Carrying On Business in Canada - A Practical Guide for Americans, September 2007

Carrying on Business in Canada is a valuable reference guide for everyday commercial issues and is designed to assist offshore businesses wanting to enter the Canadian market.

Author: Bruce McNeely

1. INTRODUCTION

The progressive liberalization of international trade and investment over the past two decades has generated new opportunities to expand business activities across national borders.

Canada has been at the forefront of this initiative, both globally, through participation in the World Trade Organization, and bilaterally, through its participation in the North American Free Trade Agreement and free trade agreements with each of Costa Rica, Chile, Israel and South Korea. Details of the bilateral trade agreements that Canada is currently pursuing are summarized on page 9.3. In addition, Canada is a party to 23 bilateral investment treaties, the last of which was signed with Peru, effective November 14, 2006.

Cassels Brock has prepared this overview of the Canadian business environment to assist lawyers and businesspeople who are considering establishing a business in Canada.

The law firm of Cassels Brock (which dates its roots back to 1888) has over 195 lawyers located in Toronto, the capital of Ontario and the financial centre of Canada. Ontario is the largest of Canada's 10 provinces. Accordingly, this brochure emphasizes Ontario's business environment and laws. The province has a population of approximately 11.9 million people (roughly one-third of Canada's total 31 million population) and an area of

1,068,587 square kilometres. Given its immediate proximity to the U.S., there are approximately 160 million people within a two-day drive of Toronto.

2. ABOUT CANADA

WHO MAKES THE LAWS IN CANADA?

Canada has a parliamentary system of government, in which the political party that elects the greatest number of members to the legislative body (federally, the House of Commons, and provincially, the Legislature) is invited to form the government of the day. The federal Prime Minister and the provincial Premiers (the respective heads of the provincial governments) are elected by members of the political parties they represent. In each case, the cabinet is composed of elected members, and in some cases at the federal level, members of the Senate. This contrasts with the U.S. system, where the individual with the greatest number of supporters in the Electoral College is declared the President and is then entitled to form a government from both elected and non-elected individuals.

As in the U.S., Canada is a federation with a written constitutionally based division of powers between the federal government and the provincial governments. Municipal governments derive their authority from the provincial governments.

Canada has two official languages, English and French, and all federal government services are available in both languages.

Federal Jurisdiction

The federal government has authority to make laws in areas of general interest to the country as a whole. For example, the federal government passes laws on income tax, bills of exchange, banking, regulation of interprovincial and international trade, bankruptcy and insolvency, intellectual property, immigration, customs duties and crime.

Provincial Jurisdiction

Provincial governments have authority to make laws in many areas, including matters affecting real and personal property rights. For example, provincial governments pass laws relating to corporate securities, the charging of secured interests in personal property, the consummation of real estate transactions, consumer protection, the incorporation of provincial companies, sales tax, insurance, the administration of the courts and enforcement of judgments.

Municipal Jurisdiction

Municipal governments have authority to make laws that are local in nature. For example, municipal governments pass laws relating to licensing requirements for conducting business within the municipality and zoning requirements affecting the use of land within the municipality.

Overlapping Jurisdictions

This three-tiered system often creates situations where overlapping levels of government regulation may purport to address a single issue. For example, all three levels of government have enacted, subject to constitutional limitations, legislation, regulations or directives intended to protect the natural environment and to impose responsibility for the cost of

cleaning up environmental damage. As well, the federal government and each of the provinces have a *Business Corporations Act*.

Obviously, it is important to be aware of changes in the laws at each of the federal, provincial and municipal levels.

WHAT IS CANADA'S LEGAL SYSTEM?

All provinces except Québec have a legal system based on the English common law tradition. Québec has a civil law legal system based on the Napoleonic Code. In a sense, this gives Canadian lawyers an advantage in that they are likely to be familiar with the underlying concepts of each of the two systems and can help bridge conflicts that arise in international transactions where both civil and common law legal systems play a role.

The Common Law

In Canada, there are many rules affecting the rights of parties conducting business in Canada. These rules derive from the judgments made every day in the courts of Canada. They form part of the law and are separate from statutes, regulations, by-laws and directives (the legislative enactments of governments). Over time, they are generally embodied in the practices observed by everyone, and are referred to as the common law.

The Québec Civil Code

The province of Québec has enacted a Civil Code containing written rules that govern such matters as the law of commerce in the province. Québec courts then interpret the Civil Code on a case-by-case basis.

EVOLUTION OF THE LEGAL SYSTEM

Business in Canada operates through the interplay of a number of components:

Commercial Practice

In contracts and commercial transactions, product innovation and changes in marketing approaches often produce changes in business practice. This has an impact on the form of agreements adopted by contracting parties.

The Common Law

The common law often evolves more slowly than does commercial practice. Courts tend to examine each commercial arrangement in relation to accepted and understood concepts and principles embodied in the existing common law and statutes. Sometimes, however, legal concepts are subject to unforeseen changes caused by unexpected judicial interpretations. This may arise as a result of unusual facts in a particular matter before the court. Because of costs, such decisions often are not appealed to higher courts for review. This can lead to some apparently conflicting decisions, exacerbated by the reluctance of courts to consider and issue rulings based on hypothetical fact situations. The rationale for foregoing is that the common law is advanced by parties litigating real issues with real consequences. This brings relevance to decisions that might otherwise be absent.

The Charter of Rights and Freedoms

The federal *Constitution Act* was amended in 1982 to incorporate the *Charter of Rights and Freedoms* that imposes limitations on federal and provincial authorities in exercising their

powers. No legislative action (including all legislation and regulations) or administrative proceeding (rulings) may be exercised by either Parliament or a provincial Legislature in a manner that would adversely affect the freedom of expression and association of individuals, certain rights of individuals with respect to the enforcement of laws and regulations and the equality of individuals under Canadian law. By far the greatest number of cases reported in Canadian law journals in recent years deal with Charter issues.

Statutes, Regulations, By-laws and Directives

These legislative initiatives may be enacted by any of the three levels of government. Generally, statutes, regulations and directives will remain relatively unchanged over long periods of time. This creates a stable environment for business, but does not prevent the enactment of new laws at the discretion of the government. Apart from the statutes themselves, the manner in which they are enforced obviously has an important effect on those who are subject to the legislation. Generally, there is a great deal of discretion in the hands of public servants, although the courts have exhibited an ever-broadening appetite to review the manner in which legislative enactments are applied, to ensure that the discretion exercised by government officials and administrative bodies is transparent, fair, reasonable and within the intent of the legislative body that granted the discretion. Canada is rightly proud of the reputation of its public officials and public service: the playing field is level for everyone.

HOW ARE DISPUTES RESOLVED IN CANADA'S LEGAL SYSTEM?

In Canada, there is a comprehensive court system for resolving commercial disputes. The judiciary system is fully independent from all levels of government and is comprised of federal and provincial courts. Judges of the courts in Canada are not elected, but are appointed for life (subject to removal for cause and certain age restrictions) by the government of the day. In addition to the court system, there are specialized independent tribunals that resolve disputes, including employment and municipal matters. In almost all cases, appeals are allowed from final decisions of courts or tribunals. For information regarding class action proceedings in Canada, see the commentary under the heading "Are Class Actions a Risk for Business in Canada?" on page 13.1.

Outside the court system, disputes can be adjudicated through arbitration if the parties have agreed to do so. In arbitrations, the decision-maker is not a judge, but rather an independent person agreed on by the parties or appointed by a judge. Each province has legislation that governs the arbitration process, if selected by the parties in their contract.

Most Canadian provinces have passed legislation adopting the *United Nations Commission on International Trade Law's Model Act* for use by parties to a commercial dispute where the parties in the arbitration have their places of business in states/provinces. However, none of the provincial Acts is effective until Canada ratifies the *U.N. Convention on the Settlement of Investment Disputes* (ICSID), a federal bill to implement the ICSID was introduced in Parliament on March 30, 2007. Generally, under both provincial and international legislation, there is no right of appeal of an award to the courts. Finally, parties are, of course, free to select the ICC-International Court of Arbitration in London as the court with jurisdiction to determine disputes; this choice will generally be given effect by courts in Canada.

WHAT DO CANADA'S CURRENT ECONOMIC INDICATORS DISCLOSE?

Since 1997 the Canadian federal government has consistently maintained significant budget surpluses. Canadian interest rates had moved gently down over several years until 2005. The commercial bank prime rate in August 2007 was 6.25%, nearly 2% higher than two years earlier. The Bank of Canada overnight lending rates charged to commercial banks is currently 4.5%.

Inflation in Canada for the 12 months ended June 2007 was 2.2%, remarkable given gasoline price increases and the strongest Canadian dollar in decades. Prior to 2003 Canadian manufacturers were able to compete internationally on the basis of lower prices created by a weak Canadian dollar. Now viewed as a petrocurrency, the Canadian dollar has increased strongly against the U.S. dollar since then, and in late September was at par with it. Canada is still working its way through a period of adjustment as it takes steps to close the productivity gap and deal with what appears to be a permanent increase in the price of oil.

Canada's unemployment rate at the end of July 2007 was 6.0%, the lowest level since 1976.

Over 80% of Canadian exports are made to the U.S. The slowdown in the U.S. economy during the last two years has led to a decline in the rate of growth of the Canadian economy. The trend has been reversed with the surge in commodity prices, including oil, gas, copper, coal and gold. The Canadian economy grew at a rate of 3.7% in the first quarter of 2007, the best in the G7.

Canada has the strongest economic performance of the G7, but is falling behind in productivity. Manufacturing shipments fell 1.4% from levels 12 months ago as a result of high energy costs, stiff competition from low-cost producers in other countries and the strong Canadian dollar. Most Canadian manufacturers anticipate continuing declines in shipments, although unfilled orders as at the end of June 2007 were 20% higher than in June 2006. Canadian governments have recently been criticized for their focus on redistribution of wealth across Canada instead of looking for ways to (i) reduce interprovincial barriers to trade, (ii) encourage excellence, innovation and wealth creation and (iii) fund major cities (usually cited as key economic engines for any economy). The result has been a decline in Canada's living standard over the last 15 years from fifth in the world in 1990 to tenth in 2005. Canada's productivity did show signs of recovery and rose in 2006 at its fastest pace since 2000.

Finally, significant uncertainty exists as to the effect of the loss of liquidity in several financial capital markets arising out of America's sub-prime mortgage lending problems and the resulting increase in the cost of capital. In Canada, the demand for short-term asset-based commercial paper collapsed when buyers lost confidence as a result of what they perceived as inadequate financial backing for the paper and buyers then failed to take up the usual volume of commercial paper as it matured in mid-August. The Bank of Canada has had to put significant funds in the overnight market to maintain interest rates at levels prior to that time and to curb the threat of inflation. Under an arrangement referred to as the Montréal Accord, the holders of the defaulted commercial paper agreed to continue to hold the paper and not exercise their remedies at least until October 15, 2007. The committee managing the Accord announced in late September that it would need additional time to identify and bring forward a solution to the liquidity crisis. It is anticipated that all future issues of Canadian commercial paper will require a full bank guarantee of repayment. This requirement would result in a significant increase in the cost of capital for Canadian business enterprises and fewer non-bank suppliers of short-term commercial paper in Canada.

Another economic factor is the anticipated continued rise of consumer demand in India and China that may put pressure on production costs and prices.

WHAT IS THE GST AND HOW DOES IT AFFECT BUSINESS?

Fifteen years ago, in line with most other industrial states, Canada implemented a value-added tax called the goods and services tax ("GST"). This 6% tax is imposed at the point of supply of a good or service in Canada subject to the said tax. Generally speaking, businesses can recover the GST they pay to the federal government by claiming input tax credits. As a result, the tax does not represent a cost to business. Ultimately, the cost of GST is paid by the end user of the product or service.

The GST does not apply to exported goods. Therefore it does not impose an additional cost on Canadian exporters. Although the tax is applied, collected, remitted and claimed back at each transaction level, a business is only required to remit to the tax authorities the amount of the excess of the tax it has collected (or ought to have collected) over the tax it has paid on purchases. The principal cost of the GST for business arises from the applicable reporting and compliance requirements. Consumers otherwise bear the full tax burden of the GST.

WHAT CAN BUSINESS EXPECT FROM THE CURRENT GOVERNMENTS IN ONTARIO, IN TORONTO AND IN CANADA?

In October 2003, the Ontario Liberal Party defeated the Ontario Progressive Conservative Party in a provincial election. Since taking office, because of a current budgetary deficit of $6 billion, the Ontario Liberals eliminated the existing cap on consumer electricity prices, and cancelled reductions in corporate and personal provincial income taxes. In addition, the government increased the minimum wage to $8.00 an hour in February 2007 with a target of $10.25 by March 31, 2010. An election was called in late August, 2007 and voting will take place on October 11, 2007. Recent polls indicate that the Liberals are likely to be returned to office with a majority for a further term in office, which usually runs for about four years.

In November 2003, the City of Toronto elected David Miller as mayor. Mr. Miller and the Federation of Canadian Cities are pressing both the provincial and federal governments for additional funding for Canada's cities. Over the last 10 years, many of the services previously provided by the provinces have been downloaded onto municipalities with no corresponding increase in federal or provincial funding to the cities. Mr. Miller was re-elected in 2006.

In a general election held in Canada in January 2006, a Conservative minority was elected, replacing the Liberals, Canada's second consecutive minority government. The new government, headed by Prime Minister Stephen Harper, has improved relations between Canada and the United States, enhanced government transparency, strengthened law enforcement and reduced the GST from 7% to 6%. The timing of the next federal election is uncertain, but there are strong indications that an election will be called within the year.

New Protocol to the Canada-U.S. Income Tax Convention

On September 21, 2007, the Honourable Jim Flaherty, Minister of Finance, and Henry M. Paulson, Jr., U.S. Secretary of the Treasury, have signed the Fifth Protocol (the "Protocol") to the Canada-U.S. Tax Convention (the "Convention"). The Protocol has taken approximately ten years to negotiate and provides many benefits for both Canadians and Americans.

We would like to highlight certain of the important changes introduced by the Protocol. Our in-depth analysis of the Protocol and the implications in respect of cross-border transactions will be forwarded by email in the near future.

Elimination of Withholding Tax on Interest Payments Between Canada and the U.S.

The current Convention generally reduces withholding tax on interest to 10%. The Protocol will eliminate withholding tax on interest paid between unrelated (arm's length) persons as of the second month after the Protocol enters into force. For interest paid between related persons (e.g., a subsidiary and its parent) there will be a full exemption as of the third year after entry into force. For the first and second years after entry into force, the source country tax rate is reduced from 10% to 7% and 4%, respectively. The Protocol provides that the withholding rates applicable to interest will not extend to (i) interest arising in the U.S. that is contingent interest of a type that does not qualify as portfolio interest under U.S. law, and (ii) interest arising in Canada that is determined by reference to receipts, sales, income or other cash flow of the debtor or a related person, changes in the value of property of the debtor or a related

person, or to certain distributions made by the debtor to a related person. Such interest will instead be subject to a 15% withholding tax rate.

Extension of Treaty Benefits to Limited Liability Companies

The current Convention does not provide any rules regarding the treatment of "hybrid" entities, such as LLCs, that are treated as corporations under the laws of one country but are treated as fiscally transparent in the other country. The Canada Revenue Agency had taken the position that a fiscally transparent LLC would not be entitled to benefits under the current Convention.

The Protocol provides that income earned through an LLC by a person who is a resident of the U.S. for purposes of the Convention will be treated by Canada as having been earned directly by that person provided the person is taxed on the amount in the same way as if the income had been derived directly. In this case, such persons will be entitled to the reduced rates of withholding tax under the Convention.

Other Provisions of the Protocol

Additional important changes in the Protocol:

- Certain key double tax issues, such as transfer pricing, may be settled through binding arbitration;

- Double taxation on emigrants' gains will be eliminated by providing for a step-up in the tax cost of property in certain cases;

- There will be mutual tax recognition of pension contributions; and

- The tax treatment will be clarified for stock options granted to employees while working in one country but who exercise or dispose of the options while working in the other country.

The Protocol must be ratified in both Canada and the U.S. in accordance with applicable procedures. Canada and the U.S. will give each other notice once its applicable procedures are satisfied. The Protocol enters into force on the date that is the later of the notifications of ratification and January 1, 2008.

2007 Federal Budget Included the Following Tax Measures for Business:

International Tax Fairness Initiative

Further changes to the international tax area are proposed in the budget, including changes that would extend the definition of "exempt surplus" to include income earned from active businesses in countries without tax treaties with Canada, as long as the country has signed a tax information exchange agreement (TIEA) with Canada. Exempt surplus of a foreign affiliate is not taxed by Canada, either in the foreign affiliate's hands or when it is repatriated to Canada. Currently, only active business income of foreign affiliates that are resident in treaty

countries with Canada can create exempt surplus. The change reflects the reality that some of Canada's tax treaty counterparties subject their residents to taxes at rates substantially lower than in Canada and also signals an increased emphasis on exchange of information between Canada and non-treaty countries.

Further, as an added incentive to enter into TIEAs with Canada, the budget proposes changes that will treat all income earned by foreign affiliates in countries that have neither a tax treaty nor a TIEA with Canada as foreign accrual property income (FAPI). This means it will be taxed in Canada as it is earned in the foreign affiliate. If Canada has already started TIEA negotiations with a country, this new tax treatment will apply starting in 2014 if no TIEA is signed with that country. For TIEA negotiations that begin after March 19, 2007, the new treatment will apply if a TIEA is not signed within five years of starting negotiations.

Deductibility of Interest for Investment in Foreign Affiliates

Related to the proposed rules increasing the scope of exempt surplus, the budget proposes to restrict the deductibility of interest expenses on investments by Canadian companies in their foreign affiliates. This change is intended to provide better matching of interest expense to income where that income may never be subject to Canadian taxes. The budget proposal provides that interest will still be deductible where it is used to generate non-exempt income.

The restriction on the deductibility of interest will apply to interest payable after 2007 on debt incurred after March 18, 2007. For existing non-arm's length debt, the restriction will apply to interest payable after 2008 and for existing arm's length debt it will apply for interest payable after 2009. This proposed change has raised concerns in the business community as being out of step with the approach taken by other countries and its implementation is uncertain.

Canada-U.S. Pension Contributions and Taxation of Stock Options

The budget announces that rules will be forthcoming to harmonize the tax treatment of pension contributions between Canada and the U.S. and clarify the treatment of stock options. Although no details are given, the changes to the tax treatment of stock options may be a codification of the current Canada Revenue Agency (CRA) administrative position where options granted for services performed outside of Canada are exercised in Canada, that is, that only the portion of the taxable benefit that arises on the exercise of the option that is attributable to services performed in Canada will be taxed in Canada.

Updated Capital Cost Allowance Rates

Depreciation rates for several classes of capital cost allowance have been updated:

- Computer equipment: rate increase to 55% (from 45%)
- Manufacturing and processing machinery and equipment: temporary rate increase to 50% (from 30%) for assets purchased before 2009
- Buildings used for manufacturing or processing: rate increase to 10% (from 4%)
- Non-residential buildings: rate increase to 6% (from 4%)

IS THIS A GOOD TIME TO START A BUSINESS IN CANADA?

This remains a good time to start a business in Canada. Canada has a well-educated, highly skilled work force, and is particularly attractive for white-collar, high-technology businesses. Canada also has reasonably priced office accommodation, industrial premises and undeveloped land available. Canada has an abundance of natural resources and extensive telecommunication and transportation infrastructure including highways, railways, sea ports, the St. Lawrence Seaway and the Great Lakes system of canals. Canadian cities are known as being safe and liveable and Canada is fortunate to have an abundant supply of clean, accessible water. Finally, Canadian business practices and legislative developments generally follow those in the U.S., giving U.S. business a unique advantage in anticipating business and legislative trends in the Canadian market.

HOW IS CANADA PERCEIVED AS A PLACE TO DO BUSINESS?

High commodity prices, significant business investment aided by the high Canadian dollar and strong consumer spending support the view that strong economic growth will continue in Canada in 2007. In 2006, Canada was the only member of the G7 with both a current account surplus and a budget surplus.

In early 2007, the Organization for Economic Co-operation and Development issued its report on seven major industrialized countries, including Canada. Canada was the only G7 country with a budget surplus. Canada's total government net debt-to-GDP ratio has been the lowest among the G7 since 2004. It is estimated that if trends continue, Canada will eliminate its public debt by 2021.

3. FORMS OF BUSINESS ORGANIZATION USED IN CANADA

Tax considerations are important in the selection of the form of business organization to be used in Canada. Refer to **Chapter 4: Taxation** of this publication for answers to general questions about income tax, the GST and other forms of direct and indirect taxation in Canada. This chapter describes the forms of business organization used in Canada.

BRANCH PLANT OPERATION

A corporation incorporated outside Canada (a foreign corporation) can establish a business in Canada by registering in the province of its choice as an extra-provincial corporation. There are several considerations to bear in mind. Note that there are two different legal concepts implied by the term "carrying on business." The issue addressed in this chapter is whether or not an entity is carrying on business in a province, requiring that entity to seek and obtain an extra-provincial licence under the Ontario *Extra-Provincial Corporations Act*. The term used from a taxation perspective under the federal *Income Tax Act* (the "Tax Act") is whether or not the entity has a permanent establishment in Canada requiring it to file returns and pay tax on income earned in Canada.

Corporate Name

Before a province will issue an extra-provincial licence, it requires some evidence that the name of the applicant foreign corporation is not so similar to an existing business name used in the province as to be confusing to the public. A search is undertaken on all corporate names used in the province, all business trade styles registered with the provincial government and all trademarks registered with the federal government. A corporation's use of a name that could be confused with the name of another entity exposes the corporation to a potential civil action, commonly referred to as a passing-off action. In such an action, a court can require the corporation to pay a portion of its profits to the complainant with a similar name and to cease and desist from using the name thereafter.

If the applicant's corporate name is not available, the province may still issue the licence but prohibit the applicant from carrying on business in the province under that name. It can, however, conduct business under a trade name selected by the applicant and available for use in the province. A separate extra-provincial licence is required for each province in which the foreign corporation carries on business. In contrast, Ontario does not require any corporation incorporated anywhere else in Canada to hold an extra-provincial licence. Any such corporation can carry on business in Ontario as of right.

Effect of Failure to Register

The critical determination is whether the foreign corporation will, in fact, be carrying on business in the province. The criteria may differ from province to province. However, for all practical purposes, once a foreign corporation employs a person who lives in the province in question, or leases or purchases real property and opens a business office, or takes out a telephone number or listing in a local telephone directory, in all likelihood that foreign corporation will be found to be carrying on business in the province. In Ontario, a foreign corporation that fails to register where it is carrying on business in the province will render the corporation unable to maintain an action or any other proceeding in any court or tribunal in Ontario until the registration is made. Fines can be imposed under the *Extra-Provincial Corporations Act*. In some other Canadian provinces, the effects of carrying on business as an unregistered foreign corporation are broader, including an inability to take title to real property in the province in question.

Attorney for Service

A foreign corporation seeking to register in a province as an extra-provincial corporation must designate a person resident in that province to accept service of legal documents. Service on the agent amounts to service on the foreign corporation. Often, the foreign corporation will designate an employee at its office in the province. Local Ontario legal counsel can also provide this service.

Limited Liability Companies — Uneven Provincial Treatment

Depending on the province in question, it may be easier (or harder) to conduct business in Canada through a LLC than through other forms of business enterprise. Ontario, for example, only requires that a LLC make a business name filing under the *Business Names Act*. No computerized name search, no licence application or review by a public servant, no waiting, and no requirement for a local agent for service. In contrast, Alberta requires a special opinion from counsel in the incorporating jurisdiction, special officer certificate, a computerized name search, a licence application that is subject to review and a resident agent for service. Other provinces treat LLCs as they would any other foreign enterprise applying for extra-provincial registration, that is, the Alberta approach without the foreign counsel opinion or certificate.

Foreign Corporations as Limited Partners of an Ontario Limited Partnership or a Foreign Limited Partnership Registered in Ontario as an Extra-Provincial Limited Partnership

As described in more detail under the heading "Limited Partnership" on page 3.17, Ontario's *Corporations Tax Act* deems each foreign corporate limited partner as having a permanent establishment in Ontario, and so may obligate each such corporation to register as an extra-provincial corporation in Ontario, to file returns and to pay tax on income earned in Ontario.

The advantages of using a branch plant to establish a business in Canada include:

- **Favourable tax treatment** — Losses commonly experienced in start-up branch operations can be written off against profits from the foreign corporation's other operations.
- **Minimal set-up costs** — No new legal entity needs to be created; the only requirement is to obtain an extra-provincial licence, as discussed above.

The disadvantages of using a branch plant to establish a business in Canada include:

- **Transfer pricing risks** — It may be difficult to isolate income earned in Canada. Cross-border transfer pricing may attract the attention of tax authorities in jurisdictions where the foreign corporation carries on business, especially in the location where it has its principal business operations.
- **Financial disclosure** — The foreign corporation is obligated to file its financial statements with its Canadian tax return. Financial statements consolidating more than one corporation are not acceptable for filing purposes.
- **Compliance with Canadian laws** — The foreign corporation will be subject to Canadian provincial and federal laws. For example, a fine or assessment representing the cost of cleaning up a contaminated work site might be satisfied by seizure of assets held outside Canada if a Canadian judgment is recognized in that jurisdiction. One strategy to mitigate this possible exposure is simply to incorporate a wholly owned subsidiary in the foreign corporation's home jurisdiction and have it register as an extra-provincial corporation in those provinces in which it carries on business, although doing so might defeat the favourable tax treatment described above.
- **Ineligibility for government funding** — Foreign corporations may not qualify for certain Canadian federal and provincial assistance programs.
- **Security for costs** — In court proceedings, a party contrary in interest to the foreign corporation may successfully apply for an order that the foreign corporation post security for costs with the court.

SOLE PROPRIETORSHIP

Non-Canadians may carry on business in Canada under their own names or trade styles, subject to compliance with the federal *Immigration Act* and registration of the business trade styles or names in the provinces in which they propose to conduct business. The considerations related to "corporate name" described above apply here.

CANADIAN CORPORATION WITH SHARE CAPITAL

There are 13 alternative Canadian statutes (10 provincial, two territorial and one federal) under which one may incorporate a corporation with share capital in Canada. This contrasts with the U.S., where it is not possible to incorporate federally. Below, we compare only the Ontario legislation (the *Business Corporations Act* (the "OBCA")) and the federal legislation (the *Canada Business Corporations Act* (the "CBCA")).

Incorporation Under the CBCA

An applicant must submit a name proposed for use in Canada to a computerized name search service. If the public servant reviewing the search concludes that the name is not available because, for example, it is too generic or too similar to an existing corporate name, business trade style or trademark used in any of the provinces, then the application will be denied.

If a proposed name is cleared, articles of incorporation are filed, along with specified initial notice forms. The government fee for filing articles of incorporation for a federal corporation is currently $200 for an electronic filing and $250 for a paper filing, plus legal fees and disbursements.

A CBCA corporation may, as of right, register as an extra-provincial corporation in each province where it carries on business and, in all cases other than Ontario and Québec, take out and maintain an extra-provincial licence. No licence is required by either Ontario or Québec for CBCA corporations. For each of the other provinces in Canada, CBCA corporations must go through the name search procedure for each province in which they conduct business and are required to hold an extra-provincial licence. Since the CBCA name search includes all names in all provinces, a newly incorporated federal company would not likely find its name refused by any province, provided the provincial name search and licence application is done within a relatively short period of time following its incorporation.

The CBCA requires the filing of a notice of change of directors and a change in the corporation's registered office.

Resident Directors

Subject to the exceptions described below, resident Canadians must comprise only 25% of the directors for CBCA corporations. A "resident Canadian" is defined as:

- A Canadian citizen ordinarily resident in Canada;
- A Canadian citizen who is not ordinarily resident in Canada but who falls into certain specified classes (e.g., a person who is a full-time employee of a Canadian controlled corporation); *or*
- A landed immigrant ordinarily resident in Canada. A landed immigrant is a person who has successfully sought lawful permission to establish permanent residence in Canada.

In the case of a landed immigrant, to remain qualified as a resident Canadian for the purposes of the CBCA, the landed immigrant must have made application for Canadian citizenship within one year of being entitled to do so. This is not a requirement for directors of an OBCA corporation.

Incorporation Under the OBCA

As in the case of the federal regime, a name search is required. Ontario name searches are conducted on the same database as for a federal incorporation. However, in Ontario, responsibility for ensuring that the proposed name is not confusing with other names rests with the applicant or its agent, and not with a public servant. Unless the name is identical, Ontario will not refuse to issue the requested articles of incorporation on the basis of the name search report.

The fee for filing articles of incorporation for an Ontario corporation is currently $360 plus legal fees and disbursements. In Ontario, articles can only be filed electronically.

An Ontario corporation must apply for an extra-provincial licence in each province in which it carries on business, other than the province of Québec. Ontario and Québec have a reciprocal arrangement under which corporations incorporated under their respective *Business Corporations Acts* are free to conduct business in the other province without the need for registration. As a result, a corporation qualified to do business in either Ontario or Québec has access to Canada's two largest markets: Toronto and Montréal.

Ontario law requires the electronic filing of an information return for all corporations carrying on business in Ontario, regardless of the legislation under which it is incorporated, (i) annually with the corporation's provincial tax return, and (ii) whenever there is a change in directors or officers or a change in the registered office of the corporation. There is no disclosure of the names of the corporation's shareholders in any publicly filed return, save as set out below under the heading "*Corporations Returns Act*" on page 3.12.

Except for corporations that are reporting issuers (see **Chapter 10: Regulation of Trading in Securities**), there is no obligation to file financial statements. A majority of directors of an OBCA corporation must be resident Canadians, although Ontario permits the use of a two-person board of directors if one of the directors is a resident of Canada.

One approach to satisfying the OBCA residency requirements is for the shareholders of the corporation to enter into a unanimous shareholder agreement under which all the directors' duties and responsibilities are assumed by the shareholders. The corporation then engages a qualified Canadian resident nominee as the sole director of the corporation. Directors (whether or not they are nominee directors) will usually require an indemnity from the corporation (or its parent company) as well as provide appropriate directors' and officers' liability insurance coverage. Only a portion of the costs incurred in negotiating and settling a shareholder agreement will be a deductible expense of the corporation for tax purposes.

Although the use of a unanimous shareholder agreement as outlined above satisfies the residency requirements, this procedure exposes the shareholder to all the obligations of a director. If the shareholder has "deep pockets," the shareholder could find itself subject to claims it would have been protected against, but for having entered into the unanimous shareholder agreement. As of June 1, 2007, section 108 of the OBCA was amended to give shareholders to a unanimous shareholder agreement the same defences that are available at law to directors. *Call us at 416 869 5300 if you require any further information regarding the use of unanimous shareholder agreements.*

The use of a unanimous shareholder agreement (USA) applies equally to CBCA corporations, although the lower resident director threshold (25% as opposed to more than 50%) may lessen the need to use USAs with CBCA corporations. It may be an advantage to incorporate federally rather than provincially if it is anticipated that a legal opinion will be required at some point, for example, on a financing or sale transaction.

Effective June 1, 2007, the OBCA was amended to bring its provisions more in line with those of the CBCA. Changes include the right to create classes of shares with identical share conditions, procedures to be followed by directors in making disclosure of conflicts of interest, confirmation that OBCA directors only owe a fiduciary duty to the corporation and not to any other stakeholders of the corporation, confirmation of the due diligence defence for directors and extension of director and officer indemnification beyond the corporation itself to affiliates of the corporation.

If the corporation in question is incorporated in one province and conducts business in another province, opinions from two different firms may be required. If, however, the corporation is federally incorporated, a firm in any province would be in a position to give most (if not all) of the necessary opinions. In addition, there may be an Internet domain name advantage to holding a federal charter. With the advent of online filing, there is no material difference between these two alternatives insofar as cost or convenience of filing is concerned.

On balance, given the choice between incorporating under the CBCA or the OBCA, our preference would be the CBCA in those cases in which there are only two shareholders. For OBCA corporations, it may be that if one of the shareholders or nominee directors refuses to attend meetings the other shareholder will be prevented from passing required corporate resolutions because of the manner in which the term “quorum” is defined in the OBCA. CBCA corporations do not face this uncertainty. If it is anticipated that the corporation will conduct business in more than one province, a CBCA corporation cannot be denied extra-provincial registration. The name clearance procedures required for incorporation include Canada-wide name conflict searches, more or less ensuring that the name will be available for registration in any province where registration is required, if done at or shortly following the date of incorporation.

The New Brunswick *Business Corporations Act*

Where the residency requirement for directors is a concern to you, non-Canadians can incorporate under the New Brunswick Business *Corporations Act*, which has no director residency requirements. The same applies to corporations incorporated under the British Columbia *Business Corporations Act* and the Nova Scotia *Companies Act*. In addition, a New Brunswick corporation may, in its articles, opt out of the financial assistance prohibitions that otherwise apply to corporations incorporated under the New Brunswick *Corporations Act*.

Unlimited Liability Corporations — Nova Scotia and Alberta (and, shortly, British Columbia)

Currently, Nova Scotia and Alberta are the only provinces that have the concept of an unlimited liability corporation (a "ULC"). As noted above, the Nova Scotia *Companies Act* (the "NS Companies Act") does not require that any of the directors of a ULC (a "NSULC") be resident in Nova Scotia or elsewhere in Canada. Under the Alberta *Business Corporations Act* (the "Alberta BCA"), at least 25% of the ULC's directors must be resident Canadians. The ULC has proven to be a popular choice with U.S. investors wishing to enter the Canadian market because of the U.S. tax treatment given to ULCs under American law, summarized below.

British Columbia passed an amendment to its *Business Corporations Act* on March 29, 2007 providing for the incorporation of ULCs under that Act ("BCULCs"). The amendment is not yet in force. One advantage of a BCULC will be that there is no requirement that any of the directors of a BCULC be resident in Canada.

Another important consideration when evaluating ULCs under the three provincial regimes is that of shareholder liability. Unlike Alberta ULCs (where the unlimited liability of shareholders captures present and past shareholders and is unlimited and joint and several), the unlimited liability of shareholders in BCULCs mirrors that of shareholders of NSULCs where shareholders have no direct liability to creditors other than on the liquidation or winding up of the NSULC. Even in this circumstance, liability does not extend to former shareholders of NS and BCULCs who have transferred their shares one year or more before the date that the company liquidates or dissolves.

Only existing BC companies may amalgamate to form BCULCs. As a result, any foreign corporations wishing to become BCULCs can only do so by continuing into British Columbia as a limited liability company and later amalgamating with another BC company.

Only certain extra-jurisdictional ULCs (including ULCs from Nova Scotia and Alberta) may continue into British Columbia as BCULCs.

Nature of Hybrid Status in Canada and the U.S.

Canadian provincial ULCs are treated for purposes of the federal *Income Tax Act* (the "Tax Act") as taxable Canadian corporations. At the same time, however, it is possible to have such Canadian provincial ULCs treated as partnerships for purposes of the U.S. *Internal Revenue Code* (the "Code").

In 1996, the U.S. Internal Revenue Service issued regulations to simplify the issue of entity classification for Code treatment by permitting eligible entities to "check the box" and thereby elect to be treated either as a branch or as a partnership for tax purposes, or as a corporation. While a standard Canadian business corporation is not eligible for "check the box" treatment (because of its limited liability nature), a ULC is permitted under the Code to make this election.

Benefits for Non-Residents Using ULC Inside Canada

The most obvious use of a ULC by an American investor is to transfer losses from operations in Canada to the U.S. parent entity, for example, as a substitute for establishing a branch plant operation in Canada in those circumstances where start-up losses are expected.

Another benefit from this structure is the step-up in the cost base of assets of the ULC for tax purposes that is recognized under the Code without, at the same time, triggering a taxable realization under the *Tax Act*. For example, a U.S. purchaser of a business (who wants to buy assets) may be able to convince a Canadian vendor (who wants to sell shares) to continue his limited liability corporation ("Opco") into Nova Scotia or Alberta (and soon, British Columbia) as a ULC. The procedure in Nova Scotia would involve the following steps:

- Continuation, say, from Ontario to Nova Scotia, by way of articles of continuance filed under each of the OBCA and the NS *Companies Act*. The move of Opco from one province to the other is not a taxable event in Canada or the U.S.
- The vendor would incorporate a shell NSULC.
- The vendor would cause Opco to amalgamate with the shell NSULC to form the target NSULC. For Canadian tax purposes, this transaction is a tax-deferred rollover under Section 87 of the *Tax Act*. For U.S. purposes, this transaction is likely to be characterized as a taxable liquidation of Opco, and a contribution by the vendor of the assets of Opco to the ULC at a cost basis equal to their fair market value at the time of amalgamation.

If the NSULC were liquidated, there will be the usual Canadian tax consequences of a deemed disposition of the company's assets at fair market value, and a deemed dividend to the extent that the proceeds paid exceed the paid-up capital of the shares held by the individual in the U.S. There will be a 15% withholding tax under the *Canada-U.S. Tax Convention* (1980). There should be no further tax in the U.S. as the payment will be characterized as a return of capital, due to the previous step-up transaction.

A second possible use of a ULC arises where a U.S. individual wishes to carry on business in Canada but cannot effectively use the foreign tax credits that would accrue from conducting business in Canada through a branch plant operation or limited liability business corporation. For example, if a limited liability business corporation ("Subco") were established in Canada, it would pay corporate tax at a rate of about 36%; at the time it paid a dividend to its U.S. shareholder it would pay a further 15% withholding tax in Canada on the amount of the dividend so paid. Under the Code, the U.S. individual would then be required to include an amount equal to the dividend paid to him in his income; however, the amount of tax credit he could use would be limited to the 15% withholding tax. The corporate tax paid in Canada cannot be used as a foreign tax credit. The resulting double tax is made worse, of course, if the U.S. individual chooses to use a U.S. Subchapter "C" corporation to hold the shares of Subco, because the Code contains no "integration" mechanism as is found under Canada's *Tax Act*. In this case, the total tax burden could approach 60%.

However, use of a ULC owned by the individual or a Subchapter “C” corporation under the Code offers the U.S. individual the ability to claim the full balance of both the Canadian corporate tax and withholding tax for foreign tax credit purposes. Use of a ULC permits the claiming of the foreign tax credit in respect of the Canadian corporate tax paid, without paying a dividend. This avoids Canadian non-resident withholding tax. Although there may still be some unused foreign tax credits, in this example, the effective combined U.S.-Canada tax rate would be approximately 42%.

There may be other advantages to using a ULC with respect to the tax treatment of payments to its U.S. shareholder and possible avoidance of the thin capitalization rules in Canada. Finally, U.S. transfer pricing rules do not apply to payments made by the Canadian ULC to its U.S. shareholder.

Disadvantages to ULCs

Notwithstanding the favourable treatment from the perspective of American tax law, there are, in fact, a number of technical concerns under the NS *Companies Act* in respect of ULCs. For example:

- The concept of the unanimous shareholder agreement does not apply to ULCs. Any limitations on the powers of directors must be set out in the articles of incorporation to the corporation.
- Financial assistance, including financial assistance for the purchase of shares in the parent of the ULC, is not permitted under the NS *Companies Act*, but is permitted by the Alberta BCA. This would complicate matters in the case of a leveraged buyout of the business conducted by the ULC. It should not be a problem under the Alberta BCA.
- Any amalgamation of a ULC constituted under the NS *Companies Act* requires the approval of the Nova Scotia court. This is not the case in Alberta.
- An NS *Companies Act* ULC may only pay dividends out of profits. Under the Alberta BCA, dividends may be paid as long as the ULC remains solvent.
- Only a Nova Scotia or Alberta lawyer can give an opinion in respect of the ULC, depending on the jurisdiction of incorporation.

Recent Changes to NSULC Taxes

Nova Scotia has recently introduced legislation, effective April 1, 2007, that will significantly reduce the costs of NSULCs in an attempt to compete with AULCs and BCULCs.

Pursuant to Nova Scotia's *Financial Measures (2007) Act*, the $2,000 initial registration tax under the *Corporations Registration Act* has been eliminated and the $4,000 incorporation or amalgamation tax under the *Companies Act* has been reduced to $1,000. Therefore, as of April 1, 2007, NSULCs will pay only $1,000 in incorporation/registration or amalgamation/registration taxes, which represents a significant decrease from the $6,000 previously payable.

However, despite the reduction to the incorporation/registration or amalgamation/registration taxes, NSULCs remain liable for an annual registration tax of $2,750. This tax is payable one year after initial incorporation for NSULCs incorporated or amalgamated on or after April 1, 2007. The annual renewal payments will be accepted at the old tax rate of $2,000 for those NSULCs with a March anniversary for incorporation.

Despite the changes introduced by the *Financial Measures (2007) Act*, NSULCs remain the most heavily taxed of the ULCs. AULCs are subject to a $100 corporate filing fee and the costs associated with having a service provider conduct the annual report filing. BCULCs will be subject to a $1,000 filing fee upon incorporation or amalgamation. Therefore, it will remain to be seen whether the reductions in the tax charges for NSULCs are sufficient to entice companies away from both Alberta and British Columbia.

Clearly, the introduction of BCULCs and the reduction in the amount of taxes payable for NSULCs signal a growing acceptance of ULCs and a desire to encourage foreign, particularly American, business in Canada. These recent changes may stimulate competition between the provinces that currently permit ULCs and will likely spur additional provinces to allow this increasingly popular corporate structure. However, in the most recent round of amendments to the *Business Corporations Act* (Ontario), which came into force on August 1, 2007, Ontario chose not to provide for the incorporation of ULCs.

British Columbia *Business Corporations Act*

British Columbia's *Company Act* (the "Old Act") had not been amended for 30 years prior to its repeal in 2004, and it contained a number of archaic provisions. British Columbia's *Business Corporations Act* (the "New Act") came into force on March 29, 2004. The following is a list of some of the more important changes to British Columbia's corporate law effected by the New Act:

- There is no residency requirement for directors.
- Companies may incorporate subsidiaries directly — incorporators do not have to be individuals.
- A company incorporated under the New Act does so by filing a notice of articles with the registrar under the New Act. The filing fee is $350 and the notice of articles contains only limited information about the company and no copy of the company's articles of incorporation. There is a right to pre-file by up to 10 days for future incorporations. This feature is attractive in that it accommodates an orderly closing in certain complex corporate reorganizations.
- A subsidiary is now permitted to hold shares of its parent, although it cannot vote those shares. In addition, a New Act company may amalgamate with a company incorporated under the legislation of another jurisdiction without requiring the corporation from the other jurisdiction to first continue under the laws of British Columbia.
- The granting of financial assistance is specifically authorized by section 195 of the New Act, and notice to all shareholders of the granting of financial assistance is required at or shortly after the giving of such assistance.
- One drawback is that there is no concept of a unanimous shareholders agreement under the New Act.
- Although the New Act did not initially provide for the incorporation of ULCs, British Columbia has amended (but not yet proclaimed in force) the New Act to provide for BCULCs.

Corporations Returns Act

The federal *Corporations Returns Act* (the “CRA”) imposes an obligation on every corporation carrying on business in Canada to file an annual return within 90 days of the end of the corporation’s fiscal year where:

- Its gross revenue from business in Canada for any fiscal period of the corporation exceeds $15 million; *or*
- The book value of the assets of the corporation at the end of the fiscal period in question exceeds $10 million;

or if any of the following conditions apply:

- Equity in the corporation held by a non-resident of Canada exceeds $200,000; *or*
- The corporation has direct or indirect debt obligations to a non-resident of Canada exceeding $200,000 with an original term to maturity of one year or more; *or*
- The corporation has direct or indirect debt obligations of any nature with a book value exceeding $200,000 to an affiliate, shareholder or director of the corporation who is a non-resident of Canada.

Each corporation that is subject to the CRA must complete and file a return within 90 days of its fiscal year-end disclosing the names, addresses and nationality/citizenship of its directors and officers, the corporation’s issued share capital, the specific shareholder interest in the corporation of each of its directors and officers, the name, address and shareholdings in the corporation of each other shareholder (or related group of shareholders) holding 10% or more

of any class of shares of the corporation, the shares (representing 10% or more of the issued shares in the company in question) owned by the corporation in other corporations doing business in Canada, and the corporation's debt obligations at the end of the period in question. The gross revenue and assets of a corporation subject to the Act include the gross revenue and assets of all affiliates of the corporation that carry on business in Canada. Obviously, this public record is a source of significant, and otherwise confidential, information about any corporation that is obligated to, and files, under CRA. *Contact us at 416 869 5300 if you want to have a search of the public record for such information as the names and shareholdings of corporations who have filed under CRA.*

The filing of a return by a holding company satisfies the filing obligation of each of its subsidiaries.

CRA also requires such corporations to provide information on any transfers of technology to them or any of their subsidiaries by any non-resident of Canada.

The information contained in the CRA reports is placed in the public record that may be searched by anyone interested in doing so.

Finally, every corporation obligated to file a CRA return must also file consolidated financial statements for the fiscal period in question. The financial statements are not made available to the public. These statements need not be audited, although an officer of the corporation is obligated to certify that the return and financial statements are correct and complete to the best of his/her knowledge and belief.

Use of a Corporation to Conduct Business in Canada

There are a number of obvious advantages to using a corporate form of business organization, including:

- **Limited Liability to the Shareholders** — A corporation incorporated in Canada (other than a ULC incorporated under either the NS *Companies Act* or the Alberta BCA) isolates the foreign parent corporation from general liabilities of its Canadian subsidiary although lenders may require the guarantee of the parent corporation or its principals.
- Separate Legal Entity.
- Perpetual Existence.
- **Transfer of Control** — Can be affected by the transfer of issued and outstanding shares.
- **Familiarity** — Ease of dealing with third parties; corporations are well-understood forms of business organization.
- Simplicity.
- **Raising Working Capital and Financing May Be Easier** — Can raise working capital by the issue of debt or shares.
- **Low-Cost** — Relative familiarity with this form of business organization throughout the marketplace ensures that corporate documentation should be less expensive to create than other business forms discussed below, apart from ULCs incorporated under the NS *Companies Act* or the Alberta BCA.
- **No Minimum Capitalization** — There are no minimum capitalization requirements, although under the *Tax Act* the thin capitalization rule (recently amended) provides that interest on debt above a 2:1 debt to equity ratio is not deductible as an expense.

The disadvantages of using a corporate form of business organization include:

- **Greater Regulatory Requirements** — *Business Corporations Act formalities, etc*.

- **Preparation of Financial Statements** — Both the federal and provincial regimes have detailed rules relating to the preparation of annual financial statements, whether or not they are audited.
- **Adherence to Financial Solvency Tests** — Business corporations incorporated in Canada must ensure that whenever shares are redeemed or purchased, or dividends are paid, the corporation will still be able to meet its obligations as they fall due. In addition, the realizable value of its assets must not be less than the sum of the corporation's third-party obligations and the stated capital (aggregate amount paid for all shares as they were allotted and issued) of each class of its issued shares.
- **Financial Assistance to Related Parties** — Under section 20 of the OBCA, an OBCA corporation is specifically authorized to give financial assistance by means of a loan, guarantee or otherwise to a related party, however, having done so it must then give a notice to its shareholders disclosing any material financial assistance so given, for OBCA corporations that are not reporting issuers within 90 days after giving the financial assistance in question, and for OBCA corporations that are reporting issuers, with the next management information circular or annual meeting materials. Similar rules apply for corporations incorporated under British Columbia's *Business Corporations Act*, although the said Act does not specify a fixed number of days following the giving of the financial assistance for compliance. Financial assistance rules are an ongoing concern for ULCs incorporated under the Nova Scotia *Companies Act*. By recent changes to the CBCA, there are no statutory requirements on CBCA corporations relating to related-party financial assistance. The better legislative approach might be that taken in the OBCA where financial assistance is specifically permitted. As is the case in the U.S., the focus of related-party transactions in Canada is on the issues of adequate consideration, fraud on the minority shareholders giving rise to "oppression" remedies under the applicable *Business Corporations Act*, and fraudulent preference issues which may affect the validity of a related-party transaction.

CORPORATIONS WITHOUT SHARE CAPITAL

Although of limited practical application, it is possible to incorporate in Canada, either federally or provincially, a corporation without share capital for certain permitted (education, scientific, philanthropic and religious) purposes. Such corporations often qualify as charities and are entitled to operate tax-free, but there are complex rules under the *Tax Act* governing what entities are permitted to issue charitable receipts for tax purposes. All profits must be applied for the purposes specified in the incorporating document. There is no standard form documentation for creating a corporation without share capital. As a result, incorporation and organization of a corporation without share capital may be more expensive. Compliance with the governing legislation is more cumbersome than compliance with *Business Corporation Act* formalities. The federal government has recently introduced legislation to amend the federal *Corporations Act*, which, if enacted, will modernize and dramatically change federal non-share capital corporations, and Ontario has initiated the usual stakeholder consultation process with a view to bringing its 1953 legislation more in line with current standards and requirements including changes relating to the qualification of directors, the removal of directors, meetings, director's and officer's liability and conflict of interest rules.

PARTNERSHIP

Partnerships are governed by provincial law. Partnerships are not separate entities, legally distinct from their partners under Canadian law. A partnership is a contractual relationship with legislated legal attributes set out in, for example, Ontario's *Partnerships Act*. A general partnership is a form of business organization where parties carry on business with a common view to making a profit. Whether or not a partnership exists is a question of fact and cannot be determined solely by the language of any agreement between the parties that either denies or asserts partnership. Several significant attributes arise if a court determines that the relationship between parties is that of partnership, including:

Fiduciary Obligations

There are fiduciary obligations between partners that result in a significant loss of freedom of action and loss of each partner's right, for example, to keep information from the other members of the partnership. One partner may be in a position to require another partner to account for profits from a competing venture that the latter may have believed were separate and apart from the partnership arrangement.

Agency

Each partner is an agent for the other partners. Even the unauthorized action of one partner may bind other partners to third parties. Authority of partners is in effect, divided among the partners.

Joint and Several Liability

There is full joint and several liability for all obligations of the partnership. This exposes all partners to the full obligation incurred by the partnership should one or more partners be unable to pay their own share or partnership debts.

Flow-Through Vehicle

A partnership is not recognized as a separate entity for purposes of the *Tax Act* or for any other purpose in Canada. Each partner is taxed at the personal level (or corporate level, if the partner is a corporation) for such partner’s share of the profits or losses from the partnership.

Qualification to Conduct Business

Each partner individually must qualify as carrying on business in those provinces of Canada in which the partnership carries on business. Significant adverse tax consequences flow as a result of a Canadian constituted partnership having a foreign member.

Partnership agreements are more expensive to prepare than the constating documents of other business forms of organization because of the detail with which they must be drafted and the dangers inherent in failing to provide for each of the matters that would otherwise be dictated by the application of provincial partnerships law.

Other Issues

It may be difficult to find and attract additional suitable partners, raising capital may be difficult, there is no perpetual existence, and the transfer of partnership interests may be complex.

LIMITED PARTNERSHIP

This is a separate form of partnership in which one class of partners, the limited partners, has limited liability for the obligations of the partnership, but otherwise have many of the same rights and obligations as the general partners, who have unlimited liability. Each limited partnership must have at least one general partner who is responsible for all obligations of the partnership to third parties.

Limited partnerships are often used in financing syndications where there are a number of passive investors who prefer the tax treatment as partners over the tax treatment as shareholders. To retain their status as limited partners, each is prohibited from participating in the management of the partnership’s business. If they do participate in management of the

partnership business, then they may be treated as general partners, lose the protection of limited liability and become jointly and severally liable with the limited partnership and all other general partners for all the obligations of the partnership.

None of the Canadian provincial *Limited Partnership Acts* has safe harbour rules similar to those set out in U.S. *Uniform Limited Partnerships Acts* to guide and protect limited partners. Generally, the Canadian provincial Acts simply prohibit participation by the limited partner in management of the partnership's business while providing no guidelines for what does and does not constitute "management" of the business.

Foreign-constituted limited partnerships in which all the partners are Canadian resident entities can conduct business in Canada, subject to registration as an extra-provincial limited partnership, without attracting taxes in the foreign incorporating jurisdiction. The usual tax-deferral rollover elections are available to such foreign-constituted limited partners as long as all of the partners are resident in Canada for purposes of the *Income Tax Act* (Canada). However, for an Ontario-constituted limited partnership carrying on business in Ontario, the *Corporations Tax Act* deems each corporate limited partner as having a permanent establishment in Ontario, obligating each such corporation not incorporated in Ontario to register in Ontario as an extra-provincial corporation under the *Extra-Provincial Corporations Act*, file tax returns and pay tax on income earned by it through the Ontario limited partnership. Although an unlikely result, a strict reading of the statutory provisions might obligate foreign corporate limited partners of an Ontario limited partnership whose business activities are entirely outside Ontario to file *Corporation Tax Act* returns in Ontario, however, the foregoing is certainly not the general practice in Ontario at this time.

In addition, the transfer of a limited partnership interest in a limited partnership that holds real estate in Ontario will trigger the requirement to pay tax under Ontario's *Land Transfer Tax Act* on the value of the land, without deduction for borrowed funds, including those secured by a mortgage or charge on the land in question.

Special rules under the federal *Income Tax Act* limit partnership losses that a limited partner may claim for tax purposes, including losses arising out of deductions for capital cost allowance (depreciation) on the capital assets of the partnership. These rules are referred to as the "at risk" rules. As in the case of general partnerships, significant adverse tax consequences flow as a result of a Canadian-constituted limited partnership having a foreign non-Canadian member.

After taking into account the above-noted concerns, Delaware limited partnerships are sometimes used in Canada in light of the relatively antiquated provincial *Limited Partnership Acts* in Canada and the ease with which one can comply with the *Delaware Act*. There had been a concern that Delaware limited partnerships would be treated as corporations for *Tax Act* purposes in Canada, but this concern seems to have been put to rest by the Canada Revenue Agency that administers the *Tax Act*.

Subject to the comments above affecting corporate limited partners, only the limited partnership itself and its general partner need qualify as carrying on business in those provinces of Canada in which the limited partnership carries on business.

CO-OPERATIVE

It is possible to constitute special corporations known as co-operative associations for certain purposes permitted by federal and provincial law. The property and assets of a co-operative are owned by the members of the co-operative through their membership in the co-operative and not through share capital. A co-operative form of business organization is intended to operate on a not-for-profit basis. The members are intended to benefit generally from the activities conducted by the co-operative. This form of corporation is sometimes used by credit unions and insurance companies, and has been popular in farm marketing and residential real

estate ownership. Obviously, this form of business entity has limited application and, in each case, is governed by specific enabling legislation.

JOINT VENTURE WITH OTHERS WHO CARRY ON BUSINESS IN CANADA

A joint venture is a form of business organization based on a contract. Each of the parties to the joint venture contributes the use of property owned by it for a single, identified, common purpose. There is no statutory basis for this form of business organization. Under a joint venture arrangement, the parties maintain a significant degree of independence in conducting their other business activities.

In practice, the most important goal in drafting a joint venture arrangement is to avoid having the structure characterized, at law, as a partnership, because of the duties imposed on partners (see discussion set out above). The existence of a partnership is a question of fact and every effort must be expended in structuring the joint venture arrangement and conducting its business to support the conclusion that the participants are not, in fact, partners.

BUSINESS TRUSTS

Although not widely used in the past, it is possible to use a form of trust known as a business trust to conduct a business enterprise in Canada. During the last five years, income and business trusts have become a more commonplace form of business enterprise and many have issued publicly traded trust units.

One of the unanswered issues faced by the holders of publicly traded trust units (in effect, the beneficiaries of the business trust) has been the extent to which they might be personally liable for the debts and obligations of the trust. By recent amendments to applicable law, trust unit holders have been given limited liability similar to that of shareholders in publicly traded corporate issuers.

In mid-2005, the federal government announced its intention to change the treatment given to trust distributions under the *Income Tax Act*. This announcement resulted in a strong backlash from investors, and the Minister of Finance announced that instead of changing the *Income Tax Act* treatment of trust distributions, the federal government would amend the Act to more or less equalize the taxes paid on dividend distributions by corporations commencing in 2006 (approximately 32%) to taxes paid on trust distributions (currently 36%, but scheduled to decline to approximately 32% by 2010).

Recent reports indicate the federal government may be reconsidering its position regarding the taxation of income trusts for certain sectors, notably in the natural resource industries. Without some change in policy, private equity firms will likely continue to acquire businesses from income funds that are no longer able to raise the capital to acquire additional businesses and make needed capital investments.

DISTRIBUTORSHIP, LICENSING AND FRANCHISE ARRANGEMENTS

Apart from establishing business operations in Canada using any one of the business forms described above, a foreign corporation or investor could enter the Canadian market indirectly through the use of independent sales agent, distribution, licensing or franchising arrangements. On the face of it, these alternatives avoid the obligation to register in each province as an extra-provincial corporation and to meet certain compliance obligations that would ordinarily arise if the foreign corporation entered Canada directly. However, out of an abundance of caution, it is our general practice to advise our foreign franchisor clients to register under the extra-provincial corporations acts of the applicable provinces. Some other aspects of these arrangements that might influence the decision to pursue them include:

Intellectual Property Protection

The investor must comply with intellectual property legislative registration requirements to ensure that foreign trade-marks, designs, patents and copyright are properly protected and do not fall into the public domain.

Withholding Tax

A 25% withholding tax applies to most payments of royalties and management fees. In some cases this is reduced to nil, 10% or 15%, depending on the applicable tax treaty with Canada.

Anti-Trust — Competition Act

There are restraint of trade laws, such as those relating to tied selling and resale price maintenance provided for in the federal *Competition Act* that should be reviewed carefully with respect to any of the arrangements referenced above.

Regulation — Franchises

In 2000, the Ontario government passed the *Arthur Wishart Act (Franchise Disclosure), 2000* (the "Arthur Wishart Act") to regulate certain aspects of the franchise industry in Ontario. Alberta and Prince Edward Island are currently the only other provinces in Canada with franchise disclosure legislation in force.

In December 2005, New Brunswick became the fourth Canadian province to introduce franchise legislation. The Act has been passed, but its draft regulations have not been finalized and as a result, the legislation has yet to be proclaimed into law. It is anticipated that the law will come into force some time in the late 2007 or early 2008.

The *Arthur Wishart Act* requires franchisors to give franchisees prospectus-like disclosure of all material facts about the business, operations, capital and control exercised by the franchisor and the subject franchise system. A material fact is one that would have a significant impact on the price or value of the franchise or on the franchisee's decision to purchase the franchise. Of the available exceptions to the disclosure requirement, there are two that are most often relied upon. The first applies where the franchisee in question has an existing franchise location and the new franchise is substantially identical and no material changes have occurred since the existing agreement was signed or renewed. The second applies to "sophisticated investors," defined as persons who will, over the next year following the execution of the franchise agreement, be investing $5 million or more in the franchise operation.

Typical of such legislation elsewhere, there is a 14-day mandatory cooling off period between the time of disclosure and the signing of any agreement related to the franchise. The *Arthur Wishart Act* imposes a fair dealing obligation on both parties, that is, a duty to act in good faith in accordance with reasonable commercial standards. Franchisees will be permitted to form dealer associations, a practice commonly prohibited by standard pre-Act Canadian franchise agreements.

Amendments to regulations that came into effect on March 22, 2004 include the following:

- A definition of "franchisor's agent" was added in order to clarify the right of action for damages against agents that is included in the Act. Before, the term was not defined. A "franchisor's agent" is now defined as a sales agent of the franchisor who is engaged by the franchisor's broker and who is directly involved in the granting of a franchise.

- The mandatory disclosure of all costs associated with the franchise was amended to limit the disclosure only to the costs associated with the establishment of the franchise. Previously, the regulation required disclosure of all costs associated with the establishment and operation of the franchise. This is a positive development, and brings Ontario in line with the disclosure regimes in other jurisdictions.
- All franchise location closures that occurred within the three fiscal years immediately preceding the date of the disclosure document must be disclosed. Previously, the regulation required continuous disclosure of all such closures within the previous three calendar years from the date of the disclosure document. This too is a positive development, as it simplifies the task of keeping disclosure documents current.
- The criteria for the exemption from the requirement to provide financial statements in the disclosure document has been expanded to recognize situations where a franchisor meets the criteria because it is controlled by a corporation that meets the prior criteria for the exemption. Certain franchisors who previously did not qualify for the financial statement exemption may now qualify.

Independent Sales Agents

An independent sales agent is usually an "order taker." Distributors usually operate on a purchase for resale basis, although consignment arrangements are possible. Consignments are not commonplace in Canada because of the high degree of control that the consigning party must exercise over the goods in question, and personal property security legislation may expose the goods to the secured creditors of the consignee.

Regulation — Distribution Arrangements

If you wish to enter the Canadian market through the use of a distributor, care should be taken to structure the arrangement so as to meet certain tests established by case law. If the tests are not met, there is a risk you will be found to be the distributor's "employer" with attendant adverse consequences.

Costs

Costs might be significant; however, standard documentation developed by a foreign business for use in other jurisdictions would likely be acceptable in Canada with some modifications.

Court Proceedings

Costs might be significant; however, standard documentation developed by a foreign business for use in other jurisdictions would likely be acceptable in Canada with some modifications

4. TAXATION

WHAT LEVELS OF GOVERNMENT LEVY INCOME TAXES?

The federal and provincial/territorial governments are entitled to levy taxes on income earned in Canada. Income tax is levied on “persons,” a term that refers to individuals, trusts and corporations. Partnerships do not pay income tax and are treated as conduits in determining any income tax their partners/members must pay.

WHAT IS THE MEANING OF THE TERM “RESIDENT” AS USED IN THE TAX ACT?

Federal income tax liability is based the concept of “residence.” However, the federal *Income Tax Act* (the “Tax Act”) does not contain an exhaustive definition of this term. Under the common law, an individual is considered to be a resident of Canada if Canada is the place

where that person regularly and customarily lives. Other factors in determining residency are intention and the existence of other ties to Canada, including the location of dwelling places, personal property, spouses and dependants, as well as social and economic interests. Also, individuals will be deemed to be residents of Canada for any year they stay in Canada for 183 days or more in that calendar year.

A corporation incorporated outside Canada will be considered resident in Canada if its central "mind" and management are located in Canada. In other words, if the directors of a foreign corporation or those who control or manage the corporation are residents of Canada and meet in Canada, the central mind and management would, as a result, be considered to be in Canada, and the foreign corporation will be a resident of Canada for Canadian income tax purposes. A corporation will be deemed to be resident in Canada if it was incorporated in Canada after April 26, 1965, or, if incorporated before that time, it was resident in Canada or carried on business in Canada at any time after April 26, 1965.

When a trust has a single trustee, the trust is generally considered to reside where the trustee or a majority of the trustees (when there is more than one trustee) who manage the trust or control the trust assets reside.

WHEN WOULD A NON-RESIDENT OF CANADA BE CONSIDERED TO BE "CARRYING ON BUSINESS IN CANADA" FOR PURPOSES OF THE TAX ACT?

Residents of Canada are liable for tax on their worldwide income from any source for the period they are residing in Canada.

If a non-resident carries on a business that has ties to Canada, the business income will be taxable in Canada only if the business activity is considered to be occurring in Canada. Often, it is possible to conduct business with Canadians without "carrying on business in Canada" for purposes of the *Tax Act*, thereby avoiding Canadian income taxes. Some factors that determine whether a person is carrying on business in a particular place include:

- Location where the contract is made;
- Location where payment for goods is made or where delivery of goods is made; *and*
- Location where the operations that result in profits take place.

The *Tax Act* also considers non-residents to be carrying on business in Canada if they provided, grew, mined, created, manufactured, fabricated, improved, packed, preserved or constructed anything in Canada. Non-residents are also deemed to be carrying on business in Canada if they solicited orders or offered anything for sale in Canada through an agent or employee, whether the contract or transaction was to be completed inside or outside Canada.

Non-residents are taxable in Canada on income from Canadian sources. This includes income from employment in Canada, from carrying on business in Canada and from the sale or transfer of taxable Canadian property. Such property, generally, is Canadian real property, shares of a private corporation resident in Canada, interests in certain trusts resident in Canada, and capital property used in carrying on a business in Canada.

WHAT EFFECT DO TAX TREATIES HAVE ON CANADIAN TAX RULES?

The above rules are often overridden by tax treaties between Canada and the country from which the non-resident operates. For example, the Canada-U.S. *Income Tax Convention (1980)* (the "Treaty") affects the tax status of a U.S. resident corporation or individual. The U.S. resident's business profits from a Canadian source are not subject to income tax in Canada unless the profits are derived from the U.S. resident's "permanent establishment" in Canada, or unless the business profits are of a special nature, such as rents, royalties, interest

or dividends. Non-resident corporations wanting to claim an exemption from Canadian income tax based on a tax treaty must file an information tax return disclosing their position.

The Treaty defines a permanent establishment as a fixed place of business, such as an office or factory, that includes someone who can effect contracts in the name of the non-resident. There are exceptions. For example, operating a business through a Canadian subsidiary will not constitute a permanent establishment for a U.S. parent corporation, although the subsidiary would be liable for Canadian income tax on its world income. A U.S. resident is not considered to have a permanent establishment in Canada if the resident carries on business in Canada through an independent agent.

Canada can tax the capital gains that U.S. residents realize when they dispose of certain types of property they own in Canada. Such properties can be real property, or the shares of certain corporations, partnerships, trusts or estates, if the value is derived principally from Canadian real estate or other business property of a permanent establishment in Canada. Otherwise, a resident of the U.S. disposing of a taxable Canadian property is generally not subject to Canadian income tax.

For a summary of the changes to the Convention arising from the Fifth Protocol to the Convention which was signed on September 21, 2007, see the comments on page 2.7 under the heading “New Protocol to the Canada-U.S. Income Tax Convention”.

WHICH TAX RATES APPLY TO INDIVIDUALS?

The calculation of an individual’s federal income tax is based on a four-bracket progressive system. The tax rates are:

- 15.5% for incomes up to $37,178
- 22% for incomes up to $74,357
- 26% for incomes up to $120,887, and
- 29% for incomes over $120,887.

The provinces also have a progressive tax rate system. The top provincial tax rates range from 10% to 24%. Adding federal and provincial surtaxes, the top personal marginal tax rate can be between 39% and 49%, but for most provinces it is closer to 46%. The top tax rate generally applies to annual taxable incomes over $120,887. Canadian dividends and capital gains receive favourable tax treatment by the Canada Revenue Agency (“CRA”). Canada Pension Plan contribution levels are significantly lower than U.S. Social Security mandatory contributions.

WHICH TAX RATES APPLY TO CORPORATIONS?

In most cases, corporations in Canada pay a flat rate of income tax, both federally and provincially, that amounts to a combined federal/provincial rate of about 32% to 38%, depending on the province. The federal and provincial governments give some relief for Canadian-controlled private businesses and manufacturing businesses. In addition, some provinces provide tax benefits for new businesses.

WHICH WITHHOLDING TAXES APPLY?

Payments to U.S. residents of dividends, interest, rent, royalties and certain management fees from Canadian sources are generally subject to a 25% Canadian withholding tax, applied at source by the payor, calculated on the gross amount of the payment. The applicable withholding rate for dividends under the Treaty is reduced to 15%. In addition, under the Treaty, only a 5% withholding tax is imposed on the gross amount of dividends paid or

credited by a Canadian corporation to its controlling, corporate shareholder resident in the U.S. The withholding tax rate for interest is reduced under the Treaty to 10%.

The Canadian government has announced that it plans to eliminate withholding tax on interest payments from Canada to arm's length recipients worldwide as well as to arm's length and non-arm's length recipients in the U.S. Most royalties are subject to a 10% withholding tax, but exceptions are made for some copyright royalties, computer software royalties and certain know-how royalties on patents or information concerning industrial, commercial or scientific expertise.

It is possible to pay management and administrative fees to a U.S. affiliate on a tax-preferred basis. Under the Treaty, management and administrative fees are included in business profits. If the U.S. affiliate provides management and administrative services for a fee and if the fee is reasonable, the subsidiary can claim it as a deduction for Canadian federal income tax purposes; and the fee will not attract Canadian withholding tax. Under Ontario's *Corporations Tax Act*, however, approximately one-third of the total of such amounts in excess of specific expenses incurred (as well as amounts paid to a non-arm's-length, non-resident person for rents, royalties or other similar payments, but not payments for computer software royalties and certain know-how royalties) are, in effect, not deductible from the income of the Canadian corporation for Ontario corporation tax purposes. This results in an additional tax of about 5% on these payments. With the harmonization of Ontario's corporate tax system with the federal tax system, this add-back rule will be eliminated for tax years beginning after 2008.

Non-Canadian clients often ask how to receive money from their Canadian subsidiaries so that the payments are deductible by the Canadian subsidiary but not subject to Canadian withholding tax. One technique is found in the management services and cost reimbursement agreement, under which the Canadian subsidiary agrees with its U.S. parent to:

- Pay reasonable management fees;
- Pay reasonable fees for contracts negotiated on its behalf by the parent; *or*
- Reimburse the parent for expenses incurred by the parent on its behalf.

Due to certain exemptions in the *Tax Act* and the Treaty, there is no Canadian withholding tax on such payments; provided the fees paid are reasonable, the Canadian subsidiary can claim them as deductions for federal income tax purposes (subject to the restriction noted above on deductibility for purposes of Ontario tax). However, due to the rules on transfer pricing, the CRA can adjust the income of a Canadian taxpayer and apply penalties if that taxpayer and a non-arm's-length non-resident person participate in a transaction:

- In which the terms and conditions differ from those that would have been made between persons dealing at arm's length; *or*
- That would not have been entered into between persons dealing at arm's length, and the transaction cannot reasonably be considered to have been entered into primarily for *bona fide* purposes other than to obtain a tax benefit.

Careful consideration must be given to loan transactions between non-resident shareholders and a Canadian corporation, and to interest charged on such loans.

WHAT ARE BRANCH TAXES?

In addition to the normal level of corporate income tax applied to business profits, a branch tax of 25% (reduced to 5% under the Treaty) is levied on the after-tax business profits of a non-resident foreign corporation carrying on business in Canada through a branch rather than as a Canadian subsidiary corporation (the "Branch Tax"). Certain Canadian branch businesses are exempt from this tax; they include communications, the transportation of people and goods, and the mining of iron ore in Canada.

The Branch Tax compensates for the 25% Canadian withholding tax (reduced to 15% or 5% under the Treaty) that would otherwise apply to dividends paid by a Canadian subsidiary to a non-resident, corporate shareholder. Generally, branch profits reinvested in Canadian business assets are not subject to the Branch Tax.

The Treaty provides that the first $500,000 earned by a Canadian branch operation of a U.S. resident company is exempt from Branch Tax. Many U.S. enterprises operate as a branch in Canada if they expect start-up losses in their Canadian operations, because such losses can then be consolidated against profits of the U.S. corporation. The foregoing treatment is not generally afforded to a separately incorporated subsidiary of a U.S. parent corporation.

Most U.S. enterprises operating branches in Canada incorporate a Canadian subsidiary once the operations become profitable and the $500,000 cumulative threshold of earnings has been used. The capital assets of the branch (other than real property) can be transferred on a tax-deferred, rollover basis to the Canadian subsidiary. Thus, the 5% tax can be deferred until dividends are paid by the subsidiary.

WHAT TAXES APPLY ON THE DEATH OF A U.S. RESIDENT?

On the death of a U.S. resident who owns certain Canadian real estate-related assets, as described earlier, the *Tax Act* stipulates that capital gains are deemed to have been realized. The Treaty permits the realization to be deferred in cases where the resident has left the property to a spouse or to a trust set up exclusively for the spouse. The Treaty also grants a tax credit for the Canadian tax on capital gains; this credit can be applied against the U.S. estate tax otherwise payable.

WHAT OTHER PROVINCIAL TAXES ARE IMPOSED ON CORPORATIONS?

Several provinces, including Ontario, impose an annual tax on the paid-up capital of corporations having a permanent establishment in the province, whether the corporation is a resident of the particular province or not. The general rates of provincial capital tax vary between 0.20% and 0.49%, with exemptions or lower rates on capitalizations under threshold amounts. A higher rate is imposed on financial institutions by provinces that levy a capital tax. This tax may not necessarily be applied in the same way for a subsidiary as for a branch. In Ontario, special rules apply to calculate the tax base of a branch and this could result in a significantly higher tax base. The tax base calculation for a branch is affected by the taxable income the foreign corporation earned in Canada; when this is significant, it may be desirable to incorporate the branch operation.

Under Ontario's *Municipal Act and the Assessment Act*, municipalities in Ontario levy property taxes on the current value or average current value of real property within the municipality. Each municipality sets the rate of property tax in each tax year. The rate of property taxes varies from one municipality to another, depending on the revenue requirements. Unpaid property taxes become a charge against the property.

Most commercial property lease payments in Ontario are net and the lease usually stipulates that the tenant is responsible for the property taxes. Some leases also stipulate that the tenant must pay the landlord's capital tax attributable to the property. If you intend to lease premises in Ontario, you should review the lease terms carefully and if you agree to assume all or part of these tax charges, get an estimate for your budgeting purposes.

All employers in Ontario must pay the Employer Health Tax of 1.95% levied on the gross amounts of wages and salaries and other remuneration paid to employees who either report for work at a permanent establishment in Ontario or are paid from or through a permanent establishment in Ontario where gross remuneration paid by the employer to its employees exceeds $400,000 per year. This tax helps to fund the Ontario health care system.

WHO IS REQUIRED TO FILE A TAX RETURN IN CANADA?

Resident individuals are required to file annual income tax returns if they have tax to pay or if they realize a taxable capital gain or dispose of capital property in the year. Non-resident individuals are required to file annual income tax returns if they are employed in Canada or carry on a business in Canada and have tax to pay or if they realize a taxable capital gain or dispose of taxable Canadian property in the year. In addition, an income tax return must be filed if so requested by the revenue authority. In general, individual income tax returns must be filed by April 30 of the year following the particular tax year. Individuals who carried on a business in the year must file their income tax returns by June 15 of the year following the tax year.

Resident corporations are required to file federal income tax returns whether or not they have any income tax to pay. Non-resident corporations are required to file federal income tax returns if they carried on a business in Canada, realized a capital gain, or disposed of taxable Canadian property in the year, or if income tax under Part 1 of the *Tax Act* is (or but for a tax treaty would be) payable by the corporation for the year. Tax returns cannot be filed on a consolidated basis; each corporate taxpayer must file its own tax return with its own financial statements. Several provinces require corporations to file separate provincial income tax returns. Corporation tax returns are due within six months of the corporation's fiscal year end, which might not necessarily be December 31. Tax is generally payable in periodic instalments throughout each year, and interest charged on deficient payments is not a deductible expense for income tax purposes.

Canadian resident corporations and non-Canadian resident corporations that carry on a business in Canada must file an information return describing certain transactions that they entered into with non-resident, non-arm's length persons.

The information return includes background information on the non-resident person and summarizes the transaction(s) entered into between the parties. This information return is due within six months of the corporation's fiscal year end and, obviously, is used by the CRA to analyze the cross-border charges between related parties.

WHAT IS THE GOODS AND SERVICES TAX?

Effective January 1, 1991, the federal government introduced the Goods and Services Tax ("GST"). It replaced the commodity or excise tax previously imposed on certain domestically produced goods. The GST is a broad-based value-added tax of 6% imposed on goods sold or rented and services provided. Certain goods and services are zero-rated; there are exemptions for others.

To eliminate the cascading effect of the GST, a system of input credits allows most businesses to claim a credit for any GST paid on the purchase of goods or services. The total GST component on most goods and services is, as a result, ultimately paid by the consumer and is 6% of the final price.

With few exceptions, every person who makes a taxable supply in the course of a commercial activity in Canada is required to register for, collect and remit the GST to the government.

WHAT PROVINCIAL SALES TAXES ARE IMPOSED IN CANADA?

All provinces except Alberta impose a retail sales tax on personal property purchased for consumption rather than resale, and on selected services.

Sample Rates of Retail Sales Tax Across Canada

Province	Rate (%)
British Columbia	7
Saskatchewan	7
Manitoba	7
Ontario	8
Québec	7.5
Prince Edward Island	10

The federal government along with the governments of New Brunswick, Nova Scotia and Newfoundland have replaced the GST with the Harmonized Sales Tax ("HST"). The HST blends or combines the 6% GST with an 8% provincial tax component, resulting in a 14% HST rate in the participating provinces.

In some provinces, retail sales tax is applied to the cost of goods including the GST, while in other provinces the retail sales tax is calculated on the price of goods excluding the GST.

There are other provincial sales taxes in Ontario, such as a 10% entertainment tax on live theatre and film performances and a tax imposed on gasoline.

WHAT ARE THE INCENTIVES TO ESTABLISH NEW BUSINESSES IN CANADA?

In contrast to the U.S., the tax system in Canada provides no special incentives to new businesses. Through recent tax reform, the federal government has attempted to make the income tax system as neutral as possible, although, it is possible to obtain modest municipal tax relief and other incentives to establish new businesses. See pages 7.9 to 7.12 for a summary of federal and provincial incentive programs available to business.

HOW ARE CERTAIN U.S. FORMS OF BUSINESS ENTITY CHARACTERIZED IN CANADA?

The characterization for Canadian income tax purposes of certain U.S. entities has been the subject of much doubt over the past few years. The CRA has, however, issued technical interpretations clarifying the status of some entities.

For example, after initial uncertainty, the CRA has taken the view that partnerships formed under the Delaware *Revised Uniform Partnership Act* or under the partnership legislation of certain other U.S. states will be treated as partnerships for Canadian tax purposes and not as corporations.

The CRA has also provided opinions that U.S. limited liability corporations ("LLC") formed under certain U.S. states will be regarded as corporations for Canadian income tax purposes even though they may be disregarded or treated as partnerships for U.S. income tax purposes.

A Nova Scotia or Alberta unlimited liability company can provide for significant flexibility in cross-border transactions. For income tax purposes, these entities are generally treated as corporations in Canada and as partnerships in the U.S. Think of the opportunities for tax planning.

WHAT OTHER TAXES ARE IMPOSED IN ONTARIO?

Each province has a right to impose indirect taxes. The following is a list of the indirect taxes that currently apply in Ontario:

- **Realty Taxes** – Under Ontario's *Municipal Act* and the *Assessment Act*, municipalities in Ontario levy property taxes on the assessed value of real property within the municipality. Properties are assessed on the basis of their current value or average current value. Residential properties have increased in value strongly over the last 3 years. Municipalities have the power to tax different classes of property at different rates. The municipality sets the amount of tax levied on a property in each tax year, and property taxes levied on comparable properties may vary from one municipality to another depending on their different revenue requirements. Property taxes, if unpaid, become a charge against the realty.
- **Land Transfer Tax** – This provincial tax is imposed at the time of the transfer of either registered or beneficial title to real property. The progressive rate is currently approximately 0.5% on the first $55,000 of proceeds on the transfer of title; 1% on the next $195,000; and 1.5% on proceeds exceeding $250,000 for lands other than residential properties. For residential properties, the land transfer tax is 2% of proceeds over $400,000.
- **Payroll Health Tax** – All employers in Ontario must pay the Employers Health Tax of between 0.98% and 1.95%, levied on the gross amounts of wages and salaries and other remuneration (gross remuneration) paid to employees who either report for work at, or are paid from or through a permanent establishment in Ontario whose gross remuneration exceeds $400,000 per year. Graduated rates apply to employers whose gross remuneration is less than $400,000. The employers' health levy helps to fund the cost of the Ontario health care system.
- **Ontario Health Premium** – In addition, there is an Ontario Health Premium. For individuals earning taxable income of between $20,000 to $200,000 the premium is $60 per year and for individuals with an annual taxable income of $20,000, increasing incrementally to $900 for individuals with an annual taxable income of more than $200,000.
- **Workplace Safety Insurance Premium** – This provincial tax is levied on employers to build a fund for workers who lose earnings when they are injured in an accident arising out, or in the course, of their employment. Employers' contributions depend on the hazard rating that the Workplace Safety and Insurance Board assigns to their industries and on their individual industrial safety records. With very few exceptions, workers are entitled to only the benefits fixed by the fund and cannot sue their employers for damages arising out of a work-related injury or disease.

In addition, two important federal social programs are funded through the tax mechanism:

- **Employment Insurance Contributions** – Employees must contribute 1.95% of insurable earnings up to a maximum annual contribution of $761. Employers must contribute an average of 1.4 times the employee contributions.
- **Canada Pension Plan Contributions** – Employers must match employee contributions to the plan. Employees contribute a maximum of 4.95% of their pensionable earnings per year up to a maximum annual contribution of $2,004.75. The rate for self-employed persons is 9.9% of pensionable earnings up to a maximum annual contribution of $4,009.50.

5. CANADIAN INTELLECTUAL PROPERTY REGIME

Canada has a comprehensive legislative scheme similar to that of the U.S. for the protection of trade-marks, copyright, patents and industrial designs. A brief overview follows.

TRADE-MARKS

The federal *Trade-marks Act* (the "Act") was brought into force in 1954 and has remained in substantially the same form since that time although amendments have been made from time to time. The Act provides for a public registry system which is national in scope, showing for each registered trade-mark the date of registration, a summary of the application for registration, a summary of all documents deposited with the application or subsequently filed affecting rights to the trade-mark, particulars of each renewal and particulars of each change of name and address. The purpose of providing this system is to define and protect the rights of registered trade-mark owners. The system facilitates the protection of trade-marks by providing for public notice of rights and granting exclusive rights to owners.

This registration system co-exists with common law trade-mark rights. Common law rights can be acquired through actual use of the common law mark in association with wares or services. As a common law trade-mark becomes known and goodwill is associated with it, the common law trade-mark owner will be able to assert claims against others who use confusing common law trade-marks in the specific region or area that the common law trade-mark owner has built up goodwill. These rights are asserted by bringing an action in the courts for "passing off."

The essence of a protectable trade-mark is its distinctiveness. Generally speaking, in order to have the benefit of protection, a trade-mark must be distinctive in the sense that it distinguishes the wares or services in association with which it is used by its owner from the wares or services of others.

The Act has been amended from time to time to allow for the licensing of trade-marks. Section 50 provides that for the purposes of the Act, if an entity is licensed by or with the authority of the owner of a trade-mark to use the trade-mark in a country and the owner has, under the licence, direct or indirect control of the character or quality of the wares or services, then the use, advertisement or display of the trade-mark by the licensee has the same effect as if done by the owner. Section 50 applies retroactively.

Under Section 50, use of the licensed mark is deemed to be use by the owner to ensure the distinctiveness of the mark is not affected by the licence. However this deemed use is only for the purpose of the Act; for any other purpose, the trade-mark owner is not deemed to have sold the goods or provided the services.

The Act does not contain any limitation concerning the form of the applicable licence other than it must be with the authority of the owner of a trade-mark who must have, under the licence, direct or indirect control of the character or quality of the licensed wares or services.

Control by the trade-mark owner of the character or quality of the licensed wares or services is of fundamental importance since a licence without adequate control may result in the invalidity of the mark. For the purposes of the Act, to the extent that public notice is given of the fact that the use of a trade-mark is a licensed use and of the identity of the owner, it will be presumed, unless the contrary is proven, that the use is licensed by the owner of the trade-mark, and the character or quality of the wares or services is under the control of the owner. The foregoing presumptions are rebuttable.

A trade name or a business style is a name under which an entity conducts business. In Ontario, trade names must be registered under Ontario's *Business Names Act*. While a trade name may be used as a component of a trade-mark, there may be technical issues relating to whether the requirements of the Act relating to trade-mark use are being satisfied. Typically, the requirements of the Act can be satisfied if specific design elements are added to the trade name to help make it clear that it is also being used as a trade-mark. However, care must be taken if such a strategy is to be adopted.

The Québec *Charter of the French Language* generally requires that commerce and business in the province of Québec be conducted in French. In particular, the *Charter of the French Language* provides that firm names, product labelling, publications, contracts, signs, posters and commercial advertising must be written in French. The Regulation Respecting the Language of Commerce and Business pursuant to the *Charter of the French Language*, however, provides an exception that permits the use of a registered or applied for trade-mark in English unless a French version has been registered. The regulation also provides that "an expression taken from a language other than in French may appear in a firm name to specify it provided that the expression is used with a generic term in the French language."

Accordingly, a corporation may, in public posting and commercial advertising, use a trade-mark in a language other than French, without any translation in French, if such trade-mark is recognized under the federal *Trade-marks Act*, and no registration of a French version has been applied for or obtained in Canada, or if it is established exclusively outside of Québec and such trade-mark is a component of a firm name.

A corporation may also, in its business name, use a trade-mark in a language other than French, without any translation in French, if such trade-mark is recognized under the *Trade-marks Act*, and no registration of a French version has been applied for or obtained in Canada provided, however, that a French generic term is included in such business name.

One recent trade-mark case of note is a decision in which the Federal Court of Appeal overturned the 50-year practice of the Canadian Trademarks Office when the Court determined that applications for confusingly similar trade-marks are to be approved on a "first to file" basis, not on the basis of when the trademark in question was first used by the competing parties. Previously, the right to register a trade-mark depended on use of the trade-mark. On the face of it, the processing of applications will be made easier in that the Office does not have to consider anything but the application date, evidence of advertisement of the application and whether or not any opposition to the trade-mark has been filed. Clients are encouraged to monitor advertisements of pending applications with even greater diligence; practitioners are expecting the number of trade-mark oppositions to increase dramatically.

COPYRIGHT

Since January 1, 1924, Canada and the U.S. have provided each other copyright protection under their national legislation. Unlike the U.S., however, Canada has never required that works be registered for them to be protected under the federal *Copyright Act*; works are automatically protected on their creation. This policy is a result of Canada's adherence to the *Berne Convention for the Protection of Literary and Artistic Works*. (Since 1989, the U.S. has also adhered to this convention.) As a result, works created in the U.S., that are in the public domain due to the owner's failure either to register or to renew the copyright when it expired, are often still fully protected in Canada for the term of copyright in Canada without being registered.

Obtaining copyright in Canada does not depend on registration or any other formal act. It is a proprietary right that arises from authorship alone. Copyright subsists in Canada in original literary or artistic works subject to certain requirements relating to the author's citizenship or residency. While copyright may be registered, if desired, the registration is simply a certificate of ownership affording an easy method of proof of authorship and copyright, should this be required.

The originality required to create copyright depends upon the expression of thought in which the work is presented. The requirement of originality means that the work must originate from the author in the sense that it is the result of a substantial degree of skill, industry or experience employed by the author of the work.

Generally the author of a work is the person who actually writes, draws or composes it. In most cases it will be readily apparent who is the "author" of a work but there are some situations that are not clear. In these cases it must be ascertained who has exercised the skill, labour or judgment that has resulted in the expression of the work in material form. The author is the person who expresses the work in an original form.

Where the author of a work was in the employment of some other person under a contract of service or apprenticeship and the work was made in the course of employment by that person, the person by whom the author was employed will be, in the absence of any agreement to the contrary, the owner of the copyright.

Where a person commissions and pays for the execution of a work other than a photograph or engraving, and the work is not performed in the course of employment under a contract of service between the parties, copyright in the work will be owned by the author, not the person who paid for the work, unless there is an assignment of the copyright to such person. The assignment must be in writing and signed by the author.

There are special rules for photographs. The individual who takes a photograph is not necessarily the author or owner of copyright in the photograph. The person who was the owner of the initial negative at the time when the negative was made, or, where there was no negative, the person who was the owner of the initial photograph at the time when the photograph was made, is deemed to be the author of the photograph. However in the case of a photograph ordered by some other person for valuable consideration, in the absence of any agreement to the contrary, the person who ordered and paid for the photograph is the owner of the copyright.

The application of these principles can be shown by considering a typical advertisement. Let us assume an advertising agency is asked to prepare an advertisement containing text extolling the virtues of the product, as well as photographs.

First, assuming that the text is sufficiently original to give rise to copyright, the specific employees of the agency who prepared it will be the author. However, assuming they are acting in the course of their employment, the agency as their employer will own the copyright.

With respect to the photographs, if the company commissioning the advertisement provides them to the agency and otherwise owns the copyright, their reproduction in the advertisement will not affect the ownership of the copyright. If the agency hires an independent photographer not employed by them to take pictures, in the absence of any agreement to the contrary, the agency will be the owner of the copyright in the photographs, so long as they pay for them. If employees of the agency took the photographs in the course of their employment, the agency will also be the owner of copyright.

If the agency owns the copyright, they have the sole right to reproduce the advertisement, subject to any contractual rights that the company may have concerning ownership of the copyright or the right to exercise the rights associated with the copyright in the future.

Claims for copyright protection and protection under the Act may co-exist. For example, a trade-mark that contains artistic or design features may also be protected under copyright if it is sufficiently original.

At the end of the last sitting of Parliament, the federal government introduced Bill C-60, an *Act to Amend the Copyright Act*. The bill provides new protections to copyright holders and is intended as a first step to implementing two World Intellectual Property Organization ("WIPO") treaties that Canada signed 10 years ago, but never ratified: the WIPO Copyright Treaty and the WIPO Performances and Phonograms Treaty. The revisions provide protection for copyright holders against the sharing of digital music files, as the author's exclusive right to

control who gets the material and how they get it has been extended to the Internet. Moreover, sound recording makers and performers will have the right to control the availability of their sound recordings and performances on the Internet.

Under the bill, copyright holders have the right to control technological protection measures and rights-management information. This change means that when rights-management information in copyright material or technological measures to protect copyright material are removed or circumvented, the perpetrators will be responsible for copyright infringement. The infringement provisions seem to focus, not on the devices that can be used to infringe, but on the people who use technology to infringe copyright (unlike in the U.S. *Digital Millennium Copyright Act*).

Under the bill copyright holders will have:

- The ability to control the first distribution of material in tangible form;
- New moral rights for performances;
- Reproduction rights for performers; *and*
- An extension in the term of protection for sound recordings, and the performers' rights in those performances, to 50 years from the publication of the sound recording.

Internet service providers ("ISPs") will be exempt from copyright liability for providing Canadians with access to the Internet. ISPs will have to keep personal information relevant to a copyright infringement claim for six months. ISPs will not be required to disclose a subscriber's identity unless ordered to by a court.

PATENTS

Canadian patent laws operate on a "first-to-file" system rather than the "first-to-invent" system used in the U.S. As a result, patent applications should be filed in Canada as soon as possible and, as a general rule, before the invention is disclosed to a third party. A patent may be rejected if there has been public disclosure before filing an application for registration. Applications filed before October 1, 1989 ("Old Act Patents"), are protected for 17 years; those filed on or after October 1, 1989 are protected for 20 years.

As a result of a ruling against Canada under the World Trade Organization in September 2000, the federal government amended federal *Patent Act* (the "New Act") effective July 2001 to the effect that non-expired patents with terms of Old Act Patents (from the date of filing in Canada) have a period of protection of 20 years in keeping with the requirements of the *Agreement on Trade-Related Aspects of Intellectual Property Rights*, to which Canada is a party.

On January 1, 1989, Canada became a member of the *Patent Cooperation Treaty* ("PCT"). As a result, for both initial filings of patent applications and patent searches, prospective patentees in Europe can obtain patent protection in Canada by making a PCT-filed patent application. Europe affords similar rights to Canada.

Both the U.S. and Canada are signatories to the *Paris Convention on the Protection of Intellectual Property*. To obtain the same application priority filing date patents filed in one member state (for instance, Canada) can be filed in the U.S. within one year of the Canadian application date.

Before 1987, new drugs had restricted protection against copying by generic drug manufacturers in Canada. As a result, generic drugs were priced 50 — 85% cheaper than brand-name drugs because the generic manufacturer faced neither the cost of development and testing nor the cost of advertising to establish a market. The federal government responded to this situation by legislating a 20-year patent protection period for new

pharmaceuticals. Compulsory licensing requirements are delayed for a number of years, in some cases for nearly the full 20-year period of patent protection. Other countries support a 20-year period of protection for new drugs without compulsory licensing.

A Federal Court ruling that higher life forms such as the Harvard Mouse are patentable under the New Act was appealed to the Supreme Court of Canada and the Court ruled in 2002 that higher life forms are not patentable in Canada.

In a decision released on May 21, 2004, although Monsanto Canada did not obtain a compensation order from a farmer who collected and used its genetically altered Roundup Ready canola seed, a majority of the Court held that infringement of a patent occurs where a person, for commercial purposes, uses a plant that contains patented genetic material. In effect, you do not need to patent the entire plant or animal; all you need is a patent for a gene or a cell in the plant or animal.

There is no dispute, however, that the method of performing the genetic modification is patentable under Canadian law.

INDUSTRIAL DESIGNS

In Canada, a design patent is valid for a fixed term of ten years, subject to paying applicable maintenance fees. A design patent cannot be renewed. An application to register the design must be filed within one year after the first public disclosure of the design. Registration is for the ornamental features of a product only, not for its functional elements.

TRADE SECRETS

Trade secret rights that do not fall within the protections outlined above must be created by private contract. Also, at common law, certain relationships, such as employment relationships, can carry with them a requirement of confidentiality.

OTHER INTELLECTUAL PROPERTY RIGHTS

In the last 15 years, two new intellectual property interests have been created by statute in Canada and form the basis for property rights that are growing in importance. The federal *Integrated Circuitry Topography Act* that came into force in Canada in 1993 allows the owner of the topography a ten-year period during which the owner can collect licence fees for any reproduction of the topography, any manufacture of products using the topography, and any products using the topography that are imported into Canada.

The federal *Plant Breeders' Rights Act* allows the developer of a new plant variety to register it and obtain the exclusive right, for 18 years, to produce and sell in Canada seeds for the new plant variety, plus all propagating material used to produce another new plant variety. The Act stipulates that the holder of the right must license the plant variety to any person wanting to use it, subject only to the payment of specified royalties. Canada, the U.S. and the United Kingdom are members of an international convention recognizing similar rights in each convention country

6. FOREIGN INVESTMENT IN CANADA

Investments in Canadian businesses by non-Canadians are regulated by the *Investment Canada Act* (the "ICA"). The ICA contains a set of complex and comprehensive rules with respect to investments by non-Canadians that are designed to ensure these investments result in a net benefit to Canada. Although on its face the regime may seem harsh, very few investments have proven problematic since the legislation was enacted in 1985.

For most industries, the ICA is administered by the Investment Review Division of Industry Canada under the direction of the Minister of Industry. For cultural businesses or businesses related to Canadian national identity, the ICA is administered by the Department of Canadian Heritage under the direction of the Minister of Canadian Heritage.

In addition, transactions involving companies operating in certain regulated industries, such as telecommunications, broadcasting, financial services (e.g., chartered banks), transportation and natural resources (e.g., petroleum and forestry), may be subject to a vast array of complex, multi jurisdictional and, unfortunately, not always consistent regulatory requirements and approvals.

WHEN DOES THE ICA APPLY?

The ICA applies to acquisitions of control of a Canadian business or establishment of a new Canadian business by a non-Canadian.

A Canadian business is a business carried on in Canada that has:

- A place of business in Canada;
- An individual or individuals in Canada who are employed or self-employed in connection with the business; and
- Assets in Canada used in carrying on the business.

A new Canadian business means a business that is not already carried on in Canada by the non-Canadian and that, at the time of its establishment:

- Is unrelated to any other business carried on in Canada by that non-Canadian; or
- Is related to another business being carried on in Canada by that non-Canadian but falls within a prescribed specific type of business activity that, in the opinion of the Governor-in-Council (the federal cabinet) is related to Canada's cultural heritage or national identity.

A Canadian is a person who is:

- A citizen;
- A permanent resident within the meaning of the federal *Immigration Act* who has been ordinarily resident in Canada for not more than one year after the time at which he/she became eligible to apply for Canadian citizenship;
- A Canadian government, whether federal, provincial or local or any other agency thereof; or
- An entity that is Canadian-controlled, as determined under the Canadian status rules of the ICA.

The ICA contains detailed rules and presumptions regarding Canadian status, including:

- Where one Canadian owns, or two or more members of a voting group who are Canadians own, a majority of the voting interests of an entity, it is a Canadian-controlled entity.
- Where one non-Canadian owns, or two or more members of a voting group who are non-Canadians own, a majority of the voting interest of an entity, it is not a Canadian-controlled entity.
- Other rules require an analysis of "control in fact," in addition to an analysis of voting interest in an entity, to determine whether it is Canadian-controlled.

The rules relating to acquisition of control are complex and comprehensive. Some of the primary rules are:

- The acquisition of a majority of voting shares of a corporation is deemed to be acquisition of control.
- The acquisition of less than a majority but one-third or more of the voting shares of a corporation is presumed to be acquisition of control, unless it can be established that the acquirer will not have "control in fact" of the corporation.
- The acquisition of less than one-third of the voting shares of a corporation is deemed not to be an acquisition of control of that corporation, unless it can be established that the acquirer will have "control in fact" of the corporation.

REVIEW VS. NOTIFICATION

Investments to which the ICA applies are subject to either pre-closing review or post-closing notification. Generally, where a direct acquisition of control of a Canadian business is reviewable, it may not be completed before the relevant Minister has approved it.

Whether an investment is reviewable or subject to a requirement to give notice depends on a number of circumstances, including whether:

- The purchaser or vendor is a resident of a WTO member country;
- The business being acquired is in a sensitive industry (i.e., uranium, financial services, transportation or cultural); and
- The transaction is a "direct" investment (acquisition of a Canadian company) or an "indirect" investment (acquisition of a non-Canadian parent).

WHICH INVESTMENTS ARE SUBJECT TO REVIEW UNDER THE ICA?

Both direct and indirect acquisitions may be subject to review.

A direct acquisition for the purpose of the ICA is the acquisition of a Canadian business by virtue of the acquisition of all or substantially all of its assets or a majority (or, in some cases, one-third or more) of the shares of the entity carrying on the business in Canada.

- A direct acquisition by a WTO investor (other than one involving any of the sensitive industries discussed below) is reviewable where the value of the acquired Canadian assets is $281 million or more for 2007. The threshold is adjusted for inflation each year.
- A direct acquisition by a non-WTO investor is reviewable where the value of the acquired Canadian assets is $5 million or more.

An indirect acquisition for the purpose of the ICA is the acquisition of control of a Canadian business by virtue of the acquisition of a non-Canadian parent entity.

- An indirect acquisition by a WTO investor (other than one involving any of the sensitive industries discussed below) in not reviewable.
- An indirect acquisition by a non-WTO investor is reviewable where the value of the Canadian assets is $50 million or more. The $5 million threshold will apply if the asset value of the Canadian business being acquired exceeds 50% of the asset value of the global transaction.

WHAT ARE THE "SENSITIVE INDUSTRIES"?

The higher WTO threshold for direct investments and the exemption for indirect investments discussed above do not apply where the relevant Canadian business is carrying on one of the following activities that have been deemed sensitive:

- The production of uranium and the ownership of an interest in a producing uranium property in Canada;
- The provision of any financial service;
- The provision of any transportation service; or
- A cultural business.

A financial service means a service of a financial nature offered by a financial institution excluding the underwriting and selling of insurance policies.

A transportation service means a Canadian business directly or indirectly engaged in the carriage of passengers or goods from one place to another by any means, including, without limiting the generality of the foregoing, carriage by air, rail, water, land and pipeline. Industry Canada is obligated to seek and obtain input from the Canadian Transportation Agency regarding the acquisition by a non-resident of any transportation service enterprise conducting business across provincial or Canadian borders.

A cultural business means a Canadian business that carries on any of the following activities:

- The publication, distribution or sale of books, magazines, periodicals or newspapers in print or machine-readable form, other than the sole activity of printing or typesetting of books, magazines, periodicals or newspapers;
- The production, distribution, sale or exhibition of film or video recordings
- The production, distribution, sale or exhibition of audio or video music recordings;
- The publication, distribution or sale of music in print or machine-readable form; or
- Radio communication in which the transmissions are intended for direct reception by the general public; any radio, television and cable television broadcasting undertakings; and any satellite programming and broadcast network services.

The Department of Canadian Heritage has also issued policies applicable to book and periodical publishing and distribution that will be taken into account during the review process.

Note that the ICA does not have a *de minimus* exemption relating to cultural activities. Even if the "cultural business" components of the Canadian business are minimal or incidental to the overall business, the investment is reviewable. Where a Canadian business includes both cultural and non-cultural components, ICA notifications and/or applications for review are filed with both Industry Canada and the Department of Canadian Heritage. Depending on the asset value of the transaction as a whole, each department will process the notice and/or conduct a review in connection with the activities of the enterprise relevant to its jurisdiction.

WHICH ACTIVITIES MAY BE RELATED TO CANADA'S CULTURAL HERITAGE OR NATIONAL IDENTITY?

The acquisition of control of an existing Canadian business or the establishment of a new one may also be reviewable, *regardless of asset value*, if the business carries on the following activities deemed to be related to Canada's cultural heritage or national identity:

- The publication, distribution or sale of books, magazines, periodicals or newspapers in print or machine-readable form;
- The production, distribution, sale or exhibition of film or video products;

- The production, distribution, sale or exhibition of audio or video music recordings; or
- The publication, distribution or sale of music in print or machine-readable form.

As described below, these investments fall under the jurisdiction of the Department of Canadian Heritage. They will be reviewable if review is recommended by the Minister of Canadian Heritage, and an Order-in-Council directing an ICA review is issued by the federal cabinet and provided to the investor within 21 days of the investor filing the completed ICA notification with the Department of Canadian Heritage.

WHAT PROCEDURES GOVERN AN ICA REVIEW?

- An application for review must set out particulars of the proposed transaction, including information about the investor, the Canadian business and the investor's plans for the business. Annual reports or financial statements for the three most recent fiscal years must be included.
- The relevant Minister has 45 days to determine whether to allow the investment. The Minister can unilaterally extend the 45-day period by an additional 30 days by sending a notice to the investor prior to the expiration of the initial 45-day period. Further extensions of time must be agreed to by the investor.
- If the investor does not receive approval or notice of extension within the applicable time then the investment is deemed approved. The investor may close a direct acquisition only after the Minister has approved, or is deemed to have approved, the investment. Failure to comply with these rules opens the investor to enforcement proceedings that can result in fines of up to $10,000 per day.
- Where the Minister determines that the investment will not be of "net benefit to Canada," the investor is provided with an opportunity to make additional representations and to submit undertakings (discussed below) that would demonstrate the "net benefit" of the investment.

WHAT FACTORS ARE CONSIDERED IN CONNECTION WITH THE "NET BENEFIT" TEST?

The ICA requires the responsible Minister to take certain factors into account, where relevant, when determining if an investment is likely to be of net benefit to Canada. The relative importance and weighting of the factors will vary from business to business, but each of the following factors should be addressed in the submissions that accompany an application for review:

- The effect of the investment on the economic activity in Canada, including employment, use of Canadian products and services, and exports from Canada;
- How many Canadians will be employed, and in what positions, in the acquired or newly formed business or in the relevant industry;
- The effect of the investment on productivity, industrial efficiency, technological development, product innovation and product variety in Canada;
- The effect of the investment on competition within the relevant industry or industries in Canada;
- The compatibility of the investment with national industrial, economic and cultural policies; and
- The contribution of the investment to Canada's ability to compete internationally.

Typically, during the initial 45-day review period, the investor will negotiate with Investment Canada or Canadian Heritage a mutually acceptable set of binding undertakings to be provided in connection with the Minister's approval of the transaction. These undertakings comprise commitments by the investor concerning its operation of the Canadian business following the completion of the transaction. Most often these commitments:

- Obligate the investor to keep the head office of the Canadian business in Canada;
- Ensure that a majority of senior management of the Canadian business is comprised of Canadians;
- Maintain certain employment levels at the Canadian business;
- Make specified capital expenditures and conduct research and development activities based on specified budgets; and
- In some cases, make a certain level of charitable contributions,

all for a specified period (usually three years).

These undertakings will normally be reviewed by Investment Canada or Canadian Heritage, as the case may be, on a 12- to 18-month basis to confirm the investor's performance.

WHEN IS AN ICA NOTIFICATION REQUIRED?

Where a non-Canadian acquires control of an existing Canadian business or establishes a new Canadian business and the acquisition is not reviewable, it will be notifiable.

Notification requires the non-Canadian investor to provide limited information on the identity of the parties to the transaction, the number of employees of the business in question, and the value of its assets. A notification may be submitted to Investment Canada before or within 30 days after the closing of the transaction. Typically, the notification is filed post-closing.

NEW MATTERS

The federal government has recently indicated that it may clarify and expand special Investment Canada review procedures relating to the takeover of Canadian businesses by foreign state-owned enterprises. Reaction to the proposal has been mixed.

7. FINANCING CANADIAN OPERATIONS

HOW CAN YOU FINANCE YOUR CANADIAN OPERATIONS?

Commercial Bank Credit Facilities

In Ontario, it is possible to finance business operations either by debt or by equity. Conventional finance sources include commercial banks qualified to provide financial services in Canada under the federal *Bank Act*. Loans to low risk enterprises are often done on an unsecured basis. More commonly, a commercial bank will take security from the borrower who charges all or part of the property and assets of the business, including accounts receivable, fixed assets and real estate. Currently, the prime lending rate of Canadian commercial banks is 6.25%. Often, banks will enter into loan arrangements based upon short-form commitment letters and the granting of security by way of a general security agreement, without the requirement of a long (and expensive) loan agreement.

Generally, the least-cost source of funding available only through the Canadian banks is by way of bankers' acceptances ("BAs"). A BA is a money-market instrument represented by a short-term note, issued by the borrower, that has been "accepted," that is, guaranteed by the borrower's Canadian chartered bank. As a result, any borrower facility can borrow money at a small premium over commercial money-market rates, in effect, using the covenant of its banker to lower its cost of funds.

Personal Property Security

Under the *Personal Property Security Act* is possible for a debtor to grant a security interest (a charge) to a third party in any form of personal property in which the debtor has an interest to secure the debtor's obligations to such secured party. The Province of Ontario maintains a public register in which filings must, as of August 1, 2007, be done by remote electronic access by anyone with the required trust account with the government and computer software. The register can be accessed outside normal business hours and registrations are immediate. This personal property security regime is a highly efficient means of registering security interest in personal property in Ontario. The system is well-understood and reliable. Similar personal property security registration systems are in place in all of the other Canadian provinces.

***Bank Act* Security**

Another financing alternative in Canada, set out in sections 426 and 427 of the federal *Bank Act*, is that certain borrowers can create and grant special security in their inventory in favour of Canadian chartered banks. However, *Bank Act* security does not permit remote electronic registrations and it has a number of arcane provisions that limit its commercial application.

Security on Land

If a borrower has an interest in real estate, it is able to charge that interest by way of a mortgage or charge in favour of a creditor. Ontario has an electronic land registration system that permits remote registration of transfers, mortgages and documents affecting title to real estate in the province. Although all land in Ontario is not yet under the electronic registration system, all properties in most major urban areas are. Title insurance is available in Ontario and its use is becoming more widespread among lenders.

Exempt Distributions in Ontario

Chapter 10 of this brochure sets out information on the sale of securities in Canada. As discussed in that chapter, Ontario's *Securities Act* (the "Securities Act") provides for a closed system relating to the distribution of securities in Ontario.

For an issuer to issue securities to the public without complying with the distribution requirements under the *Securities Act* to produce a prospectus and involve a registrant (an individual registered under the *Securities Act* such as a dealer), the issuer must rely on one of the exemptions to the distribution requirements provided for in the *Securities Act* or under applicable governmental rules. In an effort to harmonize and consolidate the various prospectus and registration exemptions available across the country, Canadian securities regulators recently introduced National Instrument 45-106 — *Prospectus and Registration Exemptions* ("NI 45 106"). In addition to greater harmonization and consolidation among the provinces, NI 45-106 also marks the return of both (i) the private issuer exemption and (ii) the $150,000 exemption to Ontario law.

The following summarizes the key elements of NI 45-106 as it relates to non investment funds.

Private Issuer Exemption

Under NI 45 106 the private issuer exemption returns to Ontario, replacing the existing closely held issuer exemption and the closed company exemption in Québec.

A closely-held issuer was:

- Not a reporting issuer (that is, an issuer had not made a distribution of securities to the public) and was not an investment fund; and
- One whose securities, other than non convertible debt securities, are (i) subject to restrictions on transfer that are contained in the issuer's constating documents or securities-holders' agreements; (ii) beneficially owned, directly or indirectly, by not more than 35 persons (apart from current and former employees) and (iii) has distributed securities only to specifically identified classes of investors, including accredited investors, persons who are not members of the public, directors, officers, control persons, the family members and close business associates thereof, employees and existing securities holders.

Closely-held issuers were permitted to raise aggregate proceeds of up to $3 million only, pursuant to issuances made in reliance on this exemption. As a result, it was effectively a "once in a lifetime" exemption. However, proceeds received by such issuer from trades made in reliance upon other exemptions, including exemptions available prior to the date on which the closely-held issuer exemption came into force, were not deducted from the $3 million aggregate proceeds limit.

The closely-held issuer exemption did not permit any selling or promotional expenses to be paid or incurred in respect of the securities issued by it, other than for services performed by a securities dealer registered under the *Securities Act* or minimal expenses such as printing or administration costs. Finally, the issuer had to supply the prospective purchasers with a "scare sheet" containing a prescribed form of information that discusses the risks of investing in private companies.

A private issuer is defined as an issuer:

- That is not a reporting issuer (that is, an issuer has not made a distribution of securities to the public) and is not an investment fund; and
- Whose securities, other than non convertible debt securities, are (i) subject to restrictions on transfer that are contained in the issuer's constating documents or securities-holders' agreements; (i) beneficially owned, directly or indirectly, by not more than 50 persons (apart from current and former employees) and (iii) has distributed securities only to specifically identified classes of investors, including directors, officers, control persons, the family members and close business associates thereof, employees and existing securities holders.

If an issuer distributes securities to a person who does not fit into one of the specifically identified classes of investors, then it will cease to be a private issuer.

Except for a trade to an accredited investor, no commission or finder's fee may be paid to any director, officer, founder or control person in connection with a trade under this exemption.

Practical effects. Constating documents should continue to contain transfer restrictions to meet the requirements of the closely held issuer exemption.

Subscription agreements for private issuers should provide that purchasers represent that they fit within one of the identified classes of exempt investors.

The return of the private issuer exemption will bring with it renewed discussions regarding the definition of the term "the public". The courts have interpreted the public very broadly in the context of securities trading.

Accredited Investor Exemption

Under the accredited investor exemption, a trade of securities of any value can be effected on an exempt basis if the purchaser is an accredited investor who purchases as principal.

Under NI 45 106, issuers will be entitled to rely on the accredited investor exemption for distributions in Québec. Prior to the implementation of NI 45 106, issuers had to file a notice with the autorité des marches financiers to issue securities to accredited investors in Québec on an exempt basis.

The definition of accredited investor differs slightly across Canada. The definition in Ontario has been modified slightly, the primary changes being that registered charities are now required to obtain advice on the securities being traded, and fully managed accounts are permitted to invest in securities of investment funds.

The accredited investor approach actually creates a laundry list of persons or entities who satisfy the notion of sophistication for specific reasons. The three most notable types of accredited investors are certain family members of directors or officers, registrants, and high net financial asset or net income individuals. The net financial asset test qualifies an individual as an accredited investor if, individually or together with a spouse, their financial assets (cash or securities) have an aggregate realizable value before taxes, net of any related liabilities, greater than $1 million. However, as an individual's principal residence is excluded from the definition of "financial assets," the number of individuals who would qualify on the high net worth basis is likely to be few. Another category of accredited investor is an individual whose pre-tax annual income is greater than $200,000 in each of the two most recent years, or greater than $300,000 if combined with a spouse's income in each of those years. To fall under this category, the investor (and the spouse, where applicable) must have a reasonable expectation of exceeding the same net income level in the current year.

Practical effects. Private placements involving purchasers who are resident in, or otherwise subject to, the laws of Québec will be simpler. Accredited investor certificates must now be updated. A common certificate can be used for all provinces. Post-closing filings with the applicable provincial securities commissions will have to be made by the issuer within 10 days of a trade made in reliance on this exemption.

$150,000 Exemption

Pursuant to NI 45-106, the minimum investment exemption returns to Ontario and the minimum amount required is set uniformly across Canada. Securities will be permitted to be sold on an exempt basis to any purchaser (accredited or otherwise) if the purchaser, acting as principal, acquires securities with an acquisition cost of not less than $150,000, which is paid in cash at closing. An issuer may trade more than one kind of security of its own issue under this exemption, provided the securities have a total acquisition cost to the purchaser of not less than $150,000.

This exemption is not available for any trade to any person that is created or used solely to purchase or hold securities in reliance on this exemption. Investment clubs are a prime example of an entity created to take advantage of the minimum investment exemption.

Practical effects. Subscription agreements will need to be changed to permit investors who are not accredited investors to participate in private placements if they invest at least $150,000. Post-closing filings with the applicable provincial securities commissions will have to be made by the issuer within 10 days of a trade made in reliance on this exemption.

Offering Memorandum Exemption

Under NI 45-106, the offering memorandum exemption previously available in each province and territory other than Québec and Ontario has been extended to Québec. The offering memorandum exemption has not been extended to Ontario.

In the participating provinces, a trade by an issuer will be exempt from prospectus and registration requirements if the issuer provides the purchaser with an offering memorandum in prescribed form and the purchaser signs a prescribed Risk Acknowledgement Form. In British Columbia, New Brunswick, Newfoundland and Labrador, Nova Scotia and Yukon, an issuer can sell any amount of securities to any purchaser under this exemption. In Alberta, Manitoba, Northwest Territories, Nunavut, Prince Edward Island, Québec and Saskatchewan, an issuer cannot issue securities to any individual purchaser with an acquisition cost in excess of $10,000, unless the purchaser is an eligible investor. An eligible investor is defined as, among other things, an individual whose (i) net assets exceeds $400,000 or (ii) net income before taxes, whether alone or with a spouse, exceeded $125,000 in each of the two most recently completed calendar years and who reasonably expects to exceed that income level in the current calendar year.

The Risk Acknowledgement Form must be retained by the issuer for eight years following the trade.

NI 45-106 requires that each purchaser must be provided a contractual right to cancel any purchase agreement within two business days after signing the purchase agreement. Further, the issuer must hold in trust all consideration paid by purchasers until a full two business days have passed after the date that purchaser signs the purchase agreement.

If applicable securities law does not provide the purchaser with a statutory right of action in the event of a misrepresentation in an offering memorandum, the offering memorandum must contain a contractual right of action against the issuer for rescission or damages if the offering memorandum contains a misrepresentation.

Practical effects. The offering memorandum exemption is extended to Québec, but not to Ontario. NI 45-106 does not affect current securities laws that provide for rights of rescission or damages in the event that an offering memorandum contains a misrepresentation, regardless of the form of the offering memorandum.

Post-closing filings with the applicable provincial securities commissions will have to be made by the issuer within 10 days of a trade made in reliance on this exemption.

Family, Friends, Business Associates and Founders

Ontario differs from the other jurisdictions in Canada in terms of the scope of the exemptions available to family, friends and business associates.

In Ontario, securities of any value can be sold on an exempt basis to (i) founders of the issuer; (ii) certain relatives of executive officers, directors and founders of the issuer; and (iii) control persons of the issuer.

In each of the other provinces and territories of Canada, securities of any value can be sold on an exempt basis to (i) directors, executive officers, control persons or founders of the issuer or an affiliate of the issuer; and (ii) certain relatives, close personal friends and close business associates of those individuals listed in (i).

The securities regulators use the concept of a “founder” and not the concept of a “promoter” in NI 45-106. A founder is a person who takes the initiative in founding, organizing or substantially reorganizing the business of the issuer and at the time of the trade is actively involved in the business of the issuer.

Post-closing filings with the applicable provincial securities commissions will have to be made by the issuer within 10 days of a trade made in reliance on this exemption.

Employees, Executive Officers, Directors and Consultants

Trades by an issuer, a control person of an issuer or related entity of an issuer to employees, executive officers, directors or consultants of such issuer or a related entity of the issuer will be exempt from the prospectus and registration requirements, if participation in the trade is voluntary (the “employee, executive officer and director exemption”). This exemption is based upon the exemptions in Multilateral Instrument 45-106 — *Trades to Employees, Senior Officers, Directors and Consultants*.

NI 45-106 establishes limits on the number of securities that may be issued to executive officers, directors, consultants and certain employees of reporting issuers whose securities are not listed on certain listed trading markets.

Practical effects. Trades to executive officers and directors can be effected on an exempt basis in every Canadian jurisdiction other than Ontario, whether or not such trade is voluntary, pursuant to the family, friends and business associate exemption. However, the resale of securities issued under that exemption will be subject to a restricted period. Securities issued under the employee, executive officer and director exemption are not subject to any restricted period. Securities can be issued to executive officers and directors in Ontario on an exempt basis under the employee, executive officer and director exemption.

Transaction Exemptions

The prospectus and registration requirements will not apply to any trade conducted in connection with (i) an amalgamation, merger, reorganization or arrangement under a statutory procedure or (ii) the dissolution or winding-up of an issuer (the “business combination and reorganization exemption”). Trades may also be completed on an exempt basis in connection with amalgamations, mergers, reorganizations or arrangements that are (a) described in an information circular that complies with National Instrument 51-102 — *Continuous Disclosure Obligations* or a similar disclosure document that is delivered to each security-holder whose approval is required and (b) approved by securities-holders.

NI 45-106 exempts any issue of securities pursuant to three cornered amalgamations, as the business combination and reorganization exemption applies to any trade made in connection with an amalgamation or merger done under a statutory procedure. Also, according to the companion policy, the business combination and reorganization exemption is available for all trades of securities that are necessary to complete an exchangeable share transaction, even where such trades occur several months or years after the transaction.

An issuer may also effect a trade on an exempt basis if it issues securities as consideration for the acquisition of (i) assets that have a fair value of not less than $150,000 or (ii) petroleum, natural gas or mining properties or any interest therein (the “asset acquisition exemption”). According to the regulator’s companion policy, it is the responsibility of the issuer and its directors to determine the fair market value of the assets to be required and to retain records to demonstrate how that fair market value was determined. With respect to the acquisition of assets that have a fair value in excess of $150,000, it is unclear whether securities may constitute a portion of the purchase price that is less than $150,000.

An issuer may also issue its own securities on an exempt basis to settle a *bona fide* debt (the "securities for debt exemption").

The prospectus and registration requirements will not apply in respect of trades made in connection with a take-over bid or issuer bid.

Resale

In most jurisdictions, securities distributed under an exemption may be subject to restrictions on their resale. Multilateral Instrument 45-102 — *Resale of Securities* has been amended to extend to Québec, making it a national instrument. It has been further amended to reflect the changes to the prospectus and registration exemptions contained in NI 45-106.

Securities issued pursuant to the following exemptions are subject to a seasoning period on resale: the private issuer exemption and the business combination and reorganization exemption.

Securities issued pursuant to the following exemptions are subject to a restricted period on resale: the accredited investor exemption, the offering memorandum exemption, the $150,000 exemption, the family, friends and business associates exemption, the asset acquisition exemption and the securities for debt exemption.

DOES CANADA HAVE AN ACTIVE VENTURE CAPITAL MARKET?

Canada has an active venture capital market, although it had been, as in the U.S., adversely affected by the high-tech meltdown. There are a number of angel investor organizations in Canada as well as venture capital funds that are willing to do early stage investments.

Capital Pool Companies

Access to the public markets is available through the capital pool company ("CPC") Program offered by the TSX Venture Exchange (the "Exchange"). The CPC Program enables qualified companies to raise up to $2 million and obtain a listing on the Exchange on a "blind pool" basis, whereby these companies proceed with a mandate to acquire certain eligible businesses or assets using cash (on hand and/or raised through private placements) and/or shares as the consideration payable to the vendors.

Upon the completion of the acquisition, which is called a Qualifying Transaction, the acquired business effectively carries on as the Exchange-listed public company. An advantage the CPC program offers is that, under the Exchange rules, a CPC does not necessarily require shareholder approval for arm's length Qualifying Transactions, unless otherwise required under the CPC's governing corporate legislation.

Recent amendments to the CPC Program have removed the prohibition on foreign non-resource Qualifying Transactions. A CPC that is a reporting issuer in Ontario may undertake a foreign non-resource Qualifying Transaction with the additional requirement that it file a prospectus with the Ontario Securities Commission. The CPC Program represents a modest source of late-stage working capital for start-up businesses in Ontario, although it may prove to have broader application in the future.

WHICH FEDERAL GOVERNMENT PROGRAMS PROVIDE FINANCIAL ASSISTANCE TO BUSINESS IN CANADA?

Budget constraints at all levels of government in Canada have reduced the number of government-sponsored incentives for business. The following is a list of current federal

programs, although with the change in governments in January 2006, it is not clear which of the following programs will remain in place.

- Export Development Canada provides risk insurance for Canadian exporters (political coverage of up to 90% of the exporter's losses, including certain loan losses), loans to foreign purchasers of Canadian capital goods, and guarantees to Canadian banks for export loans.
- The terms and conditions for the Technology Partnerships Canada program expired on December 31, 2006. Therefore, no new outlines under this program will be accepted, and no new projects will be contracted.
- The Business Development Bank of Canada ("BDC") provides high-risk loans to small and medium Canadian businesses. The BDC has entered into arrangements with a number of Canadian commercial banks pursuant to which BDC conducts an in-depth analysis of the borrower and its needs, shares this information and analysis with the borrower's primary commercial bank, and assumes a subordinated lending position to that of the primary bank. In this way, BDC supports small or emerging companies, especially in knowledge-based industries.
- Under the *Canada Small Business Financing Act*, the federal government guarantees repayment of 85% of certain equipment and fixturing loans of up to $250,000 made to small businesses by Canadian chartered banks. Eligible businesses must have annual sales of less than $5 million. Without this there would be significantly fewer restaurants in Canadian cities.
- Human Resources Development Canada ("HRDC") operates the Job Creation Partnership, in some cases delegating management to other federal departments. Programs include internships with various federal government departments; targeted wage subsidies under which HRDC will contribute to the wages paid to the employee by an employer who hires an unemployed person then receiving federal employment benefits; and work-sharing arrangements where employers reduce the number of hours of work available to a group of employees so as to avoid layoffs. HRDC pays employment insurance benefits to the employees for the hours of work lost as a result of the work-sharing program.
- HRDC has entered into agreements with all provinces and territories to define how the benefits and measures are delivered in each region. As a result, in New Brunswick, Québec, Ontario, Manitoba, Saskatchewan, Alberta, the Northwest Territories and Nunavut, programs similar to the Employment Benefits and Support Measures are delivered by the provincial or territorial government pursuant to agreements under Section 63 of the *Employment Insurance Act*.
- The National Research Council of Canada manages a research financing program known as the Industrial Research Assistance Program. To be eligible, the applicant company must have fewer than 500 employees.
- Under the Strategic Aerospace and Defence Initiative, qualifying entities may apply for long-term repayable contributions representing up to 30% of a project's total eligible costs for conducting research and development work with application in the aerospace and defence technology industries.
- Under the federal Scientific Research and Experimental Development Tax Incentive Program, qualifying companies are entitled to an income tax credit of up to 35% of qualifying research and development expenditures. A recent OECD study comparing 29 countries has categorized this Canadian program as "too generous" because the value of the tax credit is the same regardless of the aggregate amount of funds expended on research and development. Other countries use a graduated approach, increasing the tax credit as aggregate research and development expenditures exceed specified thresholds.

In addition to the foregoing programs, under the federal Immigrant Investor Program (reviewed in detail on page 11.5), preference is given to applicants who can demonstrate they have significant financial means and are willing to make qualified investments in Canada. Although immigration is a matter within federal jurisdiction, the federal government has delegated administration of the program to the provinces.

WHICH ONTARIO PROVINCIAL PROGRAMS PROVIDE FINANCIAL ASSISTANCE TO BUSINESS IN ONTARIO?

As previously noted, each province has modest government support programs. However, in Canada there is no equivalent to programs commonly found in certain U.S. states under which municipal taxes and service charges are abated, for example, to encourage new investment in manufacturing facilities in the state. Municipalities are prohibited by law from offering such tax relief and service rebates. The Ontario government does, however, support local businesses enterprises primarily through special provincial tax incentives and tax credits. These include:

Ontario Innovation Tax Credit (OITC)

The OITC is a 10% refundable tax credit for scientific research and experimental development. The maximum claim is $200,000 per taxation year.

Ontario Business-Research Institute Tax Credit (OBRITC)

The OBITRC promotes research partnerships between businesses and post-secondary educational institutions. It provides a 20% refundable tax credit for scientific research and experimental development expenditures. The maximum tax credit is $4 million.

New Technology Tax Incentive

To promote technological developments, the Ontario government offers corporations a 100% deduction off the eligible cost of qualifying intellectual property (i.e., a patent, licence, permit, commercial secret, technology transfer or other knowledge-based property) having a value of up to $20 million per year.

Co-operative Education Tax Credit

Ontario corporations that hire students for co-op work placements receive a refundable tax credit valued at 10% to 15% of eligible expenses incurred as a result of the co-op program, up to $1,000 per work placement.

Ontario Current Cost Adjustment

In addition to regular capital cost allowance claims, corporations can claim a special allowance for the cost of new pollution control machinery and equipment, provided the machinery is used in Ontario.

Industry-Specific Tax Incentives

Industry-specific tax incentives are available for businesses involved in film production, computer animation, digital media, publishing and mineral exploration. In addition to the foregoing, Ontario corporations can also apply for financial assistance under various other programs:

- **Job Connect**
  Job Connect is an Ontario government program aimed at helping unemployed individuals develop skills, receive training and obtain permanent employment. Employers in the program may qualify for a wage subsidy, up to a maximum of $2 per hour.
- **OATTC**
  Ontario's apprenticeship training tax credit program provides a refundable tax credit of up to $15,000 for training apprentices for up to three years.

- **OBPTC**
  Ontario's book publishing tax credit for publishing companies to publish and promote works by a Canadian author offers a $30,000 refundable tax credit per book title.
- **BFTIP**
  Ontario's brownfields financial tax incentive program provides tax relief matching municipal property tax relief to assist environmental remediation of contaminated property.
- **OCIF**
  Ontario's commercialization investment funds program provides grants of up to $225,000 to leverage seed capital raised for spin-off technology companies incorporated by research institute faculty, staff or students.
- **OCASE**
  Ontario offers a 20% refundable tax credit on eligible labour expenditures for computer animation and special effect activities in film and television productions.
- **OFTTC**
  Ontario offers a 20% refundable tax credit on eligible labour expenditures for film and video productions.
- **IRAP**
  Ontario's industrial research assistance program invests on a cost-shared basis for technical advisory services and financial services for medium-sized enterprises.
- **Innovation Demonstration Fund**
  This fund provides contributions of up to $2 million by way of non-interest bearing repayable or forgiveable loans, royalty agreements and equity participation to help commercialize innovative technologies.
- **OITC**
  Ontario offers a 10% refundable tax credit on eligible research and development expenditures to a maximum of $200,000.
- **Interactive Digital Media Tax Credit**Ontario offers a 20% refundable tax credit for eligible expenditures made for labour, marketing and distribution expenses relating to the creation of interactive digital media products.
- **ONTTI**
  Ontario offers a 100% immediate tax write-off of eligible expenditures for qualifying intellectual properties acquired in the course of an intellectual property transfer.
- **OCCA**
  Ontario offers a 30% tax write-off (above applicable depreciation allowances) for investments in pollution control equipment.
- **OPSTC**
  Ontario offers an 18% refundable tax credit on qualifying labour expenditures for those productions that do not meet federal Canadian content requirements.
- **Research Employee Stock Option Credit**
  Ontario eliminates personal income tax arising on exercise or disposition of eligible stock options granted by research and development companies to their eligible employees of up to $100,000 in personal income tax deductions.
- **Nominee Program**
  Ontario's nominee program allows employers (including multinational corporations investing in Ontario) to recruit and retain internationally trained employees in specified job categories.
- **AMIS**
  The Advanced Manufacturing Investment Strategy program has been re-tooled to help lift manufacturers to the next level of innovation. Reduced project thresholds of either 100 jobs created/retained or $25 million invested (previously 150 jobs or $50 million) will help more companies invest in new technologies in Ontario.

ARE THERE SPECIAL REQUIREMENTS FOR NON-RESIDENT INVESTORS?

There are a number of activities that require special licences or where control of the business activity is restricted to Canadians. The majority of such licensing is controlled by the

provinces. The following is a partial list of special licences required for certain activities and investments or activities where the participation of non-residents is prohibited or restricted:

Canada's Financial Services Sector

In Canada, although the regulatory barriers between types of financial service providers have been relaxed since 1987, some separation remains between the traditional four pillars of Canada's financial sector — banks, insurance companies, trust and loan companies and investment dealers. The federal government has exclusive jurisdiction over banks. Insurance companies and "non-bank" deposit-taking institutions, such as loan companies and trust companies, may be incorporated under federal or provincial legislation. Cooperative credit associations and societies may be formed under other federal or provincial law. Investment dealers and securities market activity are regulated by provincial agencies and self-regulatory organizations empowered under provincial laws.

Canada's federal financial sector legislation is kept relatively current and responsive to industry challenges by sunset provisions in the legislation. The federal Department of Finance is the department of the Government of Canada primarily responsible for regulation and supervision of Canada's banks and other federally regulated deposit-taking institutions and insurance companies.

Provincial governments also regulate financial institutions under their jurisdiction. For example, in the province of Ontario, the Ministry of Finance has given the Financial Services Commission of Ontario responsibilities for Ontario's regulated sector, which includes: insurance companies, agents and brokers; cooperative corporations; credit unions and caisses populaires; loan and trust corporations registered in Ontario; mortgage brokers; and pension plans.

In the insurance business, Ontario generally leaves the supervision of the solvency of companies to the regulator of the company's home jurisdiction (such as the Office of the Superintendent of Financial Institutions, for federally regulated insurers), except for those insurance companies that are incorporated under Ontario's *Insurance Act*. However, Ontario supervises the market conduct of insurance companies operating in Ontario, by regulating insurance contracts, business practices, agents, brokers and adjusters.

Since July 1, 2005, in order to be registered to carry on business in Ontario, a loan or trust corporation must be incorporated under the federal *Trust and Loan Companies Act*. British Columbia is considering a similar approach to the regulation of loan and trust companies. Ontario will not allow the registration of any new loan and trust companies in Ontario that are not federally regulated.

Foreign Bank Rules

The Canadian government regulates any Canadian business presence and activity of foreign-formed banks and financial institutions under the foreign bank provisions of the federal *Bank Act*. The definition of foreign bank is broad and includes many non-bank foreign financial service providers and members of financial service conglomerates.

To determine if the foreign bank provisions of the *Bank Act* apply, it is important to consider the entire corporate ownership structure, and the business activities of members of the corporate group as carried on in all jurisdictions.

A foreign bank is an entity formed under the laws of a country other than Canada that:

- Is a bank under the laws of any jurisdiction where it carries on business;

- Carries on a business outside Canada that would be considered, to a significant extent, to be the business of banking if carried on in Canada;
- Provides financial services and describes itself as a "bank" or its business as "banking";
- Lends money and accepts deposits transferable by cheque or other instrument;
- Provides financial services and is affiliated with another foreign bank;
- Controls another foreign bank; *or*
- Provides financial services and controls a Canadian bank.

Although the definition of foreign bank will catch *true* regulated banks and many *near* banks, near banks may be exempted from most of the foreign bank rules, including the investment rules, although an order of the Minister may be required. Foreign banks that are not exempt are subject to all aspects of the *Bank Act*'s foreign bank regime. The following discussion is relevant for those foreign banks that are not exempt.

- Except as permitted under the *Bank Act*, a foreign bank shall not:
- Carry on any business in Canada;
- Maintain a branch for any purpose;
- Establish an automated presence or maintain a remote service unit in Canada; *or*
- Control, or have direct or indirect beneficial ownership of, more than 10% of voting shares or more than 25% of the equity of any Canadian entity.
- With approval, a foreign bank may establish a presence in Canada by different means, for different purposes.
- A foreign bank may maintain a *representative office* in Canada that is not permitted to carry on business in Canada, but may promote the foreign bank's business outside Canada and provide liaison with offices outside Canada.
- If a foreign bank wishes to provide banking services in Canada, it may establish a branch in Canada, or it may form a subsidiary that is a Canadian bank.
- An authorized foreign bank may establish a *full-service branch* or a *lending branch*. Except for restrictions on deposit taking, branch business powers are similar to those of Canadian banks. A full-service branch is not permitted to accept retail deposits of less than $150,000, while a lending branch may not accept retail or wholesale deposits or otherwise borrow money in Canada, subject to limited exceptions. Different capital rules reflect these limitations on branch activity. Direct foreign bank branching allows foreign banks to take advantage of international capitalization, and increases operational flexibility.
- With approval, a foreign bank may establish a *Canadian bank* as a subsidiary of the foreign bank. Such a bank subsidiary is subject to the same rules as the Canadian banks.
- Also, a foreign bank may seek approval to own a non-bank financial institution such as a loan or trust company, insurance company or securities dealer, and a foreign insurer or securities dealer may seek approval to carry on a securities or insurance business in Canada.

If a foreign bank is not exempt under the foreign bank entry rules, then it may only invest in Canadian entities as permitted by the *Bank Act* and subject to applicable approval requirements. As well, the investment rules permit a foreign bank, with limitations, to carry on commercial business activity in Canada. The *Bank Act* contains rules that oust the application of the federal *Investment Canada Act* for certain investments (the federal financial institutions legislation will apply).

Ownership of a Canadian Financial Institution

Banks

Canadian banks are incorporated under the *Bank Act*. One goal of the legislation is to stimulate competition. Ownership rules are also intended to facilitate joint ventures and strategic alliances.

The *Bank Act* recognizes three categories of banks based on size, as measured by the bank's equity, and establishes different sets of ownership rules for each category. Large banks have equity exceeding $5 billion. They must be widely held and no person may have control. A bank is widely held if there is no person with beneficial ownership of more than 20% of any class of voting shares or 30% of any class of non-voting shares (i.e., no major shareholder).

A medium-sized bank has equity between $1 billion and $5 billion and may have a major shareholder, although at least 35% of its voting rights must attach to shares that are publicly traded and not held by a major shareholder.

There is no public ownership requirement for small banks, which have equity up to $1 billion. The minimum capital required to start a new bank is $5 million.

In all cases, the Minister of Finance must approve a person's ownership of more than 10% of any class of shares and must apply a "fitness test" in the approval process. The investor's character and integrity is the only fitness factor to be considered when seeking Ministerial approval to own more than 10% of a class of shares of a large bank but less than the ownership level of a major shareholder. No one with links to a prohibited personal property leasing business (including car leasing) may control or be a major shareholder of a bank.

Demutualized Life Insurance Companies

As with banks, ownership of more than 10% of any class of shares is subject to approval by the Minister of Finance and a "fitness test." An insurance company is widely held if no person has beneficial ownership of more than 20% of any class of voting shares or 30% of any class of non-voting shares (i.e., no major shareholder).

Large demutualized life insurance companies, for which the value of surplus and minority interests exceeded $5 billion when they demutualized, are required to be widely held unless, in any specific instance, the Minister decides to free the company from the restriction. Also, no person may control a large demutualized company. An investor may have close ownership of a demutualized company that was medium-sized at the time of conversion (i.e., the value of surplus and minority interests was between $1 billion and $5 billion), subject to the general public float requirement. If the insurer has equity of $1 billion or more, at least 35% of its voting rights must attach to shares that are publicly traded and not held by a major shareholder. There is no public float requirement for small companies of up to $1 billion.

Other Life Insurance Companies; Property and Casualty Insurers; Trust and Loan Companies

Close ownership of other (stock) life insurance companies, property and casualty insurers and trust and loan companies is permitted, although ownership of more than 10% of any class of shares is subject to approval by the Minister of Finance and a "fitness test" must be met. Such companies are subject to a 35% public float requirement if the company's equity reaches or exceeds $1 billion.

Holding Companies

Banks and life insurance companies are permitted to organize under a financial holding company.

Broadcasting and Telecommunications

Broadcasting and telecommunications are two examples of businesses in which there are restricted share requirements. A specified portion of the issued share capital of the corporation engaged in broadcasting or telecommunications must be held by resident Canadians.

The Canadian Radio-television and Telecommunications Commission (the "CRTC") was established by Parliament in 1968. It is an independent public authority constituted under the *Canadian Radio-television and Telecommunications Commission Act* and reports to Parliament through the federal Minister of Canadian Heritage.

The CRTC is vested with the authority to regulate and supervise all aspects of the Canadian broadcasting system, as well as to regulate telecommunications common carriers and service providers that fall under federal jurisdiction. The CRTC derives its regulatory authority over broadcasting from the *Broadcasting Act*. Its telecommunications regulatory powers are derived from the *Telecommunications Act* and the *Bell Canada Act*.

OTA Television Ruling

On May 17, 2007, the CRTC issued a notice describing its new regulatory policies with respect to Canadian over-the-air (OTA) television, following a public hearing that was held in November 2006.

The CRTC has decided not to implement a fee-for-carriage model for OTA television. This had been one of the major issues at the CRTC hearings, with the OTA services arguing that they required access subscriber fee revenues, as do Canadian specialty services. Although the OTA services lost on this issue, the CRTC did agree with them that greater flexibility is required to address competition from specialty services and unregulated (e.g., Internet) services. For that reason, restrictions on advertising time limits have been reduced. Beginning, September 1, 2007, OTA broadcasters are able to sell advertising on up to 14 minutes per hour during prime time (7:00 p.m. — 11:00 p.m.), an increase of two minutes per hour. In September 2008, this limit will increase to 15 minutes during each hour, for the entire 18-hour broadcast day.

Another important issue at the hearings was related to the roll-out of digital and high-definition (HD) over-the-air services. The Commission has now established August 31, 2011 as the deadline for the transition from analogue to digital and HD. This deadline will come after the equivalent U.S. deadline, February 2009.

Finally, the CRTC imposed increased closed-captioning requirements. OTA broadcasters are required to caption all programs broadcast between 6:00 a.m. and midnight unless there are circumstances beyond the broadcaster's control. Decisions about any changes to the requirements for Canadian programming will be made during the licence renewal processes for each OTA service, scheduled to take place in the spring of 2008.

Local Telephone Rates — Large Carriers

Effective June 1, 2007, the CRTC established new pricing rules to govern the rates charged by large telephone companies for local telephone services. These rules, which are known collectively as the price cap regime, apply to each of the major telephone companies: Bell Canada, TELUS, SaskTel, MTS Allstream and Bell Aliant. The Minister of Industry then overruled the CRTC and announced that regulation of telephone carriers would be simplified, permitting the telephone carriers to compete more effectively with cable companies and web-based service providers.

Airlines

Airlines and foreign air carriers are federally regulated. Although a joint “open skies” policy between Canada and the U.S. has been officially on the books for several years, it appears it will finally be implemented in 2007. Canadian and U.S. airlines can now pick up passengers and cargo in each other’s country as long as the flight is heading on to a third country. Cabotage, that is, allowing foreign airlines to pick up passengers between cities located in the host country, is still not permitted.

It is anticipated that the implementation of the open skies policy with the U.S. may lead to further bilateral agreements with other countries.

Canada has had only one national airline since the amalgamation of Air Canada and Canadian Airlines in 1988.

Fishing

Foreign fishing vessels, unless authorized under the federal *Coastal Fisheries Protection Act*, are prohibited from fishing in Canadian coastal waters.

Utilities

Utilities are regulated by provincial crown corporations and governmental ministries.

Liquor and Alcohol

Any person selling liquor in Canada is required to obtain an appropriate provincial licence. Liquor, wine and beer distribution in Ontario is restricted to a provincial crown corporation, the Liquor Control Board of Ontario.

Transport

Firms that ship goods between cities require public commercial vehicle licences. There are special X-class licences for trucks that cross provincial or international borders. Mandatory bill of lading / shipping contract terms are specified in provincial highway traffic legislation, and certain terms are automatically incorporated into all bills of lading and shipping contracts where the carriage is by motor vehicle. Foreign vessels, unless authorized under the federal *Coasting Trade Act*, are prohibited from shipping cargo or passengers by water between two coastal ports in Canada.

Warehousing

Bonded warehousemen require a licence from the Excise Branch of Canada & Revenue Agency.

Consumer Advertising

Misleading advertising and the regulation of marketing practices form part of the federal *Competition Act*. In addition, each province has legislation that regulates business practices such as false, misleading or deceptive consumer representations. There is also legislation that regulates the use of executory contracts to sell goods or services, that is, contracts where either or both parties to the sale undertake future performance, for example, payment or delivery of the goods or services. Other key areas of regulation include disclosure of the cost of borrowing (also governed by the federal Interest Act), advertising and the use of disclaimer clauses in commercial agreements.

Real Estate Agents and Mortgage Brokers

A person wishing to act as a real estate sales agent or broker, a business broker, or a mortgage broker is required to obtain a special provincial qualification and a licence. The Ontario government has enacted the *Mortgage Brokerages*, *Lenders* and *Administrators Act*, 2006 providing for new regulations regarding regulated activities, exemptions, licensing, the powers and duties of principal brokers and the standards of practice for brokerages. The new Act will come into effect July 1, 2008. The new Act would create a brokerage model for the sector under which a licensed brokerage would ensure that every broker and agent working on its behalf complies with the Act. Brokers and agents would be restricted to acting on behalf of one brokerage. Agents would only deal or trade in mortgages under the supervision of a mortgage broker. A brokerage would be required to appoint a principal broker to perform prescribed duties. The principal broker would act as a compliance officer.

The current Act imposes foreign ownership restrictions on mortgage brokers. The new Act would not include these restrictions for mortgage brokerages.

Motor Vehicles

Motor vehicle dealers are licensed provincially.

Collection Agents

Collection agencies operating in Ontario must be incorporated in Canada and certain ownership restrictions apply.

Consumer Reporting Agencies

Consumer reporting agencies must maintain their database computer records at a location in Canada.

Travel Agents

The travel industry is regulated provincially.

ARE THERE CONFLICT OF INTEREST OR OTHER SPECIAL REQUIREMENTS WHEN DOING BUSINESS WITH THE FEDERAL GOVERNMENT?

There are a number of statutes that govern how businesses deal with the Government of Canada. Legislation includes the *Federal Accountability Act*, the *Conflict of Interest Act*, the *Canada Elections Act*, the *Lobbyists Registration Act* (as noted below, upon the coming into force of an amendment to this Act, it will be known as the *Lobbying Act*), the *Public Service Employment Act*, the *Access to Information Act*, the *Public Servants Disclosure Protection Act* and the *Financial Administration Act*. Many of the acts listed above are only partly in force pending settlement of regulations, etc.

The *Federal Accountability Act* prohibits all corporate and union direct or indirect financial contributions of any kind to candidates or political parties at the federal level.

The *Conflict of Interest Act* (the "CIA") applies to public office holders ("POHs") and certain cabinet appointees. POHs include Ministers, parliamentary secretaries and ministerial staff, whether or not paid and whether or not full-time. The CIA creates an independent Commissioner of Conflicts of Interests and Ethics with broad investigatory and enforcement powers. POHs are prohibited from exercising an official power to further the POH's private interests or any other person's private interests. POHs cannot accept gifts from persons other

than family and friends unless the gifts are a normal expression of courtesy or protocol. Reporting POHs cannot act as directors of a corporation or other enterprise, hold office in a union or professional organization, act as a paid consultant or be an active member of a partnership. Post-employment prohibitions include providing advice to clients based on non-public information obtained while a POH, acting for a person in respect of which the Crown is a party or taking employment with a person with whom the PHO had direct and significant official dealings within the last 12 months of acting as a PHO.

Amendments are changing the name of the *Lobbyists Registration Act* to the *Lobbying Act*. The *Lobbying Act* creates an independent Commissioner of Lobbying with broad investigatory and enforcement powers. For instance, the Commissioner will have the authority to confirm with designated public office holders ("DPOHs") the accuracy of disclosure provided by registered lobbyists.

The Act imposes rules that are more stringent than the previous regulatory regime surrounding lobbyists. For example, lobbyists will no longer be able to work on a contingency fee basis and there are new monthly reporting requirements. In addition, the *Lobbying Act* prohibits certain DPOH from lobbying the federal government for five years after leaving their posts. Certain corporate executives and directors may be deemed to be lobbyists and be required to register pursuant to the *Lobbying Act*. Penalties and fines for non-compliance with the Act will be increased to up to $50,000 and/or six months imprisonment for summary conviction offences, up to $200,000 and/or two years for indictable offences, and a two-year prohibition on lobbying if convicted of an offence under the *Lobbying Act*.

The substantive amendments to the *Lobbyists Registration Act* are not yet in force. Before the changes are implemented, the *Lobbying Act's* regulations must be established and substantial changes must be made to the Registry of Lobbyists to accommodate the new monthly reporting requirements. Reports will include a declaration that the lobbyist is not receiving payment on a contingency basis. Former DPOHs must disclose former offices held and the date they left each position. Monthly returns must list every prescribed contact with a DPOH, the name of the DPOH, the date of the communication and particulars of the subject matter of the communication. Filings will be due within 10 days of each new undertaking and within 15 days of each month end.

Provincial and municipal governments have lobbyist registration legislation in effect, albeit not as stringent as the federal regime summarized above.

WHAT CONSUMER PROTECTION LEGISLATION APPLIES IN ONTARIO?

Ontario's *Consumer Protection Act, 2002* (the "New Act") came into force on July 30, 2005. It amends the list of unfair practices, adds implied conditions and warranties, and provides new rights and remedies for consumers under consumer agreements. The New Act also contains additional rights and obligations in respect of specific consumer agreements, such as future performance agreements, time share agreements, Internet agreements, direct agreements, remote agreements and personal development services agreements (all of which are defined under the New Act). Other changes include amendments to provisions relating to credit agreements under Ontario's existing *Consumer Protection Act* (the "Old Act") and those relating to agreements for loan brokering and motor vehicle repairs (previously governed by the *Loan Brokers Act* and *Motor Vehicles Repairs Act*, respectively), as well as new provisions relating to personal property leases.

The following summary highlights certain provisions of the New Act relating to consumer agreements generally and specific types of agreements. Note that important new provisions relating to credit transactions, leases and other matters in the New Act are not covered by this summary.

Unfair Practices, Implied Warranties and Unsolicited Goods

The New Act adopts many of the unfair practices set out in the *Business Practices Act* (now repealed) and adds misrepresentations as to: (i) the delivery or performance of goods or services within a specified time, (ii) the purpose of any charge, and (iii) the benefits that are likely to flow to a consumer if the consumer helps a business obtain new or potential customers. The New Act also provides that it is an unfair practice for a person to use his/her custody or control of a consumer's goods to pressure the consumer into renegotiating the terms of a consumer transaction. Under the New Act a consumer may exercise his/her remedies for unfair practices (i.e., rescission, or recovery of amounts paid in excess of the value of the goods or services and/or damages) within one year after entering into the agreement, as opposed to six months under the repealed *Business Practices Act*.

The Old Act rendered void any attempt to negate the implied conditions and warranties under the *Sale of Goods Act* in connection with a consumer sale. The New Act contains a similar provision for a consumer agreement (which has a similar, although not identical, meaning to consumer sale). The New Act adds a deemed warranty that services supplied under a consumer agreement are of a reasonably acceptable quality. This warranty also cannot be waived or otherwise avoided.

A provision relating to estimates is contained in the New Act, which prohibits a supplier from charging a consumer an amount that exceeds the estimate by more than 10 per cent.

Under the New Act, a consumer has no obligations for unsolicited goods or services (i.e., provided without any request by the consumer, which cannot be inferred solely on the basis of payment, inaction or passage of time). Goods or services are deemed unsolicited if there is a material change without the consumer's consent. Consent may be given in any manner, but the supplier has the onus of proving consent was obtained.

The New Act also renders invalid arbitration clauses in a consumer agreement or a related agreement.

Internet Agreements and Other Specific Consumer Agreements

A remote agreement is a consumer agreement entered into when the consumer and supplier are not present together. Agreements entered into over the phone or by mail would fall within this category. Before entering into a remote agreement, a supplier must disclose prescribed information to the consumer, which includes contact information of the supplier, description of the goods and services, a itemized list of prices, a description of additional charges, the total amount payable by the consumer, terms and methods of payment, any credit terms, date for delivery of goods or completion of services, and a supplier's refund policy.

Before a remote agreement is entered into, the supplier must provide the consumer with an express opportunity to accept or decline the agreement and to correct any errors. A copy of the remote agreement, which must include the information described above, must be delivered to the consumer by the earlier of: (i) 30 days after the supplier bills the consumer, or (ii) 60 days after the consumer enters into the agreement. The remote agreement may be delivered by e-mail, fax, mail, or any other manner that allows the supplier to prove the consumer has received it.

If the prescribed information is not provided to the consumer prior to entering into the remote agreement, it may be cancelled within seven days of receiving a copy of the agreement. A consumer may also cancel a remote agreement within one year of the date it is entered into if the consumer does not receive a copy of the agreement in accordance with the New Act.

The provisions relating to direct agreements in the New Act replace those applicable to direct sales contracts in the Old Act. Direct agreements are negotiated in person, but not at the supplier's place of business. The New Act contains a similar cancellation right within one year if the consumer does not receive a copy of the agreement that complies with the New Act, a 10-day cooling off period during which the agreement may be cancelled for any reason. However, the prescribed contents of these agreements have changed, which now must include similar information to remote agreements as well as prescribed wording about the consumer's cancellation rights.

The New Act contains provisions relating to future performance agreements similar to those applicable to executory contracts under the Old Act. However, the prescribed contents of these agreements have changed to include information similar to that for remote agreements, and new cancellation rights have been added. These agreements may be cancelled within one year if they do not comply with the New Act or the consumer does not receive a copy, or if delivery or performance under the agreement is delayed by more than 30 days (available under the Old Act only for direct sales agreements, described above).

An Internet agreement is a consumer agreement formed by text-based Internet communications. For detailed information on the application of the New Act to Internet agreements, see the heading "How Does Ontario Consumer Protection Legislation Affect Electronic Contracts?" on page 14.8.

The renewal, amendment and extension of future performance agreements, direct agreements, remote agreements and Internet agreements are subject to new requirements. If the agreement contains a provision for amendment, renewal or extension, it must (i) indicate what elements are subject to change and how often a supplier may make changes, (ii) give the consumer the alternative of terminating the agreement or retaining the existing agreement unchanged (or both alternatives), and (iii) require that the consumer be given advance notice of any change. Any change takes effect 30 days after the consumer receives notice of it, or a later date specified in the notice. The notice must comply with various prescribed requirements, which include disclosing all proposed changes. Any change cannot retroactively affect rights or obligations of the consumer. If the consumer agreement does not contain a provision regarding amendment, renewal or extension, such changes may only be made if the consumer explicitly, and not merely by implication, agrees to the proposed change. The change is effective on the date specified, but only if the supplier provides an updated version of the agreement to the consumer within 45 days after the consumer has agreed to the change, which updated version must disclose all changes.

New provisions relating to time share agreements require that they: (i) be in writing, (ii) contain prescribed information, including a consumer's cancellation rights, (iii) are delivered to the consumer, and (iv) allow for cancellation for any reason within 10 days of receiving a copy of the agreement. These agreements may also be cancelled by the consumer within one year if the consumer is not provided with a copy of the agreement that complies with the New Act.

The provisions in the New Act relating to personal development services replace and supplement those under Ontario's existing *Prepaid Services Act* (the "PSA"). While the PSA applied to all services for which payment is required in advance, professional development services are defined as services for health, fitness, modelling and talent, and matters of a similar nature, as well as facilities used for the instruction of such services.

The New Act applies only if advance payments are required and the services are **not** provided by a non-profit, co-operative, private club owned by its members, or any golf club. The New Act prescribes information that must be included in these agreements, restricts the term of agreements (which includes wording about the consumer's cancellation rights), restricts the term of agreements to one year, limits initiation fees and requires that monthly instalment plans be made available. The New Act also provides for a 10-day cooling off period (as opposed to five days under the PSA) and cancellation of the agreement within one year if the

consumer does not receive a copy that complies with the New Act. Payments for services or facilities that are not available at the time of payment must be paid to a trustee.

Application of the New Act

The New Act only applies if the consumer is an individual acting for personal, family or household purposes. It does not apply to corporate consumers or any consumer who is acting for business purposes. Subject to limited exceptions, the New Act applies to all consumer transactions where the consumer or the supplier is located in Ontario.

Internet agreements, remote agreements, future performance agreements and personal development services agreements are only subject to the New Act if the consumer's total potential payment obligation under the agreement exceeds $50.

Where a consumer agreement meets the criteria of more than one type of agreement under the New Act, all the applicable provisions must be complied with, except where the application is expressly excluded. The regulations under the New Act provide some relief to this overlapping application, such that conflict between different requirements is avoided.

The New Act does not apply to:

- Transactions regulated under the *Securities Act*;
- Financial services relating to investment products;
- Consumer transactions relating to real property, other than certain time share agreements; *and*
- Prescribed professional services, such as those provided by lawyers, accountants, engineers and architects.

In addition, the supply of accommodations, other than under time share agreements, is exempt from the provisions applicable to Internet agreements, remote agreements and future performance agreements.

HOW DOES CANADA'S BANKING SYSTEM OPERATE?

Canada has one of the most sophisticated and stable banking systems in the world. Banking services are provided by:

- 21 Canadian-controlled banks (Schedule I banks);
- 23 active foreign bank subsidiaries (Schedule II banks); and
- 24 foreign bank branches (Schedule III banks), of which 18 are full-service branches and six are lending branches.

Of the 19 Schedule I banks, six are world-class in terms of their asset value: RBC Financial Group, Canadian Imperial Bank of Commerce, The Bank of Nova Scotia, BMO Financial Group, The Toronto-Dominion Bank and National Bank of Canada. Each provides a full range of banking services through branches located throughout Canada. In some cases, Schedule I banks have made substantial investments in foreign banks operating outside Canada.

The foreign-controlled Schedule II banks (foreign bank subsidiaries) and Schedule III banks (foreign bank branches) tend to provide specialized niche banking services.

Insurance companies, trust companies and loan companies are all permitted to engage in commercial lending activity.

All major American credit cards are widely accepted. Debit cards are more widely used in Canada, on a percentage basis, than in any other country.

The Canadian Payments Association operates two national payments systems: the Large Value Transfer System ("LVTS") and the Automated Clearing Settlement System ("ACSS"). The LVTS is used for electronic wire transfers of large value and time critical payments. It provides certainty of final settlement in real time on an item-by-item basis. Cheques and automated payments clear through the ACSS, which settles clearing balances on a net settlement basis by debits and credits to the direct clearer's accounts at the Bank of Canada. Cheque volumes have declined since 1990 and paper items now represent less than 30% of the items settled using ACSS.

The direct clearers process payment items in regional data centres, transfer paper and electronic payment items to other direct clearers for other regions and provide an access port for payments cleared initially through specialized organizations such as the Canadian Depository for Securities, MasterCard, VISA Canada and the International Interbank Payments System.

As a result of (i) the foregoing and (ii) the different treatment of account deposits under U.S. and Canadian laws, in contrast to U.S. practice, lock-box arrangements, under which all receipts are paid into a designated account and wire-transferred without deduction or set-off to the payee's lending bank that holds an assignment of receivables security from the payee, are not commonly used in Canada.

Toronto is the financial capital of Canada. Although Canadian equities are traded on four exchanges in Canada, over 75% of trades are done on the Toronto Stock Exchange.

Canadian banks are prohibited by law from acting as trustees. This role is filled by the second pillar of the Canadian financial services industry, trust companies, which are incorporated both provincially and federally. The third and fourth pillars of the industry are the insurance companies and the securities dealers.

Significant changes have been made in the Canadian financial services industry over the last few years, the thrust of which has been to increase competition. As a result, there has been a blurring of lines of authority among the four pillars. For example, most brokerage houses and trust companies are owned by one of the major or chartered banks and chartered banks have begun to acquire insurance companies, although currently banks are not permitted to sell general insurance coverage through their branch network. To date, Canada has managed to avoid any significant problems similar to the savings and loan failures in the U.S. a decade ago.

All the common law provinces now have personal property security regimes similar to that contained in Article 9 of the U.S. *Uniform Commercial Code*. For provinces other than Québec, registration can be completed online during extended hours. In Ontario, there is no need for signatures or other authorizations from the affected debtor. Québec has a separate province-wide system for registering public notice of security. In addition, corporate borrowers may grant security to Canadian chartered banks against inventory and finished goods under special security provisions of the *Bank Act*. Provincial statutes govern security in real estate and registrations are made in the county in which the real estate is located. In most counties in Ontario, online registrations are mandatory.

WHAT ARE THE CURRENT RULES IN CANADA GOVERNING EXCHANGE RATE, INTEREST RATE AND OTHER HEDGE CONTRACTS?

The International Swaps and Derivatives Association, Inc. ("ISDA") periodically reviews and revises its standardized industry definition and related documents. The current set of ISDA-sponsored documents includes the:

- 2002 ISDA Master Agreement, updated in early 2003;
- 2002 Energy Agreement Bridge, updated in late 2002;
- 2002 Equity Derivatives Definitions, updated in late 2002; and
- 2003 Credit Derivatives Definitions, updated in early 2003.

Each of these documents introduced a number of key changes that affect the manner in which swaps and derivative transactions (including those concluded in the burgeoning energy and commodity sectors) are done. In particular, the 2002 ISDA Master Agreement contains substantial modifications to the usual grace periods that arise, primarily in connection with the failure to satisfy obligations as a result of bankruptcy, and the force majeure termination provisions.

As well, it also introduced a new measure for quantifying damages in the event of an early termination and mandates formal set-off rules. These changes have had a significant impact on the way in which derivative transactions are concluded by financial participants and end-users alike. Cassels Brock is fortunate to have a number of lawyers who are intimately familiar with these changes as a result of their participation on the Canadian ISDA Documentation Committee and we would be pleased to assist clients (foreign and domestic) with their treasury management legal needs.

WHAT PROTECTION IS AFFORDED BANKRUPT OR INSOLVENT BUSINESSES IN CANADA?

Insolvency and bankruptcy are governed primarily by federal legislation. Creditors have had much greater powers in dealing with insolvent businesses in Canada than in the U.S. The federal *Bankruptcy & Insolvency Act* ("BIA") provides increased levels of protection for the wages of employees of bankrupt companies, a re-ordering of priorities among creditors, and permits an unpaid supplier to take back goods from a bankrupt if the supplier has not been paid within 30 days following bankruptcy.

The initial cooling-off period for restructuring in Canada is only 30 days, compared to 120 days under comparable U.S. legislation. Under the BIA, a creditor may make a proposal that can affect the rights of both secured and unsecured creditors. Under the former *Bankruptcy Act*, only the rights of unsecured creditors could be affected by a proposal. As well, an insolvent business may be restructured under the federal *Companies' Creditors Arrangement Act* (the "CCAA"), the provisions of which favour the rehabilitation (as opposed to the wind-up) of insolvent businesses. The CCAA is frequently used in complex cross-border insolvency and reorganization situations.

On June 14, 2007, the House of Commons passed Bill C-62, the long-awaited insolvency reform legislation. The legislation has received first reading in the Senate and is expected to go to Committee in the fall. Its formal title is *An Act* to amend the *Bankruptcy and Insolvency Act*, *the Companies' Creditors Arrangement Act*, *the Wage Earner Protection Program Act and chapter 47 of the Statutes of Canada, 2005*. Bill C-55 was enacted as C.47 on November 25, 2005, but the government of the day committed to the Senate that the bill would not be proclaimed into force until the Senate had an opportunity to conduct hearings on C.47. It was also recognized that there were some clear technical issues in the drafting that were in need of repair. The new Bill C-62 implements a number of these technical amendments to the wording of C.47 to address specific problems identified by a select advisory committee that

has been working with Industry Canada since C.47 was passed. Bill C-62 also includes some additional substantive changes. The Senate hearings are therefore expected to encompass both the main C-55 amendments that became C.47 in November 2005, as well as the clean up and substantive changes to C.47 that are presently before the Senate as Bill C-62.

Most restructurings in Canada are done under the CCAA, and one area of particular concern — which is not addressed in the above amending legislation — is the lack of assurance for companies that do business with a reorganizing company on a basis that will assure that it will be paid.

In American Chapter 11 cases, companies that do business with the reorganizing company are protected by a priority claim that ranks ahead of the claims of the company's other unsecured creditors. This claim is called an "administrative expense priority." For a company to emerge from Chapter 11, it must pay its administrative expense priority obligations. The theory of an administrative expense priority is that suppliers who provide products or services to a reorganizing debtor are assisting it to survive and expand. If reorganizations are considered to be a desirable outcome to a company's financial difficulties, creditors and suppliers should be encouraged to continue doing business with reorganizing companies. Consequently, Chapter 11 provides this type of priority for suppliers of goods and services to reorganizing companies for the products they supply during the reorganization, subject to overriding supervision of the court.

By contrast, the CCAA is an excessively abbreviated statute that does not have much time or space for rules to deal with situations that are completely normal parts of all reorganizations. Among the many things missing from the CCAA is an administrative expense priority. Consequently, where a supplier supplies to a debtor that is reorganizing under the protection of the court, and the reorganization fails, the supplier's claims for post-filing goods and services ranks exactly where its pre-filing claims rank: right at the bottom of the food chain, marginally ahead of the equity. Post-filing suppliers to CCAA debtors, therefore, are assuming a credit risk that is much greater than in Chapter 11. Generally, where the outcome is uncertain, the supplier to a restructuring customer should probably only deliver new goods and services on a C.O.D. basis.

Cross-Border Insolvency Procedures

To address the special concerns that arise in cross-border insolvencies, the Canadian government expanded the recognition of foreign insolvency proceedings in Canada, including concurrent bankruptcy administrations in more than one jurisdiction. Canada permits foreign insolvency representatives to appear before the Canadian courts in insolvency matters. Canadian courts have endorsed the use of the Cross-Border Concordats in Insolvency Matters modelled on those adopted by the International Bar Association.

8. CANADIAN COMPETITION LAWS

In Canada, all aspects of competition law are governed by the *Competition Act* ("CA"), which is federal legislation administered by the Competition Bureau. The stated purpose of the CA is to maintain and encourage competition in Canada. Three aspects of the CA are of principal interest.

First, the CA contains a set of comprehensive rules with respect to both substantive and procedural requirements applicable to mergers. Second, it establishes a number of criminal offences, which subject companies and individuals involved to substantial penalties. In addition, it allows individuals to launch civil damages suits for breaches of criminal provisions. Third, the CA contains rules related to reviewable practices, which are generally legal, but can be prohibited if found to substantially lessen competition in a market in Canada. Each of these aspects of the CA is discussed in more detail below.

MERGERS

The CA contains pre-merger notification provisions, as well as substantive merger provisions, which apply independently of each other. Even if a transaction raises no substantive competition issues under the merger provisions, the parties must nevertheless comply with the filing and waiting period requirements of the pre-merger notification provisions, unless the parties apply for and obtain an exemption in the form of an advance ruling certificate ("ARC"), discussed below.

Conversely, a merger that does not meet the notification thresholds may still be subject to review by the Commissioner and an order of the Tribunal if it raises a substantive issue under the merger provisions of the CA.

What is a "Merger"?

The CA broadly defines merger to include any form (i.e., purchase of shares, assets, amalgamation, *etc.*) of direct or indirect acquisition or establishment of "control over or significant interest in" all or part of a business. Control is generally defined as ownership of more than 50% of the voting shares of a corporation or interest in a partnership. A "significant interest" is not defined in the CA, but is viewed by the Competition Bureau as having a sufficient ownership interest to materially influence the competitive behaviour of a business.

Generally, the Bureau will not consider ownership of less than 10% of the voting shares to be significant, while acquiring 10 to 50% of the voting shares would likely be open to review. It should be noted that, in the Bureau's view, a significant interest may be acquired by a variety of means, not just acquisitions of voting rights. Consequently, shareholders' agreements and management contracts may be deemed to be acquisitions of a significant interest.

When is a Merger Notifiable?

Parties must notify the Competition Bureau of a proposed merger if the transaction meets <u>both</u> of the following financial thresholds:

Size of Parties Threshold

For transactions involving either assets or shares, the parties to the transaction, together with their affiliates, must:

- Have assets in Canada that exceed $400 million in aggregate value; or
- Have gross annual revenues from sales from (export) or into (import) Canada that exceed $400 million in aggregate value.

Size of Transaction Threshold

For an acquisition of assets of an operating business, this threshold is met when:

- The aggregate value of the Canadian assets being acquired exceeds $50 million; or
- The gross annual revenue from sales in or from Canada generated by such assets exceeds $50 million.

For an acquisition of shares, this threshold is met when:

- The aggregate value of the Canadian assets owned by the corporation whose shares are being acquired (or a corporation controlled by that corporation) exceeds $50 million; or

- The gross annual revenue from sales in or from Canada of the corporation whose shares are being acquired (or a corporation controlled by that corporation) exceeds $50 million.

Asset and revenue values are calculated based on the most recently completed audited financial statements. If a party does not have its financial statements audited, unaudited statements may be used. With respect to asset values, the book value of assets is used and, subject to limited exceptions, the gross value of these assets is used to determine aggregate value.

Additional Threshold for Share Acquisitions

Even if both the "size of parties" and "size of transaction" thresholds are met, an acquisition of shares is notifiable only when:

- A purchaser acquires 20% or more of the voting shares of a **public** company (or 50% or more, if it already owns 20% of shares); or
- 35% or more of the voting shares of a **private** company (or 50% or more, if it already owns 35% of shares).

What Are the Notification Procedures?

Parties must submit either a Short Form or a Long Form filing to the Competition Bureau. Generally, the information required for both filings relates to the nature of the businesses carried on by the parties and their affiliates, their principal suppliers and customers and their affiliates, along with general financial information. The Long Form filing, however, requires considerably more information and is labour-intensive, which should be taken into account when considering timing.

As a practical matter, the Short Form is filed in almost every case. However, where the proposed transaction is likely to raise substantial issues, it is recommended that the parties submit a Long Form filing.

Note that the CA exempts information that is not reasonably necessary to the Commissioner's assessment of the competitive impact of a transaction. Accordingly, it is often unnecessary to provide all of the information required under the CA.

Once parties submit their filings to the Competition Bureau, they must wait for the expiry of the applicable mandatory waiting period, which is 14 days for a Short Form filing and 42 days for a Long Form filing. The applicable waiting period runs from the date the filing is certified by the Bureau as complete. After receipt of a Short Form filing, the Commissioner may require parties to make a Long Form filing, in which case the 42-day waiting period commences once the Long Form filing is filed and certified as complete.

The parties may not close the transaction before the applicable waiting period has expired, unless the Commissioner issues an ARC. Failure to comply with the pre-merger notification requirement or to abide by the waiting periods may result in criminal sanctions.

Following the expiry of the applicable waiting period, the parties are free to close the transaction. However, if the Commissioner has not completed her review, the parties typically agree not to close the deal until the Commissioner has completed her investigation. The Bureau has issued service standards that indicate the length of time it will take the Bureau to complete its review of a proposed transaction.

The Bureau has developed three classifications: non-complex (no competitive overlap or the post-transaction market shares are very low), complex (some competitive overlap) and very complex (many overlaps with significant issues to resolve). Where a transaction is characterized as non-complex the Bureau will make its best efforts to provide an answer within 14 days; for complex transactions, the period is 10 weeks; and for very complex transactions, the period is five months. However, these time periods are guidelines only and it may take the Bureau more or less time to review a particular transaction.

What Are Advance Ruling Certificates and No-Action Letters?

The CA grants the Commissioner the right to challenge a transaction within three years after it has closed. Consequently, the expiry of the waiting period alone does not immunize the transaction from future challenges, unless parties obtain comfort from the Commissioner that she does not intend to challenge the transaction.

The most iron-clad comfort comes in the form of an ARC. The Commissioner will issue an ARC where she is satisfied that she does not have sufficient grounds on which to apply to the Tribunal. Issuance of an ARC has the effect of exempting the transaction from the notification provisions and barring the Commissioner from applying to the Tribunal under the merger provisions unless there is a material change in circumstances, provided the transaction is substantially completed within one year after the ARC is issued. ARCs tend to be granted only in the clearest cases.

More commonly, the Commissioner will issue what is known as a no-action letter, which represents the Commissioner's written confirmation that the transaction raises no substantive issues. The no-action letter preserves the Commissioner's statutory authority to challenge the transaction for three years from closing, but provided there is no material change in the facts upon which the no-action letter is based, further action is extremely unlikely.

What Are the Filing Fees?

There is a mandatory filing fee of $50,000 for all pre-notification filings or requests for ARCs. The fee is the same regardless of the size or complexity of the transaction. Who pays the fee is a matter of negotiation. The two most common practices are that the fee is paid by the purchaser or split evenly by the parties. On occasion, parties will provide both a pre notification filing and a request for an ARC, in which case there is only one $50,000 fee. Note that where an ARC is sought, GST must also be paid; however, very often the parties can recover the GST.

When is a Merger Subject to Substantive Review?

Regardless of size, a merger is subject to substantive review by the Bureau and challenge before the Competition Tribunal if it is likely to give rise to a substantial prevention or lessening of competition in a relevant market in Canada. Cases before the Competition Tribunal have established that the relevant question is whether the merger will create, maintain or enhance the ability of the merged entity, unilaterally or in coordination with other firms, to exercise market power. Market power is the ability to profitably maintain prices above the competitive level for a significant period of time.

As a general rule, the Commissioner will not challenge a merger on the basis of the unilateral market power of the merged entity if its post-merger market share will be less than 35%. In addition, the Commissioner generally will not challenge a merger on the basis of an increase in scope for interdependent behaviour among competitors in the relevant market if (i) the aggregate post-merger market share of the four largest firms in the relevant market will be less than 65%, or (ii) the post-merger market share of the merged entity will be less than 10%.

If in the course of reviewing a proposed transaction the Commissioner identifies areas in which she believes the transaction will substantially lessen competition, she will normally try to negotiate alterations to the transaction to address her concerns. Such negotiations can be protracted. Prior to challenging a transaction before the Tribunal, the Commissioner may apply to the Tribunal for an order enjoining the parties from completing the transaction for a period not exceeding 30 days to permit the Commissioner to complete her inquiry. Should the Commissioner be unable to complete an inquiry during the initial period because of circumstances beyond her control, the Tribunal may extend this interim order to a date not more than 60 days after the initial order takes effect. If the Commissioner makes an application to the Tribunal challenging a proposed transaction, she may also apply for an interim order on the terms that the Tribunal deems appropriate.

What Are Possible Merger Remedies?

Where, on application by the Commissioner, the Tribunal finds that, on the balance of probabilities, a merger or proposed merger prevents or lessens, or is likely to prevent or lessen, competition substantially in a relevant market, the Tribunal may issue orders to remedy the situation.

With respect to a proposed merger, the Tribunal may order the parties not to proceed with all of part of the merger. With respect to completed mergers, it may order that the merger be dissolved or that specific assets or shares be divested. Although in theory these powers seem broad, in practice, the Tribunal has never in the past ordered the dissolution of a completed merger or a full divestiture.

In September 2006, the Competition Bureau issued an *Information Bulletin on Merger Remedies in Canada*. This bulletin provides guidance on the general principles applied by the Bureau when it seeks, designs and implements remedies.

In considering whether to make an order, the Tribunal takes into account a number of factors, such as the extent of foreign competition, whether the business being purchased has failed or is likely to fail, the extent to which acceptable substitutes are available, barriers to entry, remaining effective competition, whether a vigorous and effective competitor would be removed, the nature of change and innovation in a relevant market, and any other factors relevant to competition.

The CA provides for an efficiencies defence which, in theory, permits a merger that prevents or lessens, or is likely to prevent or lessen, competition substantially in any market in Canada, so long as the efficiency gains resulting from the merger exceed the anti-competitive effects of the merger. In practice, merging parties may raise the defence in the ARC submission in the initial assessment phase before the Commissioner and again, if necessary, when the Commissioner has brought an application before the Tribunal challenging the merger.

CRIMINAL OFFENCES

The CA establishes a number of criminal offences, which are investigated by the Competition Bureau and prosecuted by the Attorney General for Canada. A breach of the criminal provisions of the CA may lead to significant fines for businesses and fines and/or imprisonment for individuals responsible (including senior management or directors who oversaw the conduct). In addition, breaches of these provisions can serve as the basis for civil suits for damages, which are generally brought by way of class actions.

Conspiracy

Conspiracy, which is the Canadian equivalent of section 1 of the *Sherman Act* and section 81 of the *EC Treaty*, is the entering into an agreement or arrangement with another person that

prevents or lessens competition “unduly.” For a finding of conspiracy, there must be (i) an agreement or arrangement among two or more persons (a company cannot conspire with itself or with its affiliated companies); (ii) which has the effect of isolating the conspirators from competitive influences in a market; and (iii) whose anticompetitive effect was foreseeable at the time the agreement or arrangement was entered into. Note that, unlike in the U.S., in Canada parties must possess a moderate degree of market power (*i.e.*, the offence is not *per se*).

Most often, conspiracies involve price-fixing arrangements, although they can be broader and include agreements based on credit terms or other conditions of sale, customer and territorial allocation, and agreements not to buy from or sell to certain individuals. The agreements do not have to be written down or formalized in any way. They do, however, have to be the result of communication among the parties and not the product of independent business decisions.

Anyone found guilty of conspiracy is liable to imprisonment for a term not exceeding five years and/or a fine not exceeding $10 million. Over the past 15 years, the Commissioner has not been very successful in obtaining convictions. However, there have been some fairly hefty fines levied following guilty pleas.

Bid-rigging

Bid-rigging is an agreement or arrangement between one or more non-affiliated entities either not to submit a bid, to submit a separate but coordinated bid or to submit a joint bid. This is not permitted under the CA, unless the person calling for the bid is aware of the agreement or arrangement or the parties are affiliates of each other.

Bid-rigging is a *per se* offence, which means the prosecution does not need to prove that the conduct had any effect on the market.

The monetary fines for bid-rigging can be very high. In addition, there is a possibility of imprisonment for up to five years for the individuals entering into the arrangement or agreement. It is worth noting that the Commissioner of Competition has recently increased her enforcement of the bid-rigging provisions.

Price Maintenance

The CA prohibits agreements, promises or threats whose purpose is, either directly or indirectly, to influence customers to raise, or discourage them from reducing, the prices at which they sell or advertise any product in Canada. It is also an offence to refuse to supply someone because of their low pricing.

A resale price may be suggested to a dealer; however, it is important to point out that the dealer has no obligation to accept that suggestion, and there will be no consequences if the suggestion is not followed. Where a resale price is indicated in a company’s promotional material, the material should clearly indicate that a dealer may sell for less. Note that, unlike in the United States, in Canada price maintenance is *per se* illegal, which means it is irrelevant whether the practice has no effect on the market and a supplier cannot justify the practice by business reasons. For this reason, a published minimum advertised price policy that is legal in the U.S. is *per se* illegal in Canada.

There are no defences available if a person attempts to influence prices. However, it is lawful to actually refuse to supply someone if there is reason to believe the purchaser was loss leadering the product, or the purchaser was engaging in bait-and-switch selling or misleading advertising with respect to the product, or was supplying an unacceptable level of service in respect of a product.

The penalty for price maintenance/refusal to supply can be a fine and/or imprisonment for up to five years. The Crown has had some success in obtaining convictions in this area, and the courts do not hesitate to levy substantial fines.

Price Discrimination

The CA prohibits suppliers from discriminating among purchasers who are competitors by granting a discount, rebate, allowance, price concession or other price-related advantage to a purchaser that is not available to its competitors at the same time in respect of articles of like quality and quantity. The offence is committed only if the conduct constitutes a practice; a one-shot deal will likely not constitute price discrimination. Moreover, to be guilty of an offence, the seller must actually know, or be wilfully blind to the fact, that it is discriminating among competitors.

This provision does not replace hard bargaining. If one purchaser extracts a better deal from a supplier by way of negotiations, the supplier does not have to offer the same deal to all of the purchaser's competitors. However, any volume rebate or allowance that the supplier offers should be made available to all competitors.

There is an important difference between price discrimination laws in Canada and the U.S.: in Canada there is no proportionality requirement for a volume discount program to be legal. In other words, a volume discount program may favour large customers, so long as the discounts are truly available to all competitors.

In addition to the general price discrimination offence, there is a related offence of geographic price discrimination, which applies to situations where a firm has a policy of selling products at lower prices in one geographic region than it does in others, and where the policy substantially lessens competition, or is likely to eliminate a competitor in the region in question, or is designed to have that effect. However, this provision has not been enforced by the Commissioner in quite some time.

The penalty for price discrimination includes fines and a term of imprisonment not exceeding two years, although proceedings under these provisions are rare.

Predatory Pricing

It is an offence under the CA to engage in a policy of setting prices too low, where this policy is designed to, or has the effect of, substantially lessening competition or eliminating a competitor. The prohibition applies only to prices that are "unreasonably" low. What determines whether the prices are unreasonably low will depend upon various factors such as demand for the product and the cost of producing/selling the product. Generally, prices below average variable cost are inherently suspect, prices above average total cost are presumptively legal, and prices that fall in between these two require further analysis to determine whether they have a predatory intent or effect.

Additionally, the Competition Bureau looks at the following factors: (i) whether recoupment is possible (i.e., whether the company can raise prices to supra-competitive levels following successful predation); (ii) whether the unreasonably low pricing is part of a policy (i.e., there must be evidence that the pricing is part of a deliberate corporate program and it is in effect for a significant period of time); and (iii) whether the pricing policy has the effect or tendency, or has been designed to have the effect, of substantially lessening competition or eliminating a competitor.

Not surprisingly, there have been no predatory pricing prosecutions brought in the past 15 years. However, it is important to be aware of these provisions. The punishment for predatory pricing is a term of imprisonment not exceeding two years.

Promotional Allowances

A supplier cannot grant an allowance to one purchaser that is not offered on proportionate terms to the purchaser's competitors. An allowance is price related and has to be in respect of advertising (e.g., a co-op advertising allowance). It is an amount that is offered in addition to the sale of the product, but is itemized separately from the selling price. Any allowance must be offered to each competing purchaser in approximately the same proportion compared to the value of sales of each purchaser.

The penalty for a conviction under the promotional allowances provisions is imprisonment not exceeding two years. Note, however, that there have not been any recent cases under this provision.

Misleading Advertising

The CA prohibits materially false or misleading misrepresentations about a product or service, or about another company and its products and services, to the public. A representation is public if it is part of an advertisement in the media (such as newspaper, television, radio or billboards), or is an oral or written representations made to individual customers. Whether a representation is materially false or misleading depends on both the literal meaning, as well as the general impression, the representation made. Generally, the test is whether a representation influenced a person to purchase a product.

Misleading advertising is unique in that it is a hybrid offence, with provisions both in the criminal and reviewable parts of the CA. The Bureau reserves criminal prosecutions for fraud or deliberate breaches of the CA, and deals with most cases as reviewable matters. The Tribunal can levy significant monetary penalties for civil misleading advertising, to a maximum of $100,000 per court for first time offences by corporations.

REVIEWABLE TRADE PRACTICES

Certain trade practices, while not illegal, may be prohibited by the Competition Tribunal if found to substantially lessen competition in a market in Canada. Unlike criminal provisions, reviewable practices are subject to a civil "balance of probabilities" standard of proof. Also, there are no fines, penalties or jail terms available as remedies; all remedies are in the nature of a prohibition order from the Tribunal.

Abuse of Dominant Position

Abuse of dominant position in the CA is a broad provision akin to section 2 of the *Sherman Act* and section 82 of the *EC Treaty*.

There are three elements that must be established to make out an abuse of dominance claim. First, the Commissioner must prove that a firm has market power in one or more relevant markets in Canada. Market power means having some degree of control over prices in a relevant market. Generally, the Tribunal will look at the combination of high market shares (at least 35%, and probably over 50%) in a relevant market combined with barriers to entry into the market (*e.g.*, high sunk entry costs, existing excess capacity, regulatory constraints).

Second, the Commissioner must prove that the dominant firm has engaged in a practice of anti-competitive acts. The CA sets out a non-exhaustive list of examples of anti-competitive acts. Canadian case law has established that, to be anti-competitive, an act must be exclusionary, disciplinary or predatory in purpose or effect. The anti-competitive aspects of a practice are weighed against the efficiency-enhancing business justifications to determine whether the overall character of the practice could be determined to be anti-competitive. In practice, this analysis is similar to a rule of reason analysis under the *Sherman Act*.

Finally, the anti-competitive practice must, or be likely to, have caused a substantial lessening or prevention of competition in a market in Canada. The test established in past Tribunal jurisprudence was whether the practice had created, preserved or enhanced the dominant firm's market power by erecting barriers to entry or expansion in a market. The Federal Court of Appeal recently reformulated the test as a "but for" test: would the market(s) have been more competitive (i.e., lower prices, increase variety) "but for" the anti-competitive practice.

Note that, while certain reviewable practices may be challenged by private individuals, only the Commissioner may bring proceedings under the abuse of dominance provisions.

Refusal to Deal

Refusal to deal provisions may be triggered when a dealer or distributor is cut off and this substantially affects the dealer's or distributor's business.

If a supplier refuses to supply a product to its customer and (i) the customer is substantially affected in his business; (ii) the customer cannot obtain adequate supply of the product anywhere in the market on usual trade terms due to insufficient competition among suppliers; (iii) the customer is willing and able to meet the supplier's usual trade terms; and (iv) the refusal is having or is likely to have an adverse effect on competition in the market, the Competition Tribunal may issue an order requiring the supplier to supply the product.

Exclusive Dealing and Tied Selling

Exclusive dealing is a practice of requiring a customer, as a condition of supplying a product, to deal only or primarily with the supplier or its nominee or to refrain from dealing in certain products except as supplied by the supplier.

Tied selling is a practice of requiring a customer to purchase another product, as a condition of supplying the customer with the product the customer actually needs.

Both these practices are subject to review by the Tribunal if (i) the supplier is a major supplier of a product in a market; (ii) the practice is likely to impede entry or expansion of a firm in the market, to impede product introduction or expansion of sales in the market, or to have some other exclusionary effect; and (iii) the practice is likely to lessen competition substantially.

Market Restriction

Market restriction is a practice of supplying a product to a customer on the condition that the customer restrict its sale of that product to a specific market. If a major supplier engages in this practice and the practice is likely to substantially lessen competition, the Tribunal may make a prohibition order or such other order as is necessary to restore or stimulate competition.

Both the Commissioner and individuals may challenge refusals to deal, exclusive dealing, tied selling and market restrictions. However, now that private parties can apply directly to the Tribunal, the Commissioner will bring applications with respect to these practices only in the most compelling cases.

CIVIL ACTIONS

The CA allows individuals who have suffered damages as a result of an alleged violation of the criminal provisions in the CA or a breach of a Tribunal's order to launch civil suits. These suits are generally brought by way of class actions.

Only actual damages suffered by a person are recoverable in Canada, together with costs, in contrast to the treble damage awards that are possible in the U.S.

9. CANADIAN TRADE LAWS

WHAT GOVERNS CANADA'S TRADE REMEDY RULES?

The Canadian trade remedy system is founded on rules set down in the 1947 General Agreement on Tariffs and Trade ("GATT"). Successive multilateral negotiations have refined these provisions over the years. The most recent of these resulted in the 1994 World Trade Organization Agreement ("WTO Agreement"), concluded at the end of the Uruguay Round negotiations.

The WTO Agreement established the WTO as an international organization with a permanent secretariat in Geneva. Within its orbit are the various sectoral agreements (such as agriculture, services, intellectual property) and two key trade remedy agreements: the Anti-Dumping Agreement and the Agreement on Subsidies and Countervailing Measures.

While the WTO is functioning well as a dispute settlement forum, its negotiating arm — the Doha Round — appears to be paralyzed. This stalemate is no fault of the WTO as an institution. Rather, it's the difficulty in getting over 150 countries — large and small, rich and poor, north and south — to agree on the formulas for reducing agricultural subsidies and cutting non-agricultural tariffs. Efforts are continuing in Geneva, but the prognosis is not good.

If the Doha Round fails, the increased market access for Canadian goods through lower tariffs and reductions of non-tariff barriers will not be realized. Canadian farmers and our agriculture sector will continue to suffer from the subsidies in the U.S. and the E.U. that keep prices low in international markets.

Canada Initiates WTO Disputes

However, while WTO's Doha Round negotiations are in the doldrums, the judicial arm of the Organization functions well, and Canada is active on this front. There are four WTO cases that Canada is now pursuing, each of which (in one way or another) is significant for Canadian export interests.

China's Treatment of Auto Parts

Canada, together with the U.S. and the E.U., is pursuing a claim against China (started in 2006) regarding China's tariff treatment of imported auto parts. This is Canada's first WTO case against China. At issue are Chinese regulations that stipulate that when a car assembled in China is made up of foreign parts, those imported components are assessed at a duty rate that is more than twice the rate applied to non-OEM auto part imports. This obviously impedes Canadian automotive part imports into that country.

The case comes before a WTO panel this year and the panel is expected to issue its report in early 2008. If it goes in Canada's favour, it will benefit Canadian auto parts makers in their exports to the Chinese market by reducing the Chinese duties on these goods.

American Agricultural Subsidies

Of Canada's newer cases, by far the largest is its 2007 challenge of U.S. Farm Bill subsidies, which Canada says is well in excess of the limits the Americans agreed to at the WTO. Under current WTO rules, the U.S. is limited to US$19.1 billion annually in agricultural subsidies under the so-called "amber box" (permissible subsidies with capped upper limits per country).

Most of these were doled out between 1999 and 2005 to a wide range of U.S. agricultural products, including corn, wheat, soybeans, pulses and sugar. Canada says the U.S. vastly exceeded its permissible cap. Though a panel has yet to be formed and this case is a long-way from conclusion, a win by Canada could have a major impact on international agriculture trade by forcing a rollback in U.S. payments to its farm sector.

China's Export Subsidies

Canada's second case against China concerns a complaint launched this year by the U.S. in which Canada is intervening in support. The U.S. claims Chinese tax measures are contrary to the WTO agreement by providing refunds, reductions or exemptions to enterprises in China on the condition that those enterprises purchase domestic over imported goods, or on the condition that those enterprises meet certain export performance criteria. Any panel decision will not come before a date well into 2008. A win against China will assist Canadian companies that export to China and to third-country markets.

Belgium's Import Ban of Seal Products

A final case initiated by Canada in 2007 involving only modest trade interests is Canada's WTO challenge of a ban on imports of seal products imposed by Belgium. The case was initiated in August 2007 and must proceed through a number of steps before being heard by a panel, likely late in 2008.

HOW DO CANADA'S TRADE REMEDY LAWS WORK?

The trade remedy rules in the WTO Anti-Dumping Agreement and Subsidies Agreement have been given the force of law in Canada through the federal *Special Import Measures Act* ("SIMA"). This legislation permits the government to impose anti-dumping duties on all goods found by Canada Border Services Agency ("CBSA") to have been imported into Canada at prices below their cost of production or selling price in their home market, or which have been subsidized by their country of origin. These exceptional duties are imposed, however, only if the Canadian International Trade Tribunal ("CITT") determines that the dumping or subsidizing of those goods has caused or threatens to cause material injury to a Canadian industry.

WHAT APPEAL PROCEDURES ARE AVAILABLE?

In the case of adverse SIMA rulings by Canadian trade agencies (i.e., the CBSA or CITT), parties can seek judicial review in the Federal Court of Canada.

In the case of goods from either the U.S. or Mexico, appeals by way of judicial review may be heard by panels created under NAFTA. The NAFTA panel process is an optional procedure but is available only to NAFTA parties.

Practice over the last 15 years has shown that the NAFTA framework facilitates the orderly resolution of trade disputes and improves North American trade by creating a climate of institutional certainty.

Together with these private party appeal mechanisms, government-to-government disputes may also be referred to either the WTO or the NAFTA for resolution.

WHAT BILATERAL TRADE AGREEMENTS IS CANADA PURSUING?

In recent years, Canada has not had a strong record in concluding bilateral free trade agreements ("FTAs"), at a time when other countries, notably the U.S., have been aggressively signing pacts with their trading partners. The last FTA Canada concluded was

with South Korea in April 2007. Prior to that, the last FTA signed by Canada was with Costa Rica in 2001. Canada announced in June 2007 that it was close to completing an FTA with the European Free Trade Association (EFTA), which is composed of Norway, Sweden, Iceland and Liechtenstein. While Canada's trade with EFTA is relatively small, the FTA with EFTA is symbolically important. It just might help stimulate a Canada-European Union round of trade negotiations in 2008. FTA negotiations are also underway with Singapore, El Salvador, Honduras, Nicaragua, Guatemala (the Central American Four), Columbia, Peru and the Dominican Republic and CARICOM (the countries of the Caribbean). Even if these talks are successful, the gains for Canada will be modest.

Until recently, Canada has also lagged in concluding other types of agreements, such as bilateral science and technology cooperation agreements and, of more substantive importance, foreign investment protection agreements ("FIPAs"). While lacking the guarantees of market access that FTAs offer, FIPAs can be important building blocks for closer bilateral business relations with the country concerned. As instruments based on fundamental legal rules, they provide a degree of protection against arbitrary governmental interference, of value to Canadian businesses active in these countries.

The objective of a FIPA (sometimes called a Bilateral Investment Treaty or "BIT") is to ensure that Canadian investments in foreign jurisdictions are accorded standards of protection recognized under international law. These protections include national treatment, non-discrimination or most-favoured-nation treatment, the right to repatriate profits and move capital out of the host country, and freedom from both direct and indirect expropriation without compensation. However, the only FIPA that is arguably of substantive importance in responding to real Canadian business interests is the one signed with Russia in the early 1990s. The FIPAs with another 20 countries are largely symbolic.

After several years of little forward movement, there appears to be a policy change underway in Ottawa. Reflecting what may be a renewed interest in securing investment protection, Canada signed a FIPA with Peru, which took effect on November 14, 2006. The agreement is based on NAFTA Chapter 11, incorporates binding third-party arbitration over measures of indirect expropriation, something that Latin American countries refused to countenance for many years under the *Calvo Doctrine*, requiring all such disputes to be litigated exclusively before national courts.

In addition, the Peru FIPA contains provisions that clarify what kinds of laws or measures are — or are not — deemed to be indirect expropriation. Measures that have an overriding public purpose and are applied in good faith are not expropriations, even if they reduce the value of an investment as a result. These provisions effectively codify decisions contained in a series of NAFTA Chapter 11 arbitration decisions.

Moving beyond its 2006 FIPA with Peru, the federal government has embarked on a more focused investment protection strategy. In early March 2007, Ottawa announced "significant progress" in its FIPA negotiations with India and Jordan. The government also reported earlier that negotiations with China were making progress, the aim being "to secure a high standard agreement with comprehensive scope and coverage and substantive obligations pertaining to national treatment, most-favoured-nation treatment, minimum standard of treatment, transparency, transfers and expropriation."

If successfully concluded, these two FIPAs would give Canadian investors in both countries useful guarantees of non-discrimination, assurances of recognized standards of legal protection, application of transparent laws and procedures, and access to third-party dispute settlement through binding arbitration, the latter being an important safeguard against arbitrary application of local laws.

These arbitration provisions will be based on either the *U.N. Commission on International Trade Law* (UNCITRAL) model or the arbitration forum under the *U.N. Convention on the*

Settlement of Investment Disputes (ICSID). Due to disagreement at the federal and provincial levels, Canada has not yet ratified ICSID despite the fact that many provinces have already adopted their own provincial implementation legislation. However, a new federal bill introduced March 30, 2007, the *Settlement of International Investment Disputes Act*, finally initiates the necessary steps to implement ICSID into federal legislation and satisfy the requirements for ratification.

Most notably, successful implementation of the new bill would ensure that ICSID arbitral awards are recognized and enforced in Canada. Becoming a ratified party to ICSID will hopefully encourage reciprocal international investment, by both providing additional protections and arbitration options to Canadian investors abroad and to foreign investments in Canada.

However, the new life being breathed into the Canadian FIPA program may be a second-best substitute for failure to get traction on free trade agreements with these countries. Second, as with all bilateral agreements, FIPAs are a product of negotiation and compromise. There is an array of qualifications, exceptions and reservations in these agreements, the result being that the gains in one area are often countered by other parts of the agreement.

The FIPA with Peru is a case in point. While in the main, the provisions follow Canada's 2004 NAFTA model and embody the high-level obligations in Chapter 11 (including clarifications on expropriation, referred to above), there are exceptions in coverage. Canada has reserved all sectors where foreign investments in this country are restricted, such as banking, telecommunications, shipping, airlines and any investment reviewable in the *Investment Canada Act*. Peru has reserved sensitive sectors of its own, as well as laws regarding the preferential hiring of Peruvian persons by foreign investors.

ARE THERE ANY CURRENT TRENDS IN ANTI-DUMPING CASES BEFORE THE CANADIAN INTERNATIONAL TRADE TRIBUNAL?

Reflecting a downward global trend, Canadian anti-dumping and countervail cases are at their lowest number since the SIMA was enacted in 1984, with no active investigations currently underway by the CBSA and no new inquiries by the CITT scheduled for the remainder of 2007 or into 2008.

There are several reasons for this. The Canadian economy has been experiencing a period of sustained growth and, with that growth, companies are less likely to be experiencing injury, or threats of injury, by dumped or subsidized imports.

The structure of the global economy has also changed since the WTO's trade remedy rules came into effect in 1995. Instead of the typical pattern, when one country's goods are imported directly into the market of another, companies participate in various stages of the international supply chain, creating much more complex relationships. This means Canadian producers are not as highly dependant on the domestic Canadian market as they once were, and as a result, are less reliant on trade remedies.

HOW IS CANADA DOING IN WORLD MARKETS?

The current government's trade policy objectives are described in an important document released by Trade Minister Emerson and the Foreign Affairs and International Trade Department in early June entitled "Canada's International Market Access Report 2007."

The report sets out what is essentially a three-pronged strategy: managing the U.S. relationship, pursuing multilateral solutions in the WTO, and opening up critical markets for Canadian goods and services through bilateral trade deals. The report also provides useful information to Canadian business on trade barriers in other markets. It is well worth reading.

Canada's recent trade and investment performance is reviewed in Ottawa's companion update for 2007 entitled "Canada's State of Trade." This report card contains good, less good and some only fair grades.

While Canada's overall export performance was robust in 2006, the report confirms this was largely due to the boom in resource prices. Non-resource exports, including services, were essentially flat in 2006. In league with other reports issued recently, such as those from the Conference Board, the statistics point to a disquieting problem that demands attention by business, labour and government.

WHAT ARE THE CURRENT "HOT SPOTS" IN CANADA'S TRADE RELATIONS?

Softwood Lumber and Mad Cow Disease

Two of Canada's most contentious trade issues with the U.S. were moved off the front burner in 2006-2007. Following the mad cow scare in 2003, partial resumption of Canadian beef exports to the U.S. and elsewhere were resumed in 2007. New internationally endorsed scientific guidelines are expected to lead to full resumption of beef exports later in 2007.

The 2006 Softwood Lumber Agreement establishes base pricing and guaranteed volume access to the U.S. market going forward and refunds some $4 billion in U.S. duties back to Canada. While the dispute has been taken out of the NAFTA and WTO contexts, there may be ongoing issues with this file as the U.S. housing market continues to tumble and as the U.S. industry continues to fight off Canadian imports to protect a shrinking market. There are provisions in the 2006 agreement that contain seeds of ongoing differences with the Americans.

U.S. Imposes New Border Inspection Rules

At least two other major concerns with the U.S. are active: the new U.S. passport requirements for entering or returning persons (the Western Hemisphere Travel Initiative) and the newly imposed inspections of Canadian fruit and vegetable exports at the border. The latter means Canadian exporters will face additional costs and greater delays getting their goods into the U.S. market. These inspections may be contrary to the NAFTA and this issue shows signs of possibly blossoming into another trade dispute with the U.S. Finally, effective June 2007, the U.S. significantly increased border crossing and inspection fees charged to trucks ($5.25 per entry) and railcars ($7.75 per entry) crossing the American border. On the face of it, the new fees violate NAFTA provisions.

Trends in the Democratic Congress

The current U.S. Congress, where the Democrats control both houses, is less open to free trade than the previous Republican-dominated Congress. This attitude is seen in the resistance in giving approval to U.S. trade agreements with South Korea and with several Latin American countries. Further, Congress is unlikely to extend the President's "fast track" negotiating authority, making it virtually impossible for the WTO Doha Round to resume until after the next presidential election in 2008.

Combined with concern in the U.S. over security and terrorism, there could be some difficult times ahead for Canada, as more and more protectionist measures wind their way through Congress and as the hard-line attitude toward America's trading partners continues to hold sway.

Detroit-Windsor Gateway

On a positive note, Canada and the U.S. seem close to commencing construction of a new bridge at Detroit-Windsor, a welcome development for Canadian manufacturers and exporters and the automotive industry in particular. To many on both sides of the border, it is not in the public interest that the Ambassador Bridge, the world's largest single-border crossing in terms of trade volumes, be privately owned. Given the critical economic importance of this border point, a second, publicly owned crossing is vital. We understand that early stages of new bridge construction may finally be moving ahead in 2008.

Export Controls, Sanctions and Embargoes

Changes in Canadian export controls and sanctions in 2007 will require adjustment by Canadian business. The most recent are prohibitions on exports of all military use and nuclear-related items to Iran, following adoption of U.N. Security Council Resolutions in 2006 and early 2007. These new prohibitions make it an offence for any person to sell, supply, transport or transfer these kinds of goods, technology and services, directly and indirectly to Iran. The new regulation also requires Canadian companies to report all instances where they might be in possession of property owned and controlled by persons on the Security Council's blacklist.

ITARs Frustrate Canadian Companies

The dual-national restrictions under the U.S. *International Traffic in Arms Regulations* (ITARs) continue to prevent Canadian companies employing Canadians with dual nationality from having access to a range of U.S. defence programs. Talks with the Americans are underway to find a comprehensive solution to the ITAR problem but given heightened U.S. security concerns, this may be difficult to achieve. In the meantime, Canadian businesses involved in U.S. defence contracting will experience ongoing complications in complying with these tough ITAR requirements.

UPS Loses NAFTA Arbitration

In a major decision released June 11, 2007, an arbitration panel rejected all claims by UPS against the government of Canada under the investment provisions of Chapter 11 of the NAFTA. UPS claimed that Canada Post's operations were unfair and discriminatory against commercial couriers and contrary to Canada's obligations under the NAFTA.

The panel said that Canada Post and UPS were entirely different enterprises and therefore not subject to direct comparison. Canada Post's functions were of a public nature and those of UPS were purely commercial. Canada Post also has obligations to provide universal postal services throughout Canada. UPS has no such obligation. Hence, the benefits extended under Canadian law to Canada Post did not have to be given to UPS and, as a result, UPS' investments in Canada had not been treated improperly or unfairly under the NAFTA.

The tribunal's upholding of the right of NAFTA governments to maintain state enterprises for the provision of public services and the narrow reading of the NAFTA non-discrimination provisions are of great importance. We predict this outcome will lead to a lessening of NAFTA investment disputes.

Another element in the decision is the tribunal's broad reading of the cultural industries exemption under NAFTA. The tribunal held that this exemption was sufficiently large in scope to allow the subsidies accorded to Canada Post under the federal Publications Assistance Program. UPS had argued that the subsidized rates for these publications were discriminatory since companies did not receive the same treatment. This argument was also rejected.

Other NAFTA Disputes

There are, however, six active NAFTA investment arbitration cases that have been filed against Canada that are slowly wending their way through the system: *Crompton Corporation v. Canada* (2005), *GL Farms and Carl Adams v. Canada* (2006), *Merrill & Ring Forestry v. Canada* (2006), *Gallo v. Canada* (2007), *Mobil Investments v. Canada* (2007) and *Murphy Oil v. Canada* (2007). The Mobil and Murphy Oil claims were each filed in August 2007 and concern the Hibernia and Terra Nova offshore oil and gas projects. The claimants argue that the funding requirements for local services and research and development imposed by the Canada-Newfoundland Offshore Petroleum Board breach the prohibition against performance requirements in the NAFTA.

Montebello North American Leaders' Summit — August 2007

Canadian Prime Minister Stephen Harper, U.S. President George W. Bush and Mexican President Felipe Calderon met at Montebello, Québec in August 2007 to discuss matters of interest to the three North American countries. They have mandated their governments to take steps over the next two years to cause the consistent application of regulatory requirements and standards among the three countries, to co-ordinate efforts to protect intellectual property rights and combat piracy and counterfeiting of goods, to conform to a consistent set of rules-of-origin, to develop an integrated credentials program to permit people to cross borders efficiently, to develop common emergency response procedures and to eliminate duplicative screening of baggage and air cargo for connecting flights.

ARE THERE ANY CURRENT EFFORTS TO REDUCE INTER-PROVINCIAL TRADE BARRIERS IN CANADA?

The *Agreement on Internal Trade* is a 1995 agreement among the federal government and each of the provinces of Canada intended to reduce trade barriers and permit trade skill certifications to be recognized from province to province. It is generally viewed as being ineffective in achieving those goals. On July 1, 2007, the provinces of British Columbia and Alberta signed a sister agreement, the *Trade*, *Investment and Labour Mobility Agreement*, which is broader in scope. It provides for a dispute resolution panel with powers to make awards up to $5 million. The trade certification provisions will not take effect until April 2009.

WHAT PACKAGING AND LABELLING REQUIREMENTS APPLY TO GOODS SOLD IN CANADA?

Canada has special packaging and labelling requirements, particularly for pre-packaged products. Each of the federal *Consumer Packaging and Labelling Act*, the *Food and Drugs Act*, the *Hazardous Products Act*, the *Trade-marks Act*, the *Pest Control Products Act*, the *Textile Labelling Act*, the *Customs Tariff Act* and the *Precious Metals Marking Act*, among other legislative and administrative requirements, contains specific provisions detailing the manner in which basic information must be placed on the product container, including specifying the size of the lettering. The legislation also requires explicit country of origin designations and information identifying the Canadian distributor.

Since Canada is a bilingual country, certain information must be provided in both English and French. However, the federal bilingual language specifications do not meet the requirement for the sale of pre-packaged goods in the province of Québec where, according to the Québec *Charter of the French Language*, a product may not be sold or advertised in Québec unless all materials associated with the product are in French and English and the French version is displayed no less prominently than the English version.

Canada operates on the metric system and it is a federal requirement that all measurements be in metric units. The additional use of the imperial system, which is still used in the U.S., is optional.

Health Canada released regulations in 2003 that require Canadian food manufacturers and importers to provide nutritional information in a standardized Nutrition Facts label on their pre-packaged food products. Large food manufacturers (defined as manufacturers with gross revenues over $1 million in the 12 months prior to the regulations coming into force) had to have been in compliance with the new regulations by December 12, 2005. Small manufacturers have until December 12, 2007 to comply with the regulations. The regulations are more stringent than those in the United States, and are among the most stringent of any food labelling regulations in the world.

Finally, certain NAFTA and WTO country of origin labelling regulations apply in Canada.

WHAT INDUSTRIAL STANDARDS APPLY TO PRODUCTS MANUFACTURED IN CANADA?

A number of standards apply to goods produced or sold in Canada. In some cases, the standards fixed by an association have been adopted by legislation. In other cases, they are voluntary. There are five national standards systems:

- Canadian Standards Association (electrical products, plumbing fixtures, toys, fire and safety equipment and other consumer products),
- Underwriters' Laboratories of Canada (fire hazards and detection),
- Canadian Gas Association (gas and propane products),
- Canadian General Standards Board (textiles), and
- Bureau de Normalization du Québec (standards for Québec legislation).

WHAT IMPORT/EXPORT CONTROLS ARE IN EFFECT IN CANADA?

Generally, Canada is an open market for the import and export of goods and services, in accordance with the basic principles enshrined in GATT and the WTO agreements. However, in some cases Canada controls both imports and exports of sensitive products. For example, trade in endangered species and protected cultural artefacts is restricted in accordance with international agreements. As well, Canada controls imports and exports of uranium and nuclear-related materials, in common with other members of the International Atomic Energy Agency and following the Nuclear Non-Proliferation Treaty.

Also, import permits are required in areas where Canada is allowed to maintain import quotas under the WTO agreements, such as in the dairy and poultry sectors. Certain other goods require import permits under the federal *Import and Export Permits Act* (the "IEPA"). The permit requirements depend on the nature of the item, and it is best to confirm with federal authorities in the Foreign Affairs Department in Ottawa before making arrangements to import certain goods.

The same is true of exporting sensitive goods from Canada. Under the *IEPA*, Canada requires export permits for certain strategic and military goods and for goods destined for certain proscribed destinations, such as Cuba, Libya, Iraq and the Balkan States of Bosnia and Serbia, under applicable U.N. resolutions.

It is best to confirm with federal authorities before arrangements are made to sell goods that might be on the Export Control List or destined for countries that might be proscribed.

WHAT CANADIAN LEGISLATION GOVERNS TRADE WITH CUBA?

U.S. companies are aware that, while the U.S. government prohibits trade with Cuba, there is no such prohibition in Canada. In fact, Canadian law prohibits a Canadian subsidiary of a U.S. corporation from complying with the extraterritorial application of U.S. law restricting trade with Cuba. Any attempt by a U.S. parent to force its Canadian subsidiary to refuse to export goods and services of Canadian origin to Cuba could be an infringement of Canada's *Foreign Extraterritorial Measures Act* and could render the Canadian subsidiary and its officers liable for the penalties imposed under the Act.

On the other hand, under bilateral defence co-operation protocols, Canadian authorities apply U.S. export controls on goods of U.S. origin bound for Cuba and other controlled countries. For example, a Canadian company wishing to export U.S. products to Cuba would not be given a Canadian export permit. This avoids Canada being used as a transit country to circumvent U.S. export controls applicable in the U.S.

DOES CANADA HAVE EXCHANGE CONTROLS?

There are no exchange controls in effect in Canada, so there are no restraints on the repatriation of profits from business conducted in Canada by a foreign owner.

10. REGULATION OF TRADING IN SECURITIES

The focus of securities regulation in Canada is disclosure of information on the one hand, and the regulation of market participants on the other.

HOW ARE SECURITIES OFFERED?

The sale of securities in Canada is highly regulated, primarily through provincial and territorial legislation. There is no federal securities regulator in Canada. In Ontario, the *Securities Act* (Ontario) governs the area and is supplemented by extensive regulations, regulatory rules and policies. There is also a relevant body of national and multilateral instruments, policy statements and other sources of regulation. Generally speaking, securities legislation in all Canadian jurisdictions contains two basic requirements in connection with any sale of securities:

- A comprehensive disclosure document known as a prospectus must be provided to investors in connection with the public offering of securities. This document sets out detailed material disclosure relating to the issuer and the securities being issued and must be reviewed by the securities regulatory authorities in each province or territory in which it is proposed to sell the securities. The prospectus must contain full, true and plain disclosure about the securities and the issuer. The requirement to prepare a prospectus is, however, subject to certain statutory and discretionary exemptions (see below). The Canadian regulatory authorities have adopted what is called the Mutual Reliance Review System ("MRRS") that generally enables an issuer to only have to coordinate with one regulatory authority versus 13 when attempting to clear a prospectus.
- A registered securities dealer must participate in the sale of securities. In the case of prospectus offerings, the registrant is also responsible for ensuring that the prospectus contains full, true and plain disclosure. The requirement to involve a registrant is subject to statutory and discretionary exemptions similar to exemptions to the prospectus requirement (see below).

In many provinces and territories, securities can be sold without providing a prospectus or using a registered dealer ("Distribution Requirements") through exemptions from these

requirements. From an issuer's perspective, reliance on exemptions from Distribution Requirements are generally based upon an assessment of whether the securities can be successfully marketed to a limited number of investors who meet certain criteria that would make them eligible to acquire the securities without the need for a prospectus or the involvement of a dealer versus the ability to market the securities to the public (taking into account the inherent additional costs involved with a prospectus offering.)

In many provinces, securities offered pursuant to exemptions from the Distribution Requirements are subject to what is known as the closed system. Under the closed system, securities initially issued relying on a distribution exemption can only be resold (a) in accordance with a further distribution exemption; (b) following the satisfaction of certain resale requirements; (c) if discretionary relief from these resale requirements is granted; or (d) where the securities are qualified by a prospectus. Again, the objective is to achieve an acceptable level of disclosure for a prospective purchaser. For more information regarding the distribution exemptions that are available, see the commentary under the heading "Exempt Distributions in Ontario" on page 7.2.

The rules regarding the resale of securities sold pursuant to exemptions from National Instrument 45-102 ("NI 45-102") have been adopted by all of the securities commissions in Canada. NI 45-102 provides that unless certain conditions are met, first trades of securities distributed under an exemption are subject to the Distribution Requirements. Depending on the nature of the exemption under which the securities were originally sold, the securities may be subject to a four-month restricted period from the date of distribution during which they cannot be traded without a further exemption. In addition, among other things, the issuer of the securities must be a reporting issuer at the time of the first trade as well as for a four-month period preceding the time of the first trade. Alternatively, depending on the nature of the exemption under which the securities were issued, the securities may be subject to a seasoning period, which requires that the issuer of the securities is a reporting issuer at the time of the first trade as well as for the four-month period preceding the time of the first trade. However, the seasoning period requirements do not require that the holder of the securities have held the securities for four months. It should be noted that the restricted period conditions will generally apply to most sales made pursuant to available prospectus and registration exemptions.

The securities administrators in each province and territory also have discretionary authority to grant relief from certain requirements of the legislation. In Ontario, the discretionary authority exercised by the Ontario Securities Commission includes the granting of relief from the prospectus and registration requirements and the closed system. This procedure is essential in circumstances where the issuer is not preparing a prospectus and does not fit in any of the regulatory exemptions. It should be noted that the granting of relief is generally available only in limited circumstances.

WHAT ARE THE DISCLOSURE REQUIREMENTS?

Disclosure and Corporate Governance Requirements

In 2004, securities regulatory authorities across Canada introduced several new national and multilateral instruments concerning continuous disclosure and corporate governance that generally harmonize such rules across Canada.

- National Instrument 51-102 sets forth rules regarding continuous disclosure obligations ("NI 51-102")
- National Instrument 52-107 prescribes acceptable accounting principles and audit standards ("NI 52-107")
- Multilateral Instrument 52-109 imposes an obligation on issuer executives to certify certain financial disclosure ("MI 52-109")

- Multilateral Instrument 52-110 regulates the composition and function of audit committees ("MI 52-110")
- National Instrument 52-108 stipulates certain qualifications for auditors ("NI 52-108")
- National Instrument 71-102 provides exemptions to certain continuous disclosure rules with respect to foreign issuers ("NI 71-102")

(Please see, as well, the commentary above under the heading "Canada's Sarbanes-Oxley" on pages 10.6 to 10.17)

Continuous Disclosure

The introduction of NI 51-102 is an example of the importance that securities regulators place on disclosure. Many issuers of securities are required to disclose certain information on an ongoing basis. This requirement is known as continuous disclosure and the issuers subject to this requirement are known in most provinces and territories as reporting issuers. The information that an individual issuer is obligated to disclose depends, in part, on the size of the issuer and on whether the issuer is listed on the Toronto Stock Exchange or the TSX Venture Exchange.

Pursuant to NI 51-102, a reporting issuer is required to make the following continuous disclosure:

- Beginning with the level of disclosure established by the issuer's prospectus (or other similar document), the reporting issuer must continue to make stipulated and regular disclosure, such as filing audited annual and unaudited interim financial statements, management's discussion and analysis (MD&A) of operating results, business acquisition reports (in certain circumstances) and annual meeting and proxy solicitation materials.
- In addition, whenever a material change occurs in the affairs of a reporting issuer, it must issue and file with the regulatory authorities a press release disclosing the nature and substance of the change, as well as a prescribed form of material change report within 10 days of the material change.
- Reporting issuers who are listed on the Toronto Stock Exchange are generally required to produce an annual information form, which is a disclosure document that describes the issuer, its operations, prospects and risks, and which must be updated annually. The foregoing is not a requirement for issuers listed on the TSX Venture Exchange.

The continuous disclosure instruments require issuers to provide historical financial data in their annual financial statements for at least two years. The statements must also be accompanied by MD&A of the financial condition of the issuer and its financial results.

In this way, the continuous disclosure system maintains a steady flow of material disclosure about issuers whose securities are bought and sold by the public.

Accounting Principles and Auditing Standards

NI 52-107 buttresses the required forms of public disclosure by setting forth acceptable accounting principles and auditing standards for issuers required to file financial statements or include financial statements in a prospectus or circular. The instrument also discusses requirements regarding currency disclosure and exemptions for SEC and foreign issuers.

Certification of Financial Statements

Similar to recent requirements in the U.S., MI 52-109 requires CEOs and CFOs to certify the issuer's financial disclosure and file such certification in a prescribed form with the issuer's annual and interim financial disclosure.

Audit Committee Standards

MI 52-110, which has been adopted in every jurisdiction except British Columbia, addresses corporate governance concerns regarding the effectiveness of an issuer's audit committee. (British Columbia reporting issuers who are reporting issuers in other Canadian jurisdictions remain subject to MI 52-110.) Subject to limited exceptions, the instrument requires that a reporting issuer's audit committee have at least three members who are independent and financially literate. (TSX Venture Exchange-listed issuers are subject to different requirements though are nonetheless required to provide annual disclosure with regards to their audit committee members' independence and financial literacy.) The instrument provides extensive guidance so that directors can make these determinations. The instrument sets forth the authority and responsibilities of audit committees and stipulates the prescribed disclosure of the charter, composition and education of the audit committee which must be made in the issuer's annual information form (in the case of Toronto Stock Exchange issuers) and in the issuer's management information circular(in the case of TSX Venture Exchange issuers). Notably, the instrument also requires the pre-approval by the audit committee of all non-audit services provided by the auditors.

NI 52-108 defines the qualifications required of auditors who prepare auditors' reports on financial statements of reporting issuers. Specifically, such auditors must be a public accounting firm in good standing and subject to the Canadian Public Accountability Board.

Exemptions for U.S. Issuers

Initiatives between Canadian and American regulators in the area of continuous disclosure are bringing the integration of the disclosure standards for Canadian and U.S. capital markets closer to reality. Currently, a multijurisdictional disclosure system embodied in NI 71-102 is in place among the Canadian provincial and territorial securities commissions and the U.S. Securities and Exchange Commission (the "SEC"). Under this system, in the case of a cross-border securities offering, eligible issuers are generally required to prepare a single disclosure document rather than two disclosure documents, though certain additional limited information may be required to satisfy the requirements of the local jurisdiction.

Pursuant to NI 71-102, certain issuers who are regulated by the SEC are exempt from many of the Canadian continuous disclosure requirements provided they comply with the requirements of U.S. federal securities law regarding such disclosure and file the resulting disclosure documents in Canada. Certain foreign issuers who are not regulated by the SEC but who are subject to foreign disclosure requirements may be exempt from complying with Canadian continuous disclosure requirements if not more than 10% of their equity securities are held by resident Canadians.

CANADA'S SARBANES-OXLEY

The following is a brief list of some of the most important changes to corporate governance in Canada, which came into effect in 2004:

- CEO and CFO certification of disclosure is required;
- Audit committee independence and role is mandated;
- Auditor participation in the new Canadian Public Accountability Board (see page 10.9) is required;
- Canadian securities regulatory authorities (except in Québec and British Columbia) have set out a policy and rule relating to best corporate governance practices which require disclosure of actual corporate governance practices compared to best practices;
- The TSX withdraws its corporate governance guidelines in effect prior to these enactments;
- Independence of board members from the corporation is defined and stressed;

- Nominating and compensation committees are to be comprised entirely of independent directors;
- Written mandates and codes of business conduct and ethics are encouraged;
- Codes of business conduct and ethics, and waivers from them, are required to be disclosed;
- Performance assessments are encouraged for individual directors and boards as a whole; *and*
- There will be some exceptions, for instance, some foreign companies and mutual funds.

The Three 2004 Regulations

The securities regulatory authorities of all Canadian jurisdictions, except for British Columbia in particular areas, published three final rules on January 16, 2004. These rules came into force on March 30, 2004. These three rules are:

- CEO and CFO must certify the disclosure made in their public company's annual and interim filings (MI 52-109);
- The role and composition of audit committees is regulated (MI 52-110); *and*
- The new Canadian Public Accountability Board has been mandated to oversee auditors of public companies (NI 52-108).

In addition to the foregoing, the securities regulatory authorities of all Canadian jurisdictions, except for Québec and British Columbia, published a policy entitled "Effective Corporate Governance" and a rule entitled "Disclosure of Corporate Governance Practices" which replaced the former TSX corporate governance requirements.

CEO and CFO Certification of Certain Public Company Filings (*Multilateral Instrument 52-109*)

Taken from recent U.S. regulations, this rule requires that CEOs and CFOs of all Canadian public companies and income trusts to personally certify:

- That to their knowledge the issuer's annual or interim filings, as the case may be, do not contain any misrepresentations or omissions and that, together with the annual and interim financial statements, they fairly present in all material respects the issuer's financial condition, results of operations and cash flows. Annual and interim filings include an issuer's annual information form, annual and interim financial statements, and annual and interim management's discussion and analysis (MD&A).
- That they have designed such disclosure controls and procedures and such internal control over financial reporting (defined similarly to the SEC definitions) to provide reasonable assurance (i) that material information relating to the issuer is made known to them, and (ii) regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles (subject to transitional provisions).
- That they have evaluated the effectiveness of the issuer's disclosure controls and procedures and have caused the issuer to disclose in the annual MD&A their conclusions about the effectiveness of the disclosure controls and procedures (subject to transitional provisions).
- That they have caused the issuer to disclose in the annual MD&A or interim MD&A, as the case may be, any change in the internal control over financial reporting that occurred and has materially affected, or is reasonably likely to materially affect, the internal control over financial reporting (subject to transitional provisions).

Important to note, Canadian issuers that comply with U.S. federal securities laws and promptly file their U.S. certificates in Canada would generally be exempt from the above certification requirements. Also, certain foreign issuers, certain issuers of exchangeable securities and certain credit support issuers would be exempt from the certification requirements. Exemptions are also granted by securities regulators, however, it is anticipated that exemptions will rarely be given.

The language of the CEO and CFO certification must closely follow the language set out in the rule. An officer providing a false certification could be liable to penalties under securities laws.

Effective June 6, 2005, pursuant to amendments to the rule that requires public companies to certify their annual and interim filings, CEOs and CFOs were given an extended amount of time to satisfy themselves that they have an appropriate basis for certifying their internal control over financial reporting. As a result of the delayed effective date of the Internal Control Rule for financial years ending on or before June 29, 2006, issuers may use a form of modified certificate that does not require certification of such internal control.

Role and Composition of Audit Committees (*Multilateral Instrument 52-110*)

This rule requires that:

- Audit committees have a minimum of three directors;
- Each member of the audit committee is independent; *and*
- Each member of the audit committee is financially literate.

Not only does the rule demand that audit committee members are independent and financially literate, but it also defines what is meant by independent and financially literate. The definition of independent is similar to the U.S. definition and refers to the absence of any direct or indirect material relationship with the issuer. This includes a relationship that could, in the opinion of the board of directors, reasonably interfere with the exercise of a director's independent judgment. It should be noted that the test for independent audit committee members is more stringent than the test for other directors. What constitutes financial literacy is the ability to read and understand financial statements that represent a level of complexity of accounting issues that are generally comparable to the breadth and complexity of the issues that can be raised by the issuer's financial statements. Audit committee members who do not have the required financial literacy at the time of their appointment will be permitted to become financially literate within a reasonable period of time.

Notably, the rule does not require the issuer to disclose whether or not a financial expert is serving on the audit committee. Instead, issuers are required to describe the background of each audit committee member. This description should include the member's education and experience that relate to his or her responsibilities as an audit committee member.

The responsibilities of the audit committee must explicitly relate to the appointment, compensation, retention and oversight of the external auditor. Also, audit committees must deal with the pre-approval of all non-audit services to be provided by the external auditor. In addition, audit committees must have a written charter and have established procedures to deal with complaints regarding accounting, internal accounting controls or auditing matters and to deal with the confidential, anonymous submission by employees of their concerns regarding any questionable accounting or auditing matters.

There are some exemptions from the rule pertaining to audit committees. For instance, it does not apply to investment funds, issuers of asset-backed securities, some subsidiaries, some foreign issuers, some exchangeable security issuers and some credit support issuers. Also, partial exemptions are granted to issuers that are listed on the TSX Venture Exchange. For instance, issuers that are listed on the TSX Venture Exchange are exempt from the

composition requirements and the disclosure requirements, but are required to comply with the remainder of the rule.

Role of the Canadian Public Accountability Board (*Multilateral Instrument 52-108*)

According to this rule, the financial statements of a public company must be audited by a public accounting firm that is a participating audit firm with the Canadian Public Accountability Board ("CPAB"). Further, this accounting firm must follow any restrictions or sanctions imposed by the CPAB as of the date of the auditor's report. This rule applies to all auditor's reports prepared and dated by the public accounting firm on or after March 30, 2004.

This rule also applies to foreign companies that are reporting issuers in Canada, and requires foreign audit firms to register with the CPAB. These foreign firms had to register by July 19, 2004.

In sum, these three 2004 rules are Canada's attempts to restore investor confidence in light of recent corporate scandals seen in the United States and internationally. The rules are substantially similar to those put in place in the United States but have been tailored to reflect the differences in Canadian markets, particularly the large number of controlled companies and the smaller size and resources of Canadian public companies.

Best Practices

The Canadian regulators have preserved the guideline approach used by the Toronto Stock Exchange to recommend best practices of corporate governance. Canadian public companies are required to disclose in their annual information form if they are complying with the recommended best practices or, if they are not, the reason for such non-compliance. This approach recognizes the reality that corporate governance is in a state of evolution and that uniform governance mechanisms may not be suitable for all different kinds of companies.

The jurisdictions that are participating in this regime will be reviewing the proposed policy and the proposed rule for two years after implementation to ensure their recommendations and disclosure requirements are taken into consideration and to ensure the rules are suitable for issuers in the Canadian markets.

Best Practices for Effective Corporate Governance (*Multilateral Instrument 58-201*)

This policy recommends best practices for all reporting issuers, both corporate and non-corporate. These practices are not mandatory. The practices are largely influenced by the now repealed TSX corporate governance guidelines and the recently adopted listing standards of the New York Stock Exchange.

The practices include:

- Maintaining a majority of independent directors on the board of directors:

    - Independent means that a director has no direct or indirect material relationship with the issuer;
    - Material relationship means a relationship that could, in the view of the issuer's board, reasonably interfere with the exercise of a director's independent judgment with certain individuals being deemed to have a material relationship with the issuer. These individuals are:
        - An employee or executive officer of the issuer;
        - An immediate family member who is or has been an executive officer of the issuer;

- An employee of the auditor or having an immediate family member who is employed by the auditor of the issuer; *or*
- An individual who received or whose immediate family member receives more than $75,000 per year in direct compensation from the issuer;

- In regards to income trusts, independence should occur at the trustee level;

- In regards to limited partnerships, independence should occur at the level of the board of directors of the general partner;
- Holding separate regularly scheduled meetings with independent directors;
- Appointing an independent director as chair. If this is not appropriate, then an independent director should be appointed as a lead director;
- Setting out a board mandate in writing. This mandate should address the following matters: integrity, strategic planning, managing risk, succession planning, corporate communications, required board approvals, internal controls, management information systems and investor feedback;
- Setting out position descriptions for directors and the CEO, which should include corporate goals and objectives the CEO is responsible for meeting;
- Providing new directors with orientation;
- Providing all directors with continuing education opportunities;
- Adopting a written code of business conduct and ethics for the directors, officers and employees of the issuer which is enforced by the board. This code of conduct is aimed at deterring wrongdoing and should address some of the following topics: conflicts of interest, reporting illegal or unethical behaviour, and fair dealing with investors, customers, suppliers, competitors and employees;
- Establishing a nominating committee to nominate new directors. This nominating committee should be comprised of independent directors and have a written charter;
- Having the board conduct a review with an eye to considering the size of the board and how appropriate it is, determining what competencies and skills the board should have, determining what competencies and skills each individual member has and keeping this in mind when recruiting new directors;
- Appointing a compensation committee that has a written charter and is composed of independent directors; and
- Conducting regular assessments of board effectiveness and individual director effectiveness.

Disclosure of Corporate Governance Policies (*Multilateral Instrument 58-101*)

This rule calls for a disclosure requirement regarding corporate governance practices that the issuer has put into place. The rule also requires the issuer to publicly file with the regulators any written code of business conduct and ethics that the issuer follows. Any explicit or implicit waivers from the code granted by the board to directors or officers would have to be disclosed immediately in a press release. The rule applies to all reporting issuers. However, exemptions will apply to the following: investment funds, issuers of asset-backed securities, designated foreign issuers, SEC foreign issuers, some exchangeable security issuers and some credit support issuers.

Except for an issuer that is listed for trading on the TSX Venture Exchange, every issuer to whom the rule applies must include in its AIF specific disclosure regarding:

- The composition of the board;
- The mandate of the board;
- The position descriptions for the chair;
- The chair of each committee and directors;

- Measures adopted respecting the orientation and continuing education of directors;
- The adoption of a code of ethics;
- The composition of the nominating committee and its mandate or other nomination process;
- The composition of the compensation committee and its mandate or other compensation process; *and*
- The assessment process for the performance of the board, of each committee of the board and of each board member.

If the issuer does not follow the recommended best practices with respect to each disclosure item, the issuer would have to explain why the board considers its practice appropriate.

Conduct of the Board and Evaluation of Directors

A board of directors can only be as effective as its members. Director performance is critical to good corporate governance. Directors must be performing effectively at the board level, committee level and individual level. Companies must take the necessary steps to promote effective director and board performance. For instance, companies should impose regular evaluation of the board and of each individual director. Another tool that can be used to promote effectiveness is offering formal orientation for new board directors and continuing education for all board directors.

Evaluation of the Board as a Whole

The recommended best practices provide that boards should implement a process for evaluating the effectiveness of the board as a whole. This task can be done by the nominating or governance committee or under the leadership of a single designated independent director working with or for the committee responsible for the evaluation process. Every issuer must describe how it is complying with these guidelines or, where there is a difference, describe the difference and provide a reason for departure from the guidelines.

Regular board and committee assessment is necessary to improve corporate governance practices. The focal point should be how board or committee performance can be made more effective by establishing and meeting goals that add value. The results of performance assessments should then be reported to the board as a whole and discussed.

In the U.S., the NYSE Rules provide that a board and its committees are evaluated every year. Foreign private issuers listed on the NYSE who do not perform annual evaluations must disclose any significant differences between their processes and the NYSE Rules.

An assessment process is a great way to improve the governance system of the board of directors. The results of the evaluation can be reviewed and any problems can be identified and steps taken to remedy any deficiencies. An assessment should look at how the board is carrying out its primary functions, particularly in the following areas: (i) responsibilities and mandate, (ii) structure and organization and (iii) process and information.

Looking at the board responsibilities and mandate, boards should explicitly take responsibility for the stewardship of the company and implement a formal mandate establishing the board's stewardship responsibilities. A board should assume responsibility for implementing a strategic planning process and an annual assessment of the opportunities and risks of the business. Also, the board should identify principal risks and implementation of systems to manage business risks. The board should also establish succession planning and training and monitoring of the CEO and senior management. Another important task for the board is to communicate policies on how the company interacts with various stakeholders and how it complies with continuous and timely disclosure obligations. Finally, another important task for

the board is to maintain the integrity of internal control and management information systems.

The structure and organization of the board is key to effective functioning of it and when the evaluation is conducted, the board should consider whether the constitution is appropriate, whether the board is truly independent, what procedures are in place for director succession, whether the size is appropriate for the size of the company and if the proper committees are in place to ensure the board functions as smoothly as possible.

A final area of concern when conducting board evaluations is whether the best processes are created for receiving information to enable the board and committees to fulfil their responsibilities. For instance, the processes and the information itself must allow for the assessment of the organization's activities and management. The information must be in enough detail to make informed decisions and the processes used in gathering information must be effective enough to ensure information is gathered in a timely fashion so that the information is fresh and the recommendations made as a result of the information are effective. The usual methods of assessment include either a written questionnaire that is filled out by each of the directors or discussions between the board chair or lead director and the board.

Evaluation of Individual Directors

It is wise to hold regular evaluations of individual directors. This would help directors understand how they are performing and compare their performance to what is expected of them. Regular evaluation and review allows for directors to compare their performance level with the expectations and make appropriate changes when necessary to correct any shortfalls. Improved individual performance of a director will lead to improved relationships between board members, the board chair, management and employees of the company and the company's shareholders. On the other hand, evaluations will also highlight any deficiencies in board members that cannot be corrected and when a change in board membership is required.

Both written assessments and oral assessments can be used for individual director assessments. In addition, peer reviews or self-assessments are suitable for individual director evaluations. A peer assessment would have each director evaluate the performance of the other directors. A self-assessment would have each director reflect upon and evaluate his or her own performance and contribution. Self-assessments are more favourable than peer evaluations as they are not as stressful and do not detract from the collegiality and co-operation necessary for the efficient functioning of the board as a whole. What seems to work best is a formal evaluation process comprised of a written questionnaire completed by each director and then a follow-up discussion with the board chair, lead director or governance committee chair. The use of a written questionnaire provides all directors with the chance to answer a standardized set of questions candidly and without a director feeling pressured by answering in a one-on-one interview setting with the chair.

In any event, the results should be compiled and interpreted with the results reported to the chair. The board should consider how the results should be disclosed to the full board for review and discussion. For instance, it may be more helpful for the results to be disclosed in an aggregate manner rather than identifying specific board member's evaluation results. The compilation and interpretation of results can be done in-house or the board may choose to hire an outside consultant to perform this task.

Orientation and Continuing Education

It is a good idea for each company to offer an orientation program for new directors and continuing education opportunities for every director. It is important for new directors to understand the role of the board, the role of committees of the board and the role of directors in making the board and company run as efficiently as possible. Also, it is helpful to make new

directors aware of the commitment of time and energy that will be expected of them as directors.

A comprehensive orientation program for new directors should include both offering the directors a board manual and literature for the new director to review independently as well as an orientation session with presentations and the opportunity to ask questions and engage in a dialogue about being a director.

Continuing education programs are also important to promote ongoing director education and to ensure that directors are keeping current on laws and regulations applicable to their role. At the same time, continuing education can also serve as an opportunity for directors to review their duties and the board manual. It can be a chance for the directors to provide feedback and suggestions for changes to policies or procedures to enhance efficiency. Continuing education should take place at least once a year. One way to ensure it occurs is to tie it to the annual board evaluation process. This way, the continuing education program for directors can respond to any issues that arise from the evaluation process of the board or individuals and can give the directors the knowledge and information required to remedy any deficiencies.

Internal Accounting Processes (*Proposed Multilateral Instrument 52-111*)

Canadian Securities Administrators circulated a draft of Multilateral Instrument 52-111 (the "Internal Control Rule") in February 2005. The Internal Control Rule contemplates that public companies will be required to (i) have in place a process designed by senior management to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP, (ii) file an internal control report prepared by management, and (iii) obtain an internal control audit report from their external auditors regarding their internal control processes. The Internal Control Rule, when enacted, will require public companies other than venture issuers to implement a suitable internal control over financial reporting framework to improve the quality and reliability of financial and other continuous disclosure reporting. If enacted, the Internal Control Rule would apply for financial years ending on or after June 30, 2007, subject to certain exemptions. If the Internal Control Rule is enacted, management of every public company other than venture issuers will be required to evaluate the effectiveness of their internal control over financial reporting as of the end of each financial year.

Summary — New Corporate Governance Rules

The new policies and rules aimed at increasing corporate accountability and re-establishing investor confidence in public companies are a good start for Canada. These new regulations correspond to the American Sarbanes-Oxley legislation but still reflect some of Canada's unique market features. The requirement for CEO and CFO certification of disclosure in public companies' filings will hopefully provide comfort to investors. The requirement that CPAB will oversee the auditors of public companies will bolster public confidence in the financial documents of issuers. Finally, the fact that the role and composition of audit committees is regulated will establish a standard that this committee will be required to meet. In addition, the best practices for effective corporate governance has established a set of practices that are helpful to companies in providing guidance on how to act as well as to investors on what to expect. Investor confidence can also be bolstered by the relative transparency of corporate practices fostered by the new rule requiring disclosure of corporate governance practices. Finally, the fact that companies are taking an interest in the education and conduct of their board of directors and individual directors is significant. Corporations can increase the effectiveness of their boards by establishing clear policies and procedures for their directors and encouraging well-educated directors to be proactive in their position.

Corporate Compliance by Canadian Companies

In the KPMG 2005 survey of the largest 100 companies in 16 countries, Canada placed third behind Japan and the U.K. with a 41% compliance rating for filing separate annual reports and annual corporate responsibility reports. The U.S. ranked sixth with 32% compliance. Corporate responsibility reports contain information regarding social, environmental and health issues in relation to labour standards, working conditions, community involvement and philanthropy.

WHAT ARE THE REGISTRATION REQUIREMENTS?

Securities legislation also requires the registration of dealers, salespersons, underwriters, advisors and securities firms. As described above, where securities are offered for sale, the offering must be made through such registered parties who are registered in an appropriate category of registration, unless an exemption from the registration requirement is available.

This registration regime is supplemented by a number of large, self-regulating organizations such as the stock exchanges in Canada, the Investment Dealers Association of Canada and the Mutual Fund Dealers Association of Canada, each of whom imposes stringent rules on its members. This additional self-regulation is intended to enhance the integrity and efficiency of the capital markets in Canada. In Canada, registrants may be subject to ownership restrictions, capital requirements and proficiency requirements.

DO CANADIAN PROVINCES HAVE SECURITIES TRANSFER LEGISLATION SIMILAR TO ARTICLE 8 OF THE UNIFORM COMMERCIAL CODE?

Securities regulators have been encouraging the provinces for some time to bring provincial legislation into conformity with securities industry practices in Canada and with the laws governing the transfer of shares and other securities in other jurisdictions such as the EU and the United States. At last, Ontario and Alberta have passed legislation to address the above concerns. It is estimated that the savings in reduced financing costs to Canadian business as a result of this legislative reform will be substantial and permanent.

Until the Ontario *Securities Transfer Act, 2006* (the "STA") was passed on January 1, 2007, the rights of any person with an interest in securities governed by the laws of Ontario were uncertain. Those rights were based on the concept of physical possession of a share certificate when practically all transactions involving financial assets were based on book entries in the records of securities intermediaries where no actual certificates were issued. Ontario attempted to address the issue by one section in the Ontario *Business Corporations Act* (the "OBCA") which categorized the book entry as deemed possession of the security in question by the person in whose favour the book entry was made — a legal fiction if ever there was one.

Meanwhile, securities dealers had to get on with the business at hand and they whistled past the graveyard pretending that Ontario law was somewhat similar in effect to that of, say, New York or Great Britain. One hundred years ago, this would have been called "law merchant" — a business practice that was so accepted as to constitute a course of dealing and, in effect, the common law that applied in the circumstances in question, absent conflicting legislation.

The STA, and corresponding amendments to each of the OBCA and the *Personal Property Security Act* (the "PPSA"), have brought Ontario in line with Article 8 of the *U.S. Uniform Commercial Code*. The STA introduces a number of new concepts. It refers to securities that are represented by certificates (certificated securities) and securities that are represented by book entries in the records of a securities intermediary (uncertificated securities). The book entries, when made, create security entitlements in favour of the person whose name is recorded as having a claim against the securities intermediary in respect of the security entitlement. Parties no longer attempt to trace ownership rights through transfers of allotted and issued shares. Rather, in a book-based system, entitlement holders have security

entitlement rights against a securities intermediary; they have no interest in the securities themselves. Each book entry creates an interest, and claims are generally limited to a single level —between the two contracting parties under an agreement arising upon the opening of the securities account.

Third parties (including lenders) claiming, for example, a security interest in securities entitlements of a debtor to prevail against other adverse claims must exercise control over the securities entitlement. They can do so by entering into a three-party agreement with the debtor and the securities intermediary under which the secured party is given sufficient control of the securities entitlement to permit the secured party to realize against the securities entitlement and cause the securities intermediary to expunge the debtor's security entitlement and establish a new securities entitlement in favour of a purchaser. Proceeds from the resulting sale are then available to pay the claims of the secured party.

Under the STA, an unpaid securities intermediary has a first lien on the securities entitlement (ahead of all secured creditors) without the need to register.

A purchaser for value without notice of an adverse claim who takes control of a security is referred to as a protected purchaser. A protected purchaser takes the interest so acquired free of any adverse claim, including any existing security interest in the security created by, and perfected under, the PPSA. The rationale for this rule is that it permits the trading in securities without imposing a burden of enquiry on the persons engaged in such trading as long as they act in good faith. That is, they are being honest in fact while observing reasonable commercial standards of fair dealing. Trades are settled in real time and the securities trading system could simply not function if it permitted adverse claims to prevail against *bona fide* purchasers who give value for the interests acquired by them without notice of adverse claim.

The STA introduces a common set of conflict of laws rules that create certainty, as well as permitting the parties, in appropriate circumstances, to select a governing law. In effect, the laws are for all intents and purposes identical throughout the trading system, and parties adverse in interest are able to satisfy themselves by applying laws they understand. This necessarily reduces the perceived risks inherent in the purchase and sale of securities, and therefore, the cost of raising capital and trading securities.

Although the rules are complex, the focus is to create certainty and to limit adverse claims to the parties directly involved in the transaction. Again, the integrity of the securities trading system is preserved without adversely affecting the rights of participants.

The STA applies to financial assets, a new term that includes securities as well as any other medium of investment recognized for trading in any area or market, or any financial asset agreed to be dealt with as between the securities intermediary and the person for whom the securities account in question is maintained. The STA consistently introduces great flexibility into the marketplace and, by doing so, creates an opportunity for Canadian business to raise capital through the creation of any number of alternative financial assets.

Each of Alberta and British Columbia has passed similar legislation.

11. ADMISSION TO CANADA

WHO CAN APPLY FOR ADMISSION TO CANADA?

The federal *Immigration and Refugee Protection Act* distinguishes between visitors and immigrants. Visitors are people seeking temporary entry into Canada; immigrants are people seeking to establish permanent residence in Canada. Generally, every visitor and immigrant is required to obtain a visa before appearing at a port of entry. Application for the visa is made at a Canadian immigration office outside Canada. A person applying for a visitor's visa must

satisfy a visa officer that he or she is not an immigrant. An immigrant applying for a visa must specify the class of immigrants to which he or she is applying, the names of his or her dependants and the province of intended residence. The *Immigration Act* imposes penalties of up to $1 million in fines and life imprisonment for persons convicted of smuggling people into Canada. It is anticipated that rules will be tightened to deny a person who is on welfare, who has defaulted on spousal or child support payments, or who has been convicted of spousal abuse from sponsoring another person's entry into Canada.

TEMPORARY ENTRY

Visitors must be in good health, of good character and must have sufficient means to support themselves during their stay in Canada and to finance their departure. Visitors who wish to remain in Canada for over 90 days must undergo a medical examination before appearing at a port of entry if, at any time during the preceding five-year period, they have resided or travelled in an area that, in the opinion of the Minister of Health and Welfare, has a high incidence of tuberculosis, intestinal parasitic disease or any serious communicable disease. People who come to Canada as visitors are generally not allowed to work in Canada.

Visitors travelling to Canada who are able to satisfy immigration officials that they are nationals of the U.S. or have been lawfully admitted to the U.S. for permanent residence do not need to obtain a visa to come into Canada.

TEMPORARY WORK IN CANADA

Generally, anyone who wishes to enter Canada to work must apply to a visa officer and obtain authorization to come into Canada for that purpose. Regulations governing employment authorization are set out in the federal *Immigration Act* and Immigration Regulations, 1978, and are intended to regulate the admission into Canada of temporary foreign workers, admitting them on a temporary basis only when jobs cannot be filled by available Canadians or when their expertise could be used to train Canadians who would then take over the vacancy when qualified. However, the policy is subject to a number of important exceptions, as noted below.

No one other than a Canadian citizen or permanent resident of Canada may work in Canada without an employment authorization, a document issued by an immigration officer authorizing the employment. The prospective Canadian employer of a non-resident seeking to work in Canada must make a request in writing to the applicable Human Resources Development Canada ("HRDC") Foreign Worker Recruitment Office for job validation. The potential employer must establish why the job cannot be filled by a resident of Canada, or outline special specified benefits that will occur if the non-resident is hired.

When the job validation process is complete, HRDC issues a validation letter to the employer, with advice to give a copy to the worker and directions for that worker to apply for an employment authorization at an immigration office abroad. Some applicants may also have to meet visa requirements. People listed in Schedule II of the *Immigration Act* Regulations are visa-exempt. All nationals of the U.S. and persons lawfully admitted to the U.S. for permanent residence are visa-exempt.

The following people are exempt from employment authorization regulations:

- A representative of a foreign business coming into Canada to purchase Canadian goods or services, or a person coming to inspect goods purchased or to acquire training;
- A person carrying on business activities outside Canada coming to Canada for less than 90 days to sell goods to purchasers other than the general public;

- An employee or representative of a corporation coming into Canada for less than 90 days to consult with other employees of that organization or to inspect a Canadian branch or headquarters; *and*
- A person coming within the NAFTA "business visitor" definition.

NAFTA has significantly eased the immigration rules for many U.S. and Mexican citizens coming to Canada to work on a temporary basis, but does not apply to those with landed immigrant status in either the U.S. or Mexico. NAFTA provisions apply to only four classes of persons entering Canada to work:

- Business visitors (people who do not intend to enter the Canadian labour market and are not remunerated from Canadian sources);
- Professionals;
- Intra-company transferees; *and*
- Traders and investors.

Generally speaking, business visitors who meet the NAFTA tests may be granted admission to Canada for up to six months, provided they are engaged in specified occupations. Business visitors do not need employment authorizations.

Professionals entering Canada on a temporary basis may avoid the job validation process if they comply with Appendix 1603.D.1 of NAFTA. Professionals will require an employment authorization, which is available at the port of entry.

Intra-company transferees are the third category of potential beneficiaries under NAFTA and form a common class of temporary admittees to the country. Intra-company transferees must be classified as management or executives, or possess specialized knowledge. As a general rule, the person need only appear at a Canadian port of entry with a letter from the U.S. and Canadian employer setting out the person as an intra-company transferee and setting out the length of time and purpose of the temporary stay in Canada. The letter should identify the person's previous position or specialized skills and confirm that he or she has been employed by the employer for at least one year in the preceding three years and that the person will continue to be employed by the Canadian corporation or its parent or an affiliate corporation during the period in question. Job validation is not required and the employment authorization is made available at the port of entry. Admission may be granted, usually in 12-month renewable increments, for up to seven years (or five years in the case of people with specialized knowledge).

Traders and investors form the last class of NAFTA beneficiaries. As a general rule, this category receives greater scrutiny from the immigration authorities and the process involves applying through a consulate or embassy, rather than simply at the port of entry, to obtain approval. Entry under this category should be sought only after obtaining legal assistance in completing the application process, which often involves providing financial statements and other information to the immigration authorities.

CATEGORIES OF IMMIGRANTS

Generally, there are three categories of immigrants:

- Independent applicants;
- Refugees; *and*
- Family applicants.

Immigration applications are subject to a three-tiered selection process:

- A medical check;
- A background check; *and*
- An assessment of the immigrant's ability to settle successfully in Canada

The medical and background checks determine whether any health or security reasons prevent the applicant from being admitted to Canada as a permanent resident.

For simplicity, we will outline the regulations for independent applicants only.

HOW ARE INDEPENDENT APPLICANTS CLASSIFIED?

There are three main categories of independent applicants:

Assisted Relatives

These are specified relatives of a Canadian citizen or permanent resident of Canada, such as a brother or daughter who is a resident of Canada. The sponsoring person must have undertaken to provide the assisted relative's lodging, care and maintenance for a specified time period.

Skilled Workers

These are individuals with skills and/or education that will facilitate their establishment in and contribution to Canada.

Business Applicants

There are four sub-categories of business applicants:

Entrepreneurs

These are immigrants who:

- Intend and have the ability to establish, purchase or make a substantial investment in a business or commercial venture in Canada that will contribute significantly to the economy and create or continue employment opportunities in Canada for one or more Canadian citizens or permanent residents, other than the entrepreneur and his/her dependants, and
- Intend and have the ability to provide active and ongoing participation in the management of the business or commercial venture.

Investors

These are immigrants who:

- Have successfully operated, controlled or directed a business or commercial undertaking,
- Have made minimum investments (see below) since applying for an immigrant visa that will contribute to the creation or continuation of employment opportunities for Canadian citizens or permanent residents, other than the investor and his/her dependants, and
- Have a personal net worth, accumulated by their own endeavours, of at least $800,000.

For the purposes of this discussion, minimum investment for an investor means an investment made in accordance with an approved investment proposal that is at least $400,000.

Investors in a Province

These are immigrants whose minimum investment provides equity or loan capital to an eligible business or commercial venture operated in a province, the government of which has entered into an agreement with the federal government about the selection of immigrant investors, though the business immigration program is operated by the federal government, not the provinces.

Self-Employed Person

A self-employed person is an immigrant who intends or has the ability to establish or purchase a business in Canada that will create an employment opportunity for the immigrant and will make a significant contribution to the economy or cultural or artistic life of Canada.

WHAT IS CANADA'S BUSINESS IMMIGRATION PROGRAM?

As noted above, immigrant business investors must have a minimum personal net worth of $800,000 and must make an investment in an approved plan of $400,000.

Immigrant business investors in Canada generally use the investor and entrepreneur categories. The entrepreneur category is designed for a young immigrant who intends to run a small commercial operation in Canada. The entrepreneurial immigrant is expected to undertake the day-to-day management of the new business in Canada. The investor immigrant category is designed for older immigrants who may have a number of business interests in their home country and who are investing in a new business in Canada, without assuming day-to-day management responsibilities.

A key consideration for business immigrants is who in their immediate families will be entitled to landed immigrant visas to enter and live in Canada, and what, if any, conditions will apply to their own visas and those of their immediate family. The landed immigrant visas issued to entrepreneurial category investors are subject to conditions which, if not met, may result in the cancellation of the immigrants' visas and other visas issued as a result of their initial approval as business immigrants.

Under the investor immigrant program, the federal government recognizes that the investors will not be involved in the day-to-day management of the businesses in which their funds are invested. It is unlikely that the citizenship will be denied because the investors did not remain in Canada for significant periods of time following the initial approval of their applications. Investor immigrants may invest in funds managed by an approved issuer designed to meet the requirements of the plan. The funds are permitted to make loans to the investor to finance a portion of the investment, and the funds are permitted to guarantee a rate of return to the investor. In effect, for a cost of between $110,000 and $140,000, immigrant investors may acquire Canadian citizenship for themselves and their immediate family members. If the investor has any children who are landed immigrants in Canada and who may have been attending school in Canada, the children will be entitled to significantly lower tuition fees, which may offset the cost of the immigrant application.

WHAT IS THE UNIT SYSTEM?

The unit system is used to determine whether a candidate will be entitled to enter Canada as an immigrant. Candidates must receive at least 70 units, some of which are obtained by meeting mandatory requirements.

Candidates must obtain one unit under Item 3 (experience). If a candidate is inexperienced there are two methods of obtaining the unit: the candidate arranges employment in Canada with employers who will verify they are willing to employ inexperienced workers, or the candidate qualifies for and prepares to engage in employment in a designated occupation.

Candidates must also receive one unit for Item 4 (occupation) unless the candidates are entrepreneurs, investors or self-employed people.

The screening process comprises two stages: a review of documentation and an interview. Benchmark thresholds generate an entitlement for independent immigrants to secure an interview. For assisted relatives and skilled workers, this threshold can be as low as 55 units; for business immigrants the threshold can be as low as 25 units. There is no right of appeal against the decision made by the interviewing immigration officer, although nothing prevents an applicant from re-applying.

The Unit System Selection Criteria under the Immigration Act

Item 1: Education — a maximum of 16 units.
Units are awarded for a secondary school diploma (5 units) and further units are awarded depending on level of post- secondary study. If candidate does not have a secondary school diploma, no units are awarded.

Item 2: Education and Training — a maximum of 18 units
These units are awarded for education and formal training in the applicant's intended occupation under Item 4.

Item 3: Experience — a maximum of 8 units
These are awarded for years of experience in the applicant's intended occupation under Item 4.

Item 4: Occupational Factor — a maximum of 10 units
These units are based on the national demand for the intended occupation. The entrepreneur and investor are not assessed on this item.

Item 5: Arranged Employment
Ten units are awarded if the applicant has pre-arranged employment in Canada. The self-employed person will be given a bonus of 30 units if, in the opinion of the immigration officer, he will be able to successfully establish himself without assistance. The entrepreneur and investor are not assessed on this item.

Item 6: Demographic Factors — a maximum of 10 units
These are based on consultation with the provincial authorities and such other persons and institutions concerning regional demographic needs, labour market considerations and the ability of the regional infrastructure to accommodate population growth.

Item 7: Age — a maximum of 10 units
These are awarded to applicants aged 21 — 44, with 2 units subtracted for each year the applicant is over age 44.

Item 8: Language — a maximum of 15 units
These depend on the applicant's ability to speak, read and write in English and French. An applicant must be proficient in each ability in each language in a range from "fluently" to "well" to receive any units.

Item 9: Personal Suitability — a maximum of 10 units
These are determined at an interview and are based on the immigration officer's assessment of the ability of the applicant and dependants to become successfully established in Canada, taking into account the person's adaptability, motivation, initiative, resourcefulness and other similar qualities.

12. WHAT DOMESTIC EMPLOYMENT LAWS APPLY IN ONTARIO?

WHAT ARE THE RIGHTS OF EMPLOYEES IN CANADA?

A number of federal and provincial legislative initiatives affect all employers other than the federal government and businesses that are federally regulated. The following statutory employee rights are currently in effect in Ontario:

- **Minimum Wage Law** — Ontario's *Employment Standards Act* (the "ESA") provides for a minimum wage of $7.50 per hour for workers under the age of 18 who work 28 hours a week or less and $8.00 per hour for those 18 years of age and older. Effective March 31, 2008, in each year over the next two years, additional increases will come into effect until the minimum wage reaches $10.25 on March 31, 2010.
- **Vacation with Pay** — The ESA fixes minimum vacation pay requirements equal to 4% of the greater of an employee's gross earnings and two weeks wages.
- **Overtime Pay** — The ESA requires an employer to pay overtime wages (1.5 times the employee's regular wage rate) after an employee has worked 44 hours in a week.
- **Pay Equity** — The ESA prohibits employers from discriminating between men and women in rates of pay for substantially the same work. In addition, Ontario's *Pay Equity Act* requires employers with more than 10 employees to have pay equity, that is, female job classes must receive the same rate of pay as male job classes where the work performed is of equal or comparable value. The Act applies to all employers in the private sector in Ontario with 10 or more employees, and to all employers in the public sector.
- **Holidays** — There are only eight annual, paid, statutory holidays prescribed in the ESA. In addition, the Ontario government invariably proclaims the first Monday in August to be the Civic holiday.
- **Notice on Termination of Employment** — Under the ESA, an employee must receive at least one week's written notice of termination of employment if the employee has completed at least three months of service. As an employee's period of service increases, so does the notice required at termination (up to eight weeks notice after eight years service or more). In addition, employees of any employer with annual Ontario payroll of $2.5 million or more and who have five years service or more may be entitled to severance pay of up to 26 weeks if their employment is terminated (one week per completed year of service). Employees cannot waive their rights under this Act.

  The period of notice in mass terminations is longer. If during any four-week period, an employer proposes to terminate the employment of 50 — 199 workers, the notice period for each affected employee is eight weeks. If the number of workers whose employment is to be terminated is 200 — 499, the notice period for each affected employee is 12 weeks. If the employment of 500 or more workers is to be terminated, the notice period for each affected employee is 16 weeks.

  The foregoing are minimum statutory notice requirements that may be increased substantially by common law, depending on the circumstances of the case. In employment agreements, employees can waive their common law rights. Ontario does not have a "right to work" regime similar to that in many of the U.S. states. Employment can be terminated only for just cause, or on the giving of the minimum statutory notice as summarized above (which may be far less than the employer's common law obligations, which common law right an employee may enforce through the courts), or on payment of wages for the notice period in lieu of notice.

- **Human Rights** — Ontario's *Human Rights Code* (the "Code") and the *Bill of Rights* prohibit discrimination in employment on the basis of ancestry, race, ethnic origin, place of origin, citizenship, colour, religion, sex, sexual orientation, marital status, family status, record of offences, handicap and age. Provincial boards have the power to investigate and award damages for loss of income and distress arising out of a discriminatory practice. Employees who are discriminated against may be entitled to significant damage claims, and even reinstatement. However, the focus of the Code is to remedy the discriminatory practice, not to punish the wrongdoer.
- **Parental Leave** — The ESA gives 17 weeks of unpaid pregnancy leave to employees who have 13 weeks of service or more, as well as 35 weeks of unpaid parental leave for both men and women. The federal *Employment Insurance Act* provides paid benefits for 52 weeks after a two-week qualification period. Employees have the right to return to their jobs following the leave period.
- **Compassionate Care Benefit** — As of January 4, 2004, Employment Insurance eligible workers (600 insurable hours in previous 52 weeks) who must be absent from work to provide support to a family member who is gravely ill with a serious risk of death are entitled to up to six weeks of compassionate care benefits.
- **Mandatory Retirement** — The Ontario government has enacted the *Ending Mandatory Retirement Statute Law Amendment Act*, which came into force on December 12, 2006. The Act amends the Ontario Human Rights Code to prohibit discrimination in employment based on age. Discrimination based on age will be permitted only where it may be established that a limitation on the age of a worker is a *bona fide* occupational requirement ("BFOR"). Based on what courts have recently held when assessing BFORs in the context of accommodation responsibilities, employers will be hard-pressed to demonstrate that age is a BFOR.

  The government did not make any corresponding amendments to the *Pension Benefits Act*, and under federal legislation, workers may not make contributions or accumulate retirement benefits past the age of 69. In addition, the government left unchanged the provisions of the *Workplace Safety and Insurance Act* (WSIA). This means that wage loss benefits terminate at age 65 unless a worker is injured after age 63, in which case those benefits are payable for up to two years.

  This age cut-off is to be contrasted with that of other worker compensation systems. In Alberta, for example, 65 is commonly considered to be normal retirement age and wage loss benefits cease at that age unless "there is sufficient and satisfactory evidence to show that the worker would have continued to work past that age if the injury had not occurred."

  The question has been asked whether *Ontario Human Rights Code*, in this respect, complies with the *Canadian Charter of Rights and Freedoms* ("Charter"). In a 1991 Supreme Court of Canada decision, *Tétreault-Gadoury*, it was decided that the denial of unemployment benefits to those over age 65 violated the equality rights provision of Charter section 15(1) and could not be justified under its saving provision, section 1. There is conflicting case law that might support Ontario's decision to implement a benefits cut-off age.

  In light of the foregoing, employers should re-visit their mandatory retirement policies. Not only will such policies be soon unenforceable, but employers are likely to face the potential of increased damages when terminating employees over 65 where it is established that age was a factor. Under the *Human Rights Code* and cases, reinstatement is a possibility as well.
- **Occupational Health and Safety** — Ontario's *Occupational Health and Safety Act* provides a comprehensive set of rules that imposes duties on employers in matters relating to the health and safety of workers. Employees are obligated to participate in joint health and safety management at their places of employment. Employees must use protective equipment and machinery, and they can refuse to do unsafe work.

- **Workplace Safety and Insurance** (formerly known as Workers' Compensation) — Virtually all full-time employees and their employers must report to the Workplace Safety and Insurance Board all injuries and illnesses arising in the course of any person's employment. Employers make financial contributions to an insurance fund (out of which the Board makes disability and injury awards to injured employees) based on the history of claims in the employer's industry and the individual employer's claims history. Employees receive various benefits, including payment for loss of earnings and health care benefits. Subject to certain exceptions, injured employees who have recovered from their injuries have the right to return to work, to the same or a similar job, with the employer for whom they were working at the time of injury. The exceptions that would prevent their return to the same or a similar job are that they worked for the employer for less than one year; they failed to return to work within one year of being able to do so; or they are not able to return to work for two years or more after the date of their injury. Workers are entitled to only the benefits fixed by Ontario's *Workplace Safety* and *Insurance Act* and, with very few exceptions, cannot sue their employers for damages arising out of a work-related injury or disease.
- **Employment Equity** — The federal government enacted voluntary employment equity legislation with mixed success several years ago. The federal legislation applies to, among others, federally regulated businesses with more than 100 employees (e.g., banks).
- **Homeworkers Legislation** — Employees who work from home are covered by the ESA. In addition, the Act confers a 10% premium for such workers over provincial minimum wage rates to compensate for the workers' contribution to overhead.

Whether a claimant can successfully claim any of the foregoing entitlements if the employer goes bankrupt varies from entitlement to entitlement.

IS COLLECTIVE BARGAINING RECOGNIZED IN CANADA?

Trade unions, often affiliated with U.S. counterparts, are present in many industries in Canada. Employees have the right to be members of a trade union under both Ontario's *Labour Relations Act* and the *Canada Labour Code*. The Ontario Labour Relations Board supervises the organization of a trade union in Ontario. A union that becomes certified has the exclusive right to bargain collectively for all its members and the employer is required by law to bargain with the union in good faith. Unless permitted otherwise by order of a court or by the consent of the Labour Relations Board, anyone who purchases a business in which there are unionized workers must honour any collective agreement then in effect as a successor employer.

13. ARE CLASS ACTIONS A RISK FOR BUSINESS IN CANADA?

Yes. Several Canadian provinces have passed legislation to authorize and regulate class actions (often called "class proceedings" in Canada) in a manner similar to U.S. legislation, starting with Québec in 1976, Ontario in 1992 and British Columbia in 1995. In 2001, the Canadian Supreme Court held that, irrespective of whether legislation has been passed, class action should be recognized and implemented by the courts as a procedure available to plaintiffs throughout Canada.

A class action is a procedure whereby one or more plaintiffs who are appropriate representatives of a class of claimants may commence an action on behalf of the larger identifiable class and raise common legal issues that may be determined with respect to the class as a whole, and which is a preferable procedure for the resolution of the claims of the plaintiffs and the class members. Before a class action may proceed, the court must certify it as such.

Although Canadian class action legislation has been explicitly drafted to make the obtaining of court certification easier than in the United States, Canadian courts (with the possible

exception of Québec) have interpreted the legislation in a relatively conservative fashion. Notwithstanding this, class actions have been commenced and certified in a range of circumstances, including investor misrepresentation, securities fraud, defective and dangerous products, franchising, and standard form contracts.

There are a number of practical differences between class actions in Canada and those in the U.S. that affect business risk. These are:

- There is no *per se* right to a jury trial in a Canadian class action proceeding , and the few class actions that have proceeded to trial have been determined by a judge without a jury;
- Courts have approved levels of contingent fees for plaintiffs' lawyers which, although much greater than the norm in Canada, are relatively small compared to the fees approved in litigated and settled cases in the U.S.;
- An unsuccessful representative plaintiff in a class action is ordinarily required to pay the court costs and a portion of the fees incurred by the defendant in the case; *and*
- Both compensatory and punitive damage awards tend to be much smaller in Canada than in the U.S., and more subject to appellate review.

On balance, although class actions have quickly become a significant part of litigation practice in Canada, they have generally been regarded as a manageable cost of doing business.

The Possible Use of Arbitration Clauses to Forestall Class Action Proceedings

Two 2007 Supreme Court of Canada decisions dealt with cases that arose in circumstances where consumers attempted to commence class action proceedings when the contracts in question, by their terms, purported to bar class action proceedings in favour of private arbitration. In both cases, the Supreme Court held that the matters should be dealt with by arbitration and not by class action proceedings.

Ontario and Québec consumer protection legislation override mandatory arbitration provisions in consumer contracts. The Supreme Court held that legislation of this nature would not be applied to contracts entered into prior to the date on which the consumer protection legislation came into effect. As a result, it is important that consumer product and service providers with agreements that mandate arbitration to settle disputes carefully review the facts relating to any class action proceeding. Some members of the class action proceedings may be excluded from the class of claimants

14. HAS CANADA ENACTED DOMESTIC LEGISLATION IN FURTHERANCE OF INTERNATIONAL PROTOCOLS AND TREATIES?

HOW IS THE INTERNATIONAL SALE OF GOODS TREATED IN CANADA?

In Canada, sale of goods legislation is a provincial responsibility. The various provincial *Sale of Goods Acts* impose certain commercial rules into every contract for the sale of goods, such as when title to the goods passes or whether the buyer or seller bears the risk of damage or loss to goods before delivery. These provincial statutes also impute into each sale of goods contract conditions that will apply to the sale in question. They relate to matters such as the seller's title to the goods, the transfer of title to the goods to a bona fide purchaser for value free of any existing liens, and a warranty of the goods' fitness for their intended purpose.

Different jurisdictions have different rules relating to the sale of goods. In an attempt to reduce uncertainty, and by extension, the cost of doing business between buyers and sellers in different jurisdictions, the United Nations sponsored a *Convention on Contracts for the International Sale of Goods* (the "Convention"). Canada and each of the provinces other than

Québec ratified the Convention and it came into force in Canada in May 1992. A number of countries, including the U.S. and Mexico, are parties to the Convention.

The Convention is important from the perspective of international trade. Unless the application of the Convention is specifically excluded by the parties to a sale of goods transaction, the Convention governs any agreement of purchase and sale of goods between Canadian buyers and sellers and their respective foreign counterparts, whether or not the parties so specify in their agreement. The Convention establishes a series of rules that are implied as part of each such agreement. The Convention does not radically rewrite the rules as set out, for example, in Ontario's *Sale of Goods Act* or Article 2 of the U.S. *Uniform Commercial Code*. Rather, the Convention harmonizes the rules to reduce conflict between contracting parties. There is no longer a need to negotiate at length which applicable law will govern. The Convention rules will govern unless the parties "opt out" of the Convention.

The following is a brief summary of the matters dealt with under the Convention:

- The obligations of the seller, the obligations of the buyer, remedies for breach, the identity of the party who bears the risk of loss of the goods, and the basis on which damages may be claimed are determined in the Convention.
- There is no need for the contract to be in writing.
- It is difficult for either party to terminate a contract governed by the Convention once it is formed. The performing party may rescind the contract only if the non-performing party has committed a fundamental breach of the contract. A breach is fundamental if it deprives the other party of what he/she is entitled to expect under the contract, unless the party in breach did not foresee, or a reasonable person in the same circumstances would not have foreseen, such a result.
- The seller must deliver goods of the quantity, quality and description required by the contract. Goods are deemed not to conform with the contract unless:
- They are fit for the purpose for which they would ordinarily be used;
- They are fit for any particular purpose expressly or implicitly made known to the seller when the contract was entered into;
- They possess the qualities which the seller has held out to the buyer as a sample; *and*
- They are contained or packaged in a manner usual for such goods, or adequate to preserve or protect them.

Finally, the parties to the contract may adopt certain laws of an appropriate jurisdiction to override one or more of the rules set out in the Convention. In this way the parties can select the arrangement that make the most sense for them in their circumstances.

DOES CANADA HAVE PRIVACY LEGISLATION?

On January 1, 2001, the federal *Personal Information Protection* and *Electronic Documents Act* ("PIPEDA") came into effect. Initially, the application of PIPEDA is limited to all private organizations involved in any "federal work, undertaking or business" within the legislative authority of the federal government (e.g., banks, cable, television and telecommunication service providers) and to organizations that transfer personal information across provincial borders "for consideration."

Each province had until January 1, 2004 to enact its own counterpart legislation, failing which this federal legislation would apply to all private organizations in provinces that had not enacted their own private enterprise privacy laws. To date, only the provinces of British Columbia, Alberta and Québec have their own counterpart legislation in place that has been confirmed by the federal government as substantially similar to PIPEDA. Ontario did circulate draft legislation in 2002, but it was not enacted before the Ontario Legislature was peroged for the provincial election on October 2, 2003. The Progressive Conservative Party lost the election to the Ontario Liberal Party. As a result, Ontario did not have its own private sector

privacy legislation in place by January 1, 2004 and all Ontario businesses are now subject to the provisions of PIPEDA. The new *Personal Health Information Protection Act* ("PHIPA") came into force in Ontario on November 1, 2004. The federal government has declared that PIPEDA is substantially similar to PHIPA and may be relied upon by "health information custodians" in Ontario.

PIPEDA is based on a set of privacy guidelines that were developed by the Canadian Standards Association. The 10 privacy principles are:

- **Accountability**: An organization is responsible for personal information under its control and must designate an individual or individuals who are responsible for the organization's compliance with the 10 principles set out in the legislation.
- **Identifying the purpose**: An organization must identify the purpose for which the information is collected at or before the time the information is collected. If the purpose changes, the organization must identify the change in purpose.
- **Consent**: The individual concerned must give his or her consent to the collection, use or disclosure of personal information, except where to do so would be inappropriate.
- **Limiting collection**: The collection of personal information is strictly limited to the extent it is necessary for the purpose identified by the organization.
- **Limiting use, disclosure and retention**: The use, disclosure and retention of personal information are limited to the purpose for which it was collected, except with the consent of the individual or as required by law. The information should be retained only as long it is required to fulfil the specified purpose.
- **Accuracy**: Personal information must be accurate, complete and up-to-date.
- **Safeguards**: Personal information must be protected by security safeguards appropriate to the sensitivity of the information.
- **Openness**: An organization should make available to individuals specific information about its policies and practices relating to the management of personal information.
- **Individual access**: Upon request, an individual shall be informed of the existence, use and disclosure of personal information and shall be given access to the information. The individual can challenge the accuracy and completeness of the information and have it amended as appropriate.
- **Challenging compliance**: An individual can challenge the organization's alleged compliance with the above principles and hold the designated person accountable for the organization's compliance.

Personal information under PIPEDA means any identifiable information about an individual other than such person's "business card" information, that is, the name, title, business address or telephone number of the employee in question.

One of the key requirements of PIPEDA is that the individual's consent is required prior to sharing personal data with the collecting entity's business partners or affiliates.

PIPEDA has no "grandfather" clause for personal data collected prior to 2004, so in order to use personal data collected prior to 2004 companies need to get individuals' consent and provide access for review.

Although, outside of some sectoral specific privacy laws, the U.S. does not have comprehensive legislation of this nature in effect, there are similar privacy laws in the EU and it is obvious that the international transmission of personal data throughout the world will be regulated.

In a 2004 study, 61% of Canadian businesses linked privacy compliance policies with customer trust and loyalty. It was found that Canadian businesses were twice as likely as their U.S. counterparts to assign a senior officer as a privacy officer who reports directly to the chief executive officer of the business.

Reporting Issuer SEDAR Filings

PIPEDA (and any certified provincial counterpart) will have a significant effect on a number of key areas, including the due diligence procedure followed on the purchase and sale of a business, although PIPEDA does not contain specific rules regarding business transactions. In a 2005 ruling, the Alberta Information and Privacy Commissioner found that the Alberta Act had been breached where a schedule that was intended to identify the employees of a purchased business by inadvertence included the employees' home addresses and individual social insurance numbers. Complete copies of the agreement were posted on SEDAR. The Alberta Act contains a business transaction exception, however, the Commissioner found that the exception did not relieve the law firms involved in the transaction from liability for this breach of privacy. The Commissioner imposed obligations on the two law firms, including an obligation to appoint a privacy officer at each firm to monitor compliance.

Secondary Marketing

In mid-2005, the Privacy Commissioner of Canada ruled a bank in breach of its PIPEDA obligations when the bank included marketing materials in its monthly mailing without giving its customers an easy and immediate way of opting out of receiving them. The additional materials were found to be "secondary marketing," which is treated as an unauthorized use of personal information.

Outsourcing Services

In April 2007, the Commissioner ruled that Canadian banks participating in the Society for Worldwide Interbank Financial Telecommunications (SWIFT) were obligated to comply with subpoenas issued by the United States Department of the Treasury on the basis that although SWIFT is subject to PIPEDA, it conducts business in, and is subject to, compliance with U.S. laws. As a result, SWIFT was obligated to disclose the information referenced in the subpoenas served on it. This imposed on the Canadian banks an obligation to review the provisions of their contracts with SWIFT to ensure that those provisions complied with PIPEDA and that SWIFT had in place policies and procedures that comply with the requirements of PIPEDA. In the context of the agreements between the banks and their customers, there has to be clear disclosure that the information collected by the banks would be disclosed to an entity that is subject to the laws of another country (in this case, the laws of the United States).

Canada's World Ranking

In a recent survey, Privacy International ranked Canada as second in the world behind Germany in protecting the privacy rights of Canadians. Too much should not be read into these results other than that other countries are doing a poor job in protecting the privacy of their citizens.

If you are interested in a more complete summary of PIPEDA and its application to your business in Ontario, see the eight-page summary entitled "Your Privacy Obligations" available from the firm's website at www.casselsbrock.com.

HOW DO CANADIAN PRIVACY LAWS INTERACT WITH THE U.S. *PATRIOT ACT*?

The U.S. *Patriot Act* empowers U.S. authorities to compel persons subject to it to disclose personal information records in the possession or control of such persons. As noted in the SWIFT case summarized above where U.S. service providers have possession and control of personal information of Canadian citizens, and it is possible that an entity conducting business in Canada that collects and provides personal information on its customers, suppliers and employees to such service provider could be in breach of Canadian law unless (i) the U.S. service provider is obligated to, and does, comply with PIPEDA in dealing with the personal

information provided to it and (ii) the Canadian entity discloses to the affected Canadians that the data collected will be provided to the U.S. service provider who may be compelled under American law to U.S. governmental authorities.

One complication arises out of the fact that the use of information disclosed to U.S. authorities is secret. Ontario had enacted the Business Records *Protection Act* in 1990 in response to the U.S. *Foreign Intelligence Surveillance Act*, however, the Ontario Act is viewed as ineffective, partly because persons subject to an order issued under the American legislation are prevented by such U.S. law from disclosing the existence of the order or the fact that the records have been disclosed to U.S. authorities.

DOES ONTARIO HAVE ELECTRONIC COMMERCE LEGISLATION?

Ontario's *Electronic Commerce Act, 2000* (the "ECA") is based on the Uniform Law Conference of Canada's *Uniform Electronic Commerce Act*. It only applies to contracts governed by the laws of Ontario. The ECA is designed to reduce legal uncertainty and remove barriers to electronic contracting, including, for example, Internet contracts. It accomplishes these goals through a series of functional equivalency rules, which allow electronic communications to be used interchangeably with conventional paper-based communications. One of the key aspects of the ECA is that it adopts a facilitating rather than mandatory approach: the ECA creates standards to streamline electronic commerce, but the adoption of those standards is purely voluntary in the sense that it does not require the use, acceptance or provision of documents in electronic form.

The ECA does not apply to wills and codicils, trusts created by wills or codicils, powers of attorney to the extent that they are in respect of an individual's financial affairs or personal care, documents creating or transferring an interest in land which require registration to be effective against third parties, negotiable instruments, and other prescribed documents. The ECA also does not apply to biometric information, that is, information relating to individual biological characteristics and typically used as a means of identification.

The ECA does not affect any law that expressly authorizes or prohibits the use of electronic documents. For example, Ontario's *Land Registration Reform* creates its own system for dealing with the electronic registration of land transfer documents, and is consequently outside the ECA's application. Explicit references to "writing" or "signing" are not considered by the ECA to be express prohibitions on electronic documents or signatures.

The core of the ECA is its functional equivalency rules. These rules establish standards that must be met if an electronic communication is to satisfy the legal requirement of, and be an effective substitute for, a conventional paper-based communication. The fundamental principle behind the functional equivalency rules is that the use of electronic communications instead of conventional paper-based communications does not in itself affect the legal validity or enforceability of those communications. This does not mean that any other applicable laws governing the formation of contracts have been dispensed with by contracting electronically. Generally, the requirements of functional equivalency vary with the type of communication involved. For example, a legal requirement that a document or information be "in writing" is satisfied by an electronic document where that electronic document is in a form that can be subsequently accessed and used. A legal requirement that a person provide information or a document in writing to another person is also satisfied by an electronic document where the electronic document can be subsequently accessed, used, retained and printed by the recipient.

Under the ECA, any contracts that otherwise meet the requirements of law, but have been entered into electronically, are legally binding. The ECA states that offer, acceptance or any other matter that is material to contract formation or operation can be expressed by means of electronic information or as an electronic document; or an act intended to result in electronic communication such as clicking a mouse, touching an appropriate on-screen icon, or speaking.

The ECA also applies to "anything done in connection with a contract for the carriage of goods" including furnishing the marks, number and quantity or weight of goods, stating the nature or value or goods, issuing a receipt for goods claiming delivery of goods and authorizing the release of goods. In short, the legal requirement that any of the foregoing actions be done in writing is satisfied if the action is done electronically. The ECA creates an exception for documents of title. Where a right is granted or an obligation is to be acquired by a specific individual and, where there is a legal requirement that this be done by the transfer or use of a written document, electronic documents may only be used where they are created by a method that gives a reliable assurance that the right or obligation has become the right or obligation of that individual. The ECA provides that what will be considered a "reliable assurance" is dependent on the specific context of the situation.

The ECA allows electronic signatures as a substitute for the legal requirement that a document be signed if the electronic signature is reliable for identifying the person to whom the signature belongs and if the association between the signature and the document is also reliable. The ECA also establishes rules for when and where electronic documents are deemed to be sent and received. In some cases, actual receipt of the document is not required for a document to be deemed to have been received.

The ECA represents not so much a revolution as a refinement. It is designed to integrate electronic communication and information into Ontario's existing contract law with a minimum amount of disruption. The ECA's fundamental imperative is that documents or information will not be considered invalid simply because they are presented or exist in electronic form. This imperative, which is subject to certain qualifications and exceptions, affects virtually all of the ECA's provisions including the validity of contracts and digital signatures. As noted above, the common law remains relevant for many issues concerning electronic contracts, and there are differences among electronic commerce laws in the various Canadian provinces and among various countries. As a result, disputes based on jurisdictional issues may arise. Finally, there are additional legal requirements arising out of the application of consumer protection legislation to consumer Internet agreements, as summarized under the next heading.

HOW DOES ONTARIO CONSUMER PROTECTION LEGISLATION AFFECT ELECTRONIC CONTRACTS?

Ontario's new *Consumer Protection Act, 2002* and certain of the related regulations came into effect in July 2005. Under the Act, consumers have new rights in respect of Internet agreements. Internet agreements are defined in the Act as agreements formed by text-based Internet communications for the supply of goods or services for person, family or household purposes (i.e., not for business purposes) that involve a payment in excess of $50. The Act and draft regulations set out the following requirements for these agreements.

Disclosure of Information

Before a consumer enters into an Internet agreement, a supplier must disclose prescribed information to the consumer, which includes contact information of the supplier, a description of the goods and services, an itemized list of prices (and any additional charges and the total amount payable), terms and methods of payment, any credit terms, date for delivery of goods or completion of services, delivery arrangements, and a supplier's refund policy. This is a long list. The information must be "clear, comprehensive and prominent" and be provided in a manner that ensures the consumer has accessed the information and is able to retain and print it.

Express Opportunity to Accept/Decline and Correct Errors

Immediately before an Internet agreement is entered into, the consumer must be provided with an express opportunity to accept or decline the agreement and to correct errors.

Deliver Copy of Agreement

Within 15 days after the date an Internet agreement is entered into, the consumer must be provided with a copy by e-mail, fax, mail or any other manner that allows the supplier to prove the consumer has received it. The agreement must contain the information described under the heading "Disclosure of Information," as well as the consumer's name and date the agreement was entered into.

Cancellation of Agreement

If the prescribed information is not disclosed in advance, or there was no express opportunity to accept/decline the agreement or correct errors, an Internet agreement may be cancelled within seven days after receiving a copy of it. If a copy of the Internet agreement is not provided, the agreement may be cancelled within 30 days after it is entered into.

Amendment, Renewal, Extension

If the Internet agreement does not contain a provision regarding amendment, renewal or extension, such changes may only be made if the consumer explicitly, and not merely by implication, agrees to the proposed change. The change becomes effective on the date specified, but only if the supplier provides an updated version of the agreement, including the text before and after the change, to the consumer within 45 days after the consumer has agreed to the change.

If the Internet agreement does contain a provision for amendment, renewal or extension, such changes may be made without explicit agreement of the consumer if:

- The amending provision indicates what elements of the agreement are subject to change and how often a supplier may make changes;
- The amending provision gives the consumer, as an alternative to accepting the change, the option of terminating the agreement, retaining the existing agreement unchanged, or both options; *or*
- The agreement requires that the consumer be given advance notice of any changes.

Notice of any change to an Internet agreement effected by notice only (i.e., without the consumer's explicit consent) must be given at least 30 days in advance and cannot retroactively affect the consumer's rights and obligations before the effective date of the change. This notice must disclose all the changes to the agreement and comply with other prescribed requirements.

WHAT CONDUCT IS PROHIBITED BY THE *CORRUPTION OF FOREIGN PUBLIC OFFICIALS ACT*?

Since 1977, the U.S. has had legislation — the federal *Foreign Corrupt Practices Act* — designed to punish any U.S. business that bribed foreign officials to gain an advantage over its competitors. Although many lawyers are of the view that the federal *Corruption of Foreign Public Officials Act* ("CFPOA") is intended to apply to criminal acts, such as bribery, that take place outside Canada, because of the policy conflict between Canada and the U.S. regarding the purported extra-territorial effect of the Helms-Burton legislation, the CFPOA, in fact, only applies to conduct that takes place in Canada or criminal acts that occur outside Canada but which have a real and substantial connection to activities in Canada. As a result, the CFPOA is generally viewed as having a relatively limited scope of application. It provides that:

- It is an indictable offence to obtain or retain an advantage in the course of business, by directly or indirectly giving, offering or agreeing to give or offer a loan, reward,

advantage or benefit to a foreign public official or to a person for the benefit of a foreign public official to influence the official in connection with the performance of the official's duties or functions, or to induce the official to use his/her position to influence any acts or decisions of the foreign state or public international organization for which he/she performs duties or functions. The punishment for such actions is up to five years imprisonment.

- It is an indictable offence to either possess property or proceeds of any property knowing that all or any part of the property or proceeds were obtained as a result of an offence as summarized above, or deal in any manner with any such property or proceeds with the intent to conceal or convert that property (i.e., money laundering). These actions are punishable on indictment by up to 10 years imprisonment, and on summary conviction by up to six months imprisonment or a fine of up to $50,000, or both.
- Section 183 of the *Criminal Code* has been amended to include bribing a foreign public official, possession of property derived from such bribery and laundering proceeds within the definition of the offence.
- The federal *Income Tax Act* prohibits anyone who must file a Canadian tax return from claiming a deduction for any outlay made or expense incurred for the purposes of doing anything that is an offence under the CFPOA.
- There are certain exceptions where the payment in question is made to expedite or secure a foreign public official's performance of any routine act, apart from awarding new business or continuing an existing business arrangement.

Boards of directors of corporations carrying on business in Canada should implement a CFPOA compliance program similar to those in place to ensure compliance with the U.S. *Foreign Corrupt Practices Act*. In Canada, the Charter of Rights and Freedoms guarantees a due diligence defence to every person, including directors and officers, where breach of the offence includes the possibility of imprisonment. One essential element of this defence is a program and procedures designed to ensure compliance and adherence by management. *We can assist you in this regard — call 416 869 5300.*

WHAT TRANSACTIONS COME WITHIN THE PROVISIONS OF THE MONEY LAUNDERING ACT?

The federal government has enacted legislation intended to deter money laundering in Canada. The federal *Proceeds of Crime* (Money Laundering) and *Terrorist Financing Act* (the "Money Laundering Act") imposes obligations on financial institutions (including insurance companies), securities dealers, foreign exchange dealers, real estate brokers, accountants and casinos in Canada to keep records and report to the Financial Transactions and Reports Analysis Centre of Canada ("FinTRAC"), a Canadian federal agency constituted under the *Money Laundering Act* in a prescribed form in respect of any suspicious transaction in which a customer or client of any such person engages.

It is a crime to advise the customer or client that a report has been made by such person and it is a crime to fail to make a report. The *Money Laundering Act* lists a number of indicia that are intended to guide persons obligated to make such disclosure to the federal government. Persons who are obligated to report will have to put a compliance regime in place or run the risk of losing any due diligence defence that would otherwise have been available to such person should such person fail to make a report mandated by the *Money Laundering Act*. The *Money Laundering Act* has been widely criticized as a trap for the law-abiding, as lacking precision and creating conflicts of interest.

Lawyers have resisted the application of the "suspicious transactions" provisions to them on the ground that would require them to breach client confidentiality. Accordingly the rules with respect to reporting suspicious transactions and large cash transactions, and implementing a compliance regime do not apply to lawyers in Canada until the constitutional issue has been resolved by the Supreme Court of Canada.

Cross-border reporting regulations made under the *Money Laundering Act* require persons to report the importation or exportation of amounts over $10,000 of currency or monetary instruments in bearer form, whether carried across the border, or imported or exported by mail, courier or by any other means. There is no requirement to report bank drafts or cheques or other negotiable instruments made payable to a named person, and which have not been endorsed.

In 2002 the Canadian Payments Association changed its payment procedures with the effect that all payments of $25 million or more must be made by electronic wire transfer; they cannot, for example, be made by certified cheque. From a practical perspective, it often takes certified cheques issued by Canadian financial institutions weeks to clear, making wire transfers the clear choice for payment procedures.

Proposed Amendments

On June 27 and 30, 2007, the federal government published new draft regulations under the *Money Laundering Act* that are currently scheduled to come into effect on June 23, 2008. In December 2006, Parliament passed *An Act to Amend the Proceeds of Crime (Money Laundering) and Terrorist Financing Act ("Bill C-25")*. Bill C-25 has not been proclaimed in force as yet. The amendments, when proclaimed in force, will extend the application of the *Money Laundering Act* to three new groups: lawyers, dealers in precious metals and stones and British Columbia notaries. In addition, the amendments will create a framework for administrative monetary penalties that may be imposed by FinTRAC without having to refer the matter to law enforcement for prosecution. Maximum financial penalties for prescribed serious breaches are $100,000 per person and $500,000 per entity.

Reporting entities will have to put in place written policies and procedures to (i) assess the risk of its business activities being used for money laundering or terrorist financing activities, (ii) identify and monitor high-risk clients or activities and (iii) mitigate identified risks.

Special due diligence requirements will apply to politically exposed foreign persons ("PEFPs"). PEFPs are foreign (non-Canadian) heads of government, members of legislature, heads of political parties, ambassadors, senior military officers, heads of state-owned companies and members of the judiciary, in each case together with prescribed family members.

There are enhanced rules relating to obtaining significant information regarding the counterparty to a correspondent banking relationship before it is entered into by a Canadian deposit-taking financial institution and a prohibition on entering into correspondent banking relationships with any shell bank (one that has no physical presence in any country, unless it is controlled by a deposit-taking institution or foreign financial institution that does have a physical presence in Canada).

The amendments will require reporting entities to report both in respect of suspicious transactions that have occurred and on attempted suspicious transactions.

The amendments establish a registration regime for entities entitled to issue or redeem traveller's cheques or other bearer financial instruments.

Lawyers and accountants will be obligated to keep records for transactions with clients involving $3,000 or more. Currently, FinTRAC remains subject to a court injunction that prevents the federal government from unilaterally imposing regulations on lawyers. The issue for lawyers is the right of FinTRAC to audit client records and possibly violate the solicitor-client privilege. Negotiations between the government and the Federation of Law Societies are ongoing.

15. WHAT LAWS GOVERN THE ACQUISITION, USE AND DEVELOPMENT OF REAL ESTATE IN ONTARIO?

WHAT RULES APPLY TO THE PURCHASE AND SALE OF REAL PROPERTY?

In most provinces, a non-resident has the right to purchase, hold and sell real property. Generally, for a corporation to purchase, hold and sell real property in a province other than the one in which the corporation is incorporated, it must apply for and hold a valid extra-provincial licence.

Ontario's *Land Transfer Tax Act* provides that upon a change in the underlying (registered or beneficial) ownership of any real property located in Ontario, the party acquiring the interest must pay land transfer tax. The applicable rates are summarized below.

In addition, section 116 of the federal *Income Tax Act* requires a non-resident person who disposes of taxable Canadian property other than excluded property, whether or not the gain is exempt from Canadian tax under a tax treaty, to obtain a clearance certificate from Canada Revenue Agency ("CRA"). The following comments apply, not only to the sale of interests in real property, but also to the disposition by a non-resident of any other taxable property in Canada, such as an interest in a business in Canada.

In general terms, the non-resident vendor must send a notice to the CRA on a prescribed CRA form regarding the sale before or within 10 days after the disposition. The notice must set out certain prescribed information. In general, where the capital gain or income arising from the sale is not exempt from tax under a tax treaty, the non-resident vendor will have to pay to the CRA an amount equal to 25% of the estimated capital gain, and the applicable tax in respect of the estimated income to be realized by the vendor, before the CRA will issue a clearance certificate. Where a capital gain or income is exempt from tax under a tax treaty, the CRA will generally issue a clearance certificate to the non-resident without the prepayment of tax. However, the CRA may request certain documents from the non-resident to ascertain the applicability of the treaty exemption before issuing the clearance certificate.

Pursuant to section 116 of the *Tax Act*, a non-resident vendor is required to obtain a clearance certificate from the CRA for the sale of real property situated in Canada, shares of a private corporation resident in Canada and personal property used in a Canadian business such as depreciable property (e.g., production machinery, office furniture, motor vehicles and intellectual property), eligible capital property (e.g., goodwill, customer lists), contracts for the future supply of a good or service, and an option or interest in respect of the foregoing types of assets. It is important to note that a non-resident vendor is not required to obtain a clearance certificate for the sale of inventory other than real property.

The clearance certificate specifies a certificate limit of the amount of the estimated proceeds of sale.

If a non-resident vendor does not provide a purchaser with a clearance certificate on closing or by the 30th day of the month following the month of the closing, the purchaser is liable to pay to the CRA, on behalf of the non-resident vendor, an amount equal to 25% of the purchase price of capital property and 50% of the purchase price of depreciable property acquired from the non-resident vendor.

When the non-resident vendor files a federal income tax return, any payment remitted to the CRA under section 116 of the *Tax Act* is credited or refunded, as applicable, to the non-resident vendor's Part 1 tax liability.

Accordingly, where a non-resident vendor does not provide the purchaser with a clearance certificate on closing, the purchaser generally withholds such amounts from the purchase price.

WHAT RULES APPLY TO THE USE AND DEVELOPMENT OF REAL PROPERTY IN ONTARIO?

Ontario's *Planning Act* regulates the use and development of land in Ontario. Zoning regulations and subdivision control affect the manner in which property may be developed. Although the Minister of Municipal Affairs and Housing has supervisory powers under the *Planning Act*, many of the functions are delegated to local municipalities. Each local municipality has an official plan that sets out in broad terms the use to which lands within the municipality may be put. Zoning by-laws govern such matters as building coverage and lot-line set-backs as well as permitted uses.

WHAT RULES APPLY TO RESIDENTIAL RENTAL PROPERTIES IN ONTARIO?

In Ontario, the *Tenant Protection Act* governs residential tenancy landlord and tenant obligations. The first rent charged to a new residential tenant by a landlord is not subject to control, although all the increases thereafter, as long as the same tenant is in possession of the property or unit, are subject to rent controls. However, landlords and tenants can negotiate increases above the rent control guideline if the landlord incurs certain capital expenditures or provides additional services. In the absence of a negotiated agreement, a landlord may apply to the Ontario Rental Housing Tribunal for rent increases above the guideline.

WHAT ENVIRONMENTAL STANDARDS APPLY IN CANADA?

Legislation concerning the environment is generally within the jurisdiction of the provinces, although the federal government has also legislated in this area, particularly on issues involving matters of national environmental significance, some of which are restricted in application to federal lands (*Canadian Environmental Protection Act, Canadian Environmental Assessment Act, Fisheries Act, Canada Shipping Act, Navigable Waters Protection Act, Species at Risk Act and the Pest Control Products Act*). Responsibility for clean-up costs may be imposed on any person who has, or had in the past, the management or control of the contaminant. Environmental laws have focused on identifiable current practices or accidental events that contaminate the natural environment or property. Ontario environmental laws are no more stringent than those in effect in the United States. Environmental due diligence (Phase 1 and Phase 2 assessments) for both purchasers and lenders is usual practice throughout Canada.

In Ontario, the principal legislation is the *Environmental Protection Act*. In 2001, it was amended by the *Brownfields Statute Law Amendment Act*, which established an Environmental Site Registry of contaminated properties. The amendments provided exemptions from liability to secured parties (and receivers appointed by them or trustees in bankruptcy appointed by the courts) who make loans to owners of contaminated properties in respect of such matters as actions taken by them (i) to investigate the property, (ii) relating to the supply of water, security, insurance and payment of taxes to preserve or protect their interests in the property, (iii) relating to the safety of persons and (iv) to mitigate impairment to the natural environment. The brownfield amendments have facilitated the redevelopment of many industrial sites throughout the province since it came into force.

IS RETAIL SHOPPING ON SUNDAYS PERMITTED?

The right of retailers to remain open for business on Sundays is under provincial jurisdiction. Rules vary by province, but generally, only limited retail shopping is permitted in Canada on

Sundays. A notable exception is Ontario, which permits province-wide Sunday shopping, but no shopping on provincial holidays such as Christmas, New Year's Day, Thanksgiving or any of the other five annual statutory holidays. Shopping is allowed on Boxing Day, the first business day following Christmas, although employees cannot be compelled to work on that day.

16. OTHER FACTORS INFLUENCING INVESTMENT IN CANADA

DOES CANADA HAVE SPECIFIC LEGISLATION GOVERNING SALES IN BULK?

Only Ontario and Newfoundland have bulk sales legislation obliging those selling and buying goods outside the ordinary course of business to provide public notice of the sale. This notice must show that all of the seller's trade creditors have been paid, or arrangements for payment of such creditors have been made, or a court order exempting the transaction has been obtained. New Brunswick repealed the bulk sales legislation effective August 1, 2004.

WHAT ARE THE TIME LIMITS DURING WHICH ACTIONS MUST BE INITIATED BEFORE THE COURTS IN ONTARIO?

On January 1, 2004, Ontario's *Limitations Act, 2002* came into force. The Act limits the period of time during which a person may initiate court proceedings in Ontario in respect of a claim. For purposes of the Act, a "claim" is one to remedy an injury, loss or damage from an act or omission. The Act was amended in 2006 to permit parties to a business agreement entered into at any time on or after October 19, 2006 to vary, that is, extend, shorten or suspend the application of the basic limitation period fixed by the Act.

A business agreement is one in which neither party is a consumer as defined in the *Consumer Protection Act* (Ontario).

In addition, the ultimate 15-year limitation period (see below) may be suspended or extended, provided the claim in question has been discovered at the time the agreement to suspend or extend is made. Parties to a business agreement cannot vary the ultimate limitation period before any claim is known to exist. For example, it is not possible to provide in an Ontario contract that one party will have the right to make an indemnity at any time in the future, without limitation.

The following is a brief description of an area of the law. If you have any questions, please call us.

The Two-Year Basic Limitation Period

The new basic limitation period (the time during which an action may be commenced in Ontario) is two years from the earlier of the day on which the essential elements (act or omission by a known person resulting in damages to the claimant) of the claim are known to the claimant and the day on which they are discoverable. There is a rebuttable presumption that a claimant discovered all the essential elements of the claim on the day on which the act or omission giving rise to the subject loss or damage occurred (see below). The foregoing represents a codification of the existing common law rules.

There are a number of exceptions to the basic two-year rule. Where the two-year rule applies, it represents a significant reduction from the general six-year limitation period for contract and tort claims in effect in Ontario until December 31, 2003, and it represents an increase in certain other limitation periods. For example, the period during which a claim for unpaid wages may be prosecuted against corporate directors will increase from six months to two years. However, it does mean that a number of limitation periods of varying lengths have been eliminated. There are circumstances where the running of a limitation period will be suspended (see below).

The 15-Year Ultimate Limitation Period

In addition to the basic limitation period, there is an ultimate limitation period of 15 years from the day on which the act or omission takes place, regardless of whether the essential elements of the claim become known to the claimant or were discoverable during the 15-year period and whether any other limitation period has not run. The only exceptions to this rule are (i) where the parties to a business agreement become aware of a claim and thereafter agree to suspend the operation of the ultimate limitation period; and (ii) where the claim in question is for conversion against a *bona fide* purchaser of personal property, in which case, the ultimate limitation period is fixed at two years from the date of the sale of the property to the purchaser.

Certain Claims Subject to No Limitation Periods

There are claims that are not subject to any limitation period, for example, a proceeding:

i. for a declaration where no consequential relief is sought;
ii. to enforce an order;
iii. to obtain support under the *Family Law Act*;
iv. to enforce an award under the *Arbitration Act, 1991*;
v. by a debtor in possession of collateral to redeem it;
vi. by a creditor in possession of collateral to realize against it;
vii. by the Crown to recover fines, taxes, penalties and interest;
viii. to recover student loans, awards, social assistance recoveries and grants; and
ix. for an environmental claim that has not been discovered.

Certain Existing Statutory Limitation Periods Unchanged

There is a lengthy list of specific statutory limitation period provisions, referenced in a schedule to the Act, that will be left unchanged. The list includes provisions under the following Ontario statutes involving court applications:

- *Bulk Sales Act* (six-month limitation period for setting aside sales retained),
- *Business Practices Act* (period for rescission of a consumer contract remains at six months),
- *Construction Lien Act* (45-day limitation period and sheltering concepts retained),
- *Insurance Act* (one-year period retained),
- *Libel and Slander Act* (three-month limitation period retained),
- *Mortgages Act* (a proceeding to recover under a building mortgage still must be commenced within one year of the mortgage's maturity date),
- *Reciprocal Enforcement of Judgments Act* (six-year limitation period following original judgment retained),
- *Remedies for Organized Crime and Other Unlawful Activities Act, 2001* (15-year limitation period retained),
- *Securities Act* (90-day rescission period under section 135 and the 180-day/three-year limitation period under section 138 retained),
- *Trustee Act* (action under section 38 still may not be brought after two years from the date of the death of the deceased),
- *Judicial Review Procedure Act* (proceedings and appeals unaffected),
- *Provincial Offences Act* (proceedings unaffected),
- *Constitution Act, 1982* (aboriginal claims against the Crown continue to be governed by section 35), and
- Part 1 of the Act, to be renamed as the *Real Property Limitations Act"* (real estate limitation periods as at January 2004 unchanged).

Statutory Notice Periods Unaffected

Do not confuse the two-year basic limitation period during which a claimant can prosecute a claim in the courts with an obligation imposed by statute that a claimant in a specified period of time give a written notice of claim (e.g., to a governmental body or insurer) as a pre-condition to a claim. The Act has not changed any notice provisions in any Ontario statutes.

No Exception for Equitable Remedies

Actions for equitable remedies such as detrimental reliance and unjust enrichment are subject to the new rules.

Transition Rules

The following are the transition rules from the old regime to the new one:

- Where no proceeding in respect of a claim has been commenced before January 1, 2004 based on acts or omissions that occurred prior to that time, if the prior limitation period has expired, no proceeding may be commenced after January 1, 2004.
- Where the prior limitation period has not expired, and if the Act provides for a limitation period for claims of the nature in question and if the claim has not been discovered by the claimant, then the said causal act or omission will be deemed to have occurred on January 1, 2004. If the claim has been discovered by the claimant, then the former limitation period applies. This latter rule means that many long-term contracts such as insurance policies (and, in particular, disability insurance policies) existing as at December 31, 2003 will continue to be governed by the old rules well past a time when these rules are likely to be widely understood. There are traps for the unwary in any change of the law.
- Where no applicable prior limitation period exists, but the Act provides for a limitation period for claims of the nature in question and if the claim has not been discovered by the claimant, then the causal act or omission will be deemed to have occurred on January 1, 2004. If the claim has been discovered by the claimant, then no limitation period applies to the claim.

There are special general and transition rules under the Act for claims based on an assault or a sexual assault.

The Meaning of Discoverable

A claim is discoverable on the earlier of the day on which:

- The person with the claim first knew each of the following: (i) that the injury, loss or damage had occurred, (ii) that the injury, loss or damage was caused by an act or omission by the person against whom the claim is made, and (iii) that a proceeding would be an appropriate means to seek a remedy. Unless the claimant can prove otherwise, the claimant is presumed to know all of the foregoing on the day on which the act or omission took place; *and*
- A reasonable person with the abilities of the claimant and in the circumstances of the claimant first ought to have known each of the elements of the claim set out above.

Running of Limitation Periods Suspended in Certain Circumstances

The running of the basic limitation period is suspended for minors or incapable persons unless and until a litigation guardian has been appointed for such person. Everyone is presumed to be capable of initiating a proceeding unless the contrary is proven. A claimant may apply to

the courts for the appointment of a litigation guardian for a potential defendant and may give a written notice of claim to a potential defendant containing statements regarding each of the elements of the claim. The notice of claim can be considered by a court in determining when the defendant discovered the claim in question.

The running of both the basic and the ultimate limitation periods is suspended where the claimant and the prospective defendant have agreed to engage an independent third party to resolve the claim or assist in its resolution until the earlier of the date on which the claim is resolved, the date on which the attempted resolution terminates, and the date on which one of the parties withdraws from the agreement.

Contracting Out of the Act

A limitation period fixed by the Act cannot be varied or excluded by agreement, except for that applicable to matters arising under a business agreement as set out in the October 2006 amendment to the Act and described above. The prohibition, in any event, does not affect any contract entered into before January 1, 2004. One important effect of section 22 of the Act is that the practice in Ontario of litigants entering into an agreement to suspend the running of a limitation period for extended or indefinite periods (commonly referred to as a tolling agreement) was prohibited from and after January 1, 2004. This requires the parties to the dispute (other than those in a business agreement, as discussed above) to either litigate the matter or engage an independent third party to resolve the matter. This represents a significant change to the manner in which litigation is practiced in Ontario. The other possible effects of section 22 of the Act will not become clear until the courts have had an opportunity to consider the extent to which this provision of the Act will constrain the freedom of parties to enter into contracts that address their particular requirements.

Debt Obligations that Are Due on Demand

Hare v. Hare, a December 2006 decision of the Ontario Court of Appeal, has important implications for the use of demand promissory notes generally and, in particular in tax planning. Legal and tax planners should be aware that standard drafting language used in promissory notes may bring about unintended consequences.

In *Hare*, the taxpayer loaned a sum of money to her son and secured the loan with a promissory note. Although some interest payments were made under the note, the son did not respond to a demand for payment of the loan and the taxpayer brought an action for recovery.

At trial and on appeal, the defendant claimed the action was barred because it was made after the statutory limitation period had expired. The issue was whether the two-year basic limitation period under the Act had started to run at the time the note was issued, or on the demand for payment under the note. If the former, the action was statute-barred; if the latter, the action could proceed.

The Act provides that the two-year limitation period begins to run on the discovery of the claim. The Court of Appeal emphasized that the law that a creditor has the right to immediate repayment of a demand loan is well-settled. As the creditor under a demand note has the right to immediate payment, there is nothing to be discovered by the creditor before he or she becomes aware of their claim, which is established immediately on receipt of the demand promissory note. The Court of Appeal, therefore, found that the discovery of the claim occurred at the time the note was issued, as the creditor was in a position to enforce the note as of that date. The action was, therefore, statute-barred because it was commenced more than two years after discovery of the claim.

Payments and Acknowledgements

The practical outcome of the decision is that the limitation period for ordinary demand promissory notes will start to run on the execution and delivery of the promissory note by the debtor. Under the Act, each payment of interest or principal, if made within two years of the later of (i) the date the note is made; and (ii) the last such payment, will restart the limitation period. Similarly, a written acknowledgement of the debtor made within the basic limitation period will restart the limitation period under the Act.

If the said two-year limitation period expires before demand is made and a statement of claim issued by the holder, the holder is prevented by law from enforcing a claim against the debtor by court proceedings. Although this may not necessarily invalidate the promissory note as an obligation per se, for all practical purposes the note then has no value. It is commonplace to use demand promissory notes in many situations, and the expiration of collection rights under such notes two years after the later of the date the note is made and the date of the last payment would have grave consequences.

Therefore, as a result of this decision, it would be prudent to add language to demand promissory notes used for business purposes to the effect that:

- The promissory note is made for business purposes and is a business agreement as defined in the Act; and
- No limitation periods found in the Act, other than the ultimate limitation period found in section 15 of that Act, shall apply to the promissory note and to the obligations imposed by the note.

17. DISCLAIMER

This publication is intended to provide only a summary of the general commercial laws that apply in Canada, and focuses on the province of Ontario. The summary should not be relied on without consulting counsel.

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