DOING BUSINESS

in Western Canada

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Lawson Lundell LLP is Western Canada's business law firm. With offices in Vancouver, Calgary and Yellowknife, our lawyers are available to assist investors who wish to establish or expand their businesses in Canada.

INTRODUCTION

Canada's natural resources, educated and skilled workforce, modern transportation and communications infrastructure and close proximity to the large and growing markets of the U.S. and the Pacific Rim all contribute to Canada's vibrant business community. Historically, foreign investment has played an important part in the Canadian economy and that continues today.

As in all developed economies, the conduct of business and investment activities in Canada is subject to various regulatory regimes that attempt to balance competing interests. The following is a general discussion of the federal and provincial laws in force as at September, 2005 that are applicable to investments made or businesses conducted in Canada, particularly Western Canada.

This paper, relating to general commercial matters, focuses on the federal laws of Canada and the provincial laws of British Columbia and Alberta (the jurisdictions in which the largest Western Canadian economic centres, Vancouver, Calgary and Edmonton, are located). The laws of other relevant jurisdictions (in particular, the territories of Canada) are discussed to the extent that certain specific commercial activity, such as resource extraction, is governed by those laws. Given the significance of Ontario's capital markets in Canada, the laws of Ontario are discussed briefly where relevant under "Acquisition of Public Companies in Canada".

Canada's Legislative and Legal Systems

The development of business opportunities in Canada, through the establishment of a new enterprise or the acquisition of an existing one, occurs within a legislative and legal system that balances values and objectives shared by all modern developed societies.

Federalism

Like the U.S., Canada is a federal state. Legislative powers are divided between the federal government in Ottawa and the ten provincial governments. The three territories do not enjoy independent constitutional status and their lawmaking powers are limited to those delegated from the federal government. In addition, in the last two decades, the federal government of Canada has negotiated a series of agreements or treaties with several aboriginal peoples in the Northwest Territories, Nunavut and the Yukon Territory, effectively creating another level of administration.

The constitutional division of powers between the federal government and provincial governments is complex, but generally matters of national and international importance are within the purview of the federal government, while matters of a local nature are within the purview of the provincial governments. For example, the federal government has responsibility for international trade and commerce, banking, criminal law, shipping and interprovincial transportation, while the provinces are responsible for property law and the general law of contract.

Parliamentary System

Canada is a parliamentary democracy. The parliamentary system operates both federally and in the provinces and territories. The federal Parliament, located in Ottawa, consists of an elected House of Commons and an appointed Senate. However, the role of senators in the legislative

process is limited, so effective legislative power at the national level lies almost exclusively with the House of Commons. Each of the provinces and territories has only one legislative chamber, which is elected.

Unlike the congressional system in the U.S., which is based on a strict separation of legislative and executive powers, the parliamentary system requires that the Prime Minister and other members of the executive Cabinet be members of the legislature. The development of political parties federally and in all provinces and territories, other than the Northwest Territories and Nunavut, concentrates power in the executive Cabinet. This has two consequences. First, this focus of authority makes the rules governing businesses more certain and predictable. Second, lobbying efforts are generally directed at Cabinet and Parliamentary committees at the policy formation stage rather than legislators at the voting stage. There is a registry for lobbyists targeting federal officials. British Columbia has also enacted legislation to provide for a similar registry for lobbyists. Alberta does not have a registry for lobbyists.

Judicial System

Independence of the judiciary from the legislative and executive branches of government is a fundamental tenet of the Canadian judicial system. All government actions, including statutes, regulations, rules and administrative action, are subject to scrutiny by the judiciary. The judiciary also enforces Canada's Constitution, including the Charter of Rights and Freedoms. Unlike the Bill of Rights in the U.S., the Charter has been applied only in a limited way in respect of economic rights. Generally, Canadian society is less litigious than American society and, in Canada, civil matters are typically decided by judges rather than by juries as in the U.S. As a consequence, damage awards in Canada are more modest.

Two different legal systems govern private law in Canada. The Province of Quebec is a civil law jurisdiction, similar to that of France and other continental European countries. The rest of Canada follows the English model of common law. Historically, common law provinces have generally followed British jurisprudence; however, in recent years American case law has become increasingly influential with Canadian courts and legislators, particularly with respect to commercial matters.

FORMS OF BUSINESS ORGANIZATIONS

Introduction

A number of issues arise in choosing the appropriate form of business organization through which to carry out Canadian operations. Corporations have the choice of operating through a branch or through a subsidiary corporation. The possibility of operating through an unlimited liability corporation presents some unique tax advantages. The different jurisdictions under which a Canadian subsidiary can be incorporated have different requirements, which may be important to foreign businesses operating in Canada. Finally, the use of partnerships and joint ventures present advantages in some circumstances.

Branch versus Subsidiary

A non-resident may carry on business or conduct investment activities directly through a branch or indirectly through a Canadian subsidiary. There are many factors that a non-resident should consider before deciding to carry on business or conduct investment activities through a branch or a subsidiary.

Generally, the financial operations of a Canadian subsidiary may not be consolidated with those of other operations for foreign tax purposes. Consequently, one advantage to carrying on business or conducting investment activities through a branch of a foreign corporation rather than a Canadian subsidiary is the opportunity to offset losses in the Canadian branch against taxable profits earned by the foreign corporation in other jurisdictions, although an examination of the applicable foreign tax law should be made to determine the corporation's opportunities for such income tax offsets. This may be particularly important during start-up or reorganizations when losses may be expected.

A foreign corporation intending to carry on business as a branch in any province or territory in Canada is required to be extra-provincially or extra-territorially registered (qualified) in that province or territory. Procedures to obtain such registration or qualification are straightforward, generally requiring only the filing of an application reciting factual matters about the structure of the applicant and designating an agent-for-service in the province or territory. It is, however, necessary to obtain the approval of the provincial or territorial authorities to the business or corporate name under which the corporation will operate.

The use of a branch would directly subject the foreign corporation to provincial and federal laws. If this is a concern, consideration should be given to first creating in the home jurisdiction a wholly owned subsidiary of the foreign corporation. That subsidiary could then carry on business in Canada as a branch. Depending on the laws in the home jurisdiction, the foreign parent might then avoid direct liability for actions of the Canadian operation and might still be able to consolidate the losses, if any, of the Canadian branch into its own financial statements for tax purposes.

It may be advantageous to conduct business or investment activities in Western Canada through a Canadian subsidiary if the foreign corporation's resident jurisdiction taxes income or gains from the Canadian business or investment activity at a higher rate than the Canadian tax rate. Even in cases where the foreign corporation's resident jurisdiction taxes Canadian income and capital gains at a lower rate than Canada, it may be advisable to use a Canadian subsidiary since

Canadian withholding tax is imposed only in the year in which profits are distributed by a Canadian subsidiary to its non-resident shareholder. In contrast, branch tax is payable in the year in which the earnings occur regardless of whether those earnings are distributed to a non-resident, unless the earnings are invested in certain Canadian business assets. Since it is more difficult to control the timing of profits from investment income than it is to control the timing of dividend payments, the use of a Canadian subsidiary may result in a more efficient use of foreign tax credits that arise in foreign jurisdictions.

The thin capitalization rules do not apply to foreign corporations. Accordingly, more interest-bearing debt from shareholders and other related parties can be used to finance Canadian operations and deducted from income than would be the case if a Canadian subsidiary were used. The result is that the foreign corporation can pay to its shareholders, or other related parties, interest that is deductible for Canadian tax purposes, thus reducing the income and branch tax payable in Canada.

Also, while most government assistance programs are available to corporations whether Canadian or foreign controlled, some programs are restricted to federal or provincial corporations, and thus the choice of branch operation may result in an inability to obtain such assistance. The possibility of obtaining government assistance by using a Canadian subsidiary may then be a trade-off against the ability to deduct losses in Canada from income earned in the home jurisdiction if a branch of the foreign corporation is used.

See also the discussion under "Taxation".

Incorporation – Choice of Jurisdiction

If the decision has been made to incorporate a Canadian subsidiary corporation, the subsidiary may be incorporated under the federal laws of Canada or under the laws of one of the provinces or territories of Canada. The *Canada Business Corporations Act* (the "CBCA") is the legislation applicable to federally incorporated business corporations. The following discussion relating to the choice of the federal or a provincial (or territorial) jurisdiction in which to incorporate focuses on the CBCA and the current corporate legislation of Alberta and British Columbia. All ten provinces and three territories have comparable legislation, although their laws differ in various respects.

Certain Consequences of Federal Incorporation

Generally, a federal corporation has the capacity and the power of a natural person and may carry on business anywhere in Canada without having that capacity and power restricted by a province or territory. It can also use its name in any province or territory (subject to certain Quebec requirements that mandate French names). However, all provinces and territories regulate in some manner the corporate activities of a federal corporation through laws of general application requiring registration, the filing of returns and the payment of fees by every corporation doing business in the province or territory.

To carry on business in Alberta or British Columbia, a federal corporation must be extra-provincially registered there. A federal corporation carrying on business in Alberta or British Columbia must, in addition to filing the annual returns and notices of change of directors and registered office required by the CBCA, file in Alberta and British Columbia similar notices

reporting basic corporate changes, as required under the Alberta *Business Corporations Act* (the "Alberta Act") and the *British Columbia Business Corporations Act* (the "B.C. Act").

Extra-provincial Qualification

Corporations incorporated under the B.C. Act and the Alberta Act are also required to be extra-provincially registered in each other province or territory in which they conduct business. If the name of an Alberta corporation or B.C. company is not acceptable in the province or territory where application for the registration is being made, registration may not be granted, although in some cases it may be possible to register the corporation, if it will carry on its business under an assumed name which is acceptable. In the Province of Quebec, a corporation must either have a bilingual name or a French version of its name.

Incorporation

Incorporation is available as a matter of right and is accomplished by filing copies of charter documents in the prescribed form with the appropriate government department together with the required supporting material and fee. Prior to incorporating, it is necessary to obtain a name search report relating to the desired corporate name to determine whether the name sought is available. There are numerous restrictions on the proposed name, including that it must not be the same as or similar to that of any known entity if the use of the name would be likely to confuse the public.

The amount and type of authorized capital of a B.C., Alberta or federal corporation does not affect the incorporation fee or the corporation's capacity to carry on business. While no set percentage of authorized capital need be issued, the amount of subscribed or paid-up capital must be considered because of the "thin capitalization" provisions of the federal *Income Tax Act* (see further under "*Taxation*"). It is generally advisable to provide for a simple share structure (for example, consisting only of common shares) if the subsidiary is to be wholly owned by the non-resident. The share structure may be easily amended in the future if desired.

Directors

Alberta, B.C. and federal corporations must have at least one director, unless they are public companies, in which case they must have at least three directors.

Under the B.C. Act, there are no residency requirements for directors of B.C. companies. Accordingly, B.C. may be the choice of jurisdiction for foreign investors who do not expect to have "board-level" personnel resident in Canada.

A federal or Alberta corporation must have at least one director who is a "resident Canadian" and if the corporation has more than one director, at least 25% of the directors must be "resident Canadians".

A "resident Canadian" is defined in the CBCA as any individual who is:

- a Canadian citizen ordinarily resident in Canada; or
- a permanent resident within the meaning of the Canadian *Immigration and Refugee Protection Act* who is ordinarily resident in Canada, other than a permanent resident who

has been ordinarily resident in Canada for more than one year after the time at which the permanent resident first became eligible to apply for Canadian citizenship (usually three years); or

- a Canadian citizen not ordinarily resident in Canada who is a member of a prescribed class of persons (e.g., a member of the Canadian armed forces).

The definition of "resident Canadian" in the Alberta Act is similar to the CBCA definition except that the exception with respect to long-term permanent residents is not in the Alberta Act. Thus, in Alberta, a person with permanent resident status who is ordinarily resident in Canada continues to be qualified as a director as long as that status is retained.

Meetings of the directors of B.C., Alberta and federal corporations may be held either in or outside Canada. In order for directors of a federal or Alberta corporation to transact business at a meeting, the residency requirements referred to above must be met by the directors present at the meeting. Alternatively, a sufficient number of absent resident Canadians must subsequently approve the business transacted at the meeting such that if the absent resident Canadians had been at the meeting the required number of resident Canadians would have been present.

Unanimous Shareholder Agreements

The CBCA and the Alberta Act specifically permit "unanimous shareholder agreements" of all of the shareholders of a corporation. These agreements essentially remove from the directors of the corporation all or some of the general powers vested in the board to manage the business and affairs of the corporation. To the extent that the powers of the directors are limited by such an agreement, the directors are relieved of their duties and the shareholders assume such powers and the attendant liabilities.

The B.C. Act permits an analogous procedure, but the provisions moving the powers, duties and liabilities of the directors to the shareholders must be in the articles of the B.C. company; not in a separate agreement.

Non-Canadian tax implications of operating with a unanimous shareholder agreement (or its British Columbia equivalent) should be considered prior to putting such an agreement in place.

Notwithstanding the existence of a unanimous shareholder agreement (or its British Columbia equivalent), it would still be necessary for the corporation to have at least one director (who must be a resident Canadian in the case of a CBCA or Alberta corporation), although the director's duties and obligations would be substantially reduced. This streamlines corporate decision-making and may be particularly useful in the case of a Canadian subsidiary which is wholly owned by a non-resident. Hence, while a majority of the directors of the subsidiary must be "resident Canadians" (in the case of a CBCA or Alberta corporation), the business and affairs of the subsidiary can be controlled by non-resident shareholders rather than its directors.

Shareholders' Meetings

A B.C. company is required to hold its shareholders' meetings in British Columbia unless the Articles of the company provide otherwise, the shareholders agree otherwise by ordinary resolution or the B.C. Registrar of Companies otherwise approves on application made by the

company. Alberta and federal corporations must hold shareholders' meetings in Canada unless their By-laws provide otherwise or all shareholders entitled to vote at the meeting agree.

Accounting

Under the B.C. Act, the CBCA and the Alberta Act, financial statements of corporations governed by them must be prepared annually. Generally they must be prepared in accordance with Canadian generally accepted accounting principles.

Under the B.C. Act, this requirement does not apply to Canadian public companies and, if approved by unanimous resolution of all the shareholders of a B.C. company, certain kinds of foreign generally accepted accounting principles can be used. In addition, the preparation of financial statements can be waived by unanimous resolution of all the shareholders.

Under the CBCA, corporations which are SEC registrants can, with certain restrictions, use U.S. generally accepted accounting principles.

Federal and Alberta non-public corporations, and all B.C. companies, may avoid audit requirements simply by having all of their shareholders pass a resolution annually dispensing with the appointment of an auditor. Non-public corporations incorporated federally or under the laws of B.C. or Alberta are not required to file or make public their financial statements.

Partnerships and Joint Ventures

The use of the partnership or joint venture structure, in combination with one or more other persons or corporations in Canada, may be attractive in particular circumstances, primarily for tax reasons. Consideration must be given to whether a non-resident should hold its partnership or joint venture interest directly or through a subsidiary incorporated in Canada. If a subsidiary is used, the same considerations are relevant as those discussed above. If participation is to be held directly due to foreign tax or other considerations, this will be equivalent to operating through a branch in Canada, requiring the non-resident partner to extra-provincially register in those provinces where the partnership or joint venture carries on business.

In the case of partnerships, it is customary for a detailed partnership agreement to be entered into, in part to avoid unwanted provisions of the partnership legislation that otherwise apply. Limited partnerships are commonly used for investment purposes to permit the limited partners to obtain the benefit of tax deductions while retaining limited liability. If appropriately structured such that the general partner (with unlimited liability) is a corporation, all of the limited liability aspects of the corporate form may be preserved. The British Columbia and Alberta partnership acts are similar to comparable statutes in various states of the U.S.

True joint ventures or co-ownership arrangements, commonly involving one or more corporations, may be advantageous as an alternative to a partnership. This is particularly the case since they avoid the unlimited joint and several liability applicable to partners and permit the venturers or co-owners to regulate their tax deductions without being forced to use the same basis as other co-venturers, which would not be possible in the case of a partnership. A joint venture agreement must be carefully drafted to ensure that the joint venture is not considered to be a partnership.

REGULATION OF INVESTMENT IN CANADA

Introduction

There are few restrictions on foreign investment in Canada and those that exist relate to the following:

- restrictions in areas related to Canadian cultural heritage or identity (including broadcasting and publishing), telecommunications and banking;
- limitations on the degree of ownership in specified industries (for example, banking, telecommunications, airlines);
- those imposed by the *Investment Canada Act*; and
- those imposed by the *Competition Act*, which applies to Canadian and foreign investors.

The *Investment Canada Act*, a federal statute, subjects foreign acquisitions of Canadian businesses of a certain value to review in order to determine if the acquisition will benefit Canada. The *Competition Act*, while not specific to foreign investment, affects foreign investment to the extent that such investment could prevent or lessen competition substantially in Canada.

Canada, the U.S. and Mexico are parties to the *North American Free Trade Agreement*, which contains a number of provisions to protect investments in Canada by members of NAFTA countries.

Investment Canada Act

The *Investment Canada Act* is a federal statute that applies broadly to the regulation of investments by non-Canadians in Canadian businesses. Under the *Investment Canada Act* Industry Canada will review the foreign investment if the value of the acquired assets used in the Canadian business is equal to or greater than C$5 million for a direct acquisition. A direct acquisition is the acquisition of substantially all of the assets or a majority (in certain cases 1/3rd or more) of the shares of the entity carrying on business in Canada. An indirect acquisition is only reviewable if either (i) the value of the assets in Canada represents less than or equal to 50% of the value of all of the assets acquired in the transaction and the value of the Canadian assets is $50 million or more *or* (ii) the value of the assets in Canada represents more than 50% of the assets acquired in the transaction and the value of the Canadian assets is $5 million or more.

Notwithstanding the above thresholds, however, under an agreement establishing the World Trade Organization ("WTO"), a special status is conferred upon nationals of WTO member states and the entities controlled by them. There are two primary advantages. First, other than specific 'sensitive' industries, indirect acquisitions by a WTO investor are not reviewable. Secondly, the investment threshold limit that triggers review is higher for WTO investors and is adjusted upward every year based on the change in Canadian Gross Domestic Product. The current threshold for WTO investors is Cdn.$250 million. Any transaction below the current threshold is not reviewable unless the Canadian business is a "cultural" business, provides any financial service, engages in the production of uranium or provides any transportation service.

In order for a reviewable transaction to be approved by Investment Canada, it must result in a 'net benefit' to Canada. The *Investment Canada Act* sets out a number of factors that are to be taken into account in determining whether the proposed investment is of net benefit to Canada, including the effect of the investment on the level and nature of economic activity in Canada and the degree and significance of participation by Canadians in the existing and proposed businesses. Factors such as continued employment and the infusion of capital by the acquiror are particularly significant to Investment Canada and assist in meeting the net benefit test. Conversely, plans to downsize following a merger can be impediments to achieving approval for the investment.

Investments by non-Canadians in non-reviewable acquisitions and in the establishment of a new business are subject only to a notice filing requirement that must be made within 30 days following implementation of the investment.

Investment Review

If a proposed investment is subject to review, and is not in respect of a "cultural business", the Minister of Industry who is responsible for Investment Canada, will, on recommendation of Investment Canada, either approve or not approve the proposed investment. Investments in a business activity related to Canada's cultural heritage or national identity are the responsibility of the Minister of Canadian Heritage. The Minister of Industry has the power to order divestiture of control of a Canadian business that is the subject of an investment. The *Investment Canada Act* allows for negotiations to take place between Investment Canada and the investor to amend the terms of the application to provide for commitments, plans and undertakings, including with respect to the expenditure of certain amounts on capital or technology as well as the maintenance of employment levels or retaining head office functions in Canada so that the application is more acceptable to the Minister. Investment Canada, in the course of its review, will seek input from provincial governments or other government departments that they believe may be affected by, or have an opinion on, the investment. Investment Canada will always contact the Competition Bureau and advise of an application for review.

Waiting Periods/Fees

If a review is required, then Investment Canada must, within 45 days after receipt of a complete review application, advise the investor whether or not the investment is, in the view of the Minister, of net benefit to Canada. The Minister is entitled to a 30-day extension, on notice to the investor, for completion of the review. After such time, the Minister may request an extension, which must be mutually agreed to by the investor. The Minister has taken the position, although not supported by legislation, that if a proposed transaction is still in review by the Competition Bureau, then the Minister will not approve the investment as a net benefit to Canada until the Bureau has completed its analysis and does not propose to refer the merger to the Tribunal.

Unlike the Competition Bureau review described below, Investment Canada does not prescribe filing fees.

National Security

Although not yet law, the Minister of Industry introduced proposed amendments to the *Investment Canada Act* on June 20, 2005 (Bill C-59) which are designed to empower the Minister to take any steps he feels necessary to protect national security including prohibiting investment by a non-Canadian, where the Minister believes on reasonable grounds that the investment could be injurious to national security. There is no definition of what "national security" concerns the Minister might reasonably have, and whether it includes "economic" security or "resource" security concerns.

Competition Act

Mergers

The *Competition Act* defines a merger as any acquisition or establishment, direct or indirect, by one or more persons, by any means, of control over, or significant interest in, the whole or part of a business of a competitor, supplier, customer or other person. Therefore, a merger is broader than an acquisition of voting control.

The Commissioner of Competition may apply to the Competition Tribunal for a review of any merger or proposed merger. If the Tribunal determines that a merger or proposed merger prevents or lessens or is likely to prevent or lessen competition substantially, then the Tribunal has the power to prohibit or dissolve the merger or order divestiture of assets or shares. The Commissioner may make the application at any time up to three years after a merger has been consummated if, in the Commissioner's opinion, the merger raises concerns of substantial lessening of competition in the relevant market.

Approach to Merger Review Resolution

As the Commissioner has the power to determine whether or not to apply to the Tribunal for an order, the Commissioner will apply the substantive analysis to a proposed merger in the first instance.

Generally, mergers that raise concerns are dealt with by extensive negotiation between the Commissioner's staff and the parties involved. The Commissioner has the power and authority to accept undertakings or to request the Tribunal to issue a consent order where the Commissioner and the parties have reached agreement. Such case resolution methods are commonly used as an alternative to contested proceedings to avoid the expense of conducting a full Tribunal review.

Substantive Review

Whether a merger will be considered to substantially prevent or lessen competition depends on a number of criteria. The *Competition Act* does not define the concept of "substantial", but rather contains a non-exhaustive list of factors that the Tribunal may consider in an assessment of the likely competitive impact of a merger as follows:

- the extent of effective foreign competition;
- whether one of the merging parties is a failing business;

- the likely availability of acceptable product substitutes;
- the extent to which effective competition would remain in a market affected by the merger;
- the likelihood that the merger would result in the removal of a vigorous and effective competitor;
- any barriers to entry into a market including tariff and non-tariff barriers to international trade and any effect of the merger on such barriers;
- the nature and extent of change and innovation in a relevant market; and
- any other factor that is relevant to competition in a market affected by the merger.

In assessing whether a merger is likely to prevent or lessen competition substantially, the Tribunal will first identify the relevant markets from two perspectives: (i) the product or products with respect to which a merged firm acting alone or in concert with others is likely to be able to exercise market power; and (ii) the geographic area within which such power is likely to be exercised. Although market share is an indicator of the existence of market power, the *Competition Act* specifically prevents the Tribunal from finding a merger substantially prevents or lessens or is likely to substantially prevent or lessen competition solely on the basis of a concentration of market share.

Pre-Merger Notification

The parties to a proposed merger must notify the Competition Bureau prior to completion of the transaction where the transaction exceeds two threshold tests.

The first threshold is met if the parties to the transaction, together with their affiliates, have assets in Canada or gross annual revenues from sales in or from Canada, that exceed C$400 million. For the purposes of this test, the *Competition Act* deems the parties to a proposed acquisition of shares to be the person or persons who propose to acquire the shares and the corporation the shares of which are to be acquired.

The second threshold is met if the transaction is an acquisition, direct or indirect, of an operating business that has assets in Canada the value of which exceeds C$50 million or gross revenues from sales in or from Canada generated from those assets exceeding C$50 million. In the case of an amalgamation where at least one of the amalgamating corporations carries on, or controls a company that carries on, an operating business in Canada, the threshold is met if the continuing corporation (or corporations controlled by the continuing corporation) has assets in Canada the value of which exceeds C$70 million or gross revenues from sales in or from Canada generated from those assets exceeding C$70 million. Given the broad definition of merger, an acquisition of 20% of all outstanding publicly trading voting shares of a company or the acquisition of 35% of all outstanding voting shares of a private company that is, or controls, an operating business with assets or gross revenues that meet the prescribed threshold will require pre-merger notification.

Filing and Waiting Periods

Where pre-notification is required, one or more of the parties involved in the transaction must file a notice of the proposed merger and provide the prescribed information. There are two possible filings, a “long form” and a “short form”. Most pre-merger notifications are made on a

short form basis, and those which are more complex require long form filings. The Bureau reserves the right to require a party submitting a short form filing to file the information contained in a long form filing. The Bureau also may exercise its statutory power to obtain court orders compelling the parties to the merger and other parties, including interested stakeholders, to produce documentation and to answer specific questions.

If a short form notification is filed and accepted as complete by the Bureau, the parties may not complete the merger until 14 days after the short form notification has been receipted by the Bureau, provided that the Bureau does not require the applicant to file a long form. Generally speaking, if the short form has been correctly completed, the Bureau will issue its receipt within one business day following submission. However, the Bureau may notify the applicant that its application is incomplete, and the waiting period will not commence until the Bureau is satisfied that all required information has been received.

If a long form notification is filed, and accepted as complete by the Bureau, the parties may not complete the merger until 42 days after the long form notification has been receipted by the Bureau.

Information supplied to the Commissioner in either a short form or long form is kept confidential, although the Commissioner is entitled to present the information to the Tribunal for purposes of challenging the proposed merger.

While the parties to a transaction are free to complete the merger following expiration of the statutory waiting periods if the Commissioner has not challenged the merger, generally, the parties do not complete until the Commissioner has completed her review. Where the Commissioner has completed her review and has determined that no grounds exist to challenge a proposed transaction, the Commissioner will issue what is referred to colloquially as a "no-action" letter. The Bureau's "Fee and Service Standards Handbook" provides that a review of "complex" cases will take the Bureau 10 weeks to complete and a review of "very complex" cases will take the Bureau five months to complete. These standards do not have the force of law, but can present significant tension between the merger parties and the Bureau. As mentioned above, the Bureau has a variety of tools at its disposal to slow the process down by requiring further information.

The Commissioner reserves the right to challenge the merger if the merger raises competition issues. In addition, the Commissioner has the right to apply to the Tribunal for an interim injunction preventing the completion of a merger where the Commissioner has had insufficient time to review the application. Such interim order is granted for no more than 30 days, provided that the Commissioner may apply for an extension, which cannot exceed a further 60 days.

A long or a short form filing must be accompanied by a filing fee of C$50,000 for the transaction. Although typically the acquiror pays the fee, it is increasingly common for the parties to a friendly merger to negotiate the sharing of the fee. In addition, most applicants also file a submission or argument in support of the merger that provides the Bureau with the context and background for the merger.

Advance Ruling Certificates

Where the Commissioner is satisfied, upon application by a party or parties to a proposed transaction, that there would not be sufficient grounds on which to apply to the Tribunal for an order under the merger provisions regarding the transaction, the Commissioner may issue an advance ruling certificate ("ARC") to this effect. The Commissioner is required to consider any request for an ARC as expeditiously as possible.

If the transaction to which an ARC relates is substantially completed within one year after the ARC is issued, the Commissioner shall not apply to the Tribunal for a review of the transaction solely on the basis of information that is the same or substantially the same as the information on the basis of which the ARC was issued.

Generally, ARCs are sought in circumstances where the parties wish to avoid the extensive information requirements and time delays associated with pre-notification. However, an ARC can also be obtained when the parties desire a high degree of comfort that the Commissioner will not challenge their transaction.

The issuance of an ARC is entirely at the discretion of the Commissioner and will be issued only when the Commissioner is satisfied that there would not be sufficient grounds on which to apply to the Tribunal for an order. The application fee for an ARC is C$50,000 (plus GST of C$3,500) and it takes approximately two to four weeks following an application for the Commissioner to issue an ARC.

Information supplied to the Commissioner for the purposes of obtaining an ARC is kept confidential, although the Commissioner is entitled to present the information to the Tribunal for purposes of challenging the proposed merger. Information provided to the Commissioner in an ARC application should include an overview of both parties to the merger and an analysis of the effect, if any, on the relevant competitive product and geographic markets as a result of the merger.

Where the Commissioner is not prepared to issue an ARC, but otherwise does not have grounds to challenge the merger, she may deliver a "no-action" letter either because a short form notification was also filed (as is common practice) or because substantially all the information that would have been in a notification was provided in the submission.

North American Free Trade Agreement

Canada, Mexico and the U.S. are parties to the *North American Free Trade Agreement* ("NAFTA"), which came into force on January 1, 1994. NAFTA includes provisions that prohibit a NAFTA country from discriminating against another member country's products in favour of domestic products ("national treatment") or any other country's product ("most-favoured-nation treatment"). In addition, NAFTA includes performance requirement prohibitions and prior management nationality prohibitions.

Performance Requirements Prohibitions

NAFTA prohibits member countries from imposing requirements that tie the volume or value of imports into or sales within a territory either to the volume or value of exports from the host

country or to its foreign exchange earnings. It also contains provisions relating to technology transfers and product mandating. NAFTA not only prohibits the imposition of such performance requirements in undertakings or commitments given by other NAFTA country investors, but also proscribes the enforcement of performance requirements. Accordingly, Industry Canada is unable to enforce, as against any NAFTA country investor, any undertaking constituting or containing a performance requirement, irrespective of when such undertakings were given. There is an exception, however, for any undertaking enforced in connection with a review under the *Investment Canada Act* to locate production, carry out research and development, train employees or construct or expand particular facilities in Canada.

Similarly, NAFTA prohibits the imposition of performance requirements, such as preferential domestic sourcing, export minimums or minimum domestic content, on NAFTA investors as a condition of receiving or continuing to receive any advantage from the host NAFTA country.

Senior Management Nationality Prohibitions

NAFTA prohibits a host NAFTA country from requiring that an entity of another NAFTA country appoint to senior management positions individuals of any particular nationality. However, a NAFTA country may require that a majority of the board of directors or of any committee of the board of such an entity must be of a particular nationality or resident in the territory of the host NAFTA country, so long as that requirement does not materially impair the ability of the investor to exercise control over its investment. As discussed above under "Forms of Business Organizations – Incorporation – Choice of Jurisdiction – Directors", the corporate legislation of a number of Canadian jurisdictions imposes residency requirements for directors.

Exceptions

NAFTA's principles respecting national treatment, most-favoured-nation treatment, performance requirements and nationality of senior management and boards of directors do not apply to any existing non-conforming measure (such as the *Investment Canada Act*) that is maintained by the federal government and described in a NAFTA annex. They similarly do not apply to inconsistent measures of states and provinces that were in effect as of April 1996, thereby protecting such measures from challenge under NAFTA's dispute settlement provisions. Measures instituted after that date that establish new or increased discrimination against investors from other NAFTA countries, however, may be submitted to dispute settlement.

NAFTA explicitly acknowledges that when selling or disposing of its equity interests in, or the assets of, an existing state enterprise or an existing government entity, Canada and each province has the right to prohibit or impose limitations on the ownership of such interests or assets by investors of another NAFTA country or non-NAFTA country or their investments and to impose limits on the ability of owners of such interests or assets to control any resulting enterprise.

The national treatment, most-favoured-nation treatment and senior management principles are expressly stated not to be applicable to government procurement of goods or services or to subsidies and grants provided by a NAFTA country, including government-supported loans, guarantees and insurance. This means that NAFTA countries may discriminate against the investors of other NAFTA and non-NAFTA countries in regard to government procurement of

goods and services or to the granting of subsidies or other assistance (except as otherwise prohibited, for example, in NAFTA's rules on government procurement).

Transfers

Where an investor of a NAFTA country has an investment in the territory of another NAFTA country, the country in which the investment is located must permit transfers and international payments relating to the investment to be made freely and without delay. Transfers include:

- profits, dividends, interest, capital gains, royalty payments, management fees, technical assistance and other fees, returns in kind and other amounts derived from the investment;
- proceeds from the sale of all or any part of the investment or from the partial or complete liquidation of the investment;
- payments made under a contract entered into by the investor or its investment, including payments made pursuant to a loan agreement; and
- expropriation payments and awards made pursuant to the dispute resolution provisions of Chapter 11 ("Investment").

These provisions effectively prevent a NAFTA country from taking steps to block the transfer of funds out of the country. In addition, NAFTA investors will be able to convert local currency into foreign currency at the prevailing rate of exchange for any such transfers. Each NAFTA country is responsible for ensuring that such foreign currency may be freely transferred. This is undoubtedly intended to enhance the security of investments by other NAFTA country investors in NAFTA countries in the event that their investment is expropriated, so that the compensation required to be paid will be realizable and will not be tied up in a blocked currency. NAFTA countries are also prohibited from requiring their investors to transfer, or from penalizing its investors who fail to transfer, the income, earnings, profits or other amounts derived from or attributable to an investment in the territory of another NAFTA country.

Special Formalities and Information Requirements

A further exception to the national treatment principle permits a NAFTA host country to impose a requirement on investors of another NAFTA country that they must be residents of the host country and that investments made by such investors must be legally constituted under the laws of the host country (e.g., be held in a locally-incorporated corporation) "provided that such formalities do not impair the substance of the benefits of any of the provisions" of Chapter 11. In addition, each NAFTA country is expressly permitted to require, from an investor of another NAFTA country or its investment, routine business information to be used solely for informational or statistical purposes concerning that investment.

Environmental Measures

As a general exception, NAFTA provides that nothing in Chapter 11 is to be construed as preventing a NAFTA country from adopting, maintaining or enforcing any measure that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to environmental concerns. In addition, it is expressly recognized that it is inappropriate to encourage investment by relaxing domestic health, safety or environmental measures. In this connection, the NAFTA countries have agreed to consult with one another if one of them considers that another may have offered such encouragement.

Other Exempted Matters

Cultural Industries

Under NAFTA, Canada preserves the exemption for "cultural industries" that is provided under the Free Trade Agreement between Canada and the U.S. ("FTA"). However, each NAFTA country reserves the right to take measures of equivalent commercial effect in response to any action regarding cultural industries that would have been a violation of NAFTA but for the cultural industries exemption. These compensatory measures are not limited by obligations imposed by NAFTA.

National Security

NAFTA does not limit a party's ability to take actions that it considers necessary for the protection of its essential security interests:

- relating to the traffic in arms, ammunition and implements of war and to such traffic and transactions in other goods, materials, services and technology undertaken directly or indirectly for the purposes of supplying a military or other security establishment;
- taken in time of war or other emergency in international relations; or
- relating to the implementation of national policies or international agreements respecting the non-proliferation of nuclear weapons or other nuclear explosive devices.

Investor Dispute Resolution

General

Subchapter B of Chapter 11 of NAFTA sets out a comprehensive code for the resolution of investment disputes involving a breach or an alleged breach of NAFTA investment rules by a NAFTA country. A NAFTA investor may either seek monetary damages through binding investor-state arbitration or pursue remedies that are available in the domestic courts of the host country. In contrast, the FTA contains no provisions specifically enabling investors to require the resolution of investment disputes directly with a host country.

Choice of Arbitration Options

Subchapter B establishes a mechanism to settle investment disputes that assures due process before an impartial tribunal. An investor of in a country has an option either to resolve a claim against the country for breach of any of the provisions of Subchapter A before the tribunals of the country where the investment was made or to submit the claim to arbitration. Three arbitration options are provided: International Centre for Settlement of Investment Disputes ("ICSID") Convention arbitration (if the two countries involved are parties to the ICSID), the Additional Facility Rules of ICSID (if only one country is a party) or arbitration under the rules of the United Nations Commission on International Trade Law ("UNCITRAL Arbitration Rules"). Accordingly, the NAFTA investor dispute resolution mechanism does not involve the establishment of a new arbitral process but instead confirms investors' rights to seek arbitration for violations of NAFTA investment rules under three existing international arbitration procedures. Currently only the U.S. is a signatory to the ICSID Convention. Consequently, the option of arbitration pursuant to that convention will only become available if, as and when

another NAFTA party signs on to it. However, the Additional Facility Rules of ICSID are intended for the purpose, among others, of specifically dealing with investment disputes between signatory and non-signatory countries. The UNCITRAL Arbitration Rules are rules that international parties frequently choose to govern disputes arising out of international contracts.

The investment dispute resolution process provided for by Subchapter B overcomes problems that have been encountered in connection with the more traditional approach to the resolution of foreign investment disputes in an international context. Generally speaking, international rights are recognized as between states and, where international law is violated with reference to an individual investor from a state, it is the state and not the individual investor that has the right to assert a claim in regard to the injury sustained. Until now, individual investors, in dealing with a foreign state, have been constrained in their ability to petition directly for relief from a treaty breach by a host country. Instead, such investors were required to enlist the assistance of their own government to present their claims against the foreign state. Moreover, a further obstacle to the resolution of these kinds of disputes arose from the requirement that a private party must first have exhausted the remedies available to it under the domestic laws of the host state before presenting its claim through the diplomatic channels of its own state.

The NAFTA investor dispute provisions represent a significant reform in this area in that an investor aggrieved by measures of a host government has standing to initiate dispute settlement directly against the host government without the involvement of its own government, using existing legal procedures for the resolution of international commercial disputes. If a breach of NAFTA investment rules and consequential injury to the investor can be made out, relief by way of damages and reversal of the offending measure may be available.

Exception for Disapproved Acquisitions

NAFTA specifically exempts from the application of these investor dispute resolution rules any decision by a NAFTA country to prohibit or restrict the acquisition of an investment in its territory by an investor of another NAFTA country for national security reasons or under a foreign investment screening process. Accordingly, decisions regarding the approval or non-approval of investments under the *Investment Canada Act* are not subject to NAFTA dispute settlement.

TAXATION

Introduction

Foreign companies operating in Canada face a variety of taxes. The federal, provincial and territorial governments impose a tax on income and capital gains. The federal government imposes a capital tax on large corporations, and some provincial governments impose a corporate capital tax. The federal government levies a goods and services tax, excise taxes and customs duties. Provincial governments may levy a provincial sales tax and a tax on the transfer of real property. Municipalities impose taxes on real property.

The following is an introduction to the most significant tax considerations that affect a person investing in Alberta or British Columbia.

Income and Capital Gains Tax

Residents and Non-Residents

The federal *Income Tax Act* imposes a tax on the worldwide income of corporations and individuals resident in Canada. For Canadian purposes, income includes business, property and employment income. One half of a capital gain is included in income for tax purposes and then taxed at the applicable income tax rates.

Generally, a corporation will be considered resident in Canada if it is incorporated in Canada or if the central management and control of the corporation is located within Canada. The latter situation will exist, for example, if meetings of the board of directors of the corporation are ordinarily held in Canada. Some limited sources of income are exempt from Canadian income tax such as certain international shipping income earned by foreign corporations whose central mind and management are located in Canada.

Non-residents of Canada are liable to pay tax on taxable income earned in Canada, not on their worldwide income as is the case for Canadian residents. Non-residents are taxed:

- at regular income tax rates on income from employment or business carried on in Canada;
- at withholding tax rates on income in the form of dividends, interest, royalties and rents from investments in Canada; and
- at one-half of income tax rates on capital gains from the disposition of taxable Canadian property, which includes real estate, capital property used in carrying on a business in Canada and shares in private (i.e., not Canadian publicly traded) Canadian corporations.

If a non-resident trust of which a Canadian resident is a beneficiary receives investment income, the beneficiary will be deemed to have received the income for Canadian income tax purposes. An important exception to this general rule provides that upon becoming resident in Canada, an individual may put income-producing assets into a trust outside of Canada and for a five-year period after the individual becomes a Canadian resident, the income produced by the assets held in trust will not be subject to Canadian taxation. The establishment of such a trust, known as an "immigration trust", may significantly reduce Canadian income tax that would otherwise apply after a person immigrates to Canada.

Tax Rates

Provincial income tax rates vary. The relevant tax rates for 2005, after the provincial changes announced by British Columbia in September, 2005. including both federal and provincial income tax, are:

	British Columbia	**Alberta**
Highest marginal personal rate	43.7%	39.0%
Basic corporate rate	34.1%	33.6%

The highest marginal rate generally applies to income above C$105,000, approximately.

Business income is allocated between provinces based equally on two factors: payroll and revenue.

Branch Tax

The after-tax earnings of non-resident corporations are subject to an additional tax, commonly referred to as a "branch tax", whether or not such earnings are distributed or retained in Canada, unless the earnings are reinvested in specified business-related assets in Canada.

The rationale for the branch tax is that if a Canadian subsidiary of a non-resident corporation distributed its after-tax earnings to its parent by way of a dividend, the dividend would be subject to withholding tax. Where a Canadian branch or division of a foreign corporation earns income, it is earned directly by the non-resident corporation and withholding tax does not apply when the profits are removed from Canada. The branch tax allows Canada to recover what would otherwise be collected as withholding tax if the same after-tax profit were distributed by a Canadian corporation to its non-resident shareholder by imposing a similar tax burden on income earned through a Canadian branch or division of a foreign corporation as on the income of a Canadian subsidiary of a foreign corporation.

Under the *Income Tax Act*, the branch tax rate and the non-resident withholding tax rate on dividends are 25%. However, both of these rates have been reduced to 5% under the terms of the Canada – U.S. Tax Treaty.

Thin Capitalization Rules

The "thin capitalization rules" restrict the amount of interest a corporation can deduct for tax purposes with respect to loans from its non-resident shareholders and other related parties. If a Canadian corporation's debt to such persons exceeds two times its equity, interest on that debt in excess of the prescribed limit will not be deductible for tax purposes.

These rules are designed to restrict the amount of interest that can be paid to non-resident shareholders or certain related persons and deducted from the corporation's Canadian income. Such a deduction would reduce corporate income tax at a rate of approximately 40% and allow the corporation to pay interest that would be subject to the 5% withholding tax applicable under the Canada – U.S. Tax Treaty.

In contrast to U.S. tax rules, the thin capitalization rules merely restrict the interest deduction and do not reclassify any portion of the debt as equity.

Entity Classification

The Canadian tax system does not have "entity classification" rules such as those contained in the Internal Revenue Code. The legal form of the entity (i.e., corporation, partnership or trust) will determine its status for Canadian tax purposes. Limited liability corporations do not exist under Canadian corporate law. The Provinces of Nova Scotia and Alberta permit the incorporation of an "unlimited" liability company ("ULC"). These entities are taxed as corporations in Canada but are fiscally transparent for Internal Revenue Code purposes. ULCs are often the vehicle of choice for U.S. corporate investors because they permit U.S. consolidation of Canadian and U.S. source income. For individual investors, ULCs may unnecessarily expose Canadian source income to corporate tax in both Canada and the U.S. Individual investors often prefer limited partnerships. See "Forms of Business Organization – Unlimited Liability Company" above.

The Canadian tax system does not have consolidated return rules such as those found in the Internal Revenue Code. Moreover, the U.S. rules do not permit consolidation with a Canadian corporation. To achieve consolidation, a U.S. investor must operate in Canada directly through a branch or partnership or utilize various planning techniques such as a ULC.

Transfer Pricing

The Canadian tax system contains transfer pricing rules similar to those imposed in the U.S. Non-arm's length cross-border pricing must reflect fair market value computed using one of the accepted transfer pricing methodologies. Recently, the Canadian tax system introduced rules that penalize corporations that cannot justify their transfer price with a pricing study prepared contemporaneously with the relevant transactions.

Depreciation

Under the Canadian tax system, accounting depreciation is replaced with a system that permits permissive deduction known as capital cost allowance. Under this system, the costs of depreciable property of the same class are pooled together. The system then permits a deduction based on the value of the class at the end of the year. The deduction is normally computed on a declining balance basis but certain classes permit a straight-line deduction. The proceeds of a sale of depreciable property are subtracted from the balance of the relevant class. A negative balance at the end of year must be included in income. A positive balance after the sale of the last property in the class may be deducted from income. The following chart lists the rates associated with the more significant classes:

Class	Rate	General Description
1	4%	Buildings
2	6%	Pipelines, gas, water and heat distribution equipment
6	10%	Oil and water storage tanks, greenhouses
7	15%	Boats, ships and marine railways (but not drill ships and offshore drilling platforms that are included in Class 41)
8	20%	Most machinery and equipment
10	30%	Automobiles, gas and oil well equipment
12	100%	Computer software
13	STRAIGHT LINE	Leasehold improvements, amortized over the life of the lease
14	STRAIGHT LINE	Patents, franchises and licenses for a limited period, amortized over the life of the property
41	25%	Resource extraction property

Resource Industry

The Canadian tax system contains a system that essentially eliminates the distinction between expenses incurred on account of capital and those of a current nature in the resource industry. Similar to the capital cost allowance system, resource expenses are pooled. A positive balance of the pool at the end of the year usually permits a deduction and a negative balance usually requires that an amount be included in income.

The resource pools are called the following:

- cumulative Canadian exploration expense (CCEE);
- cumulative Canadian development expense (CCDE); and
- cumulative Canadian oil and gas property expense (COGPE).

The main reason for the division of resource expenses into three pools is to accommodate different rules for deductibility of the expenses from each class. Generally, the *Income Tax Act* defines the type of expense included in each pool and the type of income against which a positive balance in the pool may be deducted. Canadian resource pools are subject to successor

corporation rules, which permit unused pool balances to be passed to a successor when a taxpayer sells all of its resource properties.

Resource based corporations may be able to take advantage of Canada's flow-through share rules that permit, in certain circumstances, unused resource expenditures to be deducted by the corporation's shareholders.

"Flow-Through" Tax Structure

Introduction

In some situations, for U.S. tax reasons, it is desirable for a U.S. investor to hold its Canadian interests through a Canadian "flow-through" entity. While an ordinary Canadian or provincial corporation would not accomplish this objective, the Provinces of Nova Scotia and Alberta permit the creation of an unlimited liability company, which is treated for Canadian tax purposes as an ordinary corporation but which is treated in the U.S. as the equivalent of a partnership or a "check the box" flow-through entity.

Unlimited Liability Companies (created in Nova Scotia) and Unlimited Liability Corporations (created in Alberta, both referred to as "ULCs") have become useful vehicles for the acquisition of Canadian businesses by U.S. investors. The following summarizes the advantages of using a ULC, the tax treatment of a ULC in Canada and in the U.S. and the use of a ULC in the acquisition of a Canadian business.

Formation of a ULC

Once formed, a ULC is a separate legal entity and, like any other corporation has the capacity, rights and powers of a natural person. A ULC is formed in either Nova Scotia or Alberta by filing standard constating documents. Within the constating documents, a statement must be made that the entity is being formed with unlimited liability for its shareholders. However, the degree of liability is different between Alberta and Nova Scotia and the difference may be a relevant factor in determining the choice of jurisdiction of incorporation.

In Alberta, the shareholders of a ULC are jointly and severally liable for the debts of the ULC. This contrasts with the more limited liability of shareholder of a Nova Scotia ULC. Shareholders of a Nova Scotia ULC are immune from liability for the debts and activities of the company as they would be in the case of any other corporation; however, shareholders are liable if the creditors of the Nova Scotia ULC obtain a court order for the winding-up of the company or if it becomes bankrupt. Current or past shareholders are then required to contribute to the payment of the Nova Scotia ULC's debts and the cost of winding-up. Shareholders who disposed of their shares more than one year before the commencement of the winding-up are not liable.

In either case, when a ULC is used, the interposition of an ordinary limited liability company or limited partnership between the ULC and its shareholders may eliminate the risk of liability to the shareholders.

Corporate Law Issues

Alberta ULCs are incorporated pursuant to the *Alberta Business Corporations Act (*"ABCA"*)*. The ABCA is modeled after the federal *Canada Business Corporations Act (*"CBCA"*)*. The CBCA is a modern corporate statute with the same type of provisions as its Delaware counterpart. The company law of Nova Scotia is an updated version of English company law from the 19th century.

In some ways, the company law of Nova Scotia is more flexible than ABCA. For example, the Nova Scotia *Companies Act* does not have a solvency test for the payment of dividends. Articles (known as by-laws elsewhere) of a Nova Scotia ULC may typically provide that dividends are only payable out of the profits of the company, which reflects the common law rule. This test allows the payment of dividends out of accumulated profits from prior years even if the company is in a current deficit position.

In other respects the Nova Scotia company law is less flexible. For example, unlike the corporate law of most jurisdictions, the *Companies Act* of Nova Scotia requires that a court order be obtained in connection with certain amendments of a company's memorandum of association and in respect of an amalgamation.

Canadian Tax Treatment of ULCs

Under the Canadian *Income Tax Act*, a ULC is treated like any other corporation. Depending upon its particular features, it could be taxable as a private corporation or public corporation, but practically speaking it will generally be a private taxable Canadian corporation. Like other Canadian corporations, a ULC is eligible for protection under the Canada – U.S. Tax Treaty.

U.S. Tax Treatment of ULCs

U.S. "check-the-box" regulations provide for two types of entities: "per se" corporations and "eligible entities". Per se corporations are those that are required to be treated as corporations for U.S. tax purposes. This includes all corporations under Canadian federal, provincial and territorial law. Excluded from the list of per se corporations are Nova Scotia and Alberta ULCs and corporations formed under Canadian federal or provincial law if the liability of its shareholders is unlimited. Thus, Nova Scotia and Alberta ULCs are not per se corporations. As a result, for U.S. tax purposes, a ULC is classified as a branch if there is only one shareholder or as a partnership if there is more than one shareholder. Note that a ULC can elect to be treated as a corporation by checking the appropriate box on its return. If it is classified as a partnership or branch, then the ULC is treated as a flow-through entity for U.S. tax purposes.

In the end result, the ULC is a hybrid entity: a corporation for Canadian tax purposes and a flow-through entity for U.S. tax purposes.

Structuring U.S. Investments in Canada

The most straightforward approach to investing in Canada is a direct investment by a U.S. resident without interposing any legal entity. If the U.S. resident has a permanent establishment in Canada it will be subject to Canadian taxation in respect of business profits attributable to

such permanent establishment. If the U.S. investor is a corporation, it will also be subject to a branch tax.

A U.S. resident who pays taxes in Canada in relation to profits attributable to a permanent establishment in Canada will generally be able to claim a foreign tax credit to offset its U.S. tax in relation to such profit. Note however that domestic U.S. tax planning may be necessary to avoid excess U.S. foreign tax credits.

If the U.S. resident forms a Canadian corporation to invest in Canada, the corporation will be taxed as such in Canada. A U.S. shareholder of a Canadian corporation is generally not taxed on the corporation's income until it is distributed to the shareholder in some fashion. However, note that the U.S. has a system that taxes sub-Part F income, which includes certain types of passive income, of a "controlled foreign corporation".

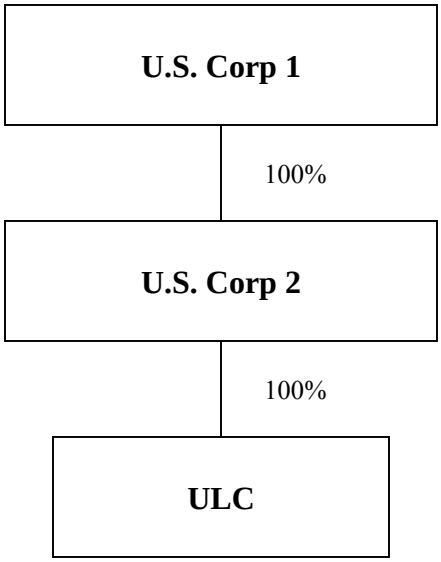
At such time as dividends are paid to a U.S. shareholder, they are subject to a 5% withholding tax in Canada. When a U.S. corporation receives a dividend from a Canadian subsidiary, it cannot deduct the dividend and it is treated as ordinary income. It can, however, claim a foreign tax credit for taxes paid by the subsidiary subject to a number of complex restrictions.

Corporations Using an ULC to Invest in Canada

An important advantage to a U.S. corporation using a ULC, as opposed to a regular Canadian corporation. is that any Canadian source losses can be flowed through to the U.S. corporate shareholder. Also, any Canadian corporate tax paid will be available as a direct foreign tax credit to the U.S. parent rather than through the complex restrictions that apply to the receipt of a dividend from a Canadian corporation.

In addition, the U.S. corporation is able to operate as if it were a branch in Canada without being subject to the branch tax. Withholding tax will be payable when profits are paid to the U.S. corporation by way of a dividend at the reduced treaty rate. This puts the U.S. corporation in control of when the distribution tax (branch tax or dividend withholding tax) is paid.

For example, the U.S. investor may be a "C" corporation, one that is taxed as a corporation rather than as a partnership. The "C" Corporation may interpose a second "C" corporation between itself and the Canadian subsidiary that is the ULC, so that the corporate structure is as follows:



U.S. Corp 2 serves the purpose of limiting the exposure of U.S. Corp 1 to the liabilities of the ULC. The ULC is treated as a foreign branch of U.S. Corp 2 for U.S. tax purposes but no Canadian branch tax will be payable. The two U.S. corporations can elect to file a consolidated return so that the income or losses of the ULC flow through to U.S. Corp 1.

A "C" corporation that invests in an ordinary Canadian corporation is entitled to a "deemed paid" foreign tax credit for the underlying Canadian tax paid by its subsidiary in the year in which dividends are paid. However, there are some restrictions. For example, the credit cannot be claimed if the U.S. shareholder owns between 10% and 50% of the outstanding shares of the Canadian corporation. Such restrictions do not apply if the subsidiary is a ULC. A direct credit is available to the U.S. corporate shareholder for taxes paid by a ULC in the year that the Canadian taxes are paid.

Financing Issues

If the Canadian operation is to be financed with borrowed money, typically to get an interest deduction, a U.S. corporation prefers to borrow the funds and lend them to the Canadian subsidiary. If a ULC is used, it can borrow the money needed to finance its operations and, for U.S. purposes, the U.S. parent is treated as the borrower and deemed to have paid the interest. This will enable the U.S. shareholder to deduct the interest expense and potentially also reduce its tax liability on U.S. source income. Borrowing at the ULC level also allows the U.S. shareholder to avoid the application of the thin capitalization rules and the interest payments by the ULC will be fully deductible in Canada. However, some care has to be taken to plan around the possible application of U.S. withholding tax to interest payments by the ULC to a Canadian resident lender.

Another approach to financing would be for the U.S. investor to lend funds to the ULC up to the allowable limit under Canadian thin capitalization rules. Provided the interest rate approximates a market rate, the interest will be deductible by the ULC for Canadian purposes. The interest payments, however, will not be income to the U.S. investor because this will be treated as an inter-branch transaction. Accordingly, the interest will be deductible against higher Canadian

corporate rates subject only to the 10% withholding tax. This has been referred to as the "poor man's double dip" because it achieves some of the benefits of a double dip without the implementation costs.

Another variation in financing is available if the Canadian subsidiary is an ordinary limited liability company and the U.S. parent does not want to convert it to a ULC. A ULC can be interposed between the Canadian subsidiary and the U.S. parent. The ULC then borrows from an arm's length party and lends the money to the subsidiary. The subsidiary agrees to pay interest to the ULC by issuing high paid-up capital shares, which are non-taxable for U.S. purposes. This achieves a deduction for the U.S. parent and for the Canadian subsidiary.

Transfer Pricing Advantage

To minimize Canadian tax, there is an incentive to set transfer prices for goods and services between a Canadian subsidiary and its parent higher on the Canadian side. If the Canadian subsidiary were an ordinary corporation and the Canada Revenue Agency reduced the amounts paid to the U.S. parent under the Canadian transfer pricing rules, this would result in double taxation unless the IRS agreed to reduce the income inclusion for U.S. purposes.

If the Canadian subsidiary is a ULC, any payments by it to its U.S. parent are disregarded for U.S. tax purposes; therefore, there is no risk of double taxation. In effect, the U.S. parent only has to be concerned with the Canadian rules on transfer pricing.

Acquisition of a Canadian Corporation by a U.S. Corporation

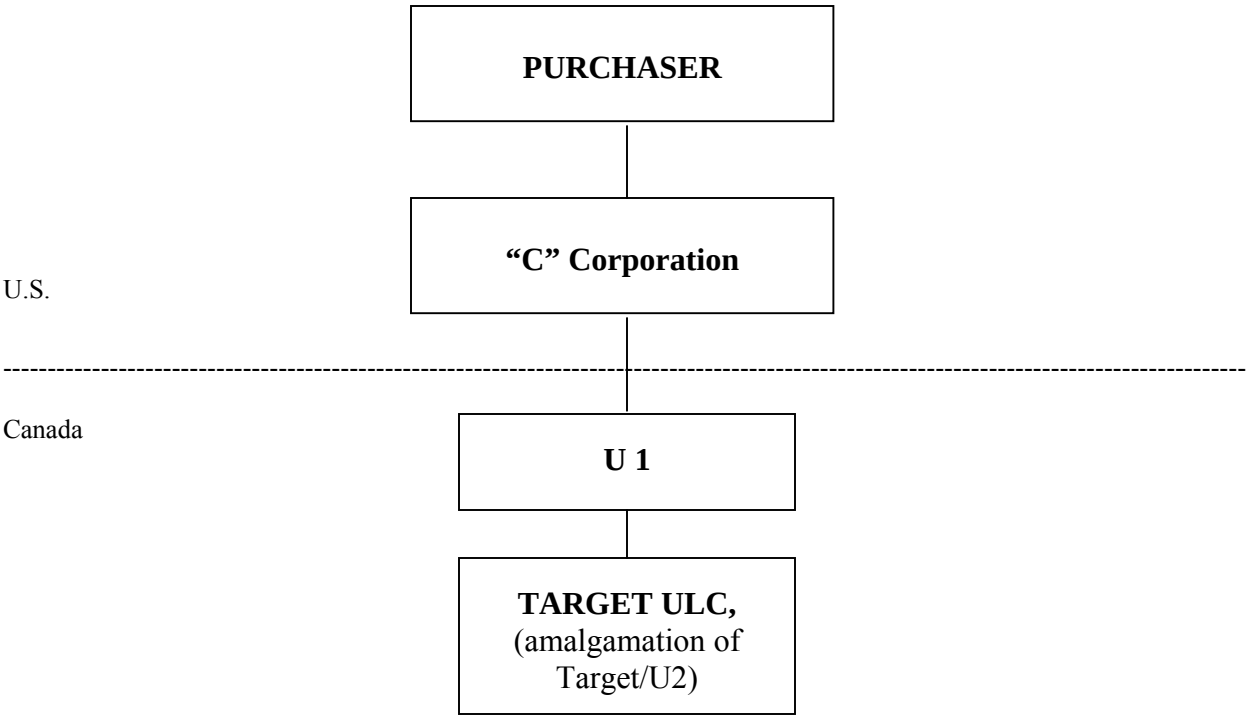
This is perhaps the most important use of a ULC and should be considered whenever a U.S. corporation is contemplating the acquisition of a Canadian corporation.

Shareholders of a Canadian corporation ("Target") with an operating business in Canada may want to sell their shares, as opposed to the corporation's assets, for a number of reasons. For example, they may wish to obtain capital gains treatment or the corporation could be the lessee of property essential to its business. The assignment of the lease might trigger a consent clause, which would not be the case if control of the corporation changed. A U.S. corporate purchaser ("Purchaser") may want to acquire the assets of the Target to get a stepped up cost base of the assets. The use of a ULC can meet the objectives of both parties as follows.

The Purchaser, a U.S. "C" corporation, forms a subsidiary in the U.S. as another "C" corporation. This provides a layer of liability protection and preserves the desired flow-through treatment for the Purchaser, as U.S. corporations may pay tax on a consolidated basis.

Two ULC's ("U1" and "U2") are then formed. The Target is then continued into the same jurisdiction as the U1 and U2 and amalgamated with U2 to form Target ULC. U1 is then capitalized by the purchaser using a combination of debt and share capital so as to stay within the thin capitalization restrictions on interest deductibility. U1 then proceeds to acquire the issued shares of Target ULC.

The resulting structure looks like this:



Tax Aspects of Acquisition Structure

Canadian Tax Treatment

The continuation of the Target into Nova Scotia or Alberta and its subsequent amalgamation with U2 are not taxable events. Target ULC inherits the cost base of the assets owned by the Target. Target ULC could be wound up into U1 and a bump could be utilized in respect of non-depreciable property.

By establishing U1 to acquire the shares of Target ULC, the Purchaser is able to step-up the paid-up capital of the target corporation for Canadian tax purposes because the purchase price will be reflected in the paid-up capital of U1.

Target ULC will be a taxable Canadian corporation carrying on business in Canada through a permanent establishment in the country and will be taxable as such at the applicable corporate rates with no small business deduction.

U.S. Tax Treatment

Under the "check the box" regulations, the two ULC's are disregarded for tax purposes so that the purchase of shares of Target ULC is treated as a purchase of the assets of Target ULC by the Purchaser under U.S. tax law. As a result, the Purchaser is treated the same way for U.S. purposes as if it had purchased the assets of the Target. The Purchaser gets a step-up in the cost base of the assets that it is considered to have acquired. The Purchaser is thereby able to claim

depreciation on the assets on their new stepped-up basis and the cost base will be recognized upon a subsequent disposition.

Under U.S. law, the wholly-owned Canadian companies, U1 and Target ULC, are tax "nothings" such that the U.S. parent is treated as owning the assets in Canada and carrying on business in Canada through a branch operation.

For U.S. purposes, all income, losses and foreign tax credits generated by the underlying business in Canada are considered to be the Purchaser's income, losses and foreign tax credits.

Repatriation of Funds by the NSULC

By capitalizing U1 with debt and preferred shares, the after-tax profits of Target ULC can be repatriated to the U.S. parent by the redemption of preferred shares or the repayment of debt without incurring withholding tax in Canada. After the tax free repatriation of capital is complete, dividends may be paid to the "C" corporation subject to the 5% withholding tax.

Other Federal Taxes

Large Corporations Tax

Historically, the *Income Tax Act* has imposed a "large corporations tax", which is a tax on corporate capital. It applied at the rate of 0.225% of the "taxable capital" of a corporation employed in Canada in excess of C$10,000,000. Taxable capital was made up of share capital, retained earnings, surpluses, reserves and debt (other than accounts payable), less an allowance for investments in other corporations to ensure that the same capital is not taxed more than once. The large corporations tax obligation is reduced by the amount of surtax paid by the corporation as part of its regular income tax calculation. Therefore, profitable corporations (i.e. those paying tax) were not generally subject to large corporations tax.

The large corporations tax is currently being phased out and will be fully eliminated after 2007.

Goods and Services Tax

The federal government levies a 7% goods and services tax ("GST"). This is a consumption tax that applies at each stage of the production and distribution process. A vendor collects GST on the sale price. The vendor is entitled to claim a credit for any GST paid on the goods or services acquired for the purpose of producing the product or service sold. As a result, only the ultimate consumer of the goods or service will bear the tax. The GST applies to both Canadian and non-Canadian producers who sell their goods or services in Canada, whether their products are produced within or outside of Canada.

Excise Taxes

Excise taxes at various rates are levied under the federal *Excise Tax Act* on the manufacturer's prices on specified luxury or non-essential goods such as jewellery, wines, liquor and tobacco, whether manufactured or produced in Canada or imported into Canada.

Customs Duties

The federal *Customs Act* levies duties on most goods imported into Canada at a variety of rates. Preferential rates are available in respect of imports from Commonwealth countries, imports from countries with which Canada has trade agreements and imports of specified commodities from certain developing nations. Since it came into force on January 1, 1994, NAFTA has either eliminated or will, over a period of time, eliminate duties on most items manufactured in Canada and exported to the U.S. or Mexico as well as on those items manufactured and imported into Canada from the U.S. and Mexico. The *Customs Act* provides for the repayment of duty on imported goods used in the manufacture of products in Canada for export and for imported materials used in the manufacture of goods otherwise exempt from import duties. Special dumping duties may apply to goods imported at less than fair market value in the country of origin if similar goods are made in Canada.

Other Provincial Taxes

British Columbia Social Service Tax

The Province of British Columbia levies a retail sales tax known as the social service tax on most purchasers, users or consumers of tangible personal property sold or leased in the province or brought into the province. This tax is levied at the rate of 7% and, although the purchaser, user or consumer pays the tax, the seller is required to collect the tax and remit it to the provincial government. The Province of British Columbia recently introduced a broad based exemption for production machinery and equipment. Social service tax is also levied in respect of the purchase of certain specified services.

The Province of Alberta does not levy a sales tax.

British Columbia (Real Property) Transfer Tax

The Province of British Columbia levies a property transfer tax, with certain exemptions, on the transfer of title to real property and leases of real property having a term exceeding 30 years. The tax rate is 1% of the first C$200,000 of the fair market value of the interest being purchased or leased and 2% on the value exceeding C$200,000. The market value of leasehold interests is determined by a formula.

The Province of Alberta does not levy a property transfer tax.

British Columbia Corporation Capital Tax

Effective September 1, 2002, the corporation capital tax for non-financial institutions was repealed. However, British Columbia still levies a tax on the net paid-up capital of financial institutions. Net paid-up capital is the aggregate of a corporation's share capital, retained earnings and certain indebtedness, less certain deductions. The available deductions include an allowance for investment in other corporations and a deduction for eligible investment in British Columbia, such as expenditures on scientific research.

Financial institutions whose net paid-up capital does not exceed C$1 billion are subject to tax at the rate of 1% of their net paid-up capital in British Columbia. Financial institutions whose net

paid-up capital exceeds C$1 billion are subject to a rate of 3% applied to net paid-up capital in British Columbia. However, if the financial institution's head office is in British Columbia and the financial institution is based in British Columbia, it is subject to a rate of 1% even if its net paid-up capital exceeds C$1 billion. Unlike the federal large corporations tax, amounts paid as capital tax will not be granted a credit against tax otherwise payable, although it may be deducted against income.

The Province of Alberta repealed its capital tax on financial institutions in 2001 and Alberta no longer imposes any capital tax.

Municipal Taxes

Municipalities impose taxes on real property. These taxes are assessed annually upon the value of land and improvements owned within the municipality.

FINANCING A FOREIGN BUSINESS OPERATING IN CANADA

Introduction

A newly established business is usually funded by equity contributed by its shareholders, debt (to its shareholders or third parties) or a combination of the two.

Debt Financing

The decision to capitalize a Canadian subsidiary by way of debt may be made for a variety of reasons. Equity capital tends to be permanent in nature and, generally, no return has to be paid for the use of the equity capital. Debt capital, on the other hand, is usually limited in time and has an interest cost associated with the use of the capital. Furthermore, in a liquidation situation, debts (particularly if secured) will be paid out prior to the return of any equity. Except as discussed below, the subsidiary company may normally deduct interest payable on debt for tax purposes, but dividends, being a distribution of profits, will not be deductible.

Thin Capitalization Rules

As discussed above under "Taxation", thin capitalization rules under Canadian tax law generally force non-residents setting up Canadian subsidiaries to provide a certain level of financing through equity rather than only debt by limiting the deductibility of interest paid to non-resident shareholders where the debt: equity ratio for the Canadian subsidiary is greater than 2:1.

Debt Financing from Banks

Banks are often the most readily accessible source of debt funding. Although there are a sizable number of banking institutions authorized to carry on business in Canada, the Canadian banking system is dominated by a handful of very large domestic chartered banks that carry on branch banking operations throughout the entire country. As in the U.S., Canadian banks typically provide both operating and term financing.

Operating Loans

Operating loans are usually provided on a demand basis for day-to-day operating expenses, for the purchase of raw materials and inventory, the cost of production and the carriage of accounts receivable. The lending institution typically establishes such loans through the granting of a revolving line of credit. Operating loans are typically utilized by way of various options, which may include actual advances, overdrafts, letters of credit and bankers' acceptances (bankers' acceptances being drafts of the borrower "accepted" - i.e. guaranteed - by the bank). Advances are generally available in Canadian and U.S. dollars and less commonly in other currencies, with interest rates based on prime rate (for Canadian dollar loans) and base rate or London Interbank Offered Rate (for U.S. dollar loans). Banks charge an issuance or stamping fee in respect of the issuance of letters of credit or the acceptance of bankers' acceptances, based on the length of the term of the letter of credit or draft.

Collateral security for operating loans typically consists of a security interest in the inventory and receivables of the borrowing company, and the amount of available credit under the operating line is customarily restricted to a percentage of the value of the inventory and receivables after taking into account such things as the borrower's bad debts, age of receivables and obsolete inventory. As in the U.S., banks will

- attempt to obtain as much security as possible in order to reduce their exposure and will often request a charge over all of the assets, property and undertaking of a company;
- require that they be named as loss payee on any insurance policies (including "key man" insurance policies);
- seek personal guarantees from the shareholders; and
- require postponements of existing shareholder loans.

Term Loans

Term loans are advanced for a fixed period of time and are customarily used for the acquisition of capital or fixed assets by the borrower. Borrowers repay term loans over the term by an agreed schedule of payments, which the bank can accelerate only upon the occurrence of an event of default specified in the loan agreement or promissory note. Term loans are usually made by way of actual advances and interest rates on such advances can either float based on the Canadian or U.S. prime rate, be based on LIBOR or be fixed for longer periods of time through hedging contracts entered into with the bank. Collateral security usually consists of a charge on fixed assets, although the bank will frequently require a general charge on the borrower's assets, property and undertaking together with the other forms of security referred to above for operating loans.

Other Sources of Financing

In addition to the large domestic banks, borrowers may also obtain external financing from a significant number of foreign banks, many of which are based in the U.S., but which conduct commercial banking operations through branches located in one or more locations in Canada. Trust companies, mortgage brokers, capital finance companies, lease finance companies, insurance companies and other institutional lenders also conduct financing operations throughout the country.

For information regarding tax affected financing, refer to financing issues on page 25.

Equity Financing

Private Placements

The sale of equity securities or debt securities pursuant to exemptions from the prospectus requirements of Canadian securities laws is referred to as a private placement. See "Acquisition of Public Companies in Canada – Private Placements" below. This type of distribution is usually effected through brokers and investment dealers.

Public Offerings

As in the U.S., securities can be distributed to the public under a prospectus that is filed with, and reviewed by, the applicable regulatory authorities. Distributions of this kind almost always involve brokers and investment dealers. Since the fees and expenses for this type of offering tend to be substantial, this route is only suitable if large sums of money are to be raised.

INVESTING IN CANADIAN REAL ESTATE

Primary responsibility for property law rests with the provinces. In all provinces except Quebec, property law has developed through the English common law process. In Quebec, property law is governed by the Civil Code, a Napoleonic Code derivative.

There is no constitutional protection for property rights in Canada. Consequently, government authorities can expropriate property but must pay appropriate compensation. However, government expropriations are rare and generally reserved for circumstances where there is a significant public interest in the subject land and its acquisition by the government cannot be successfully negotiated. Where lands are expropriated, compensation will generally be payable at or near the fair market value of the property so expropriated. Where the parties cannot agree as to the amount of the compensation, the valuation will generally be determined by an independent tribunal.

Interests in land are generally held directly in fee simple or by leases as leasehold interests. Condominium or strata title ownership is also common throughout Canada. All provinces maintain a system of public land titles registration through which interests in land are registered. There are generally no restrictions on foreign ownership of Canadian land and there are generally no consents or government approvals required to buy or sell land. See "– Disclosure Requirements on Resale to the Public" below.

Investment Vehicles

Investment in Canadian real estate can be undertaken through a variety of legal structures, including:

- a partnership;
- a limited partnership;
- a limited liability partnership;
- co-ownership (a joint venture);
- a corporation;
- a trust; or
- personal ownership.

The choice of an appropriate investment structure will be governed by various factors, including tax planning requirements, liability issues and business considerations.

Acquisitions

Real estate transactions are generally carried out as they are in the U.S., with negotiations by an agent leading up to an agreement of purchase and sale. Once the agreement of purchase and sale is signed, it is generally the responsibility of the purchaser, usually through counsel, to conduct due diligence with respect to the property being acquired, including title and zoning searches and a review of any leases and surveys of the property. The purchaser's counsel will also provide a title opinion to the purchaser. Although title insurance is available in Canada, it is not commonly utilized since the document of title is guaranteed under the land title systems in Western Canada.

Leasing

Ground Leasing

Property may be leased as well as purchased. One form of leasing arrangement is a long-term ground lease, in which a tenant leases vacant land and develops it. Once development is completed, the ground tenant will sublet space to office or industrial tenants, depending on the type of development. Ground leasehold interests may be bought and sold in a manner similar to fee simple property interests.

Commercial Leasing

Most commercial office and retail space and much of the standard industrial space in Canada is available only through a commercial lease. Most commercial lease transactions commence with an agreement to lease, which contains the business terms agreed upon by the parties, including the space, term, rent and any tenant inducements. Commercial leases in Canada are typically on a net/net rental basis, which requires a tenant to pay basic rent plus additional rent comprising a proportionate share of realty taxes, insurance, utilities and common area maintenance charges. In a retail lease, a tenant may also pay rent based on a percentage of its annual sales.

Residential Leasing

Residential leases are regulated by provincial legislation; in some cases, the applicable legislation will override the terms of the lease contract regardless of the intention of the parties. In some provinces, the ability of the landlord to increase residential rents is limited by provincial regulation.

Financing

Most real estate financing is arranged through institutional lenders such as banks, trust companies, pension funds, credit unions and insurance companies. Credit terms will vary from institution to institution and will be dependent on the nature of the transaction and the risks involved. Most institutions will not lend more than 75% of the appraised value of a property.

Interest rates are generally fixed for a specified period of time or variable based on the lending institution's prime rate. The prime rate is based upon a rate announced by the central bank, the Bank of Canada, every week. A borrower may consider borrowing in other currencies and has a choice of interest rate pricing, including LIBOR and bankers' acceptances. Certain fees, such as commitment and processing fees, are normally charged by lenders. Typically, it will be the borrower's responsibility to pay for all of the lender's legal and other costs in arranging property financing.

Lending institutions typically take both primary and collateral security in real property and related assets. Typical primary security includes a mortgage or charge, a debenture containing a fixed charge on real property or, in some cases where more than one lender is involved, a trust deed securing mortgage bonds or debentures and including a specific charge over real property. Collateral security often includes assignments of leases and rents, general security agreements and personal guarantees.

Because many foreign lenders in Canada are subsidiaries of the world's major banks, they typically participate by way of syndicated loans, which are often arranged by major Canadian lending institutions.

Environmental Concerns

The owner of property has certain duties in connection with the discharge of contaminants and hazardous materials into the environment from the property. Liabilities associated with improper waste management practices can be inherited by subsequent owners of property.

A purchaser should assess the environmental risks involved in the property by inspecting the company and public records to ascertain the environmental status of the property. In many cases, a purchaser will wish to carry out an "environmental audit" of the property being purchased, which may include conducting scientific testing and technical analysis of the property. It should be noted that government officials in Canada do not "certify" that a property is free from environmental risk, and a purchaser must undertake its own investigations in this regard. Lending institutions will often require that an environmental audit of the property by obtained before advancing any funds.

See also the discussion under "Environmental Law".

Development Controls

Property development is provincially regulated, primarily at the municipal level, and municipalities typically control land use and development density through official plans and zoning by-laws. The ability of an owner to subdivide property is restricted and regulated in a number of provinces. Development charges are also imposed by many municipalities on new developments within their jurisdiction.

Construction of new projects is also subject to provincial and municipal legislation. Building codes set specific standards for the construction of buildings and most municipalities require building permits before the commencement of construction.

Before commencing the development of any project, it is essential that all required regulatory approvals be obtained.

Disclosure Requirements on Resale to Public

Many provinces have legislation requiring the registration and distribution of a prospectus or disclosure statement where a person wishes to sell or lease or offer for sale or lease parcels of real estate to members of the public.

This disclosure document describes the material characteristics of the development of the subdivision. Exemptions often exist for commercial or industrial developments, small subdivisions of less than five lots, for example, or sales of a large number of lots from one person to another. Significant penalties exist for the failure to comply with such legislation.

IMMIGRATION FOR BUSINESS PEOPLE

Introduction

As a general rule, a person who is not a Canadian citizen or a permanent resident must hold a valid work permit in order to work in Canada. Work permits are issued by Citizenship and Immigration Canada ("CIC"). Generally, prior to the CIC issuing a work permit, an employer must receive consent from Human Resources and Skills Development Canada ("HRSDC") to offer the position to the foreign workers. The consent from HRSDC is called a confirmation of employment. In addition, foreign workers may require a temporary resident visa to work in Canada; however, citizens and permanent residents of the U.S. are exempt from this requirement.

There are a number of exemptions from the requirements for work permits and confirmations of employment, particularly under NAFTA, the General Agreement on Trade in Services ("GATS") and the Software Pilot Program. These exemptions are so numerous that they create a system that is more often governed by exemptions than by the rule.

Work Permit

Under Canadian immigration law, it is the worker who must apply for and receive the work permit. The foreign worker must submit to CIC a copy of the HRSDC confirmation of employment and a detailed description of the employment offer (provided by the employer). There is a non-refundable fee of C$150 for processing an application for an individual work permit.

A worker may apply for a work permit before entering Canada, at a port of entry or from inside Canada, depending on the worker's status. Generally, temporary foreign workers must apply for a work permit before departing for Canada, although the actual work permit will be printed and given to the foreign worker at the port of entry when they enter Canada.

If the foreign worker is from the U.S. or if the foreign worker does not need a temporary resident visa to visit Canada and an exemption is available from the requirement to obtain a confirmation of employment (see "Confirmation of Employment" below), the foreign worker is either prohibited from applying for a work permit until his or her arrival at a port of entry or, in some instances, has the option of applying before entering Canada or on arrival at the port of entry.

In the following situations a foreign worker can apply for a work permit while already located in Canada:

- if the applicant or his or her parents or spouse already have a study or work permit;
- if the applicant has been working in Canada for at least three months under an exemption, other than as a business visitor, but wants a permit to do another job; or
- if the applicant has a Temporary Resident Permit that is valid for six months or more.

In assessing the work permit application, the CIC will, on the basis of the report issued by HRSDC, ascertain whether the employment offer is genuine and "if the employment of the foreign national is likely to have a neutral or positive economic effect on the labour market in Canada."

Immigration officials cannot issue a work permit to a foreign national if:

- there are reasonable grounds to believe that the foreign national is unable to perform the work sought;
- the specific work that the foreign national intends to perform is likely to adversely affect the settlement of a labour dispute in progress; or
- the foreign national has engaged in unauthorized study or work in Canada or has failed to comply with a condition of a previous permit or authorization, subject to conditions.

Entry into Canada is subject to medical and security clearances, which vary according to the home country of the worker and the job sought. Any criminal record will preclude the issuance of a work permit, and the worker will be required to obtain Criminal Rehabilitation by an advance application.

The worker is expected to abide by the terms and conditions set out in the work permit. Work permits are valid only for a specified job, employer and time period. However, workers can apply to the CIC to modify or extend their work permit. An application to extend a work permit must be made at least 60 days prior to the permit's expiry. If the employer dismisses the foreign worker, he or she must return home.

Confirmation of Employment

As a prerequisite to issuing a work permit, an immigration officer will generally require a labour market opinion or a "confirmation of employment" from HRSDC. An employer who wishes to hire a temporary foreign worker is responsible for having the job offer validated by HRSDC.

HRSDC will base its confirmation of employment on the following factors:

- whether the work is likely to result in direct job creation or job retention for Canadian citizens or permanent residents;
- whether the work is likely to result in the creation or transfer of skills and knowledge for the benefit of Canadian citizens or permanent residents;
- whether the work is likely to fill a labour shortage;
- whether the wages and working conditions offered are sufficient to attract Canadian citizens or permanent residents to, and retain them in, that work;
- whether the employer had made, or has agreed to make, reasonable efforts to hire or train Canadian citizens or permanent residents; and
- whether the employment of a foreign national is likely to adversely affect the settlement of any labour dispute in progress or the employment of any person involved in the dispute.

If HRSDC is satisfied that the employment offer to a foreign national will not adversely impact the Canadian labour market, it will issue a confirmation of employment to the employer and enter the confirmation of employment into a database that can be accessed by immigration officials.

The employer then generally sends the foreign worker a copy of the HRSDC confirmation of employment, as well as a detailed employment offer to be presented to immigration officials upon the worker's arrival at a port of entry.

Upon receipt of the HRSDC confirmation, immigration officials will decide if the foreign worker otherwise qualifies for a work permit. The confirmation process is a distinct stage from that of the work permit, and may involve lengthy application procedures. Whenever possible, individuals should attempt to qualify for an exemption from the requirement to obtain confirmation of employment as described below.

Exemptions from the Work Permit Requirement

Certain categories of workers are exempt from obtaining work permits. Individuals who meet the requirements of these categories can engage in work in Canada without a permit and are treated as visitors to Canada. The rationale for these exemptions is that the person would require entry into Canada regardless of the labour market and unemployment conditions in Canada at the time. The exemptions that relate most closely to trade and international business activities are business visitors, guest speakers and convention organizers; however, there are a number of other workers who are exempt from obtaining work permits.

Business Visitors

A "business visitor" is a foreign national who:

- purchases Canadian goods or services for a foreign entity or receives training or familiarization in respect of such goods and services;
- gives or receives training within a Canadian parent or subsidiary of the corporation that employs them outside Canada, if any production of the goods or services that results from the training is incidental;
- represents a foreign entity for the purpose of selling goods for that entity, if the visitor is not making sales to the Canadian public at large; or
- engages in international business activities in Canada without directly entering the Canadian labour market. This means that the primary source of remuneration for their business activities is outside Canada and their principal place of business and actual place of accrual of profits remain predominantly outside Canada.

Guest Speakers

Foreign guest speakers in Canada for the sole purpose of making a speech or delivering a paper at a dinner, graduation, convention or similar function, or as a seminar leader delivering a seminar that lasts five days or less, do not need a work permit.

Convention Organizers

Certain persons who are in Canada organizing a convention or meeting do not need a work permit.

Exemptions from the Confirmation of Employment Requirement

In some cases, a work permit application is required, but there is an exemption from the requirement to obtain HRSDC confirmation of employment.

Examples of categories that require a work permit but not a confirmation of employment include workers who provide a significant benefit to Canada; spouses of temporary foreign workers;

those who qualify for the Software Pilot Project and those who qualify for exemptions under NAFTA and GATS.

Benefit to Canada

Persons performing work that creates or maintains significant social, cultural or economic benefits or opportunities for Canadians do not need confirmation from HRSDC.

Some types of entrepreneurs, intra-company transferees and other types of workers, who will provide significant benefit to Canadians or permanent residents by working in Canada do not need a confirmation of employment from HRSDC.

Spouses

Spouses (including common-law partners) of temporary foreign workers can apply for a work permit without a confirmation from HRSDC, provided that the principal applicant is authorized by a work permit to work in Canada for at least six months and the worker qualifies as a skilled worker in the National Occupational Classification. If these requirements are met, the spouse may apply for an open work permit, which allows the spouse to accept almost any job. The spouse's work permit will expire when the principal applicant's work permit expires.

Software Pilot Program

The Software Pilot Program was created in response to the need of employers to fill shortages in the software industry. In collaboration with HRSDC, Industry Canada, and the Software Human Resource Council, CIC developed a pilot project to streamline the entry of workers whose skills are in high demand in the software industry and whose entry into the Canadian labour market would have no negative impact on Canadian job seekers and workers. Under the Software Pilot Project, the job specific confirmation, where each applicant must individually apply for confirmation of a job offer, has been replaced by a national validation letter, which states that the following software positions cannot be filled by Canadian citizens or permanent residents:

- senior animation effects editor;
- embedded systems software designer;
- management information systems software designer;
- multimedia software developer;
- software developer – services;
- software products developer; and
- telecommunications software designer.

The national validation letter removes the delay associated with the job-specific confirmation of employment process. Note, however, that this expedited process is strictly targeted at workers entering the software sector on a temporary basis. It does not apply to individuals seeking permanent resident status in Canada.

NAFTA and GATS

The most common exemptions from the requirement for confirmation of employment used by Canadian businesses are those set out in NAFTA: traders, investors, professionals and intra-company transferees; and those set out in GATS: professionals and intra-company transferees.

The employment provisions of NAFTA are intended to assist temporary entry for citizens of the U.S., Mexico and Canada who are involved in the trade of goods or services or in an investment activity. NAFTA provisions apply exclusively to citizens of the U.S. and Mexico. They do not apply to permanent residents of those countries.

Those employees who are not U.S. or Mexican citizens and do not qualify under NAFTA may qualify as a citizen of one of the member nations listed in the GATS agreement or may qualify under the general provisions dealing with intra company transfers.

GATS, developed under the auspices of the World Trade Organization, establishes world wide rules on trade and investment in services, including the temporary entry of business persons under specified sectors. More than 130 nations have ratified, or are in the process of ratifying, GATS with respect to specified sectors. Canada has agreed to the inclusion of the following service sectors in the GATS agreement: business services, communication services, construction services, distribution services, environmental services, financial services, tourism and travel related services and transport services.

Traders

A NAFTA trader is a U.S. or Mexican business person seeking to enter Canada to carry on substantial trade in goods or services with Canada. The applicant must work in a supervisory or executive capacity, or one involving essential skills.

Investors

A NAFTA investor is defined as a U.S. or Mexican business person seeking to establish, administer or provide advice or key technical services to the operation of an investment, to which the person has committed a substantial amount of capital. The applicant must work in a supervisory or executive capacity, or one involving essential skills.

Professionals

A GATS professional is one who seeks to engage, as part of a services contract, in an activity at a professional level, provided that the person possesses the necessary credentials and qualifications. There are nine accepted professions:

- engineers;
- agrologists;
- architects;
- forestry professionals;
- geomatics professionals;
- land surveyors;
- legal consultants;

- urban planners; and
- senior computer specialists.

More than 60 occupations are covered by the term professional under NAFTA.

Intra-company Transferees

The intra-company transferee category allows a foreign organization to transfer senior managers, executive employees or employees with specialized knowledge to Canada to continue employment with a branch, affiliate, subsidiary or parent of the organization. Under NAFTA, the employee must have worked for the company for at least one year within the three years prior to the application for transfer in a position that is executive, managerial or involves specialized knowledge. Under GATS, the individual must have been in similar employment for at least one year in the last three years.

Specialized knowledge is either special knowledge an individual has of a company's product or service (including research, equipment, techniques and management) and its application in international markets or an advanced level of knowledge or expertise in the organization's processes and procedures. A work permit under categories requiring "special knowledge" is granted only if the worker has unusual skills and it would be difficult to train another worker to do the work.

EMPLOYMENT AND LABOUR RELATIONS

Introduction

The regulation of employment matters in Canada is divided between federal and provincial or territorial jurisdictions. The vast majority of employment matters fall within the provincial jurisdiction although the federal government has jurisdiction in certain industries such as interprovincial transportation, banking and communications. Recent Criminal Code provisions described below apply to all employers whether federally or provincially regulated.

The major pieces of federal legislation affecting employment in Canada are the *Canada Pension Plan Act*, the *Employment Insurance Act*, the *Employment Equity Act*, the *Canada Labour Code* and the *Canadian Human Rights Act*. Some of these Acts have general applications while others only apply to federally regulated employers. Employment relationships in British Columbia are governed primarily by the common law and the following provincial legislation: the *Employment Standards Act,* the *Labour Relations Code,* the *Human Rights Code* and the *Workers Compensation Act.* Employment relationships in Alberta are governed primarily by the common law and the following provincial legislation: the *Employment Standards Code*, the *Labour Relations Code*, the *Human Rights, Citizenship and Multiculturalism Act,* the *Workers' Compensation Act,* and the *Occupational Health and Safety Act*.

However, each province and territory has its own unique legislation pertaining to employment matters that must be considered when planning business operations in Canada.

Federal Labour and Employment Legislation

The following legislation affects employment relationships in B.C. and Alberta.

Canada Pension Plan

Under the *Canada Pension Plan Act*, all employers in Canada must deduct a portion of an employee's pensionable earnings and remit it to the federal government. The employer must contribute an equal amount. There is a maximum contribution by each of the employer and the employee.

Employment Insurance

The *Employment Insurance Act* requires that all employers in Canada deduct employment insurance premiums from an employee's insurable earnings and remit it on behalf of the employee. Employers must contribute a greater amount. As with the Canada Pension Plan contributions, there is a maximum contribution by the employer and by the employee.

Employment Equity

Under the *Employment Equity Act*, all federally regulated companies must implement employment equity by removing employment barriers against designated groups and reasonably accommodating members of those designated groups.

Under the Federal Contractors Program, all companies in Canada with 100 employees or more who bid on federal government contracts for goods or services in excess of C$200,000 must implement employment equity plans that meet certain criteria.

Canada Labour Code

The *Canada Labour Code* ("CLC") applies only to employment under federal jurisdiction. Federally regulated employers include those in industries such as interprovincial or international transportation, banking, radio or television broadcasting, grain elevators or seed mills. The CLC regulates such things as industrial relations, occupational health and safety, standard hours of work, minimum wages, vacations, holidays, various types of leave (such as bereavement, illness, and maternity), severance pay and the termination of employees in the federal sector. It establishes the Canada Industrial Relations Board, which is the body responsible for adjudicating labour disputes within federal jurisdiction.

Canadian Human Rights Act

Federally regulated employers are subject to the *Canadian Human Rights Act*, which prohibits employers from making distinctions on the basis of prohibited grounds, which include: race, national or ethnic origin, colour, religion, age, sex, marital status, family status, mental or physical disability, pardoned conviction or sexual orientation. This Act applies to various employment issues, such as differential treatment, harassment and systemic discrimination in the workplace.

Criminal Code

In March 2004, amendments to the *Criminal Code* came into force that significantly affect the criminal liability of all "organizations", including corporations, for criminal negligence relating to workplace safety. If a person is injured or killed in a workplace accident, including a workplace environmental incident such as a gas leak, organizations that do not have an adequate environmental and occupational health and safety regime in place could now face criminal charges. Organizations may be charged criminally even if regulatory authorities commence prosecutions under other federal or provincial statutes for the same occurrence.

As with other *Criminal Code* offences, the Crown has to prove an offence under these provisions "beyond a reasonable doubt", which is a higher standard than most regulatory contraventions, where the Crown must only prove a contravention on a "balance of probabilities". However, unlike regulatory prosecutions under other federal and provincial occupational and environmental health and safety laws, due diligence is not a defence to a criminal charge.

Provincial Labour and Employment Legislation

Employment Standards

Employment standards legislation in Alberta and British Columbia establish minimum standards in the workplace for provincially regulated employers. This legislation governs such things as the minimum wage, hours of work, overtime, statutory holidays, vacation, leaves of absence and termination. It applies to almost all employees in Alberta and British Columbia respectively with limited exceptions, including professionals such as doctors, lawyer, and professional

engineers. In addition, certain classes of employees, such as managers, are excluded from specific provisions. In particular, high technology professionals and other workers at high technology companies are exempt from portions of the *Employment Standards Act* in British Columbia. Many professionals, including information systems professionals, are exempt from portions of the Alberta *Employment Standards Code*.

The Director of the Employment Standards Branch in British Columbia and the Officers of Employment Standards in Alberta have a number of powers to investigate offences and enforce the *Employment Standards Act* or the *Employment Standards Code*. Employers who have breached the requirements of the *Employment Standards Act* or *Employment Standards Code* face stiff financial penalties.

Labour Relations

In both British Columbia and Alberta, a Labour Relations Board administers the *Labour Relations Code* for each province respectively. They have jurisdiction to hear and determine labour relations applications and to make orders. The *Labour Relations Code* of British Columbia governs all aspects of collective bargaining with respect to provincially regulated unionized employers in B.C., their employees and unions. In Alberta, the Labour Relations Board also applies the *Public Service Employee Relations Act* and the *Police Officers Collective Bargaining Act*. Together with the *Labour Relations Code*, these statutes govern the collective bargaining regime applicable to unionized employers in provincially regulated industries in Alberta.

Human Rights

General

The British Columbia *Human Rights Code* ("Code") and the Alberta *Human Rights, Citizenship and Multiculturalism Act* ("Act") prohibit discrimination in employment on the prohibited grounds set out in the *Code* and *Act*. All provincially regulated employers in British Columbia and Alberta are covered by human rights legislation regardless of size.

Prohibited Discrimination and Accommodation

In both B.C. and Alberta, an employer cannot refuse to hire or refuse to continue to employ a person or discriminate with respect to any term or condition of employment on the basis of categories that include race, colour, ancestry, place of origin, religion, family or marital status, physical or mental disability, sex, or age. Additionally in B.C., discrimination is not permitted on the basis of political belief or sexual orientation or because of a criminal conviction unrelated to employment. In Alberta, source of income is an additional prohibited group. In certain circumstances, discrimination based on a *bona fide* occupational requirement may be justified. Moreover, there can be no discrimination in employment advertisements unless the limitation, specification or preference is based on a *bona fide* occupational requirement.

There is a three-step test for determining whether a *prima facie* discriminatory standard is justifiable. In order to uphold such a standard, an employer must establish:

1. That the standard that was adopted by the employer was rationally connected to the performance of the job;

2. That the standard was adopted in an honest and good faith belief that is was necessary to the fulfillment of a legitimate work-related purpose; and

3. That the standard is reasonably necessary to the accomplishment of the legitimate work-related purpose. To show the standard is reasonably necessary, it must be demonstrated that it would be impossible to accommodate that individual without undue hardship to the employer.

An employer must not discriminate against a person because that person complains or is named in a complaint, gives evidence or otherwise assists in a complaint or other proceeding under the Code or Act.

Complaints, Investigations and Hearings

Complaints are currently filed with the British Columbia Human Rights Tribunal or the Alberta Human Rights and Citizenship Commission. In British Columbia, the Tribunal may dismiss part or all of the complaint if it determines, among other things, that there is no reasonable prospect it will succeed; it was filed for improper motives or in bad faith; or the substance of the complaint has been appropriately dealt with in another proceeding. If the Tribunal determines the complaint has merit it can, among other things, assign the complaint to a settlement meeting or order a full hearing.

In Alberta, human rights officers or investigators are empowered by statute to investigate complaints. They have a number of powers to facilitate these investigations. After a complaint is investigated, the Human Rights Commission will dismiss all or part of the complaint or refer all or part of the complaint to a hearing before the Human Rights Panel.

After a hearing, the Tribunal or Panel may dismiss the complaint or make an order against the employer. Such orders include to cease the discrimination, to take steps to ameliorate the effects of the discrimination or to compensate the employee for losses and expenses as a result of the discrimination.

Workers' Compensation

Workers' compensation in British Columbia and Alberta is a system of social insurance. Assessments are levied upon employers based on the type of industry sector in which the employer is classified. The assessments are paid into a common fund out of which benefits are paid to workers who are injured as a result a work-related illness or accident. Benefits are payable regardless of fault on the part of the employer or the worker. Moreover, the legislation bars employees from suing any other worker or any employer for injuries sustained in the course of their employment.

It is compulsory that all industries carrying on business in British Columbia be registered under the *Workers Compensation Act*. In British Columbia, industries that lie within federal regulatory jurisdiction for other purposes, such as banks, interprovincial transportation, airlines and inter-provincial railways, have workers' compensation benefits for their employees administered and

adjudicated under the provincial legislation as a result of arrangements between the Canadian federal government and the province of British Columbia. In Alberta, employers operating in a compulsory industry must open an account with the Workers' Compensation Board under the *Workers' Compensation Act* when they hire regular, casual or contract individuals. There are a few industries not covered by the Alberta *Workers' Compensation Act*; however, employers operating in one of these exempt industries may apply for voluntary coverage. The theory underlying workers' compensation is that the risk of economic loss through injury or occupational disease as a result of employment should be borne by the industry in which the worker is employed.

Assessments Levied upon Employers

The Workers' Compensation Boards of Alberta and British Columbia both use systems of classification according to industry sector to ensure a fair distribution of the costs of compensation. The basic assessment rate for each industry sector is set according to the collective liability of the sector. The cost of all claims in the industry sector is spread over all of the employers in that sector, with each employer contributing to the cost in the ratio of its payroll to that of the sector. The basic assessment rate is paid on the basis of a specified rate per C$100 of payroll. Given the wide range in applicable rates, it is very important that an employer be classified in the appropriate industry sector. The basic rate may be modified based on an employer's individual experience with its workers' claims.

Compensation

Compensation is payable for personal injury, disease, or death arising out of and in the course of employment. Compensation is also payable for occupational disease that is due to the nature of the worker's employment. In British Columbia, upon receipt of an application from a worker, a board officer will decide whether the matter is compensable. The decision of the officer may be appealed to the Workers' Compensation Review Division. The decision of the Review Division is appealable by either the worker or the employer to the Workers' Compensation Appeal Tribunal. In Alberta, an adjudicator will decide whether a worker's claim will be accepted. A worker may have this decision reviewed by the Customer Service department. The review body's decision is appealable to the Appeals Commission.

Workplace Health and Safety

The Workers' Compensation Board in British Columbia also has the authority to make regulations for the prevention of injuries and occupational diseases in places of employment. Employers are responsible for developing, implementing and maintaining programs to prevent injuries and diseases in the work place. A breach of this responsibility may result in an order to remedy the breach, a penalty assessment being levied against the employer or prosecution of the employer or its officers and managers under the criminal justice system with possible fines, imprisonment or both. Alberta also has detailed employment health and safety regulations that apply to all places of work.

Common Law Rules Affecting the Workplace

Entitlement to Notice of Termination

Unless dismissed for just cause, non-union employees in both the federal and provincial sectors are entitled to receive reasonable notice of the termination of their employment. An employer may provide an employee with "working notice", where the employee works until a specified date, or the employer may terminate the employee's employment immediately and provide the employee with a severance payment in lieu of the reasonable notice. An employer may provide a combination of working notice and payment in lieu of notice. Failure to give adequate notice of termination or severance pay in lieu is called a wrongful dismissal.

The amount of severance must compensate the employee for the loss of salary that the employee would have earned during the notice period and reimburse the employee for costs or expenses incurred by the employee in replacing benefits that previously had been provided by the employer if the employer does not continue those benefits during the notice period.

An employee who has been given notice of termination must mitigate damages by seeking and obtaining, if possible, reasonable alternate employment. The employee must accept any reasonably comparable alternate employment offered during the notice period and thus reduce any damages suffered by virtue of the termination of his or her employment.

In determining what constitutes reasonable notice for an employee, the court considers the employee's age, position, remuneration and length of service, as well as the likelihood of the employee obtaining similar alternate employment.

The courts generally provide more notice than the minimum set out under the provincial employment standards legislation. The maximum notice period awarded by the courts tends to be 24 months. Higher notice periods are generally awarded to employees with a long service period who held senior managerial positions. Additional damages are awarded by the courts where the courts determine that the employer has acted in bad faith or unfairly dealt with the employee when terminating his or her employment.

An employee may also bring a claim for wrongful dismissal where there has not been a dismissal from employment but rather where the employer has unilaterally changed the terms and conditions of employment to such an extent that there is a fundamental change in the employment relationship. This is often referred to as a "constructive dismissal" and, in general, involves an employee being demoted to a position with less status in the organization or a reduction in salary.

The concept of reasonable notice only applies to non-union employees. For unionized employees, lay-offs and termination from employment are governed by the terms of the collective agreement.

Just Cause

If an employer dismisses an employee for just cause, the employee is not entitled to notice or severance pay in lieu of notice. It is only in exceptional circumstances that an employer may summarily dismiss an employee for a single mistake. Theft, serious dishonesty, wilful

disobedience, assault, insubordination, competing with the employer's business and sexual harassment (depending on the nature of the work place) have all been found to be cause for dismissal. Incompetence can also constitute just cause, but mere unsatisfactory performance is not grounds for dismissal without notice. Economic reasons are not cause for dismissal. Whether an employer has just cause to dismiss an employee varies depending upon the specific facts of the situation.

Breach of a company policy or rule may also constitute just cause, but the employer must establish that the employee had received and knew the policy and was warned that a breach of the policy would result in dismissal. The employer must also show that the policy was reasonable and unambiguous, that the employer consistently enforced the policy and that the breach of the policy was sufficiently serious to justify dismissal.

If the employer is unable to prove just cause, the employee can recover whatever he or she would otherwise have received had the employee continued to work during a period of reasonable notice, including salary, commissions, non-discretionary bonuses, retirement savings plan and pension contributions, the employer's portion of Canada Pension Plan premiums, the value of vested stock options, the taxable value of a company car, fringe benefits and, in some instances, short-term or long-term disability payments.

Fair Dealings with Employees

Courts now place an obligation of good faith and fair dealing on employers with respect to the manner of dismissal. Employers must be reasonable and forthright with their employees. They must not mislead or be unduly insensitive to their employees. Where a court finds that an employer acted in bad faith, it can award additional damages in the form of an extended period of notice, particularly where the employer's conduct made it more difficult for the employee to find a new job.

ENVIRONMENTAL LAW

Introduction

Any prudent corporation must incorporate environmental risks into its Canadian business plan. Assessing potential environmental issues is particularly important when a corporation is purchasing or leasing real property, or when its business involves the production or movement of toxic substances or hazardous waste.

Prior to conducting business in Canada, a corporation must assess which environmental laws apply to its activities, as the regulatory framework in Canada consists of three different levels, federal, provincial or territorial and municipal.

The provinces and territories have numerous pieces of legislation relating to environmental concerns arising from business activity. Provincial policy continues to evolve as new concerns such as cumulative effects are considered. Alberta, British Columbia and the territories all have numerous statutes regarding environmental issues.

As well, the federal government has become increasingly involved in this field with the introduction of the *Canadian Environmental Protection Act* ("CEPA") in 1988 and its replacement in 1999. CEPA was designed to prevent environmental problems by addressing environmental and human health and safety issues.

There is an additional layer to environmental regulation in Canada, as municipalities also regulate and manage the environment. Municipalities' powers include environmental powers, public health powers, planning and zoning powers, business licensing and regulation powers, dangerous substances powers and plenary powers. This includes responsibility for water and sewer systems and land use planning.

To do business in Canada, therefore, a corporation must give careful consideration to the impact regulation by the three different levels of government will have on its business activities.

Federal Regulation

Canadian Environmental Protection Act

CEPA governs activities such as cross-border air pollution, the regulation of toxic substances and the movement of hazardous waste. Pollution control is also addressed including regulation of disposal at sea, fuel regulations, vehicle emissions and international water pollution. CEPA will also be the federal government's primary regulatory vehicle for implementing its obligations under the Kyoto Protocol.

Import of New Substances to Canada

A "Domestic Substances List" was established under CEPA. The substances on this list are those that are currently in use in Canada. If any significant new information arises relating to substances on this list, manufacturers and importers must report this information to the government. New substances are on a separate list and are those not in current use or on the Domestic Substances List. Before importing a new substance, a corporation must notify the

government and provide information about the nature of the substance, safety data, hazard identification information and its intended use.

Toxic Substances

A "Toxic Substances List" outlines management alternatives for toxic substances, including acceptable levels of concentrations for each substance, pollution prevention planning and programs for virtual elimination. This list includes such diverse substances as asbestos, lead, mercury, benzedrine and PCBs.

CEPA contains a comprehensive section on the release of toxic substances. A toxic substance is defined as a substance that in a particular quantity or concentration has a long-term harmful effect on the environment, or is a danger to human health. Numerous categories exempt particular substances from the prohibition on releases. Corporations must report unlawful releases of toxic substances and may be required to prepare an emergency plan for accidental releases.

Import and Export of Toxic Substances and Hazardous Waste

CEPA regulates the import and export of three categories of toxic substances. Substances on the "Prohibited Substances List" cannot be exported unless it is for the purpose of destroying the substance. For substances on the "Export Control List" and the "Restricted List", importers and exporters must notify the proper authorities and meet the requirements set out in the regulations.

Permits are required for the import, export and transit of hazardous waste. Hazardous waste includes dangerous goods, as defined in the *Transportation of Dangerous Goods Act, 1992*, and any substance on the "List of Hazardous Wastes". In addition to acquiring a permit, all importers and exporters of hazardous waste must provide notice to the relevant Canadian and foreign authorities of the hazardous waste shipment. For imports, there are also extensive notice provisions even where Canada is only a country of transit. The government can also require implementation of a reduction and phase-out plan for hazardous waste that is exported for final disposal.

Enforcement

Enforcement officers can inspect any place where there is a substance or activity regulated by CEPA and can seize evidence. Environmental protection orders can also be issued to halt illegal activity and require compliance with CEPA. Whistleblower protection is available, and it is an offence to dismiss, harass or discipline an employee who voluntarily reports a violation under CEPA. The maximum penalty under the Act is a fine of up to C$1 million dollars a day or five years' imprisonment.

Fisheries Act

The principal federal water pollution control statute is the *Fisheries Act*. The objective of the *Fisheries Act* is to protect fish habitat. It applies to all waters in the fishing zones of Canada, all waters in the territorial sea of Canada and all internal waters of Canada. To protect fish habitat, the Act prohibits the deposit of any deleterious substance in water frequented by fish. "Deleterious substances" is defined quite broadly as any substance that would degrade or alter

the quality of the water and render it harmful to fish or fish habitat. Regulations prescribe certain substances as deleterious and also outline permitted levels for effluent discharges from industries such as petroleum refining, pulp and paper and mining. Any industries located on watercourses must be aware of the impact their activities may have on fish and fish habitat. In addition, authorization is required from the federal government before commencing with any work or undertaking results in the harmful alteration, disruption or destruction of fish habitat (including activities such as stream crossings). In turn, the issuance of a "HADD" authorization triggers obligations under the *Canadian Environmental Assessment Act*.

Both active "depositing" and a lack of interference or a failure to prevent deposits constitute an offence. Penalties can be significant, including fines of up to C$1,000,000 per day.

Transportation of Dangerous Goods Act, 1992

The *Transportation of Dangerous Goods Act, 1992* prohibits any person from handling, offering for transport or transporting any dangerous goods unless the relevant safety requirements are met. Dangerous goods include several different categories of substances such as explosives, gases, poisons and nuclear substances. Each category has distinct labeling, packaging, documentation, safety and training requirements. Companies transporting dangerous goods must also develop an emergency response plan approved by the government. The provincial and federal governments have harmonized their approach to the transportation of dangerous goods. Typically provincial standards that govern the transportation of dangerous goods within the province incorporate the federal legislation by reference.

Navigable Waters Protection Act

The NWPA provides that no work shall be built or placed in, on, over, under, through or across navigable waters unless the Minister of Transport has approved the work and site plans. "Work" includes structures such as bridges, dams, wharves, and telegraph or power cables, and the dumping of fill or excavation of materials from the bed of navigable water. The *Canadian Environmental Assessment Act* applies to the Minister's approval decision.

Although "navigable waters" is not defined in the Act, the authorities suggest the term includes waters navigable in fact, even by canoes or rafts of logs.

Species at Risk Act, 2002

SARA's fundamental elements are: listing of endangered species, measures to protect listed species, including requirements for government preparation of recovery strategies, protection of critical habitat and prohibitions on taking individuals of endangered species, damaging or destroying their residences and destroying critical habitat. The "taking" and "residence damage prohibitions do not apply to provincial laws unless Cabinet has ordered application on the basis that provincial laws "do not effectively protect" the species or residences. The critical habitat destruction prohibition does not apply outside federal lands except to the extent that Cabinet orders application to specific areas on ministerial recommendation following consultation with the relevant provincial or territorial minister. As with other federal environmental statutes, penalties can be significant, including fines of up to C$1,000,000.

Canadian Environmental Assessment Act

The purpose of the *Canadian Environmental Assessment Act* is to ensure that the environmental effects of projects are considered before project approval to avoid or mitigate potential harm from the project. Only projects that involve federal approval, funds or land require an Environmental Assessment ("EA") under the Act. If a project is subject to both provincial and federal jurisdiction, some provinces have cooperative agreements with the federal government to assess the project under one regime. Two common triggers for EAs are *Fisheries Act* and *Navigable Waters Protection Act* approvals for work near or in bodies of water.

There are several levels of assessment that may be required, ranging from self-assessment to a comprehensive assessment. The extent of the assessment depends on the scope of activity and the type of area affected. Projects proposed for more ecologically sensitive or more populous areas will require a more extensive review. Currently, almost all EAs are screening level EAs, which do not require an in-depth review. However, as more EAs are required, the scope of federal environmental assessment requirements will become clearer.

Provincial Regulation

British Columbia Environmental Legislation

Environmental Assessment Act

The Act applies to a list of projects set out in the Regulation, plus any project designated by the Minster. The size of the facility is used as the trigger criteria, except for off-site biomedical and hazardous waste thermal treatment facilities and long-term storage facilities. A reviewable project may not proceed without a valid project approval certificate. The Environmental Assessment Office has full powers to review projects.

Environmental Management Act

The *Environmental Management Act* regulates vehicle emissions and fuel emissions from different industries and prohibits any person from allowing waste into the environment. A permit is required for the storage or treatment of waste. The permit may contain conditions that allow for a limited release of waste into the environment. The Act regulates the transportation of waste, setting limits for the amount that may be transferred.

The *Environmental Management Act* also governs spills. A person may be required to prepare an emergency plan and risk assessment for the accidental release of waste. If a spill occurs, the person having control of the substance must report it immediately. Following a spill, the person having control of the substance can be ordered to implement the emergency plan. The *Contaminated Sites Regulation* (see below) is also enacted under the *Environmental Management Act*.

Water Act

Industrial operations using large volumes of water may require a license issued under the *Water Act*. Likewise, persons who intend to make changes in or about a stream may require approvals under the Act.

Alberta Environmental Legislation

Environmental Protection and Enhancement Act

Under the *Environmental Protection and Enhancement Act* ("EPEA"), projects that could have an adverse effect on the environment require approval. The Director has the power to issue or refuse to issue an approval and may make approval subject to certain terms and conditions. Regulations set out a broad schedule of activities that require approval, including:

- waste management;
- substance release;
- conservation and reclamation;
- use of pesticides; and
- activity near potable water.

The Alberta Energy and Utilities Board has authority over certain resource development projects and can order that no government licence or approval be issued until Board approval is granted.

The EPEA also regulates the use of hazardous substances to ensure that animals, plants, food or drink are not contaminated during the storing and handling process. A personal identification number is required to generate, collect or transport hazardous waste.

Environmental assessments are required for specified activities, including the construction, operation or reclamation of a pulp mine, coal mine, coal processing plant, oil sands mine or pesticide plant.

A range of environment protection orders may be issued to ensure compliance with the EPEA. Environmental protection orders can be issued to stop the release of a substance, for contaminated sites, conservation and reclamation issues, problem wells and hazardous substances.

Water Act

The *Water Act* governs the management, protection and allocation of water, regulating all activities that have an effect on watercourses or water bodies. It establishes a provincial planning framework and requires that the EPEA be complied with prior to approval of a licence for the allocation of water. Approval is required for a wide variety of activities, including any construction project that alters or changes the flow of water or affects the aquatic environment.

Climate Change and Emissions Management Act

The Act provides a framework for limitation of greenhouse gas emissions from Alberta sources with a view to implementing Alberta's Climate Change Plan. An emission target of 50% of 1990 levels by 2001 (a target that differs from the national emission reduction commitment under the Kyoto Protocol of 6% of 1990 levels by 2008-2012) is established. Several techniques are outlined that are to be used to meet this target, including voluntary agreements to be negotiated with representatives of Alberta economy sectors, legal recognition of emission offsets, mandatory greenhouse gas reporting (also required by the federal government under

CEPA), establishment of an offset trading system, and establishment of a fund to promote energy conservation and efficiency. However, details of these techniques are yet to be established.

Yukon Environmental Legislation

Environment Act

The EA is a comprehensive statute that covers both environmental regulation as well as environmental planning and assessment. For corporations, some of the relevant aspects of the *Environment Act* relate to approvals, the release of contaminants and the regulation of special waste and hazardous waste. Any person undertaking a development or activity must obtain a permit before construction or abandonment of the project. The permit application requires extensive information about the nature of the proposed activity and plans for addressing its impact on the environment.

The release of contaminants in a manner contrary to the Act is prohibited, and any release above the prescribed amounts must be reported. In addition, all spills of hazardous substances, pesticides, contaminants or special waste must be reported. The person in charge of the substance has a duty to mitigate the effects of any spill.

The Act prohibits disposal of special waste without a permit and prohibits transportation of special waste except in a manner consistent with the Act. Special waste is any waste that requires special handling, storage or destruction and is prescribed as special waste in the regulations.

A risk assessment may be required prior to the release of hazardous waste and outlines detailed restrictions for the use, storage and disposal of pesticides.

The main offences under the Act (e.g. contravening orders, permitting requirements or terms and conditions) are punishable on first conviction by fines of up to $300,000, six months' imprisonment, or both and for subsequent offences, up to $1 million, three years, or both.

The Act also establishes the basis for a contaminated sites regime in the Yukon. The Contaminated Sites Regulation applies on Yukon Government lands, private land and all non-federal lands. The Regulation allows the use of risk-based standards for the restoration of contaminated sites and makes numerical standards for contaminants in soil and water consistent with other jurisdictions (particularly British Columbia). The Regulation sets out in further detail the regime including identification, restoration, and liability for, restoration of contaminated sites.

Yukon Waters Act

The *Waters Act* prohibits the deposit of waste in a waste management area or in a place where the waste products may enter the waste management area. Waste is defined as any substance that degrades water quality in a manner that is detrimental to the use of the water by people, animals, fish or plants. Unlawful depositing of waste is an offence. To be able to deposit waste, a corporation must obtain a license from the Yukon Water Board.

Northwest Territories Environmental Legislation

Environmental Protection Act

Like CEPA and the B.C., Alberta and Yukon environmental acts, the *Environmental Protection Act* takes a preventive approach. It focuses on prohibiting the release of substances that would have an adverse effect on the environment.

The *Northwest Territories Waters Act* also addresses environmental matters. This Act mirrors the *Yukon Waters Act* in its regulation of the depositing of waste into waste management areas.

The *Arctic Water Pollution Prevention Act* is federal legislation of which corporations conducting business in the Canadian North must be aware. The objective of this Act is to address developments relating to the exploitation and transportation of natural resources in the Arctic while ensuring that the welfare of the Inuit and other inhabitants of the North are maintained. It prohibits the deposit of waste except in a manner outlined in the regulations. For any work on the mainland or islands in the Arctic, the Governor-in-Council may require the person to provide a copy of plans and specifications relating to the work. In addition, the Governor-in-Council may order modifications or may prohibit the construction of the work. The Act also provides the government with the authority to regulate shipping, in particular ship specifications and navigation requirements.

The management and disposition of surface and subsurface interests in Crown land in the NWT is handed under the *Mackenzie Valley Resource Management Act*. The MVRMA has established new institutions of public government, a series of boards responsible for land and water management, land use planning, and environmental impact assessment.

Nunavut Environmental Legislation

The territory of Nunavut has adopted the Northwest Territories' environmental legislation, although the Nunavut Land Claims Agreement contains several provisions relevant to environmental matters (including, in particular, environmental assessment) and should also be consulted when doing business in most areas of Nunavut.

As well, the *Nunavut Waters and Nunavut Surface Rights Tribunal Act* deals with regulation of Nunavut waters and surface rights.

Contaminated Land

Redevelopment of contaminated land is one of the most difficult environmental issues faced by landowners in Canada. Contaminated industrial sites must be cleaned up prior to redevelopment. A draft policy for the management of risks at contaminated sites in Alberta was released in 2000. Several other provinces have issued similar guidelines. British Columbia has adopted the *Contaminated Sites Regulation*, which provides for regulations and the establishment of a registry system in respect of contaminated sites. The approaches to contaminated land taken by the different provinces continue to evolve. It is hoped that in the future a universal approach will be adopted. Guidelines, though imprecise, continue to be common and those responsible for clean up face uncertain obligations. As a result, it is important for purchasers to negotiate some level of clean up or warranty about the condition of the property in their purchase agreements.

Environmental Duties and Liabilities of Directors and Officers

Directors and officers of corporations face personal liability for causing or permitting harm to the environment under several environmental statues in Canada. Moreover, a director or officer can be personally prosecuted or named in statutory orders for the protection or restoration of the environment.

Under CEPA, an officer, director or agent who "directed, authorized, assented to, acquiesced in or participated in the commission of an offence" is guilty of the offence, whether or not the corporation is prosecuted. It is not clear whether active and passive conduct amounts to assent or acquiescence; however, it is clear that if the person had knowledge of the impugned activity, he or she will be liable. Under CEPA, every director and officer of a corporation is also responsible for taking reasonable care to ensure that the corporation complies with CEPA and its regulations as well as all orders and directions imposed by the federal Minister of the Environment. CEPA expanded the liability of directors from the previous legislation to increase personal exposure to penalties with the intent that personal penalties would induce corporate decision-makers to address environmental matters systematically and forthrightly. The provincial environment acts have very similar provisions.

Officers and directors may avoid personal liability by establishing the defence of due diligence. The threshold for establishing the defence differs for any given environmental offence. To be able to raise the defence of due diligence, directors should consider taking several steps. Directors should establish a pollution prevention system for the corporation. As well, directors should ensure that this system meets industry practices and complies with environmental laws. Directors should also direct officers to report any substantial non-compliance with the system in a timely manner. Directors are justified in placing reasonable reliance on reports provided to them by officers; however, if these reports raise concerns, or provide notice that the system is not working effectively, directors must take corrective measures immediately. The benefits of creating an environmental management system outweigh the costs, as such a system maximizes the directors' and officers' ability to defend against environmental actions that can arise regardless of how advanced the corporation's pollution controls are.

Corporations in Canada are actively seeking methods to improve their environmental systems. Some of the tools for identifying problems and developing solutions include environmental audits, training programs, the development of corporate policies and extensive reporting structures. As well, many corporations in Canada have established work committees to oversee their environmental management system.

Environmental Liabilities

There are three types of potential environmental liability of which corporations doing business in Canada should be aware:

- regulatory offences;
- administrative orders and penalties; and
- civil action.

Regulatory Offences

Prosecutions of individuals and corporations for violations of environmental legislation have risen dramatically in Canada. Legislative amendments have also increased the penalties for such offences. Fines of up to C$1 million or more for each day the offence occurs can be imposed. Moreover, individuals responsible for the offence can be imprisoned for up to five years.

Regulatory offences are generally strict liability offences, which only require the prosecution to show that the prohibited act was done; intent to commit the crime does not have to be proven. As discussed above, directors or officers may raise the defence of due diligence when charged with an environmental offence. As a result, the accused can avoid liability by proving that he or she took all reasonable care, for example by establishing due diligence through proof of an effective environmental management system.

Administrative Compliance and Enforcement Mechanisms

Canadian government authorities can utilize several different tools to ensure compliance with environmental legislation. If a person does not comply with a particular order, he or she may be prosecuted.

Reporting Obligations

Legislation, as well as the terms and conditions of a license or permit, often include reporting obligations for the operation of sites and facilities. Spills or contaminations, under most legislation, must be reported when they are likely to cause adverse effects or are out of the normal course of operations.

Inspections

Inspections are another tool utilized to ensure compliance with environmental obligations. Although powers vary under the different legislation, inspectors generally are authorized to enter premises, investigate possible statutory violations, verify compliance, identify problem areas and ensure proper use of pollution-control equipment. Inspectors may also conduct tests, take samples and interview and question employees and management. Inspectors may lay charges against the corporation and individuals directly involved in the offence.

Orders

Government authorities prefer to work cooperatively with corporations and encourage corporations to voluntarily undertake the necessary measures. However, if a corporation refuses to take voluntary action, the government has several different orders that it may issue.

There are numerous types of orders that may be issued against a corporation, ranging from termination of specified activities to a clean-up order. A clean-up order may be issued to the holder of a permit even if that holder did not cause the contamination. Corporations that are considering buying property in Canada or acquiring an interest in real property should be aware of this potential obligation. Such orders are usually issued by senior officials but may be appealed to a quasi-judicial board or court of law.

Officials may also issue a control order, requiring a designated party to take action to prevent the illegal discharge of contaminants. This may include monitoring obligations or a change in operational procedures.

Another type of order that may be issued is a stop order, which requires immediate compliance on the part of the person served with the order. These orders are used less frequently, as usually the issuing authority must have a reasonable belief that the release of a contaminant is an immediate danger to human health.

Preventive orders may also be issued. These require a corporation to minimize or prevent environmental damage. The issuing authority must have reasonable and probable grounds and such orders are generally subject to appeal.

In addition, remedial orders may be issued requiring restoration and clean-up of the land. These are often utilized in emergency situations.

As noted above, these orders may be issued to a person who is not responsible for the environmental damage. Government authorities have discretion to impose such obligations and may consider factors such as when the site became contaminated, whether the contamination was disclosed to the purchaser and whether the subsequent owner contributed to the problem. Although several owners may be responsible for the environmental damage, the government has the power to find one person solely responsible for the cost of clean-up. This is often referred to as "deep pocket" liability and corporations should note that this might include liability for directors, officers and employees, as well as lenders in possession and receivers and trustees in possession or control.

In the past, the government has not made extensive use of orders.

Ticketing

Administrative-monetary policies ("AMPs") are another method governments utilize to ensure compliance with environmental legislation. These sanctions are for less severe breaches and were first introduced in Alberta in the EPEA. The objective of AMPs is the same as an administrative order: to encourage compliance and penalize non-compliance. AMP schemes generally involve a notification procedure, which details the violation and penalty, and an administrative review of the offence.

In Alberta, the Director under the EPEA, if he or she decides that a contravention has occurred, may impose a penalty designated in the regulations. Upon receipt of the notice, a person may elect to pay the penalty and escape charges under the EPEA or elect not to pay, in which case the province can seek to recover the debt. Some examples of offences where AMPs may be imposed include operation of a facility without a certificate or approval, failure to report the discharge of a contaminant and operation of a facility without the required pollution-control mechanisms.

British Columbia has implemented an AMP regime in the forestry sector and is currently developing an AMP regime for waste management related offences generally.

Civil Liability for Environmental Harm

In addition to actions that can be taken pursuant to legislation, Canadian law also allows personal recovery for damages. There are four potential claims that can be brought to recover damages of an environmental nature.

Negligence

Where a person's activity causes damage to another person, the person suffering the loss may be entitled to compensation. To recover, the person must show that the person causing the damage owed them a duty of care and failed to meet the relevant standard of care. Typically, such an action is brought where a person mishandles contaminants and damages an adjoining landowner's property. In such a situation, the person is responsible for the cost of restoring the adjoining owner's property.

Strict Liability

Where a person allows a dangerous substance to escape from his or her property and injure the lands of another, the resulting damage is compensable even if the person exercised reasonable care to prevent the escape. For example, a company that stores a large quantity of industrial chemicals may be liable where its chemical handling practices result in contamination of groundwater on the adjoining land, even if its handling practices are reasonable.

Fraud and Deceit

If a purchaser can establish that the vendor made false statements, and that it knowingly concealed a defect or failed to disclose a latent defect that is a potential hazard to occupants, the vendor may be liable in fraud or deceit. For example, a company that does not disclose its knowledge of contamination where the company warrants that the land is not contaminated may be liable for misrepresentation or deceit. As a result, the vendor may be responsible for compensating the purchaser for any damage it suffers as a result of the contamination.

Nuisance

A person whose use and enjoyment of land is unreasonably interfered with by the actions of another may bring an action in nuisance against the person causing the interference. Some examples of nuisance include complaints of interference from toxic fumes, unpleasant odours or excessive noise. A person that shows that their enjoyment of the property has been substantially and unreasonably interfered with may recover damages for any loss suffered.

There are several additional areas of civil liability, such as trespass or breach of statute. In Canada, civil action has not been as aggressively pursued for environmental problems as it has been in other jurisdictions such as the U.S. However, the use of civil actions has increased in recent years in Canada as citizens take steps to address environmental concerns. Therefore, corporations must carefully consider any potential civil liability arising out of their Canadian business activities.

Statutory Cause of Action

Some Canadian legislation specifically provides for or creates a private, civil cause of action. For example, under the British Columbia *Environmental Management Act*, a current owner of Land may sue former owners of the land for recovery of costs to clean up contamination caused by the former owners. In addition, under the Canadian *Fisheries Act*, commercial fisherman have a cause of action against third parties for damages cause to a fishery by the deposit of any deleterious substance.

ACQUISITION OF PUBLIC COMPANIES IN CANADA

Introduction

The acquisition of equity interests in Canadian companies is governed by two sets of requirements: corporate law and securities regulatory requirements, including the rules imposed by stock exchanges. These requirements affect the way in which share acquisitions are structured.

Other requirements, relating to the threshold issue of whether one company will be permitted to acquire an equity interest in another as a matter of government policy, are set out in the *Investment Canada Act* and the *Competition Act.* See "Regulation of Investment in Canada" above.

The statute under which the target company is incorporated sets out the corporate law requirements governing its affairs. As discussed above under "Forms of Business Organizations", companies can be incorporated federally under the *Canada Business Corporations Act* or under the similar legislation of a province or territory.

In Canada, there is no federal securities regulation; instead, each of the provinces and territories has enacted its own securities legislation. While these statutes are different, many of them are similar in material respects. Each province has its own securities commission or other authority with jurisdiction over securities transactions having a connection to its jurisdiction. Despite the existence of different statutes and multiple regulatory authorities with overlapping jurisdictions, there is an emerging trend toward the harmonization of provincial securities laws.

The securities of Canadian public companies are principally listed on one of two exchanges, the Toronto Stock Exchange ("TSX"), the senior capital market, and the TSX Venture Exchange, the junior capital market. Although the listing requirements for these exchanges differ, the rules regulating the activities of listed companies are similar.

If the target company is privately held, the regulatory framework governing its financing or the acquisition of its equity is generally simpler than if it is a public company. The following discussion is generally limited to financing acquisitions of public companies that have a listing on the TSX.

Private Placements

In a private placement, an investor negotiates to acquire a treasury issue of securities from the target company. This investment may be intended to provide the investor with an initial interest in the target company after which further treasury investments or a tender offer or merger may follow. An investor in these circumstances should consider the regulatory requirements that may apply to subsequent acquisitions of this type. See "Related Party Transactions" below.

Requirement for Stock Exchange Approval

A company listed on the TSX is required to provide the TSX with advance notice of a proposed private placement and obtain TSX approval prior to the issuance of any of its listed securities or securities convertible into listed securities. In considering whether to give its approval, the TSX

applies its published private placement rules, considering in particular the size of the issue and any proposed discount to the current trading price.

Size of Issue

In circumstances where the proposed size of the private placement exceeds the 25% threshold (or in certain other cases where non-arm's length parties are involved or the TSX otherwise considers it appropriate), the TSX will require shareholder approval of the transaction, generally by a simple majority vote. This may significantly delay the completion of the transaction, since it typically takes at least 60 days to convene a shareholders' meeting. However, the TSX has adopted a working policy of allowing a company to meet any shareholder approval requirement by obtaining written consents to the proposed transaction from the holders of more than 50% of the outstanding voting shares, as long as such shareholders have no different interest in the transaction than the other shareholders.

Discount to Trading Price

The amount of the discount permitted by the TSX depends on the market price of the target company's shares. The permitted discount is based on the closing price of the target company's shares on the day before notice of the proposed private placement is given to the TSX and ranges from 15% (for share prices above C$2.00) to 25% (for share prices of C$0.50 or less).

In the course of negotiations regarding a private placement, a potential investor often finds that the stock price of the target company increases beyond what would be expected based on its business activities and prospects. This often suggests that news of the potential investment is "leaking" into the market. Given the TSX's maximum permitted discount rules, the effect of this may be that the private placement cannot be priced at the level intended by the investor. The TSX has generally adopted the practice of providing "price protection" where requested by a target company. In these circumstances, a target company involved in advance negotiations with an investor advises the TSX of this in writing on a confidential basis. The TSX will generally confirm that the transaction price may be based on the closing market price of the target's common shares the day before the request for price protection is made.

Warrants

The TSX will generally allow a listed company to attach warrants to purchase additional shares to a private placement of common shares, as a "sweetener" or inducement to the investor to make the investment. Under TSX rules, a company can issue no more than one warrant for each common share issued in the private placement and the exercise price for the warrants must be at least equal to the undiscounted market price of the company's common shares. The exercise period for the warrants cannot exceed five years from the date of the private placement.

Prospectus Exemptions

A target company issuing shares must comply with the prospectus requirements of applicable securities legislation unless an exemption from such requirements is available. Canadian securities commissions have recently implemented an uniform set of exemptions for distributions including an "accredited investor" exemption, which includes a corporation with net assets of at least C$5 million, and an exemption for investments of a minimum monetary amount of

C$150,000. While there are numerous other exemptions, the accredited investor exemption and the minimum investment amount are the ones most typically used in transactions involving significant investments.

Resale Restrictions

There are restrictions on the resale of securities acquired under an exemption from the prospectus requirements of Canadian securities legislation. In very general terms, these restrictions prohibit the resale of the securities for a four month period without the filing by the seller of a prospectus in connection with the resale. Although the seller can resell the securities during the hold period to another investor under a private placement exemption, including the accredited investor and minimum investment amount exemptions, the purchaser will inherit the hold period resale restriction. This tends to reduce the price a purchaser would pay for such securities.

Takeover Bids, Private Purchases and Mergers

The acquisition of a controlling interest in, or all of, the outstanding equity of a target company can be effected in three ways:

- by a tender offer, referred to in Canada as a "takeover bid";
- by private purchases from existing shareholders; or
- by a merger, usually effected by a statutory amalgamation or arrangement.

Generally, stock exchange approval is not required for takeover bids, private purchases or mergers unless the transaction involves the issuance of shares of a listed class, although it is necessary to advise the TSX of a pending takeover bid or merger and provide it with copies of all relevant documents.

Takeover Bids

General

A takeover bid is an offer to purchase voting or equity securities made directly to the holders of the securities where the securities offered to be purchased, together with the securities held by the bidder, constitute 20% or more of the target's outstanding securities of that class. In light of this definition, an investor's ability to make acquisitions by way of market purchases is restricted once the 20% threshold is crossed. Unlike a merger, the approval of the target company is not required for a takeover bid and offers are frequently made on a "hostile" basis.

Canadian securities laws set out various requirements that apply to takeover bids, including:

- a bidder must prepare and send a takeover bid circular to the target's shareholders;
- the offer contemplated by the circular must remain outstanding for at least 35 days;
- within 15 days after the date of the offer, the directors of the target company must issue a directors' circular containing prescribed information; and
- the directors' circular must include a recommendation of the directors to accept or reject the bid (or a statement that no such recommendation can be made, along with the reasons no recommendation is being made).

Under Canadian securities legislation, it is possible to commence a takeover bid by a newspaper advertisement (similar to the way U.S. rules permit a tender offer to be commenced), provided that the takeover bid circular is then sent to the target's shareholders within two business days after the target provides a list of its shareholders to the bidder.

If a takeover bid is being made on a friendly basis, the bidder will often negotiate "lock-up" agreements with major shareholders under which the shareholders agree that they will tender their shares to a bid to be made by the bidder on specified terms. It is also common for a bidder to attempt to negotiate a "transaction support" agreement with the target company in these circumstances. Under such an agreement, the target would agree not to solicit competing offers and otherwise support the completion of the bid. It is common for a transaction support agreement to include a "break fee" payable by the target to the bidder if the transaction is not completed in certain circumstances. Canadian courts have generally upheld break fees, provided they are reasonable in amount. However, institutional investors have recently objected to several major transactions on the basis that the amount of the break fee had effectively discouraged competing offers.

The consideration offered for a target's shares under a takeover bid can be cash, shares of the bidder (or an affiliate) or both. If the consideration includes shares of the bidder, the takeover bid circular must include prospectus-level disclosure about the bidder and pro forma financial statements of the bidder reflecting the completion of the transaction.

Shares of the bidder will generally only be attractive to the target's shareholders to the extent that they may be easily resold. Since Canadian securities legislation generally restricts the resale of securities of a company that is not a Canadian public company, the shares of many U.S. issuers are not appropriate currency in takeover bids. One solution that has gained widespread acceptance in the market is for the U.S. issuer to incorporate a Canadian subsidiary that offers "exchangeable shares" of its issue as consideration under the bid. See "Exchangeable Shares" below.

Squeeze-outs of Minority Shareholders

Under the Canadian corporate law governing target companies, a bidder that acquires at least 90% of the outstanding shares for which the bid is made is generally entitled to "squeeze out" the remaining shareholders who did not accept the offer. Since these provisions constitute an expropriation of a person's property without the person's consent, Canadian courts have insisted that the requirements for reliance on these provisions be strictly followed by the bidder. A squeeze-out can also be effected by way of a second-step amalgamation or arrangement. See "Mergers" below.

Hostile Takeover Bids

If a takeover bid is made on a hostile basis, more complicated issues can arise to the extent that the management of the target takes defensive measures in response. However, Canadian securities commissions have expressed the policy view that takeover bids "play an important role in the economy by acting as a discipline on corporate management and as a means of reallocating economic resources to their best uses". Accordingly, defensive tactics that effectively deny

shareholders the right to make an informed decision and frustrate an open takeover bid process will be carefully scrutinized by the commissions and, if found to be abusive, enjoined.

As in the U.S., many Canadian public companies have adopted shareholder protection rights plans or "poison pills". Most of these plans now contain a "permitted bid" provision under which a bid that meets certain requirements, such as remaining open for consideration by shareholders for a certain period of time, will not trigger the pill. In hostile bids, the operation of a poison pill is typically the object of significant dispute between the bidder and the target's management. Unlike in the U.S., where the arena for resolving these disputes is generally the courts, in Canada most fights over poison pills occur before provincial securities commissions. Canadian securities commissions have consistently indicated that poison pills should be intended and will only be permitted to serve the purpose of allowing the directors of a target company to conduct an auction or other process for the sale of the company once a bid has been made. As such, the commissions will generally only allow a poison pill to remain in effect for a certain period of time. Once it has served its purpose, by enabling the directors to generate competing bids or to determine that there is no prospect for another bid, the directors of the target company must waive the operation of the poison pill and let the shareholders consider the bid that has been made.

Private Agreement Purchases

A person can acquire a significant equity interest in a target company by purchasing shares privately from existing shareholders. Provided that the purchases are made from no more than five shareholders in total and the purchase price for the shares is no more than 115% of their market price, such purchases are exempt from the takeover bid circular and related rules described above under "Takeover Bids".

Mergers

In Canada, mergers are generally implemented as either an "amalgamation" or an "arrangement", the two transaction structures contemplated by most Canadian corporate legislation. Arrangements, in particular, are very flexible and can typically be structured to achieve virtually any intended result.

A merger requires the agreement of the acquiror and the target company and must be approved by the shareholders of the target company by a supermajority of the votes cast at a shareholders' meeting called to consider the transaction. Corporate legislation generally provides that shareholders may exercise dissent and appraisal rights if they do not vote in favour of the transaction at the meeting. Shareholders' meetings must be called and held in accordance with the requirements of corporate and securities legislation. The effect of compliance with these requirements is that, typically, the shareholders' meeting is held 60-90 days after the acquiror and target have agreed to the transaction.

While a number of factors are relevant to the selection of a transaction structure, acquirors often prefer mergers to takeover bids because of the lower level of shareholder support required to successfully conclude the transaction by acquiring all of the target company's outstanding equity. As noted, with a takeover bid a 90% acceptance (or tender) level is required to ensure a squeeze-out, whereas a merger generally requires only 66⅔% to 75% voting support, depending

on the applicable corporate statute and on the charter documents of the target company. On the other hand, a takeover bid can often be successfully concluded before a shareholders' meeting could be convened to consider a merger. Non-Canadian acquirors should also consider tax and other relevant cross-border issues that may influence the choice of a transaction structure.

Depending on the transaction structure and the jurisdiction involved, the governing corporate legislation may require court approval of a merger. The court considers whether the proposed transaction is fair to the shareholders of the target company. In making this determination, the court is generally influenced by the level of shareholder approval obtained at the shareholders' meeting held to consider the transaction. The court is also influenced by the existence of a fairness opinion from an investment dealer, which the board of directors of the target company usually obtains.

Consequences of Certain Ownership Thresholds

Reporting

A person that acquires more than 10% of the outstanding common shares of a target company becomes an "insider" of the company under Canadian securities legislation. There are a number of consequences of this status. An insider must file reports of changes in its holding of securities and may not purchase or sell securities while in possession of material undisclosed information about the company or "tip" another person about the existence of such information.

In addition, a person that acquires more than 10% of the outstanding common shares of a target company must promptly issue an "early warning" press release and file a report of the acquisition within two business days. Subsequent acquisitions of each additional 2% or more of the outstanding shares must be announced and reported in the same way.

Dispositions

A person that acquires more than 20% of the outstanding common shares of a target company becomes a "control person" with respect to the company. As a consequence, the person's ability to resell the securities will be subject to more significant restrictions under applicable securities legislation.

Related Party Transactions

Rule 61-501 of the Ontario Securities Commission (which applies to every listed company on the TSX and the TSX Venture Exchange) sets out various requirements that apply to transactions, including private placements, takeover bids and mergers, between a company and any significant shareholder. These requirements include:

- the preparation of a formal valuation of the target's shares by a qualified independent valuer and the communication of the valuation to the target's minority shareholders;
- in the case of a private placement or merger, the approval of the minority shareholders at a shareholders' meeting; and
- an enhanced level of public disclosure.

Exchangeable Shares

Shares of an acquiring company may be the "currency" used to acquire the shares of a Canadian target company whether the acquisition is made by a consensual take-over bid or a plan of arrangement or amalgamation. If the acquiring company is a Canadian company, the exchange of shares can occur on a tax-deferred basis. However, if the acquiring company is a U.S. company, the "roll-over" provisions of the Canadian *Income Tax Act* do not apply and the shareholders of the Canadian target company realize an immediate taxable capital gain on the exchange of shares. This can be burdensome to Canadian shareholders who may not have the cash to meet their tax obligations. The exchangeable share structure was developed to allow the shareholders of the Canadian target company to defer the realization of a capital gain on the disposition of their shares.

Exchangeable shares are issued by a Canadian subsidiary incorporated to facilitate the acquisition. Since a Canadian corporation issues the exchangeable shares, the rollover provisions of the *Income Tax Act* apply and the taxable capital gain is deferred until the holder elects to exercise the exchange right. The exchange right entitles the holder to acquire the shares of the U.S. parent company based on a predetermined formula.

In conjunction with the granting of the exchange right, the U.S. parent company reserves to itself or one of its subsidiaries a call right that can be exercised:

- after the passage of a predetermined period of time (e.g., seven years);
- when the number of outstanding exchangeable shares falls below a set threshold;
- whenever a holder of exchangeable shares purports or is deemed to exercise the exchange right; or
- if the U.S. parent company is the subject of a take-over bid or other business combination transaction.

In each case, the purchase price payable on exercise of the call right is payable only by the delivery of shares of the U.S. parent. In order to avoid material adverse tax consequences to the Canadian subsidiary, it is fundamentally important in the exchangeable share structure that the call right is exercised whenever a holder of exchangeable shares purports or is deemed to exercise the exchange right.

While the exchangeable shares are outstanding, they are intended to mirror the economic and voting rights of the U.S. parent company shares. Consequently, whenever a dividend or other payment is made by the U.S. parent, the same dividend or other payment is made by the Canadian subsidiary that issued the exchangeable shares. To provide the holders of the exchangeable shares with equivalent voting rights, the U.S. parent must issue to a trustee a class of special voting stock that has attached to it the number of votes equal to the number of shares of the U.S. parent company issuable in respect of the then outstanding exchangeable shares.

Although the exchangeable share structure can effectively achieve its tax deferral objectives, it can be expensive to implement and maintain and is not necessarily suitable for all Canadian acquisitions. Furthermore, the effectiveness of the exchangeable share structure has been called into question by recently proposed amendments to the federal *Income Tax Act* and significant

consultation is required to properly determine whether an exchangeable share transaction is suitable for a specific acquisition.

ABORIGINAL ISSUES IN WESTERN CANADA

Introduction

Aboriginal issues may affect a business operation in Canada, particularly land or resource based operations, in two main ways. First, many aboriginal groups have constitutionally protected aboriginal and treaty rights under section 35 of the *Constitution Act, 1982*. Second, current Canadian case law requires the provincial and federal governments to consult with, and accommodate the concerns of, aboriginal groups whose constitutionally protected aboriginal and treaty rights may be affected by a government decision such as granting a resource tenure or an approval for a proposed resource development activity.

Aboriginal and Treaty Rights

The *Constitution Act, 1982*, "recognized and affirmed" the existing aboriginal and treaty rights of aboriginal peoples in Canada. Aboriginal rights are communally-held common-law rights to use lands and resources that arise as a result of aboriginal groups' traditional use of lands and resources. Treaty rights include rights under historic treaties between the federal government and aboriginal groups, most of which were concluded before 1930, as well as modern land claim agreements that have been concluded with aboriginal groups in British Columbia, the Yukon, the Northwest Territories and Nunavut. In some areas of Canada, land claims have not yet been finalized. The land claims system of negotiations among individual aboriginal groups, the federal government and provincial governments is very slow, but follows established principles and procedures.

Virtually all parts of Western and Northern Canada are affected by aboriginal rights and treaty rights. Although these rights are constitutionally protected, the rights are not absolute, and governments may infringe on or limit the exercise of those rights where justified. To determine whether an infringement of an aboriginal or treaty right is justified, a government must show that the proposed infringement seeks to minimally impair the right, and that attempts have been made to mitigate and accommodate impacts on the right. Governments must consult with the affected aboriginal groups and seek to address the substance of the aboriginal groups' concerns about the proposed infringement.

Aboriginal Title

Aboriginal title is a form of common-law aboriginal right, and is a burden on the government title to land, arising from the prior use and occupation of lands by aboriginal people prior to European settlement. Aboriginal title is held communally by the members of an aboriginal group, and which can be alienated by the aboriginal group only to the federal government. In much of Canada, the federal government negotiated treaties with aboriginal groups, under which those aboriginal groups surrendered aboriginal rights and title in exchange for treaty rights and land entitlements. Except on Southern Vancouver Island and in Northeastern British Columbia, historic treaties were not negotiated with aboriginal groups in British Columbia. Only one modern land claim agreement, with the Nisga'a, has been completed in British Columbia. As a result, many aboriginal groups in British Columbia assert that they continue to have aboriginal rights on and title to lands that they have traditionally occupied. In Alberta, treaties were

negotiated with aboriginal groups in the late 1800s and early 1900s. In the North, treaties were generally not negotiated but modern land claim agreements have recently been concluded with some aboriginal groups.

An aboriginal group seeking to establish aboriginal title to a parcel of land must meet three criteria: the land must have been occupied by the aboriginal group prior to the assertion of British sovereignty; if present occupation is relied upon as proof of pre-sovereignty occupation, there must be continuity in the possession between the present and the pre-sovereignty occupation; and at the time of sovereignty the occupation must have been exclusive.

To date, there are no cases in Western Canada where an aboriginal group has established aboriginal title to a specific parcel of land through a court action. While the potential continued existence of aboriginal title has been recognized in the jurisprudence, that potential has not yet been confirmed in respect of any given parcel of land.

Aboriginal title, where established, confers on the aboriginal group the right to exclusive use and occupation of the land for a variety of purposes. However, lands held under aboriginal title cannot be sold, transferred or surrendered to anyone other than the federal government. An aboriginal group cannot convey lands held under aboriginal title to third parties, and third parties can only acquire title to such lands from the government, not from aboriginal groups.

The courts have not yet considered the effect of a grant of fee simple title or the issuance of a certificate of indefeasible title by a provincial government on lands subject to aboriginal title. The provincial government does not have the constitutional power to extinguish aboriginal title, but it does have the power to infringe aboriginal title as long as that infringement can be justified. Where an aboriginal group is able to establish aboriginal title to a parcel of land, the implications for the holder of fee simple title (or even a lesser interest) granted for that parcel by a provincial government have not been settled. The courts are only beginning to grapple with the legal and policy issues that this question presents.

Infringement of Aboriginal Title

While only the federal government can extinguish aboriginal title, the Supreme Court of Canada held that both the federal and provincial governments could infringe aboriginal title. Any infringements of aboriginal title would have to meet a test of justification.

Any infringement of aboriginal title must be pursuant to a compelling and substantial legislative objective. The Supreme Court of Canada has given this a very broad scope, including the development of agriculture, forestry, mining, hydroelectric power and other development of lands and resources.

In addition, while the government may infringe aboriginal title, the government must do so in a way that upholds the honour of the government and respects the government's fiduciary relationship with the aboriginal group in question. One important aspect of that fiduciary duty is the obligation of the government to consult with the aboriginal group in question respecting the proposed uses to which the lands would be put. The Supreme Court of Canada has emphasized that consultation in such circumstances is always necessary, although the specific content of the consultation may vary from some cases where mere consultation is required to other cases where the full consent of an aboriginal group may be required. Failure to discharge this duty could

render the imposed infringement unjustified and may render invalid any interest granted to a third party.

Government's Duty to Consult on Decisions Affecting Aboriginal and Treaty Rights

The Supreme Court of Canada has held that, in light of the government's unique relationship with Canada's aboriginal peoples, the government must consult with the aboriginal groups in respect of any proposed action that would infringe on the group's aboriginal and treaty rights. Only through consultation is it possible to minimize impacts on the aboriginal group's constitutionally protected aboriginal or treaty rights.

Government's duty to consult is triggered when the federal or provincial government has real or constructive knowledge of the potential existence of a right and contemplates conduct which may adversely affect it. The duty to consult in respect of potential aboriginal or treaty right infringements applies only to government; it is not shared by, and cannot be delegated to, industry.

The duty to consult includes both procedural and substantive components. Not only must government engage in an adequate consultation process, it must also take into account the concerns of the aboriginal group with a view to addressing those concerns in substance. Aboriginal participation in statutory public review processes with environmental and other groups may be sufficient to discharge the government's obligation to consult with aboriginal groups, as long as those processes are reasonable ways of effective consultation. Aboriginal groups must also participate in good faith in government consultation processes where reasonable opportunities to participate are offered. Very importantly, the Supreme Court of Canada has emphasized that there is no aboriginal veto over government resource decisions that could affect aboriginal rights.

While the case law emphasizes the government's responsibility for constitutional consultation obligations with aboriginal groups, industry nonetheless faces increasing pressure from government to consult with aboriginal groups, in part to assist in ensuring that governments' consultation obligations have been met. Consultations with affected stakeholders have long been industry practice, in part to meet regulatory requirements and in part due to corporate policy. However, industry can expect to be increasingly involved in constitutional consultation processes with government and aboriginal groups.

Consequences of Inadequate Consultation

Where a court finds that consultation obligations have not been adequately discharged, the implications can be significant for the companies whose activities have prompted the need for consultation. Any authorizations or approvals granted by government without satisfying consultation obligations are vulnerable to legal challenge and have been quashed in past decisions and remitted to the responsible Ministers for reconsideration. In most cases, the remedies granted are aimed at encouraging proper consultations with aboriginal groups.

Continued Evolution

The case law in Canada about aboriginal and treaty rights continues to evolve from year to year. It is essential for companies active in land and resource development activities in Western and Northern Canada to remain up to date on current case law, as aboriginal law issues can have a significant impact on operations if not addressed appropriately.

Because of the continued uncertainty regarding aboriginal and treaty rights and their potential consequences for land and resource development, many companies have expanded stakeholder consultation activities to include aboriginal communities. By consulting with aboriginal communities and attempting to address as many of their concerns as possible, companies have been able to avoid or limit the effects of aboriginal and treaty rights issues on their operations. Many companies are also finding it in their interest to work closely with relevant government departments and agencies in ensuring that roles are clearly defined and responsibilities are carried out.