just hours after the Anglo-Australian mining conglomerate Rio Tinto PLC announced its

US\$38.1 billion acquisition of Montreal-based Alcan Inc.

The five-person CPRP’s core mandate is to review the *Competition Act* and the *Investment Canada Act* and to examine the foreign ownership restrictions already in place. The panel will also look at the competition and investment regimes of other jurisdictions to assess reciprocity between their rules and those of Canada, and consider how to encourage Canadian outbound investment.

“It’s time to revisit Canada’s competition laws and see if we struck the right balance in the 1980s, if the objectives are being met,” Holsten says. “If not, then we must adjust the laws to achieve what was intended.”

Freer trade

That said, all the lawyers with whom *National* spoke oppose the creation of barriers to entry for foreign firms. “It’s critical not to put up barriers. We need to allow business to flow where it’s most efficient, so the fewer the

New horizons

As a matter of necessity, Canadian law firms join the globalization wave.

Canadian law firms are keeping a close eye on the current trend of foreign companies buying out Canadian firms, measuring how it could affect their own business.

"It's a topic all lawyers discuss — there's a concern among large law firms about international consolidation," says Norman Steinberg, co-chair of Ogilvy Renault LLP in Montreal. Al Hudec of Davis LLP in Vancouver, adds: "The loss of Canadian head offices results in the diminution of opportunities for lawyers and other professional advisory firms."

As a result, firms are looking at various ways to ensure that they remain economically strong and continue to attract top-tier business. One strategy is to seek out new business in new niches right here in Canada.

Ogilvy Renault is focusing on intellectual

property and biotechnology, a busy field in Canada. "We're also focusing on cities where certain industries are very strong, like aerospace and pharmaceuticals in Montreal," says Steinberg.

"We have to look for new types of business that will require legal services, such as alternative energy, oil sands, deregulation of electricity, and project finance," says Brock Gibson, a partner with Blake, Cassels & Graydon LLP in Calgary. "It requires firms to be thinking ahead and to be as innovative as our clients."

And that appears to be the key to success. As clients cross borders and merge with foreign entities — or acquire foreign companies — firms too must look abroad. "We have offices outside of Canada because we see globalization," says Gibson of Blakes' offices in New York, Chicago, London and Beijing.

In contrast, some firms have focused strictly

on expanding their practices to the United States. "We looked at our clients and saw that they were increasingly doing business in the U.S., so we decided on a north-south strategy rather than an east-west one," says Jay Holsten of Torys LLP, which has had an office in New York since 1999 when it acquired Haythe & Curley.

"If you want to follow the trend toward a single economic market, then you have to have the facilities to service clients who want to cross the border," says Don Ross, managing partner of Osler, Hoskin & Harcourt LLP's New York office and chair of the firm's cross-border practice. "That's the one thing we're focused on." There's a lot of work, he says, servicing clients as the bridge between the two distinct parts of the integrated North American economy.

"The global currency of legal services today is U.K. and U.S. law," concludes Edward Waitzer, a partner with Stikeman Elliott LLP in Toronto. "Major Canadian law firms are doing better today than ever before by an exponential measure, because Canadian law is similar to U.S. law."

barriers, the better to make Canada competitive in the worldwide economy," says Gibson.

"From a Canadian who serves both Canadian and foreign businesses, we have to have an environment to allow Canadian companies to grow and be attractive to investors without barriers, as well as make investments around the world." Hudec adds: "We live in an open economy, and protecting our industries is counter-productive in the long run."

Waitzer even takes a stab at some of the obstacles already in place, suggesting that limits on foreign ownership have not served Canada's banks well. "The barriers that have kept a monopoly status for banks are the same barriers that have kept Canadian banks from becoming major global players, because there is less incentive to venture afield. It limits the range of vision."

Even Bertrand, who's concerned with the toll of "hollowing out" in Quebec, is opposed to implementing any protectionist policies. "We tried it with [former prime minister Pierre] Trudeau's Foreign Investment Review Agency. It's harmful and it's not the way to go," she says. "What we could do instead is ensure strong Canadian champions of industry are also in a strong position to make acquisitions. Our companies haven't been given the tools to ensure they succeed."

The key to that success is to reform Canada's corporate tax regime, Bertrand and other say. "Our taxation has not progressed, in terms of prosperity, to where it should yet," says

Steinberg. "The federal and provincial governments are not reducing taxes as much as foreign governments around the world. And Europe, which is generally always high-tax, has been anything but in recent years."

Burney goes one further: "What's fundamentally important is that we have a policy environment that's attractive to investment — whether domestic or foreign." As an example, he points to Ireland: after reducing its corporate tax rate to among the top ten in the Organization for Economic Co-operation and Development, as well as increasing funding to education, the country has seen stellar growth. "What we need is a competitive, coherent tax strategy where the federal and provincial governments are on the same page," Burney argues. "It's the way to secure our economic future."

Although it might be difficult for Canadians to accept, our companies will continue to be acquired. After all, "when economic forces are at work, trying to stop them is like King Canute trying to hold back the tide," says Ross. But losing some Canadian flag bearers will only constitute "hollowing out," Gibson says, "if we don't recycle Canada's greatest resource — the Canadian people and their entrepreneurial spirit." ■

Pablo Fuchs is a Toronto-based writer and editor. His previous article for *National*, on the impact of the commodities boom on Canadian law firms, appeared in our December 2006 edition.