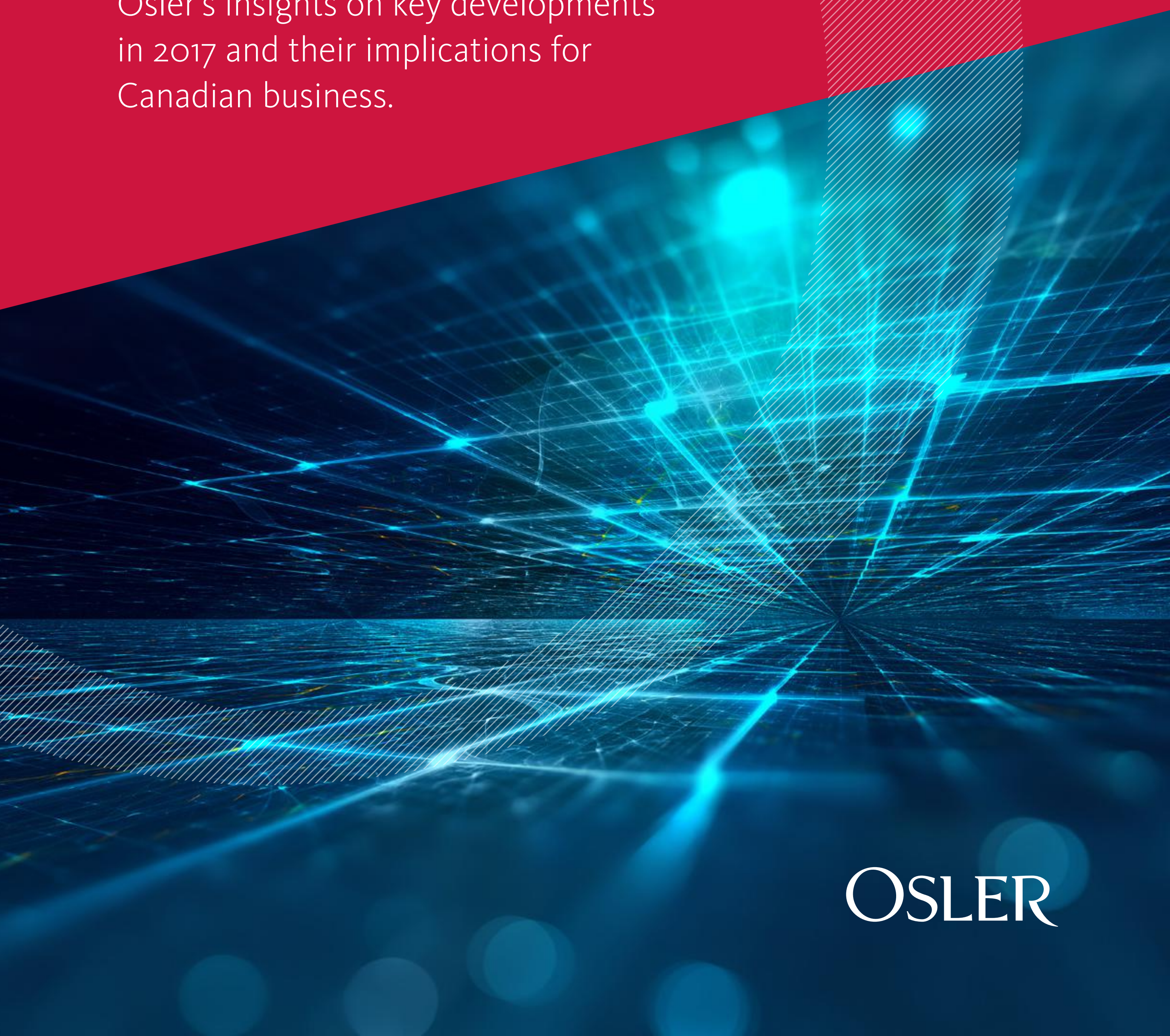
# Legal Year in Review

Osler's insights on key developments in 2017 and their implications for Canadian business.



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# Table of Contents


| | |
|---|---|
| Introduction | 3 |
| Crypto-assets go mainstream | 7 |
| Blockchain and smart contracts, cloud computing and agile development | 10 |
| Cannabis in 2017: Setting the stage for legalization | 14 |
| Using growth targets to supplement growth strategy disclosure | 21 |
| Investor and regulator interests drive change in corporate governance and executive compensation | 25 |
| Top public M&A and proxy contest developments in 2017 | 29 |
| U.S. capital markets developments in 2017: Small changes can make a big difference | 33 |
| Developments in white-collar & capital markets regulatory enforcement | 37 |
| Mining Year in Review – Progress amid volatility | 41 |
| The Ontario Fair Hydro Plan and its novel financing structure | 44 |
| Alberta's Renewable Electricity Program – Competition exceeds expectations | 47 |
| Government of Canada tests the limits under the Income Tax Act in 2017 | 50 |
| Shifting sands of the law of privilege | 54 |
| Privacy a primary concern in 2017 | 58 |
| Liberalizing foreign investment review | 62 |
| NAFTA, CETA and the TPP – Significant challenges and opportunities | 65 |

# Introduction

As 2017 comes to a close, it is time again to share with our clients and friends our observations about some of the most significant legal developments affecting Canadian business over the past year and their implications for 2018 and beyond.

Remarkable technological innovations are currently affecting all sectors of business and society. For example, in 2017, crypto-assets evolved from a fringe technological curiosity into a global business. The rapid price appreciation of crypto-assets and the incredible growth of initial coin offerings has caught almost everybody off guard. This booming market is creating both new opportunities and challenges as investor interest pushes the price of crypto-assets ever higher. Blockchain, cloud computing and Agile software development practices are revolutionizing the manner in which people enter into contracts, exchange payments or value and store and access data. Clients will need to be proactive in keeping pace with these rapid changes in order to capitalize on new opportunities and mitigate risks.

Outside the technological realm, a groundbreaking shift in social policy in 2017 set the stage for the legalization of cannabis for recreational use in Canada, which is scheduled to take effect no later than July 1, 2018. In preparing for the launch of this new market, businesses face a fluid and changing legal environment. All the rules of the game are not yet known. Provinces are in the process of passing legislation that will address issues such as marketing, purchase and use. Meanwhile, there are a number of minefields to navigate arising from lack of uniformity in regulation both inter-provincially and internationally. Businesses that fully understand all of the regulatory implications of the new regime and that anticipate and adjust to new legislative requirements as they are introduced will be best positioned to succeed.

In the corporate and securities law arena, the increase in initial public offering activity in 2017 saw an increase in the use of "growth targets" – forward-looking information about a company's medium- to long-term financial and operating results – to supplement the company's growth strategy disclosure. The quality of a company's growth strategy and management's track record for achieving growth can significantly impact the success of an IPO as well as ongoing share price performance. Although growth targets are being more closely scrutinized by investors as well as Canadian securities regulators, companies looking to go public should continue to consider their benefits.

New and renewed investor focus on issues of board diversity and proxy access and an increasing interest in climate change disclosure accounted for some of the most significant developments in corporate governance in 2017. These regulatory developments will affect corporate governance and executive compensation disclosure in 2018 and activist defensive tactics in the years to come.

While the number of Canadian M&A transactions in 2017 has been slightly higher than in 2016, the total value of deals is somewhat lower. There was also a drop in the number of proxy contests. Nevertheless, important legal developments include a new securities commission staff notice on material conflict of interest transactions, increased regulatory scrutiny of the use of private placements in the context of proxy contests, and the evolution of fairness opinion practice in light of last year's *InterOil* decision. It is too soon to assess the impact of the new take-over bid regime adopted in 2016, but it is interesting to note that there were only three hostile bids in 2017.

Meanwhile, in the United States, most developments of interest to Canadians that came from the Securities and Exchange Commission (the SEC) are more procedural than substantive. Canadian issuers registered with the SEC that report their financial statements in International Financial Reporting Standards (IFRS) will feel the pinch of at least one procedural change related to the format for filing financial statements, starting with their next annual report filing with the SEC.

In the area of enforcement, regulators continue to try to "move the needle" in their pursuit of insider trading and other white-collar misconduct. Notably, the first court-imposed conviction for bribery under the *Corruption of Foreign Public Officials Act* was upheld by the Ontario Court of Appeal. While there were few notable securities enforcement cases, the Ontario Securities Commission appears to be capitalizing on the fact that courts support the use of circumstantial evidence to prove insider trading and tipping offences.

Although 2017 saw increased activity and optimism in the mining sector compared to the previous three years, significant challenges remain. Especially for mid-tier and junior mining companies, which represent the largest segment of the Canadian mining sector, this past year could be effectively summed up as 'two steps forward, one step back' in terms of overall market conditions and outlook. However, there were a number of noteworthy trends – such as increased exploration, moderate M&A activity and continued focus on alternative financing structures – which merit close attention by deal makers as we head into 2018.

In response to political pressure due to rising electricity rates, the Ontario provincial government introduced an innovative financing structure to allow it to lower electricity bills for residential consumers, small businesses and farms. Electricity rates have been rising in Ontario due in large part to the cost of fixed-price contracts entered into with clean energy generators over the last decade. The financing structure used by the Ontario government bears watching, as (to our knowledge) it is one of the first uses of a statutory securitization mechanism to collect a current revenue shortfall from future ratepayers.

In 2017, the Alberta Electric System Operator commenced the first Renewable Electricity Program (REP) competition in Alberta. The REP is a result of Alberta's 2015 Climate Leadership Plan, which seeks to implement an economy-wide carbon levy, phase out coal, develop renewable energy, cap oil sands emissions and reduce methane gas. The REP is estimated to result in $10.5 billion in new investment and the creation of at least 7,200 new jobs. Project developers and investors should closely monitor the evolving electricity landscape in Alberta to maximize opportunities while minimizing risk.

There were a number of important tax developments in 2017. Most notably, the Department of Finance released a package of broad proposals targeting Canadian private companies and their shareholders. The measures, which were largely intended to reduce certain perceived advantages of earning income through a corporation, were widely criticized by the business community and financial advisors and several of the proposals have now been abandoned or substantially revised. In addition, the Tax Court of Canada heard the landmark *Cameco* case, now on reserve, which was the first tax appeal involving the scope of the recharacterization provisions in Canada's transfer pricing rules for related-party international transactions. In *BP Canada Energy Company v. Canada*, the CRA pursued a test case to the Federal Court of Appeal on the limits of its power to require production of a taxpayer's internal analysis of uncertain tax positions.

Limits on document production also received considerable attention outside the tax context. The Supreme Court of Canada reaffirmed the sanctity of solicitor-client and litigation privilege, setting a high standard for legislatures that intend to abrogate the broad protection that privilege offers. At the same time, two other decisions (one of the Federal Court, and one of the English High Court) could dramatically erode the protection in areas where it was thought to have been long-established – specifically, "deal" or "transaction" privilege and the privilege attaching to documents prepared by counsel during an internal investigation. If these two decisions are upheld on appeal, their potential ramifications could be far-reaching.

Privacy issues were top of mind for organizations across all sectors in 2017, in light of sophisticated cybersecurity threats, high-profile data incidents, and an explosion in the volume of data analytics initiatives. There were several notable legal and regulatory developments in the Canadian privacy and data arena – namely, a new statutory security breach notification regime, a full Parliamentary review of Canada's Anti-Spam Legislation in response to stakeholder concerns, and a renewed focus on the need for robust data governance plans.

The federal Liberal government took a number of steps in 2017 to liberalize foreign investment review, making it easier for foreigners to acquire Canadian businesses. The most noteworthy development has been the significant increase to the financial threshold used to determine whether private-sector investments in Canadian businesses will be subject to net benefit review under the *Investment Canada Act*. The threshold began the year at $600 million, was raised in the middle of the year to $1 billion, and in the fall of 2017 was set at $1.5 billion.

Unprecedented changes in the international trade landscape over the past year are likely to have a profound impact on many Canadian businesses. These include the renegotiation of the North American Free Trade Agreement (NAFTA), the implementation of the Canada-European Union Comprehensive Economic and Trade Agreement (CETA) and the potential revival of the Trans-Pacific Partnership among 11 countries (TPP-11) excluding the United States. While the renegotiation of NAFTA creates significant uncertainty, the CETA and TPP-11 provide opportunities for businesses wanting to diversify their trading relationships with markets other than the United States.

As we monitor these and other legal developments in 2018, we would be happy to discuss them with you.

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# Crypto-assets go mainstream

In 2017, crypto-assets went from being a relatively fringe technological curiosity to a global, booming business. The rapid price appreciation of crypto-assets and the incredible growth of initial coin offerings (ICOs, or sometimes referred to as token generation events) has caught almost everybody off guard, including financial institutions, regulators and yes, even law firms. This booming market is creating both new opportunities and challenges as investor interest pushes the price of crypto-assets ever higher.

Crypto-assets, including crypto-currency and crypto-tokens, are cryptographically secured digital records stored and transacted on an immutable decentralized ledger, commonly referred to as a Blockchain. The 'gold standard' crypto-asset is Bitcoin, which is often used as a store of value (not unlike physical gold), but which can also be used to transfer value over a peer-to-peer network without a trusted intermediary like a bank. The first Bitcoin was created in 2009, and except for temporary blips in 2011 and 2013, the price for one Bitcoin never exceeded US$1,000 before this year. In late 2017 however, the price for one Bitcoin soared past US$11,000, which put the total market capitalization of all Bitcoins significantly ahead of the total market capitalization of the Royal Bank of Canada, Canada's largest public company. The price of Bitcoin is extremely volatile; it is not uncommon to observe swings of more than 10% in a matter of hours.

The second-most popular example of a crypto-asset is ether, which is used to pay for the computing power that runs applications on the Ethereum Blockchain. Ether was worth approximately US$8 in early January 2017. In late 2017, it traded at more than US$400, which puts the market capitalization of all ether at more than US$40 billion – more than the market capitalization of another major Canadian bank, the Canadian Imperial Bank of Commerce. Notably, Ethereum was primarily created by a group of Toronto-based developers, many of whom still play a leading role in the development of the Ethereum Blockchain protocol and many Ethereum-based decentralized applications, or 'dapps.' While it is still in the early stages, it can be argued that Ethereum constitutes Canada's greatest digital technology success.

It is difficult to pinpoint a single explanation for the rapid increase in the value of crypto-assets. Some would argue that we are in the midst of a classic market bubble: the combination of constrained supply of many crypto-assets and high demand from investors who expect that the price of the assets will never materially decline have caused valuations to skyrocket.

Another explanation is the proliferation of ICOs. Year to date, organizations have raised more than US$3.5 billion in ICOs, greatly out-pacing traditional venture capital investment over the same time period. ICOs have become a popular tool for organizations to conduct what is essentially a global crowdfunding campaign, resulting in additional tailwinds that drive demand for crypto-assets. The structure of ICOs varies – some ICOs involve the sale of a token that has many of the attributes of equity, effectively 'tokenized' equity that grants the holder voting rights and rights to distributions or dividends. Other ICOs involve the sale of a crypto-asset that mimics the features and functionality of Bitcoin or ether, or that is designed to have a specific use within a Blockchain platform or application without any of the rights typically associated with an equity or debt security.

*Total market capitalization of crypto-currencies hovers around*

***$150 billion***[1]

A third explanation is that crypto-assets reflect a much more significant (and difficult to articulate) technological and economic shift towards a 'tokenized' open source sharing economy. In this new decentralized economy, crypto-assets can be used to both reward anyone that contributes to the value of a shared digital network and collect payment from anyone that derives value from using that network.

In the Canadian capital markets, there are two natural consequences of the rapid price appreciation and proliferation of crypto-assets. First, savvy investment managers have decided that the best way to rapidly grow their business is to create investment funds that invest in crypto-assets. And second, many growth-oriented technology companies have determined that an ICO is the best way to raise capital and transform their business models (or both).

Take Kik Interactive, which in 2015 completed a financing round that valued the privately held Waterloo technology company at more than US$1 billion. This September, Kik raised just less than $100 million in an ICO designed to introduce a new crypto-currency, Kin. The Kin token is designed as a general purpose crypto-currency for use in digital services such as chat, social media and payments within the Kin ecosystem; the Kik messaging application being the initial service in that ecosystem.

To date, few ICOs have been designed to comply with securities laws and, not surprisingly, financial regulators around the world have expressed significant concern over the rapid growth of ICOs and the use of crypto-asset sales as a fundraising mechanism. In August, the Canadian Securities Administrators issued CSA Staff Notice 46-307 – *Cryptocurrency Offerings*. The notice indicates

1 "Blockchain Investment Trends in Review" by CB Insights, Q4 2017.

that many offerings of crypto-assets, including crypto-assets that function more like a currency and which do not have the traditional attributes of a debt or equity security, involve sales of securities that are subject to Canadian securities laws, if Canadians are involved in the purchase or sale.

In an unconventional move, the Ontario Securities Commission provided further guidance on ICOs via social media in October to advise that it has established a team of executives to "respond quickly to cryptocurrency offerings." Indeed, Canadian securities regulators have demonstrated a willingness to approve ICOs subject to narrow terms and conditions, as evidenced by exemptive relief granted to Impak Coin and TokenFunder.

It is unclear what will happen next in the crypto-asset space. It is possible that there will be significant market failures (and resultant class action lawsuits) and crypto-assets will lose their lustre. It is also possible that the crypto-asset market will become increasingly professionalized, stable and legally compliant. As institutional investors continue to move into these markets and regulators subject them to greater scrutiny, it is likely that there will be improvements to market liquidity, transparency and reliability, more robust custody arrangements and an embrace of consistent global standards and best practices.

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# Blockchain and smart contracts, cloud computing and agile development

This past year saw the acceleration of transformational technologies that are increasingly impacting businesses as well as broader society. These technological developments and, more generally, the renewed and increasing pace of technological change, present tremendous opportunities for businesses.

## BLOCKCHAIN

By far the most significant headline-grabbing development in 2017 relates to the stunning rise of Blockchain. In general terms, Blockchains are a special type of database (or ledger) that can only be appended to and distributed over peer-to-peer networks, and supported by cryptography. When sufficiently widely deployed, Blockchain is virtually impervious to being overwritten. These attributes make Blockchain an ideal platform to facilitate the direct disbursements of value or to store and execute computer code that forms part of an agreement between parties (referred to as "smart contracts").

The rise of Blockchain and its potential to become a transformational technology has been compared to the advent of the internet and the worldwide web. Some of this interest is driven by the growth in alternative fundraising through "initial coin offerings" and the exponential rise in the value of the crypto-currency Bitcoin. But beyond alternative fundraising and crypto-currency, the technology has the potential to dramatically transform practices in significant segments of the economy.

Among other things, Blockchain displaces intermediaries that previously acted as central authorities in a wide range of transactions. For example, in the case of international money transfers, Blockchain technology can decentralize many of the traditional centralized payment systems required to facilitate such transfers. It can facilitate the transfer of value across borders almost instantaneously without the participation of a traditional intermediary such as a bank. Another popular use is to securely trace products as they make their way through complex supply chains. This facilitates origin tracing and the ability to recall for product safety issues.

Transformational technologies often create a period of uncertainty with respect to how legal frameworks will respond and adapt. Many such questions remain in connection with Blockchain, including with respect to risk management, best contracting approaches, privacy and security protection, jurisdiction, taxation and governance. Here are a few emerging issues to watch:

### Standards

Standards are developing to assist with the proliferation and adoption of Blockchain technology. For example, the ISO/TC307 Committee that was approved by the International Standards Organization in 2016 held its first meeting to discuss the ISO/TC 307 standard for Blockchain. This standard is expected to specify, among other things, a reference Blockchain architecture, how identity is handled, and consistent Blockchain terminology. In addition, there is a drive to establish certain Blockchain implementations as the de facto standard for the enterprise. For example, the Linux Foundation has launched Hyperledger Fabric v.1.0 and positioned the release as the leading Blockchain platform for business and enterprise application.

### Enforceability of smart contracts

While in theory smart contracts "self execute," it is unclear whether they are universally legally enforceable. There has been legislative activity this year in some jurisdictions with respect to enforceability of smart contracts, including in the state of Arizona. In addition, we have started to see examples of smart contract practices that mitigate enforceability risks (e.g., split-contract models, where terms essential for legal compliance are presented to individuals outside of the Blockchain but linked to the smart contract residing on a Blockchain).

### Privacy and security

Blockchain presents risks and opportunities for privacy and security management. Strong cryptography and the ability to manage permissions and access to information present obvious opportunities to manage consent requirements and to address how information is used. Conversely, the fact that Blockchain entries are both widely distributed and immutable creates risks of non-compliant distribution of personal information and confidential data, as well as significant challenges in correcting and mitigating such breaches when they occur. In recognition of these concerns, Vitalik Buterin, co-founder of the Ethereum (one of the prevailing Blockchain platforms for smart contracts), unveiled plans for "Ethereum 2.0," the next-generation version of Ethereum that is designed specifically to address these concerns, among others.

### Licensing issues during implementation

The prevailing Blockchain implementations are open source, meaning that the source code is free to download and inspect. There are significant benefits derived from this community-based development approach. Open-source licensing can create complexities, however. For example, some open-source licences require, as a condition of use, that all modifications are disclosed when the work product is distributed. On the other hand, other licences are difficult to comply with in conjunction with other licensing models, such as those required by widely used app stores.

Looking ahead in 2018, we expect the Blockchain ecosystem to mature at an accelerating rate. Focus will likely turn from crypto-currencies and tokens to smart contracts, with a disruptive impact on a variety of sectors, such as financial services and supply chains. The legal framework may have to quickly adapt to accommodate regulatory issues presented by the proliferation of these technologies, challenging businesses to quickly familiarize themselves with the rapidly changing landscape.

## CLOUD COMPUTING

Cloud computing is the provision of computing resources on a utility model from large, highly sophisticated data centres. Over the past year, cloud computing has continued to extend into more and more enterprises and is on its way to becoming the dominant form of delivery of computing resources and applications. Its wide availability, easy scalability and relative low cost has, among other things, fuelled the rise of a vigorous technology start-up community in Canada and elsewhere. In addition, larger enterprises that formerly maintained extensive data centre assets are now increasingly looking to cloud computing to introduce efficiencies and cost savings.

Over the past year, cloud computing has continued to extend into more and more enterprises and is on its way to becoming the dominant form of delivery of computing resources and applications.

This year saw the continuation of a trend whereby cloud computing providers invested in significant infrastructure in Canada, adding to their ability to provide certainty regarding the location from which services will be provided. This has resulted in a greater willingness of sectors previously wary of cloud computing, such as financial services, government and health care, to entertain the prospect of moving to the cloud.

There are a number of issues clients need to consider before they use cloud computing services. For clients in regulated industries such as financial institutions in Canada, the B-10 Guideline of the Office of the Superintendent for Financial Institutions (OSFI) includes certain requirements such as location of service, required audit rights and requirements for segregation of data that present challenges for the shared resource model of cloud computing. Where software as a service (SaaS) providers rely on a third-party cloud computing provider, there is no direct contract with the cloud provider, and issues such as data security and overall responsibility for service and compliance need to be considered.

Businesses that are considering a move to the cloud will need to consider issues such as application licence compliance, as well as negotiation of cloud computing agreements that take into account the client's business and regulatory requirements, including the specific risk tolerance of the particular business.

## AGILE SOFTWARE DEVELOPMENT METHODOLOGY

Agile software development is an umbrella term that refers to various approaches (e.g., Scrum) to software development that emphasize, among other considerations, customer collaboration and rapid response to change through iterative cycles of design and build. This is in contrast to the traditional models of development called the “waterfall model,” where a single design phase occurs, followed by a significant build effort. The potential benefits cited for adopting an Agile approach include higher quality software and greater customer satisfaction. As a result, we have seen a marked increase in interest in Agile software development among businesses.

Contracting for Agile software development requires a different framework than contracting for traditional software development services. Agile projects involve managing the service provider, deliverables, and costs through the use of tools that reflect the need for continuous and rapid change during a project. Agile projects also require a heightened level of customer commitment that is often novel to organizations accustomed to contracting for traditional software development services. The contracting approach must stress strong governance and accountability while respecting the Agile methodology.

## CONCLUSION

Blockchain, cloud computing and Agile software development practices are only a few examples of the remarkable technological changes currently affecting all sectors of business and society. Clients will need to be proactive in keeping pace with these rapid changes in order to capitalize on new opportunities and mitigate risks.

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# Cannabis in 2017: Setting the stage for legalization

A groundbreaking shift in policy in 2017 set the stage for the legalization of cannabis for recreational use in Canada, which the Canadian government indicates will occur no later than July 1, 2018. In preparing for the launch of this new market, businesses face a fluid and changing legal environment. The players are ready to take the field but all the rules of the game are not yet known. The businesses that will be in the best position to be successful will be those that fully understand the proposed regime and that anticipate and adjust to the legislative requirements as they are introduced.

### THE NEW CANNABIS ACT WILL CHANGE THE CURRENT LANDSCAPE

Currently, only medical cannabis is permissible in Canada. The production and sale of medical cannabis is controlled under the *Access to Cannabis for Medical Purposes Regulations* (the ACMPRs). Under the ACMPRs, cannabis is legally available only from licensed producers and only for medical purposes. There is no traditional retail distribution system for medical cannabis and storefronts operating as "compassion clinics" or "dispensaries" are currently illegal. Rather, the medical cannabis distribution system is based on direct supply with the licensed producer supplying medical cannabis directly to the patient. To obtain medical cannabis a patient must be evaluated by and receive a "prescription," called a medical document, from a physician. As part of the application process to be supplied with medical cannabis from a licensed producer, the medical document is then registered by the patient with the licensed producer. For additional information, please refer to our Osler Update entitled "On the road to legalization: Highlights of Canada's proposed Cannabis Act."

While medical cannabis is currently legal in Canada, recreational cannabis is not. In 2017, after years of campaign promises, public consultations, debate and reports, the Government of Canada introduced Bill C-45, *An Act respecting cannabis and to amend the Controlled Drugs and Substances Act, the Criminal*

*Code and other Acts* (the Cannabis Act). If enacted, the Cannabis Act will dramatically change the current legal landscape. It will create a strict legal framework for controlling the production, distribution, sale and possession of cannabis for recreational and medical use in Canada. The underlying philosophy of the Cannabis Act is to protect youth, ensure public health and safety, deter criminal activity and reduce the burden on the criminal justice system in relation to cannabis.

The Cannabis Act will create a new legal market for recreational cannabis by establishing a licensing regime for the production, processing, distribution and sale of recreational cannabis. Current holders of licences under the ACMPRs will be automatically licensed under the Cannabis Act. These producers will be able to sell both medical and recreational cannabis, as authorized by their licences. After the Cannabis Act becomes law, current licence holders for medical cannabis may therefore be at a distinct timing advantage relative to new applicants. The extent of this advantage may depend on the length of the application review process which, if experience under the ACMPRs is any indication, could take up to a year to complete. The Cannabis Act will also permit households to "grow their own" recreational cannabis subject to a maximum of four plants per household.

No producer involved in the illicit or so-called "grey" market will be entitled to obtain a licence under the Cannabis Act. In addition, if Health Canada believes that a licensed producer has been involved in the illegal market their licence could be revoked. For a more detailed look at the Cannabis Act provisions, including criminal offences, administrative penalties, seizure powers and the licensing regime, please see our Osler Update entitled "On the road to legalization: Highlights of Canada's proposed Cannabis Act".

*July 1, 2018*
*set as target date for*
***regulated and restricted***
***access to cannabis***

The federal government has set July 1, 2018 as the target date to provide regulated and restricted access to cannabis for recreational use. However, as of December 1, 2017, the Cannabis Act remains subject to parliamentary approval and royal assent.

Federal regulations have not yet been developed under the Cannabis Act. However, Health Canada has published a consultation document entitled "Proposed Approach to the Regulation of Cannabis" (the Consultation Paper) which outlines, in very general terms, certain of the regulations that will be promulgated under the Cannabis Act.

The Consultation Paper envisions an industry with both large and small players involved. There will be established standards for "micro-cultivators" and "micro-processors." Also, while medical cannabis under the ACMPRs must be cultivated indoors, the Consultation Paper indicates that both indoor and outdoor cultivation will be permitted for recreational cannabis. Further, while the regulatory proposals under the Consultation Paper primarily address dried cannabis, fresh cannabis, cannabis oil, seeds and plants, the Consultation Paper indicates that it is Health Canada's intention to enable the sale of edibles within one year following the coming into force of the Cannabis Act.

## PROVINCES: THE BALL IS IN YOUR COURT!

As a result of shared constitutional power over issues affecting the legalization of cannabis, the Cannabis Act leaves much discretion for the provinces to decide on how to implement the new law. There is no requirement for the provinces to adopt a uniform regime. Early indications are that there may be significant differences in regulation from province to province, creating further fluidity and uncertainty for businesses seeking to enter this new market.

If a province has not adopted its own legislative regime for the sale and distribution of cannabis by July 1, 2018, cannabis will be available to users under the federal regime through online ordering and secure mail delivery.

### Provincial response

As of December 1, 2017, Alberta, Ontario and Québec have published proposed legislation for the retail sale and use of recreational cannabis. Alberta's Bill 26, *An Act to Regulate and Control Cannabis,* Ontario's Bill 174 the *Cannabis, Smoke-Free Ontario and Road Safety Statute Law Amendment Act, 2017* and Québec's Bill 157, *An Act to constitute the Société québécoise du cannabis, to enact the Cannabis Regulation Act and to amend various highway safety-related provisions* will regulate the use and sale of recreational cannabis in Alberta, Ontario and Québec respectively. Other provinces, namely Manitoba, New Brunswick and Newfoundland, have also announced certain details on their proposed legislative frameworks for cannabis.

In Ontario, under Bill 174 the minimum age to purchase recreational cannabis is proposed to be 19 years, higher than the federal minimum of 18 years. Consumption will be limited to "private self-contained living quarters in any multi-unit building or facility." Use will be prohibited in public places, workplaces, motor vehicles, boats and any other prescribed place.

In Alberta and Québec, the minimum age to purchase recreational cannabis is proposed to be 18 years. New Brunswick and Newfoundland and Labrador have set the minimum age to purchase recreational cannabis at 19 years. Consumption of cannabis will be allowed in private residences and, unlike Ontario, in Alberta, Québec, New Brunswick and Newfoundland, in some public areas where smoking of tobacco is permitted. In Québec, no one will be allowed to grow cannabis for personal use inside a dwelling.

The proposed legislation in Ontario will also amend impaired driving laws for drug-impaired drivers, adopting a zero-tolerance approach for young, novice and commercial drivers. More detailed information regarding Bill 174 is available in our Osler Update entitled "Ontario proposes legislation to prepare for the federal legalization of cannabis." Manitoba has proposed Bill 25, *The Cannabis Harm Prevention Act* (the CHPA) to address drug-impaired driving and certain public safety issues. Other provinces such as Alberta, Québec and New Brunswick have also proposed amendments to their respective motor vehicle safety legislation to address drug-impaired driving.

### Provincial approaches to retail could vary significantly

Retail is one area where significant differences between the provincial regulations may arise that will almost certainly impact the way businesses can operate in this market.

Ontario, for example, has announced a wholly government-run system through a subsidiary of the Liquor Control Board of Ontario. Québec and New Brunswick will also follow a wholly government-run model. On the other hand, Alberta, Manitoba and Newfoundland will implement a hybrid approach involving government-run wholesaling and distribution and the private sector operation of licensed retail locations. In all jurisdictions that have announced details on their retail distribution system, online sales will be permitted; however, online sales and home delivery will be operated by the government. Other provinces have yet to announce the full details of their retail model.

One common element amongst the regimes so far is the separation of the sale of alcohol and cannabis (i.e.; no co-location). For further detail and analysis of Ontario's model, please see our Osler Update entitled "Ontario government announces exclusive cannabis retail distribution regime".

The retail model chosen by a province could significantly affect the manner in which producers can take advantage of this new market and may affect the ability of smaller producers to participate at all. Critics have argued that a government-exclusive retail distribution regime (such as is proposed in Ontario, Québec and New Brunswick) with a regulated, fixed pricing structure could "lock in" the dominance of Canada's largest cannabis producers. This would effectively hinder the ability of smaller cannabis producers, including micro-cultivators and micro-processors, to differentiate their premium or "craft" products. Businesses will need to understand the different provincial rules in designing a model that will allow them to take advantage of this new market.

The retail model chosen by a province could significantly affect the manner in which producers can take advantage of this new market and may affect the ability of smaller producers to participate at all.

### Pricing & tax will likely vary among provinces

Although pricing may vary from province to province, there are early indications that the price per gram will likely be around $10.

Addressing taxation, Prime Minister Justin Trudeau recently announced a minimum $1 per gram tax (or 10% of the producer's price, whichever is higher) after which retail sales levies would be applied. For example, one gram of dried cannabis costing $8 to produce would be taxed at $1 and then a sales tax of $1.17 would be added to bring the total consumer price to $10.17.

### Promotion

The Cannabis Act will restrict the promotion, packaging, labelling and display of cannabis in ways that are similar in some respects to the restrictions currently applicable to tobacco and alcohol. For example, informational promotion (i.e., factual information about cannabis or its characteristics) is permitted under certain circumstances (e.g., only where persons under the age of 18 years are not permitted by law). Facilities used for sports or cultural events will be prohibited from displaying, as part of their name or otherwise, a brand element of cannabis or the name of a person that produces, sells or distributes cannabis.

Cannabis will be prohibited from being promoted in a manner appealing to persons under the age of 18 years. The Consultation Paper proposes strict limits on the use of colours, graphics and other special characteristics of packaging to curtail the appeal of products to youth. Cannabis products will be required to be labelled with specific information about the product, contain mandatory rotating health warnings similar to tobacco products and be marked with a clearly recognizable standardized cannabis symbol. The health warning messages are to be the most prominently displayed elements. Health Canada is also considering establishing specific standards for the brand elements.

Some industry groups view these restrictions as too strict. The Coalition for Responsible Cannabis Branding (the Coalition), an alliance of 17 licensed cannabis producers, recently released proposed guidelines for the branding and marketing of cannabis. These industry-proposed guidelines would be looser than the restrictions currently proposed in the Consultation Paper but still stricter than the rules for advertising alcohol. The Coalition argues that this would enable effective promotion, branding and education, engaging consumers in such a way as to diminish the illicit market without impacting youth.

## Legalized marijuana: 5 key takeaways for your workplace

Here are several key takeaways to help your organization prepare for the legalization of recreational marijuana:

### 1 Not a licence for poor behaviour

Your organization does not need to tolerate any recreational marijuana use, impaired employees or customers (subject to disability considerations), or marijuana or marijuana paraphernalia (subject to disability considerations).

### 2 Policies are important

Having robust workplace policies will help set expectations, control workplace use of marijuana, provide a basis for disciplining employees, and help your organization comply with its legal obligations.

### 3 Key terms to review and update

You should review and update your existing policies and procedures, including the definitions of "drug" and "workplace," if your existing "fit for work" requirements are sufficient and whether exceptions to recreational marijuana use will be permitted in certain situations.

### 4 Implement and follow your policies

Your updated policies and your expectations regarding recreational marijuana in the workplace should be made clear to all employees and consistently enforced.

### 5 Provide accommodation where required

Accommodation issues with marijuana are likely to arise in two circumstances:
(i) marijuana addiction; or
(ii) medical marijuana being prescribed for a mental or physical disability.

### 6 Bonus takeaway – a reminder for management

Directors and managers need to understand the effects of marijuana and related issues, review, revise and adopt policies to address marijuana in the workplace, and ensure marijuana policies are enforced in order to avail themselves of a due diligence defence against workplace safety-related personal liability.

Read the full article by Damian Rigolo, Brian Thiessen and Shaun Parker on osler.com.

## INTERNATIONAL AND JURISDICTIONAL ISSUES

Participants in the cannabis market will also need to understand the international landscape in which they operate.

### Import & export

The import and export of cannabis will be heavily restricted. For example, the Cannabis Act provides that licences or permits for the importation or exportation of cannabis will only be issued for medical or scientific purposes or in respect of industrial hemp. Even in these situations, the Minister of Health will allow import only under limited circumstances – e.g., the import of a unique strain for scientific investigation or of starting materials for a new licensed producer.

A licensed producer wishing to apply for an import or export permit will also have to take into account Canada's obligations under international treaties, compliance with the ACMPRs, importation restrictions in the destination country and security concerns. Importation or exportation of cannabis for recreational purposes will not be permitted under the Cannabis Act and recreational cannabis will effectively be a "grown in Canada" proposition.

### CSA & TSX release guidance

Despite the legalization of marijuana for medical use in many states in the United States and the legalization for recreational use in eight states and the District of Columbia, the cultivation, distribution and possession of marijuana remains illegal under United States federal law. The conflict between state and federal law means that issuers with marijuana-related activities in the United States assume certain risks, including the risk of prosecution or seizure of assets.

To address this risk, the Canadian Securities Administrators (the CSA) has released "CSA Staff Notice 51-352 *Issuers with U.S. Marijuana-Related Activities,*" which outlines specific disclosure expectations for all issuers with (or that will have) marijuana-related activity in the United States. The issuer is expected to disclose the nature of its involvement in the United States marijuana industry in prospectus filings as well as continuous disclosure documents, such as the issuer's annual information form and management's discussion and analysis.

The Toronto Stock Exchange (TSX) has also stated that it will launch a review of listed companies engaged in the marijuana business, whether directly or indirectly, in the United States. The TSX will be undertaking "in-depth" reviews of all applicants and listed issuers in the marijuana sector. Issuers may be the subject of delisting review in the event of gaps in compliance or failure to comply with TSX listing requirements. For example, Canadian grower Aphria Inc. has assets in Arizona and Florida (both states permit the use of cannabis for medical use) and is listed on the TSX. Aphria Inc. could be forced to choose between its TSX listing or its presence in the U.S. cannabis industry. Whether Aphria and TSX can come to terms will be an important development to watch for in 2018.

Further detail regarding which issuers will be impacted and listing requirements is available in our Osler Update entitled CSA, TSX release guidance regarding marijuana-related activities in the United States for issuers of securities.

## Looking forward to 2018

In 2017, a significant shift in policy was introduced that proposes to legalize cannabis for recreational use. Moving forward, businesses engaged in the industry will face an uncertain and challenging legal atmosphere but one that also presents significant opportunity. In order to be successful, businesses will need to fully understand the proposed regime and legislative requirements, as well as stay informed of continuing developments in 2018. Key items to watch for include the finalization of the federal regulations, provincial progress (particularly with respect to retail regimes, pricing and promotion) and the TSX approach to dealing with cannabis industry listed companies.

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# Using growth targets to supplement growth strategy disclosure

The increase in initial public offering (IPO) activity in 2017 saw an increase in the use of "growth targets" – forward-looking information about a company's medium- to long-term financial and operating results – to supplement the company's growth strategy disclosure. The quality of a company's growth strategy and management's track record for achieving growth can significantly impact the success of an IPO as well as ongoing share price performance. Institutional investors are demanding more information and a greater level of detail from companies with respect to their growth plans, especially in the case of new public companies. The use of growth targets can be helpful because they quantify the impact of growth plans from management's perspective, providing greater visibility into the company's performance in the future.

## HISTORICAL APPROACH TO GROWTH STRATEGY DISCLOSURE

Growth strategies are the actions a company intends to take in order to grow revenues, earnings or other results. Until as recently as 2015, the practice in Canada has been to describe growth strategies only in general terms, without quantifying the potential impact of these strategies on the company's future financial or operating results. This historical approach has its limitations, as it leaves investors and research analysts to determine how a company's growth plans may translate into actual performance in the future without the benefit of management's own views. It may also lead to over-reliance on the company's historical growth rates as a predictor of future results. Historical growth rates may be either lower or higher than anticipated growth rates and may not account for changes to the company's business, such as the implementation of new initiatives and strategies. The use of growth targets to supplement a company's growth strategy disclosure seeks to address these issues, although investors and research analysts still need to apply their own analysis and judgment in evaluating the extent to which a company will achieve its growth objectives.

## GROWTH TARGETS ARE NOT THE SAME AS GUIDANCE

Growth targets, unlike more traditional earnings guidance, are medium- to long-term in nature (typically three, five or seven years in the future), and represent results that a company intends to achieve by a certain time in the future based on its current business plan and strategies. Growth targets are not intended to be a forecast of future results. Growth targets may be provided for different financial measures and operating metrics, such as revenue, sales, net income, EBITDA, adjusted EBITDA, margins, capital expenditures, store openings, same store sales growth, and even compound annual growth rates for revenue or earnings measures.

Whereas guidance is usually expressed as an estimated range of values for a particular financial reporting period (e.g., "guidance for fiscal 2018 revenue is in the range of $525 to $550 million"), disclosure with respect to growth targets tends to be looser (e.g., "we believe an opportunity exists to grow our annual revenue to between $525 and $550 million by 2022"). In order to avoid regulatory concerns, growth targets must have a reasonable basis and be based on reasonable assumptions. While they can be aspirational, management and the board of the company must believe they are realistically achievable.

Growth targets should not be presented as a year-by-year forecast or year-by-year guidance for the period of time covered by the targets.

## LEGAL AND REGULATORY CONSIDERATIONS RELATING TO GROWTH TARGETS

Growth targets are a form of forward-looking information under Canadian securities laws, and are subject to the same legal and regulatory requirements that apply to all forms of forward-looking information. When using growth targets, the following should be considered:

### Format

In Canada, growth targets are usually discussed in the "Outlook" section of the company's management's discussion and analysis (MD&A) or in the growth strategies section of the IPO prospectus, or both. Growth targets are often also summarized in table format in the prospectus cover page artwork and in the roadshow presentation for the IPO. In the United States, growth targets may be provided in the roadshow presentation but not in the registration statement or prospectus itself. The disclosure of growth targets is accompanied by the usual and prescribed disclaimers and cautionary statements for forward-looking information.

### Length of target period

The early Canadian examples of growth target disclosure from 2015 used a five- to seven-year period for the company to achieve its target results. However, due to regulatory concerns that targets must be limited to a period for which the information can be reasonably estimated, target periods on recent IPOs have been shorter – typically between three and five years. The Ontario Securities Commission (OSC) has indicated that it may raise comments in respect of the reasonableness of the length of the target period. Accordingly, a company should be prepared to demonstrate that sufficient visibility and predictability exists in its business and industry to warrant using a target period that extends beyond the end of its next fiscal year.

### Targets should not be presented as a year-by-year forecast

Growth targets are not intended to be, and should not be presented as, a year-by-year forecast or year-by-year guidance for the period of time covered by the targets. For instance, if a company's goal is to achieve revenue of between $525 and $550 million by 2022, it should not disclose its anticipated revenue in each of 2018, 2019, 2020, 2021 and 2022. The intention is to provide management with adequate "runway" to meet its targets within the specified timeframe using the various elements of the company's growth strategy. Growth may not be linear, and may be higher in some years as compared to other years within the target period. If appropriate, issuers should disclose the reasons for anticipated year-to-year variations and the drivers of growth.

### Assumptions underlying growth targets must be stated in detail

Securities regulators in Canada have a preference for numerous and detailed assumptions underlying growth targets. This should include a mix of qualitative descriptions of assumptions and material factors relevant to the targets (including risk factors) and, where appropriate, details as to actual amounts assumed (e.g., assumptions with respect to number of stores to be opened each year, capital expenditures required to achieve the intended growth, foreign exchange rates, etc.). The OSC has indicated that it may ask a company to limit growth targets to a shorter period (for example, one or two years) if the company is unable to sufficiently support its growth targets with reasonable qualitative and quantitative assumptions.

### Assumptions underlying growth targets must be reasonable

Securities regulators in Canada have shown a willingness to challenge the reasonableness of assumptions underlying growth targets, particularly in circumstances where the targets and anticipated future growth rates are not supported by the company's historical results and growth rates. Having reasonable assumptions is also important in terms of mitigating potential liability for misrepresentation relating to growth target disclosure. During the comment process, companies must be prepared to explain to the regulator the key drivers of anticipated growth and why the company's growth targets are reasonable. In doing so, companies must refer to the details of their specific business plans and objectives. As part of the comment clearing process, the regulator may require additional disclosure regarding assumptions to be added to the prospectus.

### Growth targets are subject to updating obligations post-IPO

Canadian legal requirements relating to forward-looking information require companies, during the period covered by the growth targets, to discuss in their MD&A or in a news release events and circumstances that are reasonably likely to cause actual results to differ materially from previously disclosed growth targets. The expected differences must also be disclosed. Companies must also discuss in their MD&A material differences between actual results achieved as compared with previously disclosed growth targets. Since 2015, practice has been mixed in terms of companies providing regular updates with respect to progress towards growth targets in the absence of a change in outlook or circumstances that would lead management to conclude that a company will not be able to achieve its target results. While we believe it is reasonable to take the view that no update should be required if a company remains on track to achieve its growth targets by the end of the target period, this view may not be shared by securities regulators in Canada. As part of the comment clearing process for an IPO prospectus, a regulator may require a company to commit to providing updates of progress towards growth targets in its annual MD&A for each financial year in the target period. This would include a discussion of growth targets disclosed in the IPO prospectus, the company's actual results and a discussion of variances from the targets.

### Liability for growth target disclosure

In Canada, growth targets are part of a company's prospectus disclosure, and therefore any statutory liability for misrepresentation would apply equally to growth targets as well as other information in the prospectus. Moreover, the liability safe harbour under Canadian laws that normally applies to guidance and other forward-looking information issued by public companies does not apply to forward-looking information contained in an IPO prospectus. This does not necessarily mean that a company's failure to achieve growth targets by the end of the target period would constitute a misrepresentation. This could be the case if the assumptions underlying the growth targets were found to be unreasonable. Nevertheless, companies must weigh the benefits of providing growth target disclosure against the potential risks. For a Canadian company undertaking a cross-border IPO (involving a public offering in Canada and the United States), the practice is not to include any growth target disclosure in the prospectus or roadshow materials due to liability concerns.

Growth targets are a useful supplement to a company's growth strategy disclosure, since they help quantify the impact of growth plans from management's perspective. Although growth targets are being more closely scrutinized by investors and more closely reviewed by securities regulators in Canada, companies looking to go public should continue to consider their benefits.

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# Investor and regulator interests drive change in corporate governance and executive compensation

New and renewed investor focus on issues of board diversity and proxy access and an increasing interest in climate change disclosure accounted for some of the most significant developments in corporate governance in 2017. Regulatory developments this year will impact corporate governance and executive compensation disclosure in 2018 and activist defence tactics in the years to come, while proposed changes to U.S. taxation of executive compensation are potentially game-changing.

## DIVERSITY: MUCH INTEREST, MODEST IMPROVEMENT

Osler's third annual report on diversity disclosure practices found that women held 14.5% of the board seats of Toronto Stock Exchange (TSX) listed issuers that provided disclosure (an increase of 1.9% from 2016), the percentage of all-male boards had dropped sharply and the proportion of companies with a written board diversity policy had increased significantly. It also found that the percentage of women executive officers was essentially unchanged from the previous year. Despite some "green shoots," these findings reflect glacial progress at the board level, and highlight that relying on director turnover is not enough to result in meaningful improvement. This is particularly true given the Canadian Securities Administrators' (CSA) findings that board turnover accounted for only 9% of board seats and that these vacant positions were filled by women only 26% of the time.

However, investor interest in board diversity increased in 2017, with leading institutional investors demanding that companies include women directors and accelerate the pace of change. Institutional Shareholder Services has also announced that, starting in 2019, it will recommend that investors withhold from voting for the chair of the nominating committee (or the board chair if there is no nominating committee) if the company has not adopted a written gender diversity policy and there are no female directors on the board. Whether this increasing pressure will be enough to accelerate the rate at which women are added to boards and executive officer ranks remains to be seen.

There has also been some movement towards mandating disclosure relating to a broader range of diversity characteristics. Proposed regulations under the *Canada Business Corporations Act* would introduce a requirement for public companies to disclose whether or not they have a written policy on diversity other than gender, or explain why they do not.

## U.S.-STYLE PROXY ACCESS COMES TO CANADA

In response to the level of shareholder support received for shareholder proposals to adopt U.S.-style proxy access at the annual meetings of The Toronto-Dominion Bank (52.2%) and Royal Bank of Canada (46.8%), six of Canada's major banks have now adopted U.S.-style proxy access policies.

The ability of shareholders to submit a shareholder proposal requiring a company to include in its proxy circular director nominations submitted by the shareholder has long been a feature under Canadian corporate law. In the U.S., however, proxy access is a fairly recent development. Generally, under the U.S. style of proxy access, up to 20 shareholders collectively holding at least 3% of the outstanding voting shares for at least three years are permitted to submit nominations for up to 20% of the director positions on the board for inclusion in the company's proxy circular.

The proxy access policies adopted by Canada's major banks are consistent with the U.S. style of proxy access except that, in order to comply with applicable law, the nominating shareholders must collectively hold at least 5% of the outstanding voting shares. Two banks have written to the Department of Finance seeking to revise the *Bank Act* provisions on shareholder nomination of directors to reduce the share ownership threshold for making such proposals to 3% from 5% and to reflect other key terms of proxy access on the same basis as their respective policies. The Canadian Coalition for Good Governance issued its final policy on proxy access encouraging issuers to adopt by-law changes reflecting U.S.-style proxy access. We expect proxy access to receive continuing focus in Canada in 2018.

*Women now hold*

**14.5%**

**of all board seats among all companies disclosing the number of women directors on their boards**

## INCREASING INTEREST IN CLIMATE CHANGE DISCLOSURE

Climate change and public disclosure regarding climate change preparedness were areas of investor focus in 2017. The CSA launched a review of climate change disclosure practices in March 2017 in response to the report of the Financial Stability Board Task Force on Climate-Related Financial Disclosures. This report recommended, among other things, disclosure of the organization's governance relating to climate-related risks and opportunities and the actual and potential impacts of these on the organization's businesses, strategy and financial planning. Disclosure of the organization's processes for identifying, assessing and managing climate-related risks and the metrics and targets used to assess and manage these risks and opportunities is also recommended.

Additionally, 11 of the world's leading banks, including Royal Bank of Canada and The Toronto-Dominion Bank, are working collectively to find ways to improve the assessment and disclosure of climate-related risks and opportunities by financial institutions. This may lead to a more consistent and standardized approach to climate change disclosure in the future.

## WEBSITE DISCLOSURE OF CORPORATE GOVERNANCE DOCUMENTS

New TSX rules require all listed issuers to post on their corporate website the issuer's articles or other constating documents and its by-laws, majority voting policy, advance notice policy for director nominations, position descriptions for the chairman of the board and the lead director (if applicable), board mandate and board committee charters. This requirement comes into effect on April 1, 2018 and will make it easier for shareholders to access the issuer's key governance documents.

## OSC DRAWS THE LINE ON PROXY CONTEST PRIVATE PLACEMENTS

The Ontario Securities Commission (OSC) overturned a decision by the TSX conditionally approving a private placement of shares made in the throes of a proxy contest, effectively drawing a line on the increasing use of private placements to friendly parties as a defensive tactic in a proxy battle. The OSC's *Eco Oro* decision effectively unwound the private placement unless it was approved by shareholders. As a result of this decision, the TSX issued a staff notice clarifying that information to be disclosed to the TSX in a notice of a private placement should include disclosure of any upcoming shareholders meeting, merger, acquisition, take-over bid, change to capital structure or other significant transaction, and of any potential dissident shareholders and/or anticipated proxy contests. Greater scrutiny is likely to be placed on applications to the TSX seeking approval of a private placement generally and in the context of an ongoing proxy contest and other contested situations in particular.

## TSX ISSUERS MUST PROVIDE NEW EQUITY COMPENSATION DISCLOSURE IN THEIR PROXY CIRCULARS

TSX-listed issuers are now required to disclose in their proxy circulars, (i) the annual burn rate for each security-based compensation plan for the last three years, (ii) where a security-based compensation arrangement includes a multiplier that increases the number of shares to be issued on settlement based on performance, the effect of that multiplier on the burn rate and (iii) vesting and term requirements for all security-based compensation plans, not just stock option plans. In addition, information on security-based compensation arrangements (other than the annual burn rate) now should be provided as at the end of the most recently completed financial year instead of the date of the meeting materials. However, if shareholders are being asked to approve a security-based compensation arrangement at the shareholders meeting, the information must be provided as at the date of the meeting materials.

## SEC PROVIDES GUIDANCE ON CEO PAY RATIO DISCLOSURE REQUIREMENTS

The U.S. Securities and Exchange Commission (SEC) pay ratio rule, which requires U.S. domestic registrants to disclose the ratio of their CEO's annual total compensation to the median employee's annual total compensation, applies to issuers as of the first fiscal year beginning on or after January 1, 2017. On September 21, 2017, the SEC released interpretive guidance to assist companies with their efforts to comply with the rule. The guidance addressed the SEC's views on the use of reasonable estimates, assumptions and methodologies, the

While the use of performance-based compensation is widespread for reasons other than corporate benefits, the elimination of the tax benefit for performance-based compensation may cause compensation committees to consider the use of compensation arrangements that include both qualitative and quantitative factors.

use of appropriate existing internal records in determining whether non-U.S. employees are required to be included in identifying the median employee, and the use of widely recognized tests to determine who is an employee.

Although foreign private issuers generally are not required to provide the pay ratio disclosure, any Canadian issuer that is a foreign private issuer in the U.S. and chooses to satisfy executive compensation disclosure requirements under Canadian securities laws in accordance with Item 402 of Regulation S-K will need to provide the pay ratio disclosure.

## U.S. RE-EXAMINES TAX RULES ON EXECUTIVE COMPENSATION

Current U.S. tax reform efforts may bring about substantive changes to the tax rules affecting executive compensation. While initial proposals to repeal *Section 409A of the Internal Revenue Code* (Code) and effectively eliminate deferred compensation as we know it are no longer on the table, modifications to the $1-million deduction limit for compensation paid to certain employees of U.S. publicly traded companies under Section 162(m) of the Code remain. Both the House and Sentate tax reform bills would eliminate the exceptions for commissions and performance-based compensation and would expand the scope of covered employees (and in the case of the Senate, covered employers). While the use of performance-based compensation is widespread for reasons other than corporate tax benefits, the elimination of the tax benefit for performance-based compensation may cause compensation committees to consider the use of compensation arrangements that include both quantitative and qualitative factors.

With a number of important developments now in play in both Canada and the U.S., the pace of change in the corporate governance and executive compensation landscape shows no sign of slowing. Companies will need to continue to actively monitor these changes and consider how their existing disclosure measures up as both legal requirements and market expectations continue to evolve over the coming year.

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# Top public M&A and proxy contest developments in 2017

While the number of Canadian M&A transactions this year has been slightly higher than in 2016, the total value of deals is somewhat lower. There was also a drop in the number of proxy contests. Nevertheless, there were a number of important legal developments. Set out below is our discussion of the most notable ones.

## CSA STAFF NOTICE ON MATERIAL CONFLICT OF INTEREST TRANSACTIONS

In an important Staff Notice (Notice) published on July 27, 2017, staff of the securities regulatory authorities in each of Ontario, Québec, Alberta, Manitoba and New Brunswick (Staff) indicated that they intend to subject material conflict of interest transactions regulated by Multilateral Instrument 61-101 *Protection of Minority Security Holders in Special Transactions* (MI 61-101) to greater regulatory scrutiny. Material conflict of interest transactions are now being reviewed on a real-time basis to assess compliance with the requirements of MI 61-101 and to determine whether the transaction raises public interest concerns.

Staff have also provided guidance regarding their expectations of enhanced disclosure and the active role to be played by special committees of independent directors.

Moreover, where a fairness opinion is obtained for a material conflict of interest transaction, Staff are requiring disclosure of the structure of a financial advisor's compensation (but not the amount of the advisor's fee) as well as the financial analysis underlying the opinion.

Issuers and their advisors in material conflict of interest transactions need to be prepared for the possibility of real-time review of disclosure documents and the risk that supplemental disclosure may be required that could delay the transaction. To minimize this risk, boards of issuers in conflict transactions should ensure that special committees are formed early in the process, retain independent advisors, and include comprehensive disclosure in the transaction circular.

Staff's guidance on fairness opinions, like the Notice as a whole, only applies to material conflict of interest transactions. Nevertheless, it will be interesting to see whether the Notice will influence fairness opinion practice more generally, particularly given the interplay of the Notice with the *InterOil* decision, which is discussed in greater detail below.

For further information regarding the Notice, please refer to our Osler Update: Securities Commission staff raise the bar for conflict transactions.

## PRIVATE PLACEMENTS IN PROXY CONTESTS

In April, the Ontario Securities Commission (OSC) overturned a decision by the Toronto Stock Exchange (TSX) conditionally approving a private placement of shares in the context of a proxy contest. The TSX had approved the issuance of almost 10% of the common shares of Eco Oro Minerals Corp. (Eco Oro) to existing shareholders supportive of the incumbent board of directors. The shares were issued just eight days prior to the record date for a shareholders meeting requisitioned to replace Eco Oro's board of directors. The OSC's decision effectively required Eco Oro to unwind the private placement unless it was approved by Eco Oro's shareholders. See our Osler Update: The Eco Oro decision – OSC invokes broad jurisdiction in effectively neutralizing a private placement.

While the OSC rendered its decision pursuant to a provision of Ontario securities law that provides for the review of TSX decisions, the OSC also indicated that, whether or not there is a TSX decision, a person may seek to invoke the OSC's public interest jurisdiction under Ontario securities laws based on the underlying policies in National Policy 62-202 – Take-Over Bids – Defensive Tactics (NP 62-202). The reference to NP 62-202 is instructive as there is a line of decisions addressing the use of private placements in the context of contested take-over bids, most recently the Dolly Varden decision described in our Osler Update entitled Contested private placements under the new take-over bid regime: the Dolly Varden decision. In that decision, the OSC and the British Columbia Securities Commission (BCSC) upheld a contested private placement by the target of an unsolicited take-over bid where they concluded that there was a legitimate need for the financing and the private placement was not implemented as a defensive tactic in response to the bid. The OSC and BCSC provided important guidance on the regulatory analysis and treatment of contested private placements in light of the traditional limitations on defensive tactics set forth in National Policy 62-202.

In response to the OSC decision in Eco Oro, in which there was some evidence that Eco Oro had not informed TSX staff of the proxy battle and impending shareholders meeting, the TSX issued a Staff Notice providing guidance with respect to the information required by issuers when completing TSX Form 11 – Notice of Private Placement. The TSX Staff Notice provides that, in connection with any notice of a private placement, the TSX expects issuers to provide the TSX with information regarding any relevant significant matters including, but not limited to, any upcoming shareholders meeting for which a record date has been or is shortly expected to be determined, any pending mergers, acquisitions, take-over bids, changes to capital structure or other significant transactions, and any details regarding potential dissident shareholders and/or anticipated proxy contests.

Material conflict of interest transactions are now being reviewed on a real-time basis to assess compliance with the requirements of MI 61-101 and to determine whether the transaction raises public interest concerns.

## FAIRNESS OPINIONS AFTER INTEROIL

In March, the Supreme Court of Yukon issued its reasons for approving Exxon Mobil's acquisition of InterOil, which closed on February 22, 2017. The original $2.3-billion arrangement had been blocked by the Yukon Court of Appeal on the basis that it was not fair and reasonable. This determination was made in large part due to the lack of disclosure of the financial analysis underlying the original fairness opinion in support of the transaction, leading to a concern that the shareholder vote approving the arrangement was not fully informed.

Responding to the criticism in the Court of Appeal decision, InterOil's revised proxy circular contained (i) a fixed fee long-form fairness opinion that contained detailed financial analysis about the value of InterOil and the consideration payable under the arrangement, and (ii) a report of an independent committee of directors in support of the arrangement.

In approving the amended arrangement, the Court noted that the interim order of the Court required the above-noted disclosure in the proxy circular and observed that, in the Court's view, these two requirements "provide a minimum standard for interim orders of any plan of arrangement. It is not acceptable to proceed on the basis of a Fairness Opinion which is in any way tied to the success of the arrangement."

Since the Yukon Court of Appeal's decision, there has been considerable debate in the legal and investment banking community as to whether Canadian practice relating to fairness opinions should change in response to the decision. So far, practice has been mixed. Market participants have not uniformly adopted the three practices suggested by the Court of Appeal and adopted by the parties in the revised InterOil arrangement: disclosure of the financial analysis underlying the fairness opinion, disclosure of the financial advisor's fees, and obtaining fixed fee opinions from financial advisors whose compensation is not conditional on the conclusion reached in the opinion or the outcome of the transaction.

As expected, several corporations completing arrangements under the laws of British Columbia have obtained a fairness opinion that includes at least some disclosure of the underlying financial analysis carried out by the provider of the opinion. The Yukon Court of Appeal is constituted with judges of the British Columbia Court of Appeal, so the decision of the Yukon Court of Appeal in *InterOil* would be expected to be followed by judges in British Columbia. There have also been arrangements in other jurisdictions in which *InterOil*-style fairness opinions have been obtained, although standard short-form opinions continue to be used in many transactions.

As noted above, Staff's guidance on fairness opinions in material conflict of interest transactions, coupled with the *InterOil* decision, may push issuers and their advisors to disclose more of the financial analysis underlying fairness opinions, as is the practice in the United States.

Until there is further judicial or regulatory consideration of this issue, market practice will likely continue to vary, depending on a number of factors, including the form of the transaction (arrangement or some other structure), the jurisdiction of the transaction, the robustness of the sale process, and the likelihood of legal challenge by a disgruntled shareholder.

## HOSTILE TAKE-OVER BIDS UNDER THE NEW BID REGIME

In May 2016, Canada's new take-over bid regime was adopted, which provides for a minimum 105-day bid period, a mandatory 50% minimum tender condition and a 10-day extension once the minimum tender condition has been satisfied. Following its adoption, there were questions as to whether the new regime – in particular the 105-day minimum bid period – might have a chilling effect on hostile bids.

Although it's too early to draw any definitive conclusions, to our knowledge, there have only been three hostile bids in 2017 to date: Nuri Telecom's bid for Apivio Systems; Pollard Banknote's bid for Innova Gaming; and Aurora Cannabis's bid for CanniMed Therapeutics. This is down from five hostile bids in 2016 and is well below the average over the past 10 years. Time will tell whether this is simply a slow year or the start of a broader trend.

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# U.S. capital markets developments in 2017: Small changes can make a big difference

Most of the developments coming from the U.S. Securities and Exchange Commission (the SEC) in 2017 that are of particular interest to Canadians are more procedural than substantive in nature, with little in the way of significant change in the Canada-U.S. cross-border regulatory landscape. Nevertheless, Canadian issuers registered with the SEC who report their financial statements in International Financial Reporting Standards (IFRS) will certainly feel the pinch of at least one procedural change starting with their next annual report filing with the SEC.

## TAG, YOU'RE IT!

For many years, SEC registrants reporting their financial statements using U.S. generally accepted accounting principles (U.S. GAAP) have been required to prepare a second version in an interactive data format, "tagged" with eXtensible Business Reporting Language (XBRL) coding. Canadian and other foreign private issuers reporting their financial statements using IFRS were able to escape this requirement, because the SEC had not yet approved a "taxonomy," or coding scheme, for IFRS.

This year, the other shoe dropped when the SEC announced that an XBRL taxonomy for IFRS had finally been approved. As a result, all Canadian issuers filing reports with the SEC will be required to include financial statements in XBRL format, even if they prepare their financial statements in accordance with IFRS. This requirement will take effect beginning with annual reports filed in 2018 relating to fiscal years ending on or after December 15, 2017.

In addition, financial statements in XBRL format will be required as an exhibit to a registration statement filed under the U.S. *Securities Act of 1933* (1933 Act), but not in connection with an initial public offering (IPO). Financial statements in XBRL format will not be required as an exhibit to a 1933 Act registration statement that does not contain financial statements, such as a Form F-10 registration statement filed by a Canadian issuer under the U.S.-Canada Multijurisdictional Disclosure System (MJDS).

## YOU'LL JUST HAVE TO LEARN TO SETTLE FOR LESS

As we predicted last year, the SEC released final rules shortening the standard trade settlement window from three business days (T+3) to two business days (T+2), unless a longer settlement period is agreed to by the trade parties at the time of the transaction. Canada followed suit. The T+2 settlement cycle became effective for secondary market trading in both the United States and Canada on September 5, 2017.

## NO NEED TO GET HYPER ABOUT HYPERLINKS

The SEC adopted a requirement for SEC registrants (including Canadian issuers filing a registration statement on MJDS Form F-10) to include a hyperlink to each exhibit listed in the exhibit index of their filings. The new rule came into effect on September 5, 2017.

Previously, someone seeking to retrieve and access an exhibit that had been incorporated by reference into a filing had to review the exhibit index to determine the filing in which the exhibit was included, and then had to search through all of the registrant's filings to locate the relevant one. This process was often time consuming and cumbersome.

The new requirement to include a hyperlink is a mechanical requirement that can usually be easily addressed by the commercial printer or other service provider preparing a document for filing with the SEC.

## S-K AND YOU SHALL RECEIVE

Regulation S-K provides the framework for most of the non-financial disclosure that U.S. public companies must include in their SEC filings, such as registration statements, annual and quarterly reports, and proxy statements. As part of its ongoing "disclosure effectiveness" project, the SEC proposed amendments to Regulation S-K to remove some disclosure requirements that it considered immaterial and unnecessary, and eliminated a number of duplicative requirements to discourage repetition.

If the proposed changes take effect, companies will be permitted to forgo discussion within their MD&A of the oldest period covered by financial statements included in a filing if it was included and discussed in a previous report and is no longer material. Further, companies will be permitted to omit information in their exhibits that is not material and would be competitively harmful without having to first seek confidential treatment from the SEC staff. Upon request, companies will be required to provide supplemental materials to the SEC staff similar to those currently required in a confidential treatment request.

The SEC has not proposed any changes to MJDS forms as part of this initiative, as these forms generally permit Canadian issuers to use Canadian disclosure documents to satisfy the SEC's registration and disclosure requirements instead of following the requirements in Regulation S-K.

The changes will apply to Canadian issuers that are SEC registrants with audit reports prepared by their auditors in accordance with PCAOB standards, even if they report their financial statements using IFRS.

## COME ON, TELL US WHAT YOU REALLY THINK

The SEC approved a proposal by the Public Company Accounting Oversight Board (PCAOB) introducing rules that will require auditors to provide new information about the audit. These proposed rules are intended to make the auditor's report on a company's audited financial statements more informative and relevant to investors.

In addition to including the traditional opinion from the auditors stating the conclusion that the financial statements fairly present the issuer's financial position in accordance with generally accepted accounting principles, the new rules will require the auditor to discuss in the audit report any "critical audit matters" (CAMs) arising from the period's audit or to state that there were no CAMs. A CAM is a matter that was raised with the audit committee in the course of the audit because it involved especially challenging, subjective or complex auditor judgment.

The requirements related to CAMs apply to audits of large accelerated filers (which are companies with a public float over US$700 million) for fiscal years ending on or after June 30, 2019. For all other companies, the requirements will apply for fiscal years ending on or after December 15, 2020.

The changes will apply to Canadian issuers that are SEC registrants with audit reports prepared by their auditors in accordance with PCAOB standards, even if they report their financial statements using IFRS. Annual reports on Form 40-F should be unaffected for the time being as the financial statements in those reports may be audited using Canadian generally accepted auditing standards. However, it would not be surprising if Canadian generally accepted auditing standards eventually also adopt a similar requirement for disclosure of CAMs.

## HOW MANY WAYS CAN YOU KEEP A SECRET?

There are now no fewer than three different ways to make a confidential SEC registration statement filing: the procedure available to foreign private issuers, the procedure available to emerging and high growth companies and this new procedure. The SEC announced that it will permit all companies to submit draft registration statements relating to IPOs for review on a non-public basis. The process will be available not only for IPOs, but also for most offerings made in the first year after a company has become an SEC reporting issuer.

An issuer conducting an IPO or an initial registration of a class of securities relying on this new confidential filing procedure must publicly file its registration statement, the initial non-public draft registration statement and all draft amendments at least 15 days before it conducts its road show or, if there is no road show, at least 15 days before the effective date of the registration statement.

In theory, Canadian issuers filing U.S. IPO registration statements under MJDS may take advantage of this new confidential filing procedure as well. However, it is unlikely to be of any practical benefit since MJDS filers are typically eligible for a three business day review period by the Canadian securities regulators and are typically not reviewed by the SEC. This means that most MJDS filings will be made too close to the road show or date of effectiveness to be entitled to any confidentiality period. Further, the Canadian securities regulators would also have to agree to keep the Canadian filing confidential (or else word would get out). In the past, the Canadian securities regulators have generally been prepared to accommodate a confidential review process in Canada when confidential treatment is available under the U.S. rules.

## VOTE EARLY, NOT OFTEN

Citing the importance of corporate governance rights, the S&P Dow Jones Indices, among others, stopped admitting new companies with multiple voting shares to certain of its U.S. equity indices. The decision was made on the heels of Snap's IPO in which shares with no voting rights were issued. The ineligibility for U.S. companies with multiple voting shares to be included in these indices could prevent certain institutional investors from investing in them.

While Canadian issuers may not be directly affected by this development, as they would not have typically been eligible for inclusion in a U.S. equity index in any case, this development certainly demonstrates the endurance of the "one share one vote" governance principle.

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# Developments in white-collar & capital markets regulatory enforcement

Regulators continue to try to "move the needle" in their pursuit of insider trading and other white-collar misconduct. Notably, the first court-imposed conviction for bribery under the *Corruption of Foreign Public Officials Act* (the CFPOA) was upheld by the Ontario Court of Appeal. While there were few notable securities enforcement cases, the Ontario Securities Commission (the OSC) appears to be capitalizing on the fact that courts support the use of circumstantial evidence to prove insider trading and tipping offences.

## DEVELOPMENTS IN WHITE-COLLAR AND ANTI-CORRUPTION ENFORCEMENT

Enforcement authorities had a mixed record in prosecuting white-collar crime in 2017:

- *R v. Karigar*: The Ontario Court of Appeal upheld Canada's first court-imposed conviction under the CFPOA. The accused was found guilty at trial of conspiring with other persons to pay bribes to foreign officials and later sentenced to three years' imprisonment. The court held that even though the illegal conduct occurred overseas, the offence could be prosecuted in Canada by virtue of the fact that the accused was a Canadian acting for a Canadian company in relation to work to be performed in Canada, and that the illegal conduct would benefit the Canadian company (the CFPOA has been amended since the offence occurred to provide that any CFPOA offence committed outside of Canada by a Canadian is deemed to have been committed in Canada). The court also clarified that an agreement to pay a bribe to a foreign public official is sufficient to constitute a conspiracy offence, even if no bribe is ultimately paid or even offered to the official.
- **SNC-Lavalin:** Three individuals – including two former SNC-Lavalin executives – were acquitted of corruption charges under the CFPOA in relation to a bridge construction project in Bangladesh. The Ontario Superior

Court excluded wiretap evidence, which was central to the prosecution's case, on the basis that the wiretap application was based on speculation and lacked direct factual evidence demonstrating reasonable and probable grounds that an offence had been or was being committed. After the court excluded the wiretap evidence, the Crown elected not to call any witnesses at trial. Although wiretap evidence remains a useful prosecutorial tool, this acquittal highlights the careful scrutiny that courts will give to wiretap evidence because it represents a significant intrusion into an individual's privacy. Corruption charges remain against other former SNC-Lavalin executives in relation to other projects.

In addition, the CFPOA has been amended to eliminate the exclusion of facilitation payments under the bribery offence. Facilitation payments, sometimes known as "grease payments," are made to expedite or secure the performance by a foreign public official of any act of a routine nature that is part of that official's duties or functions, and therefore does not require the exercise of discretion (*e.g.*, the processing of official documents such as visas and work permits, the provision of public services such as power and water).

Finally, the Government of Canada launched consultations to consider introducing deferred prosecution agreements (DPAs) into Canada. DPAs are voluntary agreements negotiated between an accused and the prosecutor that allow the accused to avoid being convicted in exchange for complying with the terms of the DPA, which usually requires full co-operation with law enforcement. The government has stated that it is considering DPAs as an additional tool for prosecutors to use in holding offenders to account and to defer corporate misconduct. In its discussion guide for the DPA consultations, the government acknowledged that DPAs possess the potential advantages of encouraging self-disclosure of misconduct (thereby enhancing detection and enforcement) and improving corporate culture and compliance.

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DPAs are available in the United States and in the United Kingdom. They have been used effectively in a number of high-profile cases to resolve investigations into alleged corporate misconduct, including bribery and tax evasion offences. Other jurisdictions are following suit: France introduced a DPA-like mechanism for anti-corruption investigations in 2016, and Australia completed consultations on a draft law for DPAs in May 2017.

## DEVELOPMENTS IN CAPITAL MARKETS REGULATORY ENFORCEMENT

In 2017, several cases and settlements by securities regulators and courts had significant implications for capital markets enforcement:

- Sino-Forest**:** The OSC, after one of the longest proceedings in its history, ruled that Sino-Forest's former CEO and others had breached Ontario securities law as a result of having "engaged in deceitful or dishonest conduct" regarding the company's assets and revenues.
- Amyot**:** Five individuals and two companies pleaded guilty in Québec in an Autorité des marchés financiers (the AMF) proceeding alleging that the respondents took part in a "pump and dump" scheme to influence the price of five securities listed on U.S. over-the-counter markets. The respondents were fined a total of $18.2 million, with one respondent also ordered to serve a three-month intermittent prison sentence.

- Home Capital**:** The OSC entered into a settlement with Home Capital Group and three of its former executives. The respondents were required to pay $12.5 million in penalties for failing to disclose information related to fraudulent activity uncovered in Home Capital's residential mortgage business. Of the ordered penalties, $11 million is to be used as part of Home Capital's $29.5-million settlement in a related class action (which has received court approval).
- Sentry Investments**:** The OSC, as part of a settlement agreement, ordered Sentry Investments to pay a $1.5-million administrative penalty for payments and gifts that were improperly made to a dealing representative. The settlement is the first time that an OSC proceeding has addressed prohibited payments and gifts by an investment fund manager. The settlement also addressed allegations of lack of internal controls, which created an environment in which these violations took place.
- Da Silva**:** An individual who had been convicted of illegally trading in securities, contrary to the Ontario *Securities Act*, pleaded guilty to *Criminal Code* charges for disobeying a court order and being unlawfully at large. After the Ontario Superior Court rejected the appeal of his *Securities Act* offences, the individual failed to surrender himself and left the country. Upon returning, he surrendered himself into custody to serve his sentence for his *Securities Act* violations and to address new *Criminal Code* allegations from the OSC's Joint Serious Offences Team.

## OSC STAFF CONTINUE TO PURSUE INSIDER TRADING AND TIPPING

The Ontario Divisional Court in *Finkelstein v. Ontario (Securities Commission)* affirmed an OSC panel's finding of insider trading and tipping (and upheld sanctions) with respect to four of five appellants, reiterating the deference that courts give to securities commission decisions. At the same time, a further downstream tippee successfully appealed the findings against him in *Finkelstein*. This successful appeal for one of the five appellants underscores the continued evidentiary challenges that regulators face in pursuing those further down the "tipping chain."

Prior to *Finkelstein*, OSC Staff had been unsuccessful in several high-profile insider trading and tipping cases, in large part due to the evidentiary difficulties in proving these offences. The misconduct is generally secret, and OSC Staff lack more powerful investigation tools such as wiretaps. The decision in *Finkelstein* affirmed the OSC panel's reliance on circumstantial evidence to make a finding of insider trading and tipping, echoing the Divisional Court's prior decision in *Fiorillo*.

OSC Staff appear to be capitalizing on their success in *Finkelstein*. In *Hutchinson*, OSC Staff issued allegations of insider trading and tipping against four individuals, including a former legal assistant at a major Bay Street law firm. OSC Staff allege that the legal assistant provided a stock trader with confidential information about a series of takeover offers, which was then passed on to a wider insider trading ring spanning Panama, Bermuda, and the British Virgin Islands.

## WHISTLEBLOWING DEVELOPMENTS

In 2017, the Alberta Securities Commission (the ASC) announced (in its most recent Strategic Plan) its plans to implement a whistleblower program in order to encourage reporting of securities law misconduct, although the ASC is not considering financial payouts for whistleblowers. More recently, the ASC has released a formal "credit for co-operation" policy.

The OSC and the AMF both established their own whistleblower programs last year. However, only the OSC's program provides financial rewards for reporting securities wrongdoing. Despite being in place for over a year, the regulators have not announced any cases brought forward as a result of their whistleblower programs (and in the OSC's case, no whistleblower payouts have been announced).

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# Mining Year in Review – Progress amid volatility

Although 2017 saw increased activity and optimism in the mining sector compared to the previous three years, significant challenges remain. Especially among mid-tier and junior mining companies, which represent the largest segment of the Canadian mining sector, this past year could be effectively summed up as 'two steps forward, one step back' in terms of overall market conditions and outlook. In such an uncertain market environment there is often no single dominant theme or issue that defines the year, especially from a legal perspective. However, there were a number of developments that significantly impacted the mining industry and merit close attention as we head into 2018.

## EXPLORATION ACTIVITY

Capital flowed back into mineral exploration in 2017, as financings of junior exploration and development companies (particularly follow-on bought deal and marketed offerings) increased and major companies allocated more money to exploration budgets. This increased activity bodes well for the market as a whole, as mineral exploration tends to fuel the Canadian mining capital markets.

This also led to a greater number of property transactions as mining companies optioned, joint ventured or sold exploration projects in an effort to optimize their property portfolios. While this should result in more exploration projects being advanced (which is a good thing in a market hungry for a new high profile discovery), many of the projects for which financing is being sought among junior companies are ones that have been assessed (or reassessed) over the years.

However, while more deals were completed, and on the whole vendors enjoyed more favourable terms than they have in the previous few years, many property transactions utilized an option or earn-in structure with relatively small committed investment amounts. Of course, options tend to start with smaller commitments which increase based on exploration success, so this is partly a return to normalcy after seeing year over year decreases in mineral exploration in Canada from 2012 to 2016. It will be interesting to track whether exploration programs on recent earn-in transactions increase into 2018.

## PRIVATE EQUITY

There has always been some skepticism as to whether private equity is a good fit for the mining sector due to commodity price volatility, long timelines from discovery to production (and cash flow), and the significant capital required to develop mines. These factors are at odds with a private equity fund's finite lifespan and mandate to deliver cash flow positive investments within that timeline. In the recent downturn, private equity funds have been quite active in various non-core asset disposition initiatives undertaken by the majors, which resulted in those projects not seeing the market devaluation that earlier stage projects experienced. However, amid market rumours of funds being wound down and seeking to exit underperforming assets, private equity funds are likely to continue to focus on lower risk, late stage assets.

Private equity funds have established a track record of success in niche metals that do not have as much of a market following. In particular, the acquisition of Dominion Diamonds Corp. by The Washington Companies is a rare example of a successful leveraged buyout by private equity in the mining space.

Especially among mid-tier and junior mining companies, this past year could be effectively summed up as 'two steps forward, one step back' in terms of overall market conditions and outlook.

## CONSOLIDATION

There was moderate M&A activity in 2017, with a number of mid-tier consolidation plays, particularly in gold. The number of deals has increased slightly in 2017 over 2016, but aggregate deal values remain relatively constant. This suggests that more junior companies with earlier stage projects are being acquired by larger companies or combining with other juniors, often with smaller change of control premiums. This reflects the continuation of the consolidation of the mining sector that has been called for by analysts and financiers in the mining sector since 2013.

## ALTERNATIVE FINANCE – STREAMS AND ROYALTIES

In 2017, there was also continued attention on alternative finance structures like metal streams (where a mining company receives an upfront pre-payment against a commitment to sell a portion of production of a specific metal at a price below the prevailing market price) and royalties (where the royalty holder acquires an interest in a mineral project which entitles them to a portion of production (or revenues) after deducting certain costs). The streaming space is becoming more crowded with a larger number of financing sources, while at the same time the impact of streams on mining companies is increasingly being scrutinized. While streams of non-core metals are more accepted by the market, streams involving the primary metal of a mineral project attract greater scrutiny over the effects of the stream on project economics. Securities regulatory authorities are also starting to weigh the impact of streams on continuous disclosure obligations.

The market for royalties is also evolving. The basic terms for royalties have not changed. However royalty agreements are becoming more comprehensive and arguably more onerous for the property owner with respect to issues such as reporting and access to data, property maintenance and reversionary interests in favour of the royalty holders. Many option or earn-in transactions are being structured in a way that the optionor's (vendor) interest in the property is immediately diluted to a royalty interest rather than a minority ownership interest in a joint venture following the exercise of the option. Current market sentiment appears to value royalty interests more than a minority ownership interest. A good illustration is the recent acquisition by Osisko Gold Royalties of the royalty portfolio of Orion Mine Finance in July 2017 for a purchase price of $1.1 billion.

A key risk for royalties is the question of whether they are more properly considered interests in land or contractual obligations. This goes to the question of whether a royalty can be bankrupt-proof. The recent downturn resulted in a number of instances where companies going through restructurings have made proposals that are dependent on striking existing royalty interests. Courts have d considered a number of factors to determine whether the parties intended the royalty to run with the property as a property interest, or whether the royalty is purely a contractual obligation.

One recent example involved the Walter Energy restructuring proceedings in British Columbia where a royalty interest was disclaimed by the debtor company upon the sale to a third party of the royalty-generating mining property. In early 2018 the Court will hear a claim from the former royalty holder for damages arising from the loss of revenue stream from the disclaimed royalty. If successful, this claim would be a significant change in the rights of royalty holders and a significant additional avenue for royalty holders in bankruptcy situations.

## MARKET VOLATILITY AND THE NEXT BIG THING

Overall, while 2017 has been a much improved year in the mining sector, headwinds still remain. In the face of global political and economic uncertainty, perhaps that is no surprise. However, typically periods of economic uncertainty have seen market conditions improve for precious metal commodities like gold, and many market watchers expected the gold price to increase as the central banks de-levered.

There has also been a great deal of market interest in metals used in batteries, such as lithium, cobalt or graphite. The changing global landscape for these metals, and potential value increases arising from the evolution of new technologies also pose challenges for regulators.

## POSTSCRIPT

We are pleased to announce that Osler's Mining Group Co-Chair James Brown has been appointed to the Canadian Securities Administrators' Mining Technical Advisory and Monitoring Committee. The MTAMC provides guidance to the provincial securities commissions on technical mining matters.

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# The Ontario Fair Hydro Plan and its novel financing structure

In response to political pressure due to rising electricity rates, the Ontario provincial government (the Province) announced earlier this year that it would be lowering electricity bills for residential consumers, small businesses and farms as part of a significant restructuring of how the costs of operating the electricity system are treated. Electricity rates have been rising in Ontario due in large part to the cost of fixed-price contracts entered into with clean energy generators over the last decade. These fixed-price contracts have increased the cost of electricity in Ontario as compared to other jurisdictions.

## WHAT DOES THE FAIR HYDRO PLAN DO?

The Province's plan, known as the "Fair Hydro Plan," contemplates an immediate 25% reduction in electricity rates for eligible consumers. At the same time, it keeps the amount payable to generators of electricity (through the clean energy contracts and otherwise) unchanged.

The Fair Hydro Plan enables the Independent Electricity System Operator (IESO) to spread out the cost of these reductions over a number of years and to hold increases in electricity rates to the rate of inflation for a four-year period, beginning as of July 1, 2017. The costs to finance the reduction will be recovered from ratepayers in future years through additional charges on their electricity bills.

As part of the Fair Hydro Plan, the Province has directed the Ontario Energy Board (OEB) to approve the rate changes required to achieve the desired rate reductions and recoveries and has appointed Ontario Power Generation (OPG) as the manager of the Fair Hydro Plan.

## HOW IS THE FAIR HYDRO PLAN FINANCED?

Instead of borrowing the required amounts to fund the reductions through the Ontario Financing Authority (OFA) or otherwise, the Province has adopted a funding structure that provides for the creation of a "regulatory asset" by the IESO, as legislated in the *Ontario Fair Hydro Plan Act, 2017*.

The "regulatory asset" represents the difference between what electricity generators are owed pursuant to their fixed-price contracts with the IESO and the reduced amounts collected from electricity ratepayers as a result of the reduction in electricity rates. In other words, the "regulatory asset" represents the shortfall created by the rate cut. The regulatory asset represents a current and irrevocable property right to impose, invoice, collect, receive and recover the amount of the shortfall by means of future charges imposed on eligible consumers.

The IESO sells this regulatory asset to a special purpose trust created by OPG. The IESO uses the funds obtained from the trust pursuant to the sale of the regulatory asset to pay the electricity generators the full amounts they are owed. Effectively, the Fair Hydro Plan is a statutory-based securitization that generates the current cash needed to pay the generators today on the strength of a regulatory asset that permits recovery of the amounts in future charges paid by future electricity ratepayers. To facilitate this, the trust borrows money from capital market participants to purchase the regulatory asset. The trust incurs interest and other expenses on its borrowings. In addition, it pays fees to OPG as manager of the trust. These costs and fees are added to the IESO's shortfall amount and therefore increase the amount of the regulatory asset that the trust buys from the IESO.

In the future, the IESO will collect the money from ratepayers to repay the principal borrowed, plus interest and expenses. However, the exact amounts will remain uncertain until they are repaid.

Statute-based securitization has been used as a financing tool for power infrastructure assets across North America for a number of decades. This type of structure is most typically used as a solution to the problem of "stranded cost" recovery, which typically arises in electricity markets as they move to deregulation where future prices will be insufficient to recover sunk costs of legacy utilities. However, in such situations, the deficit is typically already known or is estimable at the outset. Therefore, a set deferral account and repayment schedule can be established in structuring the borrowing associated with such cost recovery.

What makes the Fair Hydro Plan unique and, to our knowledge, unprecedented, is the creation of an asset that represents the right of the IESO to collect revenue from future ratepayers' use of future electricity to make up for the present shortfall. This makes the precise scope of the cost deferrals unknown.

The Fair Hydro Plan is unique in how it implements an immediate reduction in electricity rates for eligible consumers, by providing for the creation of a regulatory asset that represents the right of the IESO to collect revenue from future ratepayers to spread out the cost of these reductions over a number of years.

Critics of the Fair Hydro Plan have argued that it sets a dangerous precedent and unduly burdens future generations. However, nearly every Canadian province has, like Ontario, adopted clean energy plans that provide for some degree of subsidized provincial power purchase arrangements. It remains to be seen whether other Canadian provinces will look to Ontario's Fair Hydro Plan in developing financing strategies for the costs of investment in clean energy assets.

Osler has acted for the investment dealers, who will facilitate the financing transactions of the trust, in the design and implementation of the financing components of the Fair Hydro Plan.

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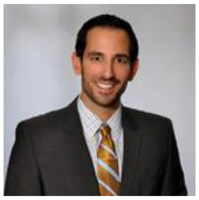

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# Alberta's Renewable Electricity Program – Competition exceeds expectations

In 2017, the Alberta Electric System Operator (AESO) commenced the first Renewable Electricity Program (REP) competition in Alberta. The REP is a result of Alberta's 2015 Climate Leadership Plan (Plan), which seeks to implement an economy-wide carbon levy, phase out coal, develop renewable energy, cap oil sands emissions and reduce methane gas. The economic impact of the REP is likely to be significant as it is estimated to result in $10.5 billion in new investment and the creation of at least 7,200 new jobs.

Project developers and investors should keep a close watch on the evolving electricity landscape in Alberta to maximize opportunities while at the same time minimizing risk.

## CLIMATE LEADERSHIP PLAN

The Plan was Alberta's response to the federal government's announcements that it would impose a carbon tax in 2018 if provinces did not enact an emissions reduction plan. Alberta's Plan seeks to respond to this requirement through a strategy designed for its unique economy.

The Plan requires that all pollution from coal-fired electricity be phased out and that 30% of Alberta's electricity come from renewable sources such as solar, wind and hydro by 2030. The Plan anticipates that this will be achieved by replacing coal-fired generation with renewable energy and natural gas. Currently, wind turbines provide 1,479 megawatts and solar provides 12 megawatts of the electricity capacity in Alberta. Reaching the target set out in the Plan will require an additional 5,000 megawatts of renewable electricity capacity.

## RENEWABLE ELECTRICITY PROGRAM

The REP encourages the development of renewable electricity generation through a series of competitions. Successful bidders will be provided with support payments by the AESO for their projects. These competitions are administered by the AESO but overseen by an objective third-party observer. Each competition may include up to three stages and will generally last for seven to 11 months. The first competition, which commenced on March 31, 2017, is expected to procure approximately 400 megawatts of renewable electricity capacity. This competition required that projects be operational in 2019 and generate five or more megawatts of renewable electricity.

The first competition consisted of three stages, a Request for Expressions of Interest (REOI), a Request for Qualifications (RFQ), and a Request for Proposals (RFP).

Alberta's electricity market is in a period of transition. The development of an additional 5,000 megawatts of renewable electricity presents significant development and investment opportunities.

### Request for Expressions of Interest

The REOI stage ran until April 21, 2017. This stage was meant to identify proponents who were interested in participating in the RFP stage and to provide them with information to assess whether to participate. Participation in the REOI stage did not obligate a proponent to continue to the RFQ stage.

### Request for Qualifications

The RFQ stage lasted from April 28, 2017 to September 2017. This stage was intended to inform bidders of eligibility requirements and to qualify bidders to participate in the RFP. The bidders were required to pay a non-refundable qualification fee and to demonstrate project eligibility; financial strength and capacity; and development, construction and operations capability.

### Request for Proposals

Qualified bidders then proceeded to the RFP stage, which runs from September 15, 2017 to December 2017. This stage determines which bidders will be selected.

Successful bidders will then enter into a Renewable Electricity Support Agreement (RESA) with the AESO. The RESA will govern the project and provide pricing support. These pricing support payments will be provided through an Indexed Renewable Energy Credit (or a contract for difference) payment mechanism. When the Alberta power pool price is less than a bidder's strike price, this mechanism will provide a winning bidder with a $/MWh payment for renewable attributes that reflects the difference between its bid price and the pool price. However, if the pool price exceeds a winning bidder's strike price, then that bidder will be required to pay the difference to the AESO. As a result, the level of support received from, or payments made to, the AESO will vary with pool prices.

This competition attracted 81 parties who participated in the REOI stage. After the completion of the RFQ stage, 29 projects qualified to advance to the RFP stage. The Alberta government has stated that these projects represent 10 times the 400 megawatts targeted for this round.

Information regarding future REP competitions is not currently available, but is expected to be released in early 2018.

Renewable electricity generation is also advancing without the incentives provided by the REP. Outside of the REP, several renewable projects are moving through the AESO's connection queue. As of October 2017, over 50 renewable projects were in this queue.

## MOVING TO A CAPACITY MARKET

Alberta is also restructuring its electricity market to facilitate the transition to renewables. On November 23, 2016, the Government of Alberta announced its endorsement of the AESO's recommendation to transition from an energy-only market to a capacity market. A capacity market pays electricity generators for having the ability (or capacity) to reliably make power available, regardless of how often they sell energy onto the grid. In this sense, it is two different markets; one involving payments for generating capacity and another for energy that is actually produced and delivered into the market.

The AESO recommended a capacity market in part to increase the stability of prices, provide greater revenue certainty for generators, and to support policy direction, including the transition to renewables and the phase-out of emissions from coal-fired generation by 2030.

A capacity market is anticipated to be in place by 2021.

## CONCLUSION

Alberta's electricity market is in a period of transition. The development of an additional 5,000 megawatts of renewable electricity presents significant development and investment opportunities. In addition, the design and implementation of a new capacity-based market will result in numerous changes to the provincial electricity framework that should be monitored as they are implemented.

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# Government of Canada tests the limits under the Income Tax Act in 2017

In 2017, the Canada Revenue Agency (the CRA) pursued litigation which tested the limits of its powers under the *Income Tax Act*. The landmark *Cameco* case, now on reserve before the Tax Court of Canada, was the first tax appeal involving the scope of the recharacterization provisions in Canada's transfer pricing rules for related-party international transactions. Likewise, in *BP Canada Energy Company v. Canada (BP Canada)*, the CRA pursued a test case to the Federal Court of Appeal on the limits of its power to seek production of a taxpayer's internal analysis of uncertain tax positions. On the legislative side, the Department of Finance released a package of broad proposals which many say unfairly targeted Canadian private companies and their shareholders. The measures, which were largely intended to reduce certain perceived advantages of earning income through a corporation, were widely criticized by the business community and financial advisors and several of the proposals have now been abandoned or substantially revised. This article explores each of these 2017 developments in the administration of Canada's tax system.

## TAX COURT HEARS LANDMARK CASE INVOLVING TRANSFER PRICING RECHARACTERIZATION RULE

The international tax system has been the subject of recent debate in the news with populist accusations of companies not paying their "fair share" of taxes, leaks of documents, and the fallout from the Base Erosion and Profit Shifting (BEPS) project of the OECD. While most of that debate focuses on whether new laws should be adopted, the Tax Court of Canada heard a landmark case (*Cameco*) in 2017 that may influence how Canada's existing transfer pricing tax rules are applied to multinational corporations. The trial heard from dozens of witnesses and lasted over 60 trial days.

In particular, the case presents the Court with its first opportunity to interpret the recharacterization provision of the transfer pricing rules – a provision that permits the Court to set aside the actual transactions between a Canadian taxpayer and a non-arm's length foreign person and recharacterize them in relation to the transactions that arm's length parties would have entered into.

In *Cameco*, the Canadian parent mined and sold uranium to its Swiss subsidiary under long-term contracts. The Swiss subsidiary also acquired uranium from third parties. The Swiss subsidiary sold its acquired uranium to third parties via a back-to-back contract with a related U.S. subsidiary.

The Minister of National Revenue challenged Cameco on three fronts. First, the Minister invoked the previously untested recharacterization provision in an attempt to eliminate the subsidiary from these transactions altogether (with profits thereby accruing to the Canadian parent). The Minister's argument was based on the assumption that arm's length parties would not have included the subsidiary in such transactions.

Second, and in the alternative, the Minister argued that the Swiss subsidiary's profit should accrue to Canada under the traditional transfer pricing rule – where the actual transactions are retained but the terms and conditions are adjusted to those that would have been agreed to by arm's length persons. While the Courts have previously dealt with this rule, *Cameco* raises a number of important issues regarding how risk is treated, how the transfer pricing rules relate to other provisions in the *Income Tax Act* and, of course, how the traditional transfer pricing rule interacts with the recharacterization rule.

Finally, the Minister has also alleged that the series of transactions undertaken by the Cameco entities was a sham under common law principles.

Cameco, represented by Osler, has vigorously contested the Minister's allegations, which Cameco believes are entirely without merit. The Court's ruling is expected in 2018 and will be closely watched by the tax community.

The Tax Court of Canada heard a landmark case (*Cameco*) in 2017 that may influence how Canada's existing transfer pricing tax rules are applied to multinational corporations.

## FEDERAL COURT OF APPEAL DEFINES LIMITS OF THE CRA'S POWER TO DEMAND DOCUMENTS

In *BP Canada*, the Federal Court of Appeal offered important guidance on the limits of the CRA's statutory powers to demand documents which relate to the taxpayer's internal analysis of uncertain tax positions. These documents are known as "tax accrual working papers," and generally refer to papers created by or for independent auditors in order to assist in the process leading to the certification of financial statements in accordance with GAAP.

In *BP Canada*, the taxpayer had been fully co-operative in providing all the facts and records that the CRA had requested on audit and had, in fact, satisfied all the CRA auditor's concerns in relation to the particular tax year. The auditor then demanded an unredacted list of the taxpayer's uncertain tax positions. The CRA auditor ultimately admitted that the purpose of this request was to use the list as a "road map" to facilitate audits of BP Canada for future taxation years.

The Court unanimously refused to grant this request, holding that the statutory regime, properly interpreted, does not make "tax accrual working papers" compellable without restriction and that the Minister cannot enlist taxpayers to reveal soft spots in their tax returns. While the tax system is one of self-assessment, the obligation to self-assess does not require taxpayers to self-audit or to perform core aspects of the CRA's audit function. The context and purpose of the statutory regime indicates that Parliament intended the document disclosure power to be used with restraint when dealing with tax accrual information and that such information is not required to be routinely provided. The Court noted that the CRA's own published policy on document disclosure states that the power to access tax accrual documents will not be used routinely. Seeking ongoing access to BP Canada's uncertain tax positions effectively turned that policy on its head.

The Court further accepted the argument that requiring tax accrual papers to be routinely provided would undermine financial reporting obligations under provincial securities legislation by creating an incentive for publicly traded corporations to refrain from documenting issues for their external auditors and to be less candid in disclosing their tax risks. In the Court's view, Parliament cannot have intended the audit powers in the *Income Tax Act* to imperil the integrity of provincial financial reporting systems.

The CRA has chosen not to appeal the *BP Canada* decision. It is anticipated that the CRA will publish an updated policy to address when it is appropriate for CRA auditors to request this type of document. It is to be hoped that the revised policy will continue to reflect the Court's admonition that such requests not be made for purposes of scoping the CRA's audit.

## PRIVATE COMPANY TAX REFORM

In July 2017, the federal government proposed sweeping changes to the manner in which Canadian private companies are taxed. The proposals addressed four broad areas; (i) income sprinkling, (ii) the taxation of passive income held in private corporations, (iii) surplus stripping (transactions intended to convert regular income into capital gains), and (iv) limiting access to the lifetime capital gains exemption (LCGE).

As a result of significant public criticism, the government indicated that it will scale back on the passive income proposals and will not be moving forward with either the surplus stripping proposals or the proposals to limit access to the LCGE.

The government also announced that the small business tax rate would be reduced from 10.5% to 10% effective January 1, 2018, and to 9% effective January 1, 2019.

### Income sprinkling

Where a child under the age of 18 receives certain taxable dividends from private corporations (or income from partnerships and trusts derived from a business or a profession), these amounts will be taxed in the child's hands at the highest personal tax rate (i.e., tax on split income). The government has proposed to expand the types of income to which the tax on split income could apply. In addition, the proposal expands the persons to whom the rules could apply to include spouses, adult children and related persons (such as aunts, uncles, nieces and nephews). Where the amount received is "reasonable" having regard to the level of contribution made by the individual to the business, the high rate of tax on split in income will generally not apply.

Draft legislation outlining the proposals and providing greater certainty for family members who contribute to the business is expected in late 2017 and is proposed to be effective for the 2018 and subsequent taxation years.

### Passive income

Very generally, the aggregate amount of tax paid on investment income earned by a corporation and distributed to shareholders as a dividend is similar to the amount of tax an individual would pay on the same investment income earned directly. However, because active business income is taxed in a private corporation at a lower tax rate than the same income earned by an individual, a private corporation earning business income will generally have more "after tax" funds to invest in passive investments.

While draft legislation has not yet been released, the government has indicated it is considering ways to address this "perceived advantage." This could ultimately result in an effective tax rate of over 70% on certain passive income. However, the government has recently confirmed that new rules will not apply to past investments and income earned on past investments. The government is also proposing to introduce a $50,000 annual exemption from the higher rate of tax.

Draft legislation for these rules is expected in the 2018 federal budget.

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# Shifting sands of the law of privilege

In the past year, the Supreme Court of Canada reaffirmed the sanctity of solicitor-client and litigation privilege, setting a high standard for legislatures that intend to abrogate from the broad protection that privilege offers. At the same time, two other decisions (one of the Federal Court, and one of the English High Court) could dramatically erode the protection in areas where it was thought to have been long-established – specifically, “deal” or “transaction” privilege and the privilege attaching to documents prepared by counsel during an internal investigation. If these two decisions are upheld on appeal, their potential ramifications could be far-reaching.

## FEDERAL COURT DEALS SIGNIFICANT BLOW TO DEAL PRIVILEGE

The Federal Court placed “deal” or “transaction” privilege under significant scrutiny in its decision in *Minister of National Revenue v Iggillis Holdings Inc (Iggillis)*. This decision is currently under appeal to the Federal Court of Appeal. Unless reversed or substantially narrowed on appeal, *Iggillis* may mean that privilege will no longer protect from production legal advice shared between parties in furtherance of a commercial transaction.

“Deal privilege” is the colloquial name for a category of common interest privilege. Normally, solicitor-client privilege over a document is waived when that document is shared with a third party. However, the courts have historically recognized that privilege may still be maintained where the document is shared with a third party that has a common interest in defending actual or anticipated litigation. In reliance on those principles, a number of Canadian courts have gone further, and have held that privilege may be maintained where a party shares a privileged document with a third party that has a common interest in completing a transaction.

The Court's ruling in *Iggillis* has now cast serious doubt on whether deal privilege still exists. In short, in the context of a privilege challenge by the Canada Revenue Agency in a tax case, the Federal Court held that privilege did not attach to a legal opinion that had been shared between opposite parties to a commercial transaction that discussed various tax issues arising from the transaction. The Court agreed that the memo reflected legal advice prepared by a lawyer for his client and was therefore protected by solicitor-client privilege in the hands of the client. However, the Court held that privilege was lost when the memo was shared with the opposing party. As a result, the Court held that the opinion had to be produced to the CRA in response to a statutory production requirement.

In its reasons, the Court expressed a concern that deal privilege had been used to allow parties to improperly shroud commercial dealings and negotiations. Deal privilege, the Court held, had significantly expanded the quantity of relevant evidence that is denied to the courts, was not available to most users of legal services, and provided no benefit to the administration of justice.

While the Court's ruling is not strictly binding on provincial Superior Courts, the Federal Court's ruling has cast serious doubt on the existence of advisory common interest privilege in Canada. However, it is important to stress that the Court did not challenge a party's ability to assert common interest privilege in respect of actual or pending litigation. Moreover, the Court continued to recognize the ability of parties to retain common counsel, and to assert privilege over communications with common counsel.

As a result of *Iggillis*, if parties to a commercial transaction wish to share legal advice relating to the transaction, they may have to exercise additional caution. In particular, until the Federal Court of Appeal releases its decision (currently under reserve), "allied lawyers" of a purchaser and vendor who wish to share legal advice on tax and legal issues may have to consider the additional formality and cost of engaging common counsel to maintain a claim of privilege over sensitive legal advice. In the absence of such measures, parties to a commercial transaction may not be able to maintain privilege over such advice and may have to produce such advice to the CRA, regulators or even third parties in response to a production demand. As such, parties to a deal will have to balance the very real risk of potentially having to produce the advice against the efficiencies that may be gained from sharing it during the transaction.

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## UK COURT FINDS INTERNAL INVESTIGATION NOTES NOT PRIVILEGED

Looking abroad, this past May, the English High Court released its decision in *Director of the Serious Fraud Office v Eurasian National Resources Corporation Ltd.* (*Eurasian National Resources*), which held that documents prepared by legal counsel during a company's internal investigation were not protected by litigation privilege. The company had carried out an internal investigation relating to allegations of corruption and bribery. In the course of the investigation, the company's external counsel prepared working papers and notes of interviews with dozens of individuals. The company claimed these documents were litigation privileged because they had been prepared under the reasonable contemplation that an investigation by the UK's Serious Fraud Office (SFO) was imminent. They further claimed the notes were protected by legal advice privilege (the British equivalent of solicitor-client privilege).

The English High Court found that a potential investigation by the SFO was insufficient to ground a claim of litigation privilege, since an investigation was merely a preliminary step before prosecution and did not constitute "adversarial litigation." It further found that documents generated under no more than a "general apprehension" of future litigation cannot be protected by litigation privilege simply because an investigation is (or is believed to be) imminent. The Court also rejected the application of legal advice privilege to the interview notes because they were not generated in the course of the company conveying instructions to its counsel. In October, the company was granted permission to appeal the decision to the Court of Appeal.

As it is not a Canadian decision, it remains to be seen what impact *Eurasian National Resources* may have on judicial thinking in Canada. On one hand, Canadian courts have, in the past, viewed UK decisions as persuasive or informative. On the other hand, Canadian courts have previously been prepared to recognize a party's ability to assert solicitor-client privilege and litigation privilege in connection with an internal investigation. At the very least, this UK decision demonstrates that the courts in other common law jurisdictions are taking a close look at the limits of privilege in the context of internal investigations.

If its reasoning is adopted by Canadian courts, the decision will raise important considerations for companies, in-house counsel and external lawyers conducting internal investigations. Counsel should not automatically assume that interview notes and other documents produced during an internal investigation will be protected by privilege. Furthermore, the decision has potential implications for companies with overseas operations and subsidiaries who are increasingly subject to cross-border government and regulatory investigations into issues like securities fraud, anti-competitive conduct, products liability, corruption, money laundering and environmental issues.

## SUPREME COURT AFFIRMS ROBUST PROTECTION AFFORDED BY SOLICITOR-CLIENT AND LITIGATION PRIVILEGE

In decisions released contemporaneously at the end of 2016 in *Alberta (Information and Privacy Commissioner) v University of Calgary* *(Alberta Privacy Commissioner)* and *Lizotte v Aviva Insurance Company of Canada* *(Lizotte)*, the Supreme Court of Canada came down on the side of protecting privilege in interpreting legislation requiring parties to produce documents that would otherwise be protected by privilege. In short, the Court held that while a legislature may override privilege in narrow circumstances, it must do so in a "clear, explicit and unequivocal" manner in light of the fundamental importance of legal privilege to the Canadian legal system.

In *Alberta Privacy Commissioner*, a former employee sought disclosure of records from the University of Calgary pursuant to Alberta's *Freedom of Information and Protection of Privacy Act (FOIPPA)*. The university withheld certain records on the basis they were subject to solicitor-client privilege. A delegate of Alberta's Information and Privacy Commissioner nevertheless ordered the university to produce the documents pursuant to s. 56(3) of *FOIPPA*, which requires a public body to produce documents to the Commissioner upon request despite "any privilege of the law of evidence." The Supreme Court held that the university was not required to produce documents protected by solicitor-client privilege. Given the importance of the privilege, the Court confirmed that it could only be statutorily abrogated by language that was "clear, explicit and unequivocal." The Court found that s. 56(3) did not meet this threshold, as solicitor-client privilege was a category of privilege broader than a "privilege of the law of evidence." While access to information is an "important element of a modern democratic society," the Supreme Court found that solicitor-client privilege is "fundamental to the proper functioning of our legal system and access to justice."

The Court's decision in *Lizotte* held that a regulator could not compel production of a regulated insurer's entire file in the face of an assertion of litigation privilege. Section 337 of the *Act respecting the distribution of financial products and services* obliges regulated insurers to "forward any required document or information concerning the activities of a representative" to the regulator. The company refused to produce certain documents on the grounds that they were litigation privileged.

The Supreme Court upheld the litigation privilege, underscoring its fundamental importance and noting that it "serves an overriding 'public interest' [...] to ensure the efficacy of the adversarial process." Applying the same threshold as it did in *Alberta Privacy Commissioner*, the Court held that "unless clear, explicit and unequivocal language has been used to abrogate" the privilege, "it must be concluded that the privilege has not been abrogated." The open-ended language in s. 337 ("any required document") did not meet this statutory threshold and, therefore, the documents did not have to be produced.

## CONCLUSION

The fundamental protections afforded by the long-established principles of solicitor-client and litigation privilege are bedrock principles underlying the administration of justice. Yet the scope of those protections is clearly still evolving and has yet to be fully determined. As the privilege landscape continues to shift, companies and their counsel need to remain fully apprised of new developments to ensure that privilege over potentially sensitive records is not inadvertently waived.

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# Privacy a primary concern in 2017

Sophisticated cybersecurity threats, high-profile data incidents, and an explosion in the volume of data analytics initiatives have resulted in privacy issues being top of mind for organizations across all sectors. Moreover, in 2017, there were several key legal and regulatory developments in the Canadian privacy and data arena, most notably relating to statutory security breach notification regimes, Canada's Anti-Spam Legislation (CASL), and data governance.

## SECURITY BREACH NOTIFICATION

The *Personal Information Protection and Electronic Documents Act* (or PIPEDA) – Canada's federal private sector privacy law – has a new security incident reporting and notification regime, which will come into force after regulations are finalized.

The new regime features a unique, three-pronged notification requirement. When an organization suffers a breach of security safeguards that gives rise to a "real risk of significant harm" in the circumstances, the organization must (i) report the incident to the Office of the Privacy Commissioner of Canada (the OPC); (ii) notify affected individuals; and (iii) notify any other third parties that are in a position to mitigate the risk of harm to affected individuals.

Critically, PIPEDA's new security breach notification regime also imposes a record-keeping requirement, under which organizations must maintain a record of all of their data breaches. Organizations are obligated under the statute to make these records available to the OPC upon request.

Draft security breach regulations were released this past September. It is expected that they will be finalized in 2018 and come into force thereafter, following a brief transition period.

We expect this notification regime to have a significant effect on the Canadian data arena. Based on client experience after U.S. states implemented their security breach notification regimes several years ago, after the *Personal Information Protection Act* (Alberta) was amended to include an incident reporting rule, and after notification rules were introduced in various provincial health privacy statutes (including enhanced rules in Ontario's health privacy legislation that came into force this year), we are expecting PIPEDA's new reporting and notification regime to have the following consequences:

- More transparency about and reporting of data security incidents within organizations, and more general awareness about the increasing volume, breadth, and sophistication of security threats.
- More notifications sent to affected individuals and other organizations about security incidents.
- More media coverage, or at least a spike in media reports, and heightened public awareness about information security safeguarding practices (or a perceived lack thereof).
- More investigations, posted decisions, and regulatory queries by privacy regulatory authorities, leading to a continuing increase in the sophistication of privacy regulatory authorities, which will, in turn, raise regulatory expectations.
- Increased class action litigation risk.

**Privacy class actions over time**

The number of privacy class actions rapidy increased from 2010 to 2016. There were only two privacy class actions commenced prior to 2010. In 2010 there were three new privacy class actions, seven in 2011 and 10 in each of 2012 and 2013, respectively. Following a slight dip in 2014 and 2015, there were 11 commenced in 2016. So far in 2017, we are aware of four new privacy class actions.


- More concern about and attention to the enhanced legal and reputational risks at the senior management and board level.
- More proactive efforts by organizations to address personal information security concerns, initially focusing, in particular, on
  - developing and/or enhancing and ensuring the appropriate implementation of security incident readiness plans and protocols; and

- intensified scrutiny of third-party vendors who have custody of the data of organizations, including enhanced vendor management practices, such as increased pre-contractual due diligence, more robust contractual obligations on vendors to safeguard data, more attention on appropriate risk allocation, and a focus on post-contractual compliance monitoring.
- And, overall, increased costs to organizations due to all of these factors.

## CANADA'S ANTI-SPAM LEGISLATION

CASL is perhaps the most stringent anti-spam legislation in the world. The legislation imposes strict and prescriptive consent, notice, and other requirements relating to the sending of commercial electronic messages and the installation of computer programs.

To date, the Canadian Radio-television and Telecommunications Commission (CRTC) – the primary body responsible for enforcing CASL – has received over 1 million complaints involving alleged violations of CASL. The penalties for non-compliance are potentially severe: organizations can be subject to administrative penalties of up to $10 million and a private right of action for damages of up to $200 per commercial email (or other type of electronic message) sent in contravention of the legislation, up to a maximum of $1 million for each day the contravention occurred.

The private right of action was originally scheduled to come into force on July 1, 2017. However, in a significant development in June of 2017, the Canadian federal government announced that it was suspending the coming into force of these provisions, noting that a parliamentary committee would be asked to review CASL.

The House of Commons Standing Committee on Industry, Science and Technology commenced the parliamentary review this past September and proceeded rapidly with its work. By early November, the Committee had heard from dozens of witnesses and received dozens of written briefs, the vast majority of which advocated for significant amendments to CASL. The federal government's response to the report of this parliamentary committee is expected in 2018.

In the meantime, companies still face potential CRTC enforcement for violations of CASL. The CRTC concluded several investigations in 2017 and has multiple other investigations in progress.

> Moving into 2018, we are expecting that 'demonstrable accountability' will remain a central focus of Canadian privacy regulatory authorities.

## THE DATA GOVERNANCE FOCUS

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 in all sectors are coming to grips with the nuanced privacy, legal, ethical, and reputational risks arising in the course of their analytics (i.e., "big data" initiatives). In a major trend aimed at identifying and mitigating these risks, more organizations have been developing or enhancing robust data governance frameworks, which incorporate privacy programs, information security governance and enterprise risk processes.

In 2017, Canadian privacy regulatory authorities also turned their attention more to organizations' privacy programs, data governance and "demonstrable accountability." In regulatory decisions and a number of public statements, privacy regulatory authorities more pointedly emphasized the need for organizations to demonstrate the effectiveness of the policies, practices, and procedures governing their personal information practices.

Moving into 2018, we are expecting that "demonstrable accountability" will remain a central focus of Canadian privacy regulatory authorities. Canadian organizations should ensure that they are in a position to demonstrate that they have up-to-date and appropriately robust data governance frameworks in place.

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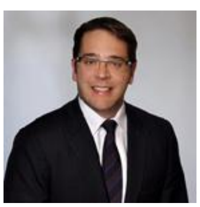

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# Liberalizing foreign investment review

The federal Liberal government has taken a number of steps in 2017 to liberalize foreign investment review, making it easier for foreigners to acquire Canadian businesses.

## HIGHER THRESHOLDS FOR "NET BENEFIT" REVIEW

The most noteworthy development has been the significant increase to the financial threshold used to determine whether private-sector investments in Canadian businesses will be subject to "net benefit" review under the *Investment Canada Act* (ICA). The threshold began the year at $600 million, was raised to $1 billion on June 22, and to $1.5 billion on September 21. These increases were a result of the implementation of the Canada-European Union Comprehensive Economic and Trade Agreement (CETA) for investors from the European Union (EU), the United States (U.S.) and select other nations that have free trade agreements with Canada that include a most-favoured nation provision. Commencing January 1, 2019, the threshold will be adjusted annually to reflect a GDP-based index.

These threshold increases also apply to transactions where the purchaser is not a private sector WTO investor or from one of the countries listed above, but where the vendor is an investor that satisfies one of those criteria. However, the threshold changes do not apply to investments by state-owned enterprises, which are still subject to a book value of assets threshold ($379 million in 2017).

The higher thresholds can be expected to result in a significant decrease in the number of investments subject to review under the "net benefit" provisions of the ICA. Review under the ICA can be time consuming (75-plus days) and approval is typically granted subject to commitments from the non-Canadian investor regarding its operation of the business following closing. Accordingly, the higher threshold will provide investors in Canada with improved timing certainty regarding the completion of acquisitions in Canada, as well as increased flexibility in their operation of acquired businesses.

### 1. National security review

While the government carefully assesses all investments in Canada from a national security perspective, including those that do not lead to a change of control, the national security review power continues to be used judiciously. The 2016-2017 Investment Canada Act Annual Report (Annual Report) includes statistics on the national security review process, providing insight into a process that has historically been opaque. The Annual Report indicates that national security reviews are rarely conducted. In FY 2017, only five of the 737 investments that were subject to notification under the ICA (at a minimum) were formally reviewed on national security grounds.

According to the Annual Report, the three most important factors that led to national security review in FY 2017 were

- the potential for transfer of sensitive dual-use technology or know-how outside of Canada;
- the potential for negative impacts on the supply of critical services to Canadians or the government; and
- the potential to enable foreign surveillance or espionage.

Very few transactions are blocked, approved subject to commitments, or materially delayed due to national security concerns. However, it should be noted that these statistics do not reflect the full impact of the national security review process. For example, the statistics do not include potential transactions that were abandoned at an early stage due to concerns raised informally. In addition, investments may be informally screened on a voluntary basis through requests for information to rule out national security concerns at an early stage.

*Significant increase to the financial threshold in 2017 -*

***from***

***$600 million to $1 billion***

*on June 22 to*

***$1.5 billion***

*on September 21*

### 2. Approach to investment from China

The current Liberal government's efforts to encourage foreign investment represent a notable shift from the previous Conservative government. The government is now more open to investment from China. Canada and China are holding exploratory discussions regarding a possible free trade agreement. Chinese investment in Canada, both in terms of number of discrete investments and the aggregate enterprise value of those investments, was second only to investments from the U.S. in FY 2017. In terms of asset value of the investments, total investment from China actually exceeded that of the U.S.

Hytera's takeover of Norsat International (Norsat) was a recent high-profile investment from China. Norsat, based in Vancouver, produces satellite equipment and transceivers, including those for military applications. Hytera, a private Chinese firm, proposed a friendly takeover. Despite considerable criticism – including from the U.S. – the transaction was approved by the Canadian government without a full national security review, instead only requiring a 45-day extension to the standard 45-day initial review period required under the ICA. While the government's approach to investment from China continues to evolve, and there continue to be certain types of investments that would be expected to attract a high level of scrutiny, the government's response to the Norsat acquisition suggests a higher level of comfort with investments from China.

Several other high-profile transactions from Chinese investors were reviewed and approved by the government in 2017. These include Anbang Insurance's (Anbang) takeover of Retirement Concepts, which operates retirement homes in British Columbia, Calgary and Montréal. Anbang, which is privately owned and one of China's largest insurers, has faced questions in the U.S. relating to its ownership structure and possible ties to the Chinese government. The Canadian government approved the transaction as being of a net benefit to the Canadian economy.

In another notable development relating to the review of investment from China in sensitive Canadian industries on national security grounds, the government revisited and approved Hong Kong-based O-Net Communications' (O-Net) takeover of Montréal-based ITF Technologies, despite the previous Conservative government's rejection of the same transaction in 2015. This approval was granted despite O-Net reportedly being 25% owned by the China Electronics Corporation, a Chinese state-owned enterprise. Though the unique facts of the O-Net transaction may limit its precedential value, it does stand as another example of the government's willingness to work with investors and find solutions in some circumstances where a viable path to approval previously may not have been possible.

The federal Liberal government has taken a number of steps in 2017 to liberalize foreign investment review, making it easier for foreigners to acquire Canadian businesses.

### 3. Cultural policy

Although the government has stated its intention to maintain existing protections for the Canadian cultural sector, it has adopted a flexible approach in addressing foreign investment in newer, digital media, most recently through the agreement reached with Netflix.

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# NAFTA, CETA and the TPP – Significant challenges and opportunities

Canadian companies that engage in cross-border trade and investments in the United States and internationally should pay close attention to the unprecedented and drastic changes in the international trade landscape that have taken place over the past year, as they will likely have a profound impact on their business strategies. These include the renegotiation of the North American Free Trade Agreement (NAFTA), the implementation of the Canada-European Union Comprehensive Economic and Trade Agreement (CETA) and the potential revival of the Trans-Pacific Partnership (TPP) among 11 countries (TPP-11) excluding the United States.

## SUCCESS OF NAFTA RENEGOTIATIONS IS UNCERTAIN

Canadian businesses engaged in cross-border trade likely spent much of the latter half of 2017 watching the NAFTA renegotiations, which are now well under way between Canada, the U.S. and Mexico. Both Canada and the U.S. revealed their core objectives for renegotiations over the summer. There were some obvious differences in the objectives, most notably in the areas of government procurement as well as trade remedies where, for example, Canada opposed, and continues to oppose, the U.S. proposal to eliminate the Chapter 19 review of domestic anti-dumping and countervailing duty decisions.

The first round of negotiations took place in Washington in August and since then four additional rounds of negotiations have taken place, with the fifth round of talks ending on November 21. The last two rounds have resulted in a stalemate with few indications that the final two rounds will provide the basis for the emergence of a modernized NAFTA.

At the end of the fourth round of negotiations, both the Canadian and Mexican officials rebuked the U.S. administration for its negotiating approach. These officials accused the U.S. of trying to “turn back the clock 23 years” by seeking to claw back so-called "unfair advantages" provided to Canada and Mexico in the negotiations leading to the finalized NAFTA. The Canadian and Mexican negotiators took issue with U.S. proposals, such as a sunset clause that would lead to the expiry of NAFTA in five years unless renewal was agreed to by the parties, the elimination of Chapter 19, restrictions on Canadian and Mexican businesses looking to participate in U.S. government procurement and a requirement that automobiles subject to NAFTA have a 50% U.S. value content. At the end of the fourth round, the ambitious goal of finalizing the renegotiated and modernized NAFTA before the year-end was abandoned.

The fifth round saw no major breakthroughs. In fact, U.S. officials argued that Canada was not properly engaging in the talks, refusing to submit counter-proposals to the U.S. proposals. Canadian officials responded, stating that they were advocating for a "facts-based" approach to get a better understanding of the U.S. proposals.

As negotiations proceed, it is clear that any revised NAFTA emerging from these renegotiations will have a profound impact on Canadian companies and on investors with ties to cross-border trade between Canada, Mexico and the U.S. Should the agreement be successfully renegotiated, it is likely that some of the more contentious U.S. proposals, including those discussed above, will be included in some form. However, if renegotiations fail or look to be failing, U.S. President Donald Trump may file notice of the U.S. withdrawal from NAFTA. Though it is unlikely that the President can withdraw from the agreement in its entirety without approval from Congress, President Trump may be able to increase tariffs without Congressional approval, allowing him to force imports from Canada and Mexico to be subject to customs duties while Congress debates a potential withdrawal from NAFTA.

The uncertainty in relation to whether NAFTA will survive, and in what form it will be in should it survive, should serve as a catalyst for Canadian companies to diversify their trade ties, with greater emphasis placed on trade with Europe and Asia. This year saw significant developments in trade with both of these regions.

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## CETA GRANTS GREATER MARKET ACCESS TO THE EU FOR CANADIAN COMPANIES

CETA, which came into force provisionally on September 21, 2017, grants Canadian businesses much greater access to the European Union (EU), the largest single consumer market in the world.

CETA's greatest impact will be on existing tariff levels between Canada and the EU, with 99% of these tariffs ultimately being eliminated by the agreement. This includes tariff reductions related to major sectors of the Canadian economy. For example, tariffs on oil and gas imports into the EU were as high as 8%, and now have been eliminated. Similarly, tariffs of up to 4.5% on automotive parts, 11-25% on fish and seafood and up to 10% on both forestry and metal products have all been eliminated under CETA.

CETA has also opened up procurement by EU governments at all levels. Though the procurements available to Canadian companies have been limited to a specific list of goods and services that are considered high-value, this provides far greater access than had previously existed.

One of CETA's other key benefits is the increased mobility that is available to business executives from Canada and the EU. Four categories of visas have been created for these executives, including a visa that will allow an intra-company transferee to move to the EU (or Canada) for up to three years.

## TPP GAINS NEW VIGOUR

Trade with Asia also promises to become more accessible. The TPP, thought all but dead when President Trump withdrew the U.S. from the agreement in January, seems to be showing signs of new life. The remaining 11 nations that were party to the TPP, including Canada, have reached an agreement on the core elements of a new pact known as TPP-11. This agreement would allow Canadian businesses greater access to markets in Australia, Brunei, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore and Vietnam. U.S. withdrawal has reduced the overall economic size of the deal, but the TPP-11 nations still have a combined GDP of US$12.4 trillion and include some of the world's fastest-growing economies. This could present Canadian businesses with some significant new opportunities to grow abroad.

Though a trade agreement of this size and scale would generally take years to negotiate, much of the agreement will be based on the text of the original TPP, finalized in 2015. As a result, a much shorter timeline to completion can be expected. Canadian businesses should continue to monitor developments on this front.

## CONCLUSION

The changes in trade and investment rules that began in 2017 can be expected to continue for the near future, and will be disruptive to the current trade and investment arrangements forged by businesses.

As long as the future of NAFTA remains uncertain, and perhaps in any event, Canadian businesses should focus on diversifying their trading relationships to take advantage of the new preferential access to the EU market based on CETA, and the potential for greater access to much of the Asian Pacific Rim through the TPP-11 and other trade arrangements.

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