



Private M&A in Canada and the U.K.

10 Considerations for Dealmakers

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Prudent investors may gain an advantage by leveraging their knowledge of differences in private M&A market practices between Canadian and U.K.-style purchase agreements. While Canadian M&A takes many cues from the United States and Europe, it is not a carbon copy of either. Canadian private M&A purchase agreements are generally more buyer-friendly whereas U.K. agreements tend to be more seller-friendly. Businesses involved in cross-border transactions between the two jurisdictions should consider the following key differences:

Conditionality: Common in Canada

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In deals where there is an interim period between signing and completion, Canadian-style purchase agreements may include conditions that the representations and warranties remain true and correct at completion (though sellers commonly seek to qualify such a condition by reference to materiality), and that there has been no material adverse change between signing and completion. In U.K.-style purchase agreements, conditionality is typically limited to regulatory or third-party approvals. Occasionally, Canadian-style deals include a financing condition to give the buyer time to put acquisition financing into place. Conversely, the U.K. approach is to require a buyer to transact on a "certain funds" basis.

Economic Risks: Different Approaches

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While locked box deals are common in the U.K., in Canada, completion accounts adjustments remain more prevalent. In the U.K.-style locked box approach, economic risk shifts to the buyer at an agreed balance sheet date prior to signing, but in a Canadian-style purchase agreement employing completion accounts adjustments, economic risk does not shift to the buyer until completion. As a result, Canadian-style purchase agreements employing completion accounts adjustments typically contain fewer detailed interim period covenants.

Claims and Remedies: Canada has More Options

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Whereas Canadian-style purchase agreements contain "representations and warranties," U.K.-style purchase agreements usually only contain "warranties." The type of claim and remedy available for incorrectness may vary depending on whether a statement is characterized as a representation or warranty. A breach of warranty gives rise to a contractual claim for damages, whereas an inaccurate representation may give rise to a misrepresentation claim for damages and potentially a right of rescission.

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Indemnity Packages: A Canadian Offer

Unlike warranties in the U.K., representations and warranties in Canada are provided on an indemnity basis, meaning there is a contractual remedy to be reimbursed on a dollar-for-dollar (or pound-for-pound) basis for all loss actually suffered (subject to agreed limitations). In the U.K., a buyer's remedy is a contractual claim for damages that were "reasonably foreseeable" and is subject to a common law duty to mitigate its losses. Indemnities are usually limited to specific liabilities that a buyer has identified in its due diligence. Therefore, the Canadian approach gives buyers a potentially broader range of remedies (including indemnification and termination), whereas the U.K. approach seeks to limit buyers to a claim for breach of contract and damages only.

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Sandbagging Clauses: Shifting Sands?

In Canada and the U.K., it is common for purchase agreements to be silent on the consequences for a representation and warranty claim if the party seeking to make the claim had knowledge of an inaccuracy or breach of the representation and warranty before completion. However, as a result of recent case law, we expect to see more Canadian-style purchase agreements expressly state the effect of knowledge on a representation and warranty claim by either including a pro-sandbagging clause (knowledge of an inaccuracy or breach does not affect a claim) or anti-sandbagging clause (knowledge of an inaccuracy or breach bars a claim). When sandbagging is expressly addressed in a purchase agreement, it is more common to see pro-sandbagging clauses in Canadian-style purchase agreements and anti-sandbagging clauses in U.K.-style purchase agreements.

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Disclosures: The U.K. is Broader

U.K. market practice is to set out both specific and general disclosures in a separate disclosure letter. Further, it is common in competitive auction processes for a seller to make general disclosures, including by reference to the data site contents, publicly available information, statutory books, audited

accounts, and vendor due diligence reports (if applicable). In contrast, Canadian market practice is to set out any disclosures in schedules to the purchase agreement, and to require that the seller's disclosures be specific and cross-referenced to the representation and warranty being qualified. While vendor due diligence reports are common in the U.K., they are an emerging trend in Canada and are only provided on multi-national transactions and on a non-reliance basis.

Full Disclosure and Undisclosed Liabilities: Canada is More Buyer-Friendly

7 In Canada, a buyer in a strong bargaining position may be able to secure "full disclosure" and/or "no undisclosed liabilities" representations and warranties. A "full disclosure" representation and warranty provides that the seller has not made any untrue statement of material fact or omitted a material fact necessary to ensure statements are not misleading. A "no undisclosed liabilities" representation and warranty provides that there are no un-provisioned liabilities except for liabilities disclosed in the financial statements and current liabilities incurred in the ordinary course of business. This type of formulation is more common in Canada than the U.K. Buyer-friendly U.K.-style purchase agreements commonly employ a formulation that the financial statements disclose all actual, contingent, or prospective liabilities required to be reflected in accordance with generally accepted accounting principles or International Financial Reporting Standards, as applicable.

Materiality Scrape: Less Common in the U.K.

8 The "materiality scrape" is becoming increasingly common in Canadian-style purchase agreements, while it is rarely encountered in the U.K. The purpose of the scrape is to eliminate, for indemnification purposes, the effect of any materiality qualifiers employed in the representations and warranties section of a purchase agreement. In the "single materiality" version, the scrape provides that if a seller has qualified its representations and warranties by materiality, amounts up to the materiality qualification threshold are expressly included in calculating the amount of damages, and not just the amount in excess of the relevant materiality threshold. In the "double materiality" version, the scrape goes further and provides that the representations and warranties of the parties shall be deemed to have been made without materiality qualifiers.

Due Diligence Reports: Reliance is Limited in Canada

9 In the U.K., it is not uncommon for buyer's counsel to agree to extend reliance on a due diligence report to certain non-client parties, for example the buyer's lenders for the purpose of obtaining acquisition financing. In contrast, Canadian law firms have not followed the practice of extending reliance to

non-clients. One reason for the differing practice is due to concerns that Canadian law society rules may prevent law firms from contractually limiting their liability (as U.K. law firms are clearly permitted to do). Nevertheless, Canadian law firms will sometimes grant a narrow consent to non-client parties using such reports for specific purposes on a non-reliance basis.

Insurance: Coverage is More Comprehensive in the U.K.

10 Warranty and indemnity insurance, or representation and warranty insurance as it is known in Canada, is common in U.K. deals. In Canada, such insurance is growing at a rapid pace, although many claims continue to be settled through escrow accounts and excess coverage from indemnification by the seller.

On Canadian deals with an interim period between signing and completion, representation and warranty insurance policies typically provide coverage as of signing, subject to a bring down call at completion to confirm that the parties are not aware of any breaches during the interim period. To date, no Canadian insurers insure against interim period breaches. In Canada, the buyer typically assumes the risks associated with interim period breaches, although a buyer in a strong bargaining position may require the seller to assume any interim period liability not recoverable under the insurance policy by way of a specific interim period indemnity or escrow regime.

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