

Co-Counsel

McCarthy Tétrault Co-Counsel:
Business Law Quarterly

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Welcome to this year's final issue of the *Business Law Quarterly*. In this issue, you will find articles on new developments in the areas of securities, business corporations legislation, M&A, and competition law, among others.

In securities, the Canadian Securities Administrators (CSA) have put forth a number of proposed amendments to securities legislation in anticipation of the transition to [International Financial Reporting Standards](#). As proxy season approaches, you may find interesting the CSA's recent review of [continuous disclosure practices and compliance with certification rules](#). And since our last issue, there have been further developments in the move toward the creation of a [single Canadian securities regulator](#). We also report on the shelving of the CSA's proposed principles-based amendments to the [corporate governance regime](#); these were put forth for comment almost a year ago.

There have also been changes to business corporations legislation: in Québec, substantial reforms to the *Companies Act* were introduced in the National Assembly this fall. We [report](#) on the implications of these changes and the differences between the proposed legislation and the *Canada Business Corporations Act*. Meanwhile, in British Columbia, the *British Columbia Business Corporations Act*, which came into effect in 2004, has brought with it several good reasons to look at incorporating your company in this province. We [share](#) some with you here.

There are also a number of developments in M&A, despite this year's decline in M&A activity. We provide a further update on the recent decision of the Ontario Securities Commission (OSC) to [refuse to cease trade a poison pill](#). We report on [changes to the Toronto Stock Exchange rules](#) requiring TSX-listed companies to obtain shareholder approval of certain public company acquisitions; these rules followed on the heels of the OSC's decision in *HudBay*. We also [update you on two decisions](#) that differed from *HudBay*, and discuss the use of private placements in the context of significant corporate transactions and on the appropriate standard of review of TSX decisions.

Our competition law update includes a discussion of [closing transactions under the Competition Act](#) since the recent overhaul of the merger review process. As well, we report on [recent developments in competition class actions](#).

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We hope you enjoy this issue of the *Business Law Quarterly* – as always, we welcome your questions and comments. If you wish to subscribe to *McCarthy Tétrault Co-Counsel: Business Law Quarterly*, simply [contact](#) us to have your name added to our mailing list.

We wish you all the best for 2010.

Yours truly,

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November 2009

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Securities

REGULATION

Additional Steps in Move to Canadian Securities Regulator

In mid-October 2009, the federal government took additional steps to advance its objective to establish a Canadian securities regulator.

As we reported in our [August 2009 issue](#), the federal government is pressing ahead with its plans to establish a single Canadian federal securities regulator pursuant to the recommendation of the Expert Panel on Securities Regulation in Canada in its final report, published on January 12, 2009.

On October 15, 2009, the federal Minister of Finance announced the appointment of the members of the Advisory Committee of Participating Provinces and Territories to the Canadian Securities Transition Office. Members of the Advisory Committee have been nominated by the three territories and seven of the 10 provinces — missing are Québec, Manitoba and Alberta, which oppose the establishment of a Canadian securities commission.

The Advisory Committee will provide advice to the Transition Office on the transition to a Canadian securities regulator, helping to ensure that the interests of each of the participating governments are represented.

On October 16, 2009, one day after the appointment of the Advisory Committee, the

federal Minister of Justice and Attorney General of Canada announced that the Government of Canada will seek the opinion of the Supreme Court of Canada as to whether Parliament has the constitutional authority to enact and implement a federal securities regulatory regime. As part of this constitutional reference, the federal government will submit to the Supreme Court of Canada draft legislation, which is expected to be ready in spring 2010.

As we previously reported, the government of the Province of Québec announced on July 7, 2009 that it would launch a constitutional reference in the Québec Court of Appeal for an opinion with respect to the decision of the federal government to proceed with the creation of a federal securities regulator. With the October announcement of the constitutional reference to the Supreme Court of Canada, the federal government has sought to seize the initiative and move directly to the country's highest court for a determinative answer on the issue.

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MINING

BCSC Facilitates Fast-Track Mining Financings: Pre-Filing Review of Mining Technical Disclosure

The British Columbia Securities Commission (BCSC) has [announced](#) steps, effective September 1, 2009, to speed up the review process for mining issuers that intend to make a short form prospectus offering under the provisions of National Instrument 44-101 *Short Form Prospectus Distributions*. Mining issuers for which the BCSC is the principal regulator can now request that staff in the BCSC Corporate Finance Division review the issuer's technical disclosure, filed on SEDAR, for compliance with National Instrument 43-101 *Standards of Disclosure for Mineral Projects*. BCSC staff will identify any potential issues that may delay either the issue of a final receipt for the short form prospectus or the communication of confirmation that they have no comments with regards to the proposed offering.

The review process will involve, at minimum, the examination of the issuer's core disclosure documents, such as the latest annual information form, the most recent technical reports for the issuer's material properties, and all news releases and material change reports since the latest annual information form. In order to take advantage of this opportunity to accelerate the prospectus qualification, issuers will need to submit written notice requesting the pre-filing review to review.request@bcsc.bc.ca at least 10 days in advance of the planned filing of the issuer's preliminary short form prospectus. Notices sent to the BCSC should contain the name of the

issuer, the name and contact details of the person making the application on behalf of the issuer, a list of the issuer's material properties, and the target date for filing of the short form prospectus.

McCarthy Tétrault Notes:

While issuers should submit a review request notice early enough to ensure they receive an answer from the BCSC before the planned filing date, obtaining a review too far in advance of a planned offering may reduce the comfort level an issuer can take from the BCSC's review because material changes may occur between the date of receipt of the BCSC's review and the date of filing of the preliminary short form prospectus.

There is no cost for use of the pre-filing review service, and both the review request notice and the results of the review process itself are confidential – meaning that the use of the pre-filing review process will not act as a signal to the market that the issuer is planning to undertake a financing.

Advantages of the new pre-filing review process for mining issuers include:

- (a) increased speed of the overall prospectus review process;
- (b) avoiding delays in the marketing of the offering; and

(c) reduced uncertainty of regulatory approval.

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STRUCTURED PRODUCTS

OSC Targets Derivatives

On October 30, 2009, the staff of the Ontario Securities Commission issued Staff Notice 91-702 *Offerings of Contracts for Difference and Foreign Exchange Contracts to Investors in Ontario*.

The Notice outlines the OSC staff's view of the securities law and other regulatory requirements applicable to offerings of contracts for difference (CFDs), foreign exchange contracts (forex or FX contracts), and similar over-the-counter derivative products (OTC derivatives) to investors in Ontario.

A CFD is a derivative product that allows an investor to obtain economic exposure (for speculative, investment or hedging purposes) to an underlying asset, such as a share, index, market sector, currency or commodity, without acquiring ownership of the underlying asset. A CFD is simply an agreement between two parties – the investor and the CFD provider – to pay each other the change in the price of an underlying asset. Depending on which way the price moves, one party pays the other the difference from the time the contract was agreed to the point where it ends. CFDs are generally cash-settled, although in some cases investors may also have the option of requesting physical delivery of the underlying asset.

CFDs are currently being offered to investors in a number of foreign jurisdictions. In Canada, CFDs are also being offered to investors, including retail investors, through Internet platforms being operated by CFD providers.

The OSC staff have concluded that CFDs, forex contracts, and OTC derivatives, when offered to investors in Ontario, constitute “investment contracts” and “securities” for the purposes of Ontario securities law, and have expressed significant concerns for retail investor protection. As a result, the OSC staff are of the view that, unless statutory exemptions are available or exemptive relief is granted, these products are subject to Ontario securities law, including the registration and prospectus requirements.

The Notice is intended to provide interim guidance pending the development by the Canadian Securities Administrators (CSA) of a harmonized CSA approach to the regulation of OTC derivatives and/or the introduction of new or revised derivatives legislation in Ontario. It was indicated that CSA staff are closely reviewing a number of developments in this area, including the recent adoption of a new *Derivatives Act* in Québec, which was discussed in an [article in our November 2008 issue](#).

In the Notice, the OSC staff acknowledged that “the prospectus requirement may not be well-suited to offerings of certain types of OTC derivative products, including CFDs and forex contracts, to [retail] investors,” and that “modified requirements, focused on ensuring appropriate transparency as to the nature of the product and investor risk, imposed as terms and conditions of an exemptive relief order exempting an issuer from the prospectus requirement, may be better suited for these products.” The OSC staff indicated that they would consider exemption applications on a case-by-case basis, so long as adequate safeguards and

disclosure are provided that address the significant investor protection concerns raised by the offering of CFDs to retail investors.

Shortly before the issuance of the Notice, the OSC published an order of the Commission on October 19, 2009 granting relief to CMC Markets UK plc (CMC UK) and CMC Markets Canada Inc. (CMC Canada) exempting them from the prospectus requirement in respect of the distribution of CFDs and forex contracts to investors resident in Ontario, subject to conditions including:

- the continued registration of CMC UK with the Financial Services Authority in the United Kingdom;
- the continued registration of CMC Canada as an investment dealer in Ontario and a member of the Investment Industry Regulatory Organization of Canada (IIROC);
- that all distributions of CFDs by CMC Canada to clients in Ontario be conducted in accordance with IIROC Rules and IIROC acceptable practices applicable to offerings of CFDs;
- that prior to a client’s first CFD trade, CMC UK and CMC Canada have provided to the client the risk disclosure document and have delivered, or previously delivered, a copy of the risk disclosure document to the OSC;
- that prior to the client’s first CFD trade and as part of the account opening process, CMC UK and CMC Canada have obtained a written or electronic acknowledgement from the

client confirming that the client has received, read and understood the risk disclosure document; and

- that the exemptive relief so granted shall immediately expire upon the earliest of:
 - (i) four years from the date that the order is issued;
 - (ii) the issuance of an order or decision by a court, the FSA, the AMF or other similar regulatory body that suspends or terminates the ability of CMC UK to offer CFDs to clients in the UK or the ability of CMC UK or CMC Canada to offer CFDs to clients in Québec; and
 - (iii) the coming into force in Ontario of legislation or a rule regarding the distribution of OTC derivatives to investors in Ontario.

McCarthy Tétrault Notes:

It is apparent, in view of the terms of the recent exemptive relief order of the OSC and the OSC Staff Notice, that the day is coming for the introduction of specific legislation or rules in respect of the distribution of CFDs, forex contracts and other OTC derivatives to retail investors in Ontario. It remains to be seen if such legislation or rules will be patterned on the Québec *Derivatives Act* or will be part of a broader CSA initiative. It is hoped that the Government of Ontario will recognize the need for, and be receptive to, such legislation or rules, if, as and when they

are submitted for approval – in contrast to the return by the Minister of Finance to the OSC in November 2000 of a proposed Rule 91-504 *Over-the-Counter Derivatives* and the related companion policy for further consideration of the need and a more detailed review of the disclosure issues at that time.

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Public Company Disclosure & Corporate Governance

CONTINUOUS DISCLOSURE

Recent CSA Reviews of Continuous Disclosure and Certification: A Reminder to Issuers to Ensure Compliance with Requirements

The Canadian Securities Administrators (CSA) have recently released, under separate notices, the results of their first certification compliance review and their annual continuous disclosure (CD) review program for the fiscal year ended March 31, 2009.

In CSA Staff Notice 52-325 *Certification Compliance Review*, the CSA summarized the results of its review of compliance with the requirements in National Instrument 52-109 *Certification of Disclosure in Issuers' Annual and Interim Filings* that came into force on December 15, 2008 (see our [September 2008 Legal Update](#) discussing this instrument). The CSA said the purpose of National Instrument 52-109 is to improve the quality and reliability of reporting issuers' annual and interim disclosure, which, in turn, is intended to help maintain and enhance investors' confidence in the integrity of Canadian capital markets.

For its review of certification compliance, the CSA selected a sample of 198 non-venture issuers and 53 venture issuers with a December 31, 2008 year-end. Thirty-eight per cent of the sample

appeared to substantively comply with the requirements of National Instrument 52-109 such that no action was required. Of the 62 per cent that were in some way non-compliant, almost half of those were so deficient that the issuers were required to re-file their annual management discussion and analysis (MD&A) and/or certificates of disclosure. The other half of the non-compliant issuer group was required to make prospective changes in future filings. Additional details about the review can be obtained by reading [CSA Staff Notice 52-325](#).

In CSA Staff Notice 51-329 *Continuous Disclosure Review Program Activities for the Fiscal Year Ended March 31, 2009*, the CSA summarized the results of its CD review program of reporting issuers, other than investment funds, for that fiscal year. The CSA has conducted an annual review of various CD requirements for the past several years. While the number of full reviews conducted in fiscal 2009 was consistent with the previous year, the number of issue-oriented reviews increased by 53 per cent. This increase is a result of the CSA's increased scrutiny of the quality of the issuers' disclosure in the last half of the fiscal year, in response to the credit crisis and market turmoil. As we [previously reported](#) in our February 2009 issue, the CSA had indicated that they would undertake increased scrutiny of certain areas of continuous disclosure in the challenging economic environment.

The CSA listed common deficiencies identified in full reviews under the categories of MD&A, financial statements, and other CD documents. Deficiencies included:

- in MD&A, repeating information from financial statements without providing sufficient analysis and absence of any or sufficient discussion about the risks and uncertainties expected to affect an issuer's future performance, given current economic conditions;
- in financial statements, failing to appropriately measure financial instruments in accordance with accounting standards (such as fair value) and failing to disclose the credit, liquidity and market risks associated with financial instruments, as well as the methodology and assumptions used to determine fair value; and
- in other CD documents, failing to provide disclosure required in National Instrument 52-110 *Audit Committees* and in National Instrument 58-101 *Disclosure of Corporate Governance Practices*, and failing to file mining and oil and gas technical reports in accordance with National Instrument 43-101 *Standards of Disclosure for Mineral Projects* and with National Instrument 51-101 *Standards of Disclosure for Oil and Gas Activities*.

This year's issue-oriented reviews were conducted in the following areas: market turmoil and credit crisis, asset-backed commercial paper, defined-benefit pension plan disclosure, financial instruments, forward-looking information,

inventory, material contracts, mining technical disclosure, and oil and gas technical disclosure. Deficiencies under these categories are discussed in [CSA Staff Notice 51-329](#).

Together, these CSA reviews are a useful reminder to reporting issuers to ensure that they are not making the same errors and to assist them in avoiding such shortcomings. Several areas of focus for fiscal 2010 are also noted in CSA Staff Notice 51-329, and should be borne in mind by issuers. These include valuation of goodwill, intangibles and asset impairments, going-concern issues, disclosures of IFRS changeover plans in the MD&A, and disclosure relating to executive compensation.

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CORPORATE GOVERNANCE

CSA Shelves Proposed Changes to the Corporate Governance Regime

On Friday, November 13, 2009, the Canadian Securities Administrators (CSA) announced that they are shelving the proposed changes to the Canadian corporate governance regime that had been published for comment on December 19, 2008.

The proposed changes, which were discussed in our [February 2009 issue](#), would have moved the Canadian corporate governance regime from a rules-dominated approach to a more principles-oriented approach in three main areas:

- National Policy 58-201 *Corporate Governance Principles*
- National Instrument 58-101 *Disclosure of Corporate Governance Practices*
- National Instrument 52-110 *Audit Committees*

The CSA received many comments that were critical of the timing of the proposed changes, pointing out the current focus of issuers on business sustainability issues in a challenging economic climate and on the transition to International Financial Reporting Standards.

The CSA have indicated that they are heeding the comments and are reconsidering whether to recommend any changes to the corporate governance regime. In addition, the CSA have stated that any further proposed changes will be published for comment and would not be

effective until the 2011 proxy season at the earliest.

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EXECUTIVE COMPENSATION

CCGG Releases Draft Say-on-Pay Policy

On October 22, 2009, the Canadian Coalition for Good Governance (CCGG) released its draft “Model Say-on-Pay Policy for Boards of Directors.” This draft follows and builds upon the CCGG’s “Shareholder Engagement and Say-on-Pay Policy,” which was released in April 2009 (see our discussion of this in our [August 2009 issue](#)). The Model Policy is intended to support the CCGG’s goal of encouraging greater engagement and accountability by boards of public companies in Canada with and to their shareholder-owners.

CCGG

The CCGG is a coalition of 41 of Canada’s leading institutional shareholders, which collectively manage in excess of \$1.4 trillion of assets. Since its founding, the CCGG has been at the forefront of efforts to promote and improve good corporate governance practices in Canadian public companies. During 2009, the CCGG sharpened its focus on ways that institutional shareholders might engage directly with the boards of directors of the companies in which they are invested, as a tool to achieve improved governance of those companies as well as accountability of the members of the boards of those companies to their owners. This approach reflects the recognition that members of the CCGG are long-term investors who cannot choose to sell the shares of Canadian public companies simply because the companies’ governance practices are not acceptable to them.

Public companies in the United Kingdom and Australia have had mandatory say-on-pay advisory votes for some years, and this practice has steadily been gaining attention in Canada. At annual shareholder meetings in the spring of 2009, shareholders of a number of Canada’s largest banks and insurance companies approved shareholder proposals calling for a say-on-pay advisory vote at their next annual meetings; boards of several other large Canadian public companies voluntarily followed suit, with the result that shareholders of at least 13 large Canadian public companies will have say-on-pay votes at their next annual meetings.

In the CCGG’s “Shareholder Engagement and Say-on-Pay Policy,” the CCGG explicitly linked say-on-pay shareholder advisory votes with its objective of encouraging direct engagement between shareholders and the boards of the companies in which they are invested. Say-on-pay votes were presented as an important part of this “engagement process,” giving shareholders an opportunity to express directly to the board their satisfaction with the board’s approach to executive compensation.

Following these developments, in July 2009 the CCGG released a policy on “Board Engagement,” in which it indicated that it would be reaching out to a number of large Canadian public companies to meet with their board and compensation committee chairs. These meetings are intended to establish a dialogue with the companies on their governance practices generally, and their executive compensation strategies in particular.

Model Policy

With its draft Model Policy, the CCGG has completed the evolution of its current approach to shareholder engagement and say-on-pay advisory shareholder votes. While the Model Policy has been released as a policy directed towards say-on-pay advisory shareholder votes, it explicitly recognizes that such votes are part of an “ongoing integrated engagement process between shareholders and boards.” The Model Policy is intended to give investors and boards of public companies in Canada guidance on how an advisory vote by shareholders on executive compensation practices can be part of the shareholder engagement process encouraged by the CCGG.

The CCGG recommends that boards voluntarily adopt the Model Policy, or some substantially similar variant of it, appropriate to their particular circumstances. By adopting the Model Policy, boards would be in effect declaring that they believe regular engagement between shareholders and members of the board — without management’s presence — should occur. This engagement would be intended to provide shareholders with an opportunity to discuss governance issues directly with members of the board. The Model Policy notes that these discussions would be subject to the obligations not to make selective disclosure of material undisclosed information; as a result, they would provide an opportunity for boards to listen directly to their shareholders and to explain to them otherwise publicly available information.

Boards would be expected to develop engagement practices appropriate to the

shareholder base of the company; meeting with large shareholders or their organizations (such as the members of CCGG and the CCGG itself) would be the easiest method, but boards would have to establish methods of engaging with smaller shareholders. The Model Policy notes that boards might consider emerging shareholder engagement practices in the US and Europe, including ‘town hall’ meetings, investor surveys, asking specific questions in the proxy process, undertaking investor surveys and using Web-based tools.

The Model Policy would also require that the executive compensation disclosure contained in the management information circular be a report to shareholders from the compensation committee of the board on behalf of the board; this is not a requirement of the securities regulatory instrument (NI51-102F6). The Model Policy states that the compensation disclosure provided to shareholders should be “complete, clear and understandable,” and that “sufficient detail will be given to shareholders to assist them in forming a reasoned judgment about the company’s approach to compensation.” The committee’s report to shareholders should clearly state the key strategic objectives of the company, and discuss how the compensation policies are designed to motivate management to achieve those objectives in order to enable shareholders to understand the goals the board is trying to achieve with its compensation policies and to understand the rationale for the compensation awards and arrangements — which, in turn, will facilitate shareholder input that may be meaningful and helpful to the board.

While compensation disclosure primarily relates to the most recently completed financial year,

the Model Policy states that this disclosure should also describe the board's approach to compensation in the current year, noting any changes made from the prior year as well as disclosing instances where discretion was exercised by the board in the prior year. Under the Model Policy, executive compensation disclosure would go beyond what is required under the disclosure form prescribed by securities law.

Recommended Form of Advisory Resolution

The CCGG has prepared a recommended form of the say-on-pay shareholder advisory resolution, which has been published as part of the Model Policy. The CCGG recommends that all issuers proposing a say-on-pay advisory resolution to their shareholders use the recommended form of resolution as closely as possible, in order to have consistency among issuers. The recommended form of resolution is:

“Resolved, on an advisory basis and not to diminish the role and responsibilities of the board of directors, that the shareholders accept the approach to executive compensation disclosed in the Company's information circular delivered in advance of the [insert year] annual meeting of shareholders.”

Approval of the resolution would require an affirmative vote of a simple majority of the votes cast at the annual meeting of shareholders.

Results of Advisory Vote

The Model Policy stipulates that the results of the shareholder advisory vote be released as part of the report on vote results for the meeting. As an advisory, non-binding resolution, the results of the vote should be taken into account by the board of the company when considering future compensation policies. The CCGG notes that if a significant number of shareholders oppose the resolution, then the board should consult with shareholders — in particular those who are known to have voted against the policy — to understand their views, and should review the company's approach to compensation in the context of those concerns. Following these further consultations, the board should disclose to shareholders a summary of the comments received from shareholders in the engagement process, as well as any changes to be made to the compensation practices of the company, or why no changes will be made.

Issues Raised by the Model Policy

The Model Policy is a careful and thoughtful advance in the CCGG's thinking; it results from significant input to the CCGG from several large Canadian public companies including, in particular, the largest banks and life insurance companies. While there is significant experience with say-on-pay advisory votes in the UK and Australia, widespread implementation of the Model Policy in Canada would need to reflect the realities of the Canadian capital markets. The CCGG itself alludes to several practical issues that arise under the Model Policy, including the following:

- *Smaller shareholder engagement* – How are boards to engage with small shareholders? Engaging with large institutional shareholders or their organizations would be significantly easier than reaching out to smaller holders.
- *Expectations on directors* – Members of boards of directors would meet shareholders without management present, which would place greater burdens of time and knowledge on directors. While this may be something that should be expected of directors, the reality is that directors would likely need to commit more time to their duties.
- *Expectations on shareholders* – With an additional matter to vote upon, responsible shareholders would need to devote time and attention to understanding the compensation practices of their investee companies. This would be a challenge for many shareholders and may increase the importance of third-party proxy reviews.
- *Avoiding selective disclosure* – Great care would need to be taken by directors engaging with shareholders to ensure that they do not selectively disclose material confidential information in any meetings. Even if such information were not disclosed, shareholders participating in meetings with directors may obtain an informational advantage over other shareholders; ensuring fair disclosure to all shareholders would be an issue.
- *Interpreting the results* – Interpreting the results of a vote would be a challenge, regardless of the results. A majority vote against the resolution would not necessarily

indicate the reasons for the negative vote; a lesser ‘no vote’ would raise other challenges for the compensation committee and board to understand.

Summary

The Model Policy is an important step forward in corporate governance in Canada generally, and continues the tradition established by the CCGG of advancing the views of large institutional shareholders on these matters. Issuers considering adopting either a say-on-pay advisory vote, or the broader shareholder engagement process advocated by the CCGG, would need to consider carefully the practicalities of implementing such policies given their particular circumstances, including their shareholder base. The experience of those large Canadian public companies that are planning say-on-pay advisory votes in the coming months will be instructive for all.

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IFRS

Changeover to IFRS Drives Proposed Changes to Securities Legislation

The Canadian Securities Administrators (CSA) have recently published for comments a series of notices that address proposed changes to securities legislation arising from the upcoming changeover to International Financial Reporting Standards (IFRS). The proposed changes are necessitated by the transition in the *Handbook of the Canadian Institute of Chartered Accountants* (the *CICA Handbook*) from the use of Canadian Generally Accepted Accounting Principles (Canadian GAAP) for public enterprises to IFRS for publicly accountable enterprises – for financial years beginning on or after January 1, 2011, the mandatory effective date.

As reported in our [August 2009 issue](#), it is expected that the *CICA Handbook* will contain two versions of Canadian GAAP for public companies for a period of time, with current Canadian GAAP for public enterprises being the standards constituting Canadian GAAP before the mandatory effective date and IFRS being the standards that will constitute Canadian GAAP for publicly accountable enterprises for financial years beginning on or after the mandatory effective date. Furthermore, the plan is to adopt International Standards on Auditing as Canadian Auditing Standards (CASs); these will be known as Canadian Generally Accepted Auditing Standards in the *CICA Handbook* and will be effective for audits of financial statements for periods ending on or after December 4, 2010.

The main notice of change of securities legislation is the proposed National Instrument 52-107 *Acceptable Accounting Principles and Auditing Standards*, published by the CSA on September 25, 2009. The proposed instrument is intended to facilitate an efficient transition to IFRS and the new CASs for issuers and registrants. The CSA have requested comments on the proposed instrument be submitted by December 24, 2009.

The proposed NI 52-107 will require domestic reporting issuers to do the following for financial years beginning on or after January 1, 2011:

- prepare financial statements in accordance with Canadian GAAP applicable to publicly accountable enterprises, that is IFRS as incorporated into the *CICA Handbook*; and
- report compliance with IFRS.

Domestic reporting issuers who also have securities registered under the US *Securities Exchange Act* of 1934 or are otherwise required to file reports under that Act will continue to have the option to use US GAAP but will no longer be required to reconcile US GAAP to Canadian GAAP. Foreign issuers will continue to have the option of using IFRS, US GAAP or home country GAAP in certain circumstances.

In the proposed instrument, financial reporting terminology will be modified to reflect IFRS terminology in replacement of current Canadian GAAP terms and phrases.

The requirements for acquisition statements under the proposed NI 52-107 were not unanimously supported by the CSA jurisdictions. Except for Ontario, the CSA jurisdictions concluded that, in addition to the other permitted accounting principles, the proposed NI 52-207 should permit acquisition statements to be prepared in accordance with Canadian GAAP applicable to private enterprises subject to certain conditions. Ontario concluded that such an approach is not appropriate and that acquisition statements should continue to be prepared in accordance with accounting standards that are required for public companies.

As a result of the amendments to be effected by proposed NI 52-107 and the changeover to IFRS, amendments have been proposed, or will be proposed, by the CSA to several other instruments and accompanying companion policies reflecting the impact of the transition to IFRS. The following proposed amending instruments have been published in September and October 2009 for comments in the 90-day period post-publication:

National Instrument 14-101 *Definitions*

National Instrument 51-102 *Continuous Disclosure Obligations*

National Instrument 41-101 *General Prospectus Requirements*

National Instrument 44-101 *Short Form Prospectus Distributions*

National Instrument 44-102 *Shelf Distributions*

National Instrument 71-102 *Continuous Disclosure and Other Exemptions Relating to Foreign Issuers*

National Instrument 52-109 *Certification of Disclosure in Issuers' Annual and Interim Filings*

National Instrument 81-106 *Investment Fund Continuous Disclosure*

National Instrument 81-101 *Mutual Fund Prospectus Disclosure*

National Instrument 81-102 *Mutual Funds*

National Instrument 81-104 *Commodity Pools*

National Instrument 41-101 *General Prospectus Requirements relating to Form 41-101F2 Information Required in an Investment Fund Prospectus*

National Instrument 31-103 *Registration Requirements and Exemptions*

National Instrument 45-106 *Prospectus and Registration Exemptions*

The proposed amendments are intended to replace existing Canadian GAAP terminology with IFRS terminology, to change disclosure requirements in instances where IFRS contemplates financial

statements that are different from existing Canadian GAAP, and to provide certain other transitional relief.

It is expected that the CSA will publish for comment IFRS-related proposals to amend the following instruments and policies:

National Instrument 51-101 *Standards of Disclosure for Oil and Gas Activities*

National Instrument 52-110 *Audit Committees*

National Policy 58-201 *Corporate Governance Guidelines*

The CSA has also indicated that it will be publishing a replacement for CSA Staff Notice 52-305 *Non-GAAP Financial Measures* and a revised National Policy 41-201 *Income Trusts and Other Indirect Offerings* on a later date, reflecting the changeover to IFRS.

McCarthy Tétrault Notes:

The proposed amendments have taken considerable effort on the part of the CSA. The transition to IFRS on the part of issuers, registrants and investment funds will require considerable time and expense. Affected entities and their advisors should review carefully the proposed amendments and consider submitting comments within the 90-day period if flaws or problems are detected in the application or operation of the proposed amendments.

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NOT-FOR-PROFIT CORPORATIONS

Modernization of Federal Legislation for Not-for-Profit Corporations Moves Forward

The *Canada Not-for-Profit Corporations Act (CNFPCA)* received Royal Assent on June 23, 2009, but will not be proclaimed in force until such time as regulations and forms for use with it have been developed and settled, likely in 2010. Industry Canada is advising that Proclamation could be anywhere between 12 and 24 months.

The *CNFPCA* will significantly overhaul and modernize the Canadian federal not-for-profit legislation. Once in force, it will replace Part II of the *Canada Corporations Act (CCA)*, which will continue to govern federal not-for-profit corporations until then. The *CCA* has remained largely unaltered since 1917; it has not kept up with modern corporate governance mechanisms and has imposed administrative and financial burdens on organizations incorporated under it.

The federal government expects that the *CNFPCA* will “promote accountability, transparency and good corporate governance for not-for-profit organizations,” and has indicated that the purpose of the *CNFPCA* is to provide a modern governance framework for the volunteer sector and to provide the Canadian public with the means to ensure that monies raised are utilized in an appropriate and responsible manner that will “boost Canadians’ level of trust in not-for-profit corporations.”

The *CNFPCA* is modelled on the corporate governance provisions contained in the *Canada*

Business Corporations Act (CBCA), the statute that governs federally incorporated for-profit business corporations. Once the *CNFPCA* and its proposed regulations come into force, organizations governed by Part II of the *CCA* will have three years to transition under the *CNFPCA* before the Director takes steps (described below) to dissolve them. This is reminiscent of the continuance process in the 1970s, when for-profit corporations had to continue from Part I of the *CCA* under the *CBCA*.

Highlights of the *CNFPCA* include:

- The legislation confirms the role of “Director” under Industry Canada, who will not only act as a public registrar for non-profit corporations, but will also exercise regulatory, administrative and investigatory powers.
- Incorporation under the *CNFPCA* is by way of right and there is no need for Ministerial approval of letters patent as there is under the *CCA*. As long as the statutory requirements for incorporation are followed, incorporation is automatic. Further, documents may be filed electronically. Bylaws need only be submitted within 12 months of incorporation. Industry Canada will no longer approve the bylaws, but will act as a repository for them.
- Under the *CNFPCA*, a non-profit corporation has the capacity and powers of a natural person. As long as its articles of incorporation permit, a non-profit corporation assumes the broader powers of a corporate legal entity. Therefore objects clauses formerly required

in letters patent for non-profit organizations under the *CCA* will no longer be needed.

- The *CNFPCA* sets out procedures for amalgamation, continuance, liquidation and dissolution.
- The *CNFPCA* recognizes two types of not-for-profit corporations, namely soliciting and non-soliciting corporations.

Soliciting corporations will be required to make their financial statements available to the public. Soliciting corporations are non-profit corporations that receive at least \$10,000 of income in the form of donations, gifts and grants in its last three years. Because they are operated for public benefit and must distribute their property to a qualified donee under the *Income Tax Act (Canada)*, e.g., a charity, the requirements respecting soliciting corporations under the *CNFPCA* are more stringent.

There are different and more onerous corporate governance and financial accountability requirements for soliciting corporations than there are for non-soliciting corporations – non-soliciting corporations do not solicit money from the public. For example, non-soliciting corporations may have a minimum of one director on the board, however, soliciting corporations must have at least three directors. Further, there are different financial reporting requirements for soliciting and non-soliciting corporations, depending on their revenue. For example,

soliciting corporations with high revenue must be audited, as must non-soliciting corporations with an annual revenue greater than \$1 million, but soliciting corporations with medium revenue may resolve to have a review engagement instead of an audit.

- Under the *CNFPCA*, members' rights will have to be detailed in the articles of the corporation rather than its bylaws, as has been the case under the *CCA*. Members have rights with regard to voting and attendance at meetings, and can vote by proxy, mailed-in ballots, telephone or electronically. Further, members have rights to utilize the derivative action remedy and the oppression remedy to address a wrong committed against the corporation or a member.
- Directors under the *CNFPCA* have the duty to act honestly and in good faith in the best interests of the non-profit corporation, and to exercise the care, diligence and skill of a reasonably prudent person. This duty and standard of care is akin to that required under the *CBCA*. Under the *CNFPCA*, directors have a "due diligence" defence against liability for negligence.
- It will be possible for members to enter into a unanimous members' agreement and withdraw to themselves some or all of the powers of the board of directors, much like the process of unanimous shareholder agreements under the *CBCA*.

Corporations requiring assistance to continue from Part II of the *CCA* under the *CNFPCA* in the

three-year period after proclamation of the *CNFP* should contact legal counsel for assistance in dealing with the procedures for continuance and in updating their corporate records and practices.

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Mergers & Acquisitions

Private Placements and M&A Transactions: Moving Beyond *Hudbay*

Following the Ontario Securities Commission's (OSC) controversial January 2009 decision in *Re Hudbay Minerals Inc.*, two decisions made by the Alberta Securities Commission (ASC) and the OSC in August 2009 provide additional perspective on the use of private placements in the context of significant corporate transactions, and on the appropriate standard for review of Toronto Stock Exchange (TSX) decisions. Together, these decisions make important distinctions and refinements to the reasoning in *Hudbay*, and will be of interest to public companies and their advisors.

For a discussion of the facts and ruling in the *Hudbay* decision, please see our [Legal Update](#) published May 6, 2009 and the [article](#) in our May 2009 issue.

In *Profound Energy Inc. and Paramount Energy Trust*, the ASC refused to exercise its public interest jurisdiction to prevent privately placed shares issued to the offeror in the context of a friendly take-over bid from being voted in connection with the subsequent going-private transaction. In doing so, the ASC explicitly rejected comments made by the OSC in the *Hudbay* decision that shares acquired in a private placement that is connected to a transaction should not be permitted to be voted in connection with that transaction.

Interestingly, the ASC concluded by remarking that, in view of the issues raised in the *Profound* transaction, a policy review of the appropriate role of private placements of voting securities in the context of M&A transactions may be warranted.

In *InterRent Real Estate Investment Trust*, the OSC determined not to intervene in the decision of the TSX to permit a company to carry out a private placement of units representing 49 per cent of its issued and outstanding units without obtaining unitholder approval. In doing so, the OSC confirmed that a high standard applies for reviewing a TSX decision, suggesting that the more interventionist stance taken by the OSC in its *Hudbay* decision was rooted more in the facts and circumstances of that case than in a broader policy shift.

McCarthy Tétrault Notes:

While the *Profound* and *InterRent* decisions appear to suggest a more permissive trend with respect to private placements made in conjunction with corporate transactions, the focus in each decision on the relevant facts and circumstances suggests that, in the absence of rulemaking in this area, outcomes will continue to be highly contextual.

The *Profound* and *InterRent* decisions clearly indicate that, consistent with well-established standards of review, securities commissions will defer to decisions of the

TSX except in limited circumstances. Interestingly, however, the OSC went on to remark in its *InterRent* decision that it may not have come to the same conclusion as the TSX on the facts of that case. This reinforces the importance of a robust decision-making process by the TSX in assuring that its decisions withstand scrutiny by regulators and provide greater deal certainty for affected parties.

On September 25, 2009, the TSX announced that effective November 24, 2009, listed issuers will be required to obtain security holder approval for public company acquisitions that result in the issuance of 25 per cent or more of their issued and outstanding shares on a non-diluted basis. See the [article](#) discussing this TSX rule change in this issue of the *Business Law Quarterly*. Although this new rule will introduce greater certainty in structuring deals, it does not directly address private placements undertaken in connection with M&A transactions and would not, on its face, have applied to the *Profound* or *InterRent* transactions.

For a more detailed discussion of the background and the decisions in these matters, please see the [full article](#) on our website.

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Private Equity Co-Investor Strategy Trips up JLL Partners' Bid for Patheon

On December 8, 2008, JLL Partners, a US-based private equity group, announced its intention to make a cash take-over bid offer, through a subsidiary, to purchase "any and all" of the restricted voting shares of Patheon Inc. that it did not already own – at a price of US \$2.00 per share. At the time of the announcement, which followed an unprecedented decline in stock market values and continuing volatility, it was not hard to imagine that Patheon would find itself in a bitter fight. Few could have imagined, however, that Patheon shareholders would still, almost one year later, be immersed in the issues that were spawned by this announcement.

Along the road – which has not yet come to an end – Patheon has been the subject of an extraordinary number of legal manoeuvres. To date, these have included a hearing before the Ontario Securities Commission, a proxy battle, an oppression action in the courts, a requisition for a further meeting of shareholders, a court proceeding with respect to that meeting requisition, and multiple court proceedings with respect to the conduct of JLL, Patheon and the directors of Patheon in connection with JLL's bid.

This article focuses on the OSC's reasons for its order and decision with respect to an application by Patheon's Special Committee of Directors for orders based on allegations that JLL had breached securities laws by entering into agreements with a group of Patheon shareholders that had failed to provide identical consideration to all shareholders and had provided collateral benefits to certain shareholders that were not available to other shareholders. The agreements in question were quite likely the product of a relatively common consideration by many private equity investors – the desire or willingness to have certain existing shareholders “roll over,” or maintain, their investment in the target as part of a going-private transaction. In short, the OSC's decision provides a stark example of how *not* to implement a strategy to have co-investors roll over or remain as continuing investors – at least in the context of a take-over bid.

JLL and its affiliates owned 1.8 per cent of the issued and outstanding restricted voting shares of Patheon. In addition, JLL and its affiliates owned certain convertible preferred shares and special voting shares of Patheon, which had been acquired pursuant to a private placement completed in April 2007. On an as-converted basis, JLL's direct and indirect holdings of restricted voting shares, convertible preferred shares and special voting shares represented approximately 30 per cent of the issued and outstanding restricted voting shares. Accordingly, JLL, which also had three representatives on the board of directors of Patheon, was an insider of Patheon.

Approximately 13.7 per cent of the outstanding restricted voting shares of Patheon were owned by Joaquin Viso, Viso's spouse, and certain others (collectively, the Mova Group) who had acquired restricted voting shares of Patheon in connection with the acquisition by Patheon of MOVA Pharmaceuticals Corporation in 2004.

In its take-over bid circular dated March 11, 2009, it was made clear that JLL's offer excluded not only those Patheon shares already held by JLL, but also those held by its affiliates, associates or any person acting jointly or in concert with the offeror within the meaning of the *Canada Business Corporations Act (CBCA)*. The reference to “persons acting jointly or in concert within the meaning of the *CBCA*” was significant in light of the disclosure – also first made on March 11, 2009 – that the Mova Group had entered into a voting agreement one day prior to the publication of JLL's take-over bid circular.

The voting agreement served to protect the position of the Mova Group if it decided not to tender to JLL's offer. The voting agreement would allow the members of the Mova Group to escape having their restricted voting shares acquired in a compulsory acquisition if JLL succeeded in acquiring a sufficient number of restricted voting shares – owned by shareholders other than JLL and the Mova Group – to undertake a compulsory acquisition or other going-private transaction in respect of the restricted voting shares not tendered to the bid and owned by shareholders other than JLL and the Mova Group. Also, members of the Mova Group would have the benefit of a stockholders'

agreement with JLL that would give them a variety of minority shareholder protections from JLL if it remained a shareholder following the proposed JLL transaction. The voting agreement was effectively the mechanism by which the Mova Group secured its rights to be a co-investor — or continuing investor — with JLL after JLL had acquired the balance of the publicly held restricted voting shares of Patheon.

The voting agreement triggered an application by the Special Committee of Patheon asking the OSC to review the legality of JLL's offer. The Special Committee's allegations were that the voting agreement violated the identical consideration requirements and prohibition on collateral benefits as set out in applicable securities legislation. OSC Staff supported these allegations, resulting in JLL making an application for an exemption from the identical consideration requirement and the prohibition against collateral benefits. In response to JLL's application for exemptive relief, the Special Committee forced the matter to an OSC hearing by applying for a variety of orders that sought to ensure JLL's compliance with the identical consideration requirement and the prohibition against collateral benefits.

The OSC held a hearing on April 15 and 16, 2009 to consider the application of the Special Committee of Patheon, and promptly rendered its decision just prior to the initial expiry time of JLL's offer on April 16, 2009. The OSC later received a request for its written and full reasons for the decision, and issued them on August 6, 2009.

As a procedural matter, the Special Committee's application to the OSC was dismissed. However, the dismissal was made subject to JLL complying with a number of conditions, which effectively gave the Special Committee much of the result that it had been seeking. The OSC dismissed the Special Committee's application provided that: (a) JLL terminated the voting agreement with the Mova Group; (b) JLL certified that no oral or written agreement, arrangement or understanding, formal or informal, direct or indirect, currently exists or will be entered into or agreed to during the period of its offer, and for a period of 120 days following the expiry of its offer with any shareholder of Patheon in respect of its offer or any second-step or compulsory acquisition transaction following the offer, or Patheon or any securities of Patheon, including the acquisition or voting thereof; (c) the Mova Group certified that no oral or written agreement, arrangement or understanding, formal or informal, direct or indirect, currently exists or will be entered into or agreed to with JLL during the period of JLL's offer and for a period of 120 days following the expiry of JLL's offer in respect of JLL's offer or any second-step or compulsory acquisition transaction following the offer, or Patheon or any the securities of Patheon, including the acquisition or voting thereof; (d) JLL amended its take-over bid circular to make full disclosure of the terms of the OSC's decision; (e) JLL issued a news release with respect to such amendments; and (f) JLL extended its offer for a period ending not less than 15 days following the mailing of such amended disclosure. The certification required is notable both for its breadth and difficulty to enforce, given that it would cover

even informal verbal understandings of JLL or the Mova Group.

On the substantive issue of whether the voting agreement between JLL and the Mova Group provided the Mova Group with additional benefits not available to other shareholders of Patheon under JLL's bid in breach of securities legislation governing take-over bids, the OSC had no trouble in applying the recent conclusions on the meaning of "consideration" set down in the OSC's 2006 decision on Sears Holdings' bid for Sears Canada — interestingly, another hostile insider bid. The OSC stated that, in its view, the voting agreement may well have breached the identical consideration requirement and the prohibition against collateral benefits. In the OSC's view, the term "consideration" used in subsections 97(1) and 97.1(1) of the *Securities Act* should be interpreted broadly in accordance with the regulatory objectives of the take-over bid regime contained in the *Securities Act*, including the principal objective of fair and equal treatment of public shareholders when a formal bid is made. The OSC stated that the concerns about fairness to public shareholders are magnified where an insider makes an "any and all" bid (with no minimum condition) at a cash price that is substantially less than the fair market value of the relevant target shares based on an independent valuation. After JLL, an insider of Patheon, announced that its bid would be made at a cash price of US \$2.00 per share, the independent valuation obtained by the Special Committee as required under Multilateral Instrument 61-101 *Protection of Minority Security Holders in Special Transactions* (MI 61-101) concluded that the fair market value of the

restricted voting shares was in the range of US \$4.20 to US \$5.00 per share.

The OSC found that the Mova Group was receiving preferential treatment that mitigated any coercion inherent in JLL's offer even if no member of the Mova Group tendered its shares to the offer. Rather than making a finding that the voting agreement in fact breached securities laws, the Commission instead elected to exercise its public interest power and issued the order dismissing the Special Committee's application subject to the conditions set forth above — while stipulating that it would entertain an application for an alternative remedy if JLL failed to comply with the conditions to the OSC's order.

McCarthy Tétrault Notes:

The saga now associated with JLL's bid for Patheon is a reminder to private equity investors of the complexities of implementing a strategy to have existing investors roll over, or maintain, their equity as part of a going-private transaction. While the ongoing support of these investors may be an important factor in the financing of a going-private transaction and the ultimate success of a private equity investment, there is a need for highly detailed planning to achieve an efficient result that complies with applicable securities laws. Failing to structure a transaction at the outset in a manner that respects the collateral benefits limitations under MI 61-101 will leave the bidder and its co-investors exposed to challenge. In hindsight, with better preparation, JLL and its co-investors

could have avoided much of the difficulties that they have encountered.

Ultimately, the JLL Patheon transaction may well be more memorable for the tenacity of the bidder and target and the sheer number of legal manoeuvres executed in a single transaction than for relatively straightforward application of the OSC's view of Ontario's rules on identical consideration and collateral benefits. The extraordinary lifespan of this transaction — the bid was renewed by JLL periodically until it expired on August 26, 2009, with JLL having acquired 26 per cent of the restricted voting shares under its offer, which was outstanding for 168 days — has in fact sparked debate as to whether Canadian take-over bid law should include some limitation on the number of times a bid may be extended or the length of time a bid may be allowed to stand. In the absence of such limitations, perhaps siege tactics will become more common in battles for control of Canadian public companies.

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Toronto Stock Exchange Requires Securityholder Approval of Certain Public Company Acquisitions

The Toronto Stock Exchange (TSX) recently announced changes to its rules that require TSX-listed companies to obtain shareholder approval of certain public company acquisitions. Effective November 24, 2009, shareholder approval is required when the number of securities issued as payment for an acquisition of a public company exceeds 25 per cent of the total number of outstanding securities of the buyer on a non-diluted basis. Previously, shareholder approval was generally only required in the case of an acquisition of a private company resulting in dilution of more than 25 per cent.

The TSX's changes follow the decision of the Ontario Securities Commission (OSC) earlier this year in respect of a proposed acquisition by HudBay Minerals Inc. (HudBay) of Lundin Mining Corporation that would have resulted in HudBay's shareholders being diluted by just over 100 per cent without their approval. The OSC found that the TSX's failure to require approval of the transaction by HudBay's shareholders significantly undermined the quality of the Canadian marketplace. In response, the TSX proposed a bright-line test requiring shareholder approval where the securities to be issued as payment for an acquisition of a public company would result in dilution of more than 50 per cent.

For a discussion of the facts and ruling in the Hudbay decision, please see our [Legal Update](#), published May 6, 2009, and the [article](#) in our May 2009 issue.

In light of the uncertainty created by the OSC's decision in HudBay, the TSX's changes provide guidance to directors of Canadian public companies proposing to acquire a public company using the buyer's securities as consideration. The new requirement is intended as a bright-line test as to when a TSX-listed company may issue shares in an acquisition without seeking the approval of its shareholders, and is generally consistent with the existing rules of the New York and London stock exchanges. The TSX will retain the discretion to require shareholder approval in transactions that will result in dilution of less than 25 per cent where the transaction could materially affect control or involves insiders.

This new requirement for shareholder approval will factor into the assessment of the completion risk associated with acquisitions of publicly traded entities in Canada as buyers and targets consider the likelihood of obtaining shareholder approval of the transaction where the 25 per cent dilution threshold is exceeded. The requirement is not likely to impact materially the time required to complete an acquisition of a public company by way of a plan of arrangement or other transaction requiring the approval of the target's shareholders so long as the shareholder meetings of the buyer and the target to approve the transaction are held within the same time period. However, acquisitions by way of a take-over bid will be impacted, as Canadian take-over bid rules require that an offer be open for acceptance for a period of 35 days, whereas a shareholders' meeting typically involves a period of 40 to 50 days. It remains to be seen what impact this change to the TSX's rules will have on Canadian public M&A activity.

This article was published initially as an [e-Alert](#) on September 25, 2009.

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OSC Opens the Door to "Just Say No" Defence: Shareholder Rights Plan Maintained in the Face of a Hostile Partial Bid

For many years, Canadian securities commissions have been saying that a shareholder rights plan cannot be used by a target company's board of directors to block indefinitely a hostile take-over bid. It has been the view of the securities regulators that shareholders, not the board of directors, are ultimately entitled to decide whether the company will be sold or not. Shareholder rights plans have been effective to allow a target company's board more time than a bidder might prefer to seek out white knights or other value-maximizing alternatives, but, at some point, the time will come for the board to waive the rights plan and allow the offer to go to the shareholders, or the securities commissions will order the rights plan removed.

In the Matter of *Neo Material Technologies Inc. et al* is a recent decision of the Ontario Securities Commission (OSC) dismissing an application by a hostile bidder seeking to cease trade a target company's tactical shareholder rights plan that had been adopted by the target's board in the face of an unsolicited partial bid and that had been approved by the shareholders.

This decision is of significant interest to boards of directors of potential targets because it represents a marked departure from earlier decisions in which securities commissions have primarily focused on whether the time had come in the circumstances to set aside the shareholder rights plan. With this decision, the OSC may have opened the door for a target's board to utilize effectively a rights plan as a tool to defend a hostile bid where the board determines that it would be in the best interests of the corporation to do so. However, it remains to be seen whether the circumstances of the *Neo* case – a partial bid by a significant shareholder and overwhelming shareholder support for the shareholder rights plan – will limit its application to other cases with similar facts or will lead to its extension to other cases with different facts.

Neo Material Technologies Inc. is a Canadian public corporation carrying on business in the mining and resources sector. Pala Investments Holdings Limited, an investment company, held approximately 20 per cent of Neo's outstanding common shares and had been an investor in Neo since July 2007. On February 9, 2009, Pala announced its intention to commence a partial bid to acquire up to an additional 20 per cent of Neo's outstanding common shares at a price of \$1.40 per share (the offer was subsequently varied by Pala to increase the offer price, reduce the number of shares subject to the offer to approximately 10 per cent and extend the expiry time).

Neo had two shareholder rights plans in effect. The first shareholder rights plan was approved by Neo's shareholders in June 2004 and subsequently

reconfirmed in April 2007. Pala's offer was structured to comply with the "permitted bid" provisions of the first shareholder rights plan, which included a minimum tender condition, so as not to trigger the issuance of rights under the plan. The second shareholder rights plan was adopted by Neo's board of directors on February 12, 2009 in response to Pala's offer, and was subsequently approved by Neo's independent shareholders at a meeting held on April 24, 2009. Approximately 83 per cent of Neo's outstanding shares were represented at the meeting and, excluding Pala's holdings, approximately 81 per cent of those shares were voted in favour of adoption of the second shareholder rights plan. The second shareholder rights plan was substantially similar to the first shareholder rights plan except that it prohibited partial bids. The focus of the OSC was on this second shareholder rights plan.

In dismissing Pala's application and refusing to exercise its public interest jurisdiction to cease trade Neo's second shareholder rights plan, the OSC took note of the key facts that Pala's offer was not for 100 per cent of Neo's outstanding shares and that Neo's shareholders overwhelmingly approved the adoption of the second shareholder rights plan. Presumably, the OSC could have stopped there and relied on these circumstances to decline to cease trade the rights plan. Instead, the OSC observed that allowing the board to seek alternative value-enhancing transactions is not the *only* legitimate purpose for a shareholder rights plan and that the directors of a target company are entitled to take steps that they conclude are in the long-term best interests of the company.

The OSC relied on the recent decision of the Supreme Court of Canada in *BCE Inc., Re*, [2008] 3 S.C.R. 560 and stated:

“Consistent with the Supreme Court’s statements in *BCE* and the established body of corporate case law it is our view that, shareholder rights plans *may* be adopted for the broader purpose of protecting the long-term interests of the shareholders, where, in the directors’ reasonable business judgment, the implementation of a rights plan would be in the best interests of the corporation.”

The OSC deferred to the business judgment of the Neo board and its determination that avoiding an auction at this time was in the long-term best interests of the corporation and the shareholders, as a whole. The OSC found that the Neo board undertook a well-structured evaluation process in response to Pala’s offer and concluded that the integrity of the board process had not been compromised. As a result, the OSC concluded that there was no evidence that the adoption of the second shareholder rights plan was not carried out in the best interest of the corporation and the shareholders and the Commission was not prepared to conclude that, even though the bid had been outstanding for more than 70 days, “the time had come for the rights plan to go.”

McCarthy Tétrault Notes:

Armed with the OSC’s decision in *Neo* and the Supreme Court of Canada’s decision in *BCE*, a target company’s board of directors that undertakes a thorough and uncompromised evaluation process and then concludes that a sale of the company

at this time is not in the long-term best interests of the company may be entitled to use a shareholder rights plan to defend against a hostile take-over bid, perhaps indefinitely. It remains to be seen whether the *Neo* decision will open the door for a target’s board to implement a “just say no” defence to an unsolicited bid or whether the decision will be limited to scenarios involving a partial bid and/or a tactical shareholder rights plan with significant shareholder support.

We expect that the *Neo* decision will cause a hostile bidder to seriously consider structuring its offer as a “permitted bid” under the target’s shareholder rights plan. Most Canadian rights plans have a concept of “permitted bids,” which must be open for 60 days and have certain other attributes. That, in turn, may lead to target boards considering the adoption of US-style shareholder rights plans that do not have the concept of permitted bids and so prevent bidders from buying shares of the target company while the rights plan remains in effect.

This article was published previously as an [e-Alert](#) on October 2, 2009.

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Corporate Law

Good Reasons to Incorporate in British Columbia

There are many good reasons to incorporate under British Columbia's *Business Corporations Act (BCA)*, which came into force in March 2004. Although the BC *BCA* has some similarities to the *Canada Business Corporations Act (CBCA)*, it also includes a number of unique features and contains flexibility not found in the *CBCA* or other Canadian provincial corporate statutes.

The following are a few of the reasons to consider incorporating your company in British Columbia:

1. Director Residency and Privacy

Under the *CBCA*, at least 25 per cent of a corporation's directors must be residents of Canada. This often puts foreign businesses with Canadian subsidiaries in the uncomfortable position of having to choose between elevating an otherwise unqualified Canadian-resident employee to the position of director or asking their lawyer to act, which many lawyers are hesitant to do. The residential address of each director of a *CBCA* corporation must be set forth in the forms that are filed and publicly available under the *CBCA*.

The BC *BCA* does not contain any residency requirements for directors. In addition, under the BC *BCA*, directors are afforded privacy of their residential address as they may use their

office address rather than their residential address in publicly searchable databases.

2. Flexibility in Tax Planning

The BC *BCA* provides flexibility in corporate and tax planning by:

- permitting par value shares;
- permitting companies to hold their own shares and permitting subsidiaries to hold shares of their parent company;
- permitting fractional shares;
- providing for optional court approval for amalgamations (which may be advantageous in qualifying for United States securities registration exceptions); and
- providing for inter-jurisdictional amalgamations.

3. Flexibility in Alterations

Under the *CBCA*, the majority required to pass a special resolution is fixed at two-thirds. The BC *BCA* allows companies to choose any level of majority between two-thirds and three-quarters. Also, under the BC *BCA*, a company's articles may give the directors the power to effect capital alterations and amendments to the articles without shareholder approval. Finally, the BC *BCA* permits share rights that are accessible only to particular shareholders of a class of shares. For example, a share may have ten votes when held

by one shareholder — but only one vote when held by another shareholder. These are powerful tools to consider when structuring the share capital of a company that will have more than one shareholder.

4. Unlimited Liability Corporations

British Columbia is one of only three Canadian jurisdictions that provide for unlimited liability corporations (ULCs), the other two being Alberta and Nova Scotia. ULCs have been used by United States-based companies for tax advantages. Recent amendments to the Canada-United States tax treaty have largely eliminated these advantages, as discussed in an [article in our August 2009 issue](#) and in another [article in this issue](#) of the *Business Law Quarterly*. However, to the extent that ULCs remain a useful vehicle, there are several reasons that the BC *BCA* is preferable to the other statutes, including low annual fees for ULCs and flexibility regarding directors' residency and corporate reorganization.

5. Waiver of AGMs and Financial Statements

The BC *BCA* allows companies to waive, by unanimous resolution of the shareholders, the requirement to hold an annual general meeting or any previous annual general meeting. Moreover, under the BC *BCA*, companies are not required to file financial statements with the registrar (though they are required to keep them in the records office) and private companies may waive, by unanimous resolution, the requirement to produce and publish financial statements.

6. Broad Powers of Rectification

Both the *CBCA* and the BC *BCA* provide for the rectification of errors in a company's records by court order or application to the applicable corporate registration. However, the BC *BCA* also provides for a broad remedial power under which a court may correct "corporate mistakes" — a broader power to correct errors in the conduct of a company's business or affairs. The BC *BCA* also provides for the correction, by unanimous resolution, of errors in the creation, allotment or issuance of shares. This simple method of confirming the issued and outstanding share capital can save thousands of dollars in court costs in the event a serious error is discovered.

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Québec Introduces Proposals to Reform and Modernize its Corporate Law

Bill 63, also known as the *Business Corporations Act*, was introduced in the Québec National Assembly on October 7, 2009. It constitutes a substantial reform and modernization of the *Companies Act (Québec) (QCA)* currently in force, while retaining some of its features. Below, we have highlighted some of the differences between Bill 63, the *QCA* and the *Canada Business Corporations Act (CBCA)* that we believe are of interest.

What Bill 63 Does Not Contain

Bill 63 does not contain any residency requirement for directors — although the company's head office must be located in Québec. Nor does Bill 63 contain any provision prohibiting or circumscribing the granting of loans or financial assistance. In addition, there is no longer any requirement for a "balance sheet" test, whether in the case of the declaration and payment of dividends, purchase and repurchase of shares, or increase or reduction of share capital or otherwise — though the "solvency" test remains applicable in all of the aforementioned situations. Furthermore, a corporation may not make a payment to purchase or redeem shares if the payment would make the corporation unable, in the event of liquidation, to repay higher or equally ranking shares.

Shareholder Rights and Protections

Bill 63 provides for an array of shareholder rights and protections typically found in most modern corporate statutes — dissent rights, oppression remedy, derivative actions, shareholder proposals — while adding certain enhancements and clarifications, as well as some novel rights. Among the rights in Bill 63, the dissent right provides a specific mechanism for beneficial shareholders to exercise this right; shareholders will be able to inspect ballots and proxies used at shareholders' meetings; shareholders are explicitly permitted to discuss relevant matters at shareholders' meetings for a "reasonable period of time"; and companies that are not reporting issuers must notify shareholders of the details of any share buy-back.

Capital Structure

Bill 63 provides unique flexibility in the area of capital structure: it retains the possibility of issuing shares without par value as well as shares that are not fully paid, while permitting shares to be uncertificated, classes and series of shares to be identical, and fractional shares to be issued carrying proportionate rights. In addition, an irregular issue of shares (i.e., shares that are issued in a manner inconsistent with the authorized share capital or articles of incorporation or that are irregular for any other reason) may be rectified by the unanimous resolution of the shareholders.

Governance

In the area of governance, Bill 63 provides directors with a clear due diligence defence pursuant to which directors are expressly permitted to rely on the report or opinion not only of professional advisors or experts, but also on an officer of the corporation that is "reliable and competent" and a board committee that "merits confidence." In addition, Bill 63 clarifies that directors may generally delegate their powers, but not, *inter alia*, those which consist in authorizing the issuance of shares or in appointing or determining the remuneration of the president of the corporation, the chair of the board of directors, the CEO, the CFO, and the COO. Bill 63 also clarifies that the quorum of directors at a meeting consists of a majority of directors "in office." Also, it prohibits directors who have an interest in a contract or a matter before the board not only from voting on the matter, but also from being present during deliberations.

Corporate Procedures

Bill 63 contains provisions that allow all typical corporate procedures – amalgamations, plans of arrangement, reorganizations, compulsory acquisitions, dissolutions – that are found in many corporate statutes, though formulated in some cases with certain modifications of interest. For example, in the case of amalgamations, a director or officer will no longer be required to file a declaration regarding the solvency of the amalgamating and amalgamated companies. However, director liability is incurred if the amalgamated company is unable to pay its debts as they become due.

Bill 63 facilitates internal corporate reorganizations, whether for the purpose of simplifying corporate structure or tax planning: certificates of amalgamation and of arrangement (as well as any other certificate) may specify an effective “time,” and subsidiaries will be allowed to hold shares of their parent for a period not exceeding 30 days. Bill 63 will also allow corporations governed by foreign laws to be continued under the Québec statute and vice-versa.

The articles of the corporation may be amended by a special resolution of shareholders, and such a resolution may specifically permit the board not to proceed with the amendment notwithstanding its approval by the shareholders. Unlike in the *CBCA*, but as in the current *QCA*, stock splits and stock consolidations are not considered to be amendments to the articles and therefore may be carried out by resolution of the board of directors without shareholder approval (except, in the case

of a consolidation, if it would result in a shareholder holding less than one share).

McCarthy Tétrault Notes:

Bill 63 keeps some of the advantages of the *QCA*, while updating Québec corporate law by the addition of certain rights, recourses and procedures – most of which are, but some of which are not, currently available under the *CBCA*. For all these reasons, if Bill 63 comes into force in its present form, the new Québec legislation on corporations will be an interesting and appealing statute for Canadian businesses, especially those based in Québec.

The transitional provisions of Bill 63 provide that all companies governed by Part IA of the *QCA* will automatically be governed by Bill 63 once it comes into force. It is not anticipated that Bill 63 will be proclaimed in force before the end of 2011.

It is expected that our clients and other existing Québec companies will require our assistance with the mandatory aspects of the transition on an ongoing basis and that we will present seminars to explain the new opportunities that Bill 63 offers. In particular, it will be important for Québec clients and companies to review their corporate bylaws with legal counsel and to obtain our advice as to where it would be useful or appropriate to modify them in accordance with the new legislation.

For a more detailed discussion of these proposed changes, please see our [Legal Update](#) published on November 6, 2009.

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Updates

COMPETITION LAW UPDATE

Closing the Transaction Over Competition Bureau Objections

There has been a good deal of discussion recently about the extent to which the amendments to the *Competition Act*'s merger review process that came into effect on March 12, 2009 centralize power and discretion in the Commissioner of Competition. To be sure, the amendments have the potential to lengthen the time for closing complex transactions. However, it is important to bear in mind the limits of those amendments.

As discussed in our [May 2009 issue](#), before the amendments, merging parties could close 42 days after complying with the standard disclosure requirements prescribed by subsection 114(1) of the *Act*. If the Commissioner objected, she could seek an injunction from the Competition Tribunal pursuant to Section 100 of the *Act* for up to 60 days if she could prove that closing would “substantially impair the ability of the Tribunal to remedy the effect of the proposed merger.” Merging parties rarely challenged the Commissioner, and consequently, the Commissioner had only twice sought Section 100 injunctions – in *Commissioner of Competition v. Superior Propane* and in *Commissioner of Competition v. Labatt Brewing*. The Commissioner failed both times; accordingly, the transactions in these cases were able to close over her objections.

In *Superior Propane*, the Commissioner also challenged the completed transaction. After four years of appeals, the Commissioner lost on the basis of the ‘efficiencies defence’ in Section 96 of the *Act*. In *Labatt*, the Commissioner investigated for almost two years after completion of the transaction before concluding that the merger did not substantially lessen competition.

The current amendments were enacted after the *Labatt* matter, and bring the Canadian merger review process closer to the US “second request” system. Now, the Commissioner may, within 30 days of receiving the standard disclosure pursuant to subsection 114(1) of the *Act*, seek “additional information that is relevant to the Commissioner’s assessment of the proposed transaction” pursuant to subsection 114(2) of the *Act*. This is the Supplementary Information Request (SIR) – the Canadian equivalent of a US “second request.” While the additional information must be “relevant,” relevance is determined by the Commissioner herself pursuant to subsection 116(3) of the *Act*. The ‘relevance’ limitation is a thin protection.

Once the merging parties – not the Commissioner – believe they have complied with the Commissioner’s second request, they can certify that they have done so pursuant to Section 118 of the *Act*. The transaction may then close 30 days after compliance, pursuant to subsection 123(1) of the *Act*.

Thus, the Commissioner cannot unilaterally block closing. Her only recourse if she believes there has been non-compliance is to apply for an injunction as described below. So, although it would be highly desirable for the parties to attempt to obtain the Commissioner's agreement that compliance is complete, her approval is not necessary if she is recalcitrant.

The Commissioner has three possible recourses if the parties insist upon closing over her objections at that point.

First, she can apply to the Competition Tribunal for an injunction pursuant to Section 100 of the *Act* to delay closing for up to a further 60 days on the basis that she needs more time. If the parties have already complied with substantial SIRs, the Competition Tribunal may be unlikely to give the Commissioner still more time in view of the Competition Tribunal's decisions against the Commissioner's applications for injunctions under Section 100 in the *Superior Propane* and *Labatt* matters.

Second, the Commissioner may apply to the "court," defined as any one of the Competition Tribunal, the Federal Court or a provincial superior court, pursuant to new Section 123.1 of the *Act*, for an injunction or other relief if she believes that the merging parties are likely to close prior to full compliance with her information request. The merging parties can defeat the injunction application by demonstrating to the court that they have "good and sufficient cause" to believe they have complied with her second request, and that the time permitted for closing has passed pursuant to Section 123 of the *Act*.

Third, the Commissioner can challenge the merger on the merits up to one year post-closing pursuant to Section 92 of the *Act* on the basis that (i) the merger is likely to substantially lessen competition in a market; and (ii) the anti-competitive effects from that merger (even if they are substantial) are not outweighed by the efficiencies pursuant to Section 96 of the *Act*. Where the Commissioner challenges a merger under Section 92, she can also seek an interim order under Section 104 of the *Act* prohibiting the parties from closing the transaction pending the outcome of her challenge.

McCarthy Tétrault Notes:

It is noteworthy that the Commissioner has challenged six mergers in the Competition Tribunal since the *Act* was promulgated in 1986, and has lost five of the challenges. It is also noteworthy that members of the McCarthy Tétrault Competition Group have been the lead counsel for the successful party in *all six cases*.

Thus, while the Commissioner can now delay closing for longer periods, the Commissioner cannot unilaterally veto closing. Absent an order of the Competition Tribunal or a court to the contrary, the merging parties can proceed to close their transaction over the Commissioner's objections 30 days after they have complied with her second request for information. After closing, the negotiating dynamics between the merging parties and the Commissioner change dramatically.

For most transactions, the recent amendments to the merger review process under the *Act* will have little significance. For large complex transactions, however, a strategy for merging parties to consider is to seek to close the transaction as soon as it is legally permitted, with – or without – the Commissioner’s approval.

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Recent Developments in Competition Class Actions in Canada

Competition class actions are on the upswing in Canada, especially those involving allegations of price-fixing. Two upcoming developments could have a significant impact on whether the number of competition class actions continues to increase:

- the ultimate outcome of two class certification applications in British Columbia and Ontario; and
- the coming into force of amendments to Section 45 of the *Competition Act* on March 12, 2010.

The British Columbia and Ontario Applications

In a class action alleging price-fixing, classes of purchasers of the allegedly price-fixed products claim damages for higher prices paid (overcharges) as a result of the alleged conspiracy. To date, there have been several settlements of competition

class actions, but plaintiffs have had limited success in contested certification applications. That is largely because price-fixing allegations raise difficult issues relating to the pass-through of any overcharge through the distribution chain. While the existence (or not) of a conspiracy can be an issue common to all class members, that is not the end of the story: the plaintiffs must also prove *where* in the distribution chain any loss was suffered. Members of the proposed class may have conflicting interests, especially when the proposed class includes direct and indirect purchasers. Hence, liability may not be a common issue for the class, and a class proceeding may not be the preferable procedure for resolution of the dispute. In recent cases, the British Columbia and Ontario courts took different approaches to these issues and came to different conclusions. The ultimate outcome of these cases could have a significant impact on future class actions in this area.

Pro-Sys Consultants Ltd. v. Infineon Technologies AG

In its May 2008 decision in *Pro-Sys Consultants Ltd. v. Infineon Technologies AG*, the British Columbia Supreme Court refused to certify a class action on behalf of direct and indirect purchasers of DRAM (Dynamic Random Access Memory) products, which are memory chips used in personal computers and other “high tech” products. The proposed class was “ ... all persons resident in British Columbia ... who purchased DRAM or products which contained DRAM in, into or from British Columbia” The court denied certification because the plaintiffs had failed to establish that liability to class members was a common issue: the plaintiffs did not demonstrate

per se liability for so called “hard core” price-fixing for a considerable period of time.

From a class action perspective, the new Section 45 will make it easier for class action plaintiffs to prove liability by removing the requirement that they prove anti-competitive effects. This may lead to some increase in class action activity.

McCarthy Tétrault Notes:

The new Section 45 may encourage plaintiffs’ class action counsel to bring more price-fixing cases. However, under the new Section 45, the plaintiffs will still have to prove damages and will still have to deal with “pass-through” issues. As such, whether the number of competition class actions in Canada will continue to increase is likely to depend more on the outcomes of the DRAM and hydrogen peroxide cases than on the enactment of new Section 45.

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LABOUR AND EMPLOYMENT LAW UPDATE

Temporary Foreign Workers in Canada

Temporary foreign workers who are employed in Canada are subject to Canadian immigration laws, unless they are either a Canadian citizen or a Canadian permanent resident. Under these laws, every person who participates in employment in Canada requires a work permit. The definition of employment is very broad, and most business travellers to Canada fall into this category.

Working in Canada Temporarily: Relevant Considerations

But when do you require a work permit? The *Foreign Worker Manual* assists in interpreting the *Immigration and Refugee Protection Act* and Citizenship and Immigration Canada’s policy with respect to temporary foreign workers. According to the *Manual*, if an individual performs an activity that will result in payment or remuneration, he or she will be considered to be engaging in work. This includes salary or wages paid by an employer to an employee, remuneration or commission received for fulfilling a service contract, or any other situation where a foreign national receives payment for performing a service.

The first step for any employer is to assess whether a foreign-based employee requires a work permit for his or her trip to Canada. Whether the person will be travelling to Canada for two days or two years is not necessarily relevant. What is much more important is the type of activity the person will engage in while

in Canada, and the company or people with whom the traveller will interact.

There are some limited categories that exempt the individual from the need to obtain a work permit. These include the North American Free Trade Agreement (NAFTA) Business Visitors and NAFTA After Sales Service Personnel.

Obtaining a Work Permit

If a work permit is necessary for an individual to participate in business activities in Canada, the next step is to determine what category he or she may be eligible under, and where the person is eligible to apply for the permit. This can usually be accomplished by forwarding a copy of the employee's resume and a detailed description of the proposed activities to your immigration lawyer for consideration.

Other Requirements

Once the proper route to apply for the work permit has been established, there are other factors to consider to ensure compliance with Canadian immigration legislation. The employee who is travelling to Canada or being transferred may require a special entry document called a temporary resident visa if he or she is a citizen of a prescribed country such as South Africa or Brazil. This visa must be obtained through a Canadian Consulate in advance and cannot be applied for at the border, otherwise the employee may be refused entry to Canada. This document is required regardless of the purpose of the trip or the duration of the stay in Canada.

Similarly, if the employee has a previous criminal record or serious health problem, he or she may be denied entry to the country. Finally, an individual may be required under certain circumstances to take an "immigration medical examination" prior to travelling to Canada.

This article previously appeared in Volume 3, Issue 3 of the *Labour and Employment Quarterly*.

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PRIVACY LAW UPDATE

Social Media Sites and Privacy at Work

More people than ever before are connecting with one another on-line. As a result of the proliferation of social media sites like Facebook, LinkedIn, MySpace and Twitter, individuals have the ability to create personal profiles and exchange e-mails, pictures, files and instant messages on the Internet.

Social media sites are being used in the workplace. Some employers develop their own internal social media sites to assist employees in working together or for the purpose of sharing company information. In many cases, social media sites are accessed by employees at work for personal reasons.

This article addresses some aspects of social media sites that concern employers. Employers should be concerned about employees' use of social media sites for personal reasons. One major concern is loss of productivity. A second major concern revolves around privacy issues.

Social media sites raise privacy concerns for employers. The monitoring of potential or existing employees by employers through personal or work-based social media sites may be subject to privacy legislation applicable in their jurisdiction. In British Columbia, for example, employers are restricted in their ability to collect, use and disclose employee personal information without an employee's consent.

Many employers use Internet search engines, personal websites and blogs to discover information about prospective employees.

Employers should be aware that even publicly available social media site pages may contain inaccurate or outdated personal information. Employers must be extremely hesitant about relying upon such information. Employers should also not use personal information obtained from such sites in a discriminatory manner against prospective employees.

Most employees view their personal social media site pages as private. Employees are often unaware that personal information posted on these sites may be accessible by their employers and co-workers. Any organization that monitors its employees' use of social media sites must ensure that its employees are aware of this practice.

There are possible consequences to employers of inappropriate use of employee personal information on social media sites. An employer that uses an employee's personal information, which has been obtained from a social media site, without that employee's consent or in a discriminatory manner, could face privacy or human rights complaints, a workplace grievance under a collective agreement, a defamation lawsuit and negative publicity.

In order to minimize the risks associated with the use of social media sites, employers should develop and communicate to all employees a clear policy on the appropriate use of social media sites. The policy should cover:

- whether work-based or personal use of social media sites is permissible in the workplace;

- under what circumstances, and when social media sites may be used, such as only during unpaid breaks;
- a description of acceptable and unacceptable use of social media sites;
- whether the employer monitors social media sites;
- whether privacy legislation applies to the collection, use and disclosure of personal information in the workplace; and
- the consequence of failure to abide by the policy.

This article previously appeared in Volume 3, Issue 3 of the *Labour and Employment Quarterly*.

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TAX LAW UPDATE

Cross-Border Tax Structures and Tax Treaties

Cross-border tax structures often optimize available tax treaty benefits having regard to the differences between various bilateral tax treaties. Structures that take advantage of such differences (e.g., holding companies situated in advantageous or lower tax jurisdictions) may, however, be susceptible to attack by tax authorities under “treaty shopping” principles.

The Canada Revenue Agency (CRA) has commented that it considers treaty shopping to include transactions that involve the establishment of entities or residency in a particular jurisdiction to permit a taxpayer to avail itself of the benefits of a particular treaty for tax avoidance purposes.

Treaty shopping has developed a high profile, and the CRA has indicated that it will target treaty shopping structures. The CRA typically seeks to challenge treaty shopping on the basis of one or more of the following five principles.

1. Specific Limitation on Benefit (LOB) Rules

Limitation on benefit (LOB) provisions in tax treaties restrict the entitlement to treaty benefits and are expressly designed to counteract treaty shopping. Although Canada’s bilateral tax treaties do not generally contain detailed LOB provisions, the Canada-US Tax Treaty was recently amended to create a reciprocal LOB rule that denies the benefits of the Canada-US treaty to certain US residents where they have an insufficient nexus with the United States.

2. General Anti-Avoidance Rule (GAAR)

Following the 2004 federal budget, the GAAR was changed retroactively to provide that the GAAR applies to tax treaties.

For the CRA to successfully attack an alleged treaty shopping structure through the GAAR, it will have to demonstrate that a particular transaction defeats the object, spirit and purpose of a particular provision of a treaty. This may be difficult for the CRA to establish in light of rules in most of Canada's treaties, which already create a framework addressing who may benefit from such treaties.

3. "Abuse of Treaties" Principle

None of Canada's tax treaties contain an express "abuse of treaties" principle. Any such principle would need to be implied. As one has not been recognized by the Canadian courts to date, it will be difficult for the CRA to sustain a treaty shopping challenge on this basis.

4. Treaty Residence

A treaty shopping challenge may also be advanced by the CRA on the basis that the treaty resident intermediary is not resident in the particular state for treaty purposes and, therefore, not entitled to treaty benefits. The issue of residence has yet to receive any recent Canadian judicial consideration in the treaty shopping context.

5. Beneficial Ownership

The CRA could also assert that the person claiming treaty benefits in respect of a particular payment

(e.g., dividends) is not the beneficial owner of such payment so that it does not qualify for treaty benefits, based upon the beneficial ownership requirement in various provisions of Canadian tax treaties.

A taxpayer has successfully defended an attack founded on beneficial ownership, and the reasoning of the court in that case highlights the need for proper directors' meetings, minutes and other corporate formalities so that it is clear the relevant company assumes the risk and control of the property and exercises its discretion to distribute or otherwise deal with dividend (or similar) proceeds.

McCarthy Tétrault Notes:

In light of the current state of Canada's LOB provisions, the GAAR jurisprudence, and the Canadian and international jurisprudence that has considered alleged treaty shopping transactions, the current state of the law in Canada remains quite favourable for transactions structured to efficiently utilize Canada's array of bilateral tax treaties. In the context of Canada-US transactions, proper consideration of the LOB provisions will be essential, and in cross-border transactions involving the United States and other countries, proper administration of such structures will be vital to ensure residency and beneficial ownership conditions are satisfied and to defend against possible attacks on the basis of the GAAR.

For a more detailed discussion of this tax-structuring issue, please see the [full article](#) published previously in Volume 1, Issue 3 of our *Tax Update*.

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