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The Pandemic and the Trade War

How the Pandemic Prepared Cross-Border M&A Lawyers for a Trade War

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Rapid shifts in global trade dynamics triggered by a continuously evolving tariff landscape are presenting North American businesses with complex legal and commercial issues. But business must—and will—go on, including M&A. And as dealmaking moves forward, U.S. buyers considering acquiring a Canadian target will benefit from multiple developments in Canadian M&A law and practice from the last period of significant unexpected international economic disruption, i.e., the Covid-19 pandemic.

Dealmaking Amid Trade Uncertainty

Canadians had mixed views on the potential second Trump presidency. The tense negotiation of NAFTA's successor, the United States-Mexico-Canada free trade agreement, aka "USMCA", remained fresh in many people's minds. Others were eager for a strong pro-business agenda that would supercharge economic activity. Few foresaw what has occurred: a continuously evolving global trade war punctuated, most recently, by the extensive slate of new import tariffs announced by the U.S. on April 2 followed by the abrupt suspension of most of these one week later.

The result is widespread market uncertainty of a degree not seen since the early days of the pandemic, and before that the 2008 financial crisis. Faced with these rather unprecedented circumstances, some companies may decide it wise to avoid major transactions for as long as elevated trade uncertainty lasts. Other companies may see opportunity amid the turbulence, such as buying strategic assets in pursuit of supply chain diversification, cost efficiencies, or market expansion. Others may turn toward strategic partnerships. Others may be forced to deal, e.g., to sell non-core assets to raise cash. Should companies enter insolvency or need restructuring, opportunities for distressed acquisitions may arise.

We are not in totally uncharted territory, however. Having recently navigated Covid-19, dealmakers on both sides of the border will benefit from several pandemic-era developments in Canadian M&A law and practice.

Key Lessons and Deal Tools From the Pandemic

The pandemic's onset saw an instant lull in M&A as buyers and sellers paused to digest unfolding events and gauge where things might go. This kept deal flow down in 2020. But after months of strategizing, government stimulus and low interest rates, dealmaking exploded across 2021 and much of 2022, even as the pandemic's fluctuations continued. And as the deals rolled forward, M&A lawyers adapted to transacting amid unusually high market uncertainty.

In Canada this included three key developments.

The first was a notable uptick in earnouts. While by no means uncommon in Canada, the use of earnouts almost doubled in frequency during the pandemic. Several earnout-related rulings were also issued by Canadian courts. On this front, U.S. buyers should know that the different efforts undertakings sometimes applied to buyer earnout undertakings, e.g., "commercially reasonable efforts", have different and well-defined meanings under Canadian common law somewhat different than those under Delaware law. U.S. buyers should also know that, regardless of any express efforts standard and unlike under Delaware law, duties of good faith will always apply.

Second, the pandemic saw two key Canadian rulings on "ordinary course of business" clauses, both of which were billion-dollar disputes. Together these two rulings considered many of the same points at issue in the landmark rulings of the Delaware Court of Chancery (in 2020) and Delaware Supreme Court (in 2021) in *AB Stable VIII LLC v. MAPS Hotels & Resorts One LLC*, including the application of "consistent with past practice" qualifiers and "buyer consent" qualifiers.

While there are many similarities between the approach of the Canadian courts and the Delaware courts, there are also important areas of divergence to appreciate, including to properly mitigate risk from a U.S. buyer's side. For example, in one of the Canadian rulings, the court held that a "not to be unreasonably withheld" qualifier in the "buyer consent" subclause could effectively lead to deemed or constructive buyer consent where the court decides it would have been unreasonable for the buyer to withhold consent to the seller's proposed course of action.

A third benefit of the pandemic is a much clearer picture of what is a "material adverse effect" (MAE) under Canadian common law. The source is again a pandemic-prompted billion-dollar M&A dispute, and the Canadian court cited the seminal 2018 ruling of the Delaware Court of Chancery in *Akorn Inc v Fresenius Kabi AG* more than any Canadian precedent. Nonetheless, multiple divergences between Delaware and Canadian law regarding MAE clauses still remain.

An example is that, notwithstanding that *Akorn* reversed Delaware law on the point, the Canadian court maintained the requirement that an MAE must arise from an "unknown event". Another example is that Canadian courts have not

followed Delaware courts to expressly impose a "heavy burden" on a buyer seeking to establish an MAE has occurred. A third example involves the interaction of "ordinary course of business" clauses and MAE clauses. The Delaware courts in *AB Stable* held that, because the two clauses serve different purposes and guard against different risks, they should not be interpreted together. By contrast, both Canadian rulings effectively held that the risk allocation set by the clauses should be considered together based on the principle that contracts should be read as a whole.

Concluding Comments

Commercial considerations will always drive dealmaking. Lawyers manage and mitigate risk to their client's best advantage while helping get the deal done. The pandemic greatly focused minds on how best to do this amid unusually high market uncertainty. It also led to multiple clarifying developments in Canadian M&A law and practice.

These won't eliminate the hazards raised by tariffs. But they may help potential cross-border M&A parties get to "yes", and they will make the road to closing the deal clearer. That said, counsel to U.S. buyers considering a Canadian acquisition should appreciate that, while Delaware and Canadian common law regarding M&A are much more similar than dissimilar, several key differences remain, including as relates to earnouts, ordinary course of business covenants, and MAE clauses.