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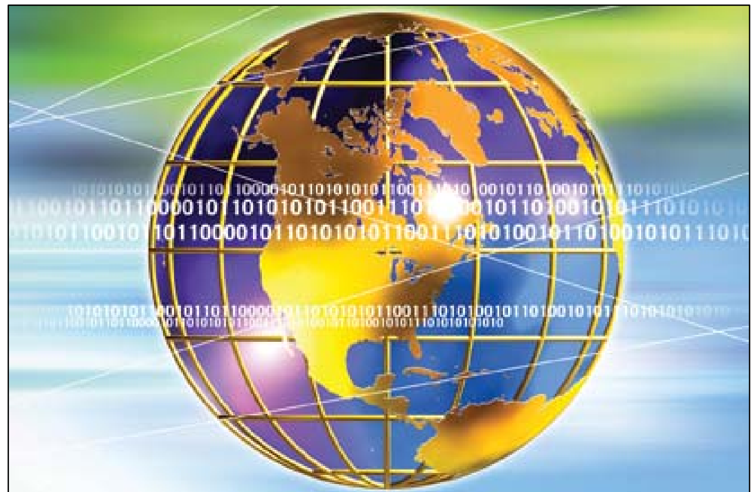

McCarthy Tétrault

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Technology Law Quarterly
Volume 5, Issue 2

Welcome to Volume 5, Issue 2 of *McCarthy Tétrault Co-Counsel: Technology Law Quarterly*. In the last quarter, the federal government has introduced a few pieces of legislation relating to communications technologies. Bill C-47 will require Internet service providers and telecommunications-related operators (TSPs) to build interception capability into their networks in order to assist law enforcement in their investigations. The bill will also impose new disclosure and preservation requirements on TSPs. Another bill, Bill C-27, is intended to target spam and spyware. However, at the webinar we recently hosted on the bill, we noted that it could also potentially impact commercial speech as well as software providers' ability to deliver and install software upgrades and patches.

In other communications developments, the CRTC has released its new media policy, deciding not to require mobile and Internet access providers to fund Canadian audio-visual content. It has also dropped the three-year limitation on upgraded high-definition feeds of already-licensed pay and speciality services.

In the clean tech area, Ontario and Québec recently introduced legislation laying the foundation for greenhouse gas (GHG) cap-and-trade-systems. The federal government has also released two guides that set out rules and guidance on the requirements and processes to create offset credits and verify registered projects' GHG reductions or removals. These schemes, when implemented, will have certainly have implications for regulated emitters, but may also present opportunities for clean tech companies.

These and many other key topics are discussed in this issue of the *TLQ*. You can browse through this PDF using the table of contents, which contains "clickable" links to articles. Or, if you wish to read these articles in HTML format, you can click on the links in the covering e-mail or go directly to our website, where they are posted. You can search the publications on our website and find additional informative articles on many subjects. If you would prefer to receive a paper copy of the *TLQ* in the future or wish to change your subscription information, please contact me at the link below.

McCarthy Tétrault is recognized by the foremost ranking publications as a leader in technology law and other practice areas. The 2009 edition of *Chambers Global*, a guide to the world's leading lawyers, confirms McCarthy Tétrault's continued top ranking in Canada for information technology as well as telecommunications & broadcasting. *PLC Which Lawyer?*, in its 2008 edition, ranks McCarthy Tétrault as the leading firm in Canada for IT and e-commerce law. The *Canadian Legal Lexpert Directory 2009* recognizes McCarthy Tétrault as having the most frequently recommended technology transactions

practice in Toronto. Our *Co-Counsel: Technology Law Quarterly* demonstrates our commitment to maintaining this position of leadership.

Heather J. Ritchie
Editor-in-Chief
July 2009

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Internet/E-World

E-COMMERCE

Canada: OSFI Ruling Permits Banks to Promote Insurance on their Websites

The Office of the Superintendent of Financial Institutions (OSFI) recently ruled that a bank website is not a bank branch for purposes of the *Insurance Business (Banks and Bank Holding Companies) Regulations*. This means that banks can promote insurance products in Canada on their websites, subject to certain conditions.

The regulations prohibit banks from promoting in Canada certain kinds of insurance policies and insurance companies, agents and brokers at bank branches.

OSFI reached the conclusion a bank website is not a bank branch for purposes of the regulations, after considering the definition of a "branch" in the *Bank Act*, the use of the terms "branch" and "websites" throughout the *Bank Act*, and the *Interpretation Act*. It noted that:

- the definition of "branch" in the *Bank Act* refers to physical premises;
- the *Bank Act* specifically distinguishes the terms "branches" and "websites"; and
- by virtue of the *Interpretation Act*, the terms used in the regulations have the same respective meanings as those in the *Bank Act*.

Therefore, the prohibitions on promoting insurance at bank branches do not apply to bank websites.

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SPAM

Canada: McCarthy Tétrault Hosts Webinar on Anti-Spam Bill

McCarthy Tétrault recently hosted a webinar on Bill C-27, the *Electronic Commerce Protection Act* (*ECPA*), Canada's proposed legislation to curtail spam and spyware. Partners Barry Sookman, Charles Morgan and Lorne Salzman discussed some of the issues with the current bill and its implications for Canadian businesses.

Barry outlined the objectives of the bill and discussed the anti-spam provisions, noting the broad prohibition against sending unsolicited commercial electronic messages in terms of the technology affected and the content captured. He observed that Bill 27, unlike anti-spam legislation in other jurisdictions, is not limited to messages sent with some element of fraud or misleading information, sent with an "intent to deceive or mislead," sent to addresses that were gathered using "automated means," or sent in bulk. Barry also provided some surprising examples of types of communications that might be classified as "spam" under the legislation, as currently drafted.

Charles then discussed the anti-spyware provisions that prohibit the installation of computer programs without the consent of the computer's owner. In its current form, the bill could potentially impact software companies' ability to deliver upgrades and patches to customers, Charles suggested. He also observed that the consent requirement could be problematic, as certain devices may not be capable of displaying consent forms and relaying consent. He then compared the *ECPA* anti-spyware provisions with legislation in other jurisdictions, where it is more curtailed.

Lastly, Lorne spoke about:

- the bill's proposed amendments to the deceptive marketing provisions of the *Competition Act* to address false and misleading spam;
- the civil offences and liabilities under the *ECPA*, noting the significant administrative monetary penalties for violations of the *ECPA*;
- a new private right of action for violations of the *ECPA* and the spam-related prohibitions in the *Competition Act*; and
- the bill's proposal to eventually apply the *ECPA* to voice calling, at which time the CRTC's Do-Not-Call List (DNCL) will be ended.

To learn more about the *ECPA*, you can watch the webinar or read our e-alert, which are available on our website. For more specifics on the implications of the *ECPA* for the DNCL, see Lorne Salzman's article in this edition.

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Technology Finance

TECH-RELATED FINANCE

North America: Time to Restructure: Canadian ULC Structures Adversely Affected by Amended Canada-US Tax Treaty

The Canada-US Income Tax Convention (Canada-US Treaty) was recently amended to include a so-called hybrid denial rule. This rule will adversely affect Canada-US cross-border structures involving Canadian unlimited liability companies (ULC). Over the last several years ULCs were used in many cross-border structures, including those employed by technology enterprises.

The hybrid denial rule is subject to a delayed coming into force rule, so that it will generally apply after January 1, 2010.

The amended Canada-US Treaty will deny treaty benefits where a US resident receives income, profit or gain from an entity that is treated as being fiscally transparent under US laws but not under Canadian law (e.g., a Nova Scotia ULC). This rule is broadly worded and applies to many situations where there is no apparent tax policy abuse. Tax treaty benefits will be denied where a US resident receives dividends or interest from a ULC even where there is no double-dip in respect of a deductible payment, such as interest, and the denial of tax treaty benefits will extend to structures used for legitimate business reasons. Generally, the effect of this rule will be to subject affected payments to 25 per cent Canadian withholding tax.

Administrative comments from both the Canadian taxing authorities and the US Treasury do not suggest the rule will be narrowly applied.

Taxpayers having such Canadian ULC structures should review their structures prior to 2010 and consider whether a restructuring is appropriate.

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Technology Contracting

OUTSOURCING

Canada: Dealing with Outsourcing Supplier Instability

While it is not possible for customers to completely insulate themselves from the risks associated with supplier instability, there are a few proactive steps that customers can take to manage and mitigate those risks. These include: carefully conducting due diligence before entering into an outsourcing arrangement and performing periodic reviews during its course, inserting specific clauses in the outsourcing agreement that pre-emptively address potential issues, and having a response plan in place in case the supplier goes bust.

The economic downturn is affecting suppliers both large and small. Whereas customers have historically focused closely on supplier stability and solvency risk when dealing with smaller suppliers, in today's environment, the continued stability of even the most blue-chip suppliers should not be taken for granted. Customers should look at re-evaluating the viability of all of their outsourcing suppliers and re-assessing the risks associated with their supplier relationships (current and prospective), to ensure they are adequately protected in the event of supplier instability.

Due Diligence

Customers often perform some degree of due diligence before entering into an outsourcing agreement. In doing so, they should ensure that the nature and scope of the due diligence is sufficient for their purposes. For example, if a customer is contracting with a subsidiary of a public company, this due diligence should include information about the financial stability of the subsidiary. The customer should not rely solely on publicly available information about the public parent. Where appropriate, customers should consider whether to require a parent guarantee as part of their contractual arrangements.

In addition to initial due diligence, it is extremely important for customers to conduct regular periodic follow-up due diligence to ensure a supplier's continued stability and to identify any potential issues as early as possible. Customers should build into their contract provisions a requirement that suppliers make available the information the customer requires to perform appropriate due diligence on a regular basis.

Contractual Protections

Due diligence

As discussed above, customers should include in their supplier contracts processes to conduct periodic due diligence. In order to make this exercise meaningful, customers should also clearly stipulate their rights and remedies if the due diligence identifies any issues. These rights may include such things as triggers for:

- governance escalation processes;
- termination rights;
- commencement of transition assistance (possibly at no additional charge);
- access to and training on the supplier's source code;
- removal of restrictive covenants, such as exclusive supplier commitments or non-solicitation commitments; and
- removal of minimum-volume commitments.

The types of due diligence results that will be sufficient to trigger the customer's rights and remedies will likely be the subject of significant negotiation: suppliers will generally want to limit trigger events to actual bankruptcy events or similarly catastrophic events, such as injunctive proceedings relating to core intellectual property. From the customer's perspective, however, this would be too little, too late; the purpose of periodic due diligence is to identify risks before they become critical and can still be mitigated.

Termination rights

Under most outsourcing contracts, the customer will have a right to terminate upon the initiation of bankruptcy or similar proceedings. It is important to recognize, however, that once a bankruptcy or restructuring filing is commenced, rights and remedies set out in a contract are often stayed. As a result, a customer's right to terminate its contract with a supplier upon the occurrence of a bankruptcy or restructuring petition or filing may not be meaningful.

If a customer wishes to ensure that it has the ability to exercise a termination right upon a supplier's insolvency, it should broaden the termination right to pre-filing events. These events may include:

- the supplier ceasing or threatening to cease carrying on business in the ordinary course;
- the supplier admitting that it is unable to pay its debts generally as they become due, or acknowledging its insolvency;
- an adverse change in a supplier's credit rating; or
- the initiation of actions by regulatory authorities that are likely to result in the supplier's inability to provide the services under the agreement.

Suppliers will typically object to such a broad termination trigger, and try to narrow these termination rights as much as possible.

Transition Assistance on Termination

An outsourcing contract should include provisions that address in detail the obligations of the supplier to assist with transition. This assistance should include:

- a supplier obligation to deliver up information and data;
- a customer right to acquire hardware, software and personnel from the supplier;
- a supplier obligation to assist the customer in finding and evaluating an alternative supplier; and
- performance and personnel commitments by the supplier to ensure a smooth transition.

Post-Termination Intellectual Property Rights

Customers should carefully consider whether, upon termination of a supplier, they will require rights to the supplier's intellectual property in order to continue the service in-house or through another supplier. If continued use of the intellectual property is realistic (as opposed to a complete shift to a new solution from the current supplier's solution), then the customer should negotiate these rights in advance if possible. Careful attention should be paid to the terms relating to the exercise of such rights to ensure they will be enforceable in the event of a bankruptcy or restructuring. The inclusion of terms relating to security interests or partial assignments of critical intellectual property should also be considered where appropriate.

Other Contractual Provisions

To help identify and address supplier instability, customers should consider including a number of other contractual provisions, such as:

- affirmative covenants requiring the supplier to proactively bring to the customer's attention potentially significant issues, such as significant litigation claims, rather than waiting for the periodic due diligence review;
- requirements for the immediate delivery of confidential information and data, including any customer personal information to the customer, upon the customer's request;
- source code escrow, source code licence or source code access and training provisions that will enable the customer to use and support a solution without the supplier;
- removal of restrictive covenants, such as exclusive supplier commitments, non-solicitation commitments or confidentiality restrictions; and
- removal of minimum-volume commitments.

Supplier Instability Response Plan

While it is advisable and important to include transition assistance provisions in the agreement, the reality is that customers should not count on receiving proper transition assistance from the supplier when the supplier is suffering from significant instability. Customers should, therefore, have internal governance processes and plans in place to ensure that a bankruptcy mitigation plan is

put into action at the earliest appropriate opportunity.

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Canada:
Making the Most of Your RFP Process — Part III

This is the last instalment in a series of articles outlining steps customers can take to improve their RFP process when sourcing complex services. In the last TLQ, we looked at timing and staffing. In this edition, we examine budgeting — and specifically the importance of accounting for all the costs of carrying out an RFP process. We also touch on several tools that you might use to increase your prospects of a successful RFP.

Building Better Budgets

The actual costs of carrying out an RFP process are often higher than clients expect. This is typically the result of underestimating the time and resources required to successfully see a RFP process from start to finish.

When thinking about the project budget, it is important to take into account not just the costs of the solution or services being purchased, but also all the incidental costs of running the procurement process, negotiating the agreement, and project-managing the purchased services after the agreement has been signed (e.g., staffing for your PMO). These can be separated into up-front capital costs and ongoing operating expenses.

In addition to including these costs in the initial budget, revisit and revise your budget following receipt of the RFP responses, as well as during and after the negotiation of the final agreement, and keep the project sponsor informed. This keeps management and the board up-to-date and engaged in the process, and will immediately highlight any potential impediments raised by cost issues.

One global outsourced-services provider estimates that ongoing project-management costs run approximately 10 per cent of the annual project fees, so unless you have properly accrued for these costs, any contingency that may have been included in the annual budget will be eaten up.

As well, expect project-management costs to be higher during the earlier phases of the project as the parties get to know one another, develop workable processes and procedures for managing change, and address any immediate scope or other issues.

Your project will have a better chance of being "on budget," which is one measure of success, when your budget reflects all of the true project-management costs.

Choosing the Right Tools

The following items will not be applicable to every procurement situation, but you may wish to take some of them into consideration when entering into your next RFP process:

1. **Fairness Monitors** — Depending on the size of your transaction and the competitive playing field in the relevant area, engaging a fairness monitor is a tool to be considered. They are most commonly used in large-dollar-value public procurement processes by government entities. A fairness monitor is like an ombudsman who is retained by the customer, but operates autonomously from the customer, to help ensure that the overall RFP process has been carried out fairly and transparently and in accordance with the rules applicable to the RFP. The fairness monitor will usually be engaged before the RFP is issued, and he or she can engage in the RFP evaluation process, either directly or by advising an RFP evaluation committee, and sometimes engaging in discussions with vendors. He or she will be privy to all communications with proponents. Ultimately the fairness monitor will document that the RFP process was fair, open and transparent, characteristics that have become increasingly important in public sector procurement over the last decade.

2. **Information Control Office** (ICO) — Having a dedicated person in charge of an "information control office" can be a worthwhile investment for a complex RFP process where you anticipate ongoing communication between your organization and vendors. The ICO will be responsible for developing process and policies for communications and information exchange, and for administering those policies, both internally and externally, to ensure a fair and equitable RFP process. An ICO gives vendors a clear path for communicating with your organization, and will provide the required Q&A process.

3. **BATNA** — BATNA refers to "Best Alternative to a Negotiated Agreement," and it essentially means that you should know your options before negotiating the agreement so that you can suggest acceptable alternatives, or walk away from a deal when appropriate. In fact, you should consider your options during the RFP planning phase. Knowing your BATNA helps in drafting the RFP, during the assessment of proposals and at the negotiating table — it is a highly effective tool to help ensure a successful project.

4. **Proponent Honorarium** — In certain complex procurements, it may be appropriate to pay an honorarium to each vendor submitting a response to your RFP to help offset the costs of preparing the response. This would usually only be done following an initial RFQ (request for qualification) process where potential vendors have been pre-screened and a small number have been selected to submit a full RFP response. The amount of the honorarium turns on the ultimate value of

the project and obviously would not cover all of a given proponent's costs; it does, however, encourage the submission of a quality response.

A tighter, more streamlined RFP process will result in better-quality proposals from vendors and lead to a more successful project. Investment up front, by all stakeholders, can result in efficient procurement processes that save time and money for both customers and vendors.

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Canada: Value Drivers For IT Outsourcing Deals In An Economic Downturn — Part I

Outsourcing — the practice of handing over responsibility for the execution of many IT functions to an outside supplier like IBM — can be a shrewd business strategy in any economic climate. What we are learning as a result of the last number of months of hard economic times, is that outsourcing deals can become even more compelling in a recession. Why? Two words — "reduced costs."

What is happening in the outsourcing marketplace is that astute customers who have contracts with one or two years left on them are not waiting until these contracts run to the natural end of their terms. Rather, they are doing early renewals now, and adding three to five years onto the duration of the new contract, thereby concluding a new five- to seven year deal.

It's All About Reduced Costs

Why would a customer go through the cost and hassle of an early renewal of a major outsourcing agreement? These are significant contractual arrangements. A renewal will involve all sorts of updating of the paperwork, and copious homework to bolster that effort. So, why go through all this when you don't really have to? Two words — "reduced costs."

The deal is actually fairly straightforward. In return for the customer agreeing to tack extra years onto the current agreement, the supplier delivers new, lower prices immediately. Therefore, the customer doesn't have to wait two years to get a material reduction in its IT costs; rather, it can get them now. And now — in the middle of these harsh economic times — is when the customer really needs these additional cost savings.

A Win-Win Proposition

So what's in it for the supplier? Why would the supplier want to open up what is likely a fairly lucrative contract, and offer price reductions immediately? The last couple of years of an outsourcing agreement tend to be the most

profitable for a supplier, so why give these up in favour of providing the customer with immediate price cuts? Three words — "avoid an RFP."

Consider the likely scenario where there is no early contract renewal of the existing deal. About 18 months before the contract ends, the customer will go to market with a Request for Proposal (RFP). The RFP will go to multiple suppliers. That means a competitive dynamic will be engaged, with the incumbent supplier having to bid against potentially much hungrier competitors. The incumbent supplier may lose the account to one of these competitors. But even if it keeps the work, it will be at reduced fees. And it has to bear the significant cost incurred in participating in a full-bodied RFP process.

Therefore, an early renewal of an existing deal has some real attractions for the supplier. Sure they will have to lower prices — but this was inevitable in any event. But on the positive side of the ledger, the supplier gets to keep the customer, and the term of the deal is extended another three to five years. Particularly in an economic downturn, this is a good result for the supplier — especially if, in the alternative scenario, the supplier loses the work altogether.

The Implications of Reduced Costs

How does the supplier effect the immediate cost savings? This is a very important question, one that all customers need to ask their suppliers — not least because the answer will likely impact the risk profile of the deal for the customer, which in turn means that appropriate adjustments need to be made to the outsourcing agreement to manage these risks.

For example, one way a supplier will invariably reduce costs is by having some of the work done by its resources located in lower cost offshore centres, such as India, the Philippines, South America or Eastern Europe. This presents a riskier service profile for the customer, particularly if the supplier needs to handle personal information of customer's employees or clients in these foreign jurisdictions. Accordingly, amendments typically have to be made to the outsourcing agreement to 'beef up' confidentiality, privacy and security provisions. Also, the agreement's limit-of-liability clause needs to be revisited to ensure that the supplier is bearing a fair share of these additional risks.

Another cost reduction strategy involves moving the customer from a 'dedicated' service delivery model (e.g., where an entire mainframe computer is used only to process that single customer's data) to a 'utility' or shared-service delivery model (e.g., where the supplier's mainframe would support two or three customers simultaneously). Again, such a shift in the delivery solution will warrant some changes to the outsourcing agreement, in order to mitigate the greater risk presented by the new operations structure.

Watch the Pricing Fine Print

Where the supplier proposes to reduce costs by delivering a certain portion of the services from

offshore centres — such as from India — you have to be very careful with the details proposed by the supplier around the new, lower pricing. Yes, the new unit pricing is reduced from the previous price, but — and this is a big but — the supplier likely will want to provide that the new price is now subject to foreign-exchange risk and foreign inflation adjustment. For example, if the Indian rupee appreciates against the Canadian dollar, the supplier wants you to bear this extra cost. Likewise, if Indian inflation exceeds a certain amount, the supplier wants you to pay the increased amount.

These two pricing issues — foreign exchange risk and foreign inflation — have become very contentious points in outsourcing deals that include a material offshore component. These two items can add significantly to the overall cost of a renewal deal (calculated over its entire length).

There are numerous ways to address these points. One is to shift the risk entirely to the supplier, but typically this is only done in return for a fixed-premium amount that is added to the regular monthly fees (in effect, this premium acts somewhat like insurance). Or, some customers are willing to agree to graduated risk-sharing formulas — such as the first three per cent of foreign inflation being the responsibility of the supplier, the next five per cent of inflation being shared 25-75 per cent, and anything above eight per cent being shared 50-50 per cent. How you approach this issue often is determined by how international your business is, and how comfortable you are manoeuvring in the world of foreign exchange and foreign inflation.

Responding with Greater Flexibility

One argument for having the supplier bear the entire risk for offshore inflation and currency risk is that the supplier is in the business of operating in many countries, and can therefore hedge this risk by shifting production to new, lower cost venues as warranted over the life of the new agreement. Indeed, the supplier is probably going to do something like this in any event, in order to keep your fees declining — and the supplier's margins healthy. So, there is a strong argument that the supplier has already baked into its price any foreign exchange and inflation risk.

In a similar vein, however, you must be willing to be fairly flexible in allowing the supplier to provide you service from different countries. Certainly you will want some pre-approval rights on the facilities from which the supplier provides the services, but you can expect this discretion on your part to be somewhat fettered so that it only speaks to issues such as site specific security, rather than to whether certain services can be provided from a specific country to begin with. In short, the more inflation/foreign currency risk you want the supplier to take on, the more flexibility you will need to show about site locations.

In the next TLQ, we turn to several other important value drivers in outsourcing deal renewals (particularly in tough economic conditions), especially focusing on flexibility.

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Canada:
Beware the Boilerplate — Part II

In the second part of our series on the "boilerplate" of tech commercial agreements, we focus on the all-important assignment. In the last TLQ, we looked at governing law and dispute resolution provisions.

Easy To Miss

In the supplier standard form contract, the assignment clause (or, rather, non-assignment clause) typically sits quietly at the end of the agreement, seemingly harmless, stating (to the few who bother to read it) that the customer may not assign the agreement without the consent of the supplier.

Many business people fail to understand the implications of this clause. That is, until two or so years later, when the customer decides to reorganize its business and sell half of it to a third-party purchaser. Then the lawyers will be all over the assignment clause, and the big cost of ignoring this key provision at the time the contract was signed finally comes to light, because the non-assignment clause prevents the contract from being moved to another entity, as called for by the reorganization. Of course the customer can always ask the supplier to amend the contract, but this tends to result in additional fees being required by the supplier — whereas these likely would have been avoided had the proper assignment clause been negotiated when the deal was originally entered into.

Reasonable Flexibility is Key

The fundamental lesson from the above example is that in this day and age, where corporate reorganizations and mergers, acquisitions and divestitures occur with great frequency, an assignment clause that simply prohibits the customer from any transfer of the agreement is clearly inappropriate. Some degree of flexibility is critical, from the perspective of the customer.

The important question is "How much flexibility?" Is it reasonable for a customer to demand total discretion, as would be the case if the contract simply provided that the customer could transfer the agreement to any third party without the consent of the supplier? Virtually all suppliers will push back hard on such a proposition, as it would give rise to a secondary market in the software or services that are the subject of the contract. There are, however, certain narrow assignment scenarios that are very important to the customer but are typically not that problematic for the supplier (at least not when negotiated as part of the initial contract; when asked for by the customer later, the same flexibility from the supplier usually comes with a hefty fee to be paid by the customer).

Intragroup Transfers

One of these is the transfer of the agreement to an affiliate of the customer. The reason for such a transfer is typically driven by some form of reorganization of the corporate group to which the customer belongs. It might be, for example, that all IT agreements of a certain kind, worldwide, are being consolidated into a single, centralized entity.

Whatever the reason, most suppliers will not have a big issue approving, in advance (i.e., when the agreement is signed) such a possible future assignment by the customer. So, don't forget to reflect it in your revised version of the contract.

Sale of Business Exception

By far the most important exception to the "no assignment" default position of the supplier that a customer needs to address, however, is the scenario where the customer sells its business. At that point, it is usually critical that the outsourcing or other material commercial arrangement be transferable to the purchaser.

This is usually not a problem if the sale is being effected by a transfer of the shares of the customer. A non-assignment clause in a contract would not typically be triggered by a sale of shares, unless the contract specifically stated that such a change in control would be deemed to be an assignment (but this is done quite rarely).

The issue (for the customer) invariably arises when there is a transfer of the business by a sale of assets. In that case, the tech commercial agreement would be one such asset, and so the modified assignment clause ideally would allow a customer to assign the agreement (without supplier's consent) to a purchaser of the customer's business.

In this regard, the supplier may want to restrict the scope of this permission to those situations where the purchaser is buying "all or substantially all" the customer's assets. Be careful with such a narrowing. It essentially limits the permission to entire sales of your company. But it might be you're splitting your business into several businesses. In that case, a better formulation would be to allow the assignment to anyone who acquires the business unit(s) that uses the technology related to the contract at issue.

In short, it is very important that customers review the boilerplate (non)assignment clause, and then revise it to provide the customer with important flexibility as invariably will be required by the customer in the course of the next few years.

Novation vs. Assignment

As a customer, you need to consider one more important assignment-related issue. In most assignment situations, the assignor is not relieved of liability under the contract; rather, for this to happen, what the customer requires is a full novation (such that the supplier agrees the assignor has no ongoing liabilities under the contract after the transfer of it). While this is

preferable to the assignor, it presents some real risks to the supplier, including as to the creditworthiness of the assignee.

It is therefore not unusual to provide, in this part of a beefed-up assignment clause, that the novation is conditional upon the assignee having a certain credit rating (typically somewhat commensurate with that of the assignor). This is not an unreasonable ask from the supplier, as its core concern under the contract is to get paid.

Supplier's Assignment Rights

To this point, we have focused only on the customer's assignment clause requirements. What about the supplier's reasonable needs?

Suppliers typically want full flexibility, and so, in their standard form agreements usually they simply don't say anything to restrict their assignment rights (silence on this point tends to mean the supplier can assign the agreement without the need for customer consent). Or, if addressed in the supplier's standard form contract, the right of supplier assignment will be made subject to obtaining customer consent, but it is also provided that such consent may not be unreasonably withheld by the customer.

Narrowing Supplier Discretion

In many cases (and in most cases involving sophisticated, big-ticket deals), the customer will want to restrain supplier discretion more than what is contemplated by the "not to be unreasonably withheld" standard. Bottom line: the customer has spent long hours in the RFP process, and in subsequent negotiations, determining that this particular supplier is the one that best suits the customer's needs. Therefore, from the customer's perspective, the supplier should not be permitted, as a matter of right, to hand off the work to an entity that the customer does not know (or worse, that the customer refused to do business with as part of the same RFP process).

What this analysis leads most customers to conclude is that the supplier should only be able to assign the agreement to an entity that acquires the supplier's entire business (on the assumption that the core business that had been providing services to the customer previously will then continue to keep so operating, but under new ownership). There is, then, some symmetry between this exception to the general no-assignment rule, and the same sort of exception required by the customer and noted above. In both cases, some flexibility is introduced into the contract, but not so much as to make the parties nervous about the future of their respective counterparties.

Carving Out Revenue Streams

The one exception to the foregoing is where the supplier wants to assign the revenue stream it receives from the customer under the contract. A supplier would do this as part of a fairly typical financing plan of the supplier's business, and for the most part, this arrangement should not present the customer with a problem.

It should be made clear in the contract, however, that notwithstanding such assignment of the payments, the customer will continue to interface only with the supplier, and that if there are any issues arising out of the contract, they will be dealt with only by the supplier (and not the assignee of the revenue stream). Thus, contractual comfort must be given to the customer that such an assignment of the fees paid or payable under the contract will have no adverse impact on the customer. For example, the language should stipulate that if the payments are assigned (or the right to receive the payments are assigned) to an entity resident outside of Canada, then the supplier will indemnify the customer from any related withholding taxes that the customer may now have to pay as a result of the assignment of the payment stream to a company not resident in Canada.

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Intellectual Property

COPYRIGHT

Canada: Microsoft Wins Substantial Damages Award for Unauthorized Distribution of its Software

A federal court has granted Microsoft Corporation default judgment against two PC Village businesses and two individuals associated with the businesses in an action for copyright and trade-mark infringement. Microsoft's investigators had purchased computers from two separate PC Village locations. The judge found that one computer contained seven unauthorized Microsoft software programs, while the other had eight.

In assessing statutory damages for copyright violations, the judge noted that the defendants had been put on notice regarding the infringing nature of their activities. The judge also found that the individual defendants had candid discussions with the Microsoft investigators about their unauthorized distribution of software. He factored the bad faith and deliberate disregard of Microsoft's rights, as well as the need to deter other infringers, into the damages award. The judge also concluded that the defendants' conduct justified a significant punitive damages award and injunctive relief. Because the individual defendants were aware of and had participated in the infringing activities, the judge held them personally liable.

To send a clear message to the defendants and other counterfeiters, the judge awarded statutory damages of $10,000 per copyright violation as well as $50,000 for punitive damages against the companies and individuals jointly and severally, and a further $50,000 for solicitor/client costs.

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Sweden: No Safe Harbour for The Pirate Bay — Operators Fined and Sentenced for Aiding and Abetting Copyright Infringement

In what is being heralded as a victory for copyright holders, a Swedish district court has found four operators of the file-sharing service The Pirate Bay guilty of aiding and abetting copyright infringement, fined them US$3.6 million, and sentenced each to a year in prison.

The defendants were involved in the operation of The Pirate Bay, reportedly one of the world's largest bittorrent-tracking website. According to the court, users could upload and store torrent files on the Pirate Bay website as well as search the site's database for torrent files to download. The service also had a tracker function, which allowed users to contact each other to share the recording or work to which the torrent file referred.

The judge found that The Pirate Bay's server contained torrent files that related to copyright-protected works and that some of its site's users used The Pirate Bay's service to unlawfully share these materials. Therefore, the judge concluded that those users had breached the Swedish *Copyright Act* and were guilty of copyright infringement.

Since the defendants provided a website with advanced search functions, easy uploading and downloading facilities and a tracker feature, the judge determined that The Pirate Bay operation aided and abetted the users' breach of the *Copyright Act*. The judge also found that the defendants acted as a "team" in operating The Pirate Bay, they knew that copyright-protected works were available through the site and were shared through the use of The Pirate Bay's tracker, and they took no steps to remove the files and prevent the infringement. Therefore, the judge concluded that the defendants were guilty of complicity in an offence.

While the judge accepted that the defendants could be regarded as "service providers" under Sweden's *Electronic Commerce and Other Information Society Services Act*, he ruled that they did not meet the requirements for the safe harbour exemptions. That Act grants service providers freedom from liability in instances where the provider is not aware of the infringing activity, or expeditiously takes steps to prevent the infringement upon being notified.

According to media reports, the defendants sought a retrial, claiming that the judge was biased against them because he allegedly belonged to several pro-copyright organizations. However, the Svea Court of Appeal rejected this contention and refused a retrial. Since then, a Swedish software company has agreed to purchase The Pirate Bay's website and intends to introduce new business models that provide compensation for content providers and copyright owners for content downloaded from the site.

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TRADE-MARKS

Canada: Court of Appeal Serves Stiffer Shot in Trade-mark Expungement Applications

In a recent decision, the Federal Court of Appeal set some ground rules for relief that can be ordered in trade-mark expungement applications. The court also considered whether ancillary relief can be ordered when not expressly requested in the Notice of Application. In addition, it cautioned against issuing sweeping orders where the respondent has no notice of the relief being requested.

Spirits International B.V. was the owner of various STOLICHNAYA trade-marks for alcohol. It sought to expunge the STALINSKAYA trade-mark registration of S.C. Prodal 94 SRL. Under the *Trade-marks Act*, the court can order that an entry in the register be struck out or amended on the ground that at the date of the application, the entry on the register does not accurately express the existing rights of the registered owner.

Prior to the expungement proceeding, Prodal voluntarily cancelled its existing STALINSKAYA mark and applied for a fresh STALINSKAYA trade-mark for alcohol. Having cancelled the trade-mark at issue in the expungement proceeding, Prodal did not file a Notice of Appearance and did not participate in the hearing.

In its memorandum of law to the court, Spirits requested a stay of proceedings and an injunction prohibiting the registrar from considering the other pending trade-mark application for STALINSKAYA (forms of relief not requested in its Notice of Application).

First Call: The Trial Court Giveth

At the hearing, the application judge declared that Prodal's trade-mark STALINSKAYA was not distinctive because it was confusing with the Spirits' registered STOLICHNAYA trade-marks. With respect to Prodal's new, pending application for STALINSKAYA, the court granted the stay and injunction requested in Spirits' memorandum of law.

Last Call: The Appeal Court Taketh Away

Court could not grant relief that was not requested

On appeal, the Court of Appeal overturned the lower court by first declaring that "[t]hat which does not exist cannot be expunged."

Furthermore, the court noted that Spirits' Notice of Application did not include a request for a stay or an injunction, nor was that relief ancillary to the relief requested in the Notice of Application. Consequently, the judge had no authority to grant that relief.

The court also found that Spirits' "basket clause" request in its Notice of Application for "such other relief as counsel may advise and this Honourable Court deems just" was insufficient to encompass the relief requested

in Spirits' memorandum. There was no support that the basket clause should be extended to the granting of stays, mandatory injunctions or orders of prohibition, the court found.

The Court of Appeal pointed to other errors of law in the lower court's decision: in order to obtain a stay, Spirits needed to satisfy the tripartite test established by the jurisprudence, but the test was not even addressed, much less satisfied. Also, a mandatory injunction requires one to act positively and thus a mandatory injunction and a stay could not co-exist, contrary to the application judge's order.

Failure to file Notice of Appearance not fatal

By way of a separate preliminary motion, Spirits sought to quash Prodal's appeal on the basis that Prodal had failed to file a Notice of Appearance on the application. However, the Court of Appeal was not persuaded that Prodal had acquiesced to the granting of relief in circumstances where it did not have notice of the relief being requested.

Moreover, as a result of having failed to file a Notice of Appearance, Prodal was unaware of the relief Spirits requested in its factum. The Court of Appeal cautioned that, in circumstances where a respondent party does not have notice of the relief being requested, such relief should not be granted until notice is given and the respondent is offered the opportunity to respond.

McCarthy Tétrault Notes:

The case highlights the importance of seeking the appropriate relief in the Notice of Application, instead of relying on a catch-all basket clause to encompass any and all relief.

The decision also has implications for cases in which the respondent does not signal an intention to oppose the application. In such a case, the applicant may well be advised to provide the named respondent with notice of precisely what is being sought and what is being argued (e.g., by serving the respondent with all court filings).

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Europe:
eBay's Legal Battles Continue: A French Victory and a Prudent English Test Case

While a French court found that eBay was not liable to L'Oréal for the sale of counterfeit cosmetics on its auction website, an English court determined it required guidance from the European Court of Justice (ECJ) on the interpretation of applicable directives before deciding key issues in a proceeding between the two parties. The English judge found that eBay was not jointly liable for trade-mark infringements committed by seven registered users of its site, but did not decide at this time

whether eBay was primarily liable for infringement or had a service provider defence.

A French Victory for eBay

After suffering two legal setbacks against Hermès and Louis Vuitton Moet Hennessy (LVMH) respectively in June 2008, eBay finally obtained a favourable decision from a French court.

Less than a year ago, a French court ordered eBay to pay, jointly with the seller of the counterfeit products, €20,000 in damages for infringing property rights of the French high fashion house Hermès. Shortly thereafter, the Tribunal de Commerce de Paris rendered a similar decision, ordering the online auction giant to pay LVMH's and its affiliates' damages, totalling €36.8 million.

In contrast to the French court's conclusion in the LVMH case, the Tribunal de Grande Instance de Paris characterized eBay as a hosting service provider and not as an online broker. Consequently, eBay could benefit from the limitation of liability concerning hosted information included in the 2004 *Loi pour la Confiance dans l'Économie Numérique* (which implemented European Directive 2000/31/EC).

Indeed, the court found that eBay only plays an intermediary role in bridging buyers and sellers online and does not have any control or authority over the selling process. Therefore, it could not be responsible for the illegal nature of the goods sold by third parties through its website. The liability of the host could only be engaged if it is proved that it knew, *de facto* or in appearance, about the illegal nature of the goods and did not act promptly to restrict the access to or remove completely such listing from its website.

However, the court found that the means taken by eBay to promote its website and the goods sold through its website, such as sponsored links and ad banners on eBay's website, are not hosting activities and are, therefore, subject to the common liability regime.

As the court found that L'Oréal failed to specifically identify the specific listings and sellers that were selling counterfeit goods, L'Oréal's action was dismissed. However, since it has been shown that eBay's website regularly contains listings of goods infringing rights of the plaintiff, the court suggested that the parties hold a mediation to discuss a better means to prevent or diminish the sales of counterfeit goods over the eBay platform.

L'Oréal has since announced that it will appeal the ruling.

English Court Shows Prudence

On the other side of the Channel, L'Oréal and its subsidiaries brought a similar action before the High Court of Justice. In that case, they sued eBay and its subsidiaries, along with seven individuals who allegedly sold infringing products through eBay's website.

L'Oréal had made three principal claims against eBay, namely:

1. eBay was jointly liable for the infringements committed by the individual sellers.

2. eBay was liable for trade-mark infringement for its use of L'Oréal's trade-marks, in sponsored links on third-party search engines and on eBay's website, in relation to infringing goods.

3. If the court found that the individual defendants had committed infringements, L'Oréal was entitled to an injunction against eBay to restrain future infringements by virtue of Article 11 of *European Parliament and Council Directive* 2004-48-EC (Enforcement Directive), even if eBay was not itself liable for trade-mark infringement.

1. *Joint liability*

Since the court concluded that there had been infringements in that case, L'Oréal contended that eBay had participated in a common design to infringe its trade-marks because eBay had combined with the sellers to secure the doing of acts that proved to be infringements. L'Oréal further argued that this common design was also based on the fact that eBay actually profits from these infringements and failed to take all reasonable measures to prevent the infringements. In addition, L'Oréal suggested that eBay already provides insurance for buyers through PayPal and therefore could, in the same way, insure its own liability.

While expressing sympathy for the notion that eBay could and should deal with the problem of infringement by accepting liability and insuring against it by means of a premium levied on sellers, the court rejected L'Oréal's arguments by acknowledging that (i) eBay is under no legal duty to prevent infringement, and (ii) facilitation with knowledge and an intention to profit is not enough to declare eBay a joint tortfeasor.

2. *Trade-mark infringement*

A) Use in sponsored links

In the judge's opinion, the display of L'Oréal's trade-marks in the sponsored links constituted "use" of those marks by eBay but he could not say that it is "acte clair." As the issue raised a number of questions of interpretation of the Trade-Marks Directive (EEC Directive 89/104), he required further guidance from the ECJ on this point.

B) Use on the website

As in the French decision, eBay claimed that it had a defence under Article 14 of the European Directive 2000/31/EC, which limits liability of hosting service providers. L'Oréal contended that eBay's activities go far beyond the mere passive storage of information provided by third parties, adding that eBay was well aware of the illegal activities occurring on its website. Even though the court seemed favourable to L'Oréal's argument, the judge declared that guidance from the ECJ was required on this issue as well.

3. *Injunction*

Finally, L'Oréal relied on Article 11 of the Enforcement Directive as entitling it to an injunction against eBay even if eBay were not liable for trade-mark infringement. L'Oréal argued that, having established a number of infringements by the individual defendants, Article 11 of the Enforcement Directive required the court to grant an injunction against eBay to prevent the same or similar infringement in the future.

The judge first noted that the United Kingdom has not taken any specific steps to implement Article 11 into United Kingdom law. Moreover, the judge noted that it would be difficult to issue an injunction against a person who does not have the allegedly infringing goods within its possession, custody or control. The judge concluded that the scope of Article 11 was unclear and was another matter upon which guidance from the ECJ was required.

> **McCarthy Tétrault Notes:**
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> Although eBay's French victory brightened its legal horizon, the battle for establishing the legal independency of online auction service providers versus the property rights infringed by its users is far from won. As the English court pointed out, there are many other cases around Europe both between the same parties and between other parties raising the same or similar issues. Considering the lack of uniformity in past European court decisions, it will be very interesting to see if any trend emerges in the subsequent cases.

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PATENTS

US:
Canadian Company i4i Wins $200-Million Verdict against Microsoft

A Texas federal jury recently awarded Toronto-based i4i $200 million in an action against Microsoft for patent infringement. i4i had sued Microsoft in 2007, alleging that certain versions of Word 2003 and Word 2007 infringe i4i's US patent entitled a "Method and System for Manipulating the Architecture and the Content of a Document Separately from Each Other." The verdict, according to Bloomberg, is the fourth-largest jury verdict in the US this year and the second-largest patent jury award in 2009 so far. Microsoft has denied that it infringed i4i's patent and claims that i4i's patent is invalid. It is seeking to overturn the verdict.

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US:
Certiorari Granted *In re Bilski* — US Supreme Court to Hear Business Method Patents Case

The US Supreme Court granted certiorari *In re Bilski*, a case that deals with the patentability of business method claims. In TLQ 5:1, we noted that the US Court of Appeals for the Federal Circuit had ruled in *Bilski* that all processes, including business methods, need to meet a "machine-or-transformation" test in order to be patentable subject matter. That test asks whether the claimed process is "tied to a particular machine, or transforms or reduces a particular article into a different state or thing." The US Supreme Court decision, it is hoped, will provide some guidance on the viability and boundaries, if any, of business method patents in the US.

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Privacy

CASES/LEGAL DEVELOPMENTS

Canada: Employer's Computer-Use Policy Passes Test — Teacher Did Not Have a Reasonable Expectation of Privacy in Information Stored on School Computer

The Ontario Superior Court of Justice's recent decision in *R.* v. *Cole* emphasizes the importance of employer policies in determining whether an employee has a reasonable expectation of privacy in information stored on an employer's computer.

In *Cole*, a teacher who had a role in supervising and monitoring student and staff use of the school's computer network was found in possession of nude photographs of one of the school's students, on a laptop owned by the school and assigned to him. The teacher had segregated the data in a "My Documents" folder on one of the laptop's drives and password-protected the laptop. A school board technician managed to access the computer without the password, and found the file containing the photographs. The accused teacher argued that he had a reasonable expectation of privacy in the laptop's hard drive — and that the search was therefore illegal.

In determining whether the teacher had a reasonable expectation of privacy, the court considered whether the teacher had a subjective expectation of privacy and whether his expectation of privacy was objectively reasonable. Given that the teacher had possession of the computer, and that he had password-protected it and shaded the folder with the images, the judge accepted that the teacher had a subjective expectation of privacy.

In assessing the second criterion, the court considered the accused's employment contract, his employer's ownership of and issuance to him of the laptop, as well as the rules regarding his use of it, including the permissibility of personal use and the user's right to privacy.

The court found that the teacher's expectation was not objectively reasonable based on the following facts:

1. The laptop computer was owned by the school board.

2. The teacher was aware of the terms of the school's acceptable-use agreement for use of the school's network. That agreement included a provision reserving the school's right to monitor work, e-mail and data stored on school computers and servers, and indicating that such files were not private. All of the teachers at the school were notified annually that they were bound by the terms of this agreement. Further, the teacher played a role in enforcing the terms of the agreement.

3. The teacher was bound by various school board policies posted on the board's website. These policies provided that all data generated on or handled by board equipment (in this case, the laptop) were board property. The policies also prohibited the access and handling of inappropriate content.

In his contextual analysis, the judge noted an employer's need to protect both its data and the operational integrity of its computer system: "I take judicial notice of the fact that employers, in their use of computers to carry on their business, invest tremendous amounts of money and time creating, inputting, analyzing, managing and protecting the data coming into, going out of, and stored on their computer system."

> **McCarthy Tétrault Notes:**
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> In TLQ 4:1, we discussed whether an employee is entitled to privacy over e-mail and other data created and stored on a computer used for work purposes as well as what rights an employer has to access that information. We noted that the answer depends on whether the employee has a reasonable expectation of privacy. The *Cole* decision provides further guidance on the circumstances in which a reasonable expectation of privacy may be found.
>
> In the *Cole* decision, two main factors against the employee's reasonable expectation of privacy were board policies governing access to data and privacy, and the acceptable-use agreement that governed both student and teacher use of the school's computer network. Employers would be well-advised to:
>
> 1. Implement clear-cut and comprehensive policies governing the employee's right to access data and systems. If an employer does not want an employee to have a reasonable expectation of privacy over any data found on a computer or the employer's network, then this should be clearly stated.
>
> 2. Ensure that employees acknowledge that they have read, understood, and agreed to abide by the employer's policies.
>
> 3. Make clear that copies of employer-owned data remain the employer's property regardless of where the data is stored.
>
> 4. Manage employee privacy expectations over information stored on laptops by providing company laptops to employees for offsite work and capitalizing on their ownership of the equipment.

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Ontario:
Production of Pages from Social Networking Sites — if it's Relevant, it Must be Disclosed

In two Ontario cases, the courts considered whether the private contents of a Facebook® profile had to be produced in the context of litigation. The decisions, *Murphy* v. *Perger* and *Leduc* v. *Roman*, add to a growing body of case law involving social networking sites and the need to disclosure relevant webpages and photographs.

Under the Ontario *Rules of Civil Procedure*, parties have a duty to disclose — and, if requested, produce for inspection any relevant "documents" in their possession. The case law has established that photographs and webpages are documents and therefore must be disclosed.

In *Murphy*, the defendant moved for production of the plaintiff's Facebook® webpage. The plaintiff had been involved in a motor vehicle accident, and claimed general damages for the resulting pain and suffering and loss of enjoyment of life. The defendant contended that photographs on the plaintiff's private Facebook® page would be relevant to the proceeding and should be produced.

Before addressing the plaintiff's privacy concerns, the court assessed whether the documents in question were relevant to an issue in the proceeding. In this case, the court noted that the plaintiff had previously served photographs taken of her prior to the accident, and therefore, she obviously felt that some photographs were relevant to her damages claims.

In the court's view, it was reasonable to conclude that there would likely be relevant photographs on the plaintiff's private Facebook® page because (i) www.facebook.com is a social networking site where users post a large number of photographs, and (ii) the plaintiff's public webpage contained photographs.

Having disposed of the relevance issue, the court then addressed the plaintiff's privacy argument. The judge ruled that any invasion of privacy was minimal and was outweighed by the value of the photographs in the litigation. The judge went on to note that "The plaintiff could not have a serious expectation of privacy given that 366 people had been granted access to the private site." In the end, the judge ordered production of the copies of the webpages posted on the plaintiff's private Facebook® site.

More recently, the Ontario Superior Court seems to have gone one step further. In *Leduc*, the plaintiff didn't have a public Facebook® page with photographs from which the court could infer that his private profile might also have photographs. Only his name and a head shot were publicly visible; he had restricted access to his posted material to his Facebook® friends.

As in *Murphy*, the plaintiff and the defendant had been in a car accident. The plaintiff claimed that the defendant's negligent driving

had lessened his enjoyment of life and the accident had caused limitations to his personal life.

Once the defendant became aware of the plaintiff's Facebook® profile, she sought an order requiring the plaintiff to preserve all the information on his Facebook® profile and to produce all the pages. The latter request was denied by the presiding master, who characterized it as a "fishing expedition." In his view, drawing an inference about the content likely to be found on a specific Facebook® profile from a "typical" Facebook® profile was pure speculation.

On appeal, the judge emphasized that while the plaintiff was under an obligation to produce all relevant documents in his possession, the onus for reviewing documents to determine their relevance rests initially with the party bearing the obligation to produce. A motion for production requires real evidence that potentially relevant undisclosed documents exist.

The judge observed that people use Facebook® to share with others personal information about themselves. Therefore, the judge concluded, it was reasonable to infer that the plaintiff's Facebook® profile likely contained some content relevant to the matters at issue (specifically, to the state of his life after the accident).

The fact that the plaintiff's site was private did not alter his disclosure obligation: According to the judge, "A party who maintains a private, or limited access, Facebook profile stands in no different position than one who sets up a publicly available profile. Both are obliged to identify and produce any postings that relate to any matter in issue in an action."

The judge did accept that mere proof of the existence of a Facebook® profile does not entitle a party to access to all of the material placed on the site, and acknowledged that he was concerned about the breadth of the defendant's request for production.

As the defendant did not learn of the plaintiff's Facebook® profile until after discovery had been completed, the judge allowed the defendant to cross-examine the plaintiff on his supplementary affidavit of documents about the nature of the content he posted on his Facebook® profile.

> **McCarthy Tétrault Notes:**
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> These cases demonstrate that, if personal information on a social networking site is relevant, it must be disclosed in litigation — regardless of an individual's privacy settings. Litigation counsel are obliged to ask their clients about Facebook® and other social networking site content to ensure that it is preserved, if it is relevant to matters in issue.

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Communications

CASES/LEGAL DEVELOPMENTS

Canada: New Legislation Targets Criminal Investigations Involving ISPs, Other Telecom-Related Operators

The Canadian government recently introduced legislation designed to facilitate criminal investigations involving ISPs and other telecommunications-related operators (TSPs). Bill C-46 grants extensive new investigative powers to Canadian police forces, while Bill C-47 imposes new obligations on TSPs to ready their facilities so as to be able to cooperate with police investigations when those investigations occur.

To learn more about the TSPs' new disclosure, preservation and interception obligations as well as the timelines for implementing facility upgrades, compensation for compliance activities, and limitations on TSPs' liability for cooperating with law enforcement, read our detailed analysis of the bills. The article also compares and contrasts the Canadian approach with the American *Communication Assistance for Law Enforcement Act* legislation.

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Canada: The Canadian Do-Not-Call List — Is Disconnection Coming?

Barely nine months after the Canadian Radio-television and Telecommunications Commission launched its long-awaited Do-Not-Call List (DNCL) to cut down on unwanted telemarketing calls, the Canadian government introduced legislation that will, if implemented in its current form, kill off the DNCL and replace it with a much stricter regime.

The source of this unexpected initiative is Bill C-27, the *Electronic Commerce Protection Act* (*ECPA*), Canada's proposed legislation to curtail spam and spyware. Under the *ECPA*, all electronic messages to encourage participation in a commercial activity are banned unless they fall under certain permitted exemptions (e.g., where prior consent is obtained or a pre-existing relationship exists between sender and recipient that is not more than 18 months old).

Although the clear focus of the *ECPA* is e-mails, the proposed legislation contains sections that extend the definition of "electronic message" beyond e-mails to include voice calling. This is not simply a matter of over-reaching

definitions. Bill C-27 contains sections that deliberately revoke the DNCL-enabling provisions in the *Telecommunications Act.*

The *ECPA*'s approach of the consumer having to consent to receive commercial electronic messages (the "opt-in" model) is in contrast to the DNCL's approach, where all telemarketing calls are permitted unless the consumer has taken the step of registering his or her number with the DNCL administration (the "opt-out" model). The former approach should be easier for the CRTC to administer, as it will not need to maintain a database of opt-out consumers. However, businesses that wish to engage in messaging activities will find a narrower scope of permitted activity.

Government officials have indicated that they do not intend to invoke the DNCL-ending sections of Bill C-27 anytime soon, but that they want to have the legislative framework in place so the government can do so in the future when such a step becomes desirable — without the need to go back to Parliament. What will trigger such action? The officials won't say, although they do suggest that any change will be preceded by appropriate consultation.

McCarthy Tétrault Notes:

Any decision to terminate the DNCL and apply the *ECPA* to voice calling will have a dramatic impact on Canadian business. Suddenly, all calls to encourage participation in a commercial activity will be illegal except where permitted by specific exemptions. Unless the exemptions that are available in Bill C-27 are expanded, business-to-business cold calling, which is allowed under the DNCL, will be forbidden. Moreover, when permitted, every such voice call will have to comply with specific requirements, including the perplexing, e-mail-oriented requirement "to set out an 'unsubscribe' mechanism." Constraints such as these will make it difficult for Canadian businesses to reach out to new customers.

Start-up businesses will be particularly hard hit. Indeed, it is hard to see how any business could start up in Canada if it cannot make cold calls or send e-mails to prospective customers. Unless changes are made to the *ECPA*, some entrepreneurs will probably find it easier, and less risky, to set up outside the country and market to Canadian businesses from there.

Bill C-27 is presently before Parliament. Business groups are making representations to parliamentarians on many aspects of the Bill — including, we expect, the sections intended to kill off the DNCL and replace it with the *ECPA*. It will be interesting to see how the government responds.

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Canada:
CRTC New Media Policy Released

The Canadian Radio-television and Telecommunications Commission (CRTC) has issued a decision in its year-long consultation on audiovisual material delivered in Canada using the Internet or an on-demand mobile platform. In *Broadcasting Regulatory Policy CRTC 2009-329*, the CRTC decided not to require mobile and Internet access providers to fund Canadian audiovisual content, nor to compel software-locked audiovisual devices to ensure shelf space for Canadian content. However, in a move that will be of interest to many "net neutrality" advocates, distributors of audio and audiovisual material over the Internet or on-demand mobile platforms will now be prohibited from conferring an undue preference or subjecting anyone to an undue disadvantage.

Other rulings include:

- reservation of the power to require exempted Internet or mobile platforms to file information with the CRTC in order to help it monitor and release better information on Canadian new media markets;
- a recommendation to the federal government that it follow the lead of countries like France and the UK in creating a national digital strategy; and
- a technical change in terminology that will resolve legal ambiguity about the status of on-demand mobile audio services.

The CRTC has launched three follow-up proceedings as a result of this decision. The first is a CRTC consultation to iron out more specifically:

- how to prohibit undue preference;
- who should be required to provide what market information to the CRTC; and
- how to redefine the CRTC's terminology for new media, which will now cover both Internet and mobile point-to-point audio and audiovisual material.

Separately, the CRTC has invoked a little-used provision to ask the Federal Court of Appeal to resolve a much-debated legal issue as to the distinction between broadcasting and telecommunications as these are defined in various statutes. Finally, the CRTC will, at an unspecified future date, initiate a proceeding to identify exactly what it should monitor in Canadian new media markets — and how.

For a more detailed discussion of *Broadcasting Regulatory Policy CRTC 2009-329*, please see the article written on this topic on our website.

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Canada: CRTC Removes Three-Year Limitation on Pay and Specialty Television Services' Upgraded High-Definition Feed

In a series of recent licence-amendment decisions, the Canadian Radio-television and Telecommunications Commission (CRTC) has dropped the three-year limitation on upgraded high-definition (HD) feeds of already-licensed pay and specialty services. This change implements the HD regulatory framework first announced in Broadcasting Public Notice CRTC 2008-100. Pay and specialty television services can now apply to offer a HD feed, known as an "upgraded" HD feed, for the balance of their remaining term of licence.

Pay and Specialty Services

Canadian pay and specialty television services include:

- Analog services, licensed between 1984 and 1996, whose analog and digital signals most regulated broadcasting distribution undertakings (BDUs) must make available to subscribers. Analog services are protected against competition from other pay or specialty services within the same genre — such services will not licensed if they are wholly competitive with an analog service.

- Digital Category 1 services, licensed since 2000, whose digital signals most regulated BDUs must make available. Digital Category 1 services are licensed only if they are not wholly competitive with any analog service, but in turn enjoy protection against competition (genre protection) from Category 2 services.

- Digital Category 2 services, also licensed since 2000, who must negotiate with BDUs for carriage.

The HD digital television format is defined for regulatory purposes as one that encodes pictures using at least 720 progressive-scan (non-interlaced) or at least 1020 interlaced lines. The CRTC has stewarded the introduction of HD television into Canada as part of the CRTC's broader approach to digital television, including both over-the-air broadcasting and discretionary services distributed directly through BDUs.

Transitional Undertakings and Upgraded Versions

The CRTC's 2006 regulatory framework for the licensing and distribution of HD pay and specialty services created two ways that pay and specialty services could begin broadcasting in HD. First, they could apply to add an upgraded HD feed of their existing non-HD service by obtaining an amendment to the existing service's conditions of licence. Second, they could apply for a new "HD-transitional licence."

An upgraded HD feed is a relatively straightforward way for existing licensees to offer a HD version of their service in the near term upon making a simple application to the CRTC. Although no minimum level of HD programming is required of the licensee's upgraded HD feed, 95 per cent of the upgraded HD feed's programming must be identical to that of its standard definition (SD) counterpart, and a BDU is not obliged to carry an upgraded HD version. As originally set out, an upgraded HD feed would be authorized only for a three-year period.

An HD-transitional licence was a second option for pay and specialty services seeking to make an HD version available. In exchange for meeting a minimum 50 per cent quota on HD programming during the broadcast day, the licensee gained the right to include on its HD feed up to 14 hours of unique HD programming that did not appear on its SD feed. In addition, the pay or specialty service's HD-transitional version would enjoy the same genre protection and carriage rights as its SD version. This was intended to make the HD-transitional option attractive, particularly to analog and digital Category 1 services: the upgraded HD version could air only 8.6 hours (five per cent of the broadcast week) of unique HD programming, and once an analog or digital Category 1 service's upgraded HD version's three years had run out, that service would no longer enjoy genre protection in the HD format. Only an HD-transitional version, with its mandatory minimum level of HD programming, would allow a service to maintain its protected status indefinitely.

Upgraded Version Wins Out

Following the establishment of the "hybrid" upgraded/transitional HD regime, a number of pay and specialty services applied, and were granted permission, to begin supplying an upgraded HD version. However, none applied for an HD-transitional licence.

Noting this in Broadcasting Public Notice CRTC 2008-100, the framework decision that reclassified analog and digital Category 1 services as "Category A" (must-offer) services, the CRTC decided that BDUs would henceforth be permitted to decide whether they would carry the SD or HD version (or both versions) of a service in order to fulfill their requirement to offer a digital version of that service, rather than be required to offer both versions of a Category A service.

In providing BDUs this flexibility, the CRTC removed one of the key "carrots" that went with the HD-transitional licence. In further deciding not to implement the rules under which an HD-transitional licence could be obtained, the CRTC also appeared poised to eliminate the three-year ramp-up after which services would be required either to program a minimum proportion of HD content, or lose their genre protection.

In a series of decisions amending pay and specialty services' conditions of licence to allow them to offer an upgraded HD version (Broadcasting Decisions CRTC 2009-55, -207, -286, -287, -288 and -289), licensing such stations (Broadcasting Decisions CRTC 2009-123, -219), or extending their three-year HD

authority to a full licence term (Broadcasting Decisions CRTC 2009-342, -343 and -344), the CRTC now appears to have confirmed that, in the absence of an HD-transitional licence to ramp up to, the three-year ramp-up cap would be removed from upgraded HD versions.

Cost of Transport

Although programming services' requirements for phasing in HD content have been relaxed, some of their costs to do so have not. Broadcasting Public Notice CRTC 2008-100 noted that the cost of signal transport for Category A services had been left to the market, but also indicated the "[t]he costs associated with transporting pay and specialty services have become a greater concern due to the increased costs of transporting HD versions of these services."

The CRTC recently concluded a public proceeding on its oversight of the transportation of television services to BDUs, hoping to stimulate greater competition in the signal transport sector. A decision is forthcoming.

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Clean Technology

CASES/LEGAL DEVELOPMENTS

Canada: The New Currency of Carbon Tonnes: Hints at $100+

The National Round Table on the Environment and the Economy (NRTEE), a federal Crown corporation, recently released a report entitled *Achieving 2050: A Carbon Pricing Guide for Canada*, concluding that "Canada must act decisively now if we are to achieve our 2050 emission-reduction targets." The NRTEE recommends carbon prices, representing the cost of purchasing permits, allowances or offsets for emitting greenhouse gases (GHGs), in the $100 to $200 per tonne range. The NRTEE characterizes such prices as "the least economic cost" by which the federal GHGs targets of 20 per cent below 2006 levels by 2020, and 65 per cent below 2006 levels by 2050 can be met. Without complementary regulations and other measures recommended in the report, the NRTEE estimates that national carbon prices upwards of $300 per tonne would be required post-2025.

Achieving 2050 emphasizes absolute rather than intensity-based targets, and recommends the development of a uniform, national, economy-wide cap-and-trade system no later than 2015. Under a cap-and-trade system, the government would set limits on the amount of GHGs that regulated facilities can emit. Emitters who are able to reduce their emissions below the limits would receive credits for the surplus, which they in turn could sell to other emitters or use to offset future emissions.

The NRTEE recommends transitioning from initial allocations of emission permits to a full auction by 2015 (with the exception of the electricity sector where a full auction is recommended immediately because permit costs can be passed through to customers). A hard cap is recommended by 2015, a full auction by 2020, and full carbon market trading beyond 2020. The NRTEE recommends that an auction initially be phased in and output-based allocations limited, but suggests that sectors particularly exposed to trade and cost challenges be able to obtain output-based allocations.

According to the NRTEE, the sort of hybrid cap-tax system recommended should include carbon taxation elements for price certainty and cap-and-trade elements for reduction certainty.

National Regime: All Jurisdictions, All Emissions

The NRTEE recommends unifying existing provincial efforts into a national scheme covering all jurisdictions and all emissions as soon as possible in order to realize necessary economic efficiencies and reinforce Canada's engagement in international markets. Regional and sector-specific disproportionate impacts are recommended to be targeted through "income support" rather than a fundamental dilution of the carbon price.

The NRTEE recommends that a national cap apply to large final emitters (including fugitive and process emissions) as well as to buildings, households, transportation, and light manufacturing sectors, which for certain sectors should include regulations or taxation based on the carbon content of the fuel purchased by such users.

Achieving 2050 suggested that domestic offsets created from sectors not covered by the cap-and-trade regime should initially be allowed, but phased out "rapidly" within the first few years.

International Linkages

The NRTEE recommends that Canadian participation in international frameworks be increased and that Canadian businesses be permitted to seek real and verifiable reductions outside Canada for domestic compliance purposes. Even at $100 to $200 per tonne, NRTEE modelling suggests that sufficient reductions will not be achieved within Canada, and that affordable, credible, and sustainable foreign opportunities must be included.

According to the report, without international trading, domestic prices could rise to $300 per tonne by 2030. With 30 per cent international credits allowed, however, prices could remain below $200 over the same period. International linkages could be through U.N. frameworks or directly to US or European schemes and should move towards a unified global carbon price.

Complementary Regulations

Along with the cap-and-trade regime, the NRTEE also recommends complementary regulations, particularly in the upstream oil and gas, pipelines, transportation, buildings, landfills, and agricultural sectors, which could mandate changes to certain practices, vehicle standards, public transportation programs, building codes, or fuel content, for example. The NRTEE estimates that complementary regulations could contribute almost half of the necessary reductions by 2020 and almost a fifth by 2050, and would effectively reduce the highest costs of abatement and help reduce the national carbon price.

Overall, *Achieving 2050* strongly recommends that there be no further delay in federal policy development and indicates that "*fast and deep*" reductions are needed prior to 2015 to avoid more expensive reduction costs in future years. The NRTEE recommends that early auction revenues be invested in technology and economic impact mitigation. Overall, the NRTEE sees three key policy wedges necessary for Canada to achieve its targets:

1. a national cap-and-trade system,

2. complementary regulations and technology policies specifically directed at hard-to-reach emissions, and

3. international carbon-abatement opportunities to help align domestic prices with those of our major trading partners.

Achieving 2050 estimates annual compliance costs of $3.4 billion by 2020, and indicates that 2020 auction revenues for the 570 mega-tonnes (Mt) available may approach $18 billion. Distribution of this value will be important and auction design will require careful consideration. In terms of macro-economic impacts, *Achieving 2050* assumes that under a "business-as-usual" scenario, Canada's economy would grow in the order of 40 per cent by 2020 and 150 per cent by 2050, and implementation of the recommended carbon policy would shrink such national economy by one to three per cent in 2020 and three to five per cent in 2050.

A more detailed description of the NRTEE report is available on our website.

> McCarthy Tétrault Notes:
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> After the NRTEE report came out, the federal government announced "Canada's Offset System for Greenhouse Gases" and published a revised overview of the proposed offset system, describing the principles underlying the system's design, setting out the requirements for offset credits, and outlining the intended use of the credits in a carbon market.
>
> Under the system, companies will be able to apply to the federal Minister of the Environment to register domestic offset projects that will result in "real, incremental, quantifiable, verifiable and unique" GHG reduction or removals. Once the GHG reductions are verified, offset credits may be issued and may thereafter be banked, traded or used for compliance purposes.
>
> As part of this initiative, the federal government also released two draft guides for public comment: *Program Rules and Guidance for Project Proponents and Program Rules for Verification and Guidance for Verification Bodies*. These documents set out rules and guidance on the requirements and processes to create offset credits and verify a registered project's GHG reductions or removals. The government expects final versions of the guides to be published in the fall of 2009.

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Ontario:
Ontario Introduces Legislative Changes to Facilitate a Cap-and-Trade System for Greenhouse Gases

The Ontario government recently introduced Bill 185, the *Environmental Protection Amendment Act* (*Greenhouse Gas Emissions Trading*), *2009*. This new legislation proposes amendments to the Ontario *Environmental Protection Act* that would provide the regulatory authority to set up a greenhouse gas cap-and-trade system in Ontario. The changes would permit the creation of regulations that would set rules around various aspects of a cap-and-trade system, such as the granting and/or

auctioning of allowances, linking to other trading systems, credit for early action, the use of offsets, and verification and reporting provisions.

The government also released a discussion paper, *Moving Forward: A Greenhouse Cap-and-Trade System for Ontario*, which outlines the elements of a cap-and-trade system, gives a background and overview of previous stakeholder comments on each element, and outlines design issues and policy options for each element. Government news releases indicate that stakeholder discussions on the details of a cap-and-trade system will continue over the summer and fall of 2009. Our information is that, at this point, the preferred model inside the government resembles the nitrogen oxides and sulphur dioxides Regulation 194/05, albeit with a possible auction component as well as provisions for offsets.

The details of the cap-and-trade system that is finally adopted in Ontario, such as the extent of credit that is given for early action and the mechanism chosen to allocate allowances (whether by auction or gratis), will have broad implications for regulated emitters.

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Québec: Québec Cap-and-Trade System Proposed

The Québec government recently introduced Bill 42, An *Act to amend the Environment Quality Act and other legislative provisions in relation to climate change*, which proposes a structure for a provincial greenhouse gas (GHG) cap-and-trade system. When considered in the broader North American context, Bill 42 will present business opportunities for clean technologies.

North American Context for Québec Regime

The adoption of Bill 42 would enable Québec to meet its commitments as a member of the Western Climate Initiative (WCI), a group of seven US states and four Canadian provinces (British Columbia, Manitoba, Ontario and Québec) that have committed to common GHG emission-reduction targets and to implementing a regional cap-and-trade system.

British Columbia's *Greenhouse Gas Reduction Act* received Royal Assent last year and will come into force by regulation. This year, Ontario introduced the *Environmental Protection Amendment Act* (*Greenhouse Gas Emissions Trading*), *2009* (Bill 185). Manitoba is expected to introduce proposed legislation shortly. Bill 42 also aligns with a June 2008 memorandum of understanding between Québec and Ontario.

These provincial regimes differ significantly from Alberta's *Climate Change and Emissions Management Act* and from federal policy set

out in the Government of Canada's "Turning the Corner" plan. They also differ in many ways from the system proposed in the American *Clean Energy and Security Act of 2009* (Waxman-Markey Bill).

Key Features of Bill 42

Reduction targets will be based on 1990 emissions and may be broken down into sector-specific targets. The proposed GHG emission-reduction objective is 10 million metric tonnes (Mt CO_2 eq.) per annum.

No specified threshold for emitter eligibility has yet been set. Emitters that are subject to the new regime will have to counter actual GHG emissions with an equivalent number of emission units. These will include: (i) free allowances granted by the Minister; (ii) allowances sold at auction or by agreement; (iii) early-action credits; and (iv) offsets. Finally, the Minister may grant any other type of emission-reduction units determined by future regulation.

These units will be fungible and emitters will be able to trade them. Emitters will be entitled to bank them for use or trade during a later period. The Minister will maintain a public register of emission allowances to ensure proper accounting and tracking. Furthermore, the Minister will have the power to enter into agreements with governments or international organizations for the harmonization and integration of cap-and-trade systems.

Failure to comply with the targets will result in penalties. All sums collected through auctions and penalties will be paid into the Green Fund, which will be used to finance measures to address climate change.

Comparison with Other Initiatives

The WCI provides for emission reductions of 15 per cent below 2005 levels by 2020, while the Waxman-Markey Bill provides for three per cent reductions below 2005 levels by 2012 and reductions of seven per cent by 2020, 42 per cent by 2030 and 83 per cent by 2050. The Canadian federal plan proposes intensity-based reductions rather than fixed emission caps. All covered industrial sectors will be required to reduce their emissions intensity from 2006 levels by 18 per cent by 2010, with two per cent continuous improvement every year after that. The federal government also indicated its intention to move from emission-intensity targets to fixed emission caps in the 2020-2025 period.

The WCI provides that early-action credits may be issued for reductions that occurred between January 1, 2008 and January 1, 2012. The Canadian federal plan proposes a very limited amount of early-action credits for reductions that occurred between 1992 and 2006. The Waxman-Markey Bill does not allow for issuance of early-action credits.

Both the WCI and the Waxman-Markey Bill allow for offsets, but propose limiting their availability for use by regulated emitters. While the WCI limits offsets to 49 per cent of total emission reductions from 2012 to 2020, the Waxman-Markey Bill proposes an upper limit of two billion tons of offset allowances, as well as

variable limits on use for regulatory compliance. In the recent report by the National Round Table on Environment and Energy (NRTEE), it proposes that the availability of offsets be phased out by 2015.

> **McCarthy Tétrault Notes:**
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> Bill 42, particularly when taken in the broader North American context, presents business opportunities for clean technologies. Emission-reduction incentives will include funding of research and development for clean technologies. Non-regulated companies may be able to leverage the economic value of reductions achieved through their technology to finance projects. Regulated GHG emitters will create demand for clean technologies and resulting offsets.
>
> As currently drafted, Bill 42 rewards early emission reductions. Forthcoming regulation should be monitored to maximize benefits from early-reduction credits. For example, as mentioned above, according to the WCI, 49 per cent of total emission reductions could be satisfied by offsets.
>
> Emission-reduction units will also present trade opportunities. The NRTEE is predicting carbon prices as high as $200 to $300 per tonne, if provincial cap-and-trade systems are not integrated and if the Canadian system is not linked internationally.

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BC:
Offsetting the Olympic Games: BC Offset and Clean Tech Companies Make Vancouver 2010 the Greenest Games Yet

The Vancouver 2010 Olympics will be the first carbon-neutral event of its kind. This is all thanks to Offsetters, a leading BC supplier of high-quality carbon offsets, and its arrangement with the BC Cleantech CEO Alliance. Under the multi-million-dollar sponsorship agreement, up to 300,000 tonnes worth of carbon offsets will be provided to the Vancouver Organizing Committee for the 2010 Olympic and Paralympic Winter Games (VANOC). This sponsorship makes the 2010 Winter Games the first in Olympics in history to have an Official Supplier of Carbon Offsets.

To provide the projects, Offsetters is working with local clean technology companies, including Nexterra, Sempa Power, Lignol Innovations, Ballard Power and Powertech — all members of the BC Clean Tech CEO Alliance. The project portfolio will comprise projects that focus on energy efficiency or the production of renewable energy. So far, the proposed offset projects include fuel cell technology in transit buses, energy-efficiency

systems, as well as biomass gasification and hydrogen fuelling stations to reduce industrial use of gasoline and electricity. The projects and technologies from these clean technology companies will play a pivotal role in bringing this undertaking to fruition.

Overall, these projects will offset a minimum of 110,000 tonnes of direct carbon emissions related to the Olympic Games. This emissions estimate includes all aspects of staging the Games in Vancouver and Whistler, including transportation, energy consumption, venue construction and the cross-country torch relay. VANOC and Offsetters also aim to offset an additional 190,000 tonnes of indirect carbon emissions through collaboration with Games partners, sponsors and participants.

All projects included in the project portfolio will be high-quality offsets consistent with standards applied by the new BC-based Pacific Carbon Trust. The Pacific Carbon Trust was created to provide carbon offsets to the BC government, to achieve its goal of carbon neutrality by 2010. The result of these policies is that there is now a market for carbon for BC-based projects, which is providing an additional revenue stream for BC clean technology projects. In the next TLQ, we'll discuss the role and benefits of the Pacific Carbon Trust.

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