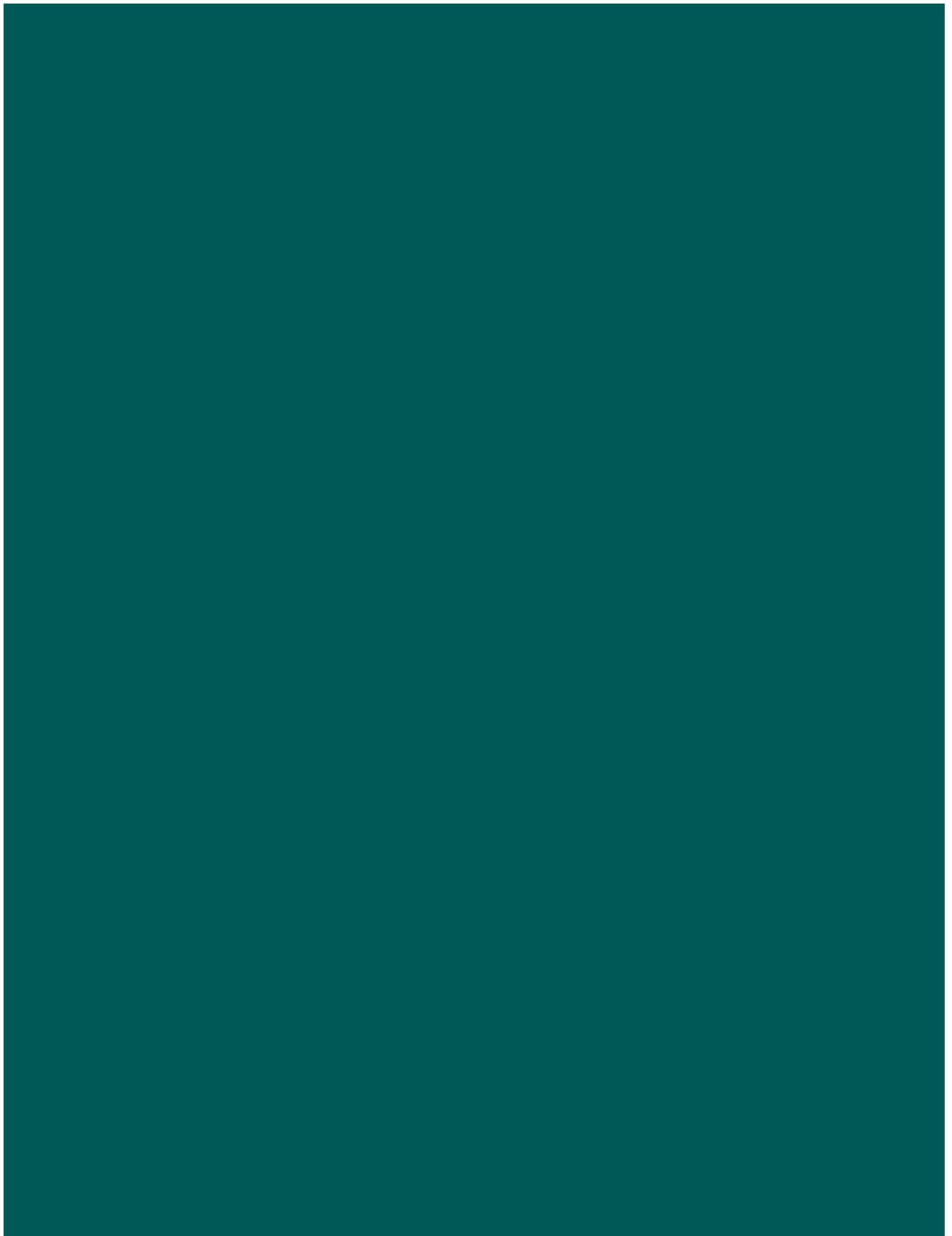

LEGAL YEAR IN REVIEW

Osler's insights on key developments
in 2014 and their implications for
Canadian business.



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Osler's insights on key developments in 2014 and their implications for Canadian business.

As 2014 comes to a close, we want to share with our clients and friends our observations on the most significant legal developments affecting Canadian business over the past year and their implications for 2015 and beyond.

Four securities regulatory developments in 2014 warrant special attention:

- The Canadian Securities Administrators (CSA) proposed a new “permitted bid” take-over regime, which will give boards of directors more time to respond to hostile take-over bids.
- The CSA made revisions to their original proposed revamp of the early warning rules, including the decision, at the urging of institutional investors, not to lower the early warning reporting threshold from 10% to 5% – the reporting threshold in the United States and many other jurisdictions.
- Following in the footsteps of the U.S. Commodity Futures Trading Commission and the European Securities and Markets Authority, securities regulators in Ontario, Québec and Manitoba now require the reporting of over-the-counter (OTC) derivatives transactions – including interest rate swaps, equity swaps, credit swaps, foreign exchange forwards and most cash-settled commodity derivatives.
- The federal government and five provinces – Ontario, British Columbia, Saskatchewan, New Brunswick and Prince Edward Island – entered into a memorandum of agreement to create a new common securities regulator and new draft provincial and federal securities legislation was published for comment.

Shareholder activism continued to influence deal making, in turn driving responses from regulators and courts. In arguably the most innovative M&A deal development of the year, Bill Ackman’s Pershing Square, an activist hedge fund, teamed up with our client Valeant in making a merger proposal to Allergan and, after being rebuffed, an unsolicited joint exchange offer. To our knowledge, this is the first time that an activist investor has made a joint offer with a strategic acquiror for a public company. The door may now be open to a wider array of transactions involving an activist investor/strategic acquiror combination.

Activism has also drawn attention to the use of “voting pills” – shareholder rights plans that are designed to thwart activists from entering into voting agreements with other shareholders. The intervention by the Ontario Securities Commission (OSC) in a proxy contest by our client Access Holdings against Tuckamore Capital Management may have implications for the continued viability of voting pills.

A court ruling in the proxy contest between Smoothwater Capital and Equity Financial has resulted in a more level playing field for management in responding to dissident attacks. In addition, in response to certain activist campaigns, including Mason Capital's unsuccessful challenge of our client TELUS's dual class share reorganization, the CSA's proposed early warning amendments disqualify activists engaged in proxy solicitation from using the alternative monthly reporting regime.

A number of this year's most important corporate governance developments, such as the regulation of proxy advisory firms, majority voting for directors and advance notice by-laws, can also be seen as a by-product of shareholder activism. Other noteworthy corporate governance developments are new requirements to disclose the number of women on boards of directors and in senior management as well as boards' increasing focus on issues of cybersecurity following some highly publicized data breaches.

Directors will want to pay attention to the Ontario Court of Appeal's ruling in *Unique Broadband Systems, Inc. (Re)*, which reminds directors of the courts' acute sensitivity to director conflicts and of the need for directors to be scrupulous and diligent in their deliberations in order to avoid personal liability.

The Supreme Court of Canada released three landmark rulings affecting Canadian business:

- In *Bhasin v. Hrynew*, the Court recognized a new duty on parties to perform contractual obligations honestly. The Court's general recognition of good faith contractual performance in all contracts, and the specific requirement to perform contracts honestly, is a change in the law in most areas of Canada (other than Québec). It remains to be seen whether the effect of this decision on commercial contracts will be significant or whether the change is truly "incremental," as the Court stated – although as a result we certainly expect plaintiffs to make arguments about bad faith with increasing frequency.
- *Tsilhqot'in Nation v. British Columbia* is now the definitive case on aboriginal title in Canada, with significant implications for the development of natural resources projects.
- *Bank of Montreal v. Marcotte*, a federalism case over consumer protection issues involving banks, could have major implications for other federally regulated industries and continues the Court's recent trend in construing federal power narrowly. The joint federal-provincial common securities regulator initiative is a direct response to the Court's decision in 2011 that the federal government does not have the jurisdiction to pass comprehensive securities legislation in Canada.

Canada suffers from a reputation for lax enforcement of white collar crimes. In the past year, prosecutors continued to struggle with the prosecution of insider trading cases. The OSC staff lost its highest profile case against two mining executives in a hearing related to the trading

of shares of Baffinland Iron Mines Corporation (*Re Jowdat Waheed and Bruce Walter*) and the Alberta Court of Appeal's decision in *Walton v. Alberta (Securities Commission)* established evidentiary hurdles that make such prosecutions harder.

With a view to freeing up resources to prosecute cases more efficiently, the OSC has introduced "no-contest" settlements for the first time in Canada. These types of settlements have long been a fixture of SEC proceedings in the United States.

In the wake of international criticism, Canada has cracked down on foreign corrupt practices, resulting in an increasing number of investigations and prosecutions, including criminal charges against several former SNC Lavalin executives.

Governments around the world took action against tax arbitrage in 2014, seeking to quell forum shopping. In response to a wave of "inversion transactions," the United States adopted regulations with a view to narrowing the range of eligible transactions and their potential benefits. We expect these constraints to have the practical effect of limiting the pool of eligible Canadian targets for U.S. corporations looking to engage in an inversion transaction. The OECD/G20's Base Erosion and Profit Shifting (BEPS) project is considering changes that could fundamentally alter the global tax system, including the tax rules applicable to inbound and outbound investment from Canada.

We examine each of these developments and their implications in the *Legal Year in Review*. We would be pleased to discuss them with you.

It's About Time – CSA Proposes Amended Take-Over Bid Regime

The Canadian Securities Administrators (CSA) announced that they intend to publish for comment amendments to the take-over bid regime in the first quarter of 2015. These amendments will significantly increase the amount of time afforded to a target company to respond to a hostile bid, effectively resulting in a 120-day “permitted bid” regime.

(For more information, refer to our Update entitled “Canadian Securities Administrators Propose Significant Amendments to Take-over Bid Regime” on osler.com.)

The proposed amendments include the following:

- All non-exempt take-over bids in Canada (including partial bids) will be subject to a 50% minimum tender condition by shareholders other than the bidder and its joint actors.
- There will be a mandatory 10-day extension after the minimum tender condition is satisfied.
- There will be a 120-day minimum bid period, subject to the ability of the target board to waive, in a non-discriminatory manner when there are multiple bids, the minimum period to not less than 35 days.

These changes will provide the board of directors of a target company with more time to respond to a bid. Providing target boards with more time to respond can result in enhanced shareholder value, as illustrated by Osisko Mining’s complicated yet successful defence against Goldcorp’s unsolicited bid in January of this year. Approximately 79 days after the original Goldcorp announcement, Osisko announced its initial white knight deal with Yamana Gold, and 14 days later announced its successful three-way transaction with Yamana Gold and Agnico Eagle at a premium to the Goldcorp offer.

Similarly, in the year’s most followed M&A story, time (in this case seven months) was a critical factor in the Allergan/Valeant-Pershing Square face-off, which resulted in an approximately 70% increase in Allergan’s share price between the time of the initial toehold acquisition by the Pershing Square-Valeant vehicle and the

announcement of the proposed white knight transaction by Actavis. Although Canadian hostile bid timelines will remain more certain and shorter than those generally seen in the United States, we believe the proposed amendments are a positive step.

There are still some unanswered questions about how the new regime will work in practice. The CSA have not explicitly addressed how rights plans will be treated, although it is generally expected that absent unusual circumstances, rights plans will be cease traded following a “50-10-120” bid, which will result in greater certainty as to the timing of bids. We expect that rights plans will still be used to protect against exempt creeping bids (e.g., through the market purchase and private agreement exemptions).

The proposed amendments also do not clearly address by how much the hostile bidder can shorten the 120-day minimum bid period after the target company enters into a white knight deal. For example, if a 120-day hostile bid is made and subsequently a 35-day white knight bid is launched with approval from the board of directors of the target company on day 20 (expiring on day 55), can the hostile bidder shorten its bid to 35 days and maintain a timing advantage or merely shorten its bid to 55 days to equalize timing with the expiry date of the white knight bid?

The timing implications for a hostile bidder if the target enters into a white knight voting transaction, such as an arrangement, are also not addressed in the CSA announcement. For example, if a 120-day hostile bid is made and a white knight arrangement is announced on day 20, with a shareholder vote scheduled for day 70, can the hostile bidder shorten its bid to 35 days to maintain a timing advantage? Will the hostile bidder be permitted to shorten the bid period to 70 days to equalize timing with the date of the target shareholder vote on the arrangement? Alternatively, must the hostile bidder keep its 120-day bid outstanding without the ability to shorten the bid period, resulting in a timing disadvantage?

We will be following market practice in the months ahead to determine how it will be affected – if at all – during the period before the proposed amendments are implemented (likely 6 to 12 months from now). For example, hostile bidders should consider making “permitted bids” in accordance with the target company’s

These changes will provide the board of directors of a target company with more time to respond to a bid, potentially resulting in greater shareholder value.

existing rights plan (typically requiring that the bid remain open for acceptance for 60 days). It will be interesting to see whether target companies with existing rights plans up for renewal at their next annual meeting will seek to amend their plans to provide for a 120-day “permitted bid.” If an issuer were to do so, it is unclear whether the leading proxy advisory firms would recommend that shareholders vote in favour of the renewal. Alternatively, would it be better for target companies to simply wait and adopt a 120-day tactical pill even if a 60-day permitted bid is made? Will the CSA agree to cease trade rights plans prior to 120 days after having uniformly agreed to a new 120-day permitted bid regime that merely awaits implementation? We look forward to the release of the detailed proposed amendments to ascertain the answers to these questions.

A More Modest Proposal – The CSA’s Proposed Amendments to the Early Warning Regime

The CSA provided an update on their proposed changes to the early warning regime in October 2014. The CSA have decided not to proceed with their original proposal to reduce the early warning reporting threshold from 10% to 5% of an issuer’s outstanding voting securities, a change that would have put Canada in line with the reporting threshold in the United States and many other countries. Activist investors and hostile bidders will still be able to accumulate toeholds of up to just under 10% without having to make public disclosure, maintaining their advantage in Canada as compared to the United States.

(For more information, refer to our Update entitled “CSA Provides Update on Proposed Changes to Early Warning Regime – Reporting Threshold Stays at 10%” on osler.com.)

In addition, the CSA are not proceeding with their original proposal to include “equity equivalent derivatives” – equity derivative positions that are substantially equivalent in economic terms to conventional equity holdings – when determining whether the early warning reporting threshold has been exceeded. The CSA’s original proposal 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.

The decision not to proceed with these proposed changes was driven in part by the fact that the overwhelming number of comments on the original proposals came from investors and advisors, as opposed to issuers.

Final amendments to the early warning regime are expected to be published in the second quarter of 2015, which will:

- Require disclosure of 2% decreases in ownership;
- Require disclosure when a shareholder’s ownership interest falls below 10%; and

The CSA have decided not to lower the early warning threshold from 10% to 5%.

- Make the alternative monthly reporting system unavailable to eligible institutional investors that intend to engage in certain kinds of proxy solicitation.

This last change will move the Canadian regime more in line with the United States and was likely influenced in part by Mason Capital's unsuccessful challenge of our client TELUS's dual class share reorganization, where Mason acquired 18.7% of TELUS's voting shares and only reported its position more than 50 days after the transaction was announced.

OTC Derivatives Regulation Comes to Canada

The largely unregulated nature of derivatives has been a source of controversy for many years, highlighted most famously by Warren Buffett's characterization of them in the 2002 Berkshire Hathaway annual report as "financial weapons of mass destruction."

In the wake of the 2008 financial crisis, governments around the world have embarked on a major effort to create new regulatory regimes capable of assessing and curbing the potential systemic risks posed by the enormous size and significant volatility of these instruments. After several years of public consultation and analysis, securities regulators this year unveiled the first major Canadian plank in this effort.

Following in the footsteps of the U.S. Commodity Futures Trading Commission and the European Securities and Markets Authority, securities regulators in Ontario, Québec and Manitoba now require the reporting of over-the-counter (OTC) derivatives transactions – including interest rate swaps, equity swaps, credit swaps, foreign exchange forwards and most cash-settled commodity derivatives. Reporting requirements for cleared transactions and transactions involving at least one dealer took effect on October 31, 2014. Reporting requirements for un-cleared transactions (i.e., not involving a dealer or clearing agency) will take effect on June 30, 2015.

The reporting rules are not perfectly harmonized, and it is unclear whether the remaining provinces and territories will adopt similar rules. Given the relatively high levels of commodity derivatives trading in Canada by Canadian energy and mining companies, there are many questions as to whether commodity derivatives with settlement optionality are reportable, and whether the energy and mining companies that trade commodity derivatives are dealers with dealer reporting obligations.

A significant number of Canadian companies actively trade derivatives, and the new reporting requirements will increase their compliance burden. However, increased transparency should improve the efficiency of derivatives markets. Regulators also suggest that reporting will enhance regulatory oversight of derivatives markets, including the identification of systemic risk and market abuse.

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We expect future derivatives rulemaking to introduce new requirements for dealer registration, mandatory clearing and electronic trading of derivatives. Also, Canadian regulators will likely be granted new surveillance and enforcement powers in respect of derivatives trading.

Strange Bedfellows – Activists as Joint Bidders

In arguably the most innovative M&A deal development of the year, Bill Ackman's Pershing Square, an activist hedge fund, teamed up with our client Valeant in making a merger proposal to Allergan. After being rebuffed, they launched a US\$46-billion unsolicited joint exchange offer. To our knowledge, this is the first time that an activist investor has made a joint offer with a strategic acquiror for a public company.

This structure is attractive for the activist since teaming with a larger strategic player validates the activist's call for change and increases the probability of completing a transaction at a premium to the activist's acquisition cost. From the strategic acquiror's perspective, the activist can provide capital, expertise in potentially contested situations and a vocal ally. Both the activist and the strategic acquiror can benefit from a toehold position. In this case, Allergan ultimately entered into a US\$66-billion white knight deal with Actavis, which resulted in Pershing Square earning a paper profit of approximately US\$2.2 billion on its 9.7% toehold and approximately US\$400 million for Valeant.

Recent litigation in the United States has raised the question whether Pershing Square violated U.S. tender offer laws in acquiring its toehold position. Although a California district court did not permanently enjoin Pershing Square from voting the shares it acquired at an impending Allergan shareholders' meeting – a significant victory for Pershing Square and Valeant – the court found that there was a serious question to be litigated as to whether there was a violation of U.S. tender offer laws.

Until there is a definitive ruling with respect to the application of U.S. tender offer laws in these circumstances, activists and strategic acquirors may be reluctant to enter into joint bidding arrangements involving tender offers (as opposed to voting transactions) in the United States.

From a Canadian perspective, we believe that if structured correctly, an activist and a strategic bidder can lawfully propose a joint acquisition by way of a takeover bid or voting transaction and acquire a toehold without violating Canadian insider trading laws.

We believe that if structured correctly, an activist and a strategic bidder can lawfully propose a joint acquisition by way of a take-over bid or voting transaction and acquire a toehold without violating Canadian insider trading laws.

Canadian strategic acquirors may have less interest in teaming up with an activist shareholder than their U.S. counterparts, due to the fact that proxy contests in Canada are not required to remove a shareholder rights plan. Nevertheless, there are still some circumstances where a Canadian strategic acquiror may benefit from having an activist in its corner, notably business combinations involving a recalcitrant target company board of directors where a hostile offer may not be feasible or optimal.

It will be interesting to see whether the Pershing Square-Valeant joint bid arrangements lead to a wider array of transactions involving activist investor/strategic acquiror combinations.

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A Pill Too Tough To Swallow – The Dubious Efficacy of “Voting Pills” to Inhibit Shareholder Democracy

A complaint to the OSC in connection with a small cap Canadian proxy contest may have major implications for the use of shareholder rights plans to frustrate coordinated shareholder voting.

Tuckamore Capital Management (Tuckamore) was the subject of a proxy contest initiated by our client, Access Holdings (Access), in which Access solicited proxies against a proposed management buy-out of Tuckamore. Access complained to the OSC about Tuckamore’s shareholder rights plan, which Access believed prevented it from entering into voting agreements with other Tuckamore shareholders if the resulting voting block constituted 20% or more of Tuckamore’s outstanding voting shares. Access was concerned that simply entering into a voting agreement would trigger the issuance of rights under the plan – resulting in potentially significant dilution – even if none of the shareholders that became parties to the voting agreement acquired a single additional share.

Access argued that Tuckamore’s rights plan should be amended to allow shareholders to exercise their voting rights and enter into voting agreements without fear of triggering the rights plan. The acknowledged purpose of shareholder rights plans in Canada is to protect a target company from unsolicited take-over bids or creeping bids, not to interfere with shareholder democracy. At the urging of the OSC, Tuckamore subsequently amended its rights plan, in particular the definitions of “acting jointly or in concert” and “beneficial ownership” in order to make clear that proxy solicitations and voting agreements, without more, did not trigger the rights plan.

Pills like the one adopted in Tuckamore are not necessarily recent innovations: a number of early pills in Canada were designed to frustrate proxy fights. But ISS was generally successful in discouraging this practice, and it largely disappeared prior to the recent wave of shareholder activism. We note that ISS has once again issued recommendations urging shareholders to vote against adopting these kinds of voting pills. Nevertheless, a number of issuers have recently adopted voting pills that have received shareholder approval even in the face of an ISS “vote against” recommendation.

The acknowledged purpose of shareholder rights plans in Canada is to protect a target company from unsolicited takeover bids or creeping bids, not to interfere with shareholder democracy.

The Tuckamore saga makes clear that the OSC is prepared to assert its jurisdiction in situations that interfere with shareholder voting rights, and that voting pills may be of dubious efficacy. That said, unless and until securities regulators outlaw voting pills, the temptation will remain to adopt them to force shareholders (activist or otherwise) to come out of the woodwork and show their cards by requesting that securities regulators strike down the voting pill.

A More Level Playing Field in Proxy Solicitation

Shareholder activism has resulted in increased proxy contest litigation, as both activist investors and company management seek to use the rules governing proxy solicitations and voting to their tactical advantage. Consequently, the courts have often been required to establish the “rules of the game” in real time.

In *Smoothwater Capital Partners LP I v. Equity Financial Holdings Inc.*, Justice McEwen of the Ontario Superior Court faced a complaint by Smoothwater that the management of Equity Financial had breached the proxy solicitation rules. Smoothwater alleged that Equity Financial had done so by issuing a press release contesting the accuracy of statements in a Smoothwater press release that solicited dissident proxies to be voted against management at the next shareholders’ meeting. Justice McEwen held that the Equity Financial press release did not expressly solicit proxies from shareholders and was limited to providing information about the company’s position on the issues raised in the Smoothwater press release. Accordingly, Equity Financial management had not violated the prohibition on soliciting proxies without having first delivered a management proxy circular.

An activist has a timing advantage under the proxy solicitation rules because the activist can solicit proxies from up to 15 shareholders or by way of public broadcast without first having to deliver a dissident proxy circular. Those exceptions are not available to management. If, as Smoothwater contended, the public statements made by management responding to the activist investor must have constituted proxy solicitations because of the circumstances in which they were made, then activists would have a meaningful head start in framing the debate and in persuading shareholders because the company would be obligated to remain silent until it delivered its proxy circular. By recognizing that management can make public statements that respond to the complaints of activists prior to delivering a management proxy circular (provided that there is no accompanying solicitation of proxies), Justice McEwen’s decision has the effect of leveling the playing field, at least as it pertains to the public debate about the issues facing the company.

Activism and Board Diversity Drive Governance Agenda

The continuing efforts of institutional and activist shareholders to wield more influence have resulted in changes in both regulation and practice in 2014. In addition, new disclosure rules were adopted with respect to the representation of women on boards and in senior management and in respect of board renewal practices. In particular, the following developments promise to have long-term implications for Canadian business:

- *Regulation of Proxy Advisory Firms.* As a follow-up to their 2012 consultation paper, the CSA issued a draft national policy in April 2014 providing guidance on recommended practices and disclosure for proxy advisory firms. The guidance addresses the need for proxy advisory firms to identify, manage and mitigate conflicts of interest; implement appropriate practices to promote transparency and accuracy of vote recommendations; and communicate with their clients regarding their practices. Comments on both the consultation paper and the proposed guidance have been sharply divided, with issuers and their advisors advocating a need for regulation and advisory firms and institutional shareholders preferring guidance as opposed to regulation or maintaining the status quo. The SEC also decided not to regulate proxy advisory firms, choosing instead to issue guidance in the form of a staff legal bulletin in July 2014.
- *Majority Voting for Directors.* Effective June 30, 2014, all companies listed on the TSX (other than majority controlled companies) are required to have majority voting for the election of directors, either through the adoption of a policy or pursuant to their constating documents or governing statute. Under the new TSX listing requirement, if in an uncontested election more votes are withheld than voted in favour of a director's election, the director must promptly tender his or her resignation and the board must determine and announce within 90 days whether or not the resignation has been accepted.
- *Advance Notice Provisions.* Companies continued to adopt provisions requiring advance notice of nominees for election as directors, although at a slightly less frenetic pace than in 2013. As a result, more than one-third of Canadian listed issuers have now adopted such provisions. Although intended as a defensive measure, some

There are new requirements to disclose the number of women on boards of directors and in senior management.

companies have applied their advance notice provision offensively by, for example, delaying their shareholder meeting while insisting that shareholders comply with a notice deadline based on the original meeting date. This tactic was used by Partners REIT in response to the proxy contest launched by Orange Capital, which resulted in an admonition from the court that advance notice provisions are intended to be used as “shields” to protect the issuer’s securityholders, and not as “swords” in the hands of management. As a result, institutional shareholders and proxy advisory firms re-examined their support for advance notice provisions. ISS has identified certain provisions that it finds objectionable and that, if included, will result in a recommendation that shareholders vote against the advance notice proposal. In addition, companies that have already amended their constating documents will not be able to receive support for any subsequent changes to their constating documents unless they also revise their advance notice provisions. ISS has stated that it will recommend that shareholders withhold from voting for some or all of the directors of any issuer that did not seek shareholder approval of its advance notice provisions.

- *Women on Boards and in Senior Management.* Under a new disclosure rule that becomes effective on December 31, 2014 in most Canadian jurisdictions, reporting issuers (other than those listed on the TSX Venture Exchange and investment funds) are required to disclose annually the number and percentage of women directors and women who are executive officers. These issuers must also disclose any targets they have adopted regarding the number or percentage of women in such positions and the progress made in achieving those targets. In addition, they must also adopt a written policy regarding women on the board and summarize its provisions, or explain why they do not have such a policy. The rule seeks additional disclosure respecting the board’s consideration of the level of representation of women when recruiting directors and appointing executive officers.
- *Disclosure of Board Renewal Practices.* The new disclosure rule regarding women on boards and in senior management also requires disclosure of whether or not the company has adopted term limits for board service or other board renewal mechanisms and, if not, why not.

Our recently published report, Planning for 2015 – a 2014 Canadian Proxy Season Retrospective, highlights many trending issues that have impacted the Canadian corporate governance landscape in 2014.

Cybersecurity and Data Management Take Centre Stage

In 2014, Canadian organizations continued to face an expanding array of legal and regulatory challenges in the privacy and data management arena, including the introduction of Canada's new anti-spam legislation (CASL), increasing cybersecurity threats and attacks, and a heightened focus on the threats inherent in the leveraging of "big data." To mitigate the risks associated with these challenges, organizations increasingly turned to compliance and data governance frameworks.

The frequency of incidents involving the loss and theft of, and unauthorized access to, personal information of Canadians spiked through the year. The growing volume, breadth and sophistication of cybersecurity attacks is posing particular challenges to organizations in all sectors. The legal, regulatory and public relations risks are continuing to escalate as well. Cybersecurity threats have become a staple of discussion among senior management and at the board level, and there is growing recognition that robust information security governance is a critical part of any risk mitigation strategy.

Data governance also became a central part of the widespread discussion about big data. Data is now regarded as a "business critical" asset of many organizations, and significant corporate resources in analytics are being dedicated to leverage the benefits of the vast (and rapidly growing) amount of information in their custody and control. Companies are beginning to face nuanced privacy, legal and broader ethical risks in the course of their big data initiatives. In an effort to identify and mitigate these risks, a small – but growing – number of organizations are re-examining (or developing) data governance frameworks designed to foster the ethical use of data.

CASL is possibly the most stringent anti-spam legislation in the world and its introduction resulted in a flurry of compliance activity across the country and in all sectors. The first phase of CASL came into force on July 1, 2014, and sets out strict consent, notice and unsubscribe requirements for the sending of commercial electronic messages. Rules covering the installation of computer programs will come into effect on January 15, 2015. The penalties for non-compliance are potentially

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severe: organizations can be subject to administrative penalties of up to \$10 million, and a private right of action of up to \$200 per contravention of the legislation.

The Canadian Radio-television and Telecommunications Commission (CRTC) has received over 160,000 complaints since CASL came into force, and several investigations are underway. Notably, CASL includes a due diligence defence that effectively serves as a bar to enforcement action. In June, the CRTC published guidelines outlining the core elements of corporate compliance programs that the CRTC stated would help businesses establish a due diligence defence in the case of a violation. Many organizations are using this guidance to develop new (or supplement existing) compliance frameworks as part of their due diligence efforts to comply with the legislation.

As a result of the risks associated with big data, the continuing cybersecurity threat and the efforts required to comply with the requirements under CASL (and applicable Canadian privacy laws), we expect data governance will be a dominant compliance theme and increasingly the subject of boardroom discussion in 2015.

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A Cautionary Case About Directors' Duties

Directors should pay careful attention to one of the rare appellate decisions in Canada on directors' fiduciary duty to the corporation. In *Unique Broadband Systems, Inc. (Re)*, the Ontario Court of Appeal agreed with the trial court that the CEO of Unique Broadband Systems, Inc., who was also a director, breached his fiduciary duty when the board of directors approved excessive compensation to him. The Court concluded that not only was he not entitled to the payments approved by the board, he was also not entitled to indemnification under contractual or other director and officer indemnities or enhanced severance upon termination of his employment.

(For more information, refer to our Update entitled "[Ontario Court Of Appeal Upholds Finding of Breach of Fiduciary Duty Respecting Executive Compensation](#)" on osler.com)

The key lessons for directors to take away from this decision include the following:

- *Compliance with conflict of interest disclosure requirements is not enough.* The Court noted that mere disclosure of a conflict does not relieve a director of his or her obligation to act honestly and in the best interests of the corporation.
- *The business judgment rule is a presumptive rule that does not shield a decision made in breach of a director's fiduciary responsibility.* The Court noted that the business judgment rule cannot operate to shield decisions that were not taken honestly and in the best interests of the corporation.
- *Directors should ensure they have properly documented the underlying basis for their decisions.* Both the trial court and the Court highlighted the absence of any contemporaneous record to evidence the basis for the board's determinations.

Unique Broadband Systems, Inc. reminds directors of the importance of being scrupulous and diligent in their deliberations in order to avoid personal liability.

- *Directors can support their decision with expert advice.* While the board considered the matter of retaining advice from outside experts, the trial court and the Court noted that the board ultimately did not seek expert advice on the reasonableness of its compensation decisions. By contrast, at trial a compensation expert stated that the CEO's compensation package did not pass any test of reasonableness.
- *Statutory corporate law prohibitions against provisions relieving a corporate fiduciary of their fiduciary responsibilities will be interpreted broadly.* The contract with the CEO's personal company did not expressly purport to relieve the CEO of liability for a breach of fiduciary duty. However, the Court was prepared to conclude that an interpretation of the contract that would result in payment of the enhanced severance despite the breach of his fiduciary duty would have had that effect in substance, and was therefore prohibited.

Our guide [Directors' Responsibilities in Canada](#) offers additional insight into corporate governance best practices, helping directors to fulfill their responsibilities.

New Duty of Honest Contractual Performance

In a landmark commercial decision released in November 2014, the Supreme Court of Canada recognized a new duty on parties to perform contractual obligations honestly. In *Bhasin v. Hrynew*, the Court's general recognition of good faith contractual performance in all contracts, and the specific requirement to perform contracts honestly, is a change in the law in all areas of Canada, except Québec. These principles have the potential to affect, among other things, the manner in which commercial parties structure agreements and the way that parties to a contract exercise existing rights, negotiate for future rights and generally communicate with each other. It remains to be seen whether the effect of this decision will be significant or whether the change is truly "incremental," as the Court stated.

(For more information, refer to our Update entitled "[Landmark Decision Establishing New Duty to Act Honestly in Performing Contracts](#)" on osler.com.)

Given the breadth of the Court's language, we anticipate that both the scope and implications of the general organizing principle of good faith and the specific duty of honest contractual performance will be the subject of significant debate by future courts seeking to interpret and apply these principles. In the meantime, the Supreme Court of Canada's decision may have the following practical implications:

- *Drafting Agreements.* Parties who are drafting agreements may want to consider including a provision that establishes their own standards of good faith performance for the purposes of the agreement. The contractual language that will be acceptable is not clear. Commercial practice in the United States may provide useful guidance.
- *Exercising Contractual Rights.* The Court's express recognition of the general organizing principle of good faith and duty of honest contractual performance could expand litigation risk and lead to increased lawsuits criticizing the way a counterparty has exercised its

These principles have the potential to affect, among other things, the manner in which commercial parties structure agreements and the way that parties to a contract exercise existing rights, negotiate for future rights and generally communicate with each other.

rights under an agreement. In light of this, in certain circumstances parties should consider documenting the process they used to arrive at discretionary decisions and exercise their contractual rights, including how they took into account the interests of counterparties.

- *Negotiating Future Rights.* The Court did not address the existence of a duty to negotiate in good faith. Where the parties have agreed to negotiate future rights in good faith, a key issue that remains to be determined is how the duty of honest contractual performance can be reconciled with the adversarial nature of such negotiations. Parties likely would not be expected to disclose their negotiating positions, but they will certainly be required to avoid any action that could be viewed as actively misleading.
- *Communicating with Counterparties.* Even though the Court is expressly concerned with conduct that is actively misleading or deceptive, and does not impose any positive duties of disclosure, many contracting parties could decide to be circumspect in what they say to each other in order to reduce litigation risk, at least until this duty is clarified. Such an effect may be counter-productive in fostering mutual cooperation between contracting parties.

Supreme Court Issues Definitive Ruling on Aboriginal Title

On June 26, 2014, the Supreme Court of Canada released its decision in *Tsilhqot'in Nation v. British Columbia* – now the definitive case on aboriginal title in Canada. The decision established aboriginal title for six Tsilhqot'in Bands to over 1,700 square kilometers of remote and sparsely populated land in north central British Columbia, and is the first legal declaration of aboriginal title anywhere in Canada. As a result, these bands now hold title to the land and, subject to a few important restrictions, can use the land and derive economic benefits from it. The Court also stated that the land in question is no longer “Crown” land, but rather aboriginal land. Significantly, the decision confirms that governments can infringe aboriginal title, where justified.

(For more information, refer to our Update entitled “[Tsilhqot'in Decision: The Sky is Not Falling](#)” on osler.com.)

Prior to proving aboriginal title, First Nations need to be consulted in respect of Crown decisions or actions that might adversely affect their potential claims of aboriginal rights and title. Once proven though, aboriginal title gives the First Nation holding that title the right to use and occupy the land for a variety of purposes that are not limited to traditional uses. Aboriginal title holders have the right to decide how the land will be used and the Crown must seek the consent of the aboriginal title holder to access the lands. If consent is not obtained, the Crown is required to justify its infringement of the aboriginal title.

The Court stated that a justification of an infringement of aboriginal title must be on the basis of the broader public good, must serve a compelling and substantial legislative objective, and must be proportionate. Here, the Court quoted from its earlier 1997 decision in *Delgamuukw v. British Columbia*, which provided a list of the types of activities that would justify an infringement, including forestry, mining, general economic development and the building of infrastructure, among others. Finally, the Court confirmed that both provincial and federal laws apply on aboriginal title lands and that both levels of government can infringe aboriginal title, where justified.

To what extent, if any, can governments regulate resource development on aboriginal title lands?

While *Tsilhqot'in* answered some questions regarding aboriginal title, it raised many more. For instance, to what extent, if any, can governments regulate resource development on aboriginal title lands? Further, what is the precise interplay between requiring consent to encroach upon aboriginal title lands versus the governments' authority to legislate in respect of those same lands?

The decision has also raised the expectations of aboriginal groups across Canada. For industry, the key issue will be how governments react to this decision in terms of regulating the development of natural resources and balancing the rights of aboriginal peoples with those of non-aboriginal peoples. On this point, at the time of writing, we have had no definitive response to the decision by the Government of British Columbia or other governments.

The Possibilities and Perils of Provincial Regulation of Federal Undertakings Post-Marcotte

In September 2014, the Supreme Court of Canada released its decision in *Bank of Montreal v. Marcotte*, dealing with the question of which level of government has constitutional authority over consumer protection issues involving banks.

Canada's Constitution provides that the regulation of banking is an exclusively federal matter, but the provinces also have a recognized jurisdiction over general consumer protection. In *Marcotte*, the issue was whether banks could be liable for failing to provide disclosure of foreign currency conversion charges on credit card transactions in accordance with provincial consumer protection law, or whether instead, because the federal *Bank Act* already had provisions related to disclosure of these types of charges, the issue was exclusively regulated by federal consumer protection regulations under the *Bank Act*. The matter was further complicated by the fact that while federal consumer protection regulations under the *Bank Act* provide for only regulatory oversight and fines, the provincial law provided a scheme for restitution and punitive damages.

For decades, the conventional wisdom has been that where a consumer protection disclosure provision already exists under the *Bank Act*, any similar provincial consumer protection disclosure requirement does not apply to a bank. In this decision, the Supreme Court of Canada adjusted the balance of federalism by holding, for the first time, that provincial consumer protection legislation can apply to banks' consumer contracts even if those provincial provisions overlap with the federal legislative scheme applicable to the same contracts. The Court did, however, leave open the possibility of applying the paramountcy doctrine to allow federal law to "trump" provincial law where the two conflict. Unfortunately, the Court did not provide much guidance on when this would be the case.

Apart from the novelty of the Court's ruling, the decision is particularly important for the questions it potentially raises regarding the scope of provincial authority more generally over banks and other federal undertakings, issues that will likely need to be litigated in future cases.

Common Securities Regulator Closer to Fruition

The elusive goal of a national securities regulator is closer to fruition. Following the Supreme Court's decision in December 2011 that the federal government does not have the jurisdiction to pass comprehensive securities regulation, the federal government has been working with the provinces on a collaborative scheme that would pass constitutional muster.

In September 2014, the federal government and five provinces – Ontario, British Columbia, Saskatchewan, New Brunswick and Prince Edward Island – entered into a memorandum of agreement setting out the terms and conditions to establish a Cooperative Capital Markets Regulatory System. The Cooperative System will have a common regulator, the Capital Markets Regulatory Authority (Authority), headquartered in Toronto, administering a single set of regulations designed to protect investors, foster efficient capital markets and manage systemic risk. There will also be a separate adjudicative tribunal.

Draft uniform provincial securities legislation (the provincial *Capital Markets Act*) along with draft complementary federal legislation addressing criminal matters and systemic risk (the *Capital Markets Stability Act*) were also published for comment. Initial draft regulations are expected in the early spring 2015, with the goal of launching the Authority in the fall of 2015.

While the new Cooperative System is not the single national regulator for which some have hoped for many years, we believe it is a step in that direction and will reduce Canada's existing system of 13 regulators. One of the remaining questions is whether any other provinces will choose to participate in the Cooperative System and if the proposed timelines will be met. From the perspective of Canadian business, if the Cooperative System is implemented, the transition must be as seamless as possible, with limited substantive changes to securities laws and an efficient interface with non-participating provinces.

Canada's record of enforcement against white collar crime pales in comparison to that of the United States by any measure.

Continued Setbacks Prosecuting Insider Trading

Regulators continued to have a woeful success record in prosecuting insider trading cases in Canada. In *Re Jowdat Waheed and Bruce Walter*, a panel of the Ontario Securities Commission dismissed allegations against two prominent mining executives who were alleged to have committed insider trading and tipping violations, saying that the required proof of the violations had not been proved. Subsequently, the Alberta Court of Appeal in *Walton v. Alberta (Securities Commission)* may have made such prosecutions even harder, by finding that “recommending or encouraging” a trade (a form of tipping) required both proof of the tipper’s knowledge of a material fact and proof of the tipper’s intention to convey information with the expectation that it be relied upon. The Court may also have raised the standard of proof in those cases, stating that findings cannot be based merely upon speculation.

Insider trading is challenging to police for regulators and prosecutors on both sides of the border. In 2014, the SEC lost some high profile cases including those brought against the co-founder of Wynnefield Capital Inc. and the founder of computer storage device maker STEC Inc. These followed on the heels of the dismissal of the SEC’s case against Dallas Mavericks owner Mark Cuban in 2013. Despite these setbacks, the United States has generally had a more aggressive and successful pursuit of white collar malfeasance.

According to a [Reuters study from September 2014](#), the length of prison terms for convicted white collar criminals in the United States has increased by approximately 32% in the five-year period from December 2007 to December 2012 as compared to the previous five-year period, from an average of 13.1 months to 17.3 months. In 2014, American prosecutorial successes included former SAC Capital Advisors Portfolio Manager Matthew Martoma receiving a nine-year sentence and prominent director and former McKinsey CEO Raj Gupta receiving a two-year sentence, in each case for insider trading-related offences.

In Canada, most capital markets wrongdoing is pursued through administrative sanction, and those efforts too are overshadowed by similar American efforts. The CSA reportedly collected \$90 million in fines in 2013, in contrast to the SEC's \$3.4 billion in the same period.

Canada's record of enforcement against white collar crime pales in comparison to that of the United States by any measure. Canada saw its first (and only) insider trading jail term imposed under the *Criminal Code* prohibitions in 2010 for 39 months, based on a plea agreement (a handful of previous convictions and short sentences had been ordered under provincial regulatory statutes). In Canada, most capital markets wrongdoing is pursued through administrative sanction, and those efforts too are overshadowed by similar American efforts. The CSA reportedly collected \$90 million in fines in 2013, in contrast to the SEC's \$3.4 billion in the same period.

To address difficulties in obtaining proof of insider trading and related activities, the OSC has requested amendments to the *Criminal Code* to facilitate the collection and use of wiretap evidence to support white collar investigations and prosecutions. The consultation draft of the Capital Markets Stability Act, the federal contribution to the proposed cooperative capital markets regime released in September 2014, contains such amendments to the *Criminal Code*.

The Introduction of “No-Contest” Settlements in Ontario

For the first time in Canada, “no-contest” settlements are available in securities regulatory proceedings in Ontario. A long-time fixture of SEC proceedings in the United States, no-contest settlements in securities regulatory proceedings allow the alleged wrongdoer to settle charges without admitting wrongdoing. OSC staff introduced this change as part of a package of initiatives aimed at improving its enforcement capability.

The OSC approved its first no-contest settlement agreement in a hearing held in September 2014 between OSC staff and Ernst & Young. Under that agreement, Ernst & Young agreed to pay \$8 million to settle allegations of negligence in regard to its audit work related to Sino-Forest Corp. and Zungui Haixi Corp.

The OSC approved its second no-contest settlement in November with four TD Bank subsidiaries in relation to four separate matters that those entities discovered and self-reported. While having neither admitted nor denied the accuracy of the facts and conclusions of OSC staff, the TD entities agreed to the settlement and will pay compensation of more than \$13.5 million to clients, a payment of \$600,000 to advance the OSC’s mandate of protecting investors plus a further payment of \$50,000 toward the costs of the investigation. (For more information, refer to our blog post entitled “[OSC Approves First No-Contest Settlement – Ernst and Young to Pay \\$8 Million](#)” on our blog [riskandcrisismanagement.com](#).)

Proponents of no-contest settlements argue that they allow regulators to move on with outstanding matters based on a satisfactory resolution, and further the public interest by freeing up valuable resources to be deployed more strategically and encouraging appropriate cases to be more efficiently resolved.

That said, the use of no-contest settlements remains controversial and is not without critics. Plaintiffs’ counsel have long relied on admissions made in regulatory proceedings as a simpler ground on which to successfully base a certifiable class action in Canada. Recently, in the Citigroup SEC settlement cases in the United States, Judge Rakoff

With a view to freeing up resources to prosecute cases more efficiently, the OSC has introduced “no-contest” settlements for the first time in Canada.

questioned whether no-contest settlements could be determined to be “fair,” “reasonable,” “adequate” or in the public interest, in the absence of a “sufficient evidentiary basis to know whether the requested relief is justified under any of these standards.” While the settlement was ultimately approved after the Appeals Court remitted it back to Judge Rakoff, the SEC announced its commitment to use the non-admission approach only in appropriate cases.

Canada Cracks Down on Foreign Corruption

Canada was until very recently criticized harshly by the OECD for its failure to enforce the *Canadian Corruption of Foreign Public Officials Act* (CFPOA). In response, Canada has stepped up its game and is now ranked among the top nine OECD countries in enforcing the foreign anti-corruption statute – behind the United States, Germany, Switzerland and the United Kingdom. Since 2011, the Canadian government has successfully prosecuted two Canadian companies, Niko Resources (fined \$9.5 million and three years' probation) and Griffiths Energy (fined \$10.35 million), and this year a court imposed a three-year jail sentence on Mr. Karigar, an agent for an Ottawa-based technology company, following a conviction under the CFPOA for conspiring to offer bribes to Air India officials.

This increased enforcement now has additional legislative backing. Several amendments made last year to the CFPOA facilitate the government's ability to prosecute Canadian companies and officers, and allow for jail terms of up to 14 years for corporate officers.

Among the more than 30 active Canadian enforcement investigations, the one that has garnered the most attention in the media is the investigation of SNC Lavalin. While the company has yet to be charged, at last count four former senior executives and two other former employees are currently facing charges in Canada in relation to the company's overseas activities.

We expect to see increasing levels of enforcement of the CFPOA by the Canadian authorities. As the [Karigar conviction](#) and SNC Lavalin employee-related charges have confirmed, the Canadian government will not stop at penalizing corporations with hefty fines – directors and officers will also be subject to prosecution. An effective compliance program is an essential first step, and an invaluable tool, to ward off charges of illegal activity and will also serve to mitigate aggressive sanctions that can be imposed for violation of anti-corruption laws.

Taking Action Against Tax Arbitrage

Inversion transactions, which generally involve the combination of a U.S. corporation and a non-U.S. target under a new non-U.S. parent corporation in order to achieve substantial tax savings, drove a substantial volume of U.S. cross-border M&A activity this year. In September 2014, the IRS released a package of detailed proposals designed to limit certain U.S. tax benefits commonly associated with these transactions.

While it is unclear whether these proposals will stop inversion transactions, the breadth of the September 2014 proposals may cause them to disrupt mainstream cross-border M&A transactions that are not commonly considered inversion transactions. Furthermore, these proposals will generally not affect cross-border combinations if shareholders of the U.S. corporation receive less than 60% of the combined company's shares or if the combined company has "substantial business activities" in the jurisdiction of the new non-U.S. parent company. As a result, cross-border mergers involving U.S. and Canadian companies should not be impaired by the September 2014 proposals if the equity value of the Canadian company is approximately equal to that of the U.S. merger partner or if the combined company has at least 25% of its income, assets and employees located in Canada.

These constraints are expected to have the practical effect of limiting the pool of eligible Canadian targets for U.S. corporations looking to engage in an inversion transaction.

In a similar attempt to stem the tide of forum shopping, the OECD/G20's Base Erosion and Profit Shifting (BEPS) project is considering changes that could fundamentally alter the global tax system, including the tax rules applicable to inbound and outbound investment from Canada.

A particular focus for Canada as part of BEPS has been on curbing perceived treaty shopping abuses. The 2014 Federal Budget proposed a domestic anti-treaty shopping rule that would have denied tax treaty benefits for certain holding companies and other intermediaries making investments into Canada.

Governments around the world took action against tax arbitrage in 2014, seeking to quell forum shopping.

In August 2014, the Government announced that, rather than proceeding with the Budget proposal, Canada will instead await further work from the OECD. As part of that work, the OECD recommended that countries adopt at least a minimum standard to prevent treaty shopping – with further consideration being given by the OECD to the circumstances in which treaty benefits should apply to collective investment vehicles and private equity investments.

Other ongoing BEPS work includes a review of interest deductibility, controlled foreign corporation rules and transfer pricing. Canada, together with other G20 countries, has committed to finalizing its work on BEPS in 2015. (For more information on the ongoing developments in the OECD/G20 BEPS project, refer to our [International Tax: OECD and G20 BEPS Action Plan Overview page](#) on osler.com.)

About Osler, Hoskin & Harcourt LLP

We thank our clients for their business this year. We have worked with them on a number of innovative and significant engagements. We hope that you find the *Legal Year in Review* to be helpful and invite you to contact your Osler lawyer or any of the contributors to discuss the topics we have covered.

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