OSLER

2014

Capital Markets Report

Osler, Hoskin & Harcourt LLP

Table of Contents

1 Introduction

6 Chapter 1
The Maturing Market for Shareholder Activism in Canada

10 Chapter 2
The Year the Music Stopped – The Precipitous Decline in SOE Investment in Canada's Oil and Gas Sector in 2013

18 Chapter 3
The Leading Role of Canadian Pension Funds at Home and Abroad

21 Chapter 4
Canada's Technology Renaissance

24 Chapter 5
Developments in Canada's Burgeoning LNG Export Industry

29 Chapter 6
It's Time to Stop Thinking of the Financing Environment After the Global Financial Crisis as the *New* Normal (It's Just Normal)

37 Chapter 7
Notable Trends and Developments in M&A

42 Chapter 8
Risks and Risk Management in Project and Resource Development

Table of contents

Introduction

by Clay Horner, Frank Turner & Douglas Marshall

2013 was a year of mixed activity levels in the Canadian capital markets. It was a very good year for the major North American equity trading markets and a record year for Canadian corporate debt issuers. There were also a number of significant Canadian IPOs. On the other hand, there was an overall reduction in the level of Canadian M&A activity and equity offerings. At Osler, we had the good fortune to advise on the two largest M&A transactions of 2013, the two largest equity financings of the year, and several of the most noteworthy IPOs. We also assisted many of our clients with key strategic and, in some cases, transformative transactions. What follows is a review of overall market activity in 2013 and some observations and predictions gleaned from the deals on which we were engaged in the year.

The S&P/TSX Composite Index closed 2013 at 13621.55, more than 9.5% higher than its close a year earlier, while the Dow Jones Industrial Average closed the year up more than 26% over the previous year's close, setting a new all time high and achieving its biggest one year gain since 1995. However, the TSX-V was down sharply for the year closing 2013 at 931.97, representing an almost 25% decline over the previous year's close and underscoring the difficult capital market conditions experienced by junior issuers in 2013.

Total equity offering proceeds for TSX and TSX-V listed issuers were approximately $43.6 billion in 2013, representing a 23% decrease compared to 2012. The private placement market was even weaker as many junior and mid-market issuers, especially those in the resource sector, struggled to raise new capital. The Canadian IPO market was somewhat improved in 2013 but could not come close to matching the strength of the U.S. IPO market. Nineteen conventional IPOs (excluding those undertaken by capital pool companies and exchange-traded funds and IPOs involving structured products) were completed in Canada in 2013, which is an increase from the 14 completed in 2012 but less than half the number in 2007. Notable IPOs completed during the year included REIT IPOs sponsored by Loblaw Companies Limited and Canadian Tire Corporation Limited, and the Oryx Petroleum Corporation Limited IPO which was the largest energy IPO of the year. Osler acted for the underwriters on the CT REIT and Oryx IPOs and on several IPOs by technology companies. While overall equity offerings were down, there were several very large offerings by issuers including Barrick Gold Corporation, Valeant Pharmaceuticals International, Inc., Empire Company Limited and BlackBerry Limited. We acted on three of these offerings and increasingly find that effective integration of our capital markets experts across offices, including between our Canadian offices and our New York office, is essential to meeting the very quick timelines required on significant capital markets transactions.

Corporate debt issuances by Canadian companies rose to an all time high in 2013 as equity financing became more difficult for some types of issuers and debt became a more attractive option. Canadian issuers raised $187 billion of new corporate debt through to December 15, 2013, representing an increase of approximately 34% over the same period in 2012. Companies from a variety of industries and across the credit spectrum took advantage of the low interest rates available in 2013 to raise additional capital, and a number of very large M&A transactions were funded in whole or in part through large debt offerings. The high yield portion of the debt market saw the overall value of new issuances decline somewhat compared to 2012, however a broad range of issuers came to the market for the first time in 2013 underscoring the viability of this market as an alternative method of raising new capital.

Osler has consistently been at the top of M&A legal advisor league tables published by Thomson Reuters, Bloomberg and Mergermarket over the past six years, with the following distinctions for year-end 2013

Osler is ranked as the #1 **law firm for Canadian deals** *(by value) and the* #3 **law firm for Canadian deals** *(by deal count) by Mergermarket*

Osler is ranked by Bloomberg among the **top 5 M&A legal advisors for global announced deals** *(by value)* **and as the #2 law firm for Canadian announced deals** *(by value)*

Osler is ranked by Thomson Reuters as the **#2 law firm for Canadian announced deals** *(by value) and the* #3 **law firm for Canadian completed deals** *(by value)*

The M&A markets were off somewhat in 2013 compared to prior periods. Canadian companies were involved in 2,325 announced deals in 2013 valued at $158.2 billion, down 28% from 2012 and representing the lowest level of activity since 2009. However, there were a number of significant M&A deals in the year including Loblaw's $12.4 billion acquisition of Shoppers Drug Mart Corporation and Valeant's $8.7 billion acquisition of Bausch + Lomb Holdings Incorporated. Osler advised a principal party on each of these transactions and observed that while each was negotiated in a short period of time, such negotiations were preceded by extensive prior engagement and preparation that were critical to effective deal making. The availability of significant equity and credit financing were important elements of many of the largest and most strategic M&A transactions undertaken in 2013. In several cases (notably Valeant, Empire and Chemtrade Logistics Income Fund), the announcement of M&A transactions was accompanied by impressive gains in the acquiror's stock price signaling the market's approval of strategic deal making. In many years, Canadian energy and mining deals rank among the largest deals, in terms of value, in international comparisons, however in 2013, Canadian retailing and healthcare deals ranked as the 11th and 13th largest worldwide deals.

The energy sector, typically a significant source of transactions, saw a dearth of M&A activity in 2013. Similarly, it was a year of low deal making activity in the Canadian mining industry. SOE investment in the energy sector, which, in 2012 accounted for almost $28 billion of activity, was almost completely absent in 2013 during which there were only two material SOE transactions worth approximately $1.5 billion in aggregate. The oil sands sector reported its lowest level of transactional activity in a decade while M&A activity in the broader energy sector was off by more than 80% compared to 2012. However, the fundamentals for the oil and gas sector appeared to be improving at year end as concerns about the pace of infrastructure development lessened somewhat in light of the approval of the Northern Gateway project and the advancement of Kinder Morgan's expansion of its TransMountain Pipeline system. Positive movement in public support for infrastructure projects and government's commitment to shorter timelines for regulatory approvals also contributed to increased optimism. There was also a sense that SOE investment in the oil & gas sector could rebound significantly in 2014 on an improving outlook for the development of a Canadian seaborne export market for domestic energy products and greater comfort with the Canadian regulatory environment for foreign direct investment in the resource sector.

After several years of stellar performance, the REIT market experienced some downward pressure at mid-year as concerns regarding future monetary policy resulted in a significant drop in the trading price of many REIT issuers, which in the case of some of the larger Canadian REITs had recovered somewhat by year end. Bright spots for the sector in 2013 included the successful REIT spin-offs by Loblaw and Canadian Tire. The REIT associated with Loblaw and Sobeys' sale of properties to Crombie REIT were important deal making elements for both the Loblaw/Shoppers and Sobeys/Safeway retail sector transactions.

Capital markets activity in the financial services sector was similarly subdued in 2013 as several financial institutions digested significant transactions from the prior year. It was a year of record earnings and the announcement or completion of significant changes in leadership at several of the biggest Canadian financial institutions.

Not surprisingly in a lacklustre capital market environment in Canada, investors sought other ways in which to maximize the value of their holdings. In this regard, 2013 saw activist investors continue to agitate for change at some of Canada's largest public companies – with mixed results. Representatives of activist investor Carl Icahn were added to the board of directors of Talisman Energy Inc., and partially in response to activist pressure, Tim Hortons Inc. took advantage of historically low interest rates to return capital to shareholders through share repurchases. However, Jana Partners was ultimately unsuccessful in seeking board representation at Agrium Inc. despite a costly proxy battle. At small to mid-sized businesses, the pace of activist activity continued at high levels, prompting several negotiated resolutions and proxy contests. The significant uptick in shareholder activism engendered both corporate and regulatory responses as boards sought protection against surprise attacks by activists, and securities regulatory authorities sought to implement changes intended to improve transparency and enhance shareholder rights.

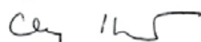
Weak capital markets in some sectors and the almost total absence of SOE investment in 2013 resulted in many companies looking at alternative options to fund growth and maximize shareholder value. Many domestic and foreign private equity firms sought to take advantage of this environment in order to build their funds and acquire significant positions in good Canadian companies. By some estimates, 2013 was the best year ever for fund raising by Canadian PE firms with more than $15 billion in new commitments being received. 2013 also saw significantly more PE investment in the Canadian oil and gas sector, and some observers believe that PE investment accounted for almost 25% of the new capital raised by the sector in the year. Venture capital was also another bright spot as there continued to be strong interest in Canadian technology companies culminating in a $165 million investment in HootSuite Media Inc., which represented the largest VC financing in Canadian history. Osler was lead counsel to HootSuite.

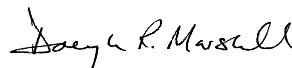
Financing and deal levels in the energy and mining sectors were sharply reduced and there were few signature transactions. Further, REIT and real estate sector activity levels were more restrained than in previous years notwithstanding a couple of high-profile REIT IPOs. However, debt financing was readily available and often in large amounts from single source lenders, and the availability of equity financing was an important element of several of the most noteworthy M&A transactions completed in the year.

In response to this dynamic capital market environment, we strove to align our service offering with our clients' changing needs. We increased our resources in private equity and corporate lending while successfully maintaining our longstanding leadership positions in M&A and Corporate Finance and our sectoral emphasis on Energy and Financial Institutions. We committed additional resources to further enhance our relationships with leading law firms in other countries to facilitate seamless international service to both their clients and our clients in light of increasing globalization. We continued to invest in improved matter management technology to enhance the efficiency of the delivery of our services as well as expanding our commitment to alternative fee arrangements to provide more cost-efficient resource use and appropriate sharing of risk with our clients. These initiatives underscore our commitment to provide our clients with the leading expertise in the areas and jurisdictions that matter most to their businesses and to be Canada's leading business law firm. Our involvement year over year and again in 2013 in a large number of the year's largest and most noteworthy transactions, coupled with the long term nature of many our client relationships, suggest we are on the right path.

As always, we continue to be grateful to our clients for the trust that you have placed in us. In particular, we were fortunate to help many longstanding clients with strategic and, in some cases, transformative transactions. We are also grateful for the outstanding opportunities provided to us by the underwriting community; we appreciate your confidence in our skills and service levels. We hope that you will find the following articles to be of interest and that our predictions for 2014 are not too far off the mark! Please do not hesitate to contact any of our legal professionals should you wish to discuss any of the articles in our 2014 Capital Markets Report.

We wish you all the best for 2014.

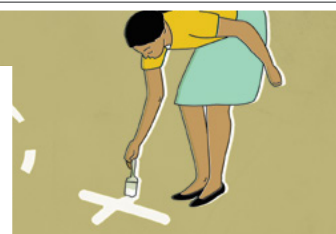




Clay Horner
Firm Co-Chair
Toronto
chorner@osler.com
416.862.6590

Frank J. Turner
Co-Chair, Corporate
Calgary
fturner@osler.com
403.260.7017

Douglas R. Marshall
Co-Chair, Corporate
Toronto
dmarshall@osler.com
416.862.4218



The Maturing Market for Shareholder Activism in Canada

by Andrew MacDougall & Noralee Bradley

Ongoing exposure to sophisticated shareholder activism in Canada is moving Canadian corporations to take a more proactive approach.

The Changed Landscape

Until recently, corporate Canada had little experience with proxy contests. Battles were few and principally resulted from a breakdown at the board level or between management and a substantial shareholder. This has changed. The emergence of tactical economic players, including well-financed players that can afford to take on some of Canada's largest companies, has led to increased activist activity and changes in company practice.

Corporate Canada now recognizes that shareholder activism has itself become a species of investment strategy in a diversified portfolio – and one that offers the hope of high short term performance to bolster portfolio returns during a period of economic uncertainty. And while large institutional investors in Canada may prefer to work behind the scenes to instigate change, they have demonstrated that in the right circumstances they will support someone else leading the charge.

The Rules They Are A-Changing

In response to pressure from both institutional shareholders and issuers, Canadian regulators are re-examining many of the rules and practices surrounding shareholder voting matters. The TSX now requires all listed issuers to provide shareholders with the ability to vote for individual directors rather than voting on a single slate, and to adopt a majority voting policy for the election of directors or explain why it has not done so. The Canadian Securities Administrators are considering whether to (i) reduce the threshold for triggering share ownership reporting requirements (from 10% to 5%) and expand the content of the report, (ii) make changes to the proxy voting infrastructure, and (iii) introduce guidelines for companies providing proxy voting advice.

Osler Comments *on The Maturing Market for Shareholder Activism in Canada.*

The increased number of proxy contests has spawned increased litigation. Results have generally favoured the corporation and its management and board, but not always. Every situation is dependent on the specific facts and circumstances. In favour of the corporation, courts have permitted:

- advance notice provisions for director elections;
- a company to disallow dissident votes where materially deficient disclosure was not corrected despite prompt notice of the deficiency; and
- a shareholder meeting to be held more than six months after receiving a shareholder requisition.

At the same time, in favour of dissident shareholders, courts have:

- declared a telephonic voting system used by a corporation to be deficient; and
- permitted a beneficial shareholder to requisition a shareholder meeting through an intermediary without providing the same information required from a registered shareholder.

Structural Responses to Activism

The initial reaction by Canadian corporations to the changed environment has been to consider the adoption of a range of structural defences to proxy contests, such as the following:

Advance Notice Provisions – A long-standing gap in structural defences in Canada compared to the U.S. has been the absence of company by-law provisions requiring advance notice to the corporation of any intention to propose nominees for director. Although a common U.S. practice, it was rare to find a Canadian company with such provisions. As a result, it has been possible for a dissident to propose director nominees with little or no notice to the corporation or other shareholders prior to the vote. This has changed. A large number of Canadian companies have now adopted such a provision and many more are in the process of doing so.

Enhanced Quorum Provisions – A smaller number of Canadian issuers have adopted an enhanced shareholder quorum provision that would increase the quorum requirement to a majority of the outstanding shares entitled to vote, in person or by proxy, for meetings at which shareholders

are being asked to vote on a contested matter, including but not limited to changes to board seats. Whether this will become a common practice in Canada is unclear, however, as ISS Canada has announced it will no longer explicitly recommend in favour of such provisions.

Prohibitions on Third Party Compensation Arrangements – Recent controversy over special compensation arrangements for director nominees of dissident shareholders has prompted issuers to adopt prohibitions against director compensation arrangements provided by third parties. While activist shareholders have justified such arrangements on the basis that it helps attract qualified director candidates and aligns their interests with the shareholders' interests, critics are concerned that such arrangements may adversely impact independence and lead both to fragmentation of the board and to excessive risk-taking. Even so, in the U.S., ISS has expressed concern about the broad scope of the wording of the prohibition and the possibility that it may result in the absence of highly qualified individuals and entrench the existing board and management.

Such measures will not, however, deter a serious shareholder activist. And there remain several features of Canadian law which provide structural advantages to activist shareholders including:

- the right to obtain the names and holdings of participants in the Canadian Depository for Securities and the names, addresses and holdings of beneficial owners in Canada who did not object to such information being provided without the consent or approval of the corporation;
- the ability to submit names of additional director nominees for shareholders to consider at the annual meeting, which the corporation must include in its proxy circular for the meeting;
- the ability to solicit proxies from up to 15 shareholders without complying with proxy solicitation rules;
- the ability to solicit proxies by public broadcast;
- the absence of a specific deadline prior to the meeting to commence a formal solicitation process; and
- the ability to requisition a special meeting of shareholders to replace directors.

Two further structural factors can work in favour of shareholder activists in Canada:

- share ownership reporting requirements are not triggered until a 10% threshold is reached (in the U.S. the threshold is 5%); and
- a shareholder rights plan that restricts the acquisition of a shareholding above a 20% limit can usually be successfully overturned after sufficient time has elapsed.

A Proactive Strategy

Strategic shareholder activists do their homework. They analyze the corporation's performance, strategy, capitalization, management and governance, assess alternatives and develop a plan they believe will increase returns to shareholders. They test their plan with larger investors and modify their approach accordingly. By the time the activist approaches management, they have a developed analysis, a sense of their support and a strategy for building further support through media relations and, if necessary, a proxy contest. Sophisticated companies are responding by taking a proactive approach.

A key starting point for management and boards is to seek advice from external legal and financial advisors on areas of potential vulnerability, and strive for an objective assessment of the corporation's strategy and plans, available alternatives and the reasons for not pursuing alternatives. Some corporations are actually conducting exercises with their management and boards and creating a game plan that can be implemented upon a first contact with an apparent activist shareholder – similar to planning exercises for unsolicited/hostile take-over bids.

Companies are also assessing their practices for communicating their strategy to investors, including, where appropriate, the reasons for not pursuing alternatives that an activist might propose. Clearly and consistently articulating the corporation's strategy and the rationale for pursuing that strategy can help build resiliency against criticism by an activist shareholder.

Shareholder engagement practices are also being re-examined, with companies gathering better information about the composition of their shareholder base and identifying more effective ways to engage with different classes of investors. Boards are considering ways to obtain more frequent feedback, and more independent sources of feedback, from investors on strategy and performance.

The activists' strategy of extensive advance planning, getting their message out front, reinforcing it frequently and modifying it as necessary has worked well. With a similar commitment to advance planning, a communications strategy, shareholder engagement and the right professional advice, corporations can reduce the likelihood of a proxy contest or increase the likelihood of success if a fight is unavoidable.

CONTRIBUTORS

Andrew MacDougall
Partner, Corporate
amacdougall@osler.com
416.862.4732

Noralee Bradley
Partner, Corporate
nbradley@osler.com
403.260.7002

The Year the Music Stopped – The Precipitous Decline in SOE Investment in Canada's Oil and Gas Sector in 2013

by Frank Turner & Peter Glossop

On December 7, 2012, Prime Minister Harper announced changes to the manner in which investments by state-owned enterprises (SOEs) in Canada would be reviewed under the *Investment Canada Act* (ICA), effectively raising the bar for such investments, as well as placing very significant limitations on acquisitions of control by SOEs of oil sands businesses.

In the wake of the Prime Minister's announcement, there was much speculation as to whether the new rules would have a chilling effect on SOE investment in the Canadian oil and gas sector and impede the growth of our domestic energy industry. As the year end approached, the answer to that question became crystal clear. SOE investment in the Canadian oil and gas sector was practically non-existent in 2013 and the industry generally experienced a shortage of new capital.

- Through to the end of the third quarter of 2013 there had been a single announced SOE deal in the Canadian oil and gas sector worth approximately $320 million, as compared to approximately $28 billion in transactions in the prior year.
- M&A activity in the Canadian energy sector generally was off more than 80% in 2013 as compared to 2012.
- Overall transactional activity in the oil sands in 2013 dropped to its lowest level in a decade.

Osler Represented

Talisman Energy Inc. *in connection with its $1.5 billion sale of British Columbia gas assets to Petroliam Nasional Berhad (PETRONAS)*

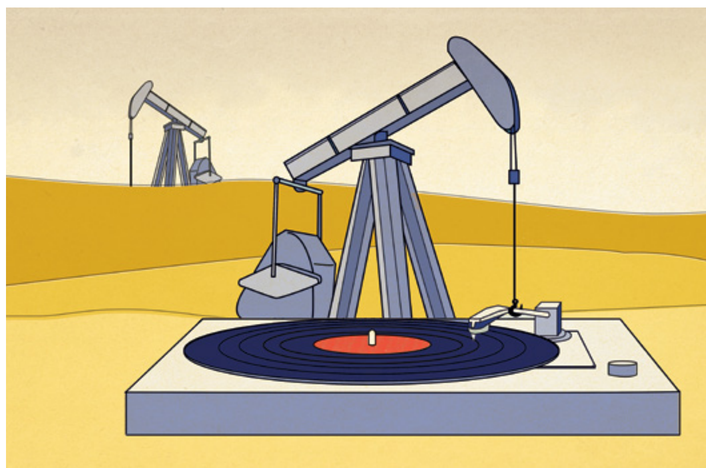
Canadian Pension Plan Investment Board *in connection with the acquisition of Progress Energy Resources Corp. by Petroliam Nasional Berhad (PETRONAS)*

The financial advisor to Nexen Inc. *in connection with its sale to China National Offshore Oil Corp. (CNOOC)*

China Investment Corporation *in connection with its investment in SouthGobi Resources Ltd.*

If the lack of SOE investment in Canada's oil and gas sector experienced in 2013 represents the new normal, it has very significant, and negative, consequences for the growth of our domestic energy industry, especially in respect of non-conventional resources, as well as Canada's ability to diversify its energy export markets by building a seaborne link to Asia.

We believe that uncertainty in the SOE community regarding the federal government's position on SOE investment in Canada is a significant factor in explaining the almost total absence of such investment in 2013. However, other factors, such as the slow pace of infrastructure development as a result of lengthy and controversial regulatory proceedings, and concerns regarding the prices that exported Canadian hydrocarbon products will receive in foreign markets are also relevant. In this paper, we examine some of the reasons underlying the precipitous decline in Asian SOE investment in the oil and gas sector in 2013 and provide our outlook as to what we can expect to see in 2014.



SOE Investment as a Catalyst to Growth in Canada's Non-Conventional Oil & Gas Sector

SOEs, especially those in Asia, have been significant investors in the Canadian non-conventional oil and gas sector, accounting for more than $50 billion of investment over the last 10 years. Over the last five years, foreign direct investment in Canadian energy projects by Asian SOEs has accounted for more than 25% of the total capital invested in those projects and the availability of such capital has been a material factor in the sector's impressive growth. Historically the oil sands have attracted the majority of Asian investment. More recently, there has been significant Asian investment in Canadian shale gas and related liquefied natural gas (LNG) projects.

With the aid of Asian investment, over the last 10 years domestic Canadian oil production has increased from 2.35 million to 3.25 million barrels per day. Approximately half of this increase is attributable to expanded production from non-conventional resources. Over the same period, Canadian oil reserves have increased from 4.9 billion barrels to 174 billion barrels, principally as a result of the recognition of reserves from non-conventional sources. Canada is now the sixth largest oil producer in the world with the third largest reserves.

Increasing Asian interest in non-conventional gas projects has, moreover, been a significant factor in the decision to proceed with these projects despite low North American gas prices. Such interest demonstrates growing international confidence that an LNG export market, via Canada's west coast, will develop. Nine western Canadian LNG projects, representing tens of billions of dollars in potential investment, have either commenced or been announced, and foreign SOEs and other foreign enterprises are participating in six of these projects. If a number of these projects were to be completed, Canada would become one of the world's leading gas producers.

Evolving Government Policy

The significant amount of Asian capital invested in Canada's non-conventional oil and gas sector is due in part to concerted efforts by the federal and western Canadian provincial governments to solicit such investment through a variety of trade missions and other trade initiatives including the entering into of a bilateral investment treaty with China in September of 2012 (which has not yet come into force). However, throughout the fall of 2012, it was evident that the federal government was reconsidering its policy on SOE investment in the resource sector. 2012 saw a rapid escalation of the pace of SOE investment in the non-conventional oil and gas sector (approximately $28 billion in 2012 compared to approximately $7 billion in 2011) and an apparent preference of Asian SOEs to seek control of the enterprises in which they were investing. Over this same period, there was growing concern among ordinary Canadians over losing domestic control over our natural resources. We believe these factors precipitated the government's announcement of the ICA rules regarding SOE investment in December of 2012.

The Conservative government, in announcing the SOE rules, attempted to ensure that Canada continued to be viewed as a jurisdiction that was welcoming of foreign investment. In this regard, the government noted the narrow application of the rules and expressly stated that SOE investments that did not amount to acquisitions of control would continue to be welcomed. Asian reaction to

Regulatory Developments

Update on amendments to the *Investment Canada Act*

The threshold for review of investments in 2014 under the ICA is expected to be $354 million of book value of assets of the Canadian business (compared to $344 million in 2013). The federal government has not yet brought into force the proposed higher threshold for review of investments by non-SOE investors. Under amendments to the ICA which are not yet in force, the threshold will increase in annual stages to $1 billion of enterprise value. However, the new threshold for certain non-SOE investors may simply rise to $1.5 billion when the proposed Canada-European Union free trade agreement comes into effect as a result of Canada's most-favoured nation trade commitments under other free trade agreements. Until the new threshold comes into force, investments in 2014 by both SOE and non-SOE investors will be reviewed at the same threshold of $354 million.

the Prime Minister's December 2012 announcement was initially positive, as it focused on the approval of CNOOC's acquisition of Nexen Inc. and the acquisition of Progress Energy Resources Corp. by Malaysian-based Petroliam Nasional Berhad (PETRONAS); however, it quickly turned negative. In commenting on the new SOE rules, Felix Chee, head of the Canadian branch of China Investment Corp., one of that country's largest SOEs and an active minority investor in Canadian resource companies, said the new rules could change the tone of business relations between Canada and China:

> This appears to be stringent. I am pleased to see the [Nexen and Progress] deals approved. But going forward one would expect Chinese companies to re-evaluate their investment plans in Canada to ensure they can still make desirable investments under the new rules.

Criticism of the SOE rules has typically focused on three themes:

- a view by Asian SOEs that they have been specifically targeted;
- a belief that the rules are intentionally ambiguous in order to allow an element of political discretion into the process; and
- observations that the pronouncement of the rules has created significant confusion with respect to the Canadian government's true position on foreign investment and appears to be at odds with earlier efforts by the Canadian government to attract such investment.

In discussing the effect of the new SOE rules, former Conservative Industry Minister Jim Prentice expressed his own reservations in October of 2013:

> Investment by Chinese SOEs in Canada's oil and gas sector… has now essentially stopped. To be sure, one factor is the confusion and diffidence surrounding Canada's ability to access international markets from the west coast. Another, however, is an environment of uncertainty regarding whether Canada really wants foreign investment in the energy sector.

Similarly, in commenting on the "drastic drop" in foreign M&A activity in the Canadian oil and gas sector in 2013, Alberta Premier Alison Redford publicly addressed the uncertainty created by the new SOE rules in November:

> There is too much uncertainty right now. This isn't just about state-owned enterprises in China. Unfortunately many of us who are looking to equity firms in different parts of the world have heard commentary that there's so much uncertainty right now with respect to the rules in Canada that it's giving them pause; sophisticated investors who understand that there's always going to be a little give and take. But the rules have been changing so quickly and so unilaterally in Canada for far too long.

The foregoing views are consistent with the experience of Canadian advisors who work with SOEs on investments and acquisitions in Canada. Many of these advisors have noted a significant uptick in concern among SOEs regarding their ability to have a deal approved by the Canadian regulatory authorities in light of the new rules and this has led to a reticence to transact.

It should be noted that the foregoing views are at odds with public statements made by the federal government that the SOE rules have not deterred investment in Canada by state-owned enterprises. For example, federal Natural Resources Minister, Joe Oliver, dismissed the notion that the SOE rules were creating a measure of uncertainty in October, 2013, following his return from a trade mission to China and South Korea:

> I didn't encounter any confusion about the rules; I wasn't asked for clarity. Nobody said to me directly or indirectly that the decline in SOE investment [in the Canadian energy sector] was the result of those rules… I certainly got no sense from anybody that they are turned off the prospect of investing in the Canadian industry.

Moreover, Prime Minister Harper has said publicly that the ambiguity embedded in the SOE rules reflects prudent policy:

> In my opinion, when you are dealing with large state investors, foreign governments as the investor, I think it would be foolish for the Canadian government to provide absolute clarity. It is absolutely necessary, when the investor is a foreign government, for the government of Canada to be able to exercise its discretion and have direct conversations with those foreign investors.

Other Factors

As set forth above, we view the uncertainty regarding Canada's receptiveness to SOE investment, especially in the resource sector, as a significant factor underlying the decline in such investment in 2013. However, there are clearly other reasons that have contributed to such decline including:

- concerns regarding the slow pace of construction of the infrastructure necessary to link western Canadian hydrocarbons to Asian markets, as a result of lengthy and controversial regulatory proceedings;
- uncertainty regarding the price that Canadian producers will receive for LNG products in Asian markets; and
- a sense that some Asian countries that have been significant acquirors of resource assets need a period of time to digest those acquisitions and perhaps divest under-performing assets or de-risk some of those investments by bringing in partners, prior to commencing a further acquisition program.

Concerns Regarding the Pace of Infrastructure Development and Pricing of Gas Exports

One of the drivers of SOE investment in the Canadian oil and gas sector has been a desire to secure a supply of hydrocarbon products for their home markets which are often high growth economies. However, transporting Canadian hydrocarbon products to Asia and other off-shore markets requires the construction of a comprehensive network of extraction and upgrading facilities, gathering systems, pipelines, LNG trains and ports, most of which has yet to be constructed or is in

the early phase of its development. Further, some announced projects, such as the Northern Gateway Pipeline, have encountered significant opposition from environmental and Aboriginal groups and this has resulted in delays in securing key regulatory approvals. At the same time, other energy producing nations, such as Australia, are much further advanced in developing an export market for their LNG products. There is concern that if a significant portion of announced LNG projects come on line, the global supply of gas will exceed total world demand by a significant margin, disadvantaging projects that are currently at an earlier stage of development. The foregoing has led to concern that Canada will miss its window of opportunity to develop its own seaborne LNG export market.

There is also uncertainty regarding the price that Canadian gas exports could obtain in Asian markets. The price of LNG in those markets has typically been linked to the price of oil which has resulted in prices in Asia for imported gas reaching $19.50 per Mcf as compared to $3.80 per Mcf in North American markets. In part, it is the significantly higher gas prices available in Asia that are fuelling the development of Canada's LNG industry. However, some LNG importers, such as Japan and India, have publicly said that it is "unreasonable" to maintain such linkage in a world flush with gas. Such pricing uncertainty creates issues as to the commercial viability of the LNG projects that have been proposed for Canada's west coast and acts as a further deterrent to investment therein.

Asian SOEs have been prodigious acquirors of oil and gas assets. Chinese companies have completed more than 80 transactions over the last five years. In 2012, Chinese buyers of oil and gas assets paid an average premium of 49% against an industry average of 31%. SOEs from South Korea and Malaysia have also been significant acquirors of Canadian oil and gas assets. Some observers have noted that it is likely that Asian SOEs will need to pause following a lengthy buying spree to digest what they have purchased, integrate the acquired assets into their national energy companies and generally "improve their competitiveness in the global energy market" prior to resuming the previous pace of acquisition. We also expect to see some divestitures of underperforming assets by SOEs and de-risking of significant acquisitions by bringing in partners.

Regulatory Developments

National security issues

On October 7, 2013, the federal government turned down Accelero Capital Holdings' proposed acquisition of the Allstream division of Manitoba Telecom Services Inc. (MTS) under the national security provisions of the ICA. The decision, which came more than four months after Accelero announced its proposed $520 million acquisition of Allstream, took the market by surprise. Other than noting that "MTS Allstream operates a national fibre optic network that provides critical telecommunications services to businesses and governments, including the Government of Canada" no reasons were given for the decision. While sending a strong signal that national security will be invoked to block a transaction, it should be appreciated that this is only the third transaction that the government has blocked under the ICA (outside the cultural area) since the legislation was enacted in 1985.

In addition, the governments of China and South Korea have both launched investigations into whether representatives of certain SOEs that completed significant foreign acquisitions, or their family members, personally benefitted from those transactions. Some commentators have suggested that these investigations could dampen the pace of further SOE foreign direct investment while they are ongoing.

Outlook for 2014

Notwithstanding the almost total lack of SOE investment in the Canadian oil and gas sector through the first three quarters of 2013, events occurring in the fourth quarter have provided some reason to be optimistic that SOE investment sentiment towards the sector is changing.

First, concerted efforts undertaken by the provincial governments of Alberta and British Columbia and the federal government to persuade Asian SOEs and other foreign investors that Canada continues to welcome their investment in the oil and gas sector appeared to be gaining some traction. In October, Alberta signed a framework agreement with China's National Energy Administration to give the province "unprecedented access" to Chinese decision makers. In commenting on the agreement, Alberta Energy Minister Ken Hughes said:

> In the eyes of China I believe we represent a tremendous supply of energy that they would be very pleased to have access to.

He further noted that the agreement:

> strengthened ties with what we believe will become one of our key markets for energy products.

B.C. Minister of Natural Gas Rich Coleman also reported receiving very positive reactions from potential Asian investors in west coast LNG projects

A number of Canadian oil sands producers struggled to attract additional funding in 2013 and several were forced to engage in strategic alternative processes at distressed valuations. The beneficiaries of this environment are multi-national enterprises, and not Canadian companies, who no longer need to compete for assets with SOEs. A competitive environment which includes multi-national enterprises, Canadian companies and SOEs gives assurance of a competitive landscape with effective Canadian participation. The federal government needs to explicitly encourage SOE participation to reverse an outcome which has clearly harmed Canadian participation.

Glen C. Schmidt
President & Chief Executive Officer
Laricina Energy Ltd.

following a B.C. trade mission to the region in November. This trip was one of a series of missions by BC officials to "further LNG prospects by strengthening the government's connection to key stakeholders in Asia."

In commenting on his discussions with such stakeholders, Mr. Coleman noted that: "[t]he buzz was that we were moving in the right direction."

Other notable developments in the fourth quarter included:

- public statements by representatives of the Chinese government that China was aiming to double the share of natural gas in its energy mix by 2020;
- the announcement by Malaysia's Prime Minister Mohd Najib of his government's intentions to spend $36 billion on the Pacific Northwest LNG facility proposed for the Prince Rupert area; and
- the announcement of the acquisition by Malaysian state-owned PETRONAS of $1.5 billion of natural gas holdings in the Montney region of British Columbia from Talisman Energy Inc., marking the first significant SOE investment in the Canadian oil and gas sector in 2013 despite PETRONAS' difficult approval process in 2012 when it acquired Progress Energy. Osler acted as lead counsel to Talisman.

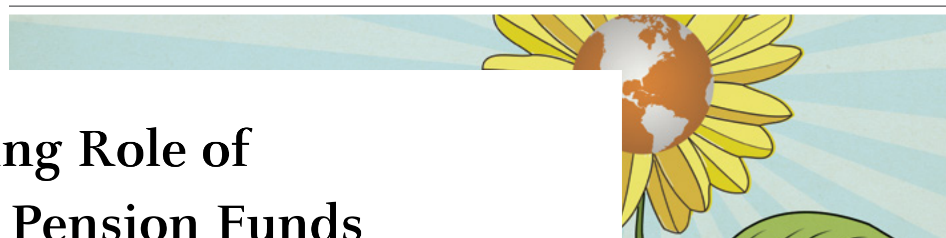
Further, concerns about the pace of infrastructure development appeared to be lessening somewhat at year-end in light of the approval of the Northern Gateway project and the advancement of Kinder Morgan's expansion of its TransMountain Pipeline system. Positive movement in public support for infrastructure projects and government's commitment to shorter timelines for regulatory approvals also contributed to increased optimism.

Accordingly, we believe that there is reason to be optimistic that there will be significantly more SOE investment in the Canadian oil and gas sector in 2014, albeit not at the levels seen in 2012. We also believe that there will be greater SOE interest in LNG and other non-conventional gas assets as opposed to other types of energy assets, and we expect that SOEs will pursue joint ventures with other parties in connection with such investments, or invest by way of a royalty purchase or through debt instruments, as opposed to seeking outright acquisitions of control of Canadian energy companies.

CONTRIBUTORS

Frank Turner
Partner, Corporate
fturner@osler.com
403.260.7017

Peter Glossop
Partner, Competition/ Antitrust
pglossop@osler.com
416.862.6554



The Leading Role of Canadian Pension Funds at Home and Abroad

by John Groenewegen & Steven Smith

Investment Activity in 2013: Canadian pension funds continued to be significant players on the global investment landscape in 2013. Pension funds participated in many of the year's most noteworthy transactions: the Alberta Investment Management Corporation (AIMCo) and the Ontario Municipal Employees System (OMERS) jointly acquired Vue Entertainment for $1.48 billion; the Ontario Teachers' Pension Plan (OTPP) provided equity financing to the Hudson's Bay Company for its US$2.9 billion acquisition of Saks Incorporated; and the Canada Pension Plan Investment Board (CPPIB), together with a large U.S. private equity fund, acquired upscale retailer Neiman Marcus for US$6 billion.

As a whole, Canadian pension funds continued to focus on alternative asset allocation as an investment strategy throughout 2013. Pension funds have increased their direct investments in private equity, infrastructure and real estate as they continue to seek to align fund investment horizons with their long-term liability profile and reap the rewards of higher returns. Preliminary results from an ongoing survey by global consultant Mercer LLC reveal that the percentage of Canadian pension funds investing in alternative investments climbed to 38% from 25% over the past three years and that the average allocation to alternatives has increased to 18% from 15% in 2010.[1] As their allocations to these areas have increased, Canadian pension funds have become highly visible in these markets. Smaller Canadian pension funds have also demonstrated an inclination towards alternative asset investing, guided by the expertise of Canadian pension consultants.

Osler Comments *on The Leading Role of Canadian Pension Funds at Home and Abroad*

1 According to Mercer's survey, real estate showed the largest gain, rising to 34% of the total alternatives asset mix from 13% in 2010, while infrastructure assets now account for 24%, up from 8% previously.

Leading the Way

The success of Canadian pension funds such as CPPIB, OMERS and OTPP has garnered worldwide attention and praise. Referred to as "Maple Revolutionaries" by *The Economist*, the Canadian funds have been recognized as rivals of Wall Street firms and are the envy of institutional investors.

Canadian pension funds have been very prominent internationally as they have continued to focus their investment strategies outside Canada in a significant way. For example, OTPP recently announced an agreement to acquire Burton's Biscuit Company, a major player in the UK biscuit market, and CPPIB announced its intended $480-million equity investment in Brazil's Aliansce Shopping Centers SA to pursue growth in the Brazilian retail sector. CPPIB also announced an alliance to acquire office buildings in major metropolitan areas in India.

The competitive edge of Canadian pension funds is largely attributable to their development of sophisticated internal management teams. This investment model has enabled them to compete directly with large alternative asset managers for investments. A primary driver for internalizing the asset management function is a reduction of fees paid to external managers. Smaller pension funds and pension funds outside Canada have taken note, and this emphasis on cost reduction by managing investments internally is a long-term trend that we see continuing.

Even with strong internal management capabilities, Canadian pension funds continue to invest through external managers in order to leverage their strategic relationships for co-investments and to further penetrate foreign markets. Canada's large pension plans are also expanding their international reach by opening foreign offices. Last year we saw the OPSEU Pension Trust (OPTrust) open an office in Sydney and OTPP now has an office in Hong Kong; CPPIB is reported to be opening offices in New York and Sao Paolo.

OPB's strategic asset allocation provides for a further shift away from public markets to private markets investments. Infrastructure has been and will continue to be a great addition to OPB's real asset class. We like the diversification aspect of infrastructure assets and their inflation-linked characteristics. In private equity we like the prospect of higher returns with much less volatility than has been experienced in public equities.

Jill Pepall
EVP and Chief Investment Officer,
Ontario Pension Board

The Year Ahead

We expect these long-term trends to continue into 2014 for Canadian pension funds. Large pension funds will continue to make opportunistic investments both at home and abroad. Pension

funds generally face less time pressure to put money to work as compared to private equity funds, and they enjoy longer investment horizons. Such flexibility enables pension funds to be more selective when making investment decisions.

We believe that large pension funds will continue to expand their international reach through increased deal flow in locations such as South America, Africa and Asia, places where they currently invest but have a less established presence. Domestic investment opportunities may be limited, but we expect Canadian pension funds to participate in infrastructure, real estate and select private equity transactions. If Canadian governments pursue a divestiture strategy, the subject of recurring discussions, we anticipate that Canadian pension funds will be active participants. We also anticipate a continued interest in the oil and gas sector. With regard to the smaller pension funds, we expect a broadening of the scope of their investment programs and a move further into alternative investment classes.

We will continue to track with interest the proposals regarding changes to the pension plan landscape such as expansion of the CPP, coined the "Big CPP"; the consolidation of pension plans in Ontario recommended in the 2012 report by special adviser Bill Morneau (the Morneau Report)[2] and the move to shared risk plans in certain jurisdictions; and the Ontario government's newly established technical working group to advise concerning the implementation of a new pooled asset management entity for public-sector single employer pension plans. Any such developments may impact the investment programs of these pension plans in terms of the size of investment, activity levels, a focus on alternative asset classes, the choice to build out internal teams and the move toward direct investments.

Overall, we foresee 2014 being another active year for Canadian pension funds on the investment front, both at home and abroad.

We founded our group at OP Trust in 2006 with the intention of building a global portfolio and now have investments in North and South America, Europe, China, and Southeast Asia. Some of our more noteworthy investments have been in the distressed area, especially in Europe. We recently opened an office in Sydney, to accompany our London and Toronto teams. We find Australia provides a conducive environment for domestic investing and also gives us exposure to the growth story in Asia, with less risk. As Canadians , we are proud of the leading role pension funds have played in diversifying Canada's global exposure.

John M. Walsh
Director, General Counsel
OPTrust Private Markets Group

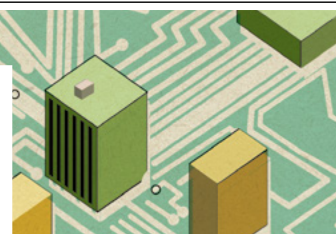
CONTRIBUTORS

John Groenewegen
Partner, Corporate
jgroenewegen@osler.com
416.862.6458

Steven Smith
Partner, Corporate
ssmith@osler.com
416.862.6547

2 The Morneau Report set out numerous recommendations intended to improve efficiencies in the investment management of public sector pension plans; most notably, the implementation of a pooled asset management framework.

Table of contents



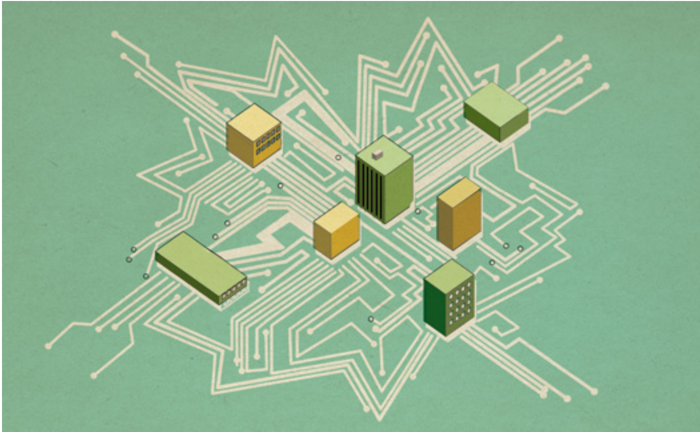
Canada's Technology Renaissance

by Chad Bayne, Geoff Taber & Craig Wright

Once upon a time, Canada had a vibrant technology sector anchored by household names like ATI, Creo, Cognos, Corel, JDS Fitel, Newbridge, Nortel and PMC. The bursting of the "dot.com" bubble signalled, in part, the end of an era for that sector of the Canadian business economy. Over time, these Canadian technology industry titans were acquired by foreign companies or were otherwise diminished.

Fortunately, the undeniable impact of Apple's incredible rebirth, Salesforce.com's meteoric rise, Google's continued success, recent IPOs (and strong commercial results) of social media heavyweights Facebook, Twitter and LinkedIn in the United States, together with the emergence of the next generation of U.S. technology upstarts such as Box, Uber, Palantir and Square and the general appetite of the U.S. capital markets for more technology company IPOs, have helped to create a renewed interest in this sector in Canada. Even in a world that features the demise of Nortel and the ongoing BlackBerry saga, the Canadian technology landscape has witnessed a significant transformation over the last three years and, with the emergence of a new generation of exciting companies, we are ready for a new "golden age."

For many in the industry, October 2011 marked an inflection point. OMERS, one of Canada's largest pension plans, launched its own venture capital arm – OMERS Ventures – to address one of the largest issues plaguing Canada's venture capital industry – a shortage of steady and patient capital, especially for companies requiring larger amounts of growth capital. Prior to OMERS Ventures, Canadian growth-stage technology companies typically had to seek expansion round/growth funding from foreign investors (predominantly in the United States, which often led to the company moving south) or consider a sale as the only other viable alternative. Since its inception, OMERS Ventures has completed almost one investment per month and has been involved in some of the largest venture capital investments made in software companies in Canadian history, including the $80-million investment (teaming with NEA) in Kitchener-Waterloo's Desire2Learn and the $165-million investment (teaming with Insight and Accel) in Vancouver's HootSuite.



The path to prosperity in Canada involves building a long-term, sustainable knowledge economy. Our innovators and entrepreneurs can hold their own globally, our real challenge is to give them the support they need to create the world-class companies of tomorrow. We were delighted to recently partner with Ontario Centres of Excellence as co-founders and Ryerson University as founding academic partner of OneEleven, a community of promising data-driven entrepreneurs in what we hope will become the home to Toronto's best technology startups. OneEleven's culture of collaboration, combining academic-based research and entrepreneurship, will help bridge the commercialization gap and create scalable entrepreneurial opportunities using highly complex, data driven, high power computing. It is a very exciting and important step in nurturing great companies and entrepreneurs, and we are pleased that Osler has joined us in support of this project.

John Ruffolo,
CEO, OMERS Ventures

Trying to emulate the success of U.S.-based technology accelerators such as Y Combinator and Techstars, Canada has seen a proliferation of accelerators from coast to coast – most notably Extreme Startups in Toronto, GrowLab in Vancouver, FounderFuel in Montreal and Hyperdrive in Kitchener-Waterloo. In each case, the accelerator provides office space, mentorship and a small amount of seed capital. In addition, the Business Development Bank of Canada provides further funding to each successful accelerator graduate in the form a $150,000 convertible note.

The federal government has demonstrated its strong commitment to the sector by announcing (as part of the 2012 budget) that it would set aside $400 million for investment in Canadian venture capital funds. The Ontario government demonstrated a similar commitment by announcing in March 2013 that it would set aside $50 million for a new Ontario venture capital fund. In addition, the Ontario government continues to be an active direct investor through initiatives such as the Ontario Capital Growth Corporation (which matches investments made by qualified investors) and MaRS Innovation Accelerator Fund (which provides seed investments of up to $500,000 to promising Ontario-based start-ups).

Canadian universities have also been active contributors to Canada's technology renaissance. The Next 36, which was developed in conjunction with the University of Toronto's School of Continuing Studies, has built a program that is designed to nurture and foster the next generation of Canadian entrepreneurs. The program is currently working with its fourth cohort and companies such as Kira Talent, Seamless Mobile + Health and Bridgit have emerged as viable businesses that are winning customers and have completed seed investment rounds. Professor Ajay Agrawal, at the Rotman School of Business, led the Rotman efforts to create the Creative Destruction Lab to facilitate the growth and

creation of massively-scalable technology-based companies that are based on technology developed within the Canadian university community, many of which (including Thalmic Labs, Bionym and Weston Expressions) have closed seed finance rounds since (or in some cases during) participation in the program. Similarly, the University of Waterloo established VeloCity to foster entrepreneurship with its students by providing seed funding, free workspace, workshops, networking opportunities and access to mentors. Kik Interactive, one of the world's largest electronic messaging services with approximately 100 million users, and BufferBox, which was sold to Google in late 2012 after being in business for only 18 months, are both "graduates" of that program.

All of this activity is starting to show up in Canadian venture capital data; the Canadian Venture Capital & Private Equity Association reported that Q3'13 was the strongest quarter in six years for the amount of money invested.

In addition, the Canadian capital markets, which for many years had largely ignored the technology sector in favour of resource issuers or yield investments, have followed the U.S. lead and are now more receptive to technology company public offerings. Ottawa-based Halogen, a SaaS-based talent management solutions provider, completed a $63-million IPO in May 2013 and followed it up with a $24-million bought deal secondary offering only four months later. ViXS Systems, a Toronto-based semiconductor company, raised $50 million in connection with its "going public" transaction by way of a reverse take-over of a capital pool company directly onto the TSX (rather than the TSX-V). And in November, Baylin Technologies, a provider of innovative antenna solutions, completed a $50-million IPO on the TSX. A number of additional technology companies have been watching closely and we expect that 2014 will be a banner year for Canadian tech IPOs.

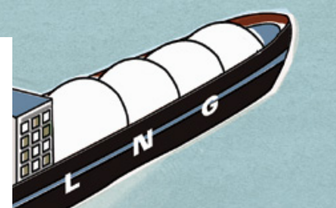
The sector's prospects have never been better. With the next generation of household names, such as HootSuite, Bionym, Builddirect, Desire2Learn, FreshBooks, Real Matters, Shopify, Thalmic, Verifyn, Vision Critical, Wattpad and Wishabi, among others, rapidly gaining prominence, the Canadian technology sector is once again well-positioned to succeed on the global stage.

CONTRIBUTORS

Chad Bayne
Partner, Corporate
cbayne@osler.com
416.862.4708

Geoff Taber
Partner, Corporate
gtaber@osler.com
416.862.6614

Craig Wright
Partner, Corporate
cwright@osler.com
613.787.1035



Developments in Canada's Burgeoning LNG Export Industry

by Janice Buckingham & Paula Olexiuk

What a difference a year can make. If the narrowing window of opportunity for capturing the Asian liquefied natural gas (LNG) export market means Canada's west coast LNG projects have "come late to the party",[1] project proponents are working around the clock to catch up and secure what is anticipated to be a lucrative and highly sought after share of the Asian LNG export market.

The proposed western Canadian LNG export industry has doubled in 2013, in both the number of projects and volume of gas sought for export. In 2012, there were five projects proposed for export from B.C., targeting aggregate volumes for export of 77.08 mtpa and by the end of 2013, another four projects sited in B.C. sought export licences for an additional 58.4 mtpa, bringing the aggregate volume of LNG proposed for export from B.C. to 135.48 mtpa. Export licences have been granted by the National Energy Board (NEB) for seven of the nine projects or 109.18 mtpa.[2]

Two other projects have also sought export licences from the NEB for a further 19 mtpa: one sourcing imported U.S. gas to be liquefied and exported from Goldboro, Nova Scotia, and the other sourcing gas from the western Canadian sedimentary basin for export to the U.S. and further liquefaction and export from Coos Bay, Oregon.

Can the size of B.C.'s vast shale gas supply match the intended markets demand for additional energy in targeted markets? There is little doubt that it could, if that were only the question. LNG exports from the west coast are competing primarily for markets in China, Korea and Japan while exports

Osler Represented

Talisman Energy Inc. *in its agreement to sell part of its Montney Shale gas position in NE B.C. to Progress Energy Canada Ltd. for $1.5 billion*

Apache Canada Ltd. *and* **Chevron Canada Corp.** *in various aspects of Kitimat LNG projects*

1 Pawel Mirski and Len Coad, "Managing Expectations, Assessing the Potential of B.C.'s Liquid Natural Gas Industry", Canada West Foundation, October 2013, p. 1.

2 See the table at the end of this article identifying the planned projects that have sought NEB export licences.

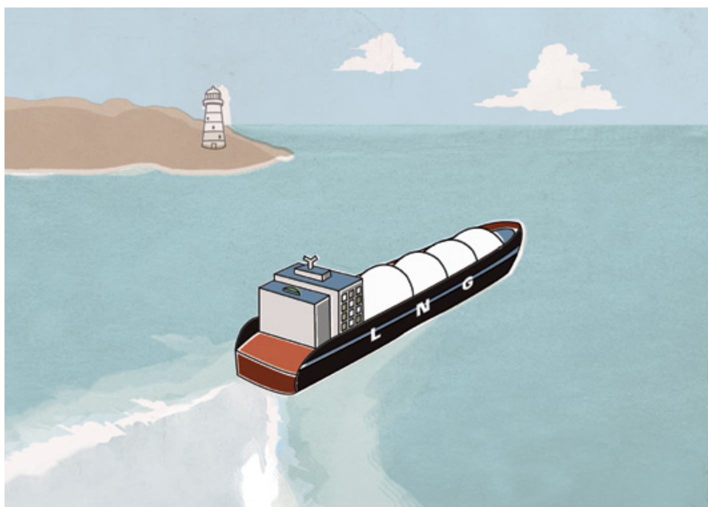
from the east coast are destined for delivery to the western European market. China is said to be planning to add five LNG receiving terminals by 2015, doubling its total capacity to 35-40 mtpa. Japan, as one of the world's largest importers of LNG, is still striving to replace the loss of its nuclear power and needs to secure long-term contracts from a stable energy supply source at competitive prices.

However, there is reason to exercise caution when anticipating demand:

> Between 2013 and 2025, Asian natural gas demand is projected to increase by 216 billion cubic metres per year. Traditional LNG suppliers to Asia currently have 96.9 bcm/year of capacity under construction, 90.1 bcm/year of capacity that has completed front-end engineering and design (FEED),and 81.9 bcm/year of capacity that has been announced. If all of this proceeds, it adds up to 268.9 bcm/year – 52.9 bcm/year more than anticipated market growth in Asia.[3]

These are sobering statistics for an industry still undergoing FEED, yet determined to supply such market.

The staggering growth in both LNG demand and proposed export capacity from Canada has occurred despite significant competitive pressure on multiple fronts, and that pressure is mounting for those in the race to be the first to declare final investment decision (FID). 2014 looms prominently as the year in which such decisions may be made by proponents of the more advanced projects. Decisions to proceed must take into account a number of key considerations: (i) significant global market pressures to secure the available projected Asian market growth; (ii) the B.C. government's political expectations for a $100 billion industry; (iii) growing environmental activism in the province against regulators and companies; (iv) a complex and multi-faceted provincial and federal regulatory regime governing approval and construction of such projects; (v) long-term price negotiations aimed at links to U.S. Henry Hub pricing rather than international crude oil prices; (vi) extensive consultations with First Nations to address potentially adverse impacts to traditional lands caused by such projects; (vii) competition for skilled labour; and (viii) an as yet uncertain export tax regime.



Based on lessons learned from mega-project development in other Canadian industries such as the oil sands and from LNG project development in other jurisdictions such as Australia, balancing schedule demands and goals against budgetary constraints will be of critical importance for the

3 *Supra*, note 1.

successful development of LNG projects in Canada. As some projects move beyond feasibility analysis into the detailed engineering and design and construction phases of development, competition for the skilled labour and resources needed for these mega-projects and the corresponding development of the natural gas reserves and pipelines and supporting infrastructure to feed such projects is also intensifying. Concerns and risks around labour and resource shortages and resulting schedule delays, cost escalation and overruns are being magnified by growing competition locally, in the U.S. and internationally in the LNG industry.

Given the relative infancy of the LNG industry in Canada, Canadian project proponents must seek out and compete for LNG expertise across the globe, while at the same time meeting local and First Nations content and employment targets and commitments that apply to their projects. Managing costs and schedules, while also meeting such commitments and addressing the challenges of constructing in remote locations with limited infrastructure and power supply, are key challenges for Canadian developers as these projects progress from the conceptual stage toward commercial reality.

Securing transportation routes and rights to connect reserves to facilities was also a focal point in 2013. TransCanada Corp. was selected by both Pacific NorthWest LNG to build the Prince Rupert Gas Transmission Project (an extension of the NGTL system) carrying natural gas to Lelu Island, and by Shell to build the Coastal Gas Link carrying natural gas to Kitimat.

LNG fuelling stations even became part of the country's proposed LNG story when ENN Canada Corp., a subsidiary of a large natural gas distributor in China, and Ferus Natural Gas Fuels announced a joint venture to build plants and fuelling stations around such plants.

Powering the plethora of LNG facilities remains an issue which the provincial hydro authority has not yet fully resolved. BC Hydro's long-term plan released November 26, 2013 offers 3,000 gigawatt hours of power for the entire LNG sector when a single plant can require 7,000 gigawatt hours to process natural gas into LNG.[4] Gas turbine drives appear to be many proponents' preferred power option given their widespread global use and success in operating LNG projects.

Announcement of the long awaited B.C. government's LNG export tax originally scheduled for November 2013, then by the end of December, has now been postponed to February 2014. There is little doubt that the uncertainty over such fiscal terms has negatively impacted the timing of proponents' final investment decisions. When coupled with the difficulty in securing long-term oil-indexed pricing, the competing brownfield projects from the U.S. west coast which are prepared to accept a more North American approach to pricing have an advantage.

4 N. Vanderklippe, J. Hunter, "LNG claim contradicted; Premier promotes clean liquefied natural gas, but production could boost greenhouse gas emissions", November 28, 2013, *The Globe and Mail*.

Market pressures increased again toward the end of 2013 as Japan and India jointly announced that oil-linked prices for LNG do not accurately reflect the LNG supply and demand balance in Asia-Pacific markets, and so they have agreed to form a buyers' group for LNG designed to reduce the Asian premium. Japanese utilities affected by the Fukushima incident are being "encouraged to negotiate LNG prices to be equal to or lower than the previous deal before they can pass on higher fuel costs to their power consumers."[5] The LNG contracts entered into by Japan in the 1970s and 1980s are also expiring, and faced with renegotiating term contracts or locating shorter-term supply, some Japanese firms are acquiring equity stakes in shale gas exploration projects linked to export facilities in order to guarantee future supply. Japan Oil, Gas and Metals National Corporation (JOGMEC) also announced that it will guarantee 75% of the bank loans to Japanese companies involved in developing LNG projects that help reduce Japan's import fuel cost.[6]

As the Canadian industry ramps up for FID, proponents also cannot ignore the increasing importance placed on having a social licence to operate large scale projects in addition to the requisite regulatory approvals. Companies succeeding on this front are getting out ahead of the issues, increasing local visibility in the communities impacted by such projects, and improving energy literacy in general. However, such actions do not guarantee immunity for the industry or the regulators, as the BC Oil and Gas Commission (BC OGC) witnessed recently. A coalition of environmental groups took the BC OGC to court in mid November 2013 allegedly for allowing oil and gas companies to withdraw large quantities of water for fracking operations under repeated short-term water permits, claiming a violation of the provincial water act.

Given the timing advantage that Australian projects have in being much closer to completion than the B.C. projects, the pricing formula that certain U.S. projects (Sabine Pass) are prepared to accept (which the B.C. projects cannot afford to accept), the tremendous cost to develop shale gas reserves and construct new pipelines to bring the gas to tidewater and liquefy it for export, the uncertainty created by the B.C. government's delayed export tax announcement, plus the growing alternatives that China has to expand its sources of natural gas supply (domestically and via increased pipeline capacity), Canada's LNG export industry requires the strength of its proponents' convictions as well as their global expertise.

As to what 2014 might bring, industry watchdogs are writing cautionary reports reminding industry, the B.C. government and the public that swift action is needed to secure Canada's competitive advantage, without losing sight of the risks facing the industry.[7] Canada can, and should, be a global player on the LNG stage. Whether it achieves that through a few or numerous projects remains to be seen, however. What is becoming clearer is that consolidation is likely to occur at some level especially if shortages of labour and resources affecting completion of these projects develop as proponents fear.

5 PFC Energy, "Japan Energy Profile: World's Largest Liquefied Natural Gas Importer – Analysis", 30 October 2013.

6 Ibid.

7 *Supra*, note 1.

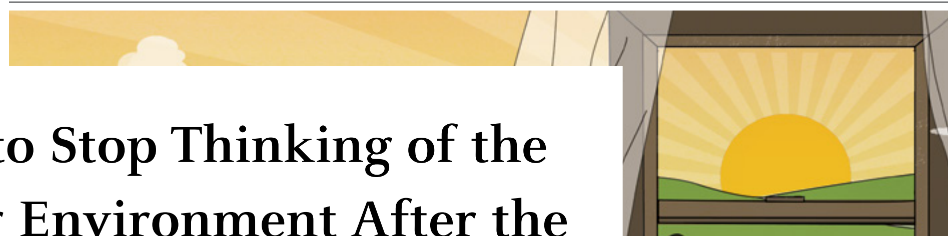
Proposed Natural Gas Liquefaction Export Projects

Planned B.C. Export Terminal Proponents (Participants)	Status of NEB Export Licence	Liquefaction Capacity (MTPA)
BC LNG Export Co-operative LLC (Douglas Channel Energy Partnership, (Golar, Haisla, LNG Partners)	20 yr licence approved	1.8
Kitimat LNG (Apache,Chevron)	20 yr licence approved	10.0
Pacific Northwest LNG (PETRONAS, Japex; PetroleumBRUNEI)	25 yr licence approved	19.68
LNG Canada Development Inc. (Shell, CNPC, Kogas, Mitsubishi)	25 yr licence approved	24
WCC LNG Ltd. (Imperial /ExxonMobil)	25 yr licence approved	30
Prince Rupert LNG Exports Limited (BG/Spectra)	25 yr licence approved	21.6
Woodfibre LNG Export Pte. Ltd.	25 yr licence approved	2.1
Triton LNG Limited Partnership (Altagas/Idemitsu)	25 yr application under review	2.3
Aurora Liquefied Natural Gas Ltd. (CNOOC/Nexen, Inpex and JGC)	25 yr application under review	24
Sub Total		**135.48**
Other Planned LNG Exports		
Veresen – Jordan Cove (export to U.S. for further export from Coos Bay, Oregon)	25 yr application under review	9
Pieridae Energy Ltd. (Goldboro LNG Limited Partnership) (export from Nova Scotia)	20 yr application under review	10

CONTRIBUTORS

Janice Buckingham
Partner, Corporate
jbuckingham@osler.com
403.260.7006

Paula Olexiuk
Partner, Corporate
polexiuk@osler.com
403.260.7080



It's Time to Stop Thinking of the Financing Environment After the Global Financial Crisis as the *New* Normal (It's Just Normal)

by Desmond Lee & Michael Innes

Slow economic growth, weak metals prices and a little bit of REIT fatigue – all part of the current financing landscape in Canada. Although equity offerings did not keep pace with the brisk activity levels we saw in the United States, 2013 was a fairly typical year in Canada in terms of overall equity financing activity and was another strong year for debt offerings. Expect more of the same this year unless we see higher-than-expected economic growth.

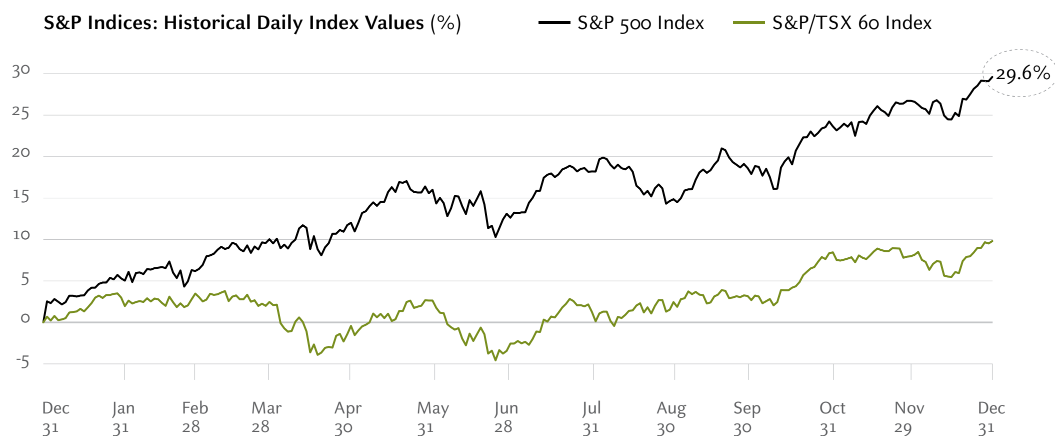
Osler Comments *on It's Time to Stop Thinking of the Financing Environment After the Global Financial Crisis as the* New *Normal (It's Just Normal)*

Equity Capital Markets

Canadian Equity Markets Up Overall, but Lag the United States

U.S. equities had a banner year thanks to favourable economic and market conditions, propelling both the S&P 500 and Dow Jones to all time highs in 2013. Strong equity market performance drove transaction activity in the U.S., which saw 222 IPOs completed in 2013 – the highest number since the height of the technology boom in 2000.

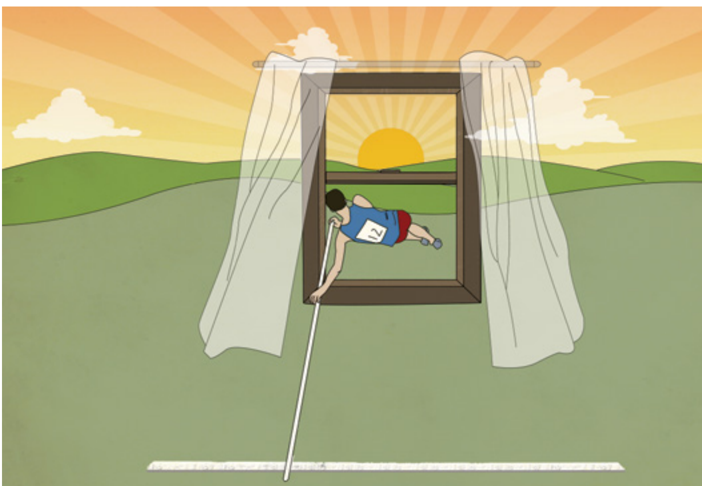
S&P Indices: Historical Daily Index Values (%)



Source: S&P Dow Jones Indices LLC, a part of McGraw Hill Financial. One-year return is as of December 31, 2013.

The underperformance of Canadian equities relative to U.S. equities became more pronounced in 2013, with the one-year return for the S&P 500 ending the year up close to 30% – almost triple the return of the S&P/TSX 60 and S&P/TSX composite indices over the same period and the highest single year return for the S&P 500 since 1997.

The Canadian IPO market did not benefit from the favourable market sentiment seen in the U.S. and did not come close to matching the strength of the U.S. IPO market, even on a relative basis. Nineteen IPOs were completed in Canada in 2013,[1] which was up over the 14 transactions completed in 2012 but still less than half the number in 2007. As in recent years, market conditions in Canada were inconsistent and remained challenging for many issuers. In some cases it was a buyer's market, with issuers having to entertain changes to price, offering size or deal terms in order for transactions to be completed. This, however, should be viewed as perfectly normal except perhaps during the middle of a bull market or frenzy for a particular product (such as income trusts in the early to mid-2000s or REITs in the past few years). It has become easy to blame the global financial crisis and the European and U.S. economic events that followed for what should be viewed as normal market risk.



For many smaller issuers, the keys to completion in difficult market conditions were flexibility, determination and an open mind. Once again we saw issuers deal with market risk by pursuing

1 Includes the IPO of Pattern Energy Group Inc., a Delaware corporation listed on the TSX.

alternatives to the conventional IPO that sought to split the processes of going public and capital raising. These strategies were used in a number of industry sectors, including real estate (PRO REIT), technology (ViXS Systems Inc.) and oil and gas (Caracal Energy Inc.).

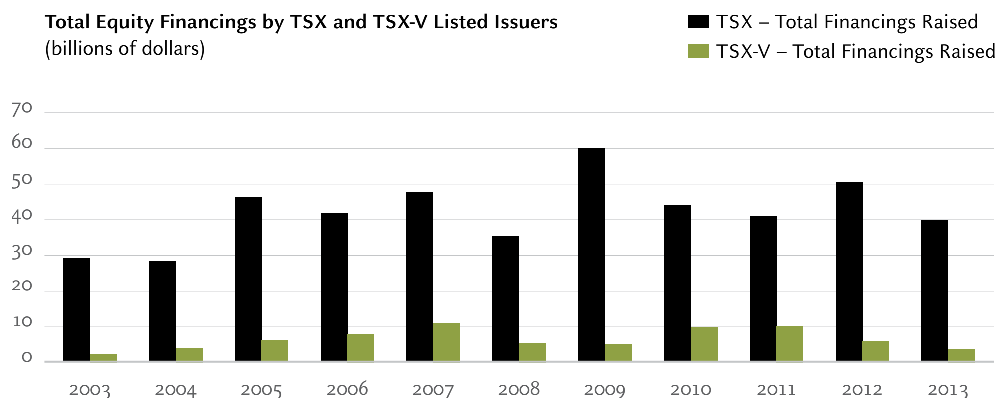
Equity Financing Down in 2013

Total equity financing activity in Canada was down in 2013 compared with 2012, although not as much as it may have seemed to issuers and their advisors. Equity offering proceeds decreased by about 23%, while equity transaction volumes fell by about 15% compared with 2012. This, combined with continued weakness in the mining sector and a substantial slowdown in equity offerings by REITs, made 2013 feel at best like a mixed year for equity financing activity in Canada, with a number of high-profile and well-received offerings taking place alongside many less-successful ones. On the positive side, we saw increased investor interest in industries outside the real estate, oil and gas, mining and energy sectors, with several successful IPOs and follow-on offerings by issuers in the technology, consumer and diversified industries.

Equity Financing Activity Consistent Over the Longer Term

Despite the perception that market conditions have been difficult since the onset of the global financial crisis, it is important to put the experience of the past few years in context. Looking back over a 10-year period, equity financing activity in Canada has been remarkably consistent.

Total Equity Financings by TSX and TSX-V Listed Issuers
(billions of dollars)

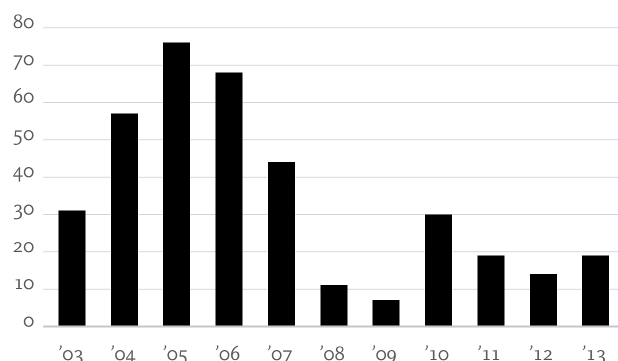


Source: TMX Group Equity Financing Statistics. Includes proceeds from both IPOs and follow-on offerings, whether on a treasury or secondary basis.

Total equity offering proceeds for TSX-listed companies from 2003 to 2013 averaged just over $40 billion per year and exceeded this average in seven of the last ten years. Even in the midst of the global financial crisis in 2008, total proceeds for TSX-listed companies were still above $35 billion. This was followed by a record-breaking

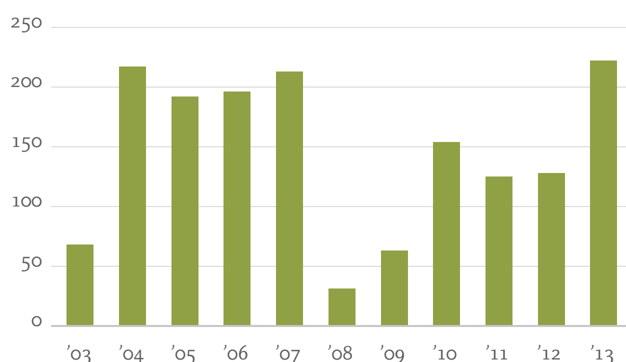
year in 2009, where total proceeds reached $60 billion on the strength of high gold and commodity prices and capital raising activity by banks and other financial institutions. These data show that activity levels since 2008 compare favourably with those seen in the pre-crisis period.

Canadian Completed IPOs
(number of transactions)



Source: FPInfomart. Includes marketed IPOs over $10 million in offering size involving either a TSX or TSX-V listing. Excludes CPC transactions and investment funds.

U.S. Completed IPOs
(number of transactions)



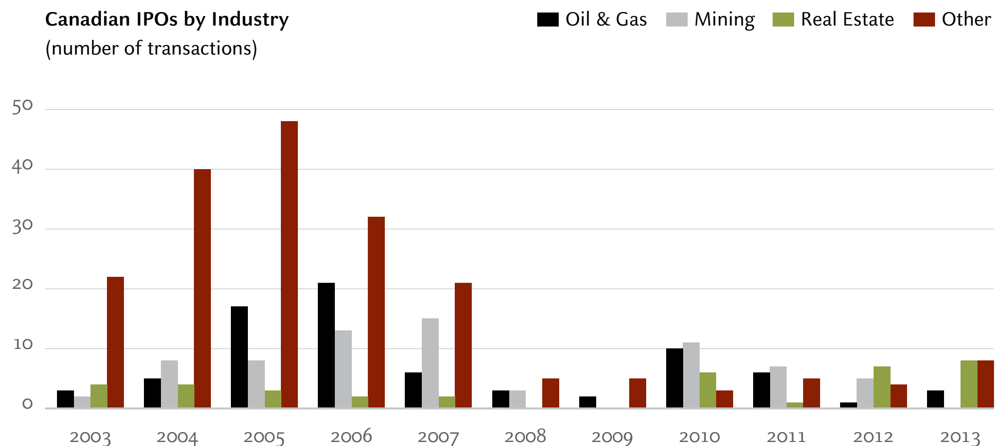
Source: IPO investment firm Renaissance Capital (www.renaissancecapital.com). Excludes SPACs, closed-end funds and trusts.

What is a Normal Market for IPOs in Canada?

Looking at Canadian IPOs over the same 10-year period, it would be easy to conclude that transaction volumes are significantly off compared with the years prior to the financial crisis. While this may be true, this overlooks the fact that the pre-crisis period saw IPO volumes that were well above historical averages in Canada due to the large number of income trust issuers coming to market at the time.

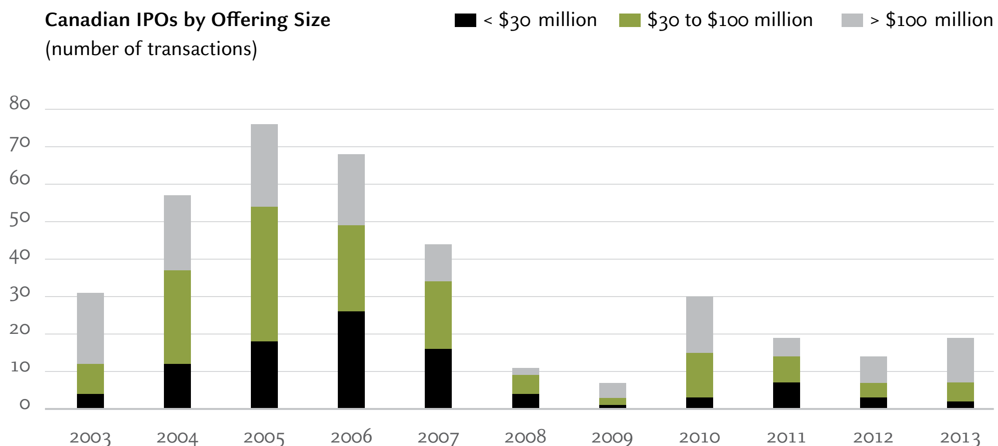
IPO volume in the U.S. prior to 2008 was fairly steady – hovering around 200 completed transactions per year – and then fell off significantly with the onset of the financial crisis in 2008. IPO activity then rebounded in the United States and may well have hit the 200 transaction mark in 2011 or 2012 were it not for the European economic crisis and the U.S. fiscal situation.

Why has IPO activity followed such a different pattern in Canada? We believe the main reason is due to the distorting effect of the income trust boom in the years leading up to the financial crisis. During this period, high transaction volumes were not an indicator of investor demand for IPOs so much as they were for tax-efficient, yield-driven products. The number of IPOs in Canada peaked in 2005 and then decreased with the Canadian federal government's announcement of the Specified Investment Flow-Through (SIFT) tax on income trusts in late 2006. Activity levels had already tapered off by the time of the onset of the financial crisis, suggesting that 2007 may be more indicative of actual IPO capacity in Canada than the prior years.



Source: FPInfomart. Includes marketed IPOs over $10 million in offering size involving either a TSX or TSX-V listing. Excludes CPC transactions and investment funds.

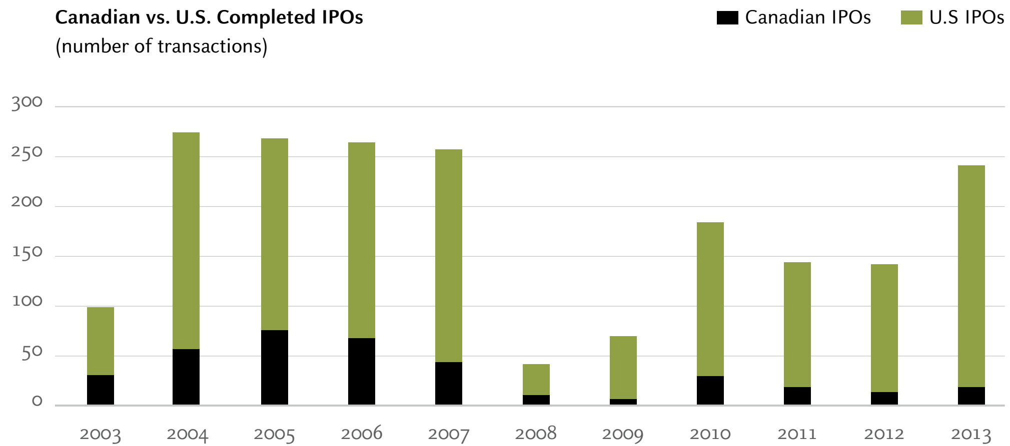
Income trusts made up the bulk of IPOs by issuers in the "other" industry category during the 2003 to 2006 period. During the same period, there was a significant increase in small and mid-sized IPOs.



Source: FPInfomart. Includes marketed IPOs over $10 million in offering size involving either a TSX or TSX-V listing. Excludes CPC transactions and investment funds.

We believe the past four years are a better indication of the natural demand for IPOs in Canada – a "normal" market, in other words – of around 20 transactions per year on average, or about one-tenth the number of completed U.S. IPOs in 2013. While we may someday see IPOs exceed the 44-transaction mark set in 2007, we think a number between 20 and 30 transactions per year is more realistic in the near term.

Canadian vs. U.S. Completed IPOs
(number of transactions)

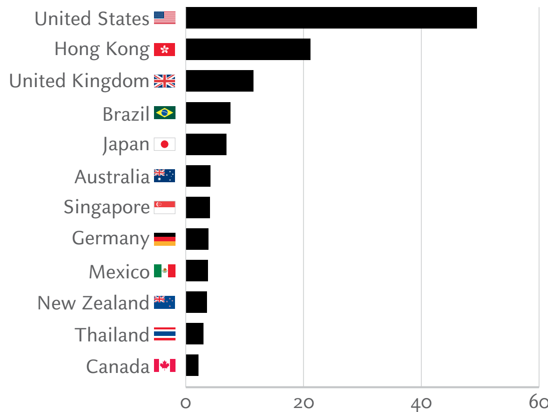


Sources: FPInfomart and IPO investment firm Renaissance Capital (www.renaissancecapital.com). Canadian transactions include marketed IPOs over $10 million in offering size involving either a TSX or TSX-V listing, and exclude CPC transactions and investment funds. U.S. transactions exclude SPACs, closed-end funds and trusts.

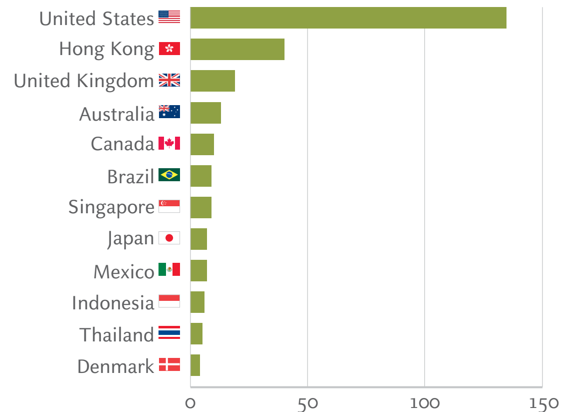
How Does Canada Compare as a Global IPO Market?

Relative to other markets, it is clear that Canada remains a mid-sized market, still largely dependent on mining and oil and gas issuers to drive IPO activity. In 2013, with no transactions by new mining issuers and only two by oil and gas issuers, Canada ranked 12th as a market measured by total IPO proceeds raised. Measured by deal count, Canada ranked 5th (behind the United States, Hong Kong, the United Kingdom and Australia), with transaction volume being approximately half that of the United Kingdom, a quarter that of Hong Kong and less than a tenth of total volume in the U.S.

Global IPO Race
(volume US$ billion)



Global IPO Race
(number of transactions)



Source: IPO investment firm Renaissance Capital (www.renaissancecapital.com). Includes all IPOs that raise over US$100 million.

Outlook for 2014

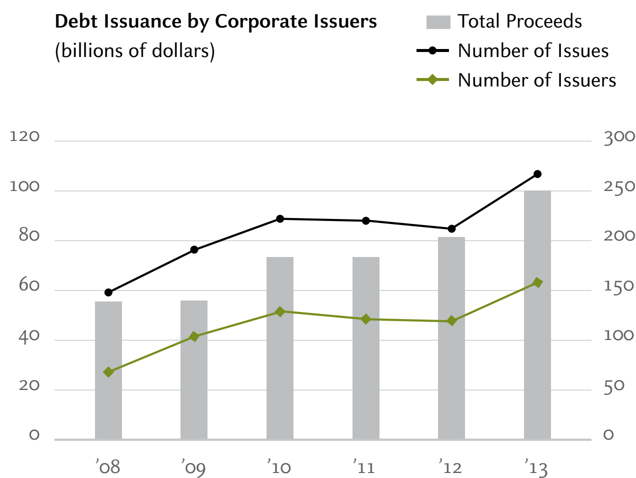
We expect that activity levels in Canada will improve somewhat in 2014, although we do not expect a substantial increase in IPOs or follow-on transactions absent higher-than-expected economic growth or commodity prices. In addition to seeing some positive signs for an improving economy, we believe many issuers will be more accepting of current market prices and will return to the markets after having sat on the sidelines for all or part of 2013. This will be the case particularly for REITs and, potentially, issuers in the mining sector that may be running short on alternatives.

Debt Capital Markets

Low Interest Rate Environment Continues

The Canadian debt markets in 2013 carried on where they left off in 2012. A historically low-interest-rate environment, combined with a lessening of concerns over imminent rate hikes by central banks, led to very strong issuance volumes. As in previous years, market windows were erratic and opportunity-driven, but an increase in issuance volumes year over year confirmed that demand for credit remains strong.

Earlier in the year we saw a rush to issue over concern that the Bank of Canada and other central banks would raise benchmark interest rates, only to see another rush to issue once the fear of increased rates subsided.



Source: FPInfomart. Excludes municipalities, governments, government agencies, asset-backed securities and mortgage bonds.

High-Yield Opportunities

We saw opportunities for Canadian issuers of high-yield debt as investors continued to seek yield in a low-rate environment. Covenant patterns in Canada continue to evolve, but generally still follow those seen in the high-yield market in the U.S. We have also seen a willingness to use high-yield debt as part of acquisition financing. Examples include the high-yield financings launched by Western Energy Services Corp. and Canadian Energy Services & Technology Corp. in 2013 to take-out short term debt financing used to fund acquisitions. This is something that has not been seen much in the Canadian market so this is an encouraging sign for growth of this market.

REITs and Floating Rate Notes

Throughout 2013 we saw a number of REITs access the debt markets for the first time, such as Dundee REIT and Granite REIT. In addition to accessing the market, in the fall of 2013 a number of REITs issued floating rate notes (notes whose interest rate is not fixed through the term of the bond but which adjusts on pre-determined dates based on changes to one or more benchmark references) for the first time. Examples included Dundee REIT, Calloway REIT and Cominar REIT.

Consent Solicitations and Tender Offers

As we noted in 2012, consent solicitations have become a more popular mechanism for seeking modifications to the terms of debt securities. We continued to see increased consent solicitation activity through 2013, both for high yield and investment grade bonds. We also started to see consent solicitations tied together with tender offers for outstanding bonds, which is a distinctly American approach to dealing with bonds that are no longer favourable to the issuer. An example of this was the Livingston International Inc. offer to purchase and consent solicitation launched in March 2013 for its 10.125% Senior Unsecured Notes due November 9, 2015. Not all consent solicitations and tender offers have been successful so this reinforces the notion that issuers should carefully consider their covenants at the time of issuance to ensure they have the flexibility they believe they will need to operate their business going forward.

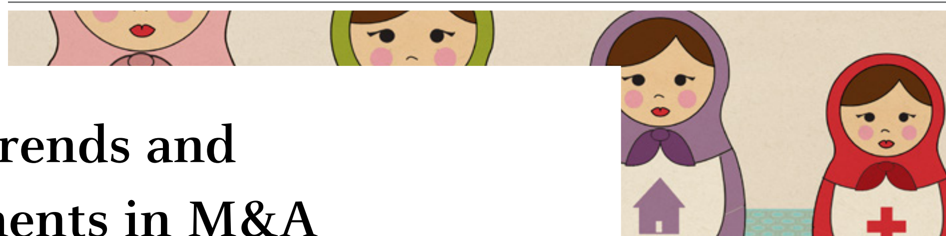
Outlook for 2014

Assuming benchmark interest rates remain stable and there is no intervening crisis of confidence on a macro economic scale, we expect to see a continued robust debt market in 2014. We expect issuers will seek to refinance their more expensive debt, replacing it with bonds bearing historically low coupons. In addition, so long as there remains uncertainty and volatility in the equity markets, the flow of capital out of the bond markets will not occur, leaving strong demand for credit generally.

CONTRIBUTORS

Desmond Lee
Partner, Corporate
dlee@osler.com
416.862.5945

Michael Innes
Partner, Corporate
minnes@osler.com
416.862.4284



Notable Trends and Developments in M&A

by Emmanuel Pressman, Clay Horner & Don Gilchrist

Return of the Strategic Deal: Although overall M&A volumes trended down in 2013, the M&A markets witnessed increased confidence in strategic dealmaking as well as investor receptivity to mergers with sound business logic and demonstrable synergistic value. Significant strategic transactions of this nature undertaken in 2013 include deals in the retail, real estate and healthcare sectors, such as Loblaw Companies Limited's acquisition of Shoppers Drug Mart Corporation, and Valeant Pharmaceuticals International, Inc.'s acquisition of Bausch + Lomb Holdings Inc., on which Osler acted for Shoppers and Valeant respectively.

Other strategic deals in these sectors undertaken in 2013 include Sobeys Inc.'s acquisition of Canada Safeway Ltd. and Hudson's Bay Co.'s acquisition of Saks Inc. Interestingly, the buy-side stock price after announcement of several of these transactions increased substantially, evidencing investor appetite for sensible, strategic transactions. Ordinarily, sell-side stock prices rise, while buy-side stock prices tend to dip due to factors such as dilution, hedging, deal risk and concerns about overpayment for a coveted asset.

We anticipate that in 2014 we will see more M&A transactions in furtherance of strategic growth – albeit in a slow and steady manner consistent with the cautious approach to strategic decision-making we have witnessed for several years. For some time, the essential ingredients of a robust M&A market have included a high-performing stock market, the availability of capital and strong corporate balance sheets (outside the mining sector). While these elements existed in large measure in 2013 and should support broader M&A activity, worldwide confidence levels have yet to return to pre-financial crisis levels.

Moreover, the energy and natural resources sectors, which historically represent nearly half of Canada's corporate economy and which in past years have generated a significant volume of transactions, saw greatly reduced dealmaking in 2013.

The last major mining take-over, First Quantum Minerals Ltd.'s acquisition of Inmet Mining Corp., on which Osler represented Inmet's special committee of independent directors, closed at the end of the first quarter of 2013. While the metals and mining sector saw significant write downs and management shuffles in 2013 that might have been a catalyst for M&A, very few companies were unaffected by the carnage inflicted by significantly reduced metal prices and massive cost overruns on flagship projects that appeared to deter broader M&A activity in the sector. In the absence of improvement in commodity prices, we expect to see more risk sharing through joint ventures, fewer blockbuster mining M&A transactions, and potential insolvencies and restructurings for junior mining companies that are not able to attract new investment.

The energy sector saw a dearth of M&A activity in 2013. Investment by state-owned enterprises (SOEs) in the energy sector, which in 2012 accounted for almost $28 billion worth of activity, was almost completely absent in 2013 during which there were only two material SOE transactions worth approximately $1.5 billion in aggregate. The oil sands sector reported its lowest level of transactional activity in a decade, while M&A activity in the broader energy sector was off by more than 80% compared to 2012. However, the fundamentals for the oil and gas sector appeared to be improving at year end as concerns about the pace of infrastructure development lessened somewhat. There was also a sense that SOE investment in the oil & gas sector could rebound significantly in 2014 on an improving outlook for the development of a Canadian seaborne export market for domestic energy products and greater comfort with the Canadian regulatory environment for foreign direct investment in the resource sector.

Regulators Have a Seat at the Table

The list of transactions rejected by the federal government on regulatory, policy and national security grounds continued to grow last year. BCE Inc.'s acquisition of Astral Media Inc. finally closed in 2013 after having been initially rejected by the Canadian Radio-television and Telecommunications Commission (CRTC) in 2012. That deal was made possible, in part, by a series of specialty television channel and radio station divestitures that Bell Media Inc. agreed to make to Corus Entertainment Inc. (Osler represented Corus). The CRTC also rejected TELUS Corporation's proposed acquisition of Mobilicity Inc. on regulatory grounds, and the Minister of Industry rejected Accelero Capital's proposed acquisition of the Allstream division from

Manitoba Telecom Services Inc. on national security grounds. Subsequently, TELUS announced that it had agreed to acquire Public Mobile and obtained regulatory approvals in the fourth quarter of 2013. Osler represented TELUS in both of those transactions.

Successful completion of acquisitions in circumstances where material regulatory approvals are required, or which are politically sensitive, require experienced advisors and careful transaction planning and execution. In our experience, completion risk can be mitigated by undertaking a comprehensive risk assessment at an early stage, and promptly engaging with political and regulatory authorities if material risk is identified. Further, friendly board-supported deals can typically be more effectively structured to mitigate the increased deal risk and uncertainty associated with transactions in regulated and politically sensitive industries.

Shareholder Activism Here to Stay

Proxy contests and other forms of shareholder activism continued to be a growth industry and a significant part of the M&A landscape in 2013. Activist initiatives represent a cost-effective way in which to effect a change in corporate control as compared to committing the funds required to launch a hostile take-over bid. Activist initiatives can often be undertaken confidentially and thus the reputational risk of being associated with a failed deal can be potentially avoided. Further, higher (10%) "early warning" reporting requirements in Canada allow activists to engage in stealth accumulations and shield their investment intentions for a longer period of time than would be the case in the United States, although greater conformity between the Canadian and U.S. reporting regimes has been proposed by Canadian securities regulators. Further, the absence of staggered boards allows activist shareholders the opportunity to achieve their objectives over a shorter period of time than is the case in jurisdictions where staggered boards are common. Not surprisingly, Canada has seen increasing levels of shareholder activism over the past couple of years by both domestic and U.S.-based funds. Going forward, we expect to see continued initiatives by activist shareholders – especially in the small cap and mid-markets. Activists are also targeting larger companies, as evidenced by Carl Icahn's recent investment in Talisman Energy Inc., resulting in two board seats in exchange for standstill commitments; Jana Partners' failed proxy battle for Agrium Inc.; and activist overtures made to Tim Hortons Inc.

Osler Represented

Shoppers Drug Mart Corporation *in its proposed $12.4-billion acquisition by Loblaw Companies Limited*

Valeant Pharmaceuticals International, Inc. *in its $8.7-billion all cash acquisition of Bausch + Lomb*

KingSett Capital *in its take-over bid for Primaris Retail REIT and, ultimately, $5.0-billion friendly plan of arrangement with H&R REIT and Primaris*

Although most proxy battles can be resolved without a fight, they have become more litigious, as both the target board of directors and the "concerned" or "dissident" shareholders increasingly resort to the courts to resolve allegations of misconduct and entrenchment. In our experience, the courts have tended to side with incumbent boards. However, the smaller size of Canadian corporations compared with U.S. and international counterparts has generally made them more vulnerable to attack. This may be attributable, in part, to these types of companies being characterized by concentrated ownership blocks, which facilitate proxy solicitation efforts and because small cap companies have more often than not been the subject of concerns expressed about entrenchment and governance practices.

Regulatory Reforms

Although there may have been a reduction in M&A activity in 2013, there was no shortage of ongoing regulatory reform proposed by Canadian securities regulators that, if implemented, will have a meaningful impact on the way in which hostile take-over bids are conducted and "early warning" disclosure is made in connection with stock accumulations. A new rule that would govern the adoption and termination of shareholder rights plans (poison pills) in Canada was announced with the expectation that it would be readily adopted. However, a competing proposal from the securities regulatory authority in Québec that would shift the balance of power to boards of directors gained traction, as did an alternative proposal by a group of senior securities practitioners that proposed more holistic reform to the take-over bid regime to address substantive deficiencies as opposed to a narrow focus on poison pills. It is expected that the shareholder rights plan rule will be re-issued for further comment in 2014 and will be the subject of ongoing debate.

A proposal to reform the early warning and alternative monthly reporting regimes was also subject to extensive comment. The proposal contemplates (i) decreasing the trigger for early warning reporting from 10% of the outstanding securities of a class to 5%; (ii) including certain equity derivatives positions and securities lending positions in the calculation of what must be reported; (iii) disqualifying eligible institutional investors from using the more permissive alternative monthly reporting system if they intend to solicit proxies relating to the election of directors or certain corporate restructurings; and (iv) prescribing enhanced disclosure of investment intent. The proposal is expected to be re-issued for further comment later in 2014.

Credentials

Osler is ranked as the #1 **law firm for Canadian deals** *(by value) and the* #3 **law firm for Canadian deals** *(by deal count) by Mergermarket*

Osler is ranked by Bloomberg among the **top 5 M&A legal advisors for global announced deals** *(by value)* **and as the #2 law firm for Canadian announced deals** *(by value)*

Osler is ranked by Thomson Reuters as the **#2 law firm for Canadian announced deals** *(by value) and the* #3 **law firm for Canadian completed deals** *(by value)*

The rights plan proposal is a welcome initiative since hearings before regulators to cease trade a rights plan under the current bid regime often result in uncertainty as to the timing of bids, detract the attention of both targets and bidders from the transaction, and typically have marginal impact on the actual outcome of the bid. Deal certainty and allocation of regulatory resources favour regulators "getting out of the business" of cease-trading pills. That said, the regulation of rights plans is a very narrow matter of law that generally speaking arises in the hostile take-over bid context. As there are only a handful of rights plans cease-traded in any year, the significance of the rule may be disproportionate to the attention paid by market participants. In contrast, the proposed changes to the early warning disclosure rules have widespread and daily implications for both activist investors and passive investors.

Looking Ahead

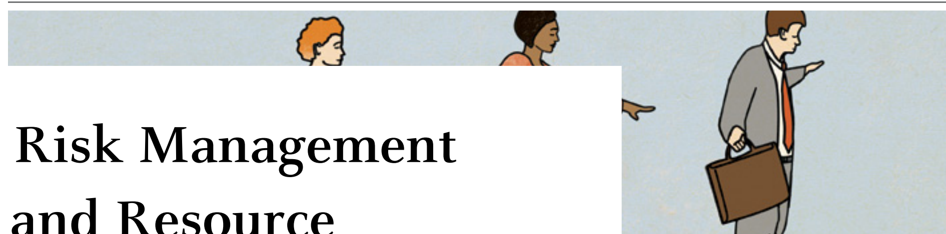
We are optimistic that M&A activity will increase somewhat in 2014 in light of increasing confidence in the strength of the economic recovery and access to capital for many companies. However, concerns about the strength of commodity prices and the pace of infrastructure development in the energy sector may continue to be a drag on deal-making. We also expect that activist shareholder initiatives will continue to be a significant part of the M&A landscape in 2014. However, widespread adoption of advance notice by-laws, potential changes to the rules regarding reporting of share ownership positions and other regulatory initiatives may dampen the rapid increase in the number of activist initiatives that we have seen in the last couple of years. Further, governmental and regulatory considerations will continue to be part of many proposed transactions. Finally, the decisions of the Canadian securities regulators concerning poison pills and defensive tactics and the other regulatory initiatives discussed above could result in important changes in the manner in which contests for control are undertaken.

CONTRIBUTORS

Emmanuel Pressman
Partner, Corporate
epressman@osler.com
416.862.4903

Clay Horner
Firm Co-Chair
chorner@osler.com
416.862.6590

Don Gilchrist
Partner, Corporate
dgilchrist@osler.com
416.862.6534



Risks and Risk Management in Project and Resource Development

by Tom Isaac & Maureen Killoran Q.C.

Companies in the energy and mining sectors have long been accustomed to managing risk, balancing exploration investments against the probability of finding a prospective mineral, for example, or using cost discipline to hedge against the possibility of commodity price declines. But risk management skills are increasingly required in the development of projects too, as negotiations, disputes and litigation have become almost standard features of every stage of a given initiative.

Behind this sweeping change lies the recognition of the Crown's "duty to consult" with Aboriginal peoples, which was codified by Supreme Court of Canada rulings in 2004 and 2005. Since that time, consultation processes for resource and other projects have been implemented as the dominant means of protecting Aboriginal and treaty rights and of balancing Aboriginal and other societal interests. Today, such processes act as both a framework for reconciliation and, increasingly, an arena of dispute.

Recent developments show the trend evolving in new directions. First, some limits are being set. In response to a challenge brought forward by the Stellat'en First Nation in *Louis v. British Columbia*, the B.C. Court of Appeal made it clear that the Crown's duty to consult Aboriginal groups only pertains to new or "novel" impacts on Aboriginal rights and does not require the re-visiting of previous authorizations. Similarly, in *Behn v. Moulton Contracting Ltd*. the Supreme Court of Canada affirmed that the Crown's duty to consult cannot be used to challenge decisions that were not opposed at the time they were being made.

Second, consultation frameworks are themselves shifting. New frameworks that have been developed by Alberta, Newfoundland and Labrador, and Ontario effectively shift responsibilities from the Crown to project proponents. Alberta has centralized its consultation process and is in the process of re-allocating responsibilities among participants. Ontario's new *Mining Act* imposes extensive responsibilities on proponents, including the submission of detailed "exploration plans" before exploration activities begin. Newfoundland and Labrador's policy, meanwhile, marks an unprecedented shift in the burden of consultation from the Crown to project proponents: companies are to pay the full costs of consultation on behalf of Aboriginal groups, for example, and are also required to provide financial "accommodation" for adverse effects of Aboriginal rights – a duty that legally rests with the Crown.

Third, litigation between project proponents and the Crown has emerged. Northern Superior Resources recently filed a Statement of Claim against the Government of Ontario alleging that the government failed to properly discharge its duty to consult, a failure that led to disputes between Northern Superior and affected First Nations and to the eventual abandonment of its mining claims. New policy uncertainties will likely only increase the odds of cases like this being pursued more often.

The general increase in risks stemming from consultation-based litigation and regulatory change has important implications for resource projects in Canada. One of the most immediate impacts is simply delay. With every stage of the consultation process now offering its own opportunity for litigation, repeated halts are all but certain – and with delays come the costs of idle employees and equipment, and the potentially much greater opportunity cost of resources left in the ground.

Successful Elements of a Strong Aboriginal Consultative Process

Upfront Planning
Integrate a litigation strategy into your overall project plan and identify litigation risks by each phase of development

Right Team
Identify all the relevant stakeholders and ensure they play a role in the assessment and mitigation of risk

Alternative Solutions
Alternative project development methods may reduce regulatory requirements and litigation risk

Budgeting
Allocate for the time and capital needed to address any contentious issues that arise

Communication
Ensure investors and others have an understanding of the costs and time frame up front

Direct costs can also mount quickly. Negotiations require negotiators, litigation requires litigators, and reworking exploration or engineering plans often requires the services of external consultants. Benefits agreements, meanwhile, come with their own price tags; the consultation costs of Aboriginal communities must often be covered by proponent firms; and the potentially broader – and still as yet undefined – responsibility for financial accommodation may push direct costs far higher.

A final impact faced by companies is on their costs of capital and their balance sheets. Investors tend to price uncertainty into their willingness to pay for a company's stock, and the greater the uncertainty a company faces in its ability to bring resources to market in a timely fashion, the lower the price it will realize for its equity (or the greater the interest it will pay on its debt). The value a company places on a specific property will vary for the same reason, and a parcel does not have to be put up for sale for its loss of value to be made tangible: Northern Superior, for example, wrote off $110 million when it abandoned its claims.

We see no sign of such risks abating in future. Indeed, we anticipate novel forms of litigation arising in the next few years from the duty to consult and from the general principle of the "honour of the Crown," from which the duty to consult derives. Resource project proponents must continue improving their risk management capabilities while at the same time making thorough and thoughtful efforts to participate effectively in the consultation processes relevant to the areas in which they operate.

CONTRIBUTORS

Tom Isaac
Partner, Litigation (Regulatory/ Environmental/ Aboriginal)
tisaac@osler.com
403.260.7060

Maureen Killoran Q.C.
Partner, Litigation (Regulatory/ Environmental/ Aboriginal)
mkilloran@osler.com
403.260.7003

osler.com

Toronto
Box 50, 1 First Canadian Place
Toronto, Ontario, Canada M5X 1B8
416.362.2111 MAIN
416.862.6666 FACSIMILE
CONTACT:
Michael Innes
Doug Marshall
Emmanuel Pressman

Montréal
Suite 2100,
1000 De La Gauchetière Street West
Montréal, Québec, Canada H3B 4W5
514.904.8100 MAIN
514.904.8101 FACSIMILE
CONTACT:
Shahir Guindi
Vitale Santoro
Robert Yalden

Ottawa
Suite 1900, 340 Albert Street
Ottawa, Ontario, Canada K1R 7Y6
613.235.7234 MAIN
613.235.2867 FACSIMILE
CONTACT:
Craig Wright
Elizabeth Walker
Edward Vandenberg

Calgary
Suite 2500, TransCanada Tower
450 – 1st St. S.W.
Calgary, Alberta, Canada T2P 5H1
403.260.7000 MAIN
403.260.7024 FACSIMILE
CONTACT:
Janice Buckingham
Robert Lehodey Q.C.
Frank Turner

New York
620 8th Avenue
36th Floor
New York, New York, U.S.A. 10018
212.867.5800 MAIN
212.867.5802 FACSIMILE
CONTACT:
Jason Comerford
Randall Pratt
Rob Lando

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