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THE IMPLICATIONS OF THE POTASH DECISION ON CANADIAN FOREIGN INVESTMENT REVIEW GOING FORWARD

The Canadian M&A story of the year was undoubtedly BHP Billiton's hostile bid for Potash Corporation of Saskatchewan and the federal Minister of Industry's rejection of the deal under the *Investment Canada Act* (ICA). Although the deal's rejection may reflect unique circumstances, its outcome is likely to affect the way foreign investors handle high-profile acquisitions in Canada.

Transaction background

When it announced the bid in August, BHP outlined the commitments it proposed to make in order to meet the ICA's "net benefit to Canada" test. The commitments were reasonably strong and consistent with those given in other large natural resource acquisitions, such as Rio Tinto/Alcan, Vale/Inco and Xstrata/Falconbridge.

Although both the federal and the Saskatchewan provincial governments initially seemed unopposed to the transaction, concerns soon developed about its financial impact on the province of Saskatchewan. According to some reports, more than 10% of Saskatchewan's revenue is derived from potash-related royalties. As the weeks passed, the Saskatchewan provincial government also became worried that the ICA framework was not sufficiently robust to protect either provincial or national interests. The provincial government pointed to a history of breached undertakings in other transactions.

BHP tried to alleviate these concerns by increasing its commitments, and said it would

- preserve provincial revenues by retaining membership in the Canpotex export cartel and forgoing tax benefits;
- agree to a monitoring regime, including a C$250 million performance bond;
- list BHP on the Toronto Stock Exchange; and
- increase employment in its Canadian businesses by 15%.

After rejecting the transaction in November, Industry Minister Tony Clement stated that BHP had failed to satisfy the statutory net benefit test. However, to most observers, politics was clearly the deciding factor. By that time, popular and political opposition to the transaction had mounted, particularly in Saskatchewan, where the minority Conservative federal government holds 13 seats – a factor that will be critical to a victory in the next federal election. The hostile nature of BHP's bid, and what some regarded as a low-ball offer price, also meant that the transaction had few commercial supporters: Potash management was opposed to the deal and the company's shareholders were indifferent. Had any one of these factors favoured BHP, the outcome could have been different.

M&A Lessons

There can be little doubt that the federal government's rejection of the bid for Potash will have implications for high-profile inbound M&A transactions. Several noteworthy M&A lessons are evident from the bid, some old and some new.

- **Foreign investors should prepare for more rigorous "net benefit" commitments.** BHP offered a strong set of ICA undertakings. This may raise the bar for commitments that foreign acquirors will have to provide in future transactions. Key areas of government concern appear to relate to transparency and enforceability. There may be a move to make undertakings public, and the independent monitor and performance bond that BHP offered may be sought in future deals.

- **The core group of M&A advisers has expanded.** The traditional advisers on M&A transactions were often seen to be lawyers, investment bankers and HR consultants. It is clear that sophisticated acquirors now also include specialists in government, media and investor relations within their core group of advisers. Their role is to improve messaging to the media and to those affected by foreign acquisitions, including provincial and federal governments, shareholders, employees, customers and other stakeholders. The Saskatchewan government played a decisive role in the Potash deal, and BHP's inability to persuade that government of the benefits of the transaction was a critical failure. Media scrutiny was intense: between announcement and withdrawal, the Potash bid was covered in well over 500 news reports in *The Globe and Mail*, the *National Post* and *The Wall Street Journal* alone, reinforcing the need for a well-crafted media strategy that will help shape the thinking of key decision makers.

- **The nature and identity of the foreign buyer may be a factor.** Media reports speculated that sovereign wealth funds (SWFs) and other state-owned enterprises (SOEs) were interested in launching a bid for Potash, alone or as participants in consortiums. Although there was some provincial political opposition to this possibility, the federal government has made it clear that SWF and SOE investors are welcome in Canada. Nevertheless, such investors should be aware of and be prepared to deal with potential political concerns.

- **A hostile transaction has increased political risk.** A negotiated transaction, particularly by SWF or SOE investors, will improve the likelihood of regulatory success. Friendly deals allow buyers and sellers to jointly plan and communicate ahead of time with relevant constituents, including governmental and regulatory authorities. Friendly transactions also provide support from the target. The target's and shareholders' lack of support for BHP's bid clearly made it easier for the government to withhold its approval.

- **Seek enhanced deal protections when there is heightened regulatory risk.** Foreign buyers should consider seeking enhanced deal protections from targets when there is a heightened risk of regulatory intervention and non-approval. These protections may include higher than normal transaction break fees, coupled with expense reimbursement if the transaction is not approved. Obtaining those protections will not always be possible because targets may reject the added risk that these protections may bring. A target may be justified in seeking its own enhanced deal protection, including a reverse break fee if the nature of a foreign buyer adds regulatory approval risk.

The federal government is aware of the potential impact of its decision in Potash and has been eager to reassure the business community that Canada remains open to foreign investment. For that reason alone, future non-approvals are unlikely, particularly in the near term. Moreover, the unusual circumstances of the Potash deal are unlikely to occur again soon. Although we expect most transactions to proceed in the normal course, Potash reminds us that in Canada, just as elsewhere, politics can be an important aspect of the foreign investment review process and that on high-profile deals prudent investors should come to Canada well prepared.

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