2021

Legal Year in Review

Osler's insights on key developments and their implications for Canadian business.

OSLER

Table of contents

Introduction

When the year began, we hoped that we would not be writing the 2021 edition of this publication while still grappling with the effects of the COVID-19 pandemic. With the pandemic approaching the end of its second year, 2021 has, like 2020, been a year like no other. In spite of the continued pandemic, we are pleased to offer updates on many important legal and business developments across a wide variety of industries and practice areas, many of which do not relate to COVID-19. We take this as a positive sign of a return to at least some aspects of pre-pandemic life.

In fact, many of our colleagues chose to write about the "new normal" or the "return to normal." But what does that mean in a year such as 2021? On the one hand, with continued lockdowns and restrictions and fluctuating case counts, many employees have continued to work remotely. Return to office, or RTO, has begun, but slow progress is being made due to the persistence of COVID-19 variants, notwithstanding the rapid rollout of vaccines. Yet, this hasn't affected transactional activity. On the contrary, mergers and acquisitions activity has been unprecedented and capital markets activity extraordinary, with one of the busiest IPO markets in Canadian history. Despite these unexpectedly high transaction activity levels, many businesses have continued to face significant challenges as a result of the ongoing pandemic. Against this backdrop, we are pleased to offer our collective thoughts on the most important legal and business developments from the past year in our eighth annual *Legal Year in Review*.

As we began to prepare this year's publication, several key themes emerged. The first is the evidence that Canadian businesses are getting "back to business." Heightened transaction volumes and significant growth in new sectors of the economy (including, for example, technology, cryptocurrency and artificial intelligence) are hallmarks of 2021. The second theme relates to

the challenges that Canadian businesses continue to face – major supply chain disruptions, workforce retention issues, debates over mandatory vaccination policies and challenges in bringing a disparate workforce back to the office safely. Third is the remarkable and heightened focus of businesses, investors and governments on the importance of Environmental, Social and Governance (ESG) considerations. Finally, governments and courts returned to legislating and adjudicating – leading to major regulatory developments and key decisions discussed in a number of our articles.

As Stephen Poloz, our esteemed Special Advisor and the former Governor of the Bank of Canada, notes, the pandemic has had a dramatic impact on the Canadian economy which is experiencing many changes as a result. These include changes of a transitory nature – such as supply chain disruptions and corresponding rises in prices for many goods – and changes that are likely more permanent – such as a shift in how employees carry out their employment. In some sectors, employees may never fully return to working in an office. It remains to be seen how the Canadian business and legal landscape will be affected in the long term.

The extraordinary deal-making activity witnessed in 2021 was driven by ripe economic conditions. At the same time, several important decisions have been issued or are pending that are likely to have significant implications for M&A practice in Canada, including, in particular, those pertaining to "busted deals." Many important developments also arose in capital markets and securities, with Canadian regulators pushing to advance their burden reduction initiatives, while at the same time reacting to dramatic increases in capital markets activity levels.

Many issuers sought to become public or take advantage of financing windows to raise capital. In particular, technology issuers led the charge in initial public offerings, including healthcare technology. In healthcare, clinical businesses also encountered significant interest in consolidation by domestic and foreign buyers. At the same time, other issuers, such as juniors in the mining industry, continued to face challenges in raising capital, both due to market dynamics and regulatory limitations. Facing increased competition from public equity markets, private equity has responded with new products and fund structures designed to provide fund managers with greater flexibility and investors with broader choices.

The prominence of technology issuers in the capital markets was mirrored by greater attention to the importance of innovation to the Canadian economy, leading to notable developments in several areas. With a dramatic rise in interest in cryptocurrencies around the world, regulators took material steps towards regulating cryptoasset businesses offering their products or services to Canadians. Other areas of the innovation economy have also made important strides in 2021, including, in particular, artificial intelligence. The ownership of intellectual property developed by artificial intelligence raised interesting questions for legislators around the world. The acquisition of artificial intelligence businesses also gives rise to important and unique diligence considerations and deal terms for potential acquirors.

As businesses pushed to get back to work, employers began to plan their RTO strategies. While some have deferred a return to office, even on a partial basis, until 2022, many employers were able to begin bringing their employees back

to the workplace in earnest. Principally driven by the mass rollout of COVID-19 vaccines and widespread availability of testing, employers and employees alike are beginning to return to office towers in downtown cores. However, RTO raises important legal questions for employers. Aside from these COVID-19 related concerns, regulators and courts implemented changes and made decisions that will be important to the workplace going forward. Employers must also grapple with important compensation questions that are likely to have an impact on behaviour and performance, particularly for executives.

Meanwhile, businesses and consumers faced significant headwinds, particularly with disrupted global supply chains and resulting increases in the price of goods. Suppliers and customers encountered major challenges in sourcing and securing consistent and timely supplies. In challenging supply environments, there is increased exposure and vulnerability to potential criminal activity. Businesses must be ever vigilant and focused on implementing and maintaining robust compliance programs to stave off potential corruption risks.

Border restrictions, supply chain issues and political disagreements have certainly had an impact on Canadian trade. However, for the most part, governments sought to preserve the status quo by expanding existing trade agreements, continuing their negotiations of new agreements and expanding sanctions and human rights rules.

Notwithstanding ongoing challenges, many took the opportunity this year to focus on change and betterment. Environmental, social and governance considerations seemed to be on everyone's mind in 2021, with increased attention on all aspects of ESG from governments, businesses, investors and consumers. ESG matters permeated corporate disclosure issues, environmental (climate change) considerations, the promotion of sustainable finance (particularly for pension funds) and corporate governance. In the latter area, the Rogers Communications boardroom saga also drew increased attention to corporate governance considerations in the context of dual class share structures.

With the Canadian federal government's *Greenhouse Gas Pollution Pricing Act* being upheld by the Supreme Court of Canada and the re-elected government emphasizing climate change as a priority, we can expect a greater focus on climate initiatives in 2022 and beyond. A key element of the government's climate strategy is imposing restrictions on greenhouse gas emissions from oil and gas projects in Western Canada. Energy transition, including the use of new and growing technologies, such as carbon capture and hydrogen, will be critical to achieving progress towards the federal government's stated goals.

Another important goal for the federal government has been reconciliation with Canada's Indigenous peoples. Despite the shadow caused by the tragic discovery of unmarked graves at former residential school sites, there has been some progress in advancing relations with Indigenous peoples. The granting of royal assent to the federal bill to adopt the United Nations Declaration on the Rights of Indigenous Peoples (UNDRIP) is a material step forward. In addition, several key decisions are likely to have significant impacts on infrastructure and resource development, requiring meaningful consultation regarding Aboriginal and treaty rights and promoting partnerships with Indigenous groups in the coming years.

Governments across the country have also advanced regulatory initiatives in other key areas. Combined with important decisions from a variety of courts, these developments are likely to have significant effects on businesses and consumers going forward.

One area that attracted significant attention in 2021 is the advancement of robust privacy legal reform. Québec's Bill 64 is the most advanced of these initiatives. Due to come into force on a staggered basis over the next three years, it will significantly revamp the approach to privacy in the province. In particular, it – as well as other measures under consideration at the provincial and federal levels – could expose companies across the country to significant penalties, risks and compliance costs. A proactive response to ensure that businesses implement robust privacy compliance mechanisms is now more important than ever.

Québec is also advancing major changes to French language laws in the province. If and when enacted, Québec's Bill 96 could also impose onerous obligations on those carrying on business in the province of Québec.

Regulatory changes also occurred in the gaming space. The federal government's decision to legalize single event sports betting was a significant amendment, which came at exactly the right time for private gaming operators who are positioning themselves to take advantage of Ontario's new iGaming market. Ontario's iGaming initiative, poised to launch in early 2022, will be the first in Canada to permit private operators to deliver online gaming to players under provincial regulatory oversight. It is hoped that the new model will pave the way for similar initiatives by other provinces.

Nationally, significant regulatory developments are taking shape in the financial services sector. This includes changes to anti-money laundering rules, payments regulation and modernization, open banking and cryptocurrencies. A key theme of financial services regulation in 2021 was the convergence of various different reforms and initiatives aimed at regulating discrete parts of the financial ecosystem that had been previously unregulated or lightly regulated.

International tax reform reflects a major undertaking for governments around the world as they struggle with the appropriate sharing of tax revenues in a post-pandemic world in which many governments are seeking to pay for economic initiatives. We saw some progress on these initiatives in 2021. The Supreme Court of Canada also rendered several important decisions involving cross-border taxation, and may have the opportunity to weigh in again in 2022. These cases provide important guidance for businesses in relation to future tax planning.

Key judicial decisions in a number of other areas may also affect businesses. In addition to those noted above, 2021 saw noteworthy judicial and administrative regulatory decisions in insolvency and capital markets enforcement.

The courts were also extremely active in the class actions arena. Notably, the courts recognized a number of tools that provide for meaningful screening of unmeritorious privacy class actions at or before the certification phase. In securities class actions, courts have also been willing to engage in meaningful assessment at early stages of the proceeding, in particular by affirming the utility of the statutory leave requirement for secondary

market misrepresentations as a robust gatekeeping tool. Finally, important developments occurred in British Columbia, where the courts confirmed that defendants should be entitled to move to dispose of or narrow unmeritorious cases through motions to strike or jurisdiction motions prior to the determination of class certification.

As you can see, 2021 has proven to be an incredibly eventful year in many different sectors. In 2022, we continue to hope for further progress back to a more "normal" existence (whatever that may mean), as vaccination rates continue to increase, case loads continue to decrease, third doses are introduced and as more and more businesses look to establish the new rules of the game. What that looks like remains to be seen, but we trust that next year will present more interesting and challenging legal and business developments.

We hope you enjoy reading this year's *Legal Year in Review*. As always, we would be pleased to discuss these developments with you.

EDITORS

Jacqueline Code
Partner and Chair, Research

jcode@osler.com
416.862.6462

James R. Brown
Partner, Corporate
Co-Chair, Mining

jbrown@osler.com
416.862.6647

ECONOMIC INSIGHT

Speculating on the "new normal" in the post-pandemic global economy

Everyone is making plans for the "new normal." But what will that look like?

When the pandemic started, we imagined an economy that could be stopped and then simply restarted, perhaps six months later. Now, we are approaching two years in semi-lockdown and the economy has evolved in many important ways. Restarting it is not like starting a train where everything is connected and must follow, perfectly spaced. It is more like getting a group of young children to play their appropriate positions in a soccer game.

As it turns out, restarting an economy is far harder than stopping it. Think about the refrigerator in your kitchen. It may be assembled in Mexico, the U.S. or in Canada, but it has components from many more countries than that. Those pieces are embedded in a complex inventory system, a global supply chain that is only as strong as its weakest link. If the factory that makes the plastic drawers for fruits and vegetables must close for four weeks due to the COVID-19 pandemic, or the factory that makes the computer chip that reminds you to change the air filter closes a couple of weeks later, those parts simply do not arrive when needed (if at all).

The refrigerator assembly operation builds some partial fridges and stacks them in inventory, but then it shuts down too. Suddenly, all the freighters show up with orders for parts placed long ago and the ports cannot handle the volume. In other words, we get congestion – a traffic jam – very similar to what you could encounter on your (pre-pandemic) daily commute because of an accident on the expressway. A short delay is nothing, but if you miss a key meeting that morning and your colleague steps up in your place, you might miss out on that big promotion you were counting on. Apparently minor hiccups become potentially life-altering.

There is more than one factory in the world that can make plastic bins for refrigerators, of course. Some are more expensive than others and there are quality variances. But there are legal contracts out there that hold the supply chain together and limit how quickly a purchaser can pivot to a new supplier. In addition, the other factories are encountering similar issues anyway. These supply systems cannot be turned on a dime. Meanwhile, a favourite activity for homeowners during the pandemic was to renovate their kitchens, replacing the refrigerator in the process. The result of high demand and a stalled supply chain is that refrigerators have become scarce, competition is reduced and the price of refrigerators has increased. Refrigerators are only one example.

Anecdotally, inflation has taken off as a result of supply chain disruptions across a wide range of products. Notwithstanding public statements that inflation is expected to be transitory, people are wondering if inflation will be permanently higher as a consequence. News feeds are filled with inflation angst, as one specific item after another is discovered to carry a much higher price than before. Some of the higher prices are for inputs that will spread throughout the economy. The inflation angst is reinforced by news that wages are rising, too, because of worker shortages.

As with all things in economics, there is some truth to all of this. However, the economy is far more complicated than it seems at first blush. If the price of a refrigerator rises by 5% because the manufacturer moves to a domestic supplier to obtain a more reliable supply of plastic bins, what would cause the price to go up a further 5% the following year? If the underlying logistics problems are solved, where would the pressure for another up-cycle in prices come from? A higher price for an item is not the same as ongoing price inflation, which repeats year after year. We have every reason to believe that, as the traffic jams in the global supply chain ease, competitive forces between suppliers will return, and prices will eventually stop rising. Indeed, because suppliers compete for this business, those prices are likely to fall back down to previous levels when stresses in the system have been relieved.

We have every reason to believe that, as the traffic jams in the global supply chain ease, competitive forces between suppliers will return, and prices will eventually stop rising.

Furthermore, people have renovated their kitchens and bought many goods during the pandemic, while hardly buying any clothing or restaurant meals or hotel rooms or airfares. As economies reopen on the back of vaccination rates and vaccination passport systems, household demand will shift away from household goods to clothing and previously restricted services, like travel. This shift will relieve pressure on the global system of goods production and shift it to airports and restaurants.

Also, a lot of prices fell during the pandemic. Prices for hotel rooms, airfares, oil and gasoline, and many other goods declined. That was not deflation, nor is it inflation when those prices start to return to more normal levels, which energy prices have done, with a vengeance. In Canada, the level of the total consumer price index is about 4% higher than it was before the pandemic. Excluding energy products, which are notoriously volatile and therefore usually omitted to discern the trend in inflation, the index is just over 3% higher. This is the cumulative rise in prices over some 20 months, not 12 months. Because prices fell before rising again, the average 12-month inflation trend has not really gone significantly above 2% since the pandemic began. It may still do so, but probably only while these supply chain stresses sort themselves out.

The uncertainty around future inflation is as high as it has been since the 1970s, given that there are so many forces pulling inflation in opposite directions. Demand has remained strong, supplies have encountered constraints, labour force participation is in flux, while companies are deploying new cost-saving technology everywhere. The net effect of all these forces will be a challenge to judge, but the situation seems to be well in hand, so far. If a policy mistake is made in the months ahead and inflation does get a foothold in the global economy, central banks have more than enough tools to restore a low-inflation environment in subsequent years; interest rates would simply be raised sufficiently to slow the economy and relieve the inflation pressures. In economic parlance, calling a rise in inflation "temporary" implies a judgment that inflation will return to normal, more or less by itself. But that temporary rise could still last a year or more, simply because of the way inflation rates are usually calculated.

The uncertainty around future inflation is as high as it has been since the 1970s, given that there are so many forces pulling inflation in opposite directions.

In other respects, life has surely changed forever. Working from home has worked well for wide swaths of businesses, and new hybrid work arrangements appear to be becoming the norm. Consequently, there will be far fewer commuters into downtown cores on any given workday. There will be adverse implications for secondary businesses that rely on foot traffic in downtown cores, from coffee shops to bars and restaurants to dry cleaners.

At the same time, companies have found it necessary to move quickly to develop more efficient customer-facing systems, many based on AI, to cope with the pandemic. This accelerated deployment of new technology will speed up the displacement of some workers, while creating new jobs for workers versed in systems development and maintenance. Moreover, governments have stepped up their greening of the economy, with implications for workers in high-emissions sectors.

In other words, the "K-shaped economy" that emerged during the pandemic will continue in the years ahead, with the economy and jobs growing rapidly in some sectors and stagnating or contracting in others. Meanwhile, the pandemic revealed that the most essential workers in our daily lives are also the least well paid. Workers and firms alike have come to this realization and pockets of wage pressures are emerging. Some workers have already migrated to better-paying jobs in the top part of the K, while others have been taking advantage of the shutdowns to upgrade their education with the intention of doing so. Still others may have decided that the risks associated with customer-facing roles merit higher wages. This was especially true when government assistance programs put a floor under incomes. The result of this unusual combination has been widespread labour shortages, and a shift in market power from employer to employee. The aging of the workforce will cause this power shift to continue for the foreseeable future.

The bottom line? The economy is experiencing several major shifts all at once and no one can truly appreciate how things will look once the dust settles. At this time, we can only speculate on what the "new normal" will look like. Some of what we are observing will ultimately prove temporary (such as inflationary pressures), but much (including hybrid and remote working) will surely be permanent. The main takeaway for companies should be that business uncertainty will remain elevated in the years ahead. Accordingly, the active management of a wider range of business risks will be of growing importance to corporate performance.

AUTHOR

Stephen Poloz
Special Advisor

spoloz@osler.com
613.787.1013

M&A

M&A: A look back at 2021 and ahead to 2022

As the world worked towards returning to a "new normal," Canadian public M&A deal volumes in 2021 outpaced those in 2020 on both a quarterly and an aggregate basis. In a year of increased deal-making activity, there was also no shortage of significant legal developments in Canadian public M&A.

Busted deal litigation in the aftermath of the pandemic

Since COVID-19 was declared a global pandemic in March 2020, there have been three notable Canadian M&A transactions that were the subject of "busted deal" litigation. These cases focused on assertions that the target had suffered a material adverse effect (MAE) or had otherwise breached the ordinary course interim operating covenants in the governing transaction agreement.

In *Rifco Inc. v. ACC Holdings Inc. and CanCap Management Inc.*, CanCap had committed to purchase Rifco by way of an arrangement. CanCap claimed that Rifco suffered an MAE and purported to terminate the transaction. In response, Rifco sought specific performance of the acquisition by CanCap in the Court of Queen's Bench of Alberta. The case settled before the court disposed of the litigation, which included a payment by CanCap to Rifco and mutual releases.

In *Fairstone Financial Holdings Inc. v. Duo Bank of Canada*, which concerned a private M&A transaction, the Ontario Superior Court of Justice found that no MAE had occurred, nor had the ordinary course operating covenants been breached by actions taken by the vendor in response to the COVID-19 pandemic. The Court awarded specific performance in favour of the vendor and required Duo Bank to complete the acquisition.

In *Fairstone*, the Court adopted a legal test for an MAE similar to the test that applies in Delaware. This test requires an unknown event, a threat to overall earnings potential and durational significance. While each of these items were established in *Fairstone*, the Court held that no MAE had occurred because there was an exception for material adverse effects resulting from, among other things, emergencies, which included the pandemic.

In interpreting whether the ordinary course covenants had been breached, the Court found that the ordinary course covenant should be read in the context of the entire transaction. Given the emergency exclusion in the MAE clause, the Court concluded it would not be appropriate to use the more general ordinary course provision to effectively override the more specific MAE provision. Doing so would not read the contract as a whole – a cardinal rule of contract interpretation – but would instead read it as a series of unrelated, stand-alone provisions. The Court also found the target's response to the pandemic was consistent with its past practices.

Given the emergency exclusion in the MAE clause, the Court concluded it would not be appropriate to use the more general ordinary course provision to effectively override the more specific MAE provision.

The Court's decision in Fairstone stands in stark contrast to the November 30, 2020 decision of the Delaware Court of Chancery in *AB Stable VIII LLC v. MAPS Hotels and Resorts One LLC, et al*. In that case, the Delaware Court found that significant changes to the target's business in response to the COVID-19 pandemic violated the target's covenant to operate its business in the ordinary course consistent with past practices. The Court made this finding despite also having concluded that the pandemic did not constitute an MAE, as it was excluded from the definition by an exception. The *AB Stable* decision was appealed to the Delaware Supreme Court and a decision is pending.

Cineplex Inc. v. Cineworld Group plc is the latest busted deal to be litigated. The decision is still pending before the Ontario Superior Court of Justice following the conclusion of the trial earlier in 2021. The case raises similar ordinary course covenant and MAE interpretational issues to those considered in *Fairstone* and *AB Stable*, but also raises novel and complex damages issues.

On December 16, 2019, Cineworld and Cineplex entered into an arrangement agreement pursuant to which Cineworld agreed to acquire all of the issued and outstanding common shares of Cineplex for $34 per share in cash. The transaction was subject to a number of conditions, including the requirement to obtain *Investment Canada Act* (ICA) approval, as well as a more bespoke condition in favour of Cineworld that Cineplex not have more than $725 million in net debt at closing.

In response to the pandemic, Cineplex took a number of steps to minimize costs. These included implementing cash management strategies, reducing spending and ceasing to pay third-party suppliers such as landlords, movie studios and film distributors.

In June 2020, Cineworld withdrew its ICA application and delivered a notice terminating the arrangement agreement on the basis that Cineplex had failed to operate its business in the ordinary course and that an MAE had occurred. This was despite the fact that there was a specific carve-out in the MAE definition for an outbreak of illness that expressly allocated the risk of a pandemic to Cineworld.

Instead of suing for specific performance under the arrangement agreement, Cineplex accepted what it alleged to be Cineworld's repudiation of the deal and sued for damages. Cineplex's damage claim included $1.3 billion for the shareholders' loss of bargain – the difference between the $34 deal price and the market price following Cineworld's termination. For the 52-week period ending December 1, 2021, Cineplex's share price has ranged from a low of $8.11 to a high of $16.76.

Based on the *Fairstone* decision, Cineplex at first blush may appear to have the better legal position. However, Cineworld has sought to distinguish *Fairstone* in part on the basis that Cineplex took certain actions in response to COVID-19 with a view to ensuring that the net debt condition was not breached and not merely in good faith to preserve the value of the business for Cineworld's benefit.

Even assuming Cineplex wins the case on the merits, there are difficult damages issues that need to be resolved. The arrangement agreement is between Cineplex and Cineworld. Cineplex's shareholders are neither parties nor third-party beneficiaries under the contract. Accordingly, Cineworld argues that Cineplex is only entitled to damages suffered by the company – not the loss of bargain suffered by its shareholders.

In addition, Cineworld argues that there was an explicit specific performance clause that Cineplex could have invoked, but chose not to. If specific performance had been granted, the clause would have required Cineworld to perform its obligations and ultimately complete the transaction. Presumably Cineplex chose not to avail itself of this remedy in part due to the uncertainty as to whether Cineworld could have successfully been compelled to obtain ICA approval in the midst of the pandemic. It was not clear on what terms the federal government would have concluded that the transaction was of "net benefit to Canada" in circumstances where Cineworld may have been forced to close theatres, lay off employees and not comply – at least in the short term – with customary undertakings. Moreover, the arrangement agreement did not include a reverse break fee in favour of Cineplex if Cineworld failed to obtain ICA approval.

M&A practitioners are anxiously awaiting the Court's decision. In the meantime, parties should carefully consider the interplay between the ordinary course of business covenants and the MAE definition in a transaction agreement to ensure risks are clearly allocated. Specific closing conditions and additional negative covenants may also be negotiated to address the allocation of risk between transacting parties. On the damages front, parties may be inclined to negotiate liquidated damages clauses in the form of reverse break fees to limit a buyer's downside and achieve certainty of damages for a target in the event of a busted deal arising from a failure to obtain regulatory approval.

Implications of total return swaps in toehold accumulation strategies

On July 12, 2021, the Alberta Securities Commission (ASC) rendered its decision in connection with Brookfield Infrastructure's (Brookfield) unsolicited take-over bid (Offer) for Inter Pipeline Limited (IPL) and IPL's subsequent proposed white knight merger transaction with Pembina Pipeline Corporation (Pembina). The decision is the first in Canada to consider the use of derivatives to acquire a toehold position in the target and will likely have a chilling effect on the future use of this strategy.

Between March and October 2020, Brookfield acquired an aggregate economic interest in IPL common shares totaling 19.65% of the outstanding shares. Of this amount, 9.9% was economic exposure in IPL through a series of cash-settled total return swap transactions (collectively, the Total Return Swap). Between November 2020 and January 2021, Brookfield and IPL engaged in discussions regarding a potential acquisition of IPL by Brookfield. In late January 2021, IPL's Board of Directors advised that it was not prepared to move forward with Brookfield's bid at the indicative offer price of $18.25 per share, which was payable in cash and up to 20% in Brookfield's common shares.

On February 10, 2021, Brookfield announced its intention to make the Offer at $16.50 in cash for each IPL share or 0.206 of a Brookfield common share for each IPL common share. Brookfield formally commenced the Offer 12 days later. On March 8, 2021, the IPL Board announced that it had rejected Brookfield's Offer. In the same month, the IPL Board adopted a Supplemental Rights Plan (poison pill). The new rights plan expanded the definition of "Beneficial Ownership" in IPL's existing shareholder rights plan (Rights Plan) to include certain financial derivatives held by an acquiror, including the IPL shares subject to the Total Return Swap, as equivalent to beneficial ownership.

On June 1, 2021, IPL announced that it had entered into a white knight transaction with Pembina where Pembina agreed to acquire each of the outstanding IPL common shares in exchange for 0.5 of a Pembina common share pursuant to a plan of arrangement.

On June 4, 2021, Brookfield increased its Offer to $19.50 per IPL common share. The revised Offer was rejected by the IPL Board on June 9, 2021. One day later, Brookfield announced that it had initiated proceedings before the ASC seeking, among other things, the ASC's intervention with respect to IPL's alleged inappropriate defensive tactics.

On June 18, 2021, Brookfield revised the Offer to include an option for IPL shareholders to elect 100% cash consideration at its increased offer price. Brookfield stated that it was further prepared to increase its offer to $20.40 per IPL common share, subject to a successful challenge at an ASC hearing against the $350 million (4.2%) break fee payable by IPL to Pembina in the event that IPL accepted a superior proposal.

In its application to the ASC, Brookfield sought orders to cease trade IPL's Rights Plan and Supplemental Rights Plan. These plans had the effect of preventing Brookfield from acquiring 5% of the IPL common shares in the market as

The decision is the first in Canada to consider the use of derivatives to acquire a toehold position in the target and will likely have a chilling effect on the future use of this strategy.

otherwise permitted by the take-over regime. As well, Brookfield applied to cease trade the proposed Pembina plan of arrangement and to restrain the break fee that IPL had agreed to pay Pembina.

IPL cross-applied to the ASC for orders requiring that Brookfield provide public disclosure regarding the material terms of the Total Return Swap and that the IPL shares relating to the Total Return Swap (TRS Shares) be considered as securities beneficially owned, or over which control or direction is exercised, by Brookfield or by a person acting jointly or in concert with Brookfield. This would have resulted in the TRS Shares being excluded from determining whether the statutory 50% minimum tender condition applicable to the Offer was satisfied.

IPL also sought an order deeming the TRS Shares to be voted at the upcoming meeting of IPL shareholders in connection with the Pembina arrangement, either in the same proportion for and against the special resolution of IPL shareholders to approve the Pembina arrangement as all other IPL common shares voted at the meeting, or in the alternative, to prevent the TRS Shares from being voted at the meeting.

The ASC dismissed Brookfield's application, finding that Brookfield had not demonstrated that IPL had engaged in improper defensive tactics either by implementing its Rights Plan and Supplemental Rights Plan or by agreeing to the break fee.

In response to IPL's application, the ASC panel, in short oral reasons delivered when issuing its order, found that the economic interest in the TRS Shares had been separated from the ownership of, and voting control over, those shares. The ASC therefore concluded that the owners of the TRS Shares did not share the same motivation to maximize shareholder value as other IPL shareholders.

The ASC did not find that Brookfield beneficially owned the TRS Shares or that the swap counterparty was acting jointly or in concert with Brookfield. Rather, the ASC was taking action to address "empty voting" concerns in this case. The ASC also acknowledged that the identities of the holders of the TRS Shares could not be ascertained. Accordingly, the ASC ordered that an adjustment be made to the minimum tender condition for Brookfield's bid such that Brookfield was not permitted to purchase IPL common shares under the Offer unless more than 55% of IPL common shares – excluding those beneficially owned by Brookfield or parties acting jointly with it – had been deposited (the Modified Minimum Tender Condition). This remedy had substantially the equivalent effect as deeming Brookfield to be the beneficial owner of the TRS Shares. The ASC also required Brookfield to make enhanced disclosure regarding the nature of Brookfield's relationship with its swap counterparty, including the name of and any material information concerning its commercial relationship with such party.

The ASC's order is particularly notable in light of the Canadian Securities Administrators' (CSA) previous statements and policy positions on derivatives. In 2013, the CSA proposed that investors include "equity equivalent derivatives" – equity derivative positions that are substantially equivalent in economic terms to conventional equity holdings, including total return swaps – in calculating their ownership levels for the purposes of determining whether the early warning reporting threshold has been exceeded. The CSA's original proposal had sought to provide greater transparency as to potential "hidden ownership" positions

accumulated by sophisticated investors through the use of derivatives to achieve economic exposure to public companies while avoiding public disclosure. In 2014, however, the CSA decided not to implement the proposal in response to market feedback expressing opposition to the change properly structured. Market participants generally took this as tacit approval by the CSA of the use of total return swaps in building toehold positions without the need for public reporting or any changes to transaction terms.

The ASC's written reasons, which have not yet been published, will be critical in understanding the implications of the decision for toehold accumulation and stake-building strategies.

Osler acted as legal counsel to the swap counterparty in connection with the ASC proceedings.

Policy of predictability of the take-over bid regime and preservation of the shareholder franchise

Since May 2016, bids under National Instrument 62-104 – Take-Over Bids and Issuer Bids have been subject to a mandatory minimum tender requirement of more than 50% of the outstanding securities of the class that are subject to the bid, excluding those beneficially owned by the bidder and its joint actors. On February 23, 2021, the OSC released the reasons in the first case to address a request for a discretionary exemption from the 50% mandatory minimum requirement, unsuccessfully brought by ESW Capital Inc. (ESW), the largest shareholder of Optiva Inc. (Optiva).

ESW, a holder of approximately 28% of the Optiva subordinate voting shares, had sought an exemption from the OSC from the mandatory minimum tender requirements before it made an unsolicited offer to acquire the outstanding shares of Optiva that it did not already own. ESW's proposed bid price was at a 122% premium to the 20-day volume-weighted average price and a 92% premium to the 10-day closing high. Rival shareholders, Maple Capital Partners Inc. and EdgePoint Investment Group Inc., who collectively owned 40.5% of Optiva, were expected to reject ESW's offer. Since ESW's 28% had to be excluded from the calculation, Maple Rock and EdgePoint's shares were sufficient to block ESW's bid from meeting the 50% threshold unless a discretionary exemption was granted. ESW alleged that the two insiders were not aligned with minority shareholders. Accordingly, ESW believed that the minimum tender requirement should exclude the shares of ESW, MapleRock and EdgePoint.

In dismissing ESW's application, the OSC followed its earlier decision in Aurora Cannabis Inc. (Re) in which it rejected an application to shorten the 105-day minimum tender period. The OSC emphasized the essential role of predictability of take-over bid regulation in ensuring that market participants know with reasonable certainty what rules govern the bid environment. Absent exceptional circumstances or improper or abusive conduct, exemptive relief will not be granted.

It is interesting to contrast the OSC's decision with the ASC's decision in *Brookfield/Inter Pipeline*, where the ASC chose to amend the minimum tender condition.

The OSC emphasized the essential role of predictability of take-over bid regulation in ensuring that market participants know with reasonable certainty what rules govern the bid environment.

One of the consequences of the 50% minimum tender condition under the bid regime is that it enhances the leverage of major shareholders vis-à-vis the bidder and the target. The OSC, in its reasons, noted that this could result in bids not being made or shareholders being deprived of the ability to respond to a bid. Market participants will note that the extraordinary premium provided by ESW was insufficient to justify the granting of exemptive relief.

Outlook for 2022

M&A activity in Canada has been remarkably robust so far in 2021 relative to this time last year. This is understandable given the uncertain and unpredictable 2020 that was defined by the global pandemic, trade wars, geopolitical tensions, the U.S. federal election and the fragility of Canada's minority parliament. During the first three quarters of 2021, there were 2,257 announced M&A transactions having approximately $114 billion in total transaction value. This represents a nearly 300% year-over-year increase in transaction value and a nearly 20% year-over-year increase in transaction volume.

Transaction volumes have been driven by several factors. One such factor is the renewal of cross-border inbound and outbound M&A flow. Another is the active deployment of capital by private equity sponsors and other private capital pools, including pension funds, sovereign wealth funds, hedge funds and family offices. Further contributing factors include strategic M&A in furtherance of domestic and global growth objectives, a low interest rate environment, and facilitative debt and equity capital markets.

These fundamental drivers of M&A activity remain strong. Consequently, we are continuing to observe a robust cycle of deal-making activity for the final stretch of 2021 and the first half of 2022 across a range of sectors, including technology, real estate, metals and mining, and consumer products.

AUTHORS

Jeremy Fraiberg
Partner, Corporate
Chair, M&A

jfraiberg@osler.com
416.862.6505

Manny Pressman
Partner and Chair,
Corporate

epressman@osler.com
416.862.4903

Alex Gorka
Partner, Corporate

agorka@osler.com
416.862.4857

CAPITAL MARKETS

Progressive changes in a historic year for capital markets activity

There was continued progression in securities law in Canada through 2021. A number of changes were implemented or proposed to reduce uncertainty, create greater efficiency or harmonize rules or the interpretation of those rules, with a view to enhancing the efficacy of the Canadian capital markets. The term "historic" was often used to describe capital markets activity levels in 2021. Transaction volumes for IPOs and follow-on offerings continued at levels not seen since before the global financial crisis, notwithstanding the continued headwinds from the COVID-19 pandemic. As noted in our article People, planet and performance: Embracing ESG, environmental, social and governance (ESG) issues stepped into the limelight and attracted significant interest from the investment community and from securities regulatory authorities. We expect ESG matters will continue to grow in importance in 2022 and in the coming years.

The final report of the Ontario Capital Markets Modernization Taskforce (the Taskforce) was presented to the Government of Ontario in January 2021 and proposed a number of significant recommendations. In October 2021, the Ontario government followed through with its commitment to enact new legislation to implement the recommendations in the report and released for comment a draft of a new *Capital Markets Act*. The report was met with a mixture of praise and pushback and it remains to be seen how the Taskforce recommendations and a number of other proposed and ongoing policy initiatives will be addressed by the Ontario government and Canadian Securities Administrators (CSA) in the year ahead.

We discuss below the year's most notable capital markets regulatory developments. Additional related developments are included in our Corporate governance in transition and Decoding crypto – Providing regulatory clarity to cryptoasset businesses articles.

Securities law and regulation

1. The impact of COVID-19 on capital markets

   As pandemic-related restrictions began to ease and people began slowly returning to the way things were at the start of 2020, Canadian securities regulators continued to monitor the impact of the COVID-19 pandemic on issuers and investors. Filing deadline extensions granted by both securities regulatory authorities and stock exchanges in the early days of the pandemic in 2020 expired and issuers were required to make ordinary course filings on schedule. Regulatory authorities focused on the need for specific disclosures from issuers about the impact of the pandemic on their business, operations and capital, as well as clear disclosure of potential risks to the issuer from the continuation of the pandemic.

   In February 2021, the CSA published the results of their targeted review of the impact of COVID-19 on issuers' businesses, finding that a majority of issuers had provided detailed, quality disclosure. The CSA further highlighted their expectation that issuers will tailor their disclosure to the specific challenges, risks and financial impacts that they are experiencing due to the COVID-19 pandemic. An OSC study also discussed the significant impact on retail investors from the pandemic.

2. Capital markets changes on the horizon? The Ontario Capital Markets Modernization Taskforce reports

   On January 22, 2021, the Taskforce published its final report (the Final Report). The Final Report outlined a broad range of recommendations in response to the Taskforce's mandate to "review the current status of Ontario's capital markets" that are intended to modernize and enhance the efficiency and competitiveness of Ontario's capital markets. The publication of the Final Report followed the release of the July 9, 2020 consultation report, on which the Taskforce sought public comment during the summer of 2020.

   It remains to be seen how broadly the recommendations will be implemented and we expect relatively slow progress over the coming years as the Ontario government works with regulators in the other Canadian jurisdictions.

It remains to be seen how broadly the recommendations will be implemented and we expect relatively slow progress over the coming years as the Ontario government works with regulators in the other Canadian jurisdictions.

Shortly after its publication, the other CSA jurisdictions published their response to the Final Report, suggesting that policy work should be developed and implemented only following national consultation and encouraging Ontario to adopt the Passport System.

For more details on the Final Report, refer to our blog post on osler.com, Ontario Capital Markets Modernization Taskforce Final Report: A set of thoughtful ideas or a blueprint for change?

On October 2, 2021, the Ontario government proposed a new draft *Capital Markets Act* as a next step in its commitment to modernize Ontario's capital markets. The draft legislation, commentary and table of concordance are open for comment until January 21, 2022.

3. ESG issues take centre stage

As noted in the article People, planet and performance: Embracing ESG, ESG issues attracted significant attention in 2021, drawing increased focus from politicians, securities regulators and investors. The CSA continued advancing these issues through their reporting on gender diversity on boards and in executive officer positions (following our own market-leading Diversity Disclosure Practice report – the most recent edition having been published on October 13, 2021).

The CSA has also proposed mandatory climate-related disclosure requirements, seeking more consistent and comparable information to assist investment decisions. Proposed National Instrument 51-107 – Disclosure of Climate-related Matters would require disclosure relating to the four core elements identified by the Task Force on Climate-related Financial Disclosures –governance, strategy, risk management, and metrics and targets. The proposed instrument is open for comment until January 17, 2022.

4. Prospectus clearance affected by significant volumes

The adoption by the CSA of a Staff Notice in 2020 establishing a nationally harmonized process for the confidential pre-filing and review of prospectuses was well-received. This process has since been widely used for initial public offerings and certain follow-on offerings. However, what most regulatory authorities could not predict was the volume of confidential filings they would encounter in the face of booming Canadian capital markets deal activity.

As a result, certain jurisdictions have adopted best practice guidance for confidential prospectus pre-filings. The guidance is intended to streamline the review process and ensure that confidentially pre-filed prospectuses meet the standard of a publicly filed prospectus. The Ontario guidance notes that OSC staff will triage all filings and prioritize the most urgent and time sensitive filings, such as bought deals and overnight marketed offerings. This has resulted in some confidential pre-filing reviews taking longer than the originally anticipated 10 working days.

Further, the OSC has also updated its service standards generally. The prospectus review standard contemplates the provision of a first comment letter within 10 working days for a long form prospectus and within three working days for a short form prospectus for "80% or more of all filings received."

Issuers and underwriters should continue to take into account potential review and clearance delays when planning their offering timelines (for both confidential and public filings).

5. Streamlining continuous disclosure

In line with the CSA's efforts to reduce regulatory burdens, in May 2021 the CSA proposed changes to the continuous disclosure requirements for non-investment fund reporting issuers. The proposal seeks to (i) streamline and clarify certain disclosure requirements in the management's discussion and analysis (MD&A) and the annual information form (AIF) for non-investment fund reporting issuers, (ii) eliminate certain requirements that are redundant or no longer applicable, (iii) combine the financial statements, MD&A and, where applicable, AIF into one reporting document called the annual disclosure statement for annual reporting purposes, and the interim disclosure statement for interim reporting purposes, and (iv) introduce a small number of new requirements to address gaps in disclosure.

The proposed revisions to National Instrument 51-102 were the subject of a comment period that closed in September. Subject to the completion of the comment process and the receipt of required approvals, the final amendments are expected to be published in September 2023 and to become effective on December 15, 2023.

6. Non-IFRS (Non-GAAP) disclosure – New rule finally takes effect

Following more than two and a half years of proposals and comments with respect to the adoption of a proposed rule regarding the use of non-GAAP measures, on May 27, 2021, the CSA published new disclosure requirements for the use of non-GAAP and other financial measures. New National Instrument 52-112 – Non-GAAP and Other Financial Measures Disclosure (NI 52-112) came into effect in August 2021 for reporting issuers starting with their documents filed for a financial year ending on or after October 15, 2021.

NI 52-112 has changed the approach to non-GAAP measures by replacing non-binding guidance (previously set out in CSA Staff Notice 52-306) with a formal instrument having the force of law. While the instrument is generally consistent with the guidance, there are clarifications and expansions on the guidance that issuers are well advised to consider in their continuous disclosure. For instance, the CSA has clarified in the companion policy that NI 52-112 applies to a reporting issuer in respect of its disclosure contained on both websites and social media. Also, NI 52-112 will permit reporting issuers to incorporate by reference certain reconciliation and other disclosures from their annual and interim MD&A where they choose not to include the required reconciliation and other disclosure in the actual document containing non-GAAP measures (such as a press release).

For more details regarding NI 52-112, refer to our Osler Update on osler.com, Understanding recent changes to non-GAAP and other financial measures disclosure.

Following more than two and a half years of proposals and comments with respect to the adoption of a proposed rule regarding the use of non-GAAP measures, on May 27, 2021, the CSA published new disclosure requirements for the use of non-GAAP and other financial measures.

7. A match made in heaven? Regulators move to combine SROs

   Following the release of the 2020 CSA consultation paper seeking feedback on the framework for self-regulatory organizations (SROs) in Canada, the CSA announced its plan to create a new, single SRO that will consolidate the functions of the Investment Industry Regulatory Organization of Canada (IIROC) and the Mutual Fund Dealers Association of Canada (MFDA). The CSA has created an integrated working committee to determine the new corporate structure for the combined SRO and will oversee a new governance structure.

   The CSA has indicated its expectations that the new SRO will facilitate easier and more cost-effective access to a broader range of investment products and services for the public. The combined SRO is also generally expected to result in cost savings for dealers. We expect the implementation of the combined SRO will require significant time and effort.

8. Making capital raising easier … potentially

   In 2021, we saw continued progress in the CSA's efforts to make capital raising more efficient for small and mid-sized issuers.

   After proposing new crowdfunding rules in 2020 that were intended to harmonize and replace a number of local rules in force in certain provinces, the CSA adopted a new nationally harmonized rule – National Instrument 45-110 – Start-up Crowdfunding Registration and Prospectus Exemptions. The new instrument builds upon the existing patchwork framework created by a multilateral instrument, together with blanket orders, that was previously in effect. The instrument also increases the maximum amount that can be raised in a 12-month period to $1.5 million (from $500,000 previously) and increases the maximum individual amounts a purchaser can subscribe for to $2,500 per offering, or $10,000 if the purchaser obtains advice from a registered dealer that the investment is suitable.

   In July 2021, the CSA also proposed a new prospectus exemption for issuers listed on a Canadian stock exchange. The new exemption would allow issuers who have been a reporting issuer for at least 12 months to file a short offering document to supplement its disclosure record. It would also permit the issuer to raise up to the greater of $5 million or 10% of the issuer's market capitalization, to a maximum of $10 million, annually. Shares distributed under the exemption would be freely tradeable. Although changes to National Instrument 45-106 – Prospectus Exemptions have been proposed and a comment period has concluded, it is not clear that changes implementing the new exemption will be adopted.

   In an effort to provide more flexibility for capital raising, securities regulators in Alberta and Saskatchewan have introduced two new prospectus exemptions. The first exemption permits sales to investors who certify that they possess certain financial or investment knowledge and who acknowledge that they understand the risks of investing. Subject to certain exceptions for investments in issuers listed on a Canadian stock exchange, self-certified investors are limited to investments of $10,000 in any one issuer and $30,000 across multiple businesses annually.

The second exemption has been proposed to provide greater access to capital by start-ups and other small businesses. It will allow these businesses to raise up to $5 million using a streamlined offering document from investors in these provinces who wouldn't otherwise qualify under other prospectus exemptions.

9. Is it significant? Or primary? CSA seek to harmonize their approach for IPO issuers

   In August 2021, the CSA proposed clarifications to Companion Policy 41-101 that are intended to harmonize the interpretation of financial statement requirements for long form prospectuses. Inconsistent interpretations between CSA jurisdictions with respect to the application of the rules relating to the treatment of acquired businesses (whether they would be treated as a "significant acquisition" or regarded as the "primary business" of the issuer) has led to issuers facing increased time, cost and uncertainty to clear a prospectus. In particular, acquisitive issuers have been required to either provide a full three years of audited financial statements for an acquired business, together with MD&A for the acquired business, or obtain exemptive relief, which is not always possible to obtain.

   The new proposal provides additional guidance on what constitutes a primary business and what constitutes a predecessor entity for purposes of the financial statement requirements. If adopted, we expect the proposed changes to result in fewer requests for exemptive relief with respect to financial statements of an acquired business in the context of a Canadian initial public offering. In our comment letter to the CSA, we applauded the CSA for the progress made in seeking to harmonize the approach nationally and encouraged the CSA to adopt the revisions quickly.

10. British Columbia Securities Commission proposes to regulate promotional activity

    On May 26, 2021, the British Columbia Securities Commission (BCSC) published proposed British Columbia Instrument 51-519 – Promotional Activity Disclosure Requirements, which would establish a framework for promotional activity disclosure. The proposed rules are intended to improve the transparency of information available to investors, while helping the BCSC "identify and hold responsible those issuers and persons who conduct problematic promotional activity."

    The proposed rules would apply to "promotional activity," which would capture a broad range of actions, including a promoter making oral statements at a sales event or investor meeting, publishing written materials such as emails or newsletters, and posting on social media. If adopted, the new rule would also require certain disclosure at the time of the promotional activity, including the name of the person retained to conduct the promotional activity, any compensation provided to the person for conducting the promotional activity, whether the person owns securities or related financial instruments that are the subject of the promotional activity and disclosure of any platform or other medium through which the promotional activity will occur. An issuer that has engaged another person to conduct promotional activities will be responsible for ensuring such promotional activity is conducted in compliance with the proposed rule.

Inconsistent interpretations between CSA jurisdictions with respect to the application of the rules relating to the treatment of acquired businesses has led to issuers facing increased time, cost and uncertainty to clear a prospectus.

Venture issuers will be subject to an additional requirement to issue a press release announcing any engagement of a person to conduct promotional activities as well as certain details of that engagement. Venture issuers would also be required to disclose the components of their promotional activities in their interim and annual MD&A where the total expenditures on promotional activities exceeded 10% of their total operating expenses.

Certain persons are excluded from the proposed rules, including directors, officers and employees of an issuer where they are conducting promotional activities for that issuer. The proposed rules were subject to a comment period that has now passed and the BCSC has not yet indicated how they intend to proceed with the proposed rules.

Continued evolution anticipated

As the CSA continues to review the regulatory landscape and to propose ways to achieve efficiencies for issuers and for other capital markets participants, continued progress in the securities regulatory landscape is likely to occur in 2022. Many of these areas will be directly affected by the continuing push to modernize Canadian securities regulation and reduce regulatory burdens, particularly as the Ontario government continues to consider the Taskforce's recommendations.

AUTHORS

James R. Brown
Partner, Corporate
Co-Chair, Mining
jbrown@osler.com
416.862.6647

Rosalind Hunter
Partner, Corporate
rhunter@osler.com
416.862.4943

Michael Innes
Partner, Corporate
minnes@osler.com
416.862.4284

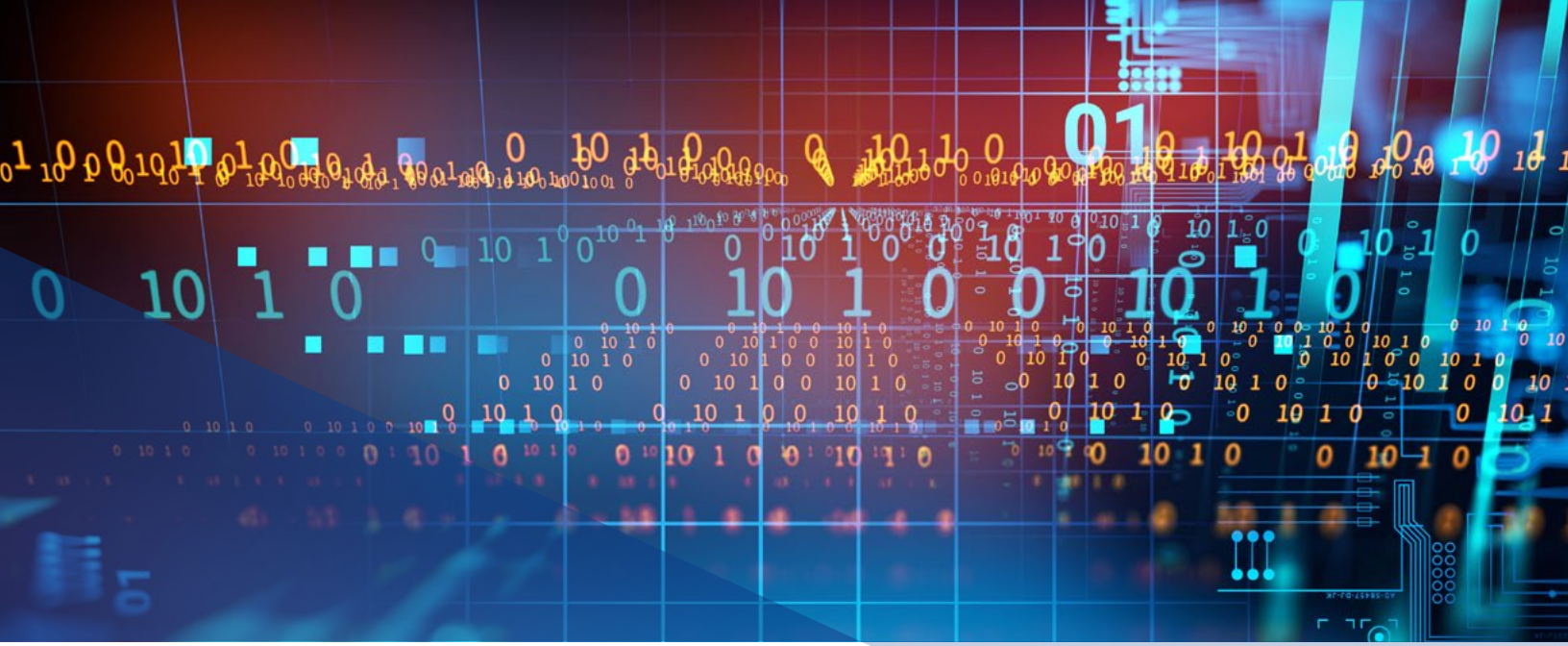
Desmond Lee
Partner, Corporate
dlee@osler.com
416.862.5945

Amelia Miao
Partner, Corporate
amiao@osler.com
416.862.4867

François Paradis
Partner, Corporate
fparadis@osler.com
514.904.5366

Trevor R. Scott
Partner, Corporate
tscott@osler.com
604.692.2755

Andrea Whyte
Partner, Corporate
awhyte@osler.com
403.260.7035



CRYPTOASSETS

Decoding crypto – Providing regulatory clarity to cryptoasset businesses

In 2021, the Canadian Securities Administrators (CSA) brought much anticipated clarity to the regulatory landscape for crypto asset businesses offering services to Canadians and/or listed on Canadian securities exchanges. There have been a number of significant developments in regulation and enforcement by the Canadian Securities Administrators (CSA) that have materially changed the legal environment in which these businesses operate in Canada.

One key change consists of the adoption of a clear registration regime for crypto assets trading platforms (CTPs) that offer custodial services to Canadian clients, pursuant to which six CTPs, five restricted dealers and one Investment Industry Regulatory Organization of Canada (IIROC) member, have now registered. Regulatory guidance has now been provided with respect to the advertising and marketing practices of custodial CTPs that are registered under securities laws. Additionally, regulatory guidance has been issued regarding public disclosure for reporting issuers that engage materially with cryptoassets.

In 2021, we also witnessed aggressive enforcement action by the Ontario Securities Commission (OSC) against several unregistered foreign CTPs. At the same time, the first Bitcoin and Ether exchange-traded funds (ETFs) in the world were launched on the Toronto Stock Exchange (TSX). Updated anti-money laundering (AML) requirements for cryptoasset businesses were imposed. Finally, the proposed retail payments framework was introduced which may apply to crypto payment services.

Registration regime for CTPs under securities legislation

Cryptoassets present novel challenges to capital markets regulators because they are structured to have the utility of commodities, but pose many investor protection risks that are traditionally associated with securities. As a result, the extent to which securities regulators have jurisdiction to regulate cryptoassets is often unclear. CSA Staff have attempted to solve this problem by exerting jurisdiction over custodial CTPs, even if the cryptoassets traded on the platform may be commodities and not securities, on the basis that the relationship between a CTP and its client is itself a security or derivative called a "Crypto Contract".

On March 29, 2021, the CSA and Investment Industry Regulatory Organization of Canada (IIROC) published Staff Notice 21-329 *Guidance for Crypto-Asset Trading Platforms: Compliance with Regulatory Requirements* (Staff Notice 21-329). Staff Notice 21-329 clarifies that dealer registration under securities laws is required for CTPs that facilitate the trading of: (i) cryptoassets that are securities (Security Tokens), and (ii) Crypto Contracts, which the CSA considers to be securities and/or derivatives when the CTP retains custody of the private keys to the cryptoassets on behalf of its clients, as opposed to immediately delivering the cryptoassets to a blockchain address specified by the client.

More information about Staff Notice 21-329 can be found in our blog post.

As of December 1, 2021, five Canadian CTPs have registered as restricted dealers under securities laws. These include Wealthsimple Crypto, Coinberry, Netcoins, CoinSmart and Bitbuy. Osler acts for Wealthsimple and Coinsmart. Restricted dealer registration is available on an interim basis to CTPs that do not provide margin or leverage to their clients.

The terms and conditions imposed upon restricted dealer CTPs indicate how the CSA are addressing key investor protection issues associated with cryptoassets:

- **Custody:** At least 80% of client cryptoassets must be held in cold storage with a "qualified custodian", such as Gemini Trust Company, LLC or Bitgo Trust Company.
- **Insurance:** The CTP must obtain a financial institution bond insurance policy that satisfies the regulatory requirements applicable to securities dealers. CTPs must arrange for third party guarantees and/or self-insurance of hot wallet losses, which are generally excluded from such policies.
- **Know your product (KYP):** CTPs must conduct diligence to satisfy themselves that none of the cryptoassets available for purchase on their platform are securities or derivatives, obtaining legal advice if necessary to make this determination.

Cryptoassets present novel challenges to capital markets regulators because they are structured to have the utility of commodities, but pose many investor protection risks that are traditionally associated with securities.

- **Risk disclosure:** Clients must be provided with (i) a risk statement setting out general disclosure of the risks associated with trading in cryptoassets; and (ii) a cryptoasset statement setting out a plain language description of the cryptoasset, the due diligence performed by the CTP with respect to the cryptoasset, risks specific to the cryptoasset and other specified matters.
- **Account appropriateness model and recommended loss limits:** CTPs that received an exemption from the suitability requirement must gather know-your-client (KYC) information about their clients and determine that an account is appropriate. They must also recommend a loss limit for the account based on the client's risk tolerance.
- **Specified cryptoassets and purchase limits:** In CSA jurisdictions other than Alberta, British Columbia, Manitoba and Quebec, the securities regulatory authorities have identified Bitcoin (BTC), Ether (ETH), Bitcoin Cash and Litecoin as "Specified Cryptoassets" which can be offered on an unlimited basis by registered CTPs to retail clients. All other cryptoassets are subject to an annual purchase limit of $30,000 on CTPs that have adopted an account appropriateness model.
- **Two-year transition to IIROC:** Restricted Dealer CTPs are expected to transition to investment dealer registration and obtain membership with the Investment Industry Regulatory Organization of Canada (IIROC) within two years of registration.

Bitbuy also obtained an exemption from the requirement to be recognized as a marketplace under securities laws. As a result, Bitbuy is allowed to offer automated order-matching functionality on its CTP, as well as API access by sophisticated market participants.

In addition to the five restricted dealer CTPs, Fidelity Clearing Canada is the first investment dealer and IIROC member to obtain approval to offer cryptoasset trade execution and custody services to institutional clients, including other IIROC members. This approval signals that IIROC is prepared to regulate cryptoasset dealers, and that it is permissible for one IIROC member to operate both a traditional securities business and a crypto trading business. More information on Fidelity's regulatory approval is available in our blog post on osler.com.

Advertising and marketing standards for CTPs

On September 23, 2021, CSA and IIROC staff published Staff Notice 21-330 *Guidance for Crypto-Trading Platforms: Requirements relating to Advertising, Marketing and Social Media Use* (Staff Notice 21-330).

Staff Notice 21-330 reminds CTPs that have registered or have applied for registration as a securities dealer that they are prohibited from using false and misleading advertising and from making unsubstantiated claims. They are also required to monitor and keep records of social media usage by personnel. Such internal controls must extend to the directors, shareholders, officers, employees and other third parties acting on behalf of the CTP.

More information on Staff Notice 21-330 is available in our Risk Management and Crisis Response blog post.

Guidance on disclosure obligations for cryptoasset reporting issuers

On March 11, 2021, staff of the CSA published Staff Notice 51-363 *Observation on Disclosure by Crypto Asset Reporting Issuers* (Staff Notice 51-363). A cryptoasset reporting issuer is a reporting issuer that engages materially with cryptoassets through mining and/or holding or trading of those assets.

Staff Notice 51-363, at the time of its publication, notes that there were 49 cryptoasset reporting issuers listed on Canadian stock exchanges. These exchanges are expected to provide adequate disclosure relating to custody, risk factors and audit.

More information on Staff Notice 51-363 is available here.

OSC crackdown on foreign CTPs offering services to Ontarians

Following the publication of Staff Notice 21-329 in March 2021, OSC staff warned CTPs offering services in Ontario that they must contact OSC staff by April 19, 2021 to discuss how to bring their operations into compliance. Otherwise, they would face regulatory action.

Beginning in May 2021, the OSC commenced enforcement proceedings against four large, non-Canadian based platforms that did not engage with the OSC within the prescribed timeline. Some large foreign CTPs such as Hong Kong-based Binance and Seychelles-based Bitmex have announced that they are not accepting new Ontario clients, or are shutting down accounts of their existing Ontario clients, within prescribed timelines.

Beginning in May 2021, the OSC commenced enforcement proceedings against four large, non-Canadian based platforms that did not engage with the OSC within the prescribed timeline.

For further details on the OSC's crypto enforcement efforts in 2021 see A dynamic year for capital markets enforcement.

Cryptoasset ETFs

In 2021, we witnessed the arrival of new regulated investment products for Canadian retail investors seeking to invest in Bitcoin and Ether.

In February 2021, with the approval of the OSC, Purpose Investments launched the Purpose Bitcoin ETF on the TSX as the world's first Bitcoin ETF. This was soon followed by the launch of the Purpose Ether ETF in April 2021. There are now 27 ETFs and closed-end funds based on Bitcoin and Ether listed on the TSX.

AML update

On June 1, 2021, substantial amendments to the regulations issued under the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* came into force along with updated guidance from the Financial Transactions and Reports Analysis Center of Canada (FINTRAC). Both of these regulatory initiatives imposed new AML requirements relating to virtual currencies, including:

- the "travel rule" that requires money service businesses (MSBs) and other reporting entities to include identifying information about the transferor and the beneficiary when they send a virtual currency transfer, as well as to take reasonable measures to ensure that this information is included on receipt of a virtual currency transfer;
- reporting of suspicious virtual currency transactions to FINTRAC; and
- large virtual currency transaction reporting obligations that require all reporting entities to report receipts of an amount in virtual currency equivalent to $10,000 or more in a single transaction, or series of transactions, within 24 hours.

For further information on the amendments, see our Financial services regulation in 2021: Back to business article and our Anti-money laundering in Canada guide on osler.com.

Canada is also watching new Financial Action Task Force (FATF) guidance published on October 28, 2021 which updates the Guidance for a Risk Based Approach to Virtual Assets (VAs) and Virtual Assets Service Providers (VASPs). The FATF suggests circumstances in which AML requirements may apply to non-fungible tokens, CTPs, stablecoins and peer-to-peer transactions. Canada's Department of Finance will need to consider the extent to which Canadian AML laws should be updated to reflect the new FATF guidance.

Retail payments framework

On April 30, 2021, the federal government introduced the *Retail Payments Activities Act* (RPAA) which establishes a framework for payments services providers (PSPs) that will be overseen by the Bank Of Canada.

These payment services providers include a variety of entities that perform electronic payment functions, such as payment processors, digital wallets, currency transfer services and other types of payment technology companies. While not certain at this time, it is expected that crypto payment services provided by regulated PSPs will be regulated under the RPAA.

For further information on the RPAA, see Financial services regulation in 2021: Back to business.

Looking ahead to 2022

2021 was a year of many firsts for cryptoasset businesses. We expect 2022 to be another year of significant growth and maturation of the industry.

A number of regulatory issues remain to be clarified, including:

- treatment of fiat-backed stablecoins, including potential regulation as prudential deposits, money market funds or something new, as discussed further here;
- the extent to which securities laws may apply to proof of stake blockchain networks and/or "staking as a service" arrangements;
- non-fungible tokens (NFTs), including fractionalization and marketplaces for trading NFTs;
- decentralized finance protocols (also known as DeFi), which facilitate transactions in cryptoassets on blockchains such as Ethereum and which can operate autonomously and outside the ownership or control of any party, potentially outside of scope of securities laws and AML laws; and
- retail investment products beyond BTC and ETH.

We are watching to see which of these will receive the attention of regulators in 2022. We expect that 2022 will be another transformative year for the cryptoasset industry in Canada, and look forward to working with our clients on new business models and challenges in the space.

AUTHORS

Lori Stein
Partner, Corporate
lstein@osler.com
416.862.4253

Asad Akhtar
Associate, Corporate
aakhtar@osler.com
416.862.4242

GOVERNANCE

Corporate governance in transition

In corporate governance, 2021 was characterized by continued use of virtual meetings, a rapid acceleration in the importance of environmental, social and governance (ESG) issues, an ongoing search for new tools and guidance for corporate governance, and a renewed focus on dual class share structures.

Virtual meetings are here to stay

In the second proxy season held during the COVID-19 pandemic, virtual shareholder meetings remained the preferred choice for the majority of Canadian issuers. Further detail is included in our Osler Update, The 2021 proxy season in review. Technical issues encountered during the initial rush to virtual shareholder meetings in 2020 were largely absent. Many issuers improved their disclosure regarding the mechanics of registering to access and vote at the meeting and to pose questions to be addressed at the meeting.

The provinces of Alberta, B.C. and Ontario modified their corporate statutes to permit the use of virtual meetings without any legislative impediment. However, the *Canada Business Corporations Act* and the corporate legislation in several other provincial jurisdictions still include the problematic requirement that attendees be able to communicate with each other, and not just with the chair of the meeting.

ESG on the agenda

ESG considerations became a strong focus of discussion among boards, management and investors in 2021.

Over the course of the year, several developments related to climate issues accelerated interest in the topic:

- proposed new requirements for disclosure in compliance with the Task Force on Climate-related Financial Disclosure in New Zealand and the U.K., as well as for those seeking to access the Large Enterprise Financing Facility in Canada
- adoption of "say on climate" shareholder votes at a number of companies internationally
- announcements about the proposed divestiture of carbon-intensive businesses by institutional investors
- proposed new disclosure requirements issued by the Canadian Securities Administrators in October 2020

The push for increased diversity on boards and senior leadership continued. As described in more detail in our seventh annual *Diversity Disclosure Report*, Canadian boards continued to add more women directors. Female directors now hold 23.4% of board seats among all TSX-listed companies and 31.5% of board seats among the S&P/TSX Composite Index companies, just slightly below comparable measures in the U.K. and Australia.

CBCA public companies improved compliance with requirements to provide disclosure regarding the representation of women, visible minorities, Aboriginal peoples and persons with a disability.

In the U.S., Nasdaq adopted bold new requirements to provide disclosure regarding the representation of women and other underrepresented groups. A breakdown must be provided of the number of directors who are African American or Black, Alaskan Native or Native American, Asian, Hispanic or Latinx, Native Hawaiian or Pacific Islander, White, two or more races or ethnicities, and LGBTQ+. In addition, most Nasdaq issuers, including Canadian issuers listed on Nasdaq, will be required to include at least two diverse directors, at least one of whom must be female, on their board or publicly disclose why they do not. Further detail is provided in our Osler Update, Nasdaq's new progressive board diversity listing requirement.

Investor interest in ESG matters has prompted increased fund flows into investments that have an ESG focus, encouraging more issuers to begin, or enhance the rigour of, their voluntary ESG reporting. Issuers also began including more detail regarding board oversight of ESG matters in their proxy materials.

Additional detail is included in our article, People, planet and performance: Embracing ESG.

Investor interest in ESG matters has prompted increased fund flows into investments that have an ESG focus, encouraging more issuers to begin, or enhance the rigour of, their voluntary ESG reporting.

Reports on corporate governance

Early in 2021, several reports advising on corporate governance matters were issued, reflecting a strong interest in enhancing governance practices in Canada:

- In November 2020, the Lambay Group issued the report *High Performance in the Boardroom*, authored by Tony Gaffney with Katie Taylor as lead advisor. The report reflects the results of a series of interviews with experienced Canadian directors conducted from late 2019 through 2020. It distills the sometimes-conflicting views of leading corporate directors on how boards can perform better in a time of accelerating change.
- As discussed in our article, Progressive changes in a historic year for capital markets activity, the final report of the Capital Markets Modernization Taskforce was issued in January 2021. The final report recommendations on corporate governance matters were substantially the same as proposed in the earlier consultation draft. The recommendations include proposals to require TSX-listed companies to set targets and provide disclosure of the representation of women and Black, Indigenous and people of colour (BIPOC) on boards and in executive officer positions. These recommendations include possible targets of 40% women and 20% BIPOC, and propose a 12-year maximum tenure limit for directors (15 for the board chair).

  Other recommendations in the final report include

  - with respect to proxy advisory firms, an opportunity for issuers to "rebut" conclusions made in the reports of such firms
  - a reduction of the threshold for early warning reports to 5% from 10%
  - mandatory annual "say on pay" votes for all issuers
  - increased ESG reporting requirements
  - a requirement for the use of a universal proxy
  - the ability of the Ontario Securities Commission to provide its views with respect to issuers seeking to exclude shareholder proposals in proxy materials
  - rules to prevent over-voting and to permit issuers to obtain the identities and shareholdings of beneficial owners who object to such disclosure
- In February 2021, Peter Dey and Sara Kaplan issued their report *360° Governance: Where are the Directors in a World in Crisis?* The authors sought input from a diverse advisory board of directors and governance advisors and academics. In summary, the report concludes that court decisions issued since 1994, when the seminal corporate governance report *Where Were the Directors?* was issued by TSX Committee on Corporate Governance chaired by Peter Dey (and supported by Osler, Hoskin & Harcourt LLP), have "underlined the legal shift from shareholder primacy to stakeholder primacy." The report proposed 13 new guidelines to enhance corporate governance practices in addressing stakeholder impacts including recommendations relating to corporate purpose, the board's consideration of stakeholder interests, director tenure, diversity at the board and senior leadership levels and in the workforce more generally, fostering by the corporation of relationships with Indigenous peoples and the disclosure and oversight of climate change-related matters.

Early in 2021, several reports advising on corporate governance matters were issued, reflecting a strong interest in enhancing governance practices in Canada.

Dual class share structures attract more attention

Dual class share structures have a long history in North American markets and have proven to be an enduring and popular feature of many recent initial public offerings. Dual class share structures enable significant shareholders to maintain control despite the disproportionate economic interest held by public shareholders. They also help insulate the public corporation against the vagaries of the market for control. Some issuers balance the structure by ensuring that the secondary class is entitled to elect a specified number of directors. In most cases, however, the significant shareholders retain the ability to replace the entire board through a separate class of voting shares or multiple voting shares.

The reality of dual class share structures became starkly apparent in 2021 when a boardroom dispute at Rogers Communications Inc. became a very public battle for control. Edward Rogers, as Chair of the Rogers Family Trust, which holds 97.5% of the company's voting class A shares, signed a consent resolution to replace five directors on the board of directors. He was able to do so without convening a shareholder meeting or conducting a vote by shareholders.

The ability to effect a change of this nature by written resolution is a unique feature of the corporate statute in British Columbia. This was the first time in Canada that a consent resolution was used to remove and replace the directors of a publicly traded company. A B.C. Supreme Court judge ruled that the consent resolution was valid, effective and binding as of the date it was signed.

Since the decision, much attention has been given to the propriety of dual class share structures that permit controlled companies to access Canadian public markets when shareholders other than the controlling shareholder have no participation in the process by which directors are chosen.

Where do we go from here?

As Canadian business begins to return gradually to normal, we expect there to be continued focus on ESG considerations and increasing demands for greater regulation to address perceived deficiencies in standards of practice.

AUTHORS

Andrew MacDougall
Partner, Corporate
amacdougall@osler.com
416.862.4732

John M. Valley
Partner, Corporate
jvalley@osler.com
416.862.5671

EXECUTIVE COMPENSATION

Executive compensation challenges, both new and old

The past year brought with it new challenges as corporations increasingly sought to incorporate environmental, social and governance (ESG) issues into compensation decision making. Old issues surrounding "say on pay" and clawbacks of incentive compensation were reinvigorated. The year also brought with it some good news in the form of a reprieve for employers. The Ontario Court of Appeal sensibly overturned a lower court decision refusing to enforce a clause requiring the forfeiture of equity grants on termination of employment without cause.

Here we summarize some of the most impactful executive compensation developments of the year.

Tying compensation to ESG

An increased interest in the environmental and social impacts of corporate activity has led to growing calls to expressly tie executive compensation to the achievement of ESG goals. The objective is to provide an express incentive to management to drive improvements in such areas.

It has always been common for companies in certain industries such as mining, utilities and energy to include some key performance measures relating to environmental and health and safety performance in the personal performance scorecard when making short-term incentive compensation payment assessments. These may also be included in the corporate performance scorecard.

However, corporations are now making greater efforts to expressly identify such performance measures in the public disclosure of their short-term incentive compensation practices. Performance measures are also being expanded to include metrics related to social responsibility more generally. However, it is rare for payouts of long-term incentive compensation to be tied to ESG metrics, in part because of the difficulty in setting and measuring longer-term ESG goals.

An increased interest in the environmental and social impacts of corporate activity has led to growing calls to expressly tie executive compensation to the achievement of ESG goals.

Say on pay

Decisions made regarding executive compensation in response to the impacts of the COVID-19 pandemic on business operations and stock prices were under close scrutiny during the 2021 proxy season. And shareholders were not hesitant to make their views known through "say on pay" votes, where held.

The average level of support among the 223 TSX companies we identified that conducted say on pay votes during 2021 was 91.5%. However, at a record six companies, investors voted against the issuers' say on pay resolution – Chemtrade Logistics Income Fund (40.1% approval), CI Financial Corp. (38.1%), Gildan Activewear Inc. (40.9%), Precision Drilling Corporation (42.4%), RioCan Real Estate Investment Trust (24.1%) and Vermilion Energy Inc. (41.8%). Issues flagged by the proxy advisors included a pay-for-performance disconnect, outsized retention and one-time awards, large discretionary CEO bonuses and poor disclosure of a former executive's severance arrangements. Shareholder dissatisfaction with compensation decisions was especially high this year. In addition to the record number of failed votes, 10 issuers received say on pay support of between 50% and 75%.

Say on pay remains a voluntary practice in Canada. However, that could change in the future. Although not yet in force, amendments made to the *Canada Business Corporations Act* (CBCA) require prescribed corporations to disclose their approach to the remuneration of the directors and members of senior management of the corporation. These changes would also require issuers to conduct an annual non-binding shareholder vote on the disclosed approach. The January 2021 final report of the Capital Markets Modernization Taskforce, which was established to review and advise on potential improvements to Ontario's capital markets, included a recommendation for mandatory annual advisory votes on executive compensation practices for all publicly listed issuers.

Compensation clawbacks

Requirements for the clawback of incentive compensation were first adopted in the U.S. under the Sarbanes-Oxley Act of 2002. Under that statute, if an issuer is required to prepare an accounting restatement as a result of misconduct, the United States Securities and Exchange Commission (SEC) has the authority to require the CEO and CFO to repay to the listed company certain incentive compensation and profits from stock sales received in the 12 months after the release of the financials that must be restated. In 2015, the SEC proposed rules that would require U.S. stock exchanges to adopt listing requirements providing for the clawback of excess incentive compensation received during the three years prior to a financial restatement. The rule also proposed to require each listed company to disclose its clawback policy and provide disclosure about its recovery of excess incentive-based compensation. Progress on the proposed rule stalled until this October, when the SEC voted to reissue its prior proposal for a new 30-day comment period.

Canadian executive compensation disclosure rules require summary disclosure of any clawback arrangements affecting named executive officers. These rules do not, however, mandate adoption of clawback policies.

Despite the absence of clawback requirements, many corporations have chosen to adopt their own incentive compensation clawback arrangements. These arrangements have continued to evolve. Larger corporations have adopted policies which reserve the right to claw back incentive compensation not only in the event of a financial restatement, but also for reasons of misconduct alone. These arrangements are being increasingly reflected in long-term incentive compensation plans and employment agreements for larger issuers.

Amendments to the CBCA that are not yet in force will require the directors of a prescribed corporation to place before shareholders, at the annual meeting, prescribed information respecting the recovery of incentive benefits or other benefits paid to directors and members of senior management. Regulations related to the amendments have not been finalized, but the requirements will likely apply only to publicly traded corporations.

It remains to be seen whether the CBCA amendments and the renewed focus of the SEC on its proposed clawback rule will lead to mandatory requirements in Canada or changes to the range of practices in effect today.

Larger corporations have adopted policies which reserve the right to claw back incentive compensation not only in the event of a financial restatement, but also for reasons of misconduct alone.

A win for employers

Last year, we reported that in *Battiston v. Microsoft Canada Inc.*, the Ontario Superior Court of Justice concluded that a termination clause requiring forfeiture of unvested long-term incentive awards on termination of employment without cause was not enforceable. This conclusion was based on the Court's view that the clause was "harsh and oppressive" and on the fact that the employee, according to the Court, did not receive notice of the clause.

On appeal, however, the Ontario Court of Appeal concluded that the judge's finding of lack of notice was an error. The Court noted that the employee had made a conscious decision not to read the stock award agreement, despite expressly confirming that he had done so for 16 years. By misrepresenting his assent to the agreement to his employer, the employee put himself in a better position than an employee who did not make a misrepresentation, thereby taking advantage of his own wrongdoing. Osler acted on the appeal for Microsoft Canada Inc.

Increasing complexity

Investors and regulators continue to scrutinize compensation determinations and outcomes closely. Both have shown that they will take action when there is a perceived disconnect between compensation outcomes and perceived value creation for investors. This disconnect will continue to add complexity to decision making by directors and has the potential to significantly affect remuneration disclosure going forward.

AUTHORS

Andrew MacDougall
Partner, Corporate

amacdougall@osler.com
416.862.4732

Lynne Lacoursière
Partner, Corporate

llacoursiere@osler.com
416.862.4719

Kelly O'Ferrall
Counsel, Employment & Labour

koferrall@osler.com
613.787.1066 (Ottawa)
416.862.4897 (Toronto)

MINING

Mining 2021 – Market windows and accessing capital

A key consideration for mining companies seeking capital in 2021 was the elusive "market window." Despite relatively strong commodity prices and market sentiment (particularly with respect to inflation), there were defined periods of inactivity and a rush to raise capital when the market window opened. The market was then strongly biased towards established issuers, leaving junior issuers still seeking much-needed capital.

New entrants to the market generally fared worse, despite a strong initial public offering (IPO) market in Canada, which did not seem to extend to the mining industry. This has forced many companies looking to go to market by means of an IPO or reverse takeover transaction (RTO) to adjust their business plans to maintain financing readiness.

As mining companies seek to access public capital, one of the biggest challenges they face is the need to maintain a current technical report under National Instrument 43-101 – Standards of Disclosure for Mineral Projects (NI 43-101).

IPO/RTO technical report considerations

A key provision of NI 43-101 is the obligation for issuers to file a current technical report to support scientific or technical information relating to a mineral project on a property material to the issuer in certain prescribed disclosure documents. This includes prospectuses and information circulars where shareholders are asked to approve an acquisition, such as an RTO.

To be considered "current," a report must contain all material scientific or technical information about the project; this can make it difficult to determine a cutoff date for the report where issuers are continuing to explore or develop the project. Additionally, the technical report is generally required to be prepared by or under the supervision of a qualified person (as defined in NI 43-101) who is independent of the issuer. While the independence requirement provides an objective verification of the asset, it also means that the timing of the report is not entirely within the issuer's control.

Stock exchange listing rules require an independent technical report to support applicable listing requirements for mining issuers. Stock exchanges also rely on the technical report to support the sources and uses of funds for the issuer based on the recommended work program set out in the technical report. The listing review process requires up-to-date information for the issuer's overall budget which the stock exchange reconciles to the issuer's available cash after giving effect to the financing.

As a result, even the most IPO/RTO-ready issuers require at least a couple of months to prepare for a public filing. With an ideal timeline of two months to complete an IPO/RTO, the overall timing is manageable. However, in 2021 two challenges to these timelines became apparent. First, issuers were often forced to wait to launch their financings until a favourable market window opened. Further, once the market window was receptive to a financing, issuers found the regulatory review times for public offerings were significantly longer due to the volume of transaction activity occurring at the same time. In some cases, issuers found themselves stalled for six months or more and were required to incur additional costs by continuously updating their technical reports over that time.

The problem is most acute for single project issuers or junior issuers where there is uncertainty whether subsequent developments are material or not. It is virtually assured that, where a technical report does not have a cutoff date in proximity to the disclosure document pursuant to which it is filed, there will be questions from securities regulators or stock exchanges about the currency of the report and whether the requirements of NI 43-101 and stock exchange listing rules have been satisfied.

While the independence requirement provides an objective verification of the asset, it also means that the timing of the report is not entirely within the issuer's control.

While there is no magical solution to this problem, there are some steps that issuers can take to minimize the disruption of an extended IPO/RTO process on their projects:

- **Be prepared for delay in work programs** Issuers may need to be flexible in planning work programs taking into account IPO/RTO timing. While this may result in less optimized programs from a technical standpoint, it is likely a better outcome than a delay in an IPO or RTO. Issuers should consider logistical timing for things like permitting and assays to ensure results are reflected in the technical report. Non-material work or interpretative preparations for subsequent work programs can be scheduled after the technical report cutoff. Plan ahead to ensure the technical report remains current in the event of IPO/RTO delays.
- **Quarantine results** It is possible to quarantine exploration results with outside contractors (such as assay labs). This may avoid the need to include them in a technical report. The issuer would disclose that work has been done, but that results are pending. There can be issues around the currency of technical reports where significant results are quarantined, however. Issuers should be prepared to provide the qualified person authoring the report with visuals or other preliminary information to offer comfort that nothing in the pending results would invalidate the conclusions in the technical report. This is more feasible for less material work such as infill drilling than work that is material to the project and will influence subsequent work.
- **Update disclosure outside of the technical report** Where additional work is not considered to be material, the issuer can finalize the technical report with a cutoff date that predates any ongoing work. The issuer can then include an update on work completed after the cutoff date of the report in a disclosure document. This way the issuer's disclosure record is up to date without having to manage moving goalposts for the technical report. However, issuers are cautioned that the qualified person authoring the technical report will need to review all subsequent technical information to ensure that it does not impact their conclusions in the report – even if another qualified person is responsible for the disclosure. In addition, the issuer needs to ensure that the budget and work program set out in the technical report are future-oriented with work to be performed utilizing the proceeds of the IPO or RTO and not past work. Disclosure rules require issuers to reconcile sources of funds up to the month end before the prospectus (IPO) or information circular (RTO) and the budget must align with such sources.

Unfortunately there is no perfect solution for the technical report currency dilemma. It is often a source of significant frustration for issuers going to market, especially where there are multiple layers of regulatory review (securities regulators and stock exchanges) and no clear delineation of materiality to the project or the issuer.

Financing alternatives without a current technical report ... changes on the horizon

For many junior issuers, a key implication of not maintaining a "current" technical report is the inability to satisfy the requirements necessary to maintain a current annual information form. The most significant repercussion is the resulting ineligibility to complete a public offering using a short form prospectus – something that is significantly more cost-effective compared to a long form prospectus. From a policy perspective, the benefits of accessing the short form prospectus regime are earned by maintaining a current, fulsome continuous disclosure record. For many issuers, that cost is prohibitive, meaning that many junior mining issuers have been practically limited to private placement financings in the exempt market.

For the past few years, the Canadian Securities Administrators (CSA) have been focused on regulatory burden reduction initiatives, including regarding capital raising. One key concern expressed by market participants, particularly in the junior mining market, is the cost of completing a public offering given the ineligibility of most junior miners to use a short form prospectus. As described in our Progressive changes in a historic year for capital markets activity article, one of the most recent initiatives proposed by the CSA is intended to fill the gap.

If adopted, the new Listed Issuer Financing Exemption will allow issuers who qualify to distribute freely tradeable listed equity securities to the public. Qualifying issuers would generally be limited to raising the greater of $5,000,000 or 10% of the issuer's market capitalization to a maximum amount of $10,000,000 in a calendar year. To qualify, issuers must have their securities listed on a Canadian stock exchange, have been a reporting issuer for at least 12 months, have filed all timely and periodic disclosure documents, and have an "active business." Although the proposed revisions to add the Listed Issuer Financing Exemption to National Instrument 45-106 – Prospectus Exemptions do not expressly describe what constitutes an active business, we expect that the CSA will take a reasonably liberal approach to the application of the requirement for mining issuers, such that issuers with early stage exploration properties that have limited work programs will still qualify.

Importantly, the offering document requirement by the Listed Issuer Financing Exemption would not trigger the technical report requirement under NI 43-101. As such, issuers can rely on the exemption to complete a financing through distribution of freely tradeable shares (without the corresponding private placement liquidity discount) without having to assess the currency of their technical reports. We expect that this exemption, if adopted, will offer an excellent financing tool for mining issuers who are not eligible to file a short form prospectus, whose technical reports may not be current and who require capital to fund their work programs in order to advance their projects and technical disclosure.

For many junior issuers, a key implication of not maintaining a "current" technical report is the inability to satisfy the requirements necessary to maintain a current annual information form.

Financing in 2022?

With new prospectus exemptions on the horizon and a continued focus from securities regulators on reducing regulatory burdens, there are likely to be new options for issuers to raise capital in 2022, where they have been previously challenged. The new financing exemptions are not affected by technical report currency issues that have historically limited issuers in their ability to complete a public capital raising. While these new exemptions are not going to assist issuers seeking to complete an IPO or RTO in maintaining a current technical report, there are a number of opportunities for issuers to consider managing their programs and results in a way that reduces potential impacts to their pending transaction. We encourage issuers to actively discuss these issues with their advisors to ensure that they are able to hit market windows when they are open.

AUTHORS

James R. Brown
Partner, Corporate
Co-Chair, Mining

jbrown@osler.com
416.862.6647

Alan Hutchison
Partner, Corporate
Co-Chair, Mining

ahutchison@osler.com
604.692.2760

FUND FORMATION

VC fund managers innovate to keep pace

Activity levels in the venture capital (VC) and growth equity market in 2021 show no signs of slowing down. In this environment and with the size, frequency and pace of later stage venture and growth equity financing rounds increasing steadily, VC fund managers have been forced to adapt. We have observed three significant developments in the Canadian VC fund market over the last 12 months: the rise of "opportunity funds," the emergence of "continuity funds" and an increased focus on permanent capital (or "evergreen") funds. We summarize these developments and also outline some of the key considerations that fund managers and investors should take into account when pursuing or evaluating an investment in one of these funds.

Opportunity funds

An opportunity fund is a new fund formed by an existing manager to provide additional capital to be invested in high performing portfolio companies of one or more of the manager's existing funds. As the name implies, these funds seek to capitalize on opportunities that a fund manager may not have been able to pursue because the current fund does not have sufficient available capital to invest. This could include leading an investment round or participating on a pro rata basis in subsequent financing rounds of a portfolio company. While the concept of an opportunity fund is not new, we have seen an increased focus on this type of vehicle in the past 12 months, with several Canadian VC fund managers raising their own opportunity funds.

An opportunity fund serves as an alternative to forming multiple special purpose vehicles or co-investment vehicles for one-off investments. This can be beneficial to managers, who will have fewer vehicles to form and manage, allowing them to move faster to close a deal. Opportunity funds can also be beneficial to investors, who may thereby gain access to a portfolio of promising companies rather than having to make individual investment decisions.

These are some of the key considerations for investors and sponsors evaluating an investment in an opportunity fund:

- While terms vary, opportunity funds typically have a lower management fee and/or carried interest rate. This is intended to reflect the reduced workload of the manager as the universe of investee companies is generally limited to existing portfolio companies.
- Fund managers considering raising an opportunity fund will need to take into account any expectations that existing investors may have regarding co-investment rights alongside the existing funds. This is particularly the case where large institutional investors have already negotiated preferential co-investment rights on a no fee/no carry basis.
- In circumstances where both the "main fund" and the opportunity fund invest in the same financing round, attention must be given to how to fairly allocate the investment opportunity and how to manage potential conflicts. In our experience, investors in the main fund will expect that the main fund's allocation will not be adversely impacted by the existence of the opportunity fund.
- If the expected financing rounds never materialize, fund managers may find themselves sitting on large amounts of available capital. In that case, parties need to consider whether the opportunity fund should have the ability to invest beyond existing portfolio companies and, if so, on what conditions.

While the concept of an opportunity fund is not new, we have seen an increased focus on this type of vehicle in the past 12 months, with several Canadian VC fund managers raising their own opportunity funds.

Continuity / continuation funds

A continuity fund (also known as a continuation fund) is a vehicle raised by an existing manager to purchase either a single asset or a portfolio of assets from one or more of the manager's existing funds. Most private equity funds have a maximum duration both for investing capital and for the overall life of the fund. Establishing a continuity fund provides flexibility to the manager at the end of a fund's life. Limited partners seeking liquidity at the maturity of the fund are able to participate in the wind-up of the fund, while other limited partners that are seeking longer-term exposure to the underlying asset or assets are able to do so through the continuity fund. This can be structured either by providing for a cash out event in the original fund and new investment in the continuity fund or an ability to "roll" their existing fund investment into the continuity fund.

While continuity funds are more common in the U.S. private equity market, these types of funds have come to Canada in the VC and growth market in the last 12 months. Inovia Capital closed its first continuity fund this year.

These are some of the key considerations for investors and sponsors evaluating an investment in a continuity fund:

- As the continuity fund and original fund are controlled by the same fund manager, the sale of existing fund assets to the continuity fund will be a related party transaction. As such, the fund manager must navigate the inherent conflicts of interest between funds, particularly around the valuation of the transfer. External valuators and investment bankers are often involved in the process to help deal with this issue.
- Because of the potential for conflicts of interest, transparency is key. It is important that existing limited partner advisory committees be kept informed throughout the process with respect to deal terms and expectations regarding the long-term viability of the asset or portfolio of assets.
- Investors in the new continuity fund will similarly need full and transparent disclosure regarding the assets being sold in the transaction.
- The sale transaction may present an opportunity for the fund manager to realize an accrued carried interest or to "roll" it into the new continuity fund. The tax impact of the transaction to the fund manager needs to be considered in either case.
- Portfolio company shareholder agreements need to be analyzed to determine any consent or waiver requirements in respect of the proposed transfers. This may be a time consuming and complex process, depending on the structure of the transaction.

Permanent capital funds

A permanent capital – or evergreen – VC fund is an open-ended fund with no fixed term. This structure allows a fund manager to continuously raise new capital from investors and to reinvest capital from exit transactions. These funds attempt to address the issues discussed above with a single vehicle (i.e., missing potential investment opportunities given lack of available capital, as well as balancing the desires of certain limited partners for liquidity with the desires of other limited partners to remain invested in promising companies for a longer term).

While evergreen VC fund managers remain rare in the VC marketplace (both in Canada and globally), over the last year we have seen increased interest from managers considering alternatives to the traditional 10-year VC fund. Sequoia's announcement of the launch of its own permanent capital strategy through the creation of a single Sequoia fund garnered significant attention. Similar conversations have been occurring throughout the market.

While evergreen VC fund managers remain rare in the VC marketplace (both in Canada and globally), over the last year we have seen increased interest from managers considering alternatives to the traditional 10-year VC fund.

These are some of the key considerations for investors and sponsors evaluating an investment in an evergreen fund:

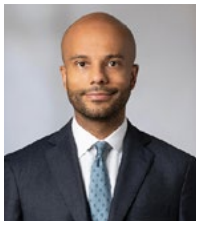
- As there is no termination date for an evergreen fund, investors need a mechanism to withdraw their capital. Fund managers need to consider how they will provide investors with liquidity from an inherently illiquid asset base. One option includes having redemption windows connected to material exit transactions or new fundraisings.
- Any redemption right construct should be limited so that the fund does not inadvertently become subject to regulation as an "investment fund" under Canadian securities laws. Additionally, because an evergreen fund typically raises money on a continuous basis, the issue of whether the manager needs to be registered as a dealer or advisor under securities laws needs to be considered.
- Valuation of private companies is an inherently difficult exercise. Valuation becomes an even more important issue in a structure where the fund manager seeks to issue new units based on the fund's net asset value from time to time and where redemptions are based on the fund's net asset value. Fund documents will need to articulate clear valuation principles that balance existing investors' desires not to be unfairly diluted on the one hand, with new investors' desires not to overpay for value that only exists "on paper," on the other.

  Traditional VC fund economics must be adapted to suit the construct of an evergreen fund. Rather than the classic distribution waterfall, managers may be better compensated in evergreen funds using structures borrowed from hedge funds. This may include annual performance distributions based on a "high-water" benchmark or other different methods for calculating a preferred return.

What to expect in 2022 and beyond

As long as markets remain active, VC fund managers will continue to explore ways to keep pace with market dynamics and to balance the desires of investors and portfolio companies. If conditions continue to remain receptive to the VC market, we expect that we will see more opportunity funds, continuity funds and permanent capital strategies in the year to come. Each of these models presents its own benefits and challenges, which investors and managers will need to continue to navigate. The extent to which these models remain a feature of the Canadian marketplace and not just a temporary reaction to the current state of affairs remains to be seen.

AUTHORS



Chima Ubani
Partner, Corporate

cubani@osler.com
514.904.5803

Shahir Guindi, Ad. E.
National Co-chair

sguindi@osler.com
514.904.8126 (Montréal)
416.862.6650 (Toronto)

Ed Vandenberg
Partner, Corporate

evandenberg@osler.com
613.787.1110

HEALTH, M&A

The latest in Canadian health clinic acquisitions

The ongoing surge in merger and acquisition transactions since 2020 has been widely commented on throughout the past year. As the initial hesitancy towards engaging in M&A activities early in the pandemic wore off, private equity firms became increasingly active, motivated by a need to deploy unused capital that had built up during earlier lulls before the expiration of applicable investment periods. In addition, M&A activity in Canada has been driven by historically low interest rates and increasing confidence in the economy's recovery as the pandemic starts to ease. With access to idle pools of funds, low interest rates and a dramatic rise in activity levels, foreign investors have entered the Canadian marketplace with fervor, particularly in the health sector.

Canada's health industry landscape: No longer perceived as the land of "free healthcare"

The Canadian health industry has been increasingly attractive to investors, particularly health clinics specializing in veterinary medicine, dentistry and orthodontic services, as well as virtual care. This growing attraction flies in the face of the mistaken view that the Canadian healthcare system is an entirely public healthcare system – a view held by many despite the fact that most health clinics in Canada are privately owned and operated.

Clinic ownership in Canada remains fragmented and has not yet encountered the mature clinic roll-up consolidation observed in the U.S. and other jurisdictions. In addition, the Canadian health industry has historically been viewed by many foreign stakeholders as a difficult sector to enter for a variety of reasons: (a) the sector is predominantly provincially regulated, meaning the provision of health services is geographically siloed; (b) certain health professions are often funded through complex government health insurance regimes; and (c) in certain health professions, provincially regulated health professionals must be the sole (or majority) shareholders, directors, officers of and/or fulfill specific management roles in any corporate entity carrying on the practice of a regulated health profession (a Health Corp.).

Clinic ownership in Canada remains fragmented and has not yet encountered the mature clinic roll-up consolidation observed in the U.S. and other jurisdictions.

Roll-up transactions and private equity investment

The U.S. market has long observed both private equity investment in health clinics and "roll-up" transactions in which a private equity investor acquires a number of clinics. Increasingly, public companies are participating in clinic acquisition strategies, with generalist companies looking at multiple service providers and specialized companies focusing on more targeted investment opportunities.

In addition to increased capital market activity, similar private equity investments in the health sector are now regularly occurring in Canada, with Canadian and foreign private equity investors taking advantage of investment opportunities. In the veterinary medicine and dental industries in particular – two sectors which are not funded by government health insurance plans (with limited exceptions) – clinic aggregation activity continues to increase.

Financing considerations

There are several interesting financial considerations for leveraged health clinic acquisitions. As noted above, depending on the health profession, there may be a requirement for the Health Corp. ownership structure to have only a licensed health professional or professionals as its shareholder(s), director(s), officer(s) and/or supervisor(s). This requirement raises potential issues of enforcement for lenders. Consideration must be given in an enforcement scenario to the ability to appoint a replacement health professional, if necessary, to take control while continuing to satisfy applicable regulatory requirements. The guarantee and security packages available to lenders will be subject to the ability of lenders to obtain "step in" rights under key servicing agreements with clinic operators, as well as any applicable statutory restrictions preventing the transfer of licences or the granting of security in licences.

Health regulatory considerations

Roll-up transactions in Canada may be structured in a variety of ways to satisfy the applicable regulatory requirements. This can include strategies for addressing prohibitions against the practice of a regulated health profession by a corporation. It is generally permissible for a regular corporation (i.e., a corporation without restrictions as to its shareholder, director or officer compositions) (a Management Corporation) to provide services to a Health Corp., including the performance of all necessary management and back-office services, equipment, technology and personnel (other than regulated personnel) necessary for a turnkey operation.

Generally, there will be some degree of reliance on the regulated health professional to fulfill certain prescribed roles within the Health Corp. (in addition to the professionals providing services within the clinics). However, there are a number of strategies that may be implemented by the investor or service provider to mitigate the risks associated with this reliance. For certain health clinics in some jurisdictions, an entity can satisfy the applicable regulatory requirements by leveraging multiple classes of shares, with a health professional holding certain shares and entering into a shareholders' agreement to allocate the financial and decision-making powers to the Management Corporation.

Another structure often implemented to meet the regulatory standards involves a services agreement between the Management Corporation and the Health Corp. Such an agreement provides the Management Corporation with financial control over the Health Corp. through the payment of a management fee that is either based on revenue or is simply a flat fee. In this structure, the oversight and responsibility for carrying on the professional health services and the engagement of the health professionals remain solely with the Health Corp. Such a structure can be replicated (and modified as necessary) to satisfy the applicable regulatory requirements in each jurisdiction.

In the context of arrangements between a Management Corporation and a Health Corp., there are also public policy and regulatory issues that arise in connection with the protection and enforcement of goodwill associated with the clinics as a result of the Health Corp. being responsible for providing the health services. These matters are typically addressed in the services agreement or other agreements between the parties through restrictive covenants and termination provisions.

In these cases, the Health Corp.'s shareholders would also have contractual restrictions on their ability to transfer the shares of the Health Corp. The Management Corporation will typically have a contractual right to appoint a different regulated health professional to hold the shares of the Health Corp. and to satisfy other regulatory requirements, if necessary. This option ensures that the Management Corporation has the ability to continue to derive economic value from the business without undue reliance on any one health professional.

Certain health professions also require the operator of the clinic or regulated health business to hold a licence to be able to conduct activities or bill the government's health insurance plan for certain fees. In some circumstances, consent from a regulatory authority is required for the transfer of that licence or to permit any change of control or change in the directors or management of the entity holding the licence. In other circumstances, a licence may be considered personal to the holder and a new licence application will be required if the entity holding the licence is subject to change. Depending on the type of licence and the relationships between the parties, it may be possible to rely upon a transition service agreement to continue operations under an existing licence while a new licence application is pending.

Additional considerations

In addition to key financing and regulatory considerations unique to the health sector, there may be other complexities relating to privacy matters and the ownership of records associated with clinic operations. These may require compliance with various private sector and health-specific privacy legislation standards to operate clinics across numerous jurisdictions.

Depending on the structure of the licensing and management arrangements, franchise disclosure and other considerations may also be applicable to roll-up transactions in the Canadian provinces that regulate franchising, namely Ontario, British Columbia, Alberta, Manitoba, Prince Edward Island and New Brunswick.

In addition to key financing and regulatory considerations unique to the health sector, there may be other complexities relating to privacy matters and the ownership of records associated with clinic operations.

Conclusion

With significant foreign investment now funding the Canadian private health sector, it is clear that Canada is no longer perceived as having only a publicly-funded healthcare system. The change in this perception has been amplified by the COVID-19 pandemic. We anticipate that continued investment and acquisition by strategic players and private equity within the health industry will continue in the coming years.

New methods of service delivery, including a shift towards greater reliance on private healthcare participants outside of the government funded system, as well as investment from private equity and the efficiencies that can be realized through the aggregation of service delivery, will continue to be both necessary and desirable to improve the efficiency of the delivery of health services and the quality of care. There are many unique and sometimes complex issues to consider in the context of these transactions, but these considerations can be successfully addressed in a variety of contexts and are no longer perceived as barriers to investment.

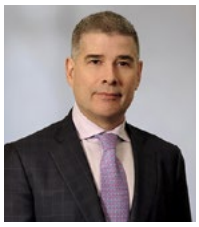
AUTHORS

Joyce M. Bernasek
Partner, Financial Services

jbernasek@osler.com
416.862.4283

Susan Newell
Partner, Health

snewell@osler.com
416.862.6797



Michael Watts
Partner, Health

mwatts@osler.com
416.862.6605

Tearney Johnston-Jones
Associate, Financial Services

tjohnstonjones@osler.com
416.862.5950

PRIVACY LITIGATION

Canadian courts confirm significant limits on privacy class actions

For businesses operating in Canada, 2021 brought welcome guidance: courts across the country repeatedly exercised their gatekeeping role to put a stop to privacy class actions that lack evidence of harm to the proposed class members. In other words, a class action should not automatically follow from a data breach or incident. Even when a class action does follow, defendants have a variety of tools to defend privacy claims or to resolve them early on.

The "some basis in fact" requirement is a meaningful screening device

Several decisions reinforced that certification is meant to be a meaningful screening device in privacy class actions:

- In *Simpson v. Facebook, Inc.*, the plaintiff alleged that a third party named Cambridge Analytica had obtained information about Facebook users from a third-party application developer. The Ontario Superior Court of Justice dismissed the plaintiff's certification motion on the basis that there was no evidence that any Canadian user's data was shared with Cambridge Analytica (and therefore no justification for a class proceeding). Justice Belobaba emphasized the Court's gatekeeping role, stating, "The dismissal of this certification motion is simply a reminder to class counsel that while certification remains a low hurdle it is nonetheless a hurdle." Similarly, in *Kish v. Facebook, Inc.*, the Court of Queen's Bench for Saskatchewan dismissed another application for class certification that was premised on allegations related to Cambridge Analytica. Justice Keene built on the growing trend of cases emphasizing the Court's gatekeeping role at the certification stage, including *Simpson* and *Setoguchi v. Uber* (discussed below). Osler acted for Facebook in both cases. Further information is set out in our Osler Updates on these two certification decisions, Ontario Superior Court denies certification of Cambridge Analytica class action and Another Canadian court denies certification of Cambridge Analytica class action.
- Similarly, in *Beaulieu c. Facebook Inc.*, the Québec Superior Court held that the plaintiff did not satisfy her burden at the authorization stage (Québec's equivalent of the certification stage) to establish an "arguable case." Justice Courchesne found that the plaintiff's allegations – that Facebook's tools allowed employers and companies to illegally exclude certain users from employment and housing opportunities – were "hypothetical and speculative." Osler acted for Facebook in this case as well.

In all three cases, the plaintiffs launched, or sought to launch, appeals. In *Kish*, however, the Court of Appeal for Saskatchewan recently dismissed the plaintiff's motion seeking leave to appeal, finding that the plaintiff's proposed appeal lacked sufficient merit to be heard by a panel of the Court of Appeal. The appeal decisions in the other two cases will likely be released in 2022.

Justice Belobaba emphasized the Court's gatekeeping role, stating, "The dismissal of this certification motion is simply a reminder to class counsel that while certification remains a low hurdle it is nonetheless a hurdle."

Plaintiffs must show evidence of harm

Other decisions confirmed that plaintiffs must show evidence of actual harm in order to obtain certification and to succeed on the merits of a proceeding alleging privacy violations. This requirement presented a serious hurdle for plaintiffs in data breach class actions:

- In *Setoguchi v. Uber*, the Court of Queen's Bench of Alberta denied certification of a proposed class action arising out of an alleged data breach involving Uber. There was no evidence that the hacker used any personal data obtained in the breach to anyone's detriment. Justice Rooke found no evidence of any real (not *de minimis*) harm; there was only "speculation about a **future possibility** of loss or harm" (emphasis in original). The court also distinguished "minor and transient upset" from "compensable injury." Justice Rooke observed that without evidence of compensable loss, "a class proceeding could be a mere 'fishing trip' based on speculation, without any evidence of fish being present."
- In March 2021, the Québec Superior Court released its decision in the first privacy class action in Canada to be determined (and dismissed) on the merits. In *Lamoureux v. IIROC*, the plaintiff alleged that an inspector working at the Investment Industry Regulatory Organization of Canada (IIROC) lost a laptop containing information about thousands of Canadians. The laptop was never found. Justice Lucas dismissed the action finding that, while it is not necessary for class members to have actually fallen victim to identity theft in order to recover, injury beyond general inconvenience must be proven. Given the lack of documentary or medical evidence proving the extent of the damages, the Court categorized the class members' fears and worries as general inconveniences. Justice Lucas also dismissed the claim for punitive damages, finding that IIROC acted diligently and implemented appropriate response measures when the loss came to light. The focus on the absence of compensable harm aligns with recent authority from the common law provinces, including *Setoguchi*. Further information is set out in our blog post First merits decision dismissing privacy class action in Canada on the *Lamoureux* decision.

Limits on intrusion upon seclusion claims against database defendants

In 2021, the Ontario Divisional Court held that a necessary element of the tort of intrusion upon seclusion is that the defendant itself *committed* the intrusion. The tort does not apply where a defendant merely failed to prevent an intrusion by a third party. In *Owsianik v. Equifax Canada Co.*, the plaintiff alleged that a third-party hacker infiltrated Equifax's database exposing personal information about thousands of consumers. A class action was initially certified. However, on appeal, a majority of the Divisional Court held that a claim for intrusion upon seclusion could not succeed against Equifax since *an intrusion* is "the central element of the tort" and Equifax did not intrude.

The Divisional Court's decision marks an important development in Canadian privacy law and reaffirms that certification judges should refuse to certify causes of action that are bound to fail. (A further appeal is being pursued by the plaintiff to the Court of Appeal and will be monitored with interest.)

The Divisional Court's decision marks an important development in Canadian privacy law and reaffirms that certification judges should refuse to certify causes of action that are bound to fail.

Pre-certification motions in privacy cases

Recent decisions have also confirmed that pre-certification motions may be appropriate to resolve privacy actions on their merits. In *Schmidt v. LinkedIn Corporation*, the B.C. Supreme Court granted leave for the defendant to have its summary trial application determined in advance of certification. The plaintiff alleged that LinkedIn's iOS app surreptitiously read and stored the contents of users' clipboards. But the plaintiff presented no evidence supporting those allegations. LinkedIn sought, and the Court granted, an opportunity to disprove these speculative factual allegations at a pre-certification summary trial. Likewise, in *Cronk v. LinkedIn Corporation*, the B.C. Supreme Court accepted LinkedIn's argument that the defendant's summary trial application should be heard concurrently with certification. The plaintiff alleged that LinkedIn violated privacy legislation by showing users their own names and profile pictures in customized "dynamic ads." LinkedIn sought to defend the case on its merits at an early stage, including on the basis that showing someone their own name and photo is not a breach of privacy. The Court agreed that a summary trial had the potential to conclusively determine the core issues in the case at an early stage. Osler acted for LinkedIn in both cases.

Both *Schmidt* and *Cronk* were B.C. cases and therefore did not address recent amendments to the *Class Proceedings Act, 1992* in Ontario, which expressly encourage pre-certification motions that could promptly resolve, or significantly narrow, putative class proceedings. Both cases are consistent with the B.C. Court of Appeal's subsequent decision in *British Columbia v. The Jean Coutu Group (PJC) Inc*. The Court of Appeal rejected older case law that established a presumption that certification should be the first procedural matter to be heard. The Court's new framework for sequencing pre-certification applications will likely expand the opportunities for defendants in privacy cases to argue summary trial applications either before or concurrently with certification, thereby providing a means for finally disposing of the action at an early stage.

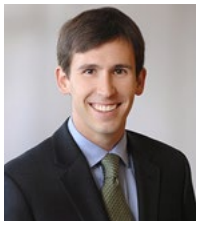
Conclusions

It remains critical for businesses to respond quickly and effectively when data incidents occur; however, businesses should be heartened by this year's developments. Despite the proliferation of privacy class action filings over the last decade, courts across Canada are making it clear that certification is not a rubber stamp. And courts have confirmed that businesses facing privacy class actions have a range of effective tools to defend privacy claims. Osler is at the forefront of these developments and will continue to report as the law regarding privacy class actions matures.

AUTHORS

Mark Gelowitz
Partner, Litigation
mgelowitz@osler.com
416.862.4743

Céline Legendre
Partner, Litigation
clegendre@osler.com
514.904.8108

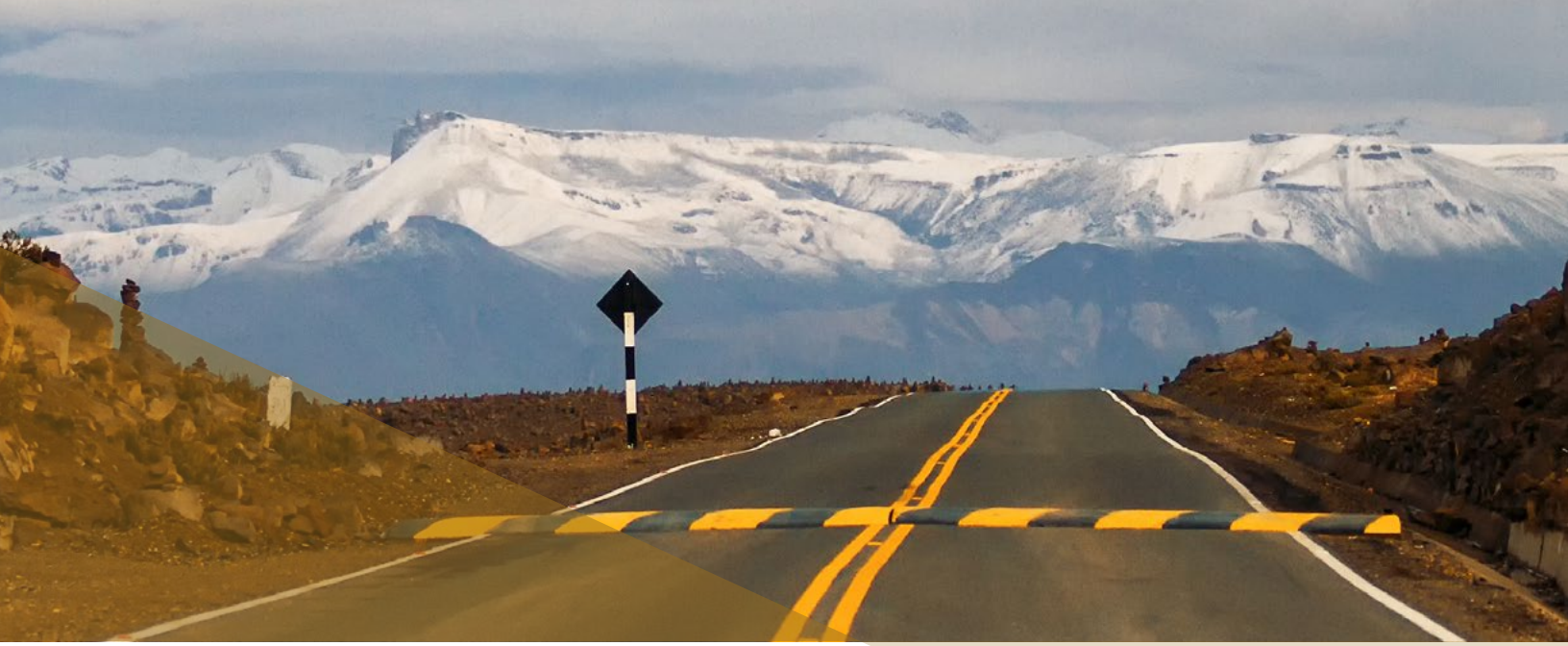


Robert Carson
Partner, Litigation
rcarson@osler.com
416.862.4235

W. David Rankin
Partner, Litigation
drankin@osler.com
416.862.4895

Emily MacKinnon
Associate, Litigation
emackinnon@osler.com
604.692.2705

Lauren Harper
Associate, Litigation
lharper@osler.com
416.862.4288



CLASS ACTIONS

Leave requirement in securities class actions: "More than a speedbump, less than the Matterhorn"

Over the course of the past year, a series of instructive decisions from the Ontario courts has re-affirmed the role of the statutory leave requirement for secondary market misrepresentation claims as a robust gatekeeping tool. In so doing, the Ontario courts have confirmed their willingness to dispose of unmeritorious secondary market proceedings at a preliminary stage. In particular, the *Cronos* and *Peters* decisions illustrate that Ontario courts are increasingly prepared to engage in a meaningful assessment of the viability of proposed class actions seeking relief under Part XXIII.1 of the *Securities Act* (Ontario) (the Securities Act) at the preliminary leave stage, in contrast to the more reserved approach exhibited in the context of the underlying motions for class certification. Similarly, the *Pretium* decision illustrates the courts' willingness to dispose of proposed securities class actions on

the basis of a summary judgment motion, even where leave under the Securities Act had previously been granted.

Taken together, these cases confirm that the courts are becoming increasingly interventionist in their role as gatekeepers, particularly in the context of unmeritorious secondary market claims. These trends should be of some comfort to issuers. The courts' interventionist approach will hopefully deter plaintiffs from commencing plainly untenable claims and demonstrate the benefits to defendants of using available tools, such as the leave requirement or summary judgment, to bring a prompt end to such claims.

All three decisions also provide useful guidance as to what courts will consider "material" when determining whether an actionable misrepresentation has been communicated. At the leave stage, the failure to plead misrepresentations with precision or without sufficient evidence can be fatal to a plaintiff's leave motion. The reliability of information (including the expertise of the party providing it) is critical in determining whether the information will be considered "material."

The courts' interventionist approach will hopefully deter plaintiffs from commencing plainly untenable claims and demonstrate the benefits to defendants of using available tools, such as the leave requirement or summary judgment, to bring a prompt end to such claims.

Statutory basis for secondary market liability

In Ontario, the rules that govern secondary market liability are set out in *Part XXIII.1 – Civil Liability for Secondary Market Disclosure* of the Securities Act. Substantially similar provisions have been adopted in other provincial securities statutes. Misrepresentation claims under the Securities Act allow secondary market investors to claim damages for misrepresentations in an issuer's continuous disclosure documents or public statements without requiring proof of a duty of care or reliance. Whether a statement or omission may qualify as a "misrepresentation" under the Securities Act depends on the materiality of the misstatement or omission, as a misrepresentation applies in respect of a "material fact." Under the Securities Act, a material fact is "a fact that would reasonably be expected to have a significant effect on the market price or value of the securities."

An action for secondary market misrepresentation under the Securities Act requires leave of the court. The court will only grant leave if it is satisfied that the action is brought in good faith and "there is a reasonable possibility that the action will be resolved at trial in favour of the plaintiff." In *Theratechnologies*, the Supreme Court of Canada articulated the applicable legal test for leave in 2015, stating that it is intended to be a "robust deterrent screening mechanism" and must amount to more than a "speed bump." To meet the threshold, the plaintiff bears the onus of proof. The plaintiff must provide a plausible analysis of the applicable legislative provisions, and credible evidence in support of the claim.

In *Theratechnologies* and the *Canadian Imperial Bank of Commerce* decisions, the Supreme Court of Canada also confirmed that the test for obtaining leave is different from – and imposes a higher threshold than – the test for the authorization or certification of a class action.

The courts affirm their gatekeeping role in recent decisions (2021)

The Cronos decision

In both *Cronos* and *Peters*, the courts denied the respective plaintiffs' motions for leave to proceed with statutory misrepresentation claims under the Securities Act and, by extension, their companion motions for certification pursuant to the *Class Proceedings Act, 1992*. In reaffirming the gatekeeping function of the leave test under the Securities Act, both cases raise interesting questions about the threshold for materiality.

In *Cronos*, the plaintiff asserted 7,449 allegations of misrepresentation related to certain financial transactions undertaken by Cronos, a cannabis company, resulting in improperly recognized revenues. The company later admitted in restated financial statements and MD&As that, in connection with the revenue recognition issues, there were material weaknesses in its internal controls over financial reporting which it had previously disclosed as functioning.

At the outset of his reasons, Justice Morgan clarified that the leave requirement was one that "open[s] the door to a more substantive rather than strictly procedural evaluation of the claim." By contrast, the motion judge is prohibited from assessing the strength of the claim at the certification stage.

Justice Morgan refused leave, finding that nothing in the record demonstrated that the thousands of alleged misrepresentations could reasonably be expected to have a significant effect on the market price or value of Cronos' securities. Importantly, in coming to his decision, Justice Morgan noted that "a restatement of financials may be evidence of a prior misstatement, but it is not so weighty that it overrides the evidence of the materiality experts who have concluded that any such corrections had little to no market impact. [...] [M]ateriality is in the eye of the investors, not the accountants."

In this particular instance, the evidence of materiality provided by the plaintiffs was all but non-existent. According to Justice Morgan, any evidence that did exist was "weak" and tended to "confuse market-wide movements in share prices, especially those coinciding with the March 2020 onset of the COVID-19 pandemic, with company-specific movements." Accordingly, he concluded that the failure of the plaintiff to precisely plead the misrepresentations, combined with the dearth of evidence of materiality, was fatal to the plaintiff's ability to show that there was a reasonable possibility of establishing at trial that the alleged misrepresentations were material.

Turning to certification, Justice Morgan considered the plaintiff's common law claims for negligent misrepresentation and statutory claim of oppression pursuant to Ontario's *Business Corporations Act*. These claims were swiftly dismissed on the basis that the plaintiff failed to plead adequate and particularized material facts to ground his claim. According to Justice Morgan, the misrepresentation claims against Cronos, whether framed in statutory or common law terms, were devoid of particulars about which misrepresentation caused loss. On this basis, both the leave and certification motions were dismissed.

The Peters decision

In *Peters*, Justice Perell similarly refused the plaintiff's motions for leave to proceed under the Securities Act and for certification. In this case, the plaintiff alleged that SNC had failed to disclose a material change when it did not disclose the Director of Public Prosecutions of Canada's decision not to invite SNC to negotiate a Remediation Agreement.

In this regard, Justice Perell noted that the fundamental fallacy in the plaintiff's argument was that it applied a material *fact* analysis and not a material *change* analysis. The plaintiff's legal analysis ignored the fundamental principle that "material facts" are a broader concept than a "material change," which is limited to "a change in the business, operations or capital of the issuer." Conversely, "material facts" encompass "any fact that reasonably would be expected to have a significant effect on the market price or value of the securities of an issuer," beyond matters that affect the business, operations or capital of the issuer.

Justice Perell noted that "no single factor such as share price movement will conclusively determine whether a material change has occurred." Thus, an actionable failure to disclose a material change requires more than just a change followed by a share price decline. Ultimately, Justice Perell found that because the evidence before him did not credibly point to a material change that could have triggered timely disclosure obligations, there was no reasonable possibility that the plaintiff's action under the Securities Act could succeed.

Justice Perell also dismissed the motion for certification on the basis that, given that leave was not granted for the statutory misrepresentation claim, it naturally followed that the statutory claim could not be certified as a class proceeding. On the common law negligent misrepresentation claims, Justice Perell stated where leave to assert a statutory claim under the Securities Act has been denied, a common law claim based on the same alleged misrepresentation will not satisfy the preferable procedure criterion and thus will not be certified.

Justice Perell noted that "no single factor such as share price movement will conclusively determine whether a material change has occurred." Thus, an actionable failure to disclose a material change requires more than just a change followed by a share price decline.

More than a speed bump, but not the Matterhorn

It is settled law that defendants are not required to lead evidence on the leave motion. The burden rests solely with the plaintiffs, reflecting the underlying policy that the leave requirement "was not enacted to benefit plaintiffs or to level the playing field for them in prosecuting an action under Part XXIII.1," but rather to protect defendants from coercive litigation and to reduce their exposure to costly proceedings. This policy rationale is reflected in both the *Cronos* and *Peters* decisions.

Notably, the first decision on the merits in respect of a secondary market misrepresentation claim, released this year, evidenced a similar approach by the courts. In *Pretium*, Justice Belobaba summarily dismissed the plaintiff's claim, finding that the defendants had not made any misrepresentation by omission and that, in any event, the defendants had a valid reasonable investigation defence. Justice Belobaba concluded that, while the plaintiff was able to meet the test for leave to proceed under the Securities Act, he did not prove on a balance of probabilities that there was a misrepresentation or reliance. In other words, even where the leave test had been satisfied, the court was still prepared

to dispose of the proceeding on a summary basis following a preliminary assessment of the underlying merits.

The plaintiff in *Pretium* alleged that Pretium committed a misrepresentation by omission when it refused to disclose a negative opinion from one of its consultants regarding the viability of its mine. At the leave motion, Justice Belobaba held that reasonable investors would have considered it material that Pretium's mining consultants fundamentally disagreed as to whether there were valid mineral resources at Pretium's new mine. However, in the face of new evidence presented at the cross-motions for summary judgment, Justice Belobaba found that the underlying opinion was unsolicited, inexpert, premature and unreliable. On the basis that objectively unreliable or erroneous opinions are not material facts, he further concluded that there was no misrepresentation.

At the outset of his decision, Justice Belobaba confirmed the distinction between the evidentiary standard at the leave stage as compared to the adjudication of the merits. He noted that he had granted the plaintiff leave because there was enough evidence provided at that stage to meet the "reasonable possibility of success" hurdle. As Justice Belobaba noted, while the leave motion is "more than a speed bump, it is not the Matterhorn." On the merits, however, the plaintiff must meet the higher standard of a "balance of probabilities." On the facts before him, he ultimately concluded that the plaintiff simply could not satisfy the higher evidentiary standard and granted summary judgment accordingly.

Key takeaways

Taken together, *Cronos*, *Peters* and *Pretium* are helpful illustrations of the courts' willingness to engage with the merits of proposed secondary market misrepresentation cases and – where such claims are found wanting – to dispose of them at an early stage in their role as gatekeepers. Indeed, this judicial role continues even after leave has been granted, such that a plaintiff's success at the leave stage does not necessarily preclude a defendant's success on the merits.

These decisions also highlight the importance of the materiality threshold for actionable alleged misrepresentations contained in public disclosures. A failure to properly plead the alleged misrepresentations with sufficient precision or without sufficient evidentiary support – including expert evidence speaking to the materiality of the statements or omissions – may be fatal to a plaintiff's request to proceed with a secondary market action.

AUTHORS

Craig Lockwood
Partner, Litigation
clockwood@osler.com
416.862.5988

Lipi Mishra
Associate, Litigation
lmishra@osler.com
416.862.4271

CLASS ACTIONS

Class actions in British Columbia: Go west, young plaintiffs, go west

British Columbia has long been a plaintiff-friendly forum for class proceedings in Canada. In contrast to other provincial jurisdictions, plaintiffs in B.C. enjoy the benefit of favourable costs rules that limit their potential exposure to adverse cost rulings at the certification stage of a case. B.C.'s popularity with potential plaintiffs as a jurisdiction for the commencement of class actions was further bolstered this year by the adoption of important amendments to Ontario's *Class Proceedings Act, 1992* in September 2020. Under these amendments, proposed representative plaintiffs now face a more onerous burden in seeking class certification in Ontario. This change has led to a migration of new national class actions away from Ontario to B.C. and other provinces. In addition, since 2018, B.C. has permitted the certification of national classes that include extra-provincial residents on an opt-out basis.

In 2021, two key decisions were issued that affect B.C. class actions practice and that have not been uniformly plaintiff-friendly. On the one hand, the Supreme Court of Canada refused leave to appeal from a decision of the B.C. Court of Appeal that affirmed a long jurisdictional reach of B.C. courts in relation to price-fixing conspiracy claims and foreign defendants in a class proceeding. On the other hand, the B.C. Court of Appeal held that certification should not be presumed to be the first step in a proposed class action; consequently, in the right case, defendants should be able to bring preliminary substantive motions, such as jurisdictional challenges or motions to strike, before the motion for certification is even heard.

Both rulings provide important guidance for class actions practice in the province. They also suggest that, although plaintiffs may view B.C. as plaintiff-friendly, defendants continue to have meaningful opportunities to dispose of or narrow unmeritorious cases through substantive motions prior to the determination of class certification.

Although plaintiffs may view B.C. as plaintiff-friendly, defendants continue to have meaningful opportunities to dispose of or narrow unmeritorious cases through substantive motions prior to the determination of class certification.

The long reach of B.C.'s jurisdiction over foreign defendants

The B.C. Court of Appeal first set out its willingness, in some cases, to take jurisdiction over foreign defendants in *British Columbia v. Imperial Tobacco Canada Ltd*. In *Imperial Tobacco*, on the specific facts of that case, the Court of Appeal found that a foreign defendant may be called to account in the jurisdiction where the alleged harm was suffered, *regardless* of where the alleged wrongful conduct occurred. The Court of Appeal also found that B.C. courts had jurisdiction over the foreign defendants who did not manufacture any cigarettes sold in Canada, but who were alleged to have participated in a conspiracy with the other defendants, including the domestic manufacturers, to prevent British Columbians from learning about the harmful and addictive properties of cigarettes.

Subsequently, in *Fairhurst v. De Beers Canada Inc.*, the B.C. Court of Appeal extended the jurisdictional approach set out in *Imperial Tobacco* to a price-fixing conspiracy claim. In *Fairhurst*, the plaintiff alleged a price-fixing conspiracy by various companies in the gem grade diamond business. While not all the defendants in *Fairhurst* conducted business in B.C., the foreign defendants' products all entered the channels of trade in B.C., and therefore those defendants were subject to the jurisdiction of the B.C. courts.

In 2020, in *Ewert v. Höegh Autoliners AS*, the B.C. Court of Appeal combined the approaches from *Imperial Tobacco* and *Fairhurst*. The Court found that a foreign defendant whose products or services do *not* enter the channels of trade in B.C. can nevertheless be subject to B.C.'s jurisdiction on the basis of conspiracy claims based on indirect economic harm suffered in the province.

In *Ewert*, the plaintiffs alleged that Höegh Autoliners AS and other roll-on/roll-off marine shipping providers conspired *outside* Canada to artificially inflate prices *inside* Canada. The alleged conspiracy was said to affect British Columbians by increasing the prices of imported vehicles in the province. The Höegh defendants moved to stay the case against them on the basis that

they had no presence in B.C., they did not carry on business in B.C., and their services had never entered the channels of trade in B.C.

In dismissing the jurisdiction motion, the Court of Appeal held that a B.C. court may take jurisdiction over a foreign defendant if the plaintiffs allege that the foreign defendant participated in a foreign price-fixing conspiracy and that it resulted in raised prices in Canada for the goods or services of *other* defendants. In other words, if the conspiracy increased prices for Canadian consumers, then *anyone* who participated in the conspiracy could be called to account in the province, whether or not the alleged foreign conspirator's own goods or services were provided in B.C. The foreign defendant can refute the presumption of jurisdiction by adducing evidence contesting the allegation that it participated in the conspiracy – raising, of course, the challenge of requiring the foreign defendant to respond on the merits at a jurisdictional stage.

In April 2021, the Supreme Court of Canada dismissed an application for leave to appeal from the *Ewert* decision.

Certification if necessary, but not necessarily certification

For over a decade, courts in B.C. have asserted that certification is presumed to be the first step in a class proceeding. This has created challenges for defendants who have struggled to have preliminary motions, such as motions to strike or jurisdictional motions that could narrow or dispose of a case, heard on a preliminary basis, before incurring the cost of a certification motion. It has also created a practical challenge, as certification of even an unmeritorious case can present a significant risk to defendants by creating settlement leverage for plaintiffs.

That changed this year. In *British Columbia v. The Jean Coutu Group (PJC) Inc.*, the B.C. Court of Appeal held that certification is not presumed to be the first procedural step in a proposed class action. Rather, the court held that each proposed motion must be considered in the context of each unique case:

> *Each pre-certification motion must be decided on its own individual merits. Each application must be determined in the context of the particular case before the court. The court's discretion ought to be exercised in a manner that facilitates and achieves judicial efficiency and the timely resolution of the dispute.... I reject the proposition that there is a presumption that the certification motion ought to be the first procedural matter to be heard. The cases that have so held were, in my opinion, wrongly decided and should not be followed.*

Jean Coutu may dampen the appeal of B.C. as a class proceedings jurisdiction. While B.C. remains a "no-costs" jurisdiction, meaning that representative plaintiffs are not liable to pay defendants' costs, that protection is only available once the certification motion has been brought. Consequently, if a defendant can have an unmeritorious claim dismissed *before* it is certified, the proposed representative plaintiff may find themselves on the hook for significant legal costs.

The future of class actions in B.C.?

As a result of changes to class action proceedings legislation and practice, particularly in Ontario, there is renewed attention being given to B.C. as a perceived plaintiff-friendly jurisdiction for class action proceedings. For several reasons, the province remains a choice jurisdiction for class action plaintiffs. B.C. class action proceedings legislation and related case law provide support for plaintiffs, lower the risk to plaintiffs of initiating a proceeding and improve the ease with which class actions may be commenced, potentially including against foreign defendants.

In 2021, however, the B.C. Court of Appeal signalled that it supports an approach that will weed out unmeritorious cases at an early stage. It remains to be seen whether the B.C. Supreme Court will take up that standard in 2022 and, if it does, how this will affect the perception of B.C. as a class action friendly province.

AUTHORS

Christopher Naudie
Partner, Litigation

cnaudie@osler.com
416.862.6811

Emily MacKinnon
Associate, Litigation

emackinnon@osler.com
604.692.2705

Sergio Ortega
Associate, Tax and Commercial Litigation

sortega@osler.com
604.692.2710

INSOLVENCY

Extraordinary first day relief, EFC guidance, good faith and more: Notable themes in CCAA restructurings

Due to a number of factors, including the extent of available capital in the markets and the continued backstop provided by government programs designed to blunt the economic effects of the pandemic, 2021 was not the apocalypse many were predicting. Nevertheless, Canadian restructuring professionals and courts continued to confront and overcome issues in a number of important areas, including extraordinary first day relief, good faith and lack thereof, eligible financial contracts and liquidating *Companies' Creditors Arrangements Act* (CCAA) proceedings. We have distilled these notable themes in restructuring law into key takeaways for anyone dealing with a distressed Canadian company – whether as the company, a lender or other stakeholder.

Just Energy: Tailored relief for unusual circumstances

The CCAA filing of the Just Energy Group in early 2021 showed that a CCAA court can grant extraordinary relief that takes effect during the first 10 days of a filing where the specific and unique circumstances faced by the debtor justify it. Osler acts for Just Energy.

Just Energy's urgent need to file under the CCAA was precipitated by financial pressures caused by an extreme weather event in Texas. For a brief period of time in February 2021, unprecedented cold weather caused electricity prices in the Texas market to spike. Just Energy, whose business consists of buying electricity and natural gas in the market for supply to its customers, was suddenly required to purchase electricity in Texas – its largest market in the U.S. – for several days at exponentially higher prices than had ever been seen before. It was then required on very short notice to make settlement payments amounting to hundreds of millions of dollars to the Texas market operator, Electric Reliability Council of Texas (ERCOT).

The resulting liquidity crunch led Just Energy to seek an initial order under the CCAA on March 9, 2021, followed by a recognition order under Chapter 15 of the U.S. *Bankruptcy Code*. In its initial order, Just Energy obtained two forms of relief that are noteworthy.

Substantial DIP financing to be drawn in the first 10 days

Under provisions of the CCAA that took effect in 2019, a debtor is only entitled to obtain an initial order for a period of 10 days. Given that an initial order is generally obtained *ex parte*, the debtor can only obtain relief for this initial 10-day period that can be justified as reasonably necessary to "keep the lights on" during that period.

Just Energy obtained $125 million of DIP financing on the first day. In Just Energy's unique circumstances, it was not possible to wait to obtain court approval of this financing and the related super-priority charge until after the come-back hearing. If Just Energy did not satisfy ERCOT's settlement payment demands within two business days, Just Energy could have lost its right to operate in the Texas market and all its Texas customers, which would effectively have made its restructuring impossible.

The quantum of the DIP charge and the fact that the DIP facility would be almost fully drawn and utilized by the business in the first 10 days was unusual. However, in light of the specific circumstances faced by Just Energy, this relief was entirely consistent with the requirements of the amended CCAA provisions to ensure that initial orders are limited to what is necessary to keep the debtor's business running.

The Court's reasoning demonstrates that the 2019 amendments to the CCAA do not entirely foreclose the ability of a debtor company to obtain approval for DIP financing in a very material amount on the first day of a filing. However, to obtain such relief, the debtor company must be prepared to demonstrate why the amount and timing of the financing are necessary before the come-back hearing when affected stakeholders can have their say.

If Just Energy did not satisfy ERCOT's settlement payment demands within two business days, Just Energy could have lost its right to operate in the Texas market and all its Texas customers, which would effectively have made its restructuring impossible.

Regulatory stay preserves the debtor's licences

The regulatory stay of proceedings obtained in Just Energy's initial order was the first of its kind. The default rule under the CCAA is that a stay of proceedings can prevent regulators from taking steps against a debtor to recover money, but cannot prevent those regulators from taking other non-monetary steps, except with leave of the court. The circumstances in which a CCAA court can agree to extend the stay of proceedings to regulatory actions, such as suspensions or revocations of licences, had never been considered before Just Energy sought this relief.

Just Energy's business is heavily regulated. The company depends on multiple licences and other relationships with regulators in both Canada and the U.S. Without those licences, Just Energy could not operate. At the time of filing, Just Energy was operating in compliance with its regulatory obligations. However, Just Energy's filing under the CCAA could itself have been a basis for regulators to seek to suspend or revoke its licences, to impose otherwise onerous terms or even to transfer its customers to another provider.

To ensure that Just Energy's business could continue as a going concern during the restructuring, the Ontario Superior Court of Justice granted a stay preventing Canadian regulators from taking steps against Just Energy based on its insolvency or its CCAA filing. A similar order was granted in relation to the U.S. regulators by the U.S. Court in the Chapter 15 recognition proceeding.

The availability of the regulatory stay was based, principally, on the premise that Just Energy would continue to comply with all applicable regulatory requirements while under CCAA protection, including the requirement to maintain its licences in good standing. This premise was key to satisfying the Court, as required under the CCAA, that the regulatory stay was not contrary to the public interest.

The Court was also prepared to grant the regulatory stay for the initial 10-day period without prior notice to the affected regulators. Despite the express requirement to provide advance notice under the CCAA, the Court recognized that it would have been impracticable to do so in the circumstances. The potential disruption that could have been caused if the regulators had taken steps against the debtor during the initial 10-day period justified this immediate *ex parte* relief. Just Energy was thereafter able to engage proactively with all affected regulators. Ultimately, no regulator formally objected to the regulatory stay, including at the come-back hearing.

The regulatory stay represents a valuable precedent for other heavily regulated debtor companies seeking to preserve their status during a CCAA proceeding.

Whither good faith?

As recognized by the Supreme Court of Canada in its 2020 decision in *Callidus* and more recently, in *Canada North*, good faith is a baseline standard of conduct that underpins the discretionary relief available to a debtor company under the CCAA. It is measured against the purposes and the remedial objectives of the CCAA.

In 2019, the CCAA was amended to mandate that "any interested person" in a CCAA proceeding shall act in good faith "with respect to the proceeding." If the court determines that such interested person has failed to do so, the court may make any order it thinks fit. An equivalent provision was also added to the *Bankruptcy and Insolvency Act* (BIA). These provisions apply to all parties in a proceeding, not just the debtor company. The provisions were enacted for the stated purpose of making insolvency proceedings more fair, more transparent and more accessible to vulnerable stakeholders such as pensioners or workers.

When first introduced, insolvency practitioners feared that a statutory duty of good faith would become an ill-defined tool to impose judicial morality on a CCAA proceeding. There was also concern that it would encourage tactical motions by stakeholders, creating uncertainty, additional expense and delay. Certain steps taken in an insolvency proceeding may appear harsh to those who will not recover their claims in full, or perhaps at all, or whose contractual relationships with the debtor may be terminated. When will such steps, which are often taken in an adversarial context, be constrained by the concept of good faith? Now that two years have elapsed since the enactment of the statutory duty, it is not yet clear whether those initial fears will prove to be justified.

When first introduced, insolvency practitioners feared that a statutory duty of good faith would become an ill-defined tool to impose judicial morality on a CCAA proceeding. Now that two years have elapsed since the enactment of the statutory duty, it is not yet clear whether those initial fears will prove to be justified.

There are few cases that analyze the scope and application of the new statutory duty in any detail. In 2021, the Ontario Superior Court of Justice decided two related CCAA cases that may help shed some light on the Court's approach.

In the CCAA proceeding seeking to restructure the affairs of Laurentian University, the debtor was party to three contracts with so-called "federated universities": Thorneloe University (Thorneloe), Huntington University (Huntington) and University of Sudbury (USudbury). The debtor determined that its restructuring required the disclaimer of all three contracts. Thorneloe and USudbury objected to the disclaimer on several grounds, including alleging bad faith. It was argued that the disclaimer was motivated by an improper purpose – namely, to eliminate two competitors of the debtor. Both Thorneloe and USudbury argued that the disclaimer would lead to their own insolvency.

The Court rejected both the Thorneloe and the USudbury objections. The Ontario Court of Appeal subsequently denied leave to appeal to Thorneloe. USudbury did not seek leave to appeal.

In the Thorneloe decision, the Court expressly stated that "restructurings are not easy" and noted that they "often result in treatment that a party can consider to be extremely harsh." However, that did not necessarily mean that the other party has acted in bad faith. The Court noted that the Monitor had supported the disclaimers without indicating any reservation about the good faith conduct of the debtor. Moreover, the Monitor supported the extension of the stay of proceedings, which required a determination that the debtor had been acting in good faith and with due diligence.

The debtor had demonstrated that the disclaimers were reasonably necessary for the restructuring and the debtor had been transparent about its intention to disclaim these agreements if a negotiated solution could not be found. One of the federated universities – Huntington – had reached a resolution with the debtor. In rejecting the objections, the Court noted that the devastating effect of the disclaimers on Thornloe and USudbury was to be balanced against the fact that the debtor company was facing its own potential demise if it could not restructure. If the restructuring failed, the federated universities would be insolvent in any event.

Consistent with *Callidus*, the focus of the bad faith argument in the Laurentian University case was on the propriety of the purpose for which the debtor sought to disclaim the agreements. The decisions provide some comfort to debtors that, as long as their actions can be justified by reference to the objectives of the CCAA, and are supported by the Monitor, the risks of a finding of bad faith should be low. Osler is continuing to monitor developments in this area, as more stakeholders seek to rely on the new statutory duty.

Port Capital: Intending to propose a plan is no longer required for a CCAA stay in B.C.

A recent B.C. decision has brought earlier precedent into step with today's flexible approach to the CCAA. Since its 2008 release, *Cliffs Over Maple Bay* has presented a hurdle to insolvent companies in B.C. According to the decision, to obtain a CCAA stay, the debtor must intend to propose a plan of arrangement or compromise to its creditors. More than 10 years and a five-judge panel later, in *Port Capital Development*, the B.C. Court of Appeal has demoted this principle from a requirement to a factor.

Port Capital loosens the restrictive approach adopted in *Maple Bay*. Like in *Maple Bay*, the debtors were also owners of a real estate project. The debtors commenced proceedings under the CCAA when their construction lender cut off funding. In addition to various liquidation offers made through a sales process, a refinancing offer emerged which, if completed, would be a materially better outcome for stakeholders. The refinancing offer required the company to remain in its CCAA proceedings for six months while financing was raised, with the expectation that the company would be able to emerge thereafter and complete the project. Critically, the refinancing did not contemplate a plan for creditors to vote on at any point.

Citing *Maple Bay*, the chambers judge refused to approve the refinancing offer under the CCAA, finding that there was nothing to suggest that any party intended to put forward a plan of arrangement or compromise for a vote. The Court of Appeal granted leave to appeal, convening a five-justice panel with the power to reconsider *Maple Bay* if appropriate.

The Court of Appeal took advantage of the opportunity to reconsider the law, holding that the expansion of the scope of the CCAA's remedial objectives and approved strategies rendered *Maple Bay's* more restrictive focus outdated. The chambers judge therefore erred in treating the absence of a proposed plan of compromise as a determinative factor.

Maple Bay was not entirely cast aside, however: whether the debtor plans to present a plan of compromise may still be relevant on the facts of the case in determining whether the protections of the CCAA should be available in the circumstances. Debtor companies should not resort to the CCAA "simply to buy time, without having some proposal in hand" that is likely to further the objectives of the CCAA. However, these objectives can be achieved by various means.

Through a clear-eyed reconsideration of its own decision, the B.C. Court of Appeal has lent even more weight to the CCAA's broad scope for innovative approaches to restructuring beyond a traditional plan of compromise or arrangement. This decision will be of particular interest to restructurings in the real estate sector, where the financing opportunities described above are common; that said, we expect to see ripple effects of this decision across all industries.

Through a clear-eyed reconsideration of its own decision, the B.C. Court of Appeal has lent even more weight to the CCAA's broad scope for innovative approaches to restructuring beyond a traditional plan of compromise or arrangement.

Re Bellatrix: Developments regarding eligible financial contracts in insolvency proceedings

The broad restructuring powers afforded debtors under the CCAA include the ability to disclaim contracts, while at the same time, counterparties are prohibited from terminating those same agreements. Such disclaimer is a powerful tool in a debtor's restructuring toolkit, with one critical carve out: eligible financial contracts (EFCs). An EFC cannot be disclaimed by the debtor. Unlike other contractual counterparties, however, an EFC counterparty can invoke its right to terminate based on the debtor's insolvency default, despite the stay of proceedings.

What constitutes an EFC is set out in the CCAA regulations. Broadly speaking, an EFC is a financial agreement meant to manage financial risk, including certain derivatives agreements and agreements to settle securities, futures, options or derivatives transactions. Even with the guidance provided in the CCAA regulation, however, EFCs by their nature are hard to define, in part because derivatives products are a constantly evolving tool in financial markets. It is necessary to consider the purpose of an agreement in evaluating its status as an EFC.

In the CCAA proceedings of Bellatrix Exploration Ltd., Bellatrix had entered into a number of contracts with BP Canada for the long-term supply of natural gas to BP. Bellatrix sought to disclaim the contracts shortly after filing for CCAA protection. The debtor also immediately ceased performing under the contracts, despite the requirement under the CCAA that any contract disclaimer is subject to a 30-day notice period.

In a February 2020 ruling, the Alberta Court of Queen's Bench determined that the gas supply agreements did fall within the definition of an EFC. The Court looked at the agreements as a whole, keeping in mind the overarching theme of management of financial risk inherent in business transactions. Notably, the contract included express language that the contracts constituted EFCs as defined by the CCAA regulations. However, while this was a relevant factor, such language in and of itself does not make a contract an EFC.

The Court considered surrounding evidence, such as Bellatrix's characterization of the contracts in a press release, as well as the purpose of the contracts to manage future price risk, to assess the true nature of the contracts. Based on the structure and purpose of the contracts and the surrounding facts, the Court held that the contracts were EFCs and therefore, could not be disclaimed.

The Alberta Court of Appeal granted leave to appeal, and heard the appeal in the fall of 2020. Before the decision could be released, in December 2020 the Alberta Court of Queen's Bench heard and determined a second motion regarding the ability of the debtor company to cease performing the agreements.

The Court determined that, even though the EFCs could not be disclaimed, the debtor was not compelled to continue to perform those contracts by delivering gas to BP at the uneconomic contract price. Requiring the debtor to keep performing a contract could prevent the debtor from restructuring at all if the contract in question is particularly onerous. Rather, the prohibition on disclaimer simply gives an EFC counterparty control over whether and when it wants to exit the relationship and close out its position.

At the time of the second motion, the Bellatrix business had been sold and BP had not terminated the EFCs. The Court held that, if the EFC counterparty does not close out its position and the debtor ceases performing its obligations, the counterparty will be left with a claim in damages against the debtor. Unless the counterparty has a security interest, it participates in the process as an unsecured creditor and recovers accordingly.

In March 2021, the Alberta Court of Appeal denied leave to appeal in the second motion, noting that there was no reason to doubt the correctness of the reasoning. Then, in April 2021, as a result of the decision in the second motion and of the sale of the business, the Alberta Court of Appeal dismissed the appeal from the first motion on the basis that it had become moot.

The dismissal of the appeal in the first motion addressing the status of the agreements as EFCs leaves uncertainty regarding the scope of the definition of EFCs. It also leaves uncertain the benefit of using express language characterizing their agreements as EFCs in an attempt to fit within the CCAA safe harbour provisions. However, the decision in the second motion confirms that debtor companies possess a further tool – unilateral cessation of performance – that could be of assistance in obtaining relief from onerous EFCs outside the disclaimer process.

Conclusion

We expect courts will continue to grapple with the thorny issues of stakeholder dynamics, good faith, the nature of eligible financial contracts and *ex parte* relief through 2022. As government programs expire and companies face financial distress in uncertain markets, those tensions will continue to be front and centre in insolvency proceedings.

AUTHORS

Marc Wasserman
Partner, National Chair, Insolvency & Restructuring

mwasserman@osler.com
416.862.4908

Jacqueline Code
Partner and Chair, Research

jcode@osler.com
416.862.6462

Kathryn Esaw
Partner, Insolvency and Restructuring

kesaw@osler.com
416.862.4905

CAPITAL MARKETS ENFORCEMENT

A dynamic year for capital markets enforcement

Despite ongoing pandemic-related slowdowns, 2021 saw significant capital markets enforcement activity from regulators and prosecutors, including notable criminal and quasi-criminal proceedings. Much of this enforcement activity has been directed at emerging industries, particularly legalized cannabis and crypto markets.

Other developments in 2021 have the potential to shape the enforcement landscape for years to come, including the publication of a draft Ontario *Capital Markets Act* which, if enacted, will replace the *Securities Act* and the *Commodity Futures Act*. Other significant changes include the announcement of a beneficial ownership registry and the adoption by the Investment Industry Regulatory Organization of Canada (IIROC) of early resolution offers.

Continuing impact of COVID-19

This year, the fallout from the sudden pandemic-induced transition to virtual regulation and enforcement continued. Regulators and market participants were required to pursue and respond to virtual investigations and hearings. Regulators were also tasked with responding to a rise in fraudulent schemes that attempted to capitalize on the widespread pandemic-related uncertainty.

In general, regulators have adjusted well to the pandemic. While enforcement activity slowed, it has continued without significant disruption. As previously reported in our blog post on osler.com, CSA releases Annual Enforcement Report for fiscal year 2020–2021, and discussed in more detail below, the Canadian Securities Administrators (CSA) Annual Enforcement Report for fiscal year 2020–2021 (the Enforcement Report) highlights the steps taken by capital markets regulators in the face of these unprecedented challenges. Addressing these challenges mandated a high degree of cooperation and coordination among CSA members and law enforcement, self-regulatory organizations, federal counterparts (including the Bank of Canada, the Office of the Superintendent of Financial Institutions and Finance Canada) and foreign regulators.

As the restrictions imposed by the pandemic loosen, it will be interesting to see how much of the switch to virtual enforcement remains, including whether there will be pressure to continue with virtual investigations and hearings and whether that will be resisted by the market participants' bar. We anticipate that virtual interviews will remain common post-pandemic and that more straightforward hearings will continue to be held virtually. We also expect the increased collaboration between CSA members to continue, given the obvious benefits to promoting prompt and coordinated investigations and prosecutions of multijurisdictional securities law violations.

We anticipate that virtual interviews will remain common post-pandemic and that more straightforward hearings will continue to be held virtually.

Enforcement activity

Administrative enforcement matters

The Enforcement Report, released on June 22, 2021, details a slow-down in enforcement activity in the 2020–2021 fiscal year relative to the prior reported period, likely because of postponements due to COVID-19. CSA members imposed a collective $20.3 million in penalties and sanctions, a significant decrease from the $45 million and $77 million imposed in the 2018–2019 and 2019–2020 fiscal years, and the lowest annual total since 2008.

However, other enforcement metrics saw significant upticks. The CSA reported an increase in whistleblower tips received (461 this year, compared to 291 last year) and a 140% increase in investor warnings and alerts. Six individuals received jail terms, ranging from five months to four and a half years, and 49 respondents received interim cease-trade and asset-freeze orders. The number of new cases commenced (52) is in line with prior years, with the majority of new matters involving illegal distribution, registrant misconduct and fraud.

The Enforcement Report also highlights a large number of COVID-19-related investment scams. The CSA participated in the North American Securities Administrators Association "Sweep" to identify and remove fraudulent websites

and advertising on social media and digital marketplaces. The "Sweep" uncovered more than 150 fraudulent schemes, 64 of which were identified by Canadian regulators. Uncertainty and volatility create fertile ground for fraudulent schemes to flourish and the advent of widespread use of social media as a means of influencing market changes (such as the Reddit-driven frenzy over GameStop) is still relatively new. Accordingly, the pandemic may prove to be a crucible in which regulators' ability to identify and address fraudulent activity is tested.

As we previously discussed in our blog post on osler.com, Québec Financial Markets Administrative Tribunal's long reach, the Court of Appeal of Québec rendered a decision related to the territorial jurisdiction of the Financial Markets Administrative Tribunal (the FMAT) on September 15, 2021. In the context of an alleged transnational "pump and dump" scheme, the Court ruled that FMAT has jurisdiction over the alleged wrongdoing despite the fact that the applicant resides outside of Québec. The decision confirmed that the FMAT must have jurisdiction over transnational matters when there is a real and substantial connection with the province. The Court emphasized the role of the FMAT, which is to protect Québec investors and to ensure the efficiency of Québec's securities market and public confidence therein.

In the U.S., the newly-appointed Chair of the United States Securities and Exchange Commission (SEC), Gary Gensler, has suggested that sweeping new changes are on the horizon. These include more aggressive use of prophylactic remedies for securities laws violations, adjustments to the SEC's current no-admit, no-deny settlement policy (which will make it more difficult for defendants to settle claims without admitting or denying wrongdoing) and amendments to the SEC's whistleblower program and insider trading rules. Canadian issuers with U.S. securities exposure will need to carefully consider these changes.

Criminal and quasi-criminal enforcement

The Ontario Securities Commission (OSC) published its 2021 Annual Report on September 2, 2021, which details the 11 cases investigated and two charges laid by the Quasi-criminal Serious Offences Team during the 2020–2021 fiscal year. While no federal *Criminal Code* proceedings were initiated in the 2020–2021 fiscal year, several such proceedings were initiated shortly after the fiscal year's end:

- In June 2021, charges were laid against three former directors of CannTrust Holdings Inc., one of Canada's first billion-dollar cannabis companies, including former CEO Peter Aceto. The three directors were charged with securities law violations following a sweeping investigation into CannTrust's failure to disclose unlicensed growing by the OSC's Joint Serious Offences Team, which includes representatives of the OSC and the Royal Canadian Mounted Police. All three directors are charged with misrepresentations while two of the directors face additional insider trading charges. In July 2021, CannTrust emerged from *Companies' Creditors Arrangement Act* protection having settled significant securities misrepresentation lawsuits against the company.

- In June 2021, husband and wife duo Marc and Helene Brunet were convicted of quasi-criminal charges under the Ontario *Securities Act*. The allegations involved the sale of more than $800,000 worth of securities in MultiCast Networks Holdings Inc. to Ontario investors between 2010 and 2016.
- In October 2021, Stephane Gagnon was charged with fraud and using a forged document. The OSC alleges that Mr. Gagnon collected more than $20 million from investors across the country by promising them immediate access to their locked-in retirement savings accounts, but instead, using investor funds for personal expenses.
- In the same month, the OSC also announced the arrest and extradition to Ontario of Bernard Justin Sevilla, a U.K. resident charged with orchestrating from the U.K. a complex international fraud targeting Ontario investors. The alleged scheme involved purchasing airtime on Ontario radio stations to solicit investments in a foreign exchange arrangement called Trans-Atlantic Direct (TAD). The scheme encouraged interested investors to register an account and send their investment funds to offshore bank accounts for foreign currency trading. Approximately 100 Ontario investors directed almost $5.2 million to TAD.

These pursuits reflect the growing priority enforcers are giving to combatting white-collar crime in a visible manner. As of October, the OSC Enforcement Branch has pursued a total of 54 quasi-criminal and criminal matters involving 78 accused in 2021.

As of October, the OSC Enforcement Branch has pursued a total of 54 quasi-criminal and criminal matters involving 78 accused in 2021.

Enforcement activity relating to crypto trading platforms

Canadian securities regulators began pursuing enforcement activity against crypto market participants. This follows on the heels of 2020's first ever settlement between the OSC and a cryptoasset trading platform (CTP).

The enforcement activity is largely driven by new registration requirements for CTPs. As we reported in our blog post on osler.com, Three week countdown for Canadian digital asset trading platforms to start getting registered under securities laws, these new requirements were jointly published on March 29, 2021 by the CSA and IIROC. At the same time, the OSC imposed an April 19, 2021 deadline for CTPs serving Ontario residents to contact the OSC to discuss registration. Other new regulatory requirements described in our Decoding crypto – Providing regulatory clarity to cryptoasset businesses article are likely to also drive a new wave of enforcement activity.

More than 70 CTPs have begun the registration process with the CSA. To date, OSC staff have published Statements of Allegations (SOA) commencing enforcement proceedings against four CTPs that failed to do so:

- Poloniex, a Seychelles-based CTP (May 25, 2021)
- KuCoin, a CTP based in the Seychelles and Singapore (June 7, 2021)
- Bybit, a CTP based in the British Virgin Islands (June 21, 2021)
- OKEx, a Seychelles-based CTP (August 19, 2021). Interestingly, the OSC pursued enforcement against OKEx in August notwithstanding the fact that, as acknowledged in the SOA, Ontario was listed as a restricted jurisdiction in the OKEx terms of service in June

The OSC alleges that each of the CTPs in question (i) are available to, and in fact used by, Ontario residents; (ii) engage in the trading of securities without prospectuses or prospectus exemptions; and (iii) have failed to engage in the CSA's registration process.

Interestingly, the OSC appears to have pursued this enforcement activity without definitively taking the position that the cryptoassets traded on the CTPs are securities. Instead, the SOAs each state that the "instruments or contracts" created when cryptoassets are deposited into the CTPs' custody are "securities or derivatives."

Internationally, this year has also seen increased enforcement activity against crypto market participants. In the U.S., the Department of Justice announced the formation of a National Cryptocurrency Enforcement Team to identify and pursue cases against cryptocurrency exchanges. The SEC has also brought a flurry of enforcement activities, including actions against unregistered crypto issuers and exchanges. Other jurisdictions also appear to be preparing to take regulatory action against unregistered crypto markets, with the U.K., Japan and the Cayman Islands issuing notices stating that Binance is not authorized in those countries.

Canadians scrutinized by foreign regulators

A number of Canadian entities faced regulatory scrutiny from the SEC in 2020–2021. For example, Sean Wygovsky, a trader at a major Canada-based asset management firm, was charged in July 2021 with fraud in connection with a front-running scheme through which he is alleged to have earned over US$3.6 million.

Canadian cannabis company, CanaFarma Hemp Products Corp., and its founders were also charged with fraud in October 2021. The company is alleged to have raised approximately US$15 million from investors and then misappropriated a significant amount of the raised funds for personal use and other unrelated purposes.

OSC guidance on enforcement investigations and document production

In July 2021, the OSC published guidance on enforcement investigations and document production to assist individuals and companies participating in enforcement assessments and investigations. This guidance included OSC Staff Notice 15-707 Enforcement Investigation Guidance and OSC Staff Notice 15-708 Document Production Guidance. Through this, the OSC clarified the processes and timelines that individuals and companies can expect in enforcement assessments and investigations and provided insight into enforcement staff's expectations. The resources also described the Enforcement Branch's preferred production methods and provided information about how to respond to requests for records and other documents.

2020–2021 IIROC Enforcement Report

The IIROC 2020–2021 Enforcement Report revealed that IIROC Enforcement received just under 1,400 complaints in 2021. Nearly a third of these complaints related to unsuitable investments, while unauthorized and discretionary trading, misrepresentation and supervision concerns made up almost half of the remainder. With the majority of its investigations taking place in Ontario and in British Columbia, IIROC referred 25% of its files to prosecutions by the end of the fiscal year. In 29 cases, prosecutions were completed, of which 21 were cases against individuals and eight against firms. Individuals were most often disciplined for improper handling of client accounts and discretionary trading charges, while firms faced discipline largely for supervision faults. In total, IIROC imposed over $950,000 in sanctions against individuals and $1.2 million in sanctions against firms and collected 31% and 100% of sanctions imposed respectively. A series of appeals were ongoing across Ontario, British Columbia and Nova Scotia as of the date of the report's publication.

In addition to enforcement statistics, the IIROC report highlighted several key themes that emerged over the course of the year, including adequacy of supervision, internal control failures and non-compliance of IIROC-regulated firms. IIROC also specifically noted the increased importance of protecting seniors and vulnerable clients, which comprised a quarter of the completed prosecutions against individuals throughout the year.

Additionally, as announced in April 2021, IIROC adopted the use of early resolution offers (EROs) to resolve cases more efficiently. EROs allow targets of disciplinary actions to secure lighter punishments, including a reduction of up to 30% for dealers and representatives on the sanctions IIROC would otherwise seek in a settlement agreement. The reduction could apply to monetary penalties and to the length of a suspension. In offering the reduction, IIROC staff will consider the extent to which there has been proactive and exceptional cooperation, remedial measures implemented and compensation paid. IIROC also announced that it would withdraw one of its other previously proposed options, the Minor Contravention Program, which had sought to address minor rule violations with standard penalties and no public disclosure. The withdrawal followed concerns expressed by public commenters that the suggested program would not serve the public interest.

In total, IIROC imposed over $950,000 in sanctions against individuals and $1.2 million in sanctions against firms and collected 31% and 100% of sanctions imposed respectively.

Enforcement-related legislative and regulatory developments

As we reported in our blog post on osler.com, Ontario Capital Markets Modernization Taskforce Final Report: A set of thoughtful ideas or a blueprint for change?, on January 22, 2021, the Ontario Capital Markets Modernization Taskforce published its final report (the Final Report), which presented a broad range of recommendations that, if adopted, would significantly rework capital markets enforcement. On October 12, 2021, based on the Taskforce's recommendations, the Ontario government released a proposed draft *Capital Markets Act* (Proposed CMA) which, if enacted, would restructure the OSC and replace both the Ontario *Securities Act* and the *Commodity Futures Act*.

The changes in the Proposed CMA are driven by a number of trends identified by the Taskforce, including the decline of primary markets; the rise of private markets; noticeable exempt market activities; the decline in active independent investment dealers; increased investor interest in environmental, social and governance (ESG) factors; increased shareholder activism; the COVID-19 pandemic's impact on markets; and the suspension of the Cooperative Capital Markets System (CCMR) initiative.

- **OSC structure:** Some of the most sweeping changes proposed in the Final Report and reflected in the Proposed CMA relate to the structure of the OSC, such as expansions to the OSC's mandate to include fostering capital formation and competition in the markets. If enacted, the Proposed CMA would also separate the OSC's regulatory and adjudicative functions. Decisions previously within the purview of the "Director" and "Executive Director" would instead be assigned to the "Chief Regulator." Accordingly, the Chief Regulator would possess sweeping powers, such as the ability to make recognition orders and decisions related to recognized entities in the public interest and the ability to revoke and vary decisions. Enforcement proceedings for offences under the Proposed CMA would only be commenced with the Chief Regulator's consent.
- **Increased penalties:** The Taskforce recommended that the maximum monetary penalties be increased for the first time since 2003 to bring Ontario into line with international jurisdictions. The Proposed CMA reflects this recommendation and proposes increases to the maximum administrative monetary penalty from $1 million to $5 million and the maximum fine for quasi-criminal offences from $5 million to $10 million.
- **Automatic recognition of orders:** The Taskforce recommended that the OSC should automatically (without the need for a hearing) reciprocate the orders of other Canadian securities regulators and streamline the reciprocation process for orders made by other bodies. This would support a consistent national approach to the enforcement of orders and settlements and reduce the use of OSC resources on reciprocation. These recommendations are reflected in the Proposed CMA, which provides for automatically reciprocating sanction orders, cease trade orders and settlements from other Canadian securities regulators. It also creates a streamlined process by which the OSC may reciprocate orders and settlements from Canadian courts, self-regulatory organizations, exchanges and foreign capital markets regulators.

- **New remedial measures:** Under the Proposed CMA, if the Chief Regulator is satisfied that an issuer has not complied with capital markets law, they may make a number of compliance orders, including cease trade orders or orders revoking exemptions. The Chief Regulator would be required to provide the issuer and, in certain cases, persons named in the order, the opportunity to be heard before making such orders. Interestingly, with respect to orders in the public interest, the Proposed CMA intends to expand the enumerated list in the *Securities Act* to include prohibitions against promotional activity; advising in connection with activities in capital markets; acting in management or consultative capacities; and voting or exercising any other rights attaching to a security at a specified meeting. In an effort to facilitate the enforcement of these new and revised offences, the Proposed CMA empowers the provincial court to issue capital markets production orders.
- **More extensive liability for exempt market participants:** The Proposed CMA would also expand civil liability recourse for investors in the exempt market by extending possible liability for misrepresentations in offering memoranda and other "prescribed offering documents" beyond issuers, including to directors, promoters and underwriters (similar to liability for misrepresentations in a prospectus).

At the time of writing, the Proposed CMA has been made available for public comment until January 21, 2022.

Greater corporate transparency through announcement of beneficial ownership registry

As we wrote in our blog post on osler.com, Canada's budget introduces long-awaited beneficial ownership registry to combat money laundering, and as discussed in our White-collar defence: Increasing risks and enforcement activity, the Canadian government, in its April 2021 annual budget (the Budget), announced dedicated funding to Innovation, Science and Economic Development Canada to build and implement a publicly accessible corporate beneficial ownership registry by 2025. The measure is intended to better "catch those who attempt to launder money, evade taxes, or commit other complex financial crimes" and follows similar approaches that have been taken in other jurisdictions, including the United Kingdom and United States.

As the government's announcement suggests, the ability to identify the parties behind the curtain of complex corporate structures is seen as a way to make it harder to engage in financial misconduct. Coupled with a high degree of international cooperation (which has been an ongoing project for many years, but is far from fully realized), beneficial ownership registries would make it harder for bad actors to hide their assets from securities regulators and tax authorities. However, having a registry that makes details of individuals' financial affairs a matter of public record also raises important privacy and other concerns. It may itself be used as a means to do harm, including "naming and shaming" people who have engaged in legitimate asset protection or tax strategies. The Paradise Papers, Panama Papers and most recently the Pandora Papers have generated tremendous media attention but, at least in Canada, very little tax or securities enforcement litigation. That may be, as some claim,

Coupled with a high degree of international cooperation, beneficial ownership registries would make it harder for bad actors to hide their assets from securities regulators and tax authorities.

because Canada is a laggard when it comes to enforcement. On the other hand, it may also be because, however interesting the details of individuals' financial affairs may be, the formation of offshore accounts may be lawful in practice.

The past year has set the stage for 2022 to be even more significant for Canadian capital markets enforcement. We will continue to report on the proposed legislative amendments and pending prosecutions, which have the potential to fundamentally alter the enforcement landscape in Canada.

AUTHORS

Lawrence E. Ritchie
Partner, Litigation
Chair, Risk Management and Crisis Response
lritchie@osler.com
416.862.6608

Alexander Cobb
Partner, Litigation
acobb@osler.com
416.862.5964

Sonja Pavic
Associate, Litigation
spavic@osler.com
416.862.5661

Simon Cameron
Associate, Litigation
scameron@osler.com
416.862.6430

Sarah Firestone
Associate, Litigation
sfirestone@osler.com
416.862.4727

Jayne Cooke
Associate, Litigation
jcooke@osler.com
416.646.3948

LITIGATION

White-collar defence: Increasing risks and enforcement activity

For businesses, this year was marked by continued increases in compliance risks relating to the ongoing global COVID-19 pandemic. Businesses were faced with growing costs of compliance, as well as greater risks of exposure to potential liability linked to supply chain disruption. In addition, they increasingly felt the challenges associated with operating across jurisdictions.

Businesses also had to prepare for and adapt to regulatory change. There were significant updates to federal anti-money laundering (AML) legislation. Other regulatory initiatives include the proposal to implement a beneficial ownership registry for corporations in Canada. The work of the Cullen Commission is ongoing. There have also been significant updates to Canada's remediation agreements regime. Furthermore, as we wrote in our blog post, Global financial crime compliance costs are trending upwards. Is Canada catching up?, the average annual cost of financial crime compliance has increased significantly. All of these issues will have significant impacts on businesses in 2022 and beyond.

Ongoing risks related to the COVID-19 pandemic

As we wrote in our 2020 Legal Year in Review, the COVID-19 pandemic has increased compliance risks for businesses and these trends continued in 2021.

Supply chain due diligence

As we discussed in our blog post, Corruption risk and the COVID-19 pandemic: Ensuring compliance in the era of the "new normal," businesses continue to face material supply chain challenges as a result of the pandemic. While supply chain disruptions will likely continue for a while, their severity should diminish over time as the pandemic resolves.

Nonetheless, even beyond the pandemic, it is critical for businesses to adhere to best practices and maintain appropriate diligence and compliance measures to manage the ever-present and inherent risks – such as opportunities for corrupt or illegal activity – associated with global supply chains. The pressures created by supply chain disruption leave cross-border businesses particularly vulnerable to falling victim to fraud and other criminal activity. At the same time, businesses have been forced to adapt to the demands represented by additional regulatory compliance requirements. Further information regarding potential supply chain issues is included in our Supply chain disruption in the face of the COVID-19 pandemic.

A number of key legal and regulatory developments continue to increase prospective liability for businesses, including in addressing supply chain compliance:

- In May 2021, Canada released its new model Foreign Investment Promotion and Protection Agreement (the 2021 Model FIPA). The 2021 Model FIPA expands on previous provisions regarding responsible business conduct (formerly called "corporate social responsibility") and includes the promotion of internationally recognized standards that investors are encouraged to incorporate into investment agreements. As we described in our blog post, New Canadian foreign investment promotion and protection model expands responsible business conduct provisions, although not obligated to do so, parties who adopt the model are encouraged to
  - reaffirm that investors and their investments must comply with domestic laws and regulations of the host state, including human rights, the rights of Indigenous peoples, gender equality, environmental protection and labour
  - reaffirm the importance of internationally recognized standards of responsible business conduct, including the OECD Guidelines for Multinational Enterprises and the United Nations Guiding Principles on Business and Human Rights
  - encourage investors to voluntarily incorporate such standards into business practices and internal policies
  - encourage investors to undertake engagement and dialogue with Indigenous peoples and local communities
  - cooperate on and facilitate joint initiatives to promote responsible business conduct
- The Supreme Court of Canada held in a 2020 decision that Canadian companies may face civil liability in Canada for human rights abuses overseas, even by indirect operating subsidiaries (refer to our Osler Update on the decision).

It is critical for businesses to adhere to best practices and maintain appropriate diligence and compliance measures to manage the ever-present and inherent risks – such as opportunities for corrupt or illegal activity – associated with global supply chains.

This increased emphasis on human rights and ethical business obligations in Canada is consistent with global trends in support of internationally responsible business conduct. For example, in June 2021, Germany passed its *Supply Due Diligence Chain Act*. This legislation, which is expected to come into effect in January 2023, will require companies to report international human rights and certain environmental abuses along their supply chains.

The German enactment followed the March 2021 adoption by the European Parliament of a proposal for a mandatory due diligence directive aimed at incorporating sustainability into long-term business strategies, which is expected to come into force in late 2022 or early 2023. Among other things, it aims to address environment and labour abuses in corporate supply chains and includes new due diligence rules to oblige companies to integrate sustainability criteria into their decision making. These measures follow the December 2020 announcement by the European Union (EU) of the introduction of a new global sanctions regime, as we discussed in New Canadian foreign investment promotion and protection model expands responsible business conduct provisions. The new regime would allow the EU to target individuals, entities and bodies (both state and non-state actors) involved in serious human rights violations worldwide regardless of where they occurred.

As a result of heightened compliance risks created by supply chain disruption and an enhanced focus on human rights and ethical business obligations in Canada and overseas, it is crucial for businesses to complete comprehensive due diligence on their suppliers and contractors. Organizations must understand with whom they are doing business at all stages of the supply chain. Businesses are also well-advised to implement appropriate oversight mechanisms within existing supplier relationships.

Corporate liability for agents

The realities of the pandemic have meant that when suppliers are unable to secure inventories or complete their functions within the supply chain, they are engaging agents to assist across domestic or global operations. In this environment, it is crucial for businesses to understand that they can be held criminally liable not only for the acts of their employees, but also of their agents.

Businesses can be held criminally liable for the acts of contractors, suppliers, distributors or other counterparties under federal legislation such as the *Criminal Code* or the *Corruption of Foreign Public Officials Act*. Potential criminal liability can arise when senior corporate officers are aware of, or turn a blind eye toward, illegal acts committed by agents, employees or counterparties, including corruption, fraud, money laundering, sanctions violations and other economic crimes.

It is the responsibility of businesses to ensure that their agents are acting in compliance with applicable laws. Given the heightened risks arising from the impact of the COVID-19 pandemic on supply chains, it is more important than ever for management to take proactive steps to ensure that a commitment to compliance emanates throughout the organization – starting with the "tone at the top." This includes not only officers, directors and employees of the organization, but also all others acting on its behalf. Best practices include having adequate compliance policies and providing compliance training for

employees and agents alike. In addition, businesses are well-advised to obtain appropriate representations and warranties in agreements entered into with agents, suppliers and other counterparties.

Risks associated with operating across jurisdictions

Given the risks associated with shifting international operations during the pandemic and the new challenges presented by increasingly sophisticated sources of crime, it is important for businesses to recognize the unique risks associated with investigations in a cross-border context. Multijurisdictional investigations have become more common, making it essential for businesses who are the targets of such investigations to understand how to effectively deal with foreign regulators and other authorities.

Businesses facing multijurisdictional investigations should consider how best to engage with foreign authorities to protect their interests. For example, it may be necessary to consider whether a global resolution is possible, particularly where it is uncertain whether authorities will coordinate their efforts with their counterparts in other jurisdictions. Further, it is good practice to involve counsel with knowledge of the local culture and regulations in the jurisdiction involved, as cultural differences and language barriers can hinder the investigation process. It is critical for businesses involved in such investigations to consider whether the laws of multiple jurisdictions potentially apply and whether those laws may be inconsistent with or conflict with each other. In cases where a foreign regulatory authority issues a request for information from a business that is the target of an investigation, certain privacy and constitutional legal requirements could be at stake in more than one jurisdiction.

Multijurisdictional investigations have become more common, making it essential for businesses who are the targets of such investigations to understand how to effectively deal with foreign regulators and other authorities.

Among other things, it may be critical to consider the application of data protection and privacy laws in respect of data sought by foreign authorities, both in the jurisdiction where the target is located and where the investigation is being conducted. Either may impose restrictions on the transfer of data across borders. For example, the EU's *General Data Protection Regulation* (GDPR) imposes certain limitations on the transfer and processing of data to a third country outside the EU for the purposes of disclosing materials to a foreign authority.

In addition, Canadian companies facing a subpoena or production order from a foreign state may not be able to rely on compulsion of law exemptions to privacy and confidentiality obligations to avoid liability for disclosure. In particular, if the instrument through which production is sought is not binding in Canada and no corresponding Canadian order is sought (for instance, U.S. securities regulators may seek production of information from a Canadian company whose securities are listed on U.S. exchanges), compulsion of law exemptions may not be available to the company. The risks associated with these types of requests have increased following amendments to the *Bank Secrecy Act* in the U.S. which granted increased powers to U.S. governmental agencies to subpoena information from foreign financial institutions if the foreign bank maintains a U.S. correspondent account. In such a case, the targeted business may find itself constrained in its ability to comply with disclosure requests from a foreign authority, while also trying to respect applicable data protection requirements in its home jurisdiction.

Anti-money laundering developments

As we wrote last year, public focus on white-collar issues in Canada has been significantly directed towards money laundering in recent years. There were noteworthy Canadian anti-money laundering developments in 2021.

Amendments to PCMLTFA

As we wrote in our blog post, Is Canada rising to the challenge? Responding to calls for more effective financial crime prevention and enforcement, significant amendments to the regulations under the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* (the Amendments) came into force on June 1, 2021. Taken together, these Amendments effect a sizeable overhaul of the anti-money laundering and terrorist financing regulatory landscape in Canada. These changes include, among other things, beneficial ownership reporting obligations, new virtual currency obligations, identification methods for KYC (know your client), and recordkeeping and reporting changes. Further information is available in our guide to the Amendments.

Beneficial ownership registry

As we wrote in our blog post, Canada's budget introduces long-awaited beneficial ownership registry to combat money laundering, and discuss in our A dynamic year for capital markets enforcement article, in its Annual Budget released April 19, 2021 (the Budget), the Government of Canada announced funding for the implementation of a beneficial ownership registry for corporations in Canada. The Budget proposed to provide $2.1 million over two years to Innovation, Science and Economic Development Canada to build and implement a publicly accessible corporate beneficial ownership registry by 2025. The purpose of the new registry was to better "catch those who attempt to launder money, evade taxes, or commit other complex financial crimes." Although the federal government was dissolved in the 2021 election, it is likely the newly elected government will enact similar measures.

The establishment of a beneficial ownership registry would represent a further step for Canada toward a risk-based approach to AML compliance consistent with the approach taken by several other jurisdictions, including the U.K. and the U.S.

Update on the Cullen Commission

The Commission of Inquiry into Money Laundering in British Columbia (the Cullen Commission), which was established in May 2019, continued its proceedings throughout 2021.

The Cullen Commission is led by B.C. Supreme Court Justice Allen Cullen and its mandate is to inquire into and report on money laundering in B.C. Specifically, the Cullen Commission is tasked with determining where and how money laundering is taking place and why it has been allowed to happen, as well as whether and how it can be prevented. The Cullen Commission's work remains ongoing and participants made closing submissions in October of this year. Recommendations from the Commission, likely to be released in 2022, are expected to have a significant impact on the regulatory approach to combating

money laundering in Canada in the future. Learn more about the Cullen Commission in our article in Osler's 2020 Legal Year in Review.

Enforcement and update on remediation agreements

Notably, a new potential remediation agreement was announced in 2021. On September 23, 2021, the RCMP announced charges of fraud against two divisions of SNC-Lavalin and two of its executives in connection with the Jacques Cartier Bridge project in Montréal. Simultaneously, the Québec Directeur des poursuites criminelles et pénales (DPCP) announced that SNC-Lavalin was invited to enter into negotiations with a view to entering into a remediation agreement.

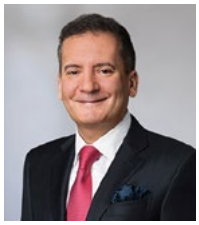
Canada's deferred prosecution agreement (DPA) regime – referred to in Canada as remediation agreements – came into force on September 19, 2018. A DPA (or remediation agreement) is an agreement entered into between a prosecutor and a company alleged to have engaged in economic crimes. The effect of the DPA is to suspend the outstanding prosecution while simultaneously establishing specified undertakings that the organization must fulfill to avoid facing the potential criminal charges. These undertakings often include fines, remediation measures, enhanced reporting requirements, as well as allowing for independent third-party oversight of corporations' compliance techniques. Once the accused company has fulfilled the terms of the DPA, the charges will be dropped. This tool has been actively used to reduce corporate criminal behaviour in other jurisdictions such as the U.K. and U.S. For more information on remediation agreements, please see our blog posts on osler.com, World bank debars German company for thirteen months, Deferred Prosecution Agreements (DPAs) come into force in Canada and Canada's deferred prosecution agreements: Still waiting for takeoff.

To date there has been little use of this new tool. Negotiation of a remediation agreement represents a significant milestone for the regime, which is likely to become an important part of Canada's white-collar crime enforcement framework in the future.

As we head into 2022 and businesses continue to face the increased compliance risks associated with the pandemic, we anticipate a continuation of increased enforcement activity and regulatory initiatives to combat white-collar crimes. In this environment, it is crucial for businesses to maintain a demonstrated commitment to compliance.

As we head into 2022 and businesses continue to face the increased compliance risks associated with the pandemic, we anticipate a continuation of increased enforcement activity and regulatory initiatives to combat white-collar crimes.

AUTHORS



Stéphane Eljarrat
Partner, Litigation
Lead, White-Collar Defence

seljarrat@osler.com
514.904.8118 (Montréal)
416.862.6623 (Toronto)

Lawrence E. Ritchie
Partner, Litigation
Chair, Risk Management and Crisis Response

lritchie@osler.com
416.862.6608

Malcolm Aboud
Associate, Litigation

maboud@osler.com
416.862.4207

Frédéric Plamondon
Associate, Litigation

fplamondon@osler.com
514.904.8109

Sarah Firestone
Associate, Litigation

sfirestone@osler.com
416.862.4727

Emily Lynch
Associate, Litigation

elynch@osler.com
514.904.8164

ESG

People, planet and performance: Embracing ESG

In 2021, we witnessed markedly greater attention being paid to Environmental, Social and Governance (ESG) considerations. These concerns about the environment and social justice are affecting all aspects of life at the moment, as they drive consumer behaviour, new laws and regulations, employment choices and investment capital decisions. ESG is no longer an incidental consideration when pursuing business opportunities. In 2021, Canadian businesses began a march towards inculcating ESG considerations into their organizations.

Pressures for corporate disclosure

On all fronts, corporations are facing demands for more rigorous disclosure and achievements regarding ESG matters. Different stakeholders have different areas of interest, resulting in an overwhelming plethora of rating agencies and reporting frameworks and standards. Unfortunately, this has the effect of reducing comparability and obscuring true performance.

However, some of the standards are starting to converge. The Climate Disclosure Project (CDP), the Climate Disclosure Standards Board (CDSB), the Global Reporting Initiative, the International Integrated Reporting Council (IIRC)

and the Sustainability Accounting Standards Board (SASB) began working on a shared vision for corporate reporting that includes both financial accounting and sustainability disclosure, connected through integrated reporting. The World Economic Forum's International Business Council (WEF), in collaboration with Deloitte, EY, KPMG and PwC, made progress towards establishing universal, material and verifiable ESG metrics and recommended disclosures for corporate reporting on a consistent and comparable basis across industry sectors and countries.

Since the middle of 2021, a number of these organizations have committed to coming together to form the International Sustainability Standards Board (ISSB). The ISSB's mandate will be to develop standards that result in a high quality, comprehensive global baseline of sustainability disclosures focused on the needs of investors and financial markets. The Task Force on Climate-related Financial Disclosure (TCFD) and WEF have announced their support for the ISSB.

Corporations are not waiting for the emergence of a single standard for ESG reporting. Increasingly, corporations have been reviewing their operations through an ESG lens to meet their own needs for better information for the purpose of internal decision making. These reviews seek to identify areas of potential concern or opportunity and have begun the process of identifying key performance indicators for measurement. They also seek to provide some measure of disclosure of interest to investors. We have been assisting our clients in addressing this desire for enhanced disclosure, while taking into account the need for diligence to protect against liability. ESG disclosures are heavily scrutinized not only by investors, but also ESG activists. For further information, refer to our webinar on ESG disclosures.

Corporations are not waiting for the emergence of a single standard for ESG reporting. Increasingly, corporations have been reviewing their operations through an ESG lens to meet their own needs for better information for the purpose of internal decision making.

Regulators also pushed for better disclosure this year.

Diversity disclosure obligations with respect to the representation of women apply to most Canadian public issuers. Public corporations governed by the *Canada Business Corporations Act* also report on the representation of visible minorities, Aboriginal peoples and persons with disabilities in senior leadership positions. Both the Canadian Securities Administrators (CSA) and Corporations Canada are reporting on progress made. The final report of the Ontario Capital Markets Modernization Taskforce recommended in January that TSX-listed companies be required to set targets and provide disclosure on the representation on boards and in executive officer positions of women and persons that are Black, Indigenous and people of colour. Starting in 2022, NASDAQ-listed issuers will be subject to mandated diversity disclosure requirements. See our seventh annual Diversity Disclosure Report for our review of diversity and leadership at Canadian public companies in 2021.

Climate-related financial disclosure is gaining increasing attention. New Zealand and the U.K. have announced their intentions to require reporting in compliance with TCFD. The CSA has issued for comment draft National Instrument 51-107 – Disclosure of Climate-related Matters, which provides a roadmap for a phased-in approach to requiring reporting substantially in compliance with TCFD. Additional details are included in our blog post, Climate change from the corporate perspective: The CSA's proposed climate-related disclosure requirements.

Building bridges towards reconciliation

The need to repair Canada's troubled relationship with its Indigenous communities received considerable focus during 2021. Two recent reports containing guidance and recommendations on Canadian corporate governance practices highlighted the need for better engagement between Canada's business community and its Indigenous peoples. Refer to our article, Corporate governance in transition, for additional information.

Indigenous communities have become significantly more sophisticated with their investment alternatives. For example, the First Nations Finance Authority (FNFA) was formed as a statutory not-for-profit organization. It operates under the authority of *The First Nations Fiscal Management Act*. The FNFA's purposes are to provide First Nations with investment options, capital planning advice and access to long-term loans with preferable interest rates. The innovative funding approach has been honoured with the Governor General's Innovation Award.

The FNFA has provided financing for a variety of First Nations investments in a number of commercial enterprises, including energy infrastructure projects, casinos and fisheries. For example, earlier this year in a historic transaction, the FNFA provided $250 million in financing to a coalition of Mi'kmaq First Nations. The coalition invested the proceeds of the financing in a partnership with Premium Brands Holdings to purchase Clearwater Seafoods for approximately $537 million. As a result of the investment, the coalition now owns 50% of Clearwater and holds Clearwater's Canadian fishing licences within a fully Mi'kmaq owned partnership. Osler acted for the FNFA.

Federal government authority to impose minimum standards regarding greenhouse gas pricing is upheld

In March 2021, the Supreme Court of Canada released a decision upholding the constitutionality of the federal *Greenhouse Gas Pollution Pricing Act*. The Act is the centrepiece of the federal government's climate change plan, which imposes minimum carbon pricing standards on the provinces. As a result, the federal government will be able to move forward to ensure that minimum standards are applied across the country. This should dissuade businesses from engaging in arbitrage of their carbon compliance costs by transferring operations from one province to another. Additional detail on the decision is provided in our article, Supreme Court ends uncertainty over constitutionality of federal carbon pricing framework.

Sustainable finance

Investor demand for investment opportunities to further environmental progress has generated an active market in Europe for sustainable finance. A borrower's environmental performance can be reflected in a variety of sustainable financing vehicles. These can include project finance loans that incorporate the Equator Principles, green bonds or sustainability-linked bond issuances in the public or private debt capital markets, and social loans. All share a common feature in that coupon or other payment obligations are directly tied to the borrower's or issuer's performance relative to a specified ESG-oriented goal.

Sustainability-linked loans offer substantial flexibility to borrowers and provide an attractive way for investors to weigh their returns against their social investing principles. Typically, these loans embed a discount to interest rates payable by the borrower upon achievement of predetermined sustainability targets. The borrower, however, can use the proceeds of the loan for general corporate purposes, and choose where and when to make investments in order to reach the ESG targets. Additional information is provided in our Osler Update, Climate change and corporate credit: Emerging trends in sustainable-impact lending practices.

In comparison, green bonds link the borrowing to a specific eligible green project. Green bonds can offer potential reduced financing rates for projects that have a recognized positive long-term environmental impact.

In 2021, TELUS Corporation established its Sustainability-Linked Bond Framework (Framework), the first of its kind in Canada. The Framework links financing under their bonds to achieving operational net carbon neutrality by 2030. Following the establishment of the Framework, TELUS Corporation and Westbank Corporation (who are joint venture partners holding TELUS Garden in Vancouver, British Columbia) completed a $225 million mortgage green bond financing. The bond offering was Canada's first green bond offering. Osler acted for TELUS Corporation with respect to its Framework and for TELUS Corporation and Westbank Corporation in relation to the initial green bond offering.

In 2021, TELUS Corporation established its Sustainability-Linked Bond Framework (Framework), the first of its kind in Canada. The Framework links financing under their bonds to achieving operational net carbon neutrality by 2030.

Corporate purchases of renewable energy and emission reductions

Corporations are increasingly looking to contribute to a reduced carbon footprint as well as a greener environment by financing sustainable energy and emission reduction projects. In 2021, a number of corporate off-takers completed renewable energy virtual power purchase agreements (VPPAs), physical power purchase agreements and verified emission reduction purchase and sale agreements. These spanned a variety of industries, including banking, automobile manufacturing, telecommunications, beverage, brewing, oil and gas, power generation, data and computing and cryptocurrency mining. Most of these commercial deals in 2021 were contracted in respect of renewable energy or emission reduction projects being developed in Alberta.

Industry stakeholders are carefully watching the development and implementation of the federal carbon offset regulation and associated protocols under the *Greenhouse Gas Pollution Pricing Act* as well as Ontario's *Emission*

Performance Standards regulation. The new Ontario regulation begins applying to large emitters in Ontario starting January 1, 2022. With a broadening of the landscape for these corporate commercial opportunities across Canada (and internationally), we anticipate increased attention on these tools in 2022 and beyond. Osler has drafted and advised on a number of recent renewable energy VPPAs and emission reduction purchase and sale agreements.

ESG investing

Institutional investors are facing their own pressures to allocate funds to ESG investments, especially climate-based investments. Increasingly, pension fund members are demanding to know how the pension fund investments are contributing to a better world. A greater proportion of investors in mutual funds are directing their capital toward funds that have an ESG investment focus. According to Canada's Responsible Investment Association's 2020 Canadian TI Trends Report, responsible investment assets under management in Canada grew to $3.2 trillion as at December 31, 2019, accounting for 61.8% of Canadian assets under management. The 2021 RBC Global Asset Management Responsible Investment Survey notes that 92% of institutional investors in Canada believe ESG-integrated portfolios do as well or better than non-ESG integrated portfolios.

A principal concern of ESG investors is the risk that issuers and investment opportunities may be prone to greenwashing – namely, portraying the issuer or opportunity as being more environmentally friendly than it actually is. Consistent, international standards for disclosure will help address this concern, as will the use of third-party audits of stated practices and ESG-focused infrastructure projects. Additional information is provided in our ESG Investing webinar.

Fair taxation

To address perennial complaints about corporations not paying their fair share of taxes in the jurisdictions in which they operate, in October many of the world's nations, including Canada, agreed to work on a fairer system of taxing profits where they are earned. This also includes an agreement to enforce a corporate tax rate of at least 15%. For more details, see our article, Tax planning developments: Important international tax changes.

ESG: More to come

There are many risks and opportunities in ESG – and they continue to evolve. They encompass pending new laws on carbon emissions and emissions trading, enhanced engagement with Indigenous communities, better disclosure on climate, environmental and social metrics, and new capital raising and investment opportunities. In particular, movement towards standardization across global carbon markets could bolster trading in carbon offsets and other instruments tied to environmental attributes and spur further investment in carbon reduction initiatives. In multiple ways, ESG is driving business strategy, performance assessment and sustainable value creation at Canadian corporations.

AUTHORS

Andrew MacDougall
Partner, Corporate

amacdougall@osler.com
416.862.4732

Jacob A. Sadikman
Partner, Commercial

jsadikman@osler.com
416.862.4931

Jonathan Wypych
Associate, Pensions & Benefits

jwypych@osler.com
416.862.6432

Patrick G. Welsh
Partner, Litigation; Regulatory, Environmental, Indigenous and Land

pwelsh@osler.com
416.862.5951

Trevor R. Scott
Partner, Corporate

tscott@osler.com
604.692.2755

Timothy Hughes
Partner, Tax

thughes@osler.com
416.862.6573

Andrea Boctor
Partner, Chair, Pensions & Benefits

aboctor@osler.com
416.862.4945

Richard J. King
Partner and Co-Chair, Regulatory, Environmental, Indigenous and Land

rking@osler.com
416.862.6626

Martha Martindale
Partner, Financial Services

mmartindale@osler.com
604.692.2759

SUPPLY CHAIN

Supply chain disruption in the face of the COVID-19 pandemic

The COVID-19 pandemic has raised significant challenges for the global supply chain. This is a result of unprecedented demand for goods paired with ongoing restrictions on travel and production. While the global business community is slowly beginning to emerge from COVID-19, the supply chain disruption caused by the pandemic continues to be front page news. Whether it is ongoing labour shortages, factory and plant closures, semiconductor chip scarcity, container shortages and port delays, or lumber and other commodity supply volatility, the interconnectedness of global business and the fragility of the supply chain that underpins it have never been more apparent.

Despite the gradual easing of pandemic-related restrictions, the disruption to the supply chain is far from over. Supply chain uncertainty and delays are predicted to continue to create challenges for Canadian businesses well into 2022. As businesses have become more attuned to these supply chain risks and the vulnerability inherent in certain traditional approaches to supply chain risk management, they have begun to re-evaluate their contractual rights, processes and remedies in the event their own supply chain is affected.

We discuss some of the contract-related steps that businesses should be proactively taking to help mitigate these risks.

Thorough due diligence

COVID-19 has exposed significant gaps in the supply chains of many Canadian businesses and highlighted the importance of having a strong and dependable supply chain, from the manufacturing source right through to the customer. Understanding the supply chain and identifying potential "weak links" in the chain can assist a business in addressing underlying risks. Undertaking comprehensive end-to-end due diligence of suppliers in advance can identify these risks and potentially mitigate their impact should a supply chain failure occur.

We often see clients perform extensive due diligence in relation to their immediate suppliers, without a clear understanding of the dependencies upon which the supplier itself relies in order to meet its own customers' demands. In many cases, intermediate suppliers may not perform any due diligence further down the supply chain beyond their immediate supplier. A robust due diligence process should extend beyond the business's immediate suppliers to include every step in the supply chain.

A robust due diligence process should extend beyond the business's immediate suppliers to include every step in the supply chain.

The due diligence process should be multi-faceted, assessing the supplier's strength and reliability through a variety of lenses. In particular, thorough due diligence should include, at a minimum, an understanding and assessment of

- the corporate structure and the financial strength of not only the supplier counterparty with which a business is contracting, but also relevant parent companies or affiliates
- the operational viability of the supplier
- potential regulatory risks
- business continuity and disaster recovery plans and processes
- information security standards, policies and processes
- litigation risk relating to the services to be provided
- key subcontractor risks

Understanding how a supplier has serviced its customers is also of the utmost importance. A thorough due diligence process should include meaningful reference checks. Ideally, this should extend to both current and former customers of the supplier, including, if possible, a customer who terminated its relationship with the supplier.

Due diligence can be particularly challenging where the supplier, product or service is new to the market. In those circumstances, it can be difficult to assess the risk associated with the supplier, product or service, as there may be little or no assets, performance history or customer experience to draw on. Where proper due diligence is not possible, additional contractual protections to mitigate the risks associated with a new or untested supplier, such as additional insolvency protections, are especially important.

Suppliers should consider improving their own vetting and due diligence processes of their intermediate vendors. They should also consider updating and documenting their internal business continuity plans and processes. These proactive efforts will put suppliers in a better position to respond to requests from customers. Moreover, having robust diligence processes and disaster recovery plans could create a competitive advantage over a less proactive supplier.

Due diligence may not be able to identify global supply chain failures arising from a global pandemic, but ensuring a robust supplier due diligence process is in place can mitigate other risks. For example, it can allow for a customer to appropriately plan for the worst by including redundancies in its supply chain.

In our article White-collar defence: Increasing risks and enforcement activity, we discuss a number of other supply chain considerations involving compliance with laws.

Flexible contracting

Traditional approaches to contracting have been rigid, with substantial reliance on template agreements that are not customized for the context of the particular arrangement. The pandemic has demonstrated that this approach, which may be suitable in static circumstances, fails to address ways in which a relationship might need to change over time. The changing circumstances of the pandemic have highlighted the value of a flexible contractual framework. Customers and suppliers are well-advised to review and update their supplier agreements to build in the requisite flexibility with a view to enabling them to withstand changes both within the relationship and more broadly.

Examples of key changes and terms that should be considered and discussed include

- a shift away from longer-term agreements that lock parties in with little recourse in favour of agreements with shorter terms, paired with unilateral renewal rights that give the customer greater flexibility and optionality
- the addition of specific termination rights tied to clearly measurable events of non-performance
- the inclusion of termination for convenience rights
- the addition of detailed termination assistance services
- the elimination of exclusive supply commitments
- the inclusion of robust, detailed terms relating to business continuity planning and disaster recovery

- the inclusion of more robust audit rights, access to information and rights to perform ongoing due diligence
- the inclusion of robust governance and dispute resolution processes that facilitate transparency, communication and a proactive approach to identifying and resolving issues

While these provisions are largely customer-friendly, they are important topics of discussion between suppliers and customers. Fostering a mutually beneficial relationship that works for both parties is key to building a resilient supply chain. Suppliers, while initially reluctant to change long-standing historic contracting practices, are recognizing that market changes and increased risks that customers are now facing must be addressed going forward.

Where there is a concern about the financial stability or viability of a supplier, additional contractual protections are advisable. It should be noted, however, that protections and remedies that are tied to a supplier's insolvency, such as a termination right, may not be enforceable in many jurisdictions. Accordingly, it is important to engage local insolvency counsel to work through creative and enforceable protections.

Fostering a mutually beneficial relationship that works for both parties is key to building a resilient supply chain.

Maintaining relationships: Supplier and contract management

Too often, clients enter into agreements with suppliers and then promptly put the contracts "in a drawer." The pandemic has further reinforced the importance of ongoing management of the supplier relationship, including the contract with the supplier. This should occur in the post-contract formation period to make sure that the processes, rights and remedies that are included in the contract to mitigate risks are considered on an ongoing basis and leveraged appropriately as a tool to manage the customer-supplier relationship at a business level.

Whether it is through regular monitoring of the financial health of the supplier or relying on the rights and remedies included as part of the contract, it is important that businesses find an appropriate balance between enforcing the terms of the contract and maintaining their ongoing business relationship. The contract terms can and should be used as a critical tool in supplier relationship management.

Technology

The pandemic has accelerated the implementation of, and reliance on, supply chain logistics technologies. Whether to assist with supply chain communications or to support the back-end processes or order management, artificial intelligence (AI) platforms and software are being leveraged globally to improve supply chain efficiency.

Many traditional supply chain contracts do not include sufficiently robust terms and conditions relating to the use of technology in the supplier relationship. If a customer and supplier are using technology to manage and facilitate their relationship, it is important to ensure that appropriate terms relating to the use of such technology are incorporated. Such terms include licence rights and

restrictions, technology support and maintenance obligations, data use rights, data security obligations, intellectual property rights and risk allocation terms.

These terms can be particularly tricky where the parties are deploying AI as part of their supply chain operations, as traditional contract terms relating to data use and intellectual property rights are unlikely to be suitable. It is therefore important that businesses carefully consider the specific facts relating to the use of technology in their supplier relationships and include appropriately tailored terms to address this use.

Looking forward to 2022

The pandemic has reinforced the importance of taking a flexible and context-specific approach to supply chain contracting that will withstand the uncertainty of the future. We can expect the existing disruption to the supply chain to linger, but eventually disappear. However, we believe that the lessons learned from the challenges to supply chain management that the pandemic has brought to the fore represent best practices that customers and suppliers should continue to adopt, even as we emerge from the pandemic and the supply chain issues it has caused.

AUTHORS

Andraya Frith
Partner and Chair,
Franchise & Distribution

afrith@osler.com
416.862.4718

Wendy Gross
Partner and Chair,
Technology

wgross@osler.com
416.862.6737

Shira Dveris
Articling Student

sdveris@osler.com
416.646.3946

INDIGENOUS LAW

Look before you leap: Impact of recent developments in Indigenous law

Indigenous law in Canada has evolved significantly over the last decade, and 2021 was no exception. While the past year was overshadowed by the tragic discovery of unmarked graves at former residential school sites and resulting pressures to advance reconciliation with Indigenous peoples, 2021 also included significant developments in Indigenous law affecting infrastructure and resource development, including (1) the federal United Nations Declaration on the Rights of Indigenous Peoples (UNDRIP) bill receiving royal assent; (2) the British Columbia (B.C.) Supreme Court's ruling that cumulative effects of industrial development infringed the treaty rights of a B.C. First Nation; and (3) the Federal Court's recognition of the Crown's duty to consult regarding economic benefits linked to Aboriginal rights. These developments are likely to have significant impacts on infrastructure and resource development, Aboriginal and treaty rights, and partnerships with Indigenous groups in the coming years.

Federal UNDRIP bill becomes law

On June 21, 2021, Bill C-15, the *United Nations Declaration on the Rights of Indigenous Peoples Act* (Canada) (the Act) received royal assent. The Act is Canada's first substantive step towards ensuring federal laws reflect the standards outlined in UNDRIP, a non-binding international instrument that sets out "the minimum standards for the survival, dignity and well-being of the indigenous peoples of the world."

The Act sets out two key goals:

1. affirm UNDRIP as a universal international human rights instrument with application in Canadian law
2. provide a framework for the government of Canada to implement UNDRIP

The Act requires Canada, in consultation with Indigenous peoples, to take all measures necessary to ensure that Canada's federal laws are consistent with UNDRIP. To accomplish this, the Act requires the designated minister to, within two years, prepare and implement an action plan to achieve the objectives of UNDRIP. The Act also requires federal law-makers, when adopting new statutes and amendments, to consider whether they are consistent with UNDRIP.

Perhaps most notably, UNDRIP requires states to obtain "free, prior and informed consent" (FPIC) in their consultations with Indigenous peoples. Although the stated intention is not for FPIC to operate as a "veto" power, the concept of FPIC will likely change current consultation approaches and the practical expectations of parties involved in such consultations. The Act's implementation will also likely strengthen incentives for proponents to partner with Indigenous groups in project development, thereby achieving their FPIC.

Perhaps most notably, UNDRIP requires states to obtain "free, prior and informed consent" (FPIC) in their consultations with Indigenous peoples. Although the stated intention is not for FPIC to operate as a "veto" power, the concept of FPIC will likely change current consultation approaches and the practical expectations of parties involved in such consultations.

Cumulative effects of industrial development and treaty rights

In *Yahey v. British Columbia*, the B.C. Supreme Court (BCSC) ruled that the rights of Blueberry River First Nations (BRFN) under Treaty 8 had been infringed by the cumulative impacts of decades of industrial development within BRFN's traditional territory in northeast B.C. This precedent-setting decision represents the first time a Canadian court has found an infringement of Indigenous treaty rights based on the cumulative impacts of policies and permitted development over decades, rather than based on a specific action or regulatory regime.

Following a trial, the BCSC concluded that B.C. had taken up lands in BRFN's traditional territory to such an extent that there were no longer sufficient and appropriate lands to allow BRFN's members to meaningfully exercise their treaty rights. The Court also ruled that the government of B.C., having had notice of BRFN's concerns but having permitted the cumulative impact of industrial development to erode BRFN's treaty rights, breached its fiduciary duty and its obligations to BRFN under Treaty 8. B.C. thereby failed to uphold the honour of the Crown. As a result of these failures, the BCSC declared that (1) B.C. cannot continue to authorize activities in BRFN's traditional territory that infringe BRFN's exercise of treaty rights; and (2) B.C. and BRFN must negotiate timely

enforcement mechanisms to assess and manage the cumulative effects of industrial development. The BCSC suspended the first declaration for six months to provide B.C. and BRFN time to negotiate a new regulatory framework.

B.C. determined not to appeal the decision.

Yahey has direct and serious implications for future development in BRFN's traditional territory, which covers most of northeast B.C. (including the Site C hydroelectric dam, most of the natural gas production in B.C. and several other resource developments including mines, wind projects and forestry operations). While B.C. and BRFN are actively negotiating changes to the regulatory process to comply with *Yahey*, it is unclear what changes will ultimately be agreed to, when this agreement will be struck and how other Treaty 8 First Nations in northeast B.C. (many of whose territories overlap with BRFN's) will be involved in the process. In the meantime, B.C. has suspended its review of all new permit applications in BRFN's territory and has also indefinitely suspended several existing permits in areas of special interest to BRFN. In effect, *Yahey* has given BRFN substantial control (if not a veto) over the future of resource development in northeast B.C.

The effects of *Yahey* are not likely to be confined to northeast B.C. The *Yahey* decision demonstrates a viable path to establishing an infringement of treaty rights on the basis of cumulative effects. Many parts of Canada have seen material population growth, as well as infrastructure and/or resource development since the time of historic treaties with Indigenous groups. We expect *Yahey* will lead to similar cumulative effects claims across Canada, particularly across the Prairies and northern Ontario under the historic numbered treaties similar to Treaty 8. Such claims could inject further uncertainty into Canada's regulatory approval processes, and, if successful, could significantly change the future of resource and infrastructure development in Canada.

We expect *Yahey* will lead to similar cumulative effects claims across Canada, particularly across the Prairies and northern Ontario under the historic numbered treaties similar to Treaty 8.

Duty to consult and economic rights

In *Ermineskin Cree Nation v. Canada (Environment and Climate Change)*, Canada's Federal Court expressly recognized that the Crown must consult with Indigenous groups that have negotiated economic benefit agreements with resource developers before the Crown takes any action to delay or deny such developments.

In *Ermineskin*, Ermineskin Cree Nation (Ermineskin) had entered into benefit agreements with Coalspur Mines (Operations) Ltd. (Coalspur) respecting the potential impacts of its two proposed thermal coal projects in Alberta. While Coalspur's projects did not trigger the federal *Impact Assessment Act* (IAA), the federal Minister of Environment and Climate Change (Minister) decided to designate Coalspur's projects under the IAA without notifying Ermineskin (the Decision). The Decision created the potential for significant delays to Coalspur's projects that could eliminate Ermineskin's economic interests under the benefit agreements. Ermineskin challenged the Decision on the basis that the Minister had breached the Crown's duty to consult.

The Federal Court found that the Crown owed Ermineskin a duty to consult respecting the Decision's potential to adversely affect Ermineskin's economic rights. The duty to consult arose because Ermineskin's economic rights are closely related to, and derive from, its Aboriginal and treaty rights. Since there was "no consultation at all" in this case, the Crown failed to fulfil its consultation duty and, as such, the Federal Court quashed the Decision.

Ermineskin establishes that Indigenous groups have the right to be consulted whenever Crown conduct may affect their economic interests in resource development. Many Indigenous groups have substantial economic interests in resource development, and this decision highlights the value of Indigenous partnerships both for proponents and those Indigenous groups.

Outlook

We encourage resource and infrastructure developers across Canada to keep abreast of changes in Indigenous law and incorporate Indigenous considerations at the outset of project development. While the law in this area continues to evolve and often presents challenges and risks for new projects, it also creates opportunities for proponents who proactively identify and manage these issues. In particular, for projects that will affect specific Indigenous groups, partnerships or other forms of benefit agreements with those Indigenous groups may allow the developer to successfully manage project regulatory risk, while also providing meaningful benefits to local Indigenous communities.

AUTHORS

Richard J. King
Partner and Co-Chair, Regulatory, Environmental, Indigenous and Land

rking@osler.com
416.862.6626

Sander Duncanson
Partner, Regulatory, Environmental, Indigenous and Land

sduncanson@osler.com
403.260.7078

Alexander (Zander) McGillivray
Associate, Construction, Infrastructure and Energy

amcgillivray@osler.com
416.862.5956

CLIMATE CHANGE

Supreme Court ends uncertainty over constitutionality of federal carbon pricing framework

Even before the *Greenhouse Gas Pollution Pricing Act* (the GGPPA) received royal assent in June 2018, questions arose about the federal government's jurisdiction to enact a federal carbon pricing regulatory framework. For nearly three years, constitutional challenges brought by multiple provincial governments – Saskatchewan, Ontario and Alberta – worked their way through the courts, leading to conflicting decisions as to the GGPPA's constitutionality.

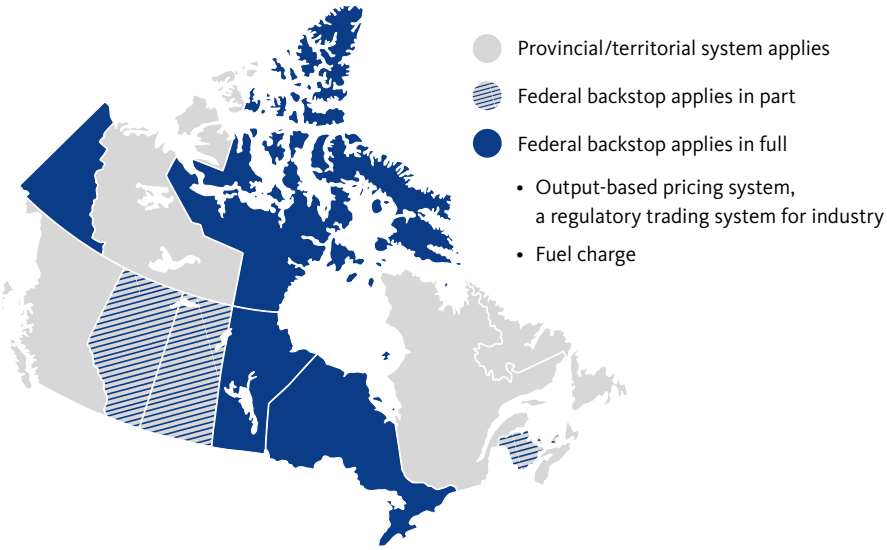
For businesses across Canada, this uncertainty ended on March 25, 2021 when the Supreme Court of Canada (the Court) upheld the constitutionality of the GGPPA. In a 6-3 decision in *References re Greenhouse Gas Pollution Pricing Act*, the majority of the Court confirmed and applied the "division of powers" analysis under Canadian constitutional law to uphold the validity of the GGPPA. In doing so, the Court emphasized the importance of a national approach in addressing climate change.

The decision provides much-needed clarity on the constitutional question of the federal government's ability to impose a minimum price on carbon going forward. While the decision represents a conclusive verdict on the GGPPA's general constitutionality, the result of the decision does not preclude future policy initiatives by the federal government or by the provinces to address climate change. With increasing political attention on climate change, 2022 is certain to result in greater regulation and activity in the space, with significant effects felt from the Court's decision.

The Greenhouse Gas Pollution Pricing Act

The GGPPA implements a carbon pricing regime that is central to the federal government's plan to meet Canada's commitments under the Paris Agreement to reduce greenhouse gas (GHG) emissions to 30% below 2005 levels by 2030. Divided into two main parts, the GGPPA (a) imposes a fuel charge on fuel producers and distributors; and (b) introduces an output-based pricing system for large industrial emitters. The GGPPA also imposes minimum requirements on provinces and territories to meet the GGPPA's pricing and emissions reduction benchmarks. This approach, with the federal government intervening only where a province has failed to legislate in accordance with the minimum requirements of the GGPPA, has led to a patchwork of carbon pricing systems across Canada. In certain provinces and territories, the federal system operates alone, while others have implemented a wholly provincially-legislated regime. The balance are subject to a mixed approach involving both federal and provincial regulation.

The following graphic prepared by the Government of Canada summarizes the applicable regime in each province and territory:



Carbon pricing across Canada	
Alberta	Federal fuel charge, Alberta TIER regulation for industry
British Columbia	Provincial carbon tax
Manitoba	Federal Backstop
New Brunswick	Provincial fuel charge as of April 1, 2020, intent to transition federal OBPS to provincial OBPS for January 1, 2021
Newfoundland and Labrador	Provincial carbon tax + OBPS
Northwest Territories	Territorial carbon tax
Nova Scotia	Cap-and-Trade
Nunavut	Federal Backstop
Ontario	Federal fuel charge, intent to transition federal OBPS to provincial OBPS for January 1, 2022
Prince Edward Island	Provincial fuel charge, Federal OBPS
Quebec	Cap-and-Trade
Saskatchewan	Federal fuel charge Provincial OBPS on some sectors, federal OBPS on others
Yukon	Federal Backstop

The Court of Appeal decisions

Between May 2019 and February 2020, each of the Saskatchewan, Ontario and Alberta Courts of Appeal considered the constitutionality of the GGPPA. In May of 2019, a 3-2 majority at the Saskatchewan Court of Appeal determined that the GGPPA was a valid use of federal legislative jurisdiction. A 4-1 majority at the Ontario Court of Appeal reached the same conclusion in June of 2019. However, in February of 2020, a 4-1 decision of the Alberta Court of Appeal found the GGPPA to be unconstitutional on the grounds that it exceeded federal jurisdiction. These split decisions, and the divergent legal bases upon which they were made, created uncertainty for businesses pending a final resolution by the Supreme Court of Canada.

The Supreme Court of Canada's decision

Writing for the majority of the Supreme Court, Chief Justice Wagner held that the GGPPA was constitutional and that Parliament had the jurisdiction to enact it as a matter of national concern under the national concern branch of the "peace, order and good government" (POGG) clause of s. 91 of the Canadian Constitution.

In determining the constitutionality of the GGPPA, the Court was required, first, to identify the true subject matter of the GGPPA and then to classify that subject matter with reference to the division of powers set out in the Constitution. In doing so, the Court gave effect to the principle of cooperative federalism, which requires that an appropriate balance be maintained between the powers of the federal government and those of the provinces. The majority of the Court considered the importance of preserving provincial autonomy, but favoured a flexible view of federalism and the Constitution that supports "modern cooperative federalism."

The majority's finding was informed by what it referred to as the "essential factual backdrop of the case," namely that "[c]limate change is real. It is caused by greenhouse gas emissions resulting from human activities, and it poses a grave threat to humanity's future. The only way to address the threat of climate change is to reduce greenhouse gas emissions." The Court further found that "[a]ddressing climate change requires collective national and international action. This is because the harmful effects of GHGs are, by their very nature, not confined by borders."

In undertaking its division of powers analysis, the majority began by considering the purpose and effects of the GGPPA in order to identify its "pith and substance," or true subject matter. In this regard, the Court, having analyzed the title, preamble, legislative debates, purpose and legal and practical effects of the GGPPA, found that "the true subject matter of the GGPPA is establishing minimum national standards of GHG price stringency to reduce GHG emissions."

The majority held that establishing such minimum national standards was of sufficient concern to Canada as a whole that it warranted consideration in accordance with the national concern doctrine. In doing so, the Chief Justice remarked that "[t]here is broad consensus among expert international bodies … that carbon pricing is a critical measure for the reduction of GHG emissions" and that the matter of the GGPPA "is critical to our response to an existential threat to human life in Canada and around the world."

> "While each province's emissions do contribute to climate change, there is no denying that climate change is an 'inherently global problem' that neither Canada nor any one province acting alone can wholly address. This weighs in favour of a finding of provincial inability. As a global problem, climate change can realistically be addressed only through international efforts. Any province's failure to act threatens Canada's ability to meet its international obligations, which in turn hinders Canada's ability to push for international action to reduce GHG emissions. Therefore, a provincial failure to act directly threatens Canada as a whole."
> – Chief Justice Wagner

The majority then examined whether the matter at hand had a "singleness, distinctiveness and indivisibility that clearly distinguishes it from matters of provincial concern" as federal jurisdiction in the interests of "peace, order and good government" should only be found to exist where the evidence establishes provincial inability to deal with the matter. In the case of GHG emissions, the majority concluded that "federal jurisdiction is necessitated by the provinces' inability to address the matter as a whole through cooperation, which exposes each province to grave harm that it is unable to prevent."

The final element of the Court's analysis assessed whether the impact on provincial jurisdiction was acceptable, having regard at the same time to the impact on the interests that would be affected if Parliament was unable to constitutionally address the matter at a national level. The majority held that upholding the constitutionality of the GGPPA would have a "clear impact on provincial autonomy" that would be "limited" and would "ultimately be outweighed by the impact on interests that would be affected if Parliament were unable to constitutionally address this matter at a national level." The Court noted that provinces remain free to regulate GHG emissions and can design any GHG pricing system they choose as long as they meet the federal government's outcome-based targets.

To address the concern that the Court's decision raised the spectre of further federal incursion into areas of provincial jurisdiction, the majority of the Court remarked that its ruling would not "[open] the floodgates to federal 'minimum national standards' in all areas of provincial jurisdiction." In particular, the decision did not extend the national concern doctrine under the POGG power to cover any matter touching on climate change, but was specifically and narrowly limited to GHG pricing.

Impacts of the decision

Beyond providing clarity on the specific question of the constitutionality of the GGPPA, the decision also provided long-awaited guidance regarding the application of the national concern doctrine under the POGG power and its application to environmental legislation more broadly. The decision is a forceful endorsement by the Supreme Court of the principle of cooperative federalism, particularly in respect of "matters which, by their nature, transcend the provinces." This principle may have future application to environmental and other matters that, due to their nature, provinces alone are unable to address.

The decision provides welcome certainty as to the ability of the federal government to impose a carbon pricing regime. However, in a practical sense, the cooperative federalism approach to carbon pricing leaves businesses with national operations subject to a patchwork of carbon pricing regimes across Canadian jurisdictions. Navigating these inconsistencies has imposed increased regulatory burdens on businesses and impeded the broader development and use of carbon finance instruments and markets in Canada to date.

While the decision represents an important marker for climate change developments in 2021, the decision has preceded other significant developments in 2021, including the release of the report of the United Nations' Intergovernmental Panel on Climate Change, the passage of the *Canadian Net-Zero Emissions Accountability Act* which supports Canada's efforts to achieve

net-zero emissions by 2050, and the numerous commitments made by Canada at the United Nations Climate Change Conference (COP26). Statements by the Government of Canada at COP26 emphasized the role of the GGPPA in meeting its carbon-reduction commitments and encouraging the development of a clean energy transition. However, the commitments made at COP26 – including in respect of deforestation and methane emissions – indicate that the GPPAA will likely be joined by other climate-focused legislation from the federal government.

These developments have occurred in a year that has seen rapidly accelerating focus on energy transition and environmental, social and governance (ESG) matters by a wide variety of industries and sectors across Canada. ESG factors are gaining momentum as strong drivers of private foreign direct investment and institutional investment, as stakeholders lend their support to more sustainable, less carbon-intensive opportunities. Many global corporations and major asset owners have already announced and taken actions to achieve their own commitments to reducing emissions and meeting other ESG-based targets across their operations irrespective of regulatory requirements. ESG considerations are explored in greater detail in our article "People, planet and performance: Embracing ESG."

For more information on the federal carbon pricing system, as well as other federal and provincial/territorial initiatives to fight climate change, visit Osler's Carbon and Greenhouse Gas Legislation webpage.

AUTHORS

Richard J. King
Partner and Co-Chair, Regulatory, Environmental, Indigenous and Land
rking@osler.com
416.862.6626

Jennifer Fairfax
Partner, Litigation; Regulatory, Environmental, Indigenous and Land
jfairfax@osler.com
416.862.5998

Jacob A. Sadikman
Partner, Commercial
jsadikman@osler.com
416.862.4931

Patrick G. Welsh
Partner, Litigation; Regulatory, Environmental, Indigenous and Land
pwelsh@osler.com
416.862.5951

Isabelle Crew
Associate, Litigation; Regulatory, Environmental, Indigenous and Land
icrew@osler.com
416.862.4222

ENERGY

Carbon capture and hydrogen development central to Western Canada's energy transition

In 2021, Canada increased its commitments under the *Paris Agreement* and formalized its goal of achieving net-zero carbon emissions by the year 2050. Canada also recently announced at the COP26 conference in Scotland that it will cap emissions from the oil and gas sector. These commitments have spurred a transition in Canada's energy sector towards low- and no-carbon processes, technologies and products. This energy transition will have an impact on broad sectors of the economy, including energy production/generation, transmission, distribution and consumption.

At the energy production and generation level, these developments are leading to increased interest and advancements in energy storage, renewable energy technologies and commercial arrangements that support investment in low-carbon energy, such as power purchase agreements. Among the most significant areas of interest and opportunity in Western Canada are carbon capture, utilization and storage (CCUS) and blue hydrogen. These technologies affect the full energy value chain, from production through to consumption. While each of these emerging technologies and sectors presents significant opportunities to spur economic growth, attract "green" capital into Canada's energy sector and reduce national (and global) emissions, they also introduce a range of technical, economic and legal challenges for companies and governments to navigate.

Why CCUS and blue hydrogen?

"Blue" hydrogen is hydrogen produced from methane in natural gas. It has become a key focus in Western Canada as it represents a unique opportunity to produce a low- or zero-emission fuel while maintaining (or even growing) the oil and gas sector, a staple of Western Canada's economy. With its abundant natural resources, geological setting and existing infrastructure, Canada is well-positioned to be a world leader in hydrogen production, which would reduce national greenhouse gas emissions while creating significant export potential.

Blue hydrogen is generally produced through steam methane reforming (SMR), combining natural gas or a refined petroleum product with steam to release bonded hydrogen. To be "blue" hydrogen, the SMR process must be paired with CCUS to prevent the carbon dioxide (CO_2) released through SMR from being emitted. Blue hydrogen requires plentiful supplies of natural gas or refined petroleum, water for feedstock and access to suitable facilities or reservoirs to securely sequester or process the captured CO_2. Further information about the production process and key considerations can be found in our Emerging technologies in energy: Blue hydrogen publication.

Since spring 2021, several billion dollars' worth of blue hydrogen and CCUS investments have been announced in Canada. The federal and provincial governments have also released hydrogen policies touting hydrogen as one of the primary ways that Canada will achieve its net-zero carbon goals. However, key uncertainties remain. Carbon capture remains expensive and, in most cases, uneconomic, without higher carbon prices (which are expected in the future, but do not yet exist). Suitable reservoirs for sequestration are abundant in some parts of Western Canada, but not others. From a legal perspective, the regulatory systems in Western Canada also do not specifically address hydrogen production, giving rise to ambiguities and uncertainties for certain types of projects. Three key initiatives are underway to address these uncertainties, at least in part: (1) targeted tax incentives, (2) Alberta's competitive bid process for CCUS hubs, and (3) CCUS carbon offset credits.

While each of these emerging technologies and sectors presents significant opportunities to spur economic growth, attract "green" capital into Canada's energy sector and reduce national (and global) emissions, they also introduce a range of technical, economic and legal challenges for companies and governments to navigate.

Tax incentives

We previously outlined how the federal 2021 budget injected fiscal stimulus into Canada's energy transition. The federal budget contained several key tax incentives in respect of blue hydrogen and CCUS:

- an investment tax credit for capital invested in certain types of CCUS projects (the details of which are still being developed, but are expected to be available in 2022)
- a commitment of $319 million over seven years for Natural Resources Canada to support research and development to improve the commercial viability of CCUS technologies
- a "green project funding initiative" of $4 billion over seven years to the Net Zero Accelerator (adding to the $3 billion over five years committed on December 11, 2020). Proponents of CCUS and blue hydrogen projects may apply to the Net Zero Accelerator to access a portion of this funding

Blue hydrogen developments and facility expansions in Saskatchewan may also be eligible for transferable royalty tax credits of 15% of project costs through the Oil and Gas Processing Investment Incentive.

Alberta's competitive bid process for CCUS hubs

With the increasing industry interest in CCUS and concerns about proliferation of carbon sequestration operations (particularly in areas with limited sequestration potential, such as Fort Saskatchewan), the Alberta government announced a competitive bid process for CCUS "hubs" in the spring of 2021. Alberta is envisioning that, in areas where multiple companies are interested in carbon sequestration, CCUS "hubs" will be developed where sequestration rights are awarded to a single operator who must operate the hub on an "open access" basis and provide competitive market service rates.

Further details of the competitive bid process were announced in September 2021, which we described in our Energy blog. Expressions of interest from potential proponents were due on October 12, 2021. Alberta will post its request for full project proposals in December 2021, with successful proponents expected to be selected in March 2022.

On September 7, 2021, Saskatchewan also announced that it would be exploring opportunities for CCUS infrastructure hubs, although it has not yet announced any details.

Carbon credits and offset opportunities

Both British Columbia and Alberta have frameworks that allow proponents to receive credits if their projects offset and reduce greenhouse gas emissions: the *Greenhouse Gas Emission Control Regulation* (GGECR) in British Columbia and the *Technology Innovation and Emissions Reduction Regulation* (TIER) in Alberta. These carbon credits form a key revenue stream for eligible project proponents.

In British Columbia, hydrogen manufactured for use in place of petroleum diesel is considered a renewable fuel under the GGRA and is eligible to generate carbon offset credits. The GGRA does not, however, allow CCUS operations to generate carbon credits.

In Alberta, emission offset projects must meet requirements established under the TIER, the Standard for Greenhouse Gas Emission Offset Project Developers and an approved quantification protocol. Alberta has an approved quantification protocol in place for CCUS in deep saline aquifers, but not other types of CCUS (such as sequestration as part of enhanced oil recovery operations).

While Saskatchewan is lagging behind its western neighbours in developing a program for carbon offsets, the government announced on September 7, 2021 that it would develop such a program and that it would specifically allow carbon credits to be generated from CCUS. The details of Saskatchewan's program have not yet been released.

Federally, Canada is in the process of developing a carbon offset credit system, including regulations, offset protocols and a credit and tracking system. The federal government published draft regulations in March 2021, which are expected to be issued in final form by the end of 2021. These draft regulations and associated publications are silent with respect to CCUS, and given Canada's intention to avoid overlap with provincial offset regimes, it appears that the question of whether and how CCUS activities can generate carbon credits will remain a provincial matter.

Across provinces and at the federal level, consultation and government relations activity is taking place among interested industry participants. The goal of many participants is to ensure that the carbon offset protocols being revised or developed are consistent with the principle of additionality (meaning that the activity would not occur absent a market for carbon offset credits) and account for the full range of carbon-reduction technologies or techniques that exist.

Given Canada's intention to avoid overlap with provincial offset regimes, it appears that the question of whether and how CCUS activities can generate carbon credits will remain a provincial matter.

The future of blue hydrogen and CCUS

We expect to see significant developments in blue hydrogen and CCUS in Western Canada over the coming year. While many of the initiatives described above are still in the development phase and lack key details, those details are expected to become available in 2022. This will allow project proponents and investors to verify the commercial viability of their projects and take the necessary steps to initiate those projects before their window of opportunity closes. It will also be critical for all levels of government to move quickly to eliminate the remaining barriers to blue hydrogen and CCUS development so that Canada can capitalize on this important opportunity while enabling its existing natural resource sector to thrive into the future.

AUTHORS

Sander Duncanson
Partner, Regulatory, Environmental, Indigenous and Land
sduncanson@osler.com
403.260.7078

Paula Olexiuk
Partner, Energy
polexiuk@osler.com
403.260.7080

Dana Saric
Partner, Banking and Financial Services
dsaric@osler.com
403.260.7036

Jessica Kennedy
Associate, Regulatory, Environmental, Indigenous and Land
jkennedy@osler.com
403.260.7062

Maeve O'Neill Sanger
Associate, Regulatory, Environmental, Indigenous and Land
msanger@osler.com
403.260.7059

EMPLOYMENT & LABOUR

Back to the office? New workplace norms expected to evolve in coming years

As we emerge from the fourth wave of the COVID-19 pandemic in Canada, employers are increasingly focused on establishing new workplace norms following an unprecedented period of disruption. While COVID-19 and related issues, such as vaccine mandates, remain top of mind for many employers, important legal developments in employment law that are unrelated to COVID-19 continue unabated and have even picked up steam.

In this article, we address the continued impact of the COVID-19 pandemic on employers, including vaccine mandates, regular testing requirements and mask policies. We also review other legal developments that have affected employers in 2021 and that employers should continue to plan for in 2022. These include worker-friendly legislative proposals in Ontario, federal pay equity legislation and new French language laws.

COVID-19: What employers are asking us

More than any other question related to COVID-19, employers most commonly ask us "What are you seeing?" It seems that, in determining how to respond to ongoing issues arising from the pandemic, clients are focused on ensuring that they are generally in line with (or at least, not significantly out-of-step with) market practices. These are some of our top frequently asked questions relating to the COVID-19 pandemic:

Are employers in the private sector implementing mandatory vaccination policies?

By about August 2021, we witnessed a sharp increase in the number of employers implementing workplace mandatory vaccination policies and we have seen growing enthusiasm for such policies ever since. Many employers that implemented such policies have faced a wave of exemption requests on the basis of protected grounds under human rights legislation, almost exclusively on medical or religious (or creed) grounds. Where an employee cannot comply with a workplace mandatory vaccination policy for a legitimate reason related to a protected ground under human rights legislation, the employee must be accommodated to the point of undue hardship. This could mean excusing the affected employee from complying with a mandatory vaccination policy.

Thanks in large part to the guidance and communications from various governmental authorities and regulatory bodies that have limited their eligible medical exemptions to a short list of conditions, requests for medical exemptions have generally been relatively straightforward to respond to. For example, the COVID-19 FAQ for physicians issued by the Ontario College of Physicians and Surgeons specifically states that there are "very few" medical exemptions to the COVID-19 vaccine. This FAQ refers to the list of medical reasons why a person may not be able to receive a COVID-19 vaccine published by the Ontario Ministry of Health. That list includes only four circumstances that could provide a medical basis for someone to refuse the COVID-19 vaccine.

We continue to recommend that requests for accommodation on medical grounds be considered on a case-by-case basis. However, the aforementioned guidance is helpful for employers charged with sifting through medical exemption requests, some of which may be little more than disguised personal preferences.

Employee requests for exemptions on the basis of religion or creed in connection with workplace mandatory vaccination policies present somewhat different challenges. Such requests are subjective in nature and existing case law was almost exclusively decided outside the context of a global pandemic. Helpfully, several human rights commissions (including in Ontario and British Columbia) have issued guidance or statements regarding vaccination policies that have, to some extent, clarified that (a) mandatory vaccination policies are not inherently contrary to human rights legislation and may be justified in order to protect the health and safety of workers; and (b) a personal choice or singular beliefs against receiving the COVID-19 vaccine do not amount to creed or religion. While helpful, such guidance has not provided legal clarity to employers regarding how to properly evaluate religion-based

We continue to recommend that requests for accommodation on medical grounds be considered on a case-by-case basis.

requests for accommodation in relation to mandatory vaccination policies in the context of a global pandemic, taking into account the reality that certain requests of this nature may not necessarily be made in good faith.

For employers who are contemplating or in the process of implementing a vaccine mandate in their workplace, more details about the relevant risks and considerations related to such policies can be found in our prior Osler Updates, Mandatory vaccinations for employees: What are the issues? and Can employers mandate vaccines? Answering the biggest COVID-19 employment and labour law questions.

Can we require employees to undergo regular COVID-19 testing?

Many employers are inquiring about implementing regular COVID-19 testing as an addition or alternative to imposing a mandatory vaccination policy. Generally, if implemented properly, a COVID-19 testing regime can be a valuable tool in preventing the spread of COVID-19 within workplaces. In the unionized context, arbitrators have found such policies to be a reasonable exercise of management rights. For example, in *EllisDon Construction Ltd. v. Labourers' International Union of North America, Local 183*, the arbitrator upheld a twice-weekly rapid antigen testing regime on construction job sites. The testing regime was conducted in accordance with Ministry of Health guidelines and used only a throat and bilateral lower nostril swab (as opposed to the less comfortable nasopharyngeal swab). The arbitrator found that the employer's policy was reasonable when weighing the intrusiveness of the test against the important objective of the policy.

A variety of other considerations relevant to COVID-19 testing programs are discussed in our The second year of COVID-19: A rapidly changing health landscape article.

Do I still have to require my employees to wear masks at work? What if we are all vaccinated?

With the increase in vaccination rates (and anecdotal reports of increasing weariness with compliance with COVID-19 restrictions and rules), we have seen a growing reluctance among employers to require their employees to wear face coverings in private workplaces (to be clear, masks in public places remain both required and the norm across most of Canada). Where physical distancing of at least six feet can be maintained, employees and employers are more frequently dispensing with the requirement to wear a face covering in the workplace, where permitted by public health regulations. However, even with higher vaccination rates, face coverings may be advisable from a health and safety perspective where there is a risk of accidental transmission and/or poor ventilation.

We suspect that going into 2022, as more employees return to the physical workplace, breakthrough infections may become more common, potentially leading to an increase in workplace requirements to use face coverings through the winter months.

When do COVID-19 leaves end?

In Ontario, two temporary COVID-19-related leave programs were implemented that are set to end in 2022:

- Paid infectious disease emergency leave provides for up to three days of paid time off for certain reasons related to COVID-19 (as described in our prior Osler Update, Ontario employers must provide new paid COVID-19 leave). This program will end on December 31, 2021 unless it is further extended.
- Unpaid infectious disease emergency leave is a job-protected leave that is deemed to occur where an employee ceases performing their duties for certain reasons related to COVID-19. This program is set to end on January 2, 2022 (as described in our prior Osler Update, Ontario government changes the rules on temporary layoff and constructive dismissal due to the COVID-19 pandemic). Employers in Ontario should consider in advance of January 2, 2022 how they will deal with employees who continue to be on unpaid deemed emergency leave in Ontario. Their change in status as of that date should be approached carefully and in light of the desired business objectives.

British Columbia also implemented a temporary paid sick leave program relating to COVID-19. The B.C. program ends December 31, 2021 as well.

Federal and provincial employment legislative updates

As more employees are returning to the office, governments are focusing on implementing new employment-related legislation that is unrelated to COVID-19.

As more employees are returning to the office, governments are focusing on implementing new employment-related legislation that is unrelated to COVID-19.

Bill 27, Working for Workers Act (Ontario)

The Ontario legislature passed Bill 27, Working for Workers Act, 2021 on November 30, 2021. Bill 27 amends employment-related legislation, including the *Employment Standards Act, 2000* (ESA) and the *Occupational Health and Safety Act* (OHSA). These are some of the most notable of the amendments:

- **Disconnecting from work policy:** Under changes to the ESA, employers with 25 or more employees are required to develop a "disconnecting from work" policy. "Disconnecting from work" means not engaging in work-related communications such as emails, telephone calls, video calls or sending or reviewing messages, after the end of a work day, so as to free employees from the performance of work in non-working hours.
- **Ban on non-competition agreements:** Subject to commercial exceptions (i.e., in the context of a sale of business), employers are prohibited from entering into a non-competition agreement with a non-executive employee that restricts the employee from engaging in post-employment activity or work. The ban is deemed to have come into force on October 25, 2021. Employers will need to consider other methods for discouraging (without outright prohibiting) employees from competing unfairly, such as by adjusting severance and/or incentive compensation mechanics post-employment. Notably, the ban carves out C-suite executives but does not contain exceptions for other members of management or critical employees.

- **Temporary help agencies:** Temporary help agencies and recruiters operating in Ontario are required to apply for a licence to operate. These agencies are also required to confirm that they have complied with all orders, met the requirements of the ESA and the *Employment Protection for Foreign Nationals Act, 2009* and will carry on business "with honesty and integrity and in accordance with the law." Businesses are prohibited from engaging or using the services of an unlicensed agency or recruiter. The stated intent of this change is to protect vulnerable workers from exploitation.
- **Washroom access:** The OHSA is amended to require business owners to provide washroom access to workers making deliveries. There are exceptions where access would not be reasonable or practical for reasons related to health and safety, security, workplace conditions or the location of the washroom, or where the washroom can only be accessed through a residence.

Pay Equity Act (federal sector)

The new federal *Pay Equity Act* (PEA) came into force in August 2021. The PEA requires federally regulated employers with 10 or more employees to take steps to close the gender wage gap and ensure that workers receive equal pay for work of equal value. Employers were required to post a notice by November 1, 2021 informing employees of the employer's intention to create a pay equity plan. Employers must then develop and post a pay equity plan prior to August 31, 2024.

The PEA requires that employers pay any adjustments that may be required to achieve pay equity. In addition, employers that have 100 or more employees, or employers with fewer employees but where some employees are represented by a union, must establish a pay equity committee with management and employee representatives. Our earlier blog post on osler.com on the PEA provides an overview of the requirements for committee membership.

Canadian Labour Code (federal sector)

Earlier this year, new federal regulations on workplace harassment and violence came into effect. The new regulations include a duty to investigate workplace harassment and an obligation to provide greater protection for employees. The protections include the ability of the complainant to maintain agency and control during the resolution process. Additionally, a high threshold of competence is required for an investigator to review a complaint. Greater accountability is also required of employers in preventing and resolving incidents of workplace harassment and violence. For more information, please see our earlier Osler Updates on this topic: Federal government interpretive guidelines on Workplace Harassment and Violence Regulations and Less than 2 months for employers to prepare for the new Federal Regulations on Workplace Harassment and Violence.

Bill 96, Charter of the French Language (Québec)

Bill 96 was introduced in Québec which, if passed, will require employers in Québec to show compliance with language regulations addressing employee communications, employment offers, job postings, recruitment and hiring – or risk facing fines. Please refer to our Osler Update, Québec aims to strengthen communication in French at work – SHRM, on how Québec employers may need to rethink their strategy on language choice and webinars for an overview of the impact of these changes. Further detail is also provided in our article, Government of Québec proposes stricter French language law.

Key employment decisions from 2021

There were a number of notable decisions relating to employment law in 2021:

Hawkes v. Max Aicher (North America) Limited *(Hawkes)*

In Ontario, employees with five or more years of service are entitled to severance pay pursuant to the ESA if their employer's payroll is equal to or exceeds $2.5 million. The traditional view was that only the employer's payroll in Ontario needed to be taken into account for the purposes of determining whether the employer's payroll was equal to or more than $2.5 million (and thus whether its employees are entitled to statutory severance pay). This view is supported by, among other evidence, statements from government ministers at the time the ESA was introduced.

In 2021, the Ontario Divisional Court in *Hawkes* found that the entire global payroll of the parent entity of the employer must be included in determining whether the employer must provide severance pay pursuant to the ESA. This decision has implications for global employers whose payroll in Ontario is less than $2.5 million, but whose global payroll, potentially including that of its affiliates, is equal to or greater than $2.5 million; employees of those employers who have five or more years of service may be entitled to statutory severance pay.

Perretta v. Rand A Technology Corporation *(Perretta) and Russell v. The Brick Warehouse LP (Russell)*

Perretta and *Russell* both have implications for drafting termination letters and executing terminations. In *Perretta*, an Ontario court held that an employer's failure to promptly pay an employee's contractual severance entitlement constituted a repudiation of the employment agreement. As a result, the employee was entitled to reasonable notice of termination at common law.

Similarly, in *Russell*, an Ontario court held that a plaintiff employee was entitled to $25,000 in aggravated damages because the termination letter provided by the employer failed to strictly comply with the requirements under the ESA. The employer did not inform the employee that he would immediately receive his ESA entitlements if he did not accept the offer of a severance package from the employer. Employers should examine their termination letters closely to ensure that such letters do not result in increased liability.

Bill 96 was introduced in Québec which, if passed, will require employers in Québec to show compliance with language regulations addressing employee communications, employment offers, job postings, recruitment and hiring – or risk facing fines.

Rahman v. Cannon Design Architecture Inc. *(Rahman)*

An Ontario judge held that a termination clause in an employment agreement was enforceable on the basis that it was negotiated by legally sophisticated parties with the benefit of independent legal advice and with no marked disparity in bargaining power. In doing so, the judge distinguished the case from the landmark decision in *Waksdale v. Swegon*, in which the court struck down a termination "without cause" provision based on what was essentially a technical flaw (additional commentary regarding the *Waksdale* decision can be found in our earlier Osler Update, The Ontario Court of Appeal's latest decision striking down attempts to control severance cost).

Hucsko v. A.O. Smith Enterprises Limited *(Hucsko)*

In *Hucsko*, the Ontario Court of Appeal upheld the termination of an employee for just cause where the employee engaged in sexual harassment and refused to accept wrongdoing or apologize for the behaviour. This case is notable because, unlike many other "for cause" termination cases, the finding was not based solely on the employee's workplace harassment, but was also based on his post-harassment conduct and his willingness to accept responsibility for his actions.

We expect that the impact of COVID-19 on workplaces will continue to be significant in 2022. Many employers who have not yet opened their physical workplaces plan to do so in the coming months. Having now mastered the virtual work environment, employers and employees will need to reorient their efforts to reintegration and ensuring workplace safety on an ongoing basis. This will be particularly important as COVID-19 restrictions are lifted and people are allowed to gather (outside the workplace) in greater numbers and with fewer protocols in place. At the same time, employers will need to monitor legislative developments as governments turn to non-COVID-19 priorities.

AUTHORS

Kelly O'Ferrall
Counsel, Employment & Labour

koferrall@osler.com
613.787.1066 (Ottawa)
416.862.4897 (Toronto)

Melanie Simon
Associate, Employment & Labour

msimon@osler.com
416.862.6835

Shari Cohen
Associate, Employment & Labour

sjcohen@osler.com
416.862.4203

Steven Dickie
Partner, Employment & Labour

sdickie@osler.com
416.862.4275

Shaun Parker
Partner, Employment & Labour

sparker@osler.com
403.260.7013 (Calgary)
604.692.2765 (Vancouver)

Emilie Dillon
Articling Student

edillon@osler.com
416.646.3937

PRIVACY

Canada's freight train of privacy legislative reform continues

Over the past year, legislative reform was the key focal point in the highly dynamic Canadian privacy arena. The Provinces of Québec and British Columbia enacted legislative amendments, while other Canadian jurisdictions were also active in legislative reform efforts. The new Québec privacy law – and what appears to be the inevitable amendment to the federal and provincial private sector privacy regimes – will expose companies across Canada to severe financial penalties, enhanced litigation risk and significant compliance costs. It is more important than ever for companies to have a thorough understanding of their personal information practices and their privacy obligations, all with a view to identifying and mitigating the expanding array of privacy, legal and reputational risks associated with the collection, use and disclosure, and other processing of personal information.

Here is how the privacy legislative arena is changing.

Québec: Bill 64 overhauls Canada's first private sector privacy law

The most significant legislative development in the Canadian privacy arena occurred in the province of Québec. Bill 64, *An Act to modernize legislative provisions as regards the protection of personal information*, received royal assent on September 22, 2021, following its introduction at the Québec National Assembly on June 12, 2020 and subsequent amendments by the Committee on Institutions. The bill introduces sweeping changes to Québec's existing privacy regime (the Québec Privacy Act), which was Canada's first private sector privacy law, enacted in 1994.

One of the most notable additions to the Québec Privacy Act's current framework is the creation under Bill 64 of a new enforcement regime. Within two years of Bill 64's enactment, failure to comply with the Québec Privacy Act can expose organizations to fines of up to the greater of $25 million and the amount corresponding to 4% of worldwide turnover for the preceding fiscal year. Organizations can also be exposed to administrative monetary penalties of up to the greater of $10 million and the amount corresponding to 2% of worldwide turnover for the preceding fiscal year.

Organizations will also face increased costs arising from operational measures required to comply with Bill 64's expanded and prescriptive requirements. These are the key changes introduced by Bill 64:

- **Data governance:** Organizations will be required to create an internal policy suite to address the lifecycle of personal information in their custody and control.
- **Processing of personal information:** Organizations will be required to conduct privacy impact assessments for any project involving the acquisition, development or overhaul of an information system or electronic service delivery system involving the processing of personal information.
- **Stronger consent requirements:** Bill 64 strengthens consent requirements and creates new exceptions to consent for personal information processing. Organizations will need to examine all collections, uses and disclosures of personal information, improve their consent notices, develop or enhance consent management practices and otherwise ensure the lawful processing of personal information.
- **Data localization restrictions:** Organizations will have to create an inventory of all cross-border disclosures and transfers (including transfers of personal information to other Canadian provinces) and conduct a privacy impact assessment prior to any disclosure of personal information outside Québec to ensure that the personal information will be "adequately protected" in the other jurisdictions. Under Bill 64, organizations will be prohibited from transferring or disclosing personal information outside the province of Québec in circumstances where such information will not receive "adequate protection," determined in light of "generally recognized principles regarding the protection of personal information."

[f]ailure to comply with the Québec Privacy Act can expose organizations to fines of up to the greater of $25 million and the amount corresponding to 4% of worldwide turnover for the preceding fiscal year... Organizations will also face increased costs arising from operational measures required to comply with Bill 64's expanded and prescriptive requirements.

- **Security breach notification:** Organizations will be required to review and enhance incident response protocols to comply with security breach reporting and notification requirements.
- **"Confidentiality by default":** Under this novel requirement, organizations must implement the "highest level" of confidentiality by default with respect to public-facing products or services.
- **Use of technology to collect personal information:** Organizations collecting personal information from individuals using technology that allows those individuals to be identified, located or profiled must first inform the individual of such technology and of the means available to activate such functions.

Bill 64 also affords individuals in Québec several new data subject matter rights, including a right to be forgotten, a data portability right, and certain transparency and other rights with respect to automated decision making.

Bill 64's coming into force is staggered across the next three years, but most of the provisions under Bill 64 (including monetary penalties, damages and new substantive requirements) will come into force on September 22, 2023.

Federal government: Privacy reform remains a priority

The federal government's *Digital Charter Implementation Act, 2020* (DCIA or Bill C-11) died on the order paper on August 15, 2021, when the federal election was called. Tabled on November 17, 2020, Bill C-11 aimed to modernize Canada's current federal private sector privacy legislation, the *Personal Information Protection and Electronic Documents Act* (PIPEDA), by drawing on the principles established in *Canada's Digital Charter*. Passage of Bill C-11 would have enacted two new statutes, the *Consumer Privacy Protection Act* (CPPA) and the *Personal Information and Data Protection Tribunal Act* (PIDPTA).

Privacy legislative reform apparently remains a priority for the Liberal government, but the precise timing is unclear as to when a new bill replacing PIPEDA will be tabled in Parliament. Many observers expect the Liberal government to introduce a bill that is a slightly revised version of Bill C-11 by spring of 2022.

Through the CPPA, the federal government sought to introduce significant reforms to PIPEDA. These included establishing a new enforcement regime backed by significant administrative monetary penalties (up to the greater of 5% of the organization's gross global revenue or C$25 million). In addition, the CPPA would have created a private right of action for losses or injuries arising from contraventions of the CCPA, and would have given the Office of the Privacy Commissioner of Canada (OPC) order-making powers. Meanwhile, the PIDPTA created a Personal Information and Data Protection Tribunal to which decisions, orders and recommendations of the OPC could be appealed.

Other key features of the CPPA included internal privacy management program requirements, strengthened consent requirements, enhanced statutory transparency obligations and new data subject matter rights, including personal information "disposal" and data mobility (portability) rights.

Ontario: Continued efforts to develop private sector privacy law

In 2021, the Ontario Government continued its efforts to develop a provincial private sector privacy law. Following consultations in 2020, the Ontario Ministry of Consumer and Government Services launched a second consultation and issued a white paper outlining its plans, as well as proposed provisions, on June 17, 2021.

The Province of Ontario is contemplating greater regulatory oversight and enforcement powers for the Office of the Privacy Commissioner of Ontario, including order-making powers, investigations and audits. Also proposed are significant administrative monetary penalties (for individuals, a maximum of $50,000; for organizations, the greater of $10 million or 3% of the preceding year's gross global revenue) and statutory offences (for organizations, a maximum of the greater of $25,000,000 or 5% of the preceding year's gross global revenue).

Given the pending election this spring in the province of Ontario, it seems unlikely that a bill setting out a private sector privacy legislative scheme will be introduced in the short term.

British Columbia: Public and private sector reform

PIPA BC

In February 2020, a special committee was struck by the British Columbia Legislative Assembly to review the British Columbia *Personal Information Protection Act* (PIPA BC). The Information and Privacy Commissioner for British Columbia issued a briefing for the special committee in June 2020, making high priority recommendations to enact breach reporting requirements, as well as to grant the Commissioner the authority to impose administrative monetary penalties, to initiate investigations and to make orders. The Committee initiated consultations the same month through a consultation portal, which closed in August 2020.

The special committee is scheduled to publish a report regarding proposed amendments to PIPA BC to the Legislative Assembly by December 8, 2021.

FOIPPA

The Government of British Columbia tabled a bill proposing material amendments to its public sector privacy and access legislation, the *Freedom of Information and Protection of Privacy Act* (FOIPPA). Bill 22 includes a rewrite of FOIPPA's data residency provisions, mandatory privacy breach reporting and a fee for non-personal freedom of information requests.

Although Bill 22 removes data residency rules for access and storage, a public body will be authorized to disclose personal information outside of Canada only if the disclosure is in accordance with regulations. The regulations require that the head of a public body undertake a privacy impact assessment "with respect to each of the public body's programs, projects and systems in which personal information that is sensitive is disclosed to be stored outside of Canada."

The regulations require that the head of a public body undertake a privacy impact assessment "with respect to each of the public body's programs, projects and systems in which personal information that is sensitive is disclosed to be stored outside of Canada."

Bill 22 also expands pre-existing data location rules in respect of metadata and the duration of processing. It remains to be seen how these rules will be interpreted and whether they will impact the ability of public bodies in British Columbia to engage domestic or foreign service providers.

Alberta: Private sector legislative reform on the horizon

In late November 2020, Alberta's Information and Privacy Commissioner wrote a letter to the Minister of Service Alberta, proposing amendments to Alberta's *Personal Information Protection Act* (Alberta PIPA).

The Commissioner proposed that the Office of the Commissioner be granted authority to levy administrative monetary penalties (which should be consistent with those of other jurisdictions) and that it be required to create rules for such penalties. She also recommended that fines for offences be increased to mirror those in other Canadian jurisdictions.

Other key proposed amendments include privacy management program requirements, as well as provisions addressing de-identified personal information (defining the concept, addressing permitted uses and creating offences for attempted de-identification). Also proposed is an expansion of the scope of Alberta PIPA to include all non-profit organizations and political parties, and the recognition of data portability rights. The Commissioner also encouraged the Alberta Government to engage in consultations regarding the right to erasure and de-indexing and to examine the possibility of incorporating a concept of "data trust" into a legislative scheme similar to the model under Ontario's health privacy regime.

This past summer, the Ministry of Service Alberta solicited feedback on privacy legislative reform, but it is unclear when the Province of Alberta is likely to introduce a bill reforming Alberta PIPA.

Conclusion

Continued major changes to the Canadian federal and provincial privacy landscape are likely forthcoming next year. We encourage all companies to proactively consider these pending changes and plan for their likely implementation.

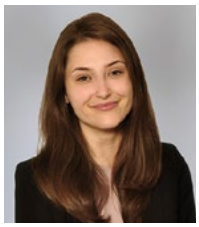
AUTHORS

Adam Kardash
Partner and Chair, Privacy and Data Management National Lead, AccessPrivacy

akardash@osler.com
416.862.4703

Michael Fekete
Partner, Technology National Innovation Leader

mfekete@osler.com
416.862.6792



Maryna Polataiko
Associate, Privacy & Data Management

mpolataiko@osler.com
416.862.5965

FRENCH LANGUAGE LAW

Government of Québec proposes stricter French language law

On May 13, 2021, the Government of Québec tabled *An Act Respecting French, the Official and Common Language of Québec* (the Act), which proposes the most significant changes to the *Charter of the French Language* (the Charter) since its enactment in 1977.

A number of these amendments, if adopted, would result in new and more onerous requirements and would present material and novel legal risks for those who carry on business in Québec. We have highlighted the most significant considerations that may apply should the legislation come into force. Several of these key amendments may be particularly significant in light of the new private right of action created in the Act, which could create material exposure for those not complying with the Act.

New right for employees to carry on their activities in French

The Act proposes to modify the existing obligation for communications in writing with employees to be in French and would provide for a broader right to "carry on [...] activities in French." This would include, in particular, the publication of job offers, contracts of employment, written communications, application forms, documents relating to conditions of employment and training documents. Job offers will be subject to a new requirement for a French language version to be simultaneously published "using transmission means of the same nature and reaching a target public of proportionally comparable size" as the English or other language version.

Stricter test for making knowledge of English a condition of employment

The Act proposes to introduce more prescriptive requirements for an employer to satisfy before being permitted to make knowledge of English a condition of employment. Under the Act, an employer would be required to demonstrate that

- an assessment of the actual language needs associated with the duties to be performed was carried out
- other employees who are already required to be proficient in English could not carry out the duties of the position that require the knowledge of English
- the duties requiring English proficiency have been concentrated as much as possible within certain positions, so as to restrict as much as possible the number of positions that require such proficiency

Communications with clients

The Act introduces a new mandatory requirement for businesses to "inform and serve" clients in French, regardless of whether they are consumers. While clients can opt to be served in another language, this must be initiated by the client and in certain situations, notably in respect of contracts, French documents must be presented to clients before they are able to elect to proceed in another language.

Standard form contracts

The Charter already requires standard form contracts to be available in French, unless it is the express wish of the parties that the contract be in another language. A practice exists for many commercial standard form contracts to include a clause confirming it is the express wish of the parties that the contract be in English, rather than developing a French version of the standard form contracts. Under the Act, this practice would be curtailed by requiring a business to first present the standard form contract in French. Only if the client requests an English version could it then be made available. Moreover, the new private right of action could render unenforceable standard form contracts entered into in English in violation of these new requirements, and give rise to damages, including punitive damages.

The new private right of action could render unenforceable standard form contracts entered into in English in violation of these new requirements, and give rise to damages, including punitive damages.

Use of non-French trademarks and signage

The Charter currently allows the use of non-French trademarks, provided such trademarks are recognized under the federal *Trademarks Act* and no French version has been registered. The Act would limit this exemption somewhat by specifying that the non-French trademark can only be used in signage and advertising if it has been formally registered (i.e., not just recognized) under the federal *Trademarks Act*.

In respect of signage on the exterior of business premises, French text accompanying a non-French trademark will continue to be mandated, but will now be required to be "markedly predominant" in relation to the trademark. Under the Charter, this is essentially defined to require the use of French text that is twice the size of the non-French text.

New order-making powers for the OQLF

The Act would give the Office québécois de la langue française (OQLF) new powers to issue orders, as well as the right to directly seek the enforcement of those orders before the Superior Court of Québec. In addition, although the Charter currently provides for injunctions in respect of advertising, the Act would extend the availability of injunctions to most violations of the Charter, including in respect of product packaging and communications with clients.

Finally, in cases of repeated contravention of the Charter, the Act proposes to grant the OQLF the ability to apply to the new Minister of the French Language to have the Minister suspend or revoke any government-issued permit or authorization provided to a business.

Private rights of action

Currently, recourse for violations of the Charter is limited to complaints to the OQLF for an individual. An employee has the right to bring certain workplace violations to a specialized labour standards tribunal.

The Act introduces a private right of action, enabling individuals to seek injunctive relief in respect of a failure to have been provided services in French or a failure by an employer to honour their right to work in French. Under this new right, a claimant (which could be an individual or a business) could seek the annulment of standard form contracts entered into in English, or damages, at their election. Similarly, standard form contracts or any document that does not comply with the Charter, as amended by the Act, could be deemed unenforceable by the business that prepared them, but could nonetheless, be enforced against that business.

Finally, the Act would inscribe in the Québec *Charter of Human Rights and Freedoms* (the "Québec Charter of Rights") a new "right to live in French to the extent provided for in the Charter of the French Language". This could open the door to claims under the Québec Charter of Rights for violation of the Charter. Such claims, if proven, could give rise to injunctive relief, damages and punitive damages.

If adopted, the Act will surely provoke a wave of private language rights litigation, including class actions.

Public consultations regarding the Act were completed in October and the Act will likely be passed in the coming months, given that an election is scheduled for October 2022. Businesses should review their commercial and employment practices in Québec, not only to prepare for the new requirements but also to identify compliance gaps in respect of existing requirements. This will be particularly important given that the new private rights of action materially increase the risks associated with non-compliance.

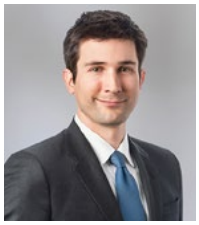
AUTHORS

Alexandre Fallon
Partner, Litigation

afallon@osler.com
514.904.5809

Sven Poysa
Partner, Employment & Labour

spoysa@osler.com
416.862.5934 (Toronto)
514.904.5376 (Montréal)



Julien Ranger
Partner, Pensions & Benefits

jranger@osler.com
514.904.5631

GAMING

Upping the ante: Ontario's iGaming model will be industry game changer

The developments that occurred this past year in the regulation of gaming activities in Canada can only be described as "game-changing."

Perhaps the most significant for the gaming industry is the development of an Internet gaming (iGaming) regulatory framework in Ontario. The iGaming agency model between iGaming Ontario (iGO) and private Internet gaming operators is the first of its kind in Canada, moving beyond the limited online gaming platforms offered exclusively through government lottery corporations to involve regulated participation by private operators. The new model is paving the way for similar initiatives by other provinces. The opportunities in this area are immense. The Canadian Gaming Association estimates that Canadians currently spend $14 billion yearly on offshore betting websites.

The focus of the new iGaming model is on protecting consumers by regularizing a market that has long been operating in a legally ambiguous "grey" zone. At the same time, the iGaming model promises to provide meaningful revenue-generation opportunities for both private operators and the Government of Ontario, though that could, in part, depend on the liquidity model selected by Ontario, which remains outstanding.

The development of this new model coincides with the legalization by the federal Parliament of single event sports betting – one of the most popular forms of betting in the market. This was a welcome development for players, governments and industry, particularly since the provisions of the *Criminal Code* prohibiting most forms of gambling in Canada are rarely amended. As a result of these amendments and Ontario's new iGaming regulations, private operators will be able to offer single event sports betting to consumers in Ontario, under the oversight of the Alcohol and Gaming Commission of Ontario (AGCO).

As the iGaming regulatory landscape in Ontario continues to develop, we are working diligently with numerous operators and gaming-related supplier clients who recognize the importance of the Ontario market as part of their North American licensing strategy.

The focus of the new iGaming model is on protecting consumers by regularizing a market that has long been operating in a legally ambiguous "grey" zone.

Legalization of single event sports betting

On June 22, 2021, the Senate approved Bill C-218, the *Safe and Regulated Sports Betting Act*, which amended the *Criminal Code* (Code) to allow betting on the outcome of "any race or fight, or on a single sport event or athletic contest." Such gaming activity was historically prohibited under s. 207(4)(b) of the Code. The amendment came into force on August 27, 2021, before the federal election.

This amendment will benefit a range of stakeholders, including consumers of this form of gambling, government, and gaming operators and suppliers. The federal government's stated objective in decriminalizing single event sports betting was to permit provinces and territories to conduct and manage these activities in their respective jurisdictions. If provinces and territories choose to do so, Canadians will have an opportunity to place bets in a regulated and safe environment either online or in physical facilities, with the exception of betting on horse racing, which will continue to be regulated by the federal government.

The federal government anticipates that revenues generated from this type of gambling could be used by the provinces and territories to fund programs and services in areas such as healthcare and education, as they currently do with other lottery revenues.

With the development of the iGaming model in Ontario, described below, online single event sports betting (as well as casino, poker and other gaming activities) will be offered by private operators in Ontario, under the oversight of the AGCO.

Ontario's regulated iGaming market breaks new ground

By far the most significant development in the Canadian gaming space is Ontario's iGaming initiative. Other Canadian provinces, such as B.C., Alberta and Québec, have offered or are offering online gaming platforms exclusively through government lottery corporations with no opportunity for participation by private operators. The iGaming model, by contrast, is based on delivery of online gaming by private operators on behalf of the government through commercial relationships with iGO, a newly incorporated subsidiary of the AGCO. It therefore represents an opportunity for private gaming operators that has not previously existed in Canada.

The Ontario government selected the AGCO, which is responsible for administering the *Gaming Control Act* in relation to land-based gaming in the Province of Ontario, as its principal Internet gaming regulator. Under the land-based gaming regime, Ontario has permitted registered private operators to operate land-based casinos for years.

Like the land-based gaming regime, the iGaming model similarly involves registering industry participants who intend to operate Internet gaming sites or act as a gaming-related supplier in Ontario. In addition, iGO, which is a Crown corporation, will enter into commercial relationships with registered private Internet gaming operators.

Since the completion of the government's consultation process in the spring of 2021, the AGCO and iGO have focused on releasing various standards and regulations that are intended to flesh out the requirements that will apply in the newly legalized iGaming market in the province. Osler is assisting a number of industry clients to understand these standards and to navigate the registration process.

Registration process

To become a registered iGaming operator or supplier in Ontario, each operator or supplier must submit an application through the iAGCO portal.

The AGCO opened this iGaming application portal on September 13, 2021 for prospective operators and gaming-related suppliers. For operators, a separate application will be required for each distinct online gaming site. The AGCO application requires prospective operators and suppliers to provide a wide variety of information, including a description of gaming-related goods and services, gaming site information and branding details. In addition, registration requires comprehensive entity and personal disclosures in relation not only to the proposed registrant, but also to certain other entities and individuals associated with the registrant, such as parent companies and individuals holding key management or operational roles.

We expect that the market will launch in early 2022 to allow operators and suppliers sufficient time to complete their application, ensure compliance with applicable requirements and obtain approval to commence operating in Ontario. This includes entering into operating agreements with iGO in the case of operators (which will be in alignment with the timing of registration issuance).

Standards and policies

The newly regulated iGaming market in Ontario will be governed by a complex set of standards which will take effect when the iGaming market is officially launched. On September 9, 2021, the AGCO released the finalized Registrar's Standards for Internet Gaming (the Standards).

These Standards were adapted from the AGCO's existing standards for non-Internet-based gaming and also apply to all sports, esports, novelty, betting exchange and fantasy sports products. The AGCO noted, in releasing these Standards, that the Registrar's focus was on providing increased consumer choice, reducing red tape and fostering stronger consumer protection.

Under the Standards, operators are expected to ensure that any Standards that relate to the creation and operation of their gaming product or platform are met. This requirement applies regardless of who is responsible for carrying out the applicable activities – for example, third parties or suppliers.

Those that receive approval to operate in the legalized iGaming market in Ontario will also need to comply with any documents, including policies, released by iGO.

Under the Standards, operators are expected to ensure that any Standards that relate to the creation and operation of their gaming product or platform are met. This requirement applies regardless of who is responsible for carrying out the applicable activities – for example, third parties or suppliers.

Areas requiring further consideration

The current regulatory regime proposed for the iGaming market in Ontario raises a number of issues, many of which are in the process of being resolved.

- **Liquidity:** "Liquidity" refers to the ability to have a critical mass of players involved in the game, contributing to the prize pools and to the overall game experience. An international or global "open" liquidity model would permit Ontario players to play opposite players from outside Ontario. By contrast, a "closed" liquidity model would permit Ontario players to play only against other players in Ontario.

  Open liquidity provides a number of benefits, including larger prize pools, a broader range of gaming products that can be offered and a richer gaming experience for players looking to participate in different games on demand at different times of day. This in turn improves the revenue-generating potential of Internet gaming for industry participants and government.

  In the Ontario government's Discussion Paper: A model for internet gaming in Ontario, in which the government sought feedback from stakeholders regarding the proposed iGaming model, the Government of Ontario stated that the iGaming market will be based on closed liquidity on the basis that an open liquidity model is believed to be contrary to the Code. Over the course of the spring and summer of 2021, the Government of Ontario received a number of submissions in support of the conclusion that an open liquidity model is not prohibited under the Code and that such a model would be in the best interests of the province, Ontario players and industry participants. Osler made two submissions on behalf of stakeholders in this process, including one of the leading global online gaming companies and two gaming associations.

At the time of writing, we understand the Government of Ontario may refer the question of whether open liquidity is permitted under the Code to the Ontario Court of Appeal. Depending on the timing of the launch of the iGaming market, as well as the release of any court decision, the iGaming market may well be launched on the basis of a closed liquidity model, with the potential for open liquidity to be considered in future.

- **Anti-money laundering (AML):** AML has always been a major consideration in any regulatory framework involving gaming. The iGaming model is no exception.

  In addition to the Standards, iGaming operators are required to comply with iGO's AML requirements. In support of such compliance, iGaming operators will be required to maintain internal AML operating procedures that comply with Canadian federal regulatory requirements, as well as the entirety of iGO's AML program. The latter consists of (1) AML Policies and Procedures; (2) Operational Guidance (for implementing the AML policies and procedures); and (3) AML Risk Assessment Framework. For more information, read Getting ready for the opening of iGaming in Ontario on osler.com.

  Of potential concern are the breadth and complexity of the AML requirements. The gaming sector is broadly subject to the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* (PCMLTFA) and regulated by the Financial Transactions and Reports Analysis Centre (FINTRAC). iGO's AML program is accordingly structured around the threshold requirements established by the PCMLTFA and FINTRAC. However, iGO's AML program sets out its own comprehensive suite of AML obligations for registered operators, and many of its obligations and restrictions go above and beyond FINTRAC's threshold requirements.

- **Operating Agreement:** All registered operators are required to enter into an operating agreement with iGO on iGO's form of agreement as a condition of their admission into the legalized market. The terms of such agreement will likely be a matter for discussion among operators, iGO and their counsel as the launch approaches.

- **Privacy:** An iGaming site necessarily involves the collection, disclosure, processing and use of data, including personal information about the players. There are therefore significant privacy considerations that must be addressed. We expect that the best way to address privacy compliance requirements will also be worked out as operators prepare to participate in the new market. Osler is advising a number of clients on these matters.

What's to come? iGaming in 2022

The legalization of single event sports betting evidences a more modern approach to gaming that involves recognizing the types of activities engaged in by Canadians and opting for regulation, rather than prohibition, of these activities. This relaxation of prior prohibitions came at exactly the right time for operators seeking to participate in Ontario's new iGaming market. This new online gaming model, which is intended to legalize the existing "grey" market for the benefit of Ontario residents (and in turn, the Ontario government), is itself a welcome move to recognize the evolution in technology and its influence on gaming. These changes signal an acknowledgement of a new approach to gaming regulation in the 21st century that better serves the interests of all participants in this industry.

At the time of writing, the future of iGaming in Ontario appears bright. Its potential will be further enhanced if the Government of Ontario determines that an open liquidity model is permissible and if other provinces and territories begin to follow suit to implement their own equivalent regimes.

Osler will continue to monitor these developments, as well as assist industry participants in navigating the registration process to best position themselves to take advantage of the new iGaming market in Ontario.

AUTHORS

Eric M. Levy
Partner, Corporate
Chair, Gaming

elevy@osler.com
416.862.5884 (Toronto)
514.904.8177 (Montréal)

Ted Liu
Partner, Technology

tliu@osler.com
416.862.6459

Jacqueline Code
Partner and Chair,
Research

jcode@osler.com
416.862.6462

Natasha Chin
Associate, Technology

nchin@osler.com
416.862.4225

Shira Dveris
Articling Student

sdveris@osler.com
416.646.3946

HEALTH

The second year of COVID-19: A rapidly changing health landscape

Over the course of 2021, workplaces across all industries and sectors faced ongoing challenges when implementing and adapting their policies and procedures in response to the COVID-19 pandemic. In particular, boards of directors (Boards) were required to discharge their fiduciary duties and duties of care in an environment with dramatically fluctuating standards of care as industry standards, government restrictions and scientific knowledge changed at a rapid pace.

Boards and management teams have been subject to intense scrutiny as they make decisions relating to the timing of return to the workplace and the conditions under which employees will be expected to operate. These decisions have potentially significant impacts on the health and safety of workers and, in some cases, the ability of employers to continue operations or continue employing some of their workforce. In making decisions regarding their organization's response to COVID-19, Boards are required to satisfy certain common law, contractual and statutory obligations (including under occupational health and safety legislation in relation to hospitals and other

high risk settings, as we outlined in our post, Ontario COVID-19 vaccination policy update for high risk settings: Key considerations for hospitals and healthcare organizations).

When considering what is reasonable in the circumstances, Boards should take into account many factors, including the relative risks of implementing mandatory vaccination policies and other response measures, the impact of their decision on key stakeholders, the then-current COVID-19 circumstances and the measures and policies adopted by other employers and organizations in similar industries.

The third and fourth waves of COVID-19 experienced in 2021 brought with them a variety of new legal issues, some of which we describe below.

The mayhem of the COVID-19 vaccine rollout in Canada

In addition to authorizing new drugs and medical devices for COVID-19, the federal government has been responsible for procuring vaccines for Canadians which it then distributes to the provincial and territorial governments, who have primary responsibility for healthcare matters, to make available to their residents. Much like the responses of the provincial and territorial governments in early matters relating to COVID-19, the strategies implemented by the public health authorities across Canada in connection with vaccine distribution were varied and lacked cohesion.

Canada's access to vaccines lagged behind other countries' due to a lack of local manufacturing. Early in 2021, many international employers with Canadian operations attempted to proactively implement vaccine policies in their Canadian workplaces at a time when U.S. residents were able to easily access vaccines and their Canadian counterparts were months away from being considered eligible. This created an interesting predicament for employers with cross-border operations. Encouraging, incentivizing or requiring vaccination was impractical at a time when Canadian employees were unable to access the vaccine and Canadian public health authorities had not yet issued guidance regarding whether any of the public health measures, such as masking and social distancing, could be relaxed for those who had been vaccinated.

Encouraging, incentivizing or requiring vaccination was impractical at a time when Canadian employees were unable to access the vaccine.

Interesting legal issues also arose when certain employers and organizations implemented programs to offer vaccines directly to their employees on behalf of public health authorities or otherwise voluntarily offered to assist other organizations experiencing COVID-19 outbreaks. As the private sector participants assumed the cost and responsibility for matters falling squarely within the purview of the public health authorities in an effort to help, issues related to the allocation of the corresponding liability arising from providing such assistance presented unique challenges. By way of example, pursuant to the *Health Protection and Promotion Act* (Ontario) (the HPPA), persons working under the direction of a medical officer of health or pursuant to a directive or direction under the HPPA have statutory protection from liability so long as they are acting in good faith. As a result, parties responding to and assisting with potential problems proactively in a benevolent manner were exposed to

potential legal liability they would not have encountered if they had waited until they were legally compelled to take action pursuant to a directive under the HPPA.

As vaccines became more readily available, vaccination regrettably morphed into a political issue, as well as a public health issue, with passionate views emerging on both sides. Mandatory vaccination policies in the workplace and public spaces were widely debated. Once again, public health authorities implemented fragmented orders, directives and legislation on the issue across Canada.

For example, in August 2021, British Columbia's Public Health Officer announced a public health order requiring mandatory vaccination for certain healthcare workers and the federal government announced mandatory vaccination for certain federal employees. On August 17, 2021, the Chief Medical Officer of Health in Ontario issued a directive requiring the implementation of a mandatory vaccination policy in healthcare settings. Under these policies, workers are required to be vaccinated or undergo regular testing if a specified medical exemption was not available. Further detail is included in our Osler Update, Ontario COVID-19 vaccination policy update for high risk settings: Key considerations for hospitals and healthcare organizations. The Boards of many public hospitals in Ontario approved vaccination policies that went beyond the government directive, requiring mandatory vaccination for all workers (without permitting the alternative option to undergo testing) with limited scope for human rights exemptions.

These announcements followed Alberta's decision to lift most public health restrictions and Saskatchewan's decision to lift all public health restrictions in July 2021, creating a disjointed federal landscape for employers attempting to implement nationwide policies.

When viewed in the context of the ongoing worldwide pandemic, states of emergency, ongoing public health orders and legislation and directives requiring that vaccination policies be adopted, the pre-pandemic common law addressing vaccination policies for influenza provided very little in the way of relevant guidance. By September 2021, we witnessed mandatory vaccination policies being implemented more frequently in a variety of workplaces, including non-essential ones. As these policies came into force, a variety of court challenges to vaccination policies quickly followed, discussed in more detail in our Osler Update, Ontario Superior Court of Justice dissolves injunction to stay terminations under hospital's mandatory vaccination policy.

Additional information regarding employment considerations are included in our article, Back to the office? New workplace norms expected to evolve in coming years.

Further evolution of COVID-19 testing in the workplace

In 2021, the COVID-19 testing and screening landscape also evolved from simple symptom-checking to on-site workplace testing and screening for certain employers. Provincial governments made asymptomatic antigen screening testing programs available to some employers, with testing devices being paid for by government. Many provincial public health authorities provided detailed guidance regarding how antigen screening should be conducted.

Some employers wanted to implement other types of asymptomatic screening or testing in the workplace, such as self-testing devices recently authorized by Health Canada or PCR tests (considered the gold standard in COVID-19 testing). These employers had the challenge of navigating the legal, health, employment and privacy issues with limited (and in some cases no) guidance from public health authorities. Many employers engaged third-party providers to assist them to avoid having to consider complex matters relating to the implementation of testing programs. Such matters include collecting specimens, handling personal information, engaging laboratory services, communicating a diagnosis, reporting test results to public health authorities (where applicable) and disposing of hazardous waste.

Vaccine passports and privacy matters

Throughout 2021, the term "vaccine passport" also became politically charged as each provincial government adopted their own approach to the issue. For example, vaccine passports were initially rejected by the Ontario government. They were subsequently introduced through a QR code after the government imposed restrictions requiring that patrons attending restaurants for indoor dining or gyms had to be fully vaccinated or hold a medical exemption. Every province or territory has now implemented a process to obtain a Canadian COVID-19 proof of vaccination.

Privacy issues remain relevant to employers, since COVID-19 response measures generally involve collecting or using personal information from employees that is deemed to be sensitive in nature and that should be protected by appropriate safeguards. Regardless of whether an employer is subject to privacy legislation in Canada, they will want to take care in collecting and storing employees' personal information, including their vaccination status and any related information. Those employers that are subject to private sector privacy legislation in Canada will also need to consider compliance with the limitation on collection and use principles, and what personal information is strictly necessary to collect and to store, all for the purposes of ensuring a safe workplace.

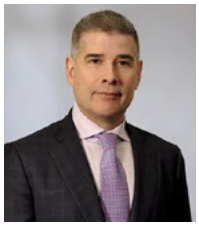
Privacy issues remain relevant to employers, since COVID-19 response measures generally involve collecting or using personal information from employees that is deemed to be sensitive in nature and that should be protected by appropriate safeguards.

Conclusion

Boards of organizations who have not yet had employees return to work and organizations who are already operating under existing COVID-19 policies, including with respect to vaccination, should continue to be vigilant in monitoring the constantly evolving circumstances relating to COVID-19. In formulating a decision with respect to appropriate COVID-19 return to work policies, including vaccination policies, Boards should exercise their judgment on an informed and independent basis, after reasonable investigation and analysis of the situation and with a reasonable basis for believing that their actions are in the best interests of the organization.

It will be important that Boards follow an appropriate decision-making process and appropriately document the discharge of their duties, given the risks that decisions made could be challenged in the courts, particularly if they relate to vaccination status. These decisions should not be treated as final and should be continually reassessed on an ongoing basis.

AUTHORS



Michael Watts
Partner, Health
mwatts@osler.com
416.862.6605

Susan Newell
Partner, Health
snewell@osler.com
416.862.6797

Marty Putyra
Associate, Health
mputyra@osler.com
416.862.4898

REGULATORY

Financial services regulation in 2021: Back to business

After the tumult of 2020, 2021 was marked by a return to regulatory functions, as well as growth in key areas. While a full return to "normal" remains on the horizon, stop-gap and emergency measures began to make way in 2021 for renewed priorities for medium- and long-term planning. The message from regulators and industry alike is clear – normal or not, they are back to business. Below we highlight some of the notable developments from the past year.

Anti-money laundering

On June 1, 2021, major amendments to the regulations under the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* (PCMLTFA) came into force, together with new and updated guidance from the Financial Transactions and Reports Analysis Centre of Canada (FINTRAC). These changes effected a sizeable overhaul of the AML regulatory landscape in Canada and finalized the legislative and regulatory amendment process that began in 2019.

Key changes introduced in June include a number of new virtual currency obligations, such as requirements for reporting large virtual currency transactions and suspicious transactions pertaining to virtual currency.

Additionally, new recordkeeping obligations were imposed, together with new requirements for casinos, financial entities and money services businesses to comply with the travel rule reporting requirement for virtual currency transfers.

The amendments also included new obligations to screen for and take certain measures with respect to politically exposed persons and heads of international organizations. Foreign money services businesses are now required to comply with the full suite of requirements under the PCMLTFA. Compliance obligations for financial entities in relation to prepaid payment products now align with other account-based obligations that financial entities already have, such as identity verification for account holders and account users, suspicious transaction reporting, recordkeeping, etc.

All entities with obligations under the PCMLTFA must now comply with beneficial ownership determination requirements. Amendments were also made to the requirements related to recordkeeping and reporting, the implementation of the 24-hour rule, business relationship screening, ongoing monitoring requirements and identification methods for know-your-client checks.

For additional details regarding these and other changes under the PCMLTFA as of June 1, 2021, please refer to our Client Guide that we published earlier in 2021 to help clients navigate the new regime. Further information regarding the impact of these rules as they apply to virtual currencies can be found in our article Decoding crypto – Providing regulatory clarity to cryptoasset businesses.

Also noteworthy in the AML space was the Government of Canada's funding announcement for a new beneficial ownership registry for corporations in Canada. Additional details are included in our article White-collar defence: Increasing risks and enforcement activity.

Meanwhile at the provincial level, on June 3, 2021, Québec passed Bill 78, *An Act mainly to improve the transparency of enterprises*, which makes beneficial ownership information available on Québec's existing corporate registry.

When it comes into force, the RPAA will represent a sea change in the payments sector, which to date has been lightly regulated in Canada outside banks and other regulated financial institutions.

Payments regulation activity picks up speed

Retail Payment Activities Act

The *Retail Payment Activities Act* (RPAA) was introduced in the federal budget bill released on April 19, 2021 and approved by Parliament on June 29, 2021. When it comes into force, the RPAA will represent a sea change in the payments sector, which to date has been lightly regulated in Canada outside banks and other regulated financial institutions.

The RPAA positions payments as a matter of federal jurisdiction. Its preamble states that it is in the national interest to address the national security risks posed by payment service providers (PSPs) and to mitigate operational risks and safeguard end-user funds. The RPAA will apply to retail payment activities performed by PSPs that have a place of business in Canada or that direct retail payments activities at individuals or entities in Canada, subject to key exclusions. Excluded from the new regime are entities whose payment functions are incidental to other services or business activities, regulated financial entities, prepaid payment products, ATM transactions, transfers made using designated

systems, certain eligible financial contracts and securities transactions, and agents and mandataries of PSPs.

Many steps are still required, including the adoption of regulations to implement the new statutory framework, as well as publication of regulatory guidance. At a minimum, the RPAA will require PSPs to register with the Bank of Canada, mitigate operational risks, safeguard user funds and notify the Bank of Canada of incidents with material impacts on end users, other PSPs or clearing houses. Additional information about the RPAA can be found in our Osler Update.

Payments modernization

As part of its ongoing payments modernization initiative, on September 1, 2021, Payments Canada announced the initial launch of Lynx, which replaces the Large Value Transfer System for clearing and settling high-value payments. Lynx processes large-value wire payments with real-time settlement and provides enhanced cybersecurity capabilities.

A second release of the Lynx system, currently slated for late 2022, will introduce the ISO 20022 global payments message standard for large-value payments. By adopting this standard, Lynx will support Canadian financial institutions' compliance with the ISO 20022 global requirements which take effect in November 2022. Additionally, adopting the ISO 20022 messaging standard will allow for greater insight into cash management, reduction of manual processes and increased visibility into the value chain.

On September 28, 2021, Payments Canada announced that Citibank, N.A. had become a Lynx participant, along with the 16 other participating financial institutions that were part of the initial Lynx launch. Meanwhile, Peoples Trust was approved by Payments Canada to become a new direct clearer on Payments Canada's retail batch system, the Automated Clearing Settlement System (ACSS).

Industry participants should watch closely in 2022 for the implementation of the new real-time payments system, Real-Time Rail (RTR). The RTR is a hallmark payments modernization project of Payments Canada. If RTR follows similar trends to Lynx, it may be that more participants could gain access to the system under a framework to be established under the RPAA.

Open banking

On August 4, 2021, the Advisory Committee on Open Banking (the Advisory Committee) released its Final Report, including 34 recommendations for the implementation of an open banking system in Canada together with an 18-month roadmap to implementation. The Final Report recommends common rules to ensure consumer protection with a focus on liability, privacy and security, an accreditation system for third-party service providers entering the open banking system and technical specifications to ensure safe and efficient data transfer.

To implement this framework, the Advisory Committee recommended a two-staged approach. The first stage sets a January 2023 target date for the initial rollout of a low-risk system with limited scope and functionality. It then leaves room to expand the scope following the initial implementation period.

Although a basic framework has now been recommended, many steps remain before the proposed open banking framework could be implemented in Canada. For further information about the Advisory Committee's report, please see our Osler Update.

Cryptocurrency

The explosive growth in the use of cryptocurrency and digital assets has enormous implications for the financial services industry. At this time, new regulation specifically targeting this space has been largely driven by the securities regulators (apart from AML, as discussed above). Learn more about cryptocurrency regulation can be found in our article Decoding crypto – Providing regulatory clarity to cryptoasset businesses.

We expect increasing pressure on more traditional financial regulation as this growth continues.

Federal Financial Consumer Protection Framework

After much anticipation, June 30, 2022 was fixed as the day the remainder of the *Bank Act* amendments comprising the new Financial Consumer Protection Framework (Framework) for banks and authorized foreign banks will finally come into force. Following that announcement, the *Financial Consumer Protection Framework Regulations* were published on August 18, 2021 and will come into force alongside the Framework. These regulations, as expected, largely prescribe details to fill the gaps left open by the Framework and incorporate the pre-existing consumer protection regulations. Additional information about the Framework can be found in our Osler Update.

OSFI guidelines and advisories

In August 2021, the Office of the Superintendent of Financial Institutions (OSFI) released a new Technology and Cyber Security Incident Reporting Advisory (Advisory), which prescribes requirements for federally regulated financial institutions to disclose and report technology and cybersecurity incidents to OSFI. The Advisory makes a number of dramatic departures from the previous advisory, including a different reporting period timeframe, lower reporting thresholds for technology or cybersecurity incidents and greater enforcement powers for OSFI.

The Advisory makes a number of dramatic departures from the previous advisory, including a different reporting period timeframe, lower reporting thresholds for technology or cybersecurity incidents and greater enforcement powers for OSFI.

In November 2021, OSFI published a Draft Guideline B-13 Technology and Cyber Risk Management, which includes a number of new requirements intended to promote and develop federally regulated financial institutions' technology and cyber resilience. A three-month public consultation is seeking feedback regarding the clarity of the new requirements and the application of the new expectations to institutions of different sizes and scopes, among other categories.

Changes to Guideline B-10 Outsourcing of Business Activities, Functions and Processes are also forthcoming, and are expected to deal with the flow-down of risks to third parties during outsourcing arrangements. Taken together, these changes exemplify the trend in 2021 towards an increased focus on the

operational risks that financial service providers face, and the measures they will be expected to take to address these operational risks.

OSFI also released several guidance updates in 2021. The Draft Pillar 3 Disclosure Guideline for Small and Medium-Sized Banks was released in August 2021 and will take effect November 1, 2022. The guideline will serve as a comprehensive guide to OSFI's expectations for the Pillar 3 disclosure requirements for small and medium-sized banks. In July 2021, OSFI released Guideline E-4 Foreign Entities Operating in Canada on a Branch Basis. This guideline reflects new amendments to the location of records requirements in the *Insurance Companies Act* and the *Bank Act*. There is a six-month transition period for compliance with the guideline, which ends in January 2022.

OSFI also issued several guidance documents that will take effect November 1, 2022 or January 2023, depending on the institution's fiscal year. These updates are intended to align with international standards. These include the Draft Capital Adequacy Requirements Guideline that makes a number of changes to capital targets, introduces new operational risk capital rules and provides for a reduction of credit risk capital requirements, among other changes. In addition, OSFI issued the Draft Leverage Requirements Guideline that applies a leverage ratio buffer to domestic systemically important banks and makes other changes to the leverage requirements. Finally, OSFI issued the Liquidity Adequacy Requirements Guideline that enhances the net cumulative cash flow requirements and changes certain reporting timelines. OSFI also proposed a new instrument that provides guidance for institutions using the Basel III Standardized Approach for Operational Risk in Canada. A Proposed Operational Risk Capital Data Management Expectations has been published as well, though no timeframe has been provided for its implementation.

Financial title protection regimes

The movement towards financial title protection continues to gain momentum following Ontario's introduction of the *Financial Professionals Title Protection Act* in 2019 and Saskatchewan's *Financial Planners and Financial Advisors Act* in 2020. In May 2021, the Financial Services Regulatory Authority of Ontario (FSRA) released for public consultation an updated proposed title protection framework for financial planners and advisors. The Financial and Consumer Affairs Authority of Saskatchewan followed Ontario's lead shortly thereafter, releasing proposed regulations for public comment in July 2021. When the Ontario and Saskatchewan title protection regimes are operational, anyone who uses the titles "Financial Planner," "Financial Advisor" or specified similar titles in either jurisdiction will be required to hold appropriate credentials from a credentialling body approved by the regulator.

No in-force date has yet been announced for either the Ontario or Saskatchewan titling regimes, but the trend towards regulation of financial titles is apparent: New Brunswick has now also recently concluded its own public consultation regarding a framework for the protection of titles used by financial professionals as of October 25, 2021. Further information can be found in our blog post on osler.com, Movement towards financial title regulation expands across Canada.

Fair treatment of customers

FSRA issued a new fair treatment of customers in insurance approach (the Approach) which came into effect on January 1, 2021. The Approach adopts the joint guidance issued by the Canadian Council of Insurance Regulators and Canadian Insurance Services Regulatory Organizations to streamline the requirements for the fair treatment of customers for insurers and insurance intermediaries licensed in Ontario.

Under the Approach, Ontario insurers and insurance intermediaries are required to adhere to sound business practices; exemplify ethical, good-faith behaviour in dealings with customers; manage conflicts of interest; and manage outsourcing arrangements. They must also provide appropriate customer disclosures before and at the point of sale; provide accurate, clear and not misleading marketing; provide relevant advice taking into account the customer's circumstances; handle and settle claims in a diligent and fair fashion; and protect personal information, among other requirements. Further details about the Approach are available in our blog post on osler.com, FSRA streamlines fair treatment of customers approach for insurance industry.

What's next?

A key theme of financial services regulation in 2021 was the convergence of various different reforms and initiatives aimed at regulating discrete parts of the financial ecosystem that had been previously unregulated or lightly regulated. These include cryptocurrency, PSPs, foreign money services businesses and open banking. These reforms are being driven by the significant evolution of the financial services industry, particularly in the payments space. While these changes may subject industry participants to additional burdens and competing standards, expanded regulatory oversight over participants in the new ecosystem could also translate into enhanced opportunities to access new frameworks such as the Real-Time Rail. Certainly, there will be more to come in 2022.

AUTHORS

Victoria Graham
Partner, Corporate
vgraham@osler.com
416.862.4856

Elizabeth Sale
Partner, Banking and Financial Services
esale@osler.com
416.862.6816

Haley Adams
Associate, Banking & Financial Services
hadams@osler.com
416.862.6614

Lawrence E. Ritchie
Partner, Litigation
Chair, Risk Management and Crisis Response
lritchie@osler.com
416.862.6608

TAX

Tax planning developments: Important international tax changes

In 2021, a number of significant changes were proposed for international taxation in Canada. The 2021 Canadian federal budget (Budget 2021) introduced three key international tax proposals relating to earnings stripping, anti-hybrid measures and a digital services tax. Individually, each proposal represents a significant change to existing practice and gives rise to complex tax issues affecting a wide range of large international corporations. Collectively, they represent an ambitious project intended to conform with some of the core proposals coming out of the OECD Base Erosion and Profit Shifting (BEPS) work. Budget 2021 provided descriptions of the expected rules with varying degrees of specificity, but without specific statutory language.

In addition, Canada continues to work with the OECD, G20 and approximately 140 members of the Inclusive Framework on BEPS on significant international tax reform proposals (the Two Pillar Solution or BEPS 2.0).

Earnings stripping proposals

The first key proposal is a new limit on interest deductibility (reflecting OECD BEPS Action 4). Its purpose is to reduce earnings stripping through the use of third-party, related party and intragroup debt by taxpayers to achieve interest deductions considered by the government to be excessive or that finance the production of exempt or deferred income. A new limit would be created that would preclude the deductibility of interest above a specified threshold, which is expected to be 30% of EBITDA (calculated in accordance with the new rule).

Interest expenses denied under the new rule may be carried forward for up to 20 years or back for up to three years. Certain taxpayers – generally, smaller taxpayers and most corporate groups that do not include any non-resident members – will be exempt entirely from the limit. Some taxpayers may be able to deduct interest to a higher limit if the ratio of net third-party interest to EBITDA of their consolidated group suggests this would be appropriate (for example, because some sectors or groups may be more highly leveraged, such as real estate and infrastructure). The new rules are expected to be phased in with an initial fixed ratio of 40% for taxation years beginning on or after January 1, 2023, but before January 1, 2024. The 30% limit will apply to subsequent years.

Separately, Canada has had thin capitalization rules for many years that generally limit interest deductibility where the ratio of debt owing to certain non-resident shareholders to equity exceeds 1.5:1. The government has proposed to retain the existing thin capitalization rules and have them apply alongside the proposed earnings stripping rules. The new rules will significantly increase the complexity faced by taxpayers in respect of cross-border interest deductibility, particularly compared to the relatively straightforward approach under the thin capitalization rules. In addition, unlike the existing thin capitalization rules, the proposals will apply to borrowings from arm's length persons and Canadian residents.

The new rules will significantly increase the complexity faced by taxpayers in respect of cross-border interest deductibility, particularly compared to the relatively straightforward approach under the thin capitalization rules.

Anti-hybrid proposals

The second key proposal concerns new anti-hybrid measures. These are designed to reduce the tax advantages currently available in some situations as a result of an entity being treated differently by different jurisdictions (reflecting OECD BEPS Action 2). Four types of hybrid mismatch arrangements will be targeted:

- "deduction/non-inclusion mismatches" where an amount is deducted in Country A, but not included in income in Country B
- "double deduction mismatches" where one economic expense gives rise to tax deductions in two or more countries
- "imported mismatches" where an entity in Country A deducts a payment and an entity in Country B includes the payment as ordinary income but offsets that inclusion by a deduction from an arrangement with an entity in Country C

- "branch mismatches" where the residence country of a taxpayer and the country where its branch is located have different views of how to allocate income and expenditures between the branch and the taxpayer

The proposed rules are expected to deny deductions relating to such arrangements on a mechanical basis (i.e., without any consideration of purpose). In particular, the proposals are expected to target certain inbound hybrid structures involving a U.S. parent company and a Canadian subsidiary that have been the subject of CRA audit activity.

New digital services tax

The third key proposal is a 3% digital services tax (DST) on revenue in excess of C$20 million from digital services that rely on the engagement, data and content contributions of Canadian users. In-scope revenue will include revenue from online marketplaces, social media, online advertising and user data. The DST would only apply to groups with global revenue from all sources in the previous calendar year of at least €750 million.

The DST proposal is framed as an interim measure pending a global deal under the OECD/G20 Pillar One framework. One annual return and payment would be required for each group, though all members are jointly and severally liable for the tax. The DST is expected to apply from January 1, 2022, though the tax will only be collectible starting in 2024 if a global Pillar One deal does not come into effect prior to the end of 2023.

International tax reform – BEPS 2.0

Canada continues to work with the OECD, G20 and the Inclusive Framework on international tax reform proposals. A high-level agreement was reached in 2021 that is expected to be refined in 2022. These proposals are generally expected to come into force in 2023.

Two pillars form the agreement:

- **Pillar One** provides a new taxing right for market jurisdictions (where customers are located) to obtain a share of residual profit of a multinational enterprise (MNE) (Amount A). It further contemplates the calculation of a fixed return for certain baseline and marketing and distribution activities in jurisdictions where an MNE has a physical presence (Amount B). It also contains dispute prevention and resolution mechanisms (referred to by the OECD as Tax Certainty).
  - Under this proposal, 25% of residual profit (defined as profit in excess of 10% of revenue) will be allocated to market jurisdictions with sufficient nexus and measured using a revenue-based allocation key.
  - The tax will apply initially to MNEs with global turnover in excess of €20 billion and profitability above 10%. The revenue threshold will be reduced to €10 billion pending successful implementation (determined seven to eight years after Pillar One comes into effect).

- Profits and losses are required to be measured by reference to financial accounting income, with a small number of adjustments. Losses will be carried forward, although it is currently unclear whether the carry-forward period will be indefinite.
- Pillar One will be implemented by means of a to-be-developed multilateral convention expected to be signed in mid-2022 and to come into effect in 2023.
- Once implemented, participating countries will remove any DSTs or similar measures.

- **Pillar Two** provides a global minimum tax of 15% imposed by means of two domestic rules and one treaty-based rule.
  - The domestic income inclusion rule (IIR) will impose current taxation on the income of a foreign-controlled entity (or foreign branch) if that income was otherwise subject to an effective tax rate that is below a certain minimum rate.
  - The domestic undertaxed payments rule (UTPR) will either deny a deduction or require an equivalent adjustment on base eroding payments unless the payments are subject to tax at or above a specified minimum rate in the recipient's jurisdiction.
  - The treaty-based rule, known as the subject to tax rule (STTR), will allow source countries to impose withholding taxes on certain related party payments (particularly interest and royalties) that are subject to tax below a minimum rate of 9% in the recipient jurisdiction. STTR taxes will be creditable in determining the effective tax rate for purposes of the IIR and UTPR.
  - These new rules will apply to MNEs with total consolidated group revenue of at least €750 million. Countries can also choose to apply the IIR to MNEs headquartered in their country that do not meet the threshold.
  - The calculation of the effective tax rate in a jurisdiction, which will drive the application of Pillar Two, will use a common definition of covered taxes and a tax base determined by reference to financial accounting income (with agreed adjustments consistent with the tax policy objectives of Pillar Two and mechanisms to address timing differences).
  - Certain exclusions and carve-outs will be available. The two most significant exclusions are (i) a formulaic substance carve-out that will exclude an amount of income that is 5% of the carrying value of tangible assets and payroll in a jurisdiction, and (ii) a *de minimis* exclusion, which applies where the MNE has revenues of less than €10 million and profits of less than €1 million. During an initial 10-year transition period, the carve-out will be more generous but will decrease over the 10-year period to the proposed amounts.
  - Rules to give effect to the Pillar Two changes are expected to be developed by the end of November 2021, with an additional multilateral instrument to be developed by mid-2022 and an implementation framework by the end of 2022.

Both pillars come after years of international political negotiations, which remain ongoing. While many details remain to be determined and final implementation of the pillars is not guaranteed, the International Framework agreement represents an important milestone towards a consistent, global approach to these issues. It will be important to closely monitor these developments – and the responses of Canada, the United States and other countries – as they could have a significant impact on many multinational enterprises.

Both pillars come after years of international political negotiations, which remain ongoing. While many details remain to be determined and final implementation of the pillars is not guaranteed, the International Framework agreement represents an important milestone towards a consistent, global approach to these issues.

As Canada and the rest of the world look to reshape the international tax system, there will be many new challenges (and potential planning opportunities) for multinational enterprises. Osler's national tax group can assist in determining the optimal manner in which to anticipate or respond to these changes.

Osler's Federal budget briefing 2021 offers additional insight into the three budget proposals, as well as other proposals and changes from Budget 2021. Further information about the OECD/G20 Inclusive Framework two pillar proposals is available in our Osler Update on osler.com.

AUTHORS

Patrick Marley
Partner and
Co-Chair, Tax

pmarley@osler.com
416.862.6583

Ilana Ludwin
Associate, Tax

iludwin@osler.com
416.862.4215

TAX

Spotlight on statutory interpretation and tax avoidance: Three key decisions in 2021

In 2021, the Supreme Court of Canada (SCC) heard two cases involving the permissible limits of international tax planning, giving the Court the opportunity to clarify the process of statutory interpretation in the tax context. The exercise of interpreting a tax provision involves examining three interrelated factors: the text of the provision; the context in which the text appears; and the purpose of the statutory scheme in which the provision is found. Canadian courts have repeatedly referred to this exercise as a "textual, contextual and purposive" analysis. The way in which this analysis is conducted is of particular interest in cases involving allegations of tax avoidance.

The first of the two cases decided by the SCC, *Canada v. Alta Energy Luxembourg SARL*, considered the application of the general anti-avoidance rule (GAAR) to provisions of an income tax convention. The Court released its decision in this case on November 26, 2021. The second case, *Canada v. Loblaw Financial Holdings Inc.*, considered the interpretation of a specific provision in the foreign accrual property income (FAPI) rules in the *Income Tax Act* (the Tax Act) and

the decision was released on December 3, 2021. The Court may also hear a third case in 2022 involving the application of the GAAR to tax planning undertaken in the domestic context.

The decisions in *Alta Energy* and *Loblaw Financial* provide guidance from our highest court on the application of the GAAR and on the conduct of ordinary statutory interpretation, giving important direction to taxpayers for future tax planning.

Canada v. Alta Energy Luxembourg SARL

In *Alta Energy*, a majority of the SCC confirmed the decision of the lower courts that the GAAR did not apply where the taxpayer, a Luxembourg-resident company, relied on the tax convention between Canada and Luxembourg (the Treaty) to exempt a capital gain from Canadian income tax. Wagner CJ and Rowe and Martin JJ dissented in favour of the Crown.

In this case, the FCA found that the purpose of the relevant Treaty provisions was clear from its text and that the Treaty benefit (in this case, the exemption from tax in Canada on the capital gain) should be available to any resident of Luxembourg that otherwise met the requisite conditions in the Treaty. The FCA declined the Crown's invitation to read in additional requirements not grounded in the text and that could in theory preclude certain residents from obtaining Treaty benefits.

On appeal to the SCC, the Crown took the position that the FCA had erred in its application of the GAAR, having grounded its analysis in the text of the relevant Treaty provisions rather than its policy or underlying rationale. The Crown argued that the policy of the Treaty provisions was to allocate taxing rights based on economic connections to each contracting state. Although the Crown conceded that the taxpayer was a resident of Luxembourg for purposes of the Treaty, it took the position that the taxpayer had limited economic or commercial ties to Luxembourg and therefore had engaged in "treaty shopping," contrary to the policy of the Treaty provisions on which the taxpayer relied.

In response, the taxpayer argued that the policy of the relevant Treaty provisions was no broader than the text itself and that a textual, contextual and purposive analysis of those provisions evidenced no intention to depart from the carefully defined criteria negotiated and agreed upon by the treaty partners. The taxpayer also argued that the Crown, in seeking to have the GAAR applied, was effectively adding an unexpressed condition to the test for residency under the Treaty (i.e., sufficient economic connections).

Justice Côté, writing for a six-member majority of the SCC, agreed with the taxpayer that the policy of the relevant Treaty provisions was clear from the text and was supported by the context and purpose of these provisions. The majority thus concluded that the Treaty benefit in question should not be denied to a resident of Luxembourg that has otherwise met the requisite conditions in the Treaty on the basis that its ties to Luxembourg are somehow insufficient.

The majority cautioned that in applying the GAAR courts should not conflate a transaction being primarily (or even solely) tax motivated with it being abusive. Nor should the GAAR analysis be conflated with value judgments. It should be grounded in the specific provisions at issue rather than on broader policy statements.

The majority cautioned that in applying the GAAR courts should not conflate a transaction being primarily (or even solely) tax motivated with it being abusive.

The majority also pointedly rejected the Crown's argument that treaty shopping is inherently abusive and declined the Crown's invitation to read in additional requirements not grounded in the text of the Treaty and effectively allow Canada to "revisit its bargain" with Luxembourg such that certain residents may be precluded from obtaining Treaty benefits.

Writing for a three-member dissent, Rowe and Martin JJ held that treaty shopping is abusive where there is an absence of a "genuine economic connection with the state of residence." The dissenting judges found there to be an absence of such a "genuine" connection in this case.

At the time that Canada entered into the Treaty, the international community had not made significant efforts to curb treaty shopping. Such efforts have occurred more recently, resulting most notably in the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (the MLI), which Canada, Luxembourg and many of Canada's other treaty partners have signed and ratified.

The impact of the SCC's decision on future transactions has been tempered by the introduction of the MLI and, in particular, the introduction of the principal purpose test (PPT), as well as the amended preamble (which indicates that treaties are not intended to create opportunities for non-taxation or reduced taxation through treaty-shopping arrangements). The PPT is a broad anti-avoidance rule that is applicable to many of Canada's bilateral treaties pursuant to the MLI. Largely similar to the GAAR, the PPT denies a treaty benefit where it is reasonable to conclude that one of the principal purposes of the arrangement or transaction in question was to gain the benefit, unless it is established that granting that benefit would be in accordance with the object and purposes of the relevant treaty provisions.

Going forward, the interaction between the GAAR and the PPT will be a key issue as tax disputes arise involving treaties covered by the MLI. As well, Budget 2021 confirmed that the government would take steps to strengthen and modernize the GAAR, as had been announced in the 2020 Fall Economic Statement. It remains to be seen what, if any, modifications are made in response to *Alta Energy* and other recent GAAR decisions.

Canada v. Loblaw Financial Holdings Inc.

In *Loblaw Financial*, the SCC unanimously affirmed the decision of the FCA that Canada's FAPI regime did not apply to tax Loblaw Financial Holdings Inc. on the income of its Barbados resident subsidiary, Glenhuron Bank Limited.

The decision provides rare guidance from our highest court on how to interpret and apply important elements of the foreign affiliate rules in the Tax Act. The decision is directly relevant to Canadian financial institutions and other Canadian companies with subsidiaries carrying on banking and other financial businesses outside of Canada. However, the decision has broader implications for tax planning, particularly in the context of complex statutory provisions like those applicable to Canada's foreign taxation system.

In this case, the Minister of National Revenue (the Minister) assessed Loblaw on the basis that Glenhuron carried on an "investment business," as defined in subsection 95(1) of the Tax Act and that its income was FAPI. Under the FAPI regime, a Canadian resident taxpayer may be required to pay tax in Canada on certain income earned in a foreign subsidiary. The Minister's position was that Loblaw did not qualify for the financial institution exception to that definition. As an alternative to her primary assessing position, the Minister also relied on the GAAR.

The Tax Court of Canada (TCC) found that Glenhuron satisfied all but one of the conditions necessary to qualify for the financial institution exception: the requirement to conduct business principally with arm's length persons (namely, the arm's length test). Glenhuron therefore could not benefit from the exception. The TCC also concluded in *obiter* that the GAAR did not apply because there was no avoidance transaction.

In allowing Loblaw Financial's appeal, the FCA found that the TCC had erred in its interpretation of the arm's length test by reading in conditions not grounded in the text, context and purpose of the exception. The FCA applied the plain meaning of the phrase "business conducted ... with," and held that the focus should be on business relationships, and not on receipts and uses of funds. The FCA thus concluded that Glenhuron conducted business principally with arm's length persons.

Although the Crown did not rely on the GAAR in its appeal, it argued, among other things, that the arm's length test should be interpreted in its favour because Glenhuron's income would otherwise not be subject to tax in Canada. In response to this argument, the FCA observed that such concerns do not enable courts to give statutory provisions a broader interpretation than they can reasonably bear. Gaps in legislation, if any, are for Parliament to address.

The fundamental premise of the Crown's case before the SCC was that Parliament *intended* Glenhuron's business income to be subject to tax in Canada as FAPI. According to the Crown, the financial institution exception was meant only for foreign affiliates that compete for capital or customers and not for foreign affiliates that use their own capital and retained earnings to generate income. The Crown argued that Glenhuron did not compete for capital and essentially managed an investment portfolio for its own account and therefore should not benefit from the exception.

In response, Loblaw Financial took the position that Parliament had made explicit tax policy choices and enacted specific provisions in the FAPI rules to ensure that precisely the type of income earned by foreign affiliates like Glenhuron would not be taxed in Canada. It argued that the Crown's interpretation of the arm's length test was at odds with that explicit legislative direction. Osler acted for Loblaw Financial.

Justice Côté, writing for the Court, characterized the FAPI regime as "one of the most complex tax schemes, with hundreds of definitions, rules, and exceptions that shift regularly." Given the particularity of the provisions found in this regime, Justice Côté held that courts should "focus carefully on the text and context in assessing the broader purpose of the scheme."

Applying this approach to the financial institution exception at issue, Justice Côté held that a parent corporation does not conduct business with its controlled foreign affiliate when it provides capital and exercises corporate oversight. The SCC also rejected the Crown's argument that the financial institution exception had an anti-avoidance purpose or imposed a requirement for competitiveness. Acknowledging that there was no direct evidence that specifically spoke to the purpose of the arm's length requirement, the Court concluded that the purpose was the same as the FAPI regime overall: an attempt to balance the conflicting goals of preserving the ability of Canadian companies to compete abroad and preventing the erosion of Canada's tax base.

This ruling accords with longstanding SCC precedent, and with the prior published administrative practice of the CRA interpreting the financial institution exception. The interpretive approach taken by the Court also echoes the majority reasons in the context of tax treaty interpretation in the *Alta Energy* decision. Both decisions emphasize predictability and certainty as essential components of a well-functioning tax system. The decisions also stress the need to respect the deliberate policy choices made by Parliament, as reflected in the text, and by the context, of the relevant provisions.

The financial institution exception has been amended since the taxation years at issue in this case to restrict the class of Canadian taxpayers that can claim the exception. However, the decision has broader implications for tax planning because it offers guidance on how to approach the tension between interpreting tax provisions purposively while respecting their precise language. The decision also provides comfort to taxpayers that courts may take into account prior published administrative practices of the CRA in situations where the CRA tries to repudiate them at a later date.

The financial institution exception has been amended since the taxation years at issue in this case to restrict the class of Canadian taxpayers that can claim the exception. However, the decision has broader implications for tax planning because it offers guidance on how to approach the tension between interpreting tax provisions purposively while respecting their precise language.

Canada v. Deans Knight Income Corporation

Most recently, on October 4, 2021, the taxpayer sought leave to appeal the FCA's decision in *Canada v. Deans Knight Income Corporation*. This third case concerned the application of the GAAR to a tax loss monetization arrangement. The application for leave to appeal was accompanied by a letter of support from the Tax Executives Institute, which was intended to provide a "cross-industry voice to the choir of business taxpayers concerned about the newfound uncertainty" created by the FCA's decision.

The case involves the application of the loss restriction rules in subsection 111(5) of the Tax Act as well as the GAAR. Under the rule in subsection 111(5), if a person or group of persons acquires *de jure* control of a corporation, the corporation's use of losses incurred before that time is restricted. The Canadian courts have confirmed that *de jure* control, which is also known as effective control, means the acquisition of a majority of voting shares by persons in a position to vote them in common.

The taxpayer in this case was a Canadian public corporation with tax attributes comprising unused non-capital losses and other deductions. The taxpayer sought to monetize these tax attributes. To do so, it underwent a reorganization that "turned the reins" over to a venture capital company, Matco Capital Ltd. (Matco). However, Matco did not acquire *de jure* control of the taxpayer. Matco arranged for the taxpayer to complete an initial public offering (IPO), with the taxpayer using the funds raised from the IPO to commence a new business that generated profits against which the losses were claimed. As a result of the IPO, the taxpayer became widely held and no specific person or group of persons acquired voting control of the taxpayer.

The Minister assessed the taxpayer to deny the pre-IPO losses on the basis that they had been lost as a result of an acquisition of control of the taxpayer or, alternatively, that the GAAR applied to prevent the taxpayer from claiming them. The TCC disagreed with this assessing position. It determined that the policy of subsection 111(5) is "to target manipulation of losses of a corporation by a new person or group of persons, through effective control over the corporation's actions," and that Matco did not have effective control.

The FCA allowed the Crown's appeal and overturned the TCC decision. Despite acknowledging that the term "acquisition of control" in subsection 111(5) had been judicially determined to mean *de jure* control,[1] the FCA concluded that the policy of the provision required it also to apply where there has been an acquisition of "actual control." The FCA thus "rearticulated" the policy of subsection 111(5) as restricting "the use of specified losses, including non-capital losses, if a person or group of persons has acquired actual control over the corporation's actions, whether by way of *de jure* control or otherwise." Having made this determination, the FCA concluded that Matco had "actual control" of the taxpayer and, as a result, the GAAR applied.

As in *Alta Energy* and *Loblaw Financial*, the decision in *Deans Knight* considers arguments in which the Crown seeks to characterize the policy of specific tax provisions broadly by reference to economic realities and use that characterization to interpret the relevant text. The decision has been criticized in the tax community for the uncertainty caused by the FCA's adoption of a novel and undefined concept of "actual control" that is distinct from the two other control concepts – *de jure* (legal) and *de facto* (factual) control – which are used throughout the Tax Act and have a generally understood meaning.

The SCC will likely render its decision on whether leave should be granted in *Deans Knight* in 2022.

1 This generally means the ability, through the ownership of shares, to elect the majority of the board of directors.

Concluding observations

In *Alta Energy* and *Loblaw Financial*, our highest court has provided important guidance on the principles of statutory interpretation, both in the ordinary and GAAR contexts. Additional guidance may be forthcoming if leave is granted in *Deans Knight*. Given the fundamental role of statutory interpretation in tax cases, the direction received from the Court is likely to impact the scope of future disputes and tax planning.

AUTHORS

Pooja Mihailovich
Partner, Tax

pmihailovich@osler.com
416.862.6624

Mary Paterson
Partner, Litigation

mpaterson@osler.com
416.862.4924

TRADE

Trade regulation in 2021: A year of evolution

In many ways, maintaining the status quo was the defining feature of the 2021 trade landscape. There was a Canadian federal election, but very little changed, with the Liberal Party maintaining its minority government. Further, despite the significant impact of COVID-19 on individuals, supply chains and businesses worldwide, the Canadian government has indicated no intention to deviate from its existing trade policy goals as a result of the pandemic. Clear signals regarding trade policy in the post-pandemic "new normal" indicate that the government intends to continue implementing and expanding existing trade agreements, negotiating new agreements and expanding sanctions and human rights rules.

As the COVID-19 pandemic continued into its second year, businesses and governments became increasingly adept at navigating its challenges. Businesses should expect to continue adapting to these shifts in 2022, even as we begin to emerge from the pandemic.

CUSMA – One year on

Now that the Canada-U.S.-Mexico Free Trade Agreement (CUSMA) has been in force for over a year, the "ordinary course of business" under the agreement has begun to emerge. Our 2020 Legal Year in Review noted that the stability many had hoped CUSMA would bring to Canada-U.S. trade was short-lived. The Biden administration has maintained a measure of the protectionist rhetoric that was the hallmark of the prior regime, including

- the President's commitment to "buy American," which has been formalized with an Executive Order, dated January 25, 2021
- the U.S. House panel's proposed legislation to boost electric vehicle credits up to US$12,500 per vehicle, including additional credits of US$4,500 for union-made vehicles produced in the U.S. and US$500 for batteries made in the U.S.; starting in 2027, vehicles would need to be assembled in the U.S. to qualify for these tax credits
- the President's pledge that he will maintain the tariff protections for the steel and aluminum industries imposed by the Trump administration

In the face of these initiatives, the Canadian and U.S. governments have discussed exemptions to certain of the measures which would allow Canadian companies to retain access to U.S. government contracts.

As is the case with any new trade agreement, a detailed understanding of how it will be implemented is still developing. For example, Canada has joined Mexico in seeking formal consultation with the U.S. with regard to the interpretation of content rules for automobiles set out in the agreement. Further clarity regarding the practical impacts of CUSMA's implementation should come over the course of 2022. In the interim, statements from U.S. officials continue to signal a protectionist approach in the near term.

Further clarity regarding the practical impacts of CUSMA's implementation should come over the course of 2022. In the interim, statements from U.S. officials continue to signal a protectionist approach in the near term.

Trade disputes

The most significant change between CUSMA and the North American Free Trade Agreement (NAFTA) (its predecessor agreement) is the abolishment of the dispute provisions under NAFTA's Chapter 11. As a result, private citizens and businesses will soon no longer have standing to bring claims under the treaty.[1] Private investors can bring NAFTA legacy disputes for a three-year period, which began to run when CUSMA came into force on July 1, 2020.

Legacy disputes under NAFTA (including Chapter 11 disputes and other state-to-state disputes) remain ongoing. Notably – consistent with the protectionist rhetoric mentioned above – 2021 saw a new chapter in the decades-old softwood lumber dispute between Canada and the U.S. As discussed by Minister Ng in her statement, the U.S. Department of Commerce concluded the second administrative review of its anti-dumping and countervailing duty orders on certain softwood lumber products from Canada in May 2021. As a result of this review, the U.S. doubled tariffs on Canadian softwood lumber imports.

1 Private citizens continue to have rights under foreign investment treaties and private contracts (i.e., arbitration clauses).

Only state-to-state disputes are permitted under CUSMA. In May 2021, the U.S. advanced the first such state-to-state dispute when it called for the establishment of a dispute panel to review measures announced by the Canadian government in June and October 2020 and May 2021 that allegedly undermined the ability of American dairy exporters to sell a range of products to Canadian consumers. Specifically, the U.S. is challenging the allocation of dairy tariff-rate-quotas (TRQs) and in particular the setting aside of a percentage of each dairy TRQ exclusively for Canadian processors. As the first dispute advanced under the new agreement, this matter may provide important insight into what investors can expect from the dispute resolution process under CUSMA going forward.

Canadian courts remain stalwart in their deferential approach to the review of decisions of trade tribunals constituted under free trade agreements. As we wrote earlier this year in our blog post on osler.com, United Mexican States v. Burr reinforces hesitance of Canadian courts to overturn decisions of international tribunals, the Ontario Superior Court's July 20, 2020 decision in *Mexico v. Burr* affirmed that Canadian courts will be loath to overturn the decisions of such trade tribunals. In this case, a number of U.S. investors brought a claim against the Mexican government in response to its decision to shut down their casinos in Mexico. The International Centre for Settlement of Investment Disputes tribunal dismissed the Mexican government's jurisdictional challenges and issued a partial award in favour of the investors. Whether constituted under the former NAFTA or another trade agreement, domestic review of decisions of international tribunals remains subject to a highly deferential standard of review. Canadian investors should consider such barriers when determining whether and how to appeal such decisions.

Sanctions and human rights: An evolving framework

Numerous developments in Canadian sanctions and human rights law occurred in 2021. Expansions in both spaces appear to be part of a broader trend to support internationally responsible conduct on the part of businesses. Individuals and entities doing business in Canada and Canadian entities doing business abroad should be mindful of the ever-evolving sanctions framework, particularly the government's increased focus on human rights and ethical business practices.

The Canadian government has both imposed new sanctions and expanded existing frameworks. Specifically, in 2021, Canada took the significant step of imposing new sanctions against China for human rights violations committed in the Xinjiang region. The sanctions, implemented under the *Special Economic Measures Act*'s new China Regulations, prohibit dealings in the property owned, held or controlled by the four designated individuals and one designated entity. Every person has an obligation to report to Canadian law enforcement if they have reason to believe that they have such property in their possession or control. As the U.S. has now dropped the charges against Huawei CFO Meng Wanzhou, and Canadians Michael Kovrig and Michael Spavor have been released from Chinese detention, it remains to be seen what 2022 holds for Sino-Canadian relations. The Canadian government has not yet made a decision about whether Huawei will be permitted to sell 5G equipment in Canada. Canada's allies (the U.S., Australia and the UK) have all banned such sales.

The Canadian government also expanded the scope of existing sanctions against Crimea, Russia, Belarus and Myanmar, designating additional individuals and entities under existing regulations. For more information on certain of these sanctions, please see our blog posts on osler.com, Canada's expanded, sector-specific sanctions on Belarus and Canada joins the U.S., E.U. and U.K. in sanctioning Chinese officials over the treatment of Uyghur Muslims.

Further, there have been clear signals that the government expects that Canadian businesses will operate ethically abroad. As we wrote in our blog post on osler.com, New Canadian foreign investment promotion and protection model expands responsible business conduct provisions, the Canadian government has released a new model Foreign Investment Promotion and Protection Agreement (FIPA) intended to serve as a basis for future investment negotiations with foreign counterparties. The model FIPA expands provisions encouraging parties to comply with domestic and international human rights and responsible business conduct standards. The Canadian government has also proposed modern anti-slavery legislation (Bill S-216) that would impose reporting requirements on various entities involved in the manufacture of goods in Canada or elsewhere, or in the importation of goods into Canada. These reporting requirements relate to the steps that the entity has taken to prevent and reduce the risk that child labour or forced labour has been used at any stage of the production of goods in Canada or elsewhere, or of goods imported into Canada.

These developments are part of a clear trend towards encouraging businesses operating in Canada and Canadian businesses operating abroad to conform with international and domestic human rights rules and norms.

These developments are part of a clear trend towards encouraging businesses operating in Canada and Canadian businesses operating abroad to conform with international and domestic human rights rules and norms.

Another Trudeau term: A new era of trade agreements?

Now that CUSMA, the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), and the Canada-European Union Comprehensive Economic and Trade Agreement (CETA) are in force and are being implemented, the frameworks for Canada's trade relationships with its largest partners have become increasingly entrenched. The global movement toward increasingly formalized trade relationships with larger trading blocs through agreements that are broader in scope than the WTO agreements continues. Among other developments along these lines, both the U.K. and China have applied to join the CPTPP. In addition, the Canadian government has made the pursuit of bilateral trade agreements with Asia-Pacific and South American nations (particularly the Mercosur group) a key goal of its international trade agenda. The government has also announced plans to create a federal "hub" so businesses can benefit from international trade agreements. With the current Liberal government having been re-elected with another minority government in September, these policies are likely to continue in the near term.

Businesses should expect to continue to operate within these formalized agreements and to monitor their implementation and interpretation, which should clarify the "rules of the game." Individuals or entities with specific interests should consider whether and how best to communicate concerns to government to ensure their interests are considered as new agreements are negotiated and implemented.

As businesses and governments continue to adapt and learn to operate as we emerge from the pandemic, trade law will necessarily evolve. Businesses have faced a range of challenges in the past year, particularly as supply chains remain disrupted. Government policy goals – particularly, in 2021, the promotion of free trade, human rights and sanctions enforcement – will only increase the compliance burden for businesses operating internationally as we move into 2022. It will therefore be important to obtain expert advice on how best to navigate the challenges presented by this evolving landscape.

AUTHORS

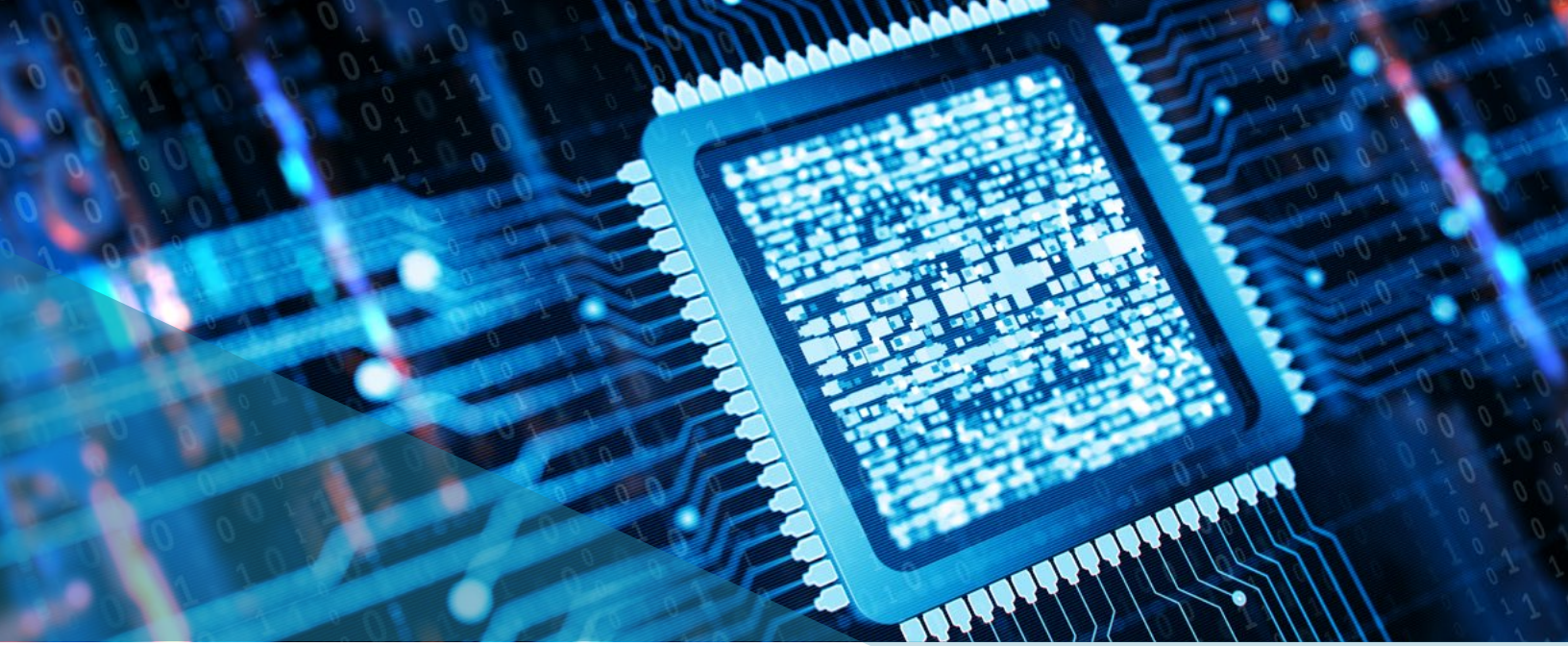
Alan Kenigsberg
Partner, Tax
akenigsberg@osler.com
416.862.6659

Malcolm Aboud
Associate, Litigation
maboud@osler.com
416.862.4207

Gajan Sathananthan
Associate, Competition/ Antitrust and Foreign Investment
gsathananthan@osler.com
416.862.4287

Chelsea Rubin
Associate, Competition/ Antitrust & Foreign Investment
crubin@osler.com
416.862.4852

Sarah Firestone
Associate, Litigation
sfirestone@osler.com
416.862.4727



INTELLECTUAL PROPERTY

Time to talk about ownership of AI-generated intellectual property assets

Systems for protecting intellectual property (IP) have been in place since the Middle Ages, encouraging skilled, innovative technicians by granting monopolies within particular industries. For hundreds of years, intellectual property policy has been driven by the imperative of rewarding the human creativity or ingenuity that brings new creative works and useful inventions to society, in exchange for disclosure of those works and inventions to further foster progress – the so-called "bargain."

The advent of machine-learning and modern artificial intelligence (AI) is now challenging this paradigm. Computers have become more powerful and as they acquire higher-order brain function through machine-learning, they have developed the capacity for activity that humans would otherwise consider original or inventive, creating works worthy of copyright protection and inventions worthy of patents. Quantum computers are guaranteed to accelerate this trend.

But who owns these in silico creations? The answer is far from clear, in part owing to the competing policy goals underpinning IP systems. Though IP protection is designed to reward humans for their creativity and ingenuity to foster such behaviour, so too is IP protection designed to advance technological progress irrespective of how it arises. IP statutes are designed by humans for humans – but must it be so?

The past year has brought this issue to the forefront, in the fields of both patent and copyright.

Though IP protection is designed to reward humans for their creativity and ingenuity to foster such behaviour, so too is IP protection designed to advance technological progress irrespective of how it arises.

Patents: Can AI be an inventor?

In 2021, we saw the first global court decisions to grapple with whether a non-human can be an inventor for the purposes of patent law. A patent application having an AI inventor named DABUS (Device for Autonomous Bootstrapping of Unified Sentience) has been filed in 17 countries. DABUS was created by Dr. Stephen Thaler and he is stated to be the owner of the patent applications. Patent offices have been forced to determine whether a patent can be issued with DABUS as the named inventor. So far, four countries have weighed in, with mixed results.

In July 2021, DABUS scored two wins. First, the South African Patent Office issued a patent listing DABUS as inventor, although no reasoning was provided because South Africa grants patents without substantive examination (and this patent remains subject to court challenge).

Shortly after, the Federal Court of Australia came to the same result under Australian law, explaining that patent law contains no requirement that an inventor be human. The Australian Court was motivated by the need to promote and reward technological innovation, noting that the term "inventor" was undefined and its ordinary meaning (like other agent nouns, such as "computer" or "dishwasher") does not exclude non-humans. After concluding that DABUS was the inventor, the Court found that Dr. Thaler was the invention's owner because he derived title from the inventor, DABUS. To reach this result, the Court reasoned that it was not necessary that an inventor be a legal person capable of assigning rights to conclude that an owner's title has been "derived" from the inventor in accordance with the Australian *Patents Act*. It will be interesting to see if this rationale justifying the assignment of rights from a non-human inventor to a human assignee will be applied in other jurisdictions.

Courts in the United Kingdom and United States have come to a different conclusion on the inventorship issue. The U.K. Court of Appeal concluded that the character and obligations of an inventor necessitate that they be human. Machines lack legal personality and cannot have rights, nor can they transfer rights to their owners. A machine cannot offer a statement that it is the true inventor of an invention. In the United States, the U.S. District Court for the Eastern District of Virginia pointed to the definition of an inventor in U.S. patent law as being an "individual," which must be a "natural person" under U.S. law, and to the human-oriented requirement of an inventor to indicate their "belief" regarding their inventorship.

No Canadian authority has yet weighed in on this issue, although as Canadian patent law is modeled most closely on U.S. and U.K. law, it stands to reason that the perspectives in those jurisdictions will carry weight in any future case. However, like in Australia, there is no definition of "inventor" in Canada's *Patent Act*.

Copyright: Can AI be an author?

AI also raises novel issues with respect to copyright, including on the question of authorship and ownership of works generated by AI. Under current copyright law in Canada, it is unclear whether AI-generated works are protected by copyright. Copyright protects works that are the product of the exercise of an author's skill and judgment. The default rule is that the author is the first owner of copyright (subject to certain exceptions). There is no definition of "author" in Canada's *Copyright Act*, but copyright jurisprudence suggests that an author must be a natural person.

AI systems are now capable of creating works that are generated – to some degree or even entirely – independent of human intervention. This development challenges established legal doctrine which has understood and defined authorship as an act of expression originating from a human being. Whether AI-generated works are protected by copyright, and if so, who owns legal rights to the work, is an important issue with implications for public policy and the Canadian economy.

Whether AI-generated works are protected by copyright, and if so, who owns legal rights to the work, is an important issue with implications for public policy and the Canadian economy.

In July 2021, the Government of Canada published a consultation paper soliciting submissions on, among other things, a modern copyright framework for AI in Canada. With respect to authorship and ownership of AI-generated works, the consultation paper suggested three possible approaches:

- The first approach is to make entirely AI-generated works ineligible for copyright protection. This approach reflects the state of the law in a number of countries, including Australia, where (unlike for patented inventions) copyright only protects works produced by a human author, not machine-generated works.
- The second approach is to attribute authorship to the human or humans who arranged for the creation of the work (but not to the AI that actually created the work). This approach to AI-generated works has been implemented through legislative changes in several common law jurisdictions, including the United Kingdom, Ireland and New Zealand.
- The third approach is to permit copyright protection of AI-generated works, but to consider them to be "authorless." Under this approach, presumably no moral rights would attach to AI-generated works, meaning that no individual would have the right to have their name attributed to the work as the author or to preserve the integrity of the work.

While adopting any of the above approaches would help to clarify legal rights to AI-generated works under Canadian law, each one has significant economic and public policy implications. This is particularly the case given the importance of AI in the modern economy and the public interest in promoting AI development and use in Canada. It remains to be seen which approach Canada will adopt.

Implications of increasing recognition of AI-generated IP

Important consequences flow from the decision whether to formally recognize and reward AI-generated creations within intellectual property systems.

If AI-powered service providers cannot protect their creations, they will lack bargaining power in commercial arrangements. In that situation, commercial affairs will need to be structured to involve human contributions as a basis to assert or obtain copyright or patent protection. If patent and copyright systems are seen as inadequate, businesses may also choose to preserve their innovations as trade secrets rather than publicly disclosing their IP. Differences between jurisdictions will complicate these business assessments.

Conversely, if AI-generated creations are eligible for patent or copyright protection, then owners of the most powerful AI will be empowered to seize control of whole areas of IP, potentially triggering an IP arms race, pitting humans against machines. At this early stage, where AI is only occasionally inventive, it is difficult to truly imagine where this empowerment may lead.

Canadian IP policy decisions on AI-generated creations are likely to be driven by the desire to attract, rather than deter, investment into AI research and development in Canada. These decisions will demand thoughtfulness and creativity, and (we dare say) a human touch.

AUTHORS

Nathaniel Lipkus
Partner, Intellectual Property
nlipkus@osler.com
416.862.6787

Barry Fong
Partner, Intellectual Property
bfong@osler.com
613.787.1097

J. Bradley White
Partner, Intellectual Property
bwhite@osler.com
613.787.1101

Ryan Howes
Associate, Intellectual Property
rhowes@osler.com
613.787.1021

Leah McGurn
Associate, Intellectual Property
lmcgurn@osler.com
613.787.1023

TECHNOLOGY

Acquiring an AI business – Not your typical tech transaction

The race for leadership in artificial intelligence (AI) technology picked up speed in the past year. Multinational and domestic players were relentless in their quest for game-changing AI-enabled solutions and the accompanying talent, including leading data scientists and experienced machine learning engineers. While development and refinement of AI technologies still represent an important growth area for these issuers, growth through acquisition was certainly a noticeable trend in 2021 – one that we anticipate will continue to intensify in the coming years.

The past year also brought into focus how the acquisition of an AI company raises unique risks for purchasers that, in many respects, differ from those in transactions involving traditional technology and software companies. These risks require a re-thinking of legal due diligence and allocations of risk in purchase agreements. Given the novelty of these types of transactions, expertise in AI acquisitions is still developing and purchasers should ensure that they have professional advisors with the best experience and knowledge available to protect themselves.

Why acquisitions of AI companies require new thinking

The starting point for providing effective legal advice on any M&A transaction is to understand the client's business rationale for making the acquisition. Without insight into how the client values the target's assets, it is challenging to ensure that client's interests are protected through both the purchase agreement and the legal due diligence that informs it. In the case of all technology transactions, it is critical to understand how the target's technology assets will be used by the purchaser.

For a traditional technology company, the primary strategic asset is usually its software. Understanding software-driven businesses and the risks that need to be investigated in these businesses in connection with an acquisition transaction is a well-trodden path. In undertaking due diligence with respect to software, it is typical for the purchaser and its professional advisors to undertake a deep dive into the target's software code and software development practices, focusing on intellectual property and data security. This often includes assessing the target's use of open source software and the presence of software bugs and security vulnerabilities. These considerations are also reflected in multiple elements of the transaction purchase agreement, including in software-focused representations and warranties, indemnities and closing conditions.

Unlike a software business, the core value of an AI company is often found in the company's rights to datasets and the proprietary models that are used to ingest and analyze the data. It is the combination of data and these models that enables computers to mimic human intelligence and learn over time as they train themselves to perform increasingly complex tasks. Although an AI company may have developed proprietary software, such as a user interface to present the analysis performed by the company's models, the code for the software usually performs a function that is only ancillary in its value to the company's primary business.

Understanding the different drivers of value for AI companies is critical in the context of M&A transactions as these drivers change the nature of the purchaser's focus. Similarly, advisors seeking to protect their purchaser clients need to appreciate this distinction in order to provide the right advice.

Understanding the different drivers of value for AI companies is critical in the context of M&A transactions as these drivers change the nature of the purchaser's focus. Similarly, advisors seeking to protect their purchaser clients need to appreciate this distinction in order to provide the right advice.

When assessing an AI target from a due diligence perspective, the purchaser and its advisors must adopt an approach that reflects the value of the target's dataset and proprietary models. Rather than emphasize looking at software development and data security issues, purchasers must expand their focus to include the target's rights to own and use data, the target's ownership of proprietary models and improvements, the "outputs" of the models and the company's practices to train, improve, test, maintain and explain such models. Investigating complex datasets and models from a legal diligence perspective requires a thorough knowledge of the construct and use of these assets in a manner that differs significantly from traditional technology acquisitions. Given the rapidly expanding uses of AI, knowledge of privacy considerations is also critical.

Once a purchaser and its advisors have sufficiently assessed the underlying assets and risks, and conducted thorough diligence on the target, these findings must be appropriately reflected in the transaction purchase agreement. It is important that a purchase agreement for an AI business be tailored to address AI and its unique attributes and risks. Although each transaction needs to be considered individually, there are a number of key considerations that should be addressed.

In particular, definitions require careful crafting to ensure that the agreement sufficiently captures relevant characteristics of artificial intelligence. For example, definitions focused on "AI technology" should be drafted sufficiently broadly to capture both techniques that enable computers to mimic human intelligence, including deep learning, machine learning and algorithms that make use of or employ neural networks, statistical learning algorithms or reinforcement learning, and software and hardware used to train, test and deploy the AI solution.

In preparing representations and warranties regarding the business, the purchaser should seek comprehensive disclosure and protection through reps and warranties that, among other considerations that may be identified through diligence, address

- ownership of, and rights to use, AI models and datasets, including those that are both owned and licensed
- the quality of the company's datasets, including the degree of completeness, consistency and accuracy
- the company's practices relating to the testing, improvement and development of AI models
- responsible use and ethical design of AI, including testing for bias or other harmful impacts
- use of facial recognition or other high risk use-cases that leverage AI
- the allocation of AI-related liability in agreements with suppliers and customers
- compliance with laws and industry standards and practices applicable to AI

These representations and warranties require particular attention to ensure that all aspects of the AI business are subject to comprehensive disclosure. Appropriate care needs to be taken in preparing indemnification provisions in the purchase agreement to appropriately balance liability. Particular consideration should be given to whether the quantum of the "hold-back" should be increased or the timeframe for paying out the hold-back extended.

Looking to the future

Over the past year, sophisticated purchasers have demonstrated their willingness to invest time and resources into following best practices for AI acquisitions as they seek to grow their ownership of these assets. This includes having their professional advisors explore the nuances of AI as part of the diligence process and tailoring purchase agreements to reflect their findings. We expect this trend to continue, given the significant growth in AI-focused businesses, the significant growth in AI M&A and ongoing demand and competition for assets and talent. We also expect that purchasers of AI companies will increasingly seek to engage sophisticated legal counsel who have a comprehensive understanding of AI and how to protect their clients' interests.

AUTHORS

Michael Fekete
Partner, Technology
National Innovation Leader

mfekete@osler.com
416.862.6792

Sam Ip
Associate, Technology

sip@osler.com
416.862.5955

Shira Dveris
Articling Student

sdveris@osler.com
416.646.3946

LEGAL INNOVATION

Lawyers and the AI knowledge gap

While lawyers increasingly recognize the importance of legal technology, and specifically artificial intelligence (AI), for efficient and effective client service, there remains a significant gap between the anticipation of the impact of technology and an understanding of the technology itself. In the recent Future Ready Lawyer report, 70% of responding lawyers in corporate legal departments noted that AI will have an impact on their organization in the next three years. However, only 28% of respondents indicated that they understand AI technology very well. A similar gap in knowledge was found among responding lawyers at law firms.

In this article, we hope to reduce that knowledge gap by way of a practical review of some common legal work that can be supported by AI tools readily available today, much of which can be applied in contracting, a core component of any legal department.

What is AI?

AI can be described as the use of computers and software to replicate human decision making. This could range from the automation of simpler tasks to the exercise of human-like judgment. AI in legal practice today has recently been described as "better search and find" and "'Control + F' on steroids," including when applied to the review of contracts. This highlights both the power of AI and its current limitations in the context of legal work.

How is AI commonly applied to contracts today?

The most common and effective applications of AI to contracts today are at the beginning and end of the contracting cycle. At the beginning, AI assists in the creation of first drafts (for example, through tools such as Contract Express, HotDocs, GhostDraft (Korbitec) and Leaflet). AI can be equally useful in the review of completed contracts (for example, through tools such as Kira Systems, eBrevia, Diligen and Luminance).

Document automation tools can be used to assist in the generation of first drafts of contracts. Beginning with appropriate template documents, various fields can be "coded" to prepare them for use – these effectively provide placeholders for users to apply common provisions in contracts that change. Once coded, the contracting tool receives values for each field from users, often through the completion of a pre-set form. Those values are then compiled into the coded template to complete a draft agreement. Though not often included as an example of AI, these tools replicate basic human decision making and automate related tasks.

The use of AI to support human review of completed contracts is now commonplace. The strength of these tools is in finding and categorizing requested types of clauses. A subject matter expert can then more easily review the identified clauses and exercise judgment. The time, cost and resources required to "manually" complete due diligence in transactions were the primary business drivers for the development of these AI-based contract review tools. There are now many commercially available tools that are pre-trained "out-of-the-box" to identify hundreds of common contract clause types, in many cases more quickly and accurately than human-only review. To varying degrees, these tools can also be trained by users to identify new types of clauses.

Common application of these tools is expanding beyond transactional due diligence. For example, large document sets can be reviewed to collate clauses for future contract drafting or to bring forward clauses for downstream contract management purposes. Data regarding contracts can be collected over time, providing risk profiles and informing future contract negotiations.

AI can be described as the use of computers and software to replicate human decision making. This could range from the automation of simpler tasks to the exercise of human-like judgment.

Developing use cases: contract review and negotiation

AI tools to support the pre-execution review and negotiation of contracts are becoming more readily available. AI tools can carry out a variety of baseline proofreading activities, reviewing cross-references, defined terms and definitional uses. Newer, more complex applications review clauses in a contract under negotiation to show variances from preferred forms of clauses. Optional language can be suggested for clauses varying from a standard. Automated comments or "redlines" of a document can be generated for user review.

In this way, AI tools are moving up the value chain to support more judgment-oriented contract work. From a practical perspective, tools for this phase of contracting initially focused on high volume commercial contracts (such as non-disclosure agreements). Increasingly, this technology can be applied to a variety of other contracts selected by the user. Whether AI tools are useful for a contract type may depend on whether there are enough suitable examples to enable the AI software to make valuable comparisons.

What are the benefits?

AI-supported contract assembly and review offer several potential benefits to users and their clients. The time required to draft and review contracts can be greatly reduced. This allows legal subject matter experts to focus on the delivery of higher value aspects of practice for their clients. AI contract generation can also reduce the overall cost of contract work. AI tools have been shown to complete tasks with greater accuracy relative to human-only review. Incorporating AI in contract review can reduce risk of error, thereby increasing client satisfaction. And an added benefit of having the support of technology to complete what are often the more mundane aspects of contract work is that it makes for happier practitioners.

Humans and AI robots

Hopefully, it is now trite to ask whether robots will replace lawyers, and equally trite to counter that they will not. Where a clear-cut decision-making process can be automated, it should be; this is not "lawyering" *per se*. However, most legal work in which clients see higher value requires that judgment be exercised, often in contexts not yet easily accounted for by AI. Common AI contract review tools can spot indemnity provisions in multiple locations in a contract, but judgment of a legal professional is required to assess the contextual risk to a client. The value proposition of AI in law is to enable legal professionals to more quickly and accurately complete certain complex high-volume work as well as common repeatable tasks. The measure of success for AI in legal is whether it enhances the delivery of client service by the legal subject matter experts themselves.

Streamlining legal work is effectively a process improvement project. Like any technology, AI is simply a tool to help improve a process. Before engaging with technology, users should ensure they have a clear understanding of existing processes and desired improvements. Automating a flawed process may amplify inefficiencies. If AI technology is the right tool, users can expect to invest significant upfront time and expertise in configuration, in addition to the cost of licensing the technology. Even the simplest use case for document automation technology requires considerable work to prepare templates for automation. Anticipated gains in efficiency must be measured against upfront investment.

Maximizing return on investment from AI technology might also mean specialist staffing. When AI contract tools are used at scale, larger legal organizations and alternative legal service providers may have dedicated personnel with legal and technical expertise to use or support the use of the technology. Each tool has its own user interface, functionality and workflows which can generate greater value if the technology is used by an expert. At the same time, it is important that any specialists dedicated to this work also be well-connected to or integrated with the client service teams they support; they cannot exist in silos.

For some use cases, users may also have to make a significant investment in "training" or "feeding" AI technology at the front end. Commercially available tools for the AI supported review of contracts generally come ready or "pre-programmed" to identify certain contract clauses. To apply such AI tools to new clauses may require extensive training, including loading significant sample volumes into the tool. This may also require legal subject matter expertise to validate or correct the findings of the AI tool as it learns.

The number of samples required will vary depending on the use case. In the example of automated generation of comments noted above, 100 or more suitable contracts might be required to establish a standard or "playbook" from which consistently valuable comparisons or redlines can be generated. That number may be reduced over time through enhancements in the technology.

Like any technology, AI is simply a tool to help improve a process. Before engaging with technology, users should ensure they have a clear understanding of existing processes and desired improvements.

Humans aren't perfect, neither is software

Like humans, software systems are imperfect. AI tools considered "market ready" do not perform perfectly. This is acceptable, provided users understand their limitations. When lawyers hesitate to use AI, it is sometimes because they believe the outputs should be perfect; but this isn't (and can't be) a practicable objective. Legal professionals are beneficiaries of efficiency gains in their capacity as users of AI review tools, but they also play a quality assurance role.

Users should expect to work closely with legal technology companies to understand and refine applications of AI. Lawyers should also be transparent regarding the use of AI tools with their clients.

Looking ahead

Though the group of professionals in the legal industry who need to be functional experts in AI can be small, a critical mass of lawyers who are versant in the possibilities and limitations of AI in the legal space is necessary for AI to become more widely adopted (and for organizations to reap the benefits). While change management will be no mean feat for organizations in implementing AI technologies, scaling that mountain now will ensure that legal departments and their clients will improve their centralized data and be better prepared for the other uses of AI that may be coming.

Additional information regarding a number of these and other legal technology tools can be found at the Legal Technology Hub.

AUTHORS

Simon Wormwell
Chief Knowledge
& Innovation Officer

swormwell@osler.com
416.862.6720

Gillian S.G. Scott
Partner, Innovative
Products

gscott@osler.com
416.862.4872

About Osler, Hoskin & Harcourt LLP

Osler is a leading law firm with a singular focus – your business. From Toronto, Montréal, Calgary, Ottawa, Vancouver and New York, we advise our Canadian, U.S. and international clients on an array of domestic and cross-border legal issues. Our collaborative "one firm" approach draws on the expertise of over 450 lawyers to provide responsive, proactive and practical legal solutions driven by your business needs. For over 150 years, we've built a reputation for solving problems, removing obstacles, and providing the answers you need, when you need them.

It's law that works.

Osler, Hoskin & Harcourt LLP
Toronto Montréal Calgary Ottawa Vancouver New York | **osler.com**

OSLER