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How to Enter the Canadian Market:

A Legal Road Map

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This publication has been prepared to provide an overview to foreign investors and business people who have an interest in doing business in Canada. The material in this publication is intended to provide general information only and not legal advice. This information should not be acted upon without prior consultation with legal advisors.

Additional information about doing business in Canada may be obtained by contacting Minden Gross LLP
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Introduction

According to Statistics Canada, in 2007, there were 32,777,304 people living in Canada. The United States is smaller in area, but the Canadian population is approximately 1/10 of the population of the United States.

Over 90 per cent of Canadians live less than 200 miles from the U.S.-Canada border. As a result, Canada and the United States share many economic imperatives and cultural influences. The economic and material aspirations and realizations of the Canadian and U.S. populations are strikingly similar.

From an historical perspective, however, Canada remains significantly different than the United States. Canada today is a highly multicultural society which generally respects and enshrines cultural heritage rather than encouraging the population to form a homogeneous melting pot. Colonized by the British and French, Canada remains a bilingual country; English and French are the two official languages. About 25 per cent of the population is French speaking, with the greatest concentration in the province of Québec.

Canada's economy has expanded faster than expected over the past few years due to high energy exports, which have helped boost Canada's account surplus. This growth has continued with low unemployment rates and the Canadian dollar at a 30-year high. Canada's resource-rich economy has also attracted many foreign investors, with an increased trend in the number of acquisition of Canadian companies over the past few years.

Except in certain industry specific situations where cultural values are at risk, Canada is receptive to foreign investment. Despite its relatively small population, Canada is the seventh largest trading nation in the world. Although historically Canada was an exporter of raw materials and an importer of manufactured goods, shipments from Canada are now more balanced between raw materials and finished goods. In addition, Canada has become a "wired" community on both the individual and business level, and is recognized internationally as a world leader in such areas as fibre optics and telecommunications.

The Canadian economy is also heavily influenced by the state of the U.S. economy. Canadian exports to the United States represent about 25 per cent of Canada's gross national product and 75 per cent of its total exports; 40 per cent of all Canadian manufacturing output is produced by corporations controlled by Americans. The American influence in Canada has become much more visible. In recent years, a flood of large American retailers, like the Gap, Wal-Mart, Home Depot and Old Navy, as well as the penetration of other major U.S. retailers, has altered the Canadian retail environment.

This paper is intended to provide a general overview of particular matters of interest to businesses considering entry into the Canadian market. Where appropriate, descriptions of both federal and Ontario laws are provided. However, this paper should not be considered an exhaustive review, and particular businesses may be subject to industry specific legislation and other legal requirements which are not dealt with in this paper. Accordingly, before undertaking any business transaction involving entry into Canada, it is prudent to seek the advice of counsel.

Legislative Jurisdiction

Canada's Constitution creates mutually exclusive jurisdictions for federal and provincial legislation. For example, Canada's intellectual property, bankruptcy and criminal laws are solely within the purview of the federal government. Provincial legislative authority is granted for the regulation of trade and commerce, education and health within the province; however, the jurisdictional distinctions are often blurry and the subject matter of federal and provincial legislation sometimes overlaps.

Bankruptcy is governed by the federal *Bankruptcy and Insolvency Act*. However, receiverships often are governed by private contractual relationships which are interpreted in accordance with provincial law. Corporations may be incorporated either federally or provincially. Similarly, both levels of government assess personal income taxes. The regulation of broadcast, pharmaceutical and most transportation industries are within the federal purview; however, virtually all professions are governed by provincial statutes.

Property and civil rights are matters within the purview of provincial governments. Accordingly, businesses may find themselves regulated by securities laws and environmental legislation from several jurisdictions. Although much of the law is consistent in the various provinces, it may be necessary to review statutes in each province in which an enterprise carries on business.

All jurisdictions in Canada other than Québec operate under common law principles. Accordingly, unless ousted by legislation, the law governing business relationships is derived from the decisions of the judiciary. Québec is a civil law jurisdiction with a civil code based on the Napoleonic code governing provincial matters. Québec is subject to all federal laws.

Form of Business Organizations in Canada

The first issue facing foreigners setting up business in Canada is the type of entity which should be used to operate the business. Among the most commonly used are:

- branch of foreign corporation
- Canadian corporations
- limited partnerships
- general partnerships
- trusts

The choice of form of business organization is dependent upon a number of factors. The nature of the business and taxation issues, which may revolve around the desirability to consolidate income for tax purposes, are two important criteria. Availability of incentive or assistance programs may also impact the decision. Foreign investors should obtain professional legal and accounting advice to determine the most advantageous method of carrying on business.

Canadian Corporations

Most businesses in Canada are carried on by corporations. A corporation is a distinct legal entity which has perpetual existence and is afforded all the right to own property and the right to carry on business as is enjoyed by a natural person.

There are several advantages to utilizing a corporate form of organization. Firstly, the liability exposure of the shareholders of a corporation is limited to the amount of their equity investment. Secondly, a corporation offers investors access to a wider variety of capital and financing opportunities than most other forms of organization. Since a corporation is a flexible form of organization for business, various classes of shares and debt instruments may be utilized to provide different levels of shareholder and lender participation which reflect the degree of risk inherent in the investment.

Canadian corporations can either be private corporations or public corporations. Private corporations are generally those which have restrictions on the right to transfer shares (generally the need consent of a majority of the directors or shareholders). Articles of incorporation often contain restrictions to ensure that the corporation is a private corporation. Such restrictions exempt the corporation from additional regulatory and securities law rules that apply to public corporations in areas such as proxy solicitation, takeover bids, and public financial disclosure.

Corporations may be incorporated and organized under either the federal *Canada Business Corporations Act* (the “CBCA”) or the equivalent legislation of each of the provinces. Incorporation and organization under the CBCA does not automatically give rise to a right to carry on business in each province. A federal corporation must register in each province in which it proposes to carry on business. Similarly, a provincial corporation may carry on business in another province, provided an extraprovincial licence is obtained. There are some exceptions, e.g., Ontario and Québec corporations may carry on business in each other’s provinces without

a licence. For certain highly regulated business undertakings such as insurance companies, banks and trust companies, specific statutes set incorporation, organization and operational standards.

When consulted by a foreign company wishing to carry on business in Canada through a Canadian subsidiary, a lawyer will compare the features of the CBCA and the provincial statute of the province in which the head office of the subsidiary will be located in order to determine the preferred corporate statute under which to incorporate and organize. Although the statutes are substantially similar, there are slight differences in the areas of public disclosure of financial statements and residency requirements for directors, which may affect the choice of incorporating jurisdictions.

Under the provincial corporate statute in Ontario, a majority of the directors must be Canadian residents. For the purposes of the *Ontario Business Corporations Act* (the “OBCA”), Canadian residents are citizens or landed immigrants. In the event there are only two directors of an Ontario corporation, only one need be a Canadian resident. There is currently legislation at the 3rd Reading Stage which would change this to be the same requirements as with the CBCA. The CBCA requirements are that at least one-quarter of the directors must be resident Canadians. Also, certain provinces do not have residency requirements such as Nova Scotia, New Brunswick, Prince Edward Island and Yukon Territory. Landed immigrants may lose their status as resident Canadians for CBCA purposes unless they become citizens within one year of first eligibility. As well, in certain circumstances under the CBCA, the residency requirements are reduced for holding corporations.

There are other factors which may tip the scales in deciding whether or not the federal jurisdiction or the provincial jurisdiction should be utilized for incorporation. For example, certain financing incentives provided by one level of government may dictate incorporation within that jurisdiction. There is also a perception that certain businesses that supply goods or services to a particular province should strongly identify with that province, making it advisable to incorporate within that jurisdiction. Finally, some political considerations and peculiarities (such as the inability to export a corporation incorporated under provincial legislation in Québec) may make it prudent to utilize a federal corporation for any business which does or has aspirations of doing business outside the province of Québec.

Corporate names may have separate English and French versions. In such cases, the versions may be used interchangeably. If a corporation wishes to do business with the government of Québec, it is necessary to adopt a French version of its corporate name.

Federal and provincial corporate statutes also provide shareholders with dissent and appraisal rights which may require a corporation to acquire a shareholder’s interest for its fair value if a corporation implements a fundamental change. Corporate legislation also contains statutory oppression remedies which give the courts broad rights to grant equitable remedies where shareholders or creditors have been subject to corporate activity that is unfairly prejudicial or unfairly disregards their respective interests. These remedies are in addition to any remedies flowing from fiduciary duties which have been compromised.

Unlimited Liability Corporations

Each of the provinces of Nova Scotia and Alberta provide for the incorporation of unlimited liability corporations which have significant tax advantages for U.S. corporations.

Unanimous Shareholder Agreement

The term unanimous shareholder agreement (“USA”) is used to refer to a shareholders’ agreement amongst all of the shareholders of a corporation whereby some or all of the powers of the board of directors have been delegated to the shareholders. USAs are utilized for the purpose of restricting the scope and nature of the powers of directors to manage the business and affairs of the corporation which are stipulated by the governing statute. Further, any shareholder who is party to a USA may be specifically delegated all or some of the rights, powers and duties as directors and the directors are accordingly released from their duties and liabilities. As a result, USAs are often prepared, even if a corporation has only one shareholder. Where a corporation has few shareholders they will often want to customize their relationship to provide for an arrangement which is different from that contemplated in the OBCA, CBCA or at common law.

USAs can regulate a specific topic or every detail of a corporation’s operation. The following are subjects which are commonly covered in USAs:

- (i) **Board of Directors:** Shareholders may wish to stipulate the size of the board of directors and often wish to indicate the number of directors a certain shareholder or shareholders group will be entitled to nominate.
- (ii) **Dividends:** Shareholders may wish to establish a dividend policy for the shareholders.
- (iii) **Share Transfers:** Shareholders may want to set up mechanisms to restrict share transfers (which are typically subject to a right of first refusal) and the issuance of additional securities.
- (iv) **Dispute Resolution:** Shareholders may want to resolve their disputes by such means as arbitration, instead of by means of the relative voting power of different shareholders.
- (v) **Financing Arrangements:** Shareholders may wish to stipulate a policy for financing the business which, for example, could stipulate when equity versus debt financing will be utilized.

Branch of Foreign Corporation

Often, foreign investors wish to carry on the Canadian operations as a branch of a foreign corporation or U.S. subsidiary. Foreign corporations are generally entitled to carry on business in this manner in most areas of commercial activity, provided that extraprovincial licences to carry on business are obtained in the relevant jurisdictions. Once again, the decision to use a foreign branch is dependent upon a number of considerations. Incorporation often makes it easier for small and medium-sized businesses to deal with Canadian suppliers and customers. It is often assumed that choosing a Canadian corporation demonstrates a commitment to Canadian operations. Such assumption has no foundation in law. If independent financing for

the Canadian operation is required, local financing is much easier to obtain through the use of a Canadian-owned subsidiary. The failure to create a separate corporate entity will expose the foreign corporation to all liabilities incurred in the Canadian operations.

The tax treatment for branch operations is discussed elsewhere in this paper. Income tax must be paid in Canada on Canadian branch profits. The ability to claim a full foreign tax credit at the parent corporation level must be considered to ensure that double taxation is avoided. Accordingly, the taxation of the foreign corporation and the projected income or losses which will be incurred by Canadian operations are important (and usually determinative) factors to be considered.

Partnerships

A partnership is a relationship that exists between two or more people (individuals, corporations, partnerships or other entities) who carry on a business in common with a view to earning profit. In a general partnership, it can generally be said that:

- each partner is liable for all of the debts and other liabilities of the partnership
- net income will be determined at a partnership level and such net income will be allocated to the partners
- a partner may not be entitled to be a creditor of the partnership (although a party related to the partner is entitled to be a creditor)
- unless otherwise specified by a partnership agreement, all partners must contribute equally to the capital of the partnership and are entitled to share equally in the profits of the partnership; likewise, all losses would be shared equally
- the liability of a partner in connection with partnership liabilities extends to the full extent of the partner's assets

Partnerships are governed by the provisions of provincial statutes. Written partnership agreements can override many of the provisions of various Partnerships Acts and it is advisable to enter into a partnership agreement in order to avoid certain arbitrary provisions of these statutes. As stated above, in the absence of a written agreement to the contrary, amongst themselves partners may be equally liable for partnership obligations, notwithstanding their unequal capital contributions or profit sharing arrangements.

Under Canadian tax law, partnerships do not pay income taxes. Although net income is calculated at the partnership level, the net income is allocated to the partners, who are obligated to pay tax. A foreign partner allocated income from a Canadian partnership would, therefore, be obligated to pay Canadian income tax on the foreign partner's share of income.

Limited Partnerships

A limited partnership is a type of partnership which restricts the exposure of passive individual partners for the liabilities of the partnership. Limited partnerships are creatures of provincial statutes. These statutes contain subtle differences with respect to the exposure of individuals

to liability in excess of the capital invested in the partnership by such individuals. These differences are dependent on the province in which a limited partnership is organized.

A limited partnership consists of one or more general partners (who are exposed to unlimited liability) and one or more limited partners. Under the Ontario legislation, a limited partner may become liable as a general partner in the event such limited partner takes part in the control of the business. In other words, in some circumstances, the limited partner will have unlimited liability as a result of its participation in the control of the business. In some provinces, the extent to which a limited partner is exposed to liability is limited to the result of the acts such limited partner performs in the management and operation of the business of the limited partnership.

A limited partnership does not come into existence until it is registered under the laws of the province in which it is established. Typically, registration requires filing forms which provide specific information about the identity of the general partner. These forms may or may not require the identities of the limited partners. There is no requirement that the limited partnership agreement itself be filed in an office where it may be scrutinized by the public.

Limited partnerships are useful vehicles where there is a desire to flow through income and expenses and yet limit the liability of the individual participants in a particular venture. However, its suitability requires that the investment of the limited partner/investor be passive in nature.

Limited Liability Partnerships

On June 11, 1998, the *Partnership Statute Law Amendment Act, 1998* was enacted and recognizes a new type of legal entity in Ontario known as a 'limited liability partnership'.

General partnership law in Ontario imposes unlimited personal liability on partners for all of the partnership's debts and liabilities. Under the new provisions, all of the partners remain personally liable for their own actions and for the actions of those they directly supervise or control. The legislation provides, however, that a partner will not be liable for liabilities of the limited liability partnership resulting from any negligent act or by another employee or partner of the limited liability partnership not under the partner's direct supervision or control.

Limited liability partnerships are only available to those persons:

- (i) who are practising in a profession where the statutory regime governing the profession expressly permits the practice through a limited liability partnership, which is the case now with accountants and lawyers;
- (ii) who have met minimum insurance requirements as established by the professional governing body; and
- (iii) who have registered the firm name under the *Business Names Act*.

The amendments to the *Partnership Act* contained in the Act recognize extra-provincial limited liability partnerships and require certain filings be made with respect to its limited liability partnership.

Co-Tenancies and Joint Ventures

Real estate investments are often held in the names of co-tenancies or joint ventures. A co-tenancy is not a tax-paying entity, nor is it a relationship such as a partnership which is treated like an entity for the purposes of calculating net income. Accordingly, there is some flexibility available in the preparation of financial statements for co-tenancies. Each co-tenant or joint venturer may determine the amount of depreciation expense which will be utilized by it in the calculation of income for tax purposes.

In the case of joint ventures, agreements are virtually always negotiated prior to undertaking joint venture activities. Since a joint venture is not recognized as a distinct and separate entity, it cannot sue or be sued. The joint venture agreement will delineate the respective rights and liabilities of the joint venturers, including their right to bind other parties.

The use of a co-tenancy or joint venture assumes that the parties are not in a partnership relationship. Accordingly, where a joint venture structure is contemplated, care must be taken to analyze whether or not the joint venture structure will survive the scrutiny of a third party who may seek to impose full liability on each co-tenant as if it was a partner in a general partnership. Notwithstanding language contained in the typical joint venture which confirms that the parties are joint venturers and not partners, if the threshold partnership test of carrying on business in common with a view to a profit is met, there is a risk that the co-tenancy will be deemed to be a partnership and the individual co-tenants liable as partners in a general partnership.

Agency & Distribution Arrangements

In some cases, the decision to expand into Canada may be realized without actually having the foreign business entity carry on business in Canada. The entering into of a distribution contract or agency agreement in Canada does not, in and of itself, constitute carrying on business in Canada. Accordingly, it is often appropriate for a foreign entity to consider the use of a Canadian agent or distributor to expand its business operations into Canada.

In each case, the relationship should be governed by contract to avoid ambiguity and to ensure that necessary controls and methods of recourse are clearly established. Generally speaking, if an agency relationship exists, the agent will have the right to bind its principal to contractual commitments. A distributor does not have such rights and is generally considered to be an independent contractor.

The ownership and protection of intellectual property rights and exclusivity rights are often given insufficient emphasis when establishing an initial relationship with a Canadian entity. Such diffidence can create significant problems when the relationship between the parties changes. In addition, termination rights must be considered. In the absence of a written contract, a Canadian agent or distributor will be entitled to reasonable notice before the termination of its contract. If insufficient notice of termination is given, a court may award damages in lieu of notice.

Franchise Arrangements

Franchising is yet another method which may allow foreign businesses to enter the Canadian market. In Canada, regulation of the franchisor/franchisee relationship falls within provincial jurisdiction. Currently, only two provinces, namely Alberta and Ontario, have enacted legislation dealing specifically with franchises. Of course other federal and provincial laws which affect businesses generally (as described elsewhere in this publication), will continue to apply as well.

Province of Alberta

The *Alberta Franchises Act* (the “Alberta Act”) applies to the sale of any franchise that will be operated in Alberta, but only if the purchaser is an Alberta resident or has a permanent establishment in Alberta. The Alberta Act also governs all franchise-related agreements and imposes a duty of “fair dealing” on both franchisor and franchisee with respect to their ongoing business relationship in Alberta.

Under the Alberta Act, franchisors are required to give prospective franchisees a disclosure document, similar to a prospectus, at least 14 days before any payment is made or any agreement is signed relating to the franchise, whichever is earlier. The disclosure document must contain all material facts about the franchise, including (but not limited to) those facts required by regulation. If a franchisor provides its disclosure document after the 14 day limit, then the franchisee may cancel all franchise agreements within 60 days after receiving the document. If the franchisor doesn’t provide any disclosure document, the franchisee may cancel the franchise within two years after it was granted. In both cases, the franchisor must compensate the franchisee for the net losses incurred in acquiring, setting up and operating the franchise. The franchisee can also sue the franchisor for damages for any misrepresentation made in the disclosure document.

Province of Ontario

Ontario’s *Arthur Wishart Act (Franchise Disclosure), 2000* (the “Ontario Act”) is similar to the Alberta Act, with some important differences. First, unlike the Alberta Act, the Ontario Act applies even if the potential franchisee does not reside in or have a permanent establishment in Ontario. All that is needed is that the prospective franchise be intended to be operated in Ontario.

Secondly, the content of the disclosure document required in Ontario is different. For example, the Ontario document must include various warnings, including that independent legal and financial advice in relation to the franchise agreement should be sought prior to entering into the franchise agreement, and that a prospective franchisee is strongly encouraged to contact any current or previous franchisees prior to entering the franchise agreement. The Ontario Act requires disclosure of significant information about all directors and officers of the franchisor while Alberta restricts the requirement to directors and officers who are active in management of the franchise. The Ontario Act also requires a franchisor to disclose various licenses and permits the franchisee may need. The Alberta Act has no such requirements, but

does require franchisors to recite certain sections of the Alberta Act relating to franchisee's rights to rescission, cancellation and damages.

Unlike Alberta, Ontario requires a franchisor to provide a disclosure document to a prospective franchisee *before* taking a deposit, a deposit agreement or a confidentiality agreement. The effect of failing to provide the disclosure document on time (or at all) is the same as in Alberta; however, the Ontario Act gives the franchisee more potential compensation than the Alberta Act. The Ontario Act requires a franchisor to refund all money received from the franchisee, re-purchase any inventory, supplies and equipment at a price equal to the purchase price paid by the franchisee, and to compensate the franchisee for any losses incurred in acquiring, setting up and operating the franchise.

Province of Québec

Franchisors who are considering an expansion to the province of Québec must consider two important statutes: the *Civil Code of Québec* and the *Charter of the French Language*. The Québec Civil Code governs all business relationships in the province of Québec. For example, the Civil Code applies to “contracts of adhesion” which are defined as a contract drafted by one party and imposed upon the other. Most franchise agreements are contracts of adhesion because they are basically non-negotiable. When a franchise agreement is considered to be a “contract of adhesion”, the Civil Code requires it be written in clear and understandable language. The agreement may not refer to provisions in other contracts unless those provisions are expressly brought to the franchisee's attention. Any abusive or overly onerous provisions will not be enforceable.

The aim of the *Charter of the French Language* is to preserve and promote the French language in Québec. The Charter requires that most contracts, advertisements, websites, and other documents and services be made available in French in Québec. Public signs and commercial advertising may be in English as well as French, but the French must predominate.

Other Provinces

The Alberta Act, Ontario Act and Québec Code all impose duties of good faith on franchisors and franchisees. The common law of the other provinces may do so as well. Generally, in Canada it is likely that each party to a contract is required to act honestly, fairly and reasonably, and must not prevent the other party from enjoying the fruits of the contract. In addition, most of the provinces of Canada have also enacted laws regarding trade practices, consumer protection, advertising, income and sales tax, and other business and property-related issues.

Online Searches

Online searches of the Ontario Business Information System, the official database of all registered businesses in Ontario, are now available from three Primary Service Providers authorized by the Ontario government:

- OnCorp Direct Inc. at www.oncorp.com,
- Cyberbahn Inc. at www.cyberbahn.ca, and
- Dye & Durham at www.eservicedd.ca.

A variety of reports are currently available from these websites including Corporation Profile Reports, Certificates of Status, Corporations Business Names Lists, Business Names Reports, Partnership Business Names Reports, Partnership Business Names Lists etc. This online ability is the first phase of a broader-reaching plan of the Ministry of Government Services which has now added online incorporation of corporations and various governmental filings. The Ministry also has a toll free help and general enquiries line:

1-800-361-3223 (Ontario only) and 416-314-8880 (Toronto).

Directors' Liabilities

Under both the *Ontario Business Corporations Act* (OBCA) and the *Canadian Business Corporations Act* (CBCA), every director and officer of a corporation is required to act honestly and in good faith with a view to the best interests of the corporation when exercising his or her duties. In addition, every director and officer must utilize the care, diligence and skill that a reasonably prudent person would exercise in similar circumstances. Directors and officers are also required to comply with the legislation, the regulations, articles, by-laws and any unanimous shareholder agreement.

In certain circumstances, directors will attract personal liability. For example, liability will be imposed upon individual directors under both the OBCA and the CBCA for authorizing corporate actions which are in violation of specified sections of the applicable Acts. Directors are exposed to personal liability, for example, for improper declaration of dividends, or the corporate purchase or redemption of shares where such acts render the corporation insolvent. In addition, directors will be liable to the corporation for certain acts which constitute breaches of trust, misfeasance and gross negligence. Directors may be liable for acting in excess of their authority or for their own actions which are tortious. However, directors will not be responsible for tortious acts of the corporation unless these acts were expressly directed by them.

In addition, under the CBCA and OBCA, directors are jointly and severally liable for employee wages, not exceeding six months, which have become payable while they were directors. Under the OBCA, individual directors are also responsible for not more than 12 months of vacation pay which accrued under the *Employment Standards Act* (Ontario) while they were directors. Under the *Income Tax Act* (Canada) (the "Act"), directors may be held personally liable for any amount which the corporation has failed to deduct, withhold or remit on behalf of the corporation's employees as required under the Act. Directors may also be liable if the corporation fails to remit GST or unemployment insurance premiums under the *Excise Tax and Employment Insurance Acts* respectively.

Environmental protection statutes also impose liability upon directors. Case law appears to require positive steps to be undertaken by directors to seek out, monitor, and resolve environmental issues in order to avoid statutory liability. These issues are discussed elsewhere in this paper.

Securities Regulation in Canada

Generally, the main purpose of Canadian securities legislation is to preserve the integrity of capital markets and to protect the investing public. In Canada, there are no federal statutes relating to the marketing and sale of securities. Rather, each province and territory has its own legislation which regulates the marketing and sale of securities in that province or territory. More recently, many provinces and territories have adopted “multi-jurisdictional” policies and instruments (and in some cases “national” policies and instruments) which augment their provincial legislation in an effort to better harmonize the securities laws throughout Canada.

Securities Markets

Securities markets in Canada are similar to those in the United States, although significantly smaller in size and volume. Recently, public markets have been restructured in an effort to ensure a strong exchange system for Canadian capital markets participants.

In addition, very significant amounts of capital are raised in what is referred to as the “exempt market”. This market exists because certain trades in classes of securities and trades to certain types of purchasers have been exempted from the detailed filing and prospectus requirements of the securities legislation. Securities issued in this manner may only be resold without a prospectus if a further statutory exemption is available or an exemption ruling is obtained. This is sometimes referred to as the “closed system”.

Securities Legislation in Canada

Generally speaking, the basic functions of Canadian securities laws are the following:

- (i) registration and regulation of persons or institutions who trade in securities;
- (ii) registration of securities distributed in each province;
- (iii) provisions for continuous and timely disclosure of relevant information to the investing public;
- (iv) regulation of take-over bids; and
- (v) provisions for investigative, preventative, and punitive mechanisms to enforce the securities laws and combat fraud.

Raising Capital

There are basically two ways to raise capital in Canada:

- (a) by filing a prospectus in one or more provinces; and
- (b) by raising money without a prospectus which is possible if an exemption is available.

Exemptions to the Prospectus Requirements

Exemption from prospectus requirements fall into two basic categories:

- (i) **Exemptions for Securities:** By reason of their nature, they are regarded as “safe” investments. Typically, these are securities issued by Canadian governments, municipal corporations, and certain other Canadian institutions.
- (ii) **Exemptions for Certain Defined Types of Distributions:** Several of these exemptions exist because the purchasers are presumed to be so wealthy or sophisticated that the legislature believes that any issuer should be able to market securities to them without satisfying the prospectus procedures of the Act.

Other important exemptions include the following:

The “private” or “closely held” issuer exemptions which generally allow a company to offer its securities without filing a prospectus, provided the offer is made to not more than a small number of prospective purchasers.

Mortgages and other encumbrances upon real or personal property (other than those secured by a bond, debenture, or trustee) are also exempt from the prospectus requirements so long as they are offered for sale by a registered mortgage broker.

It should be understood that a very significant portion of the capital raised in Canada is raised in circumstances where exemptions are available.

Disclosure Requirements

When an entity accesses the securities market in Canada in a manner that requires it to file a prospectus, it becomes a “reporting issuer” in every jurisdiction where it files that prospectus. If an entity makes a take-over bid and is required to file a “take-over bid circular” it also becomes a reporting issuer. When that status is obtained, that entity must thereafter comply with various “continuous disclosure” requirements. These continuous disclosure requirements are of two types:

- (i) regular disclosure at predictable fixed intervals (such as at the time of filing annual financial statements, interim financial statements and proxy solicitation materials); and
- (ii) irregular or special disclosure which is generally triggered by a material event or material change in the entity’s affairs.

Continuous disclosure filing requirements can be further categorized as follows:

Financial Disclosure

Canadian securities laws require reporting issuers to disseminate annual audited financial statements and quarterly financial statements, including a balance sheet, income statement and a narrative management discussion and analysis describing the results. In most cases, such financial disclosure must be “certified” by the issuers Chief Executive Officer and Chief Financial Officer.

Material Changes

Canadian securities laws also require that public disclosure be made when changes occur in the business or affairs of the reporting issuer that would be likely to have a significant effect on the market price or value of the reporting issuer's securities. This information is usually released to the public by means of a media release issued to the news media and filed with the applicable Securities Commissions. In addition, a formal material change report must be filed with the applicable Securities Commissions as soon as practicable and within 10 days after the date on which the change occurs.

Insider Trading Rules

Insider trading rules supplement the timely disclosure of material change regulations. These rules are designed to protect the "equal opportunity for investment" concept and are principally directed at the period before the dissemination of information. Trading upon and discussing material information must be restricted so that people who have access to information do not take advantage of that fact to the disadvantage of other investors. Persons who are categorized as "insiders" under Canadian securities laws must file an initial insider report when they acquire securities of the reporting issuer. Thereafter the insiders must file a monthly report of any change in their direct or indirect beneficial ownership of or control or direction over securities of that reporting issuer.

Proxy Solicitation

Whenever notice is given of a meeting to holders of voting securities of a reporting issuer, Canadian securities laws require that management solicit proxies from all voting security holders and that an information circular in the required form be sent to these holders relating to the matters to be dealt with at the meeting.

Variation of Reporting Requirements

Under certain circumstances, a reporting issuer may apply to the applicable Securities Commissions for relief from or variation of the reporting requirements of applicable securities laws. In certain other circumstances, automatic relief is provided.

Take-over Bids

The take-over bid rules are designed to ensure that all security holders of a target entity have an equal opportunity under the bid and sufficient up-to-date relevant information to allow them to make an informed decision on the bid. Generally, a take-over bid is an offer to acquire securities that will constitute at least 20 per cent of the outstanding securities of that class when combined with the securities of the same class held by the offeror. Canadian securities laws set out procedural requirements for the offering and provides for the delivery of a take-over bid circular disclosing all material information relating to the bid.

E-Commerce

Canada's Internet Community

Canada has a vibrant Internet community. On a per capita basis, more Canadians have Internet access than Americans. Also, as a result of the greater penetration of cable television in Canada, Canadians often have access of a higher calibre, speed or bandwidth than do their American counterparts.

Canadian Internet Content Restrictions

The Canadian Commission which regulates Broadcasting and Telecommunications, the Canadian Radio and Television Commission ("CRTC"), has confirmed that, for the time being, it will not impose its' regulatory controls on the provision of content on the Internet. This is significant because television and radio stations in Canada are subject to strict content quotas. For example, no less than 35 per cent of radio content must be "Canadian", as defined by the CRTC. Accordingly, a Canadian based website that provides content is not as constrained as would be their television and radio counterparts. This may significantly impact the music industry, as online music delivery becomes more popular. The online music industry in Canada, as in the United States, is undergoing a period of uncertainty and change with new tariffs being imposed by the federal government for music downloads and music performances online. Certain recent rulings of the Supreme Court of Canada have also contributed to the sense that Canada may be more tolerant of the use of copyright content online than is currently allowed in the United States. Recent amendments to the *Copyright Act* have addressed the issue of the retransmission or rebroadcast of television over the Internet. Subject to the CRTC revisiting its current position on this issue, any party in Canada that wishes to rebroadcast television content over the Internet should still consider seeking the permission of the copyright holder. Internet rebroadcasters cannot participate in the compulsory license regime available to traditional retransmitters and cable companies.

Online Commerce

While the Internet may be borderless, border controls and customs duties are imposed on all goods shipped into Canada notwithstanding the fact they are purchased online. Accordingly, the competitive advantage of lower prices in the U.S. will be diluted unless the distribution centres of U.S. online vendors are located in Canada. Similarly, from a computer services point of view, despite greater bandwidth, it is still advisable to place mirror sites throughout Canada in order to better manage the transfer of data and download times.

Copyright

Canada is a signatory of the *Berne Convention* and accordingly, copyright laws in Canada have similar thresholds to those in most western countries. Under Canadian copyright laws, only the owner of a copyright work is entitled to reproduce, broadcast or telecommunicate to the public that work or to authorize others to do the same. Any party who engages in any of these or similar acts without the express permission of the copyright owner will be held liable for

copyright infringement. Canadian copyright law has been applied to the unlicensed use of copyright works on the Internet. The express permission of the copyright owner must be sought if one wishes to reproduce that work on the Internet. Canadian record and television industry companies have been vigorous in enforcing their copyrights in cyberspace.

Privacy

As in the United States, the Canadian legislature has taken certain steps to protect privacy on the Internet. Any company that is interested in pursuing a data mining or data collection agreement with a Canadian company should be mindful of the provisions contained in the new federal privacy legislation, the *Personal Information Protection and Electronic Documents Act*. At its core, the legislation codifies the following 10 principles which must be adhered to by Internet companies interested in data collection. These ten principles are:

- 1) accountability,
- 2) the purpose of the data collection must be identified,
- 3) there must be consent,
- 4) the information collected must be relevant to the purpose stated,
- 5) the information cannot be used for purposes other than those for which it was collected,
- 6) the impression must be kept accurately,
- 7) the information must be protected,
- 8) the data collection policies of the organization must be open to the public,
- 9) an individual must be allowed access to any information collected about him by an organization, and
- 10) an individual may challenge an organization with respect to their compliance with the legislation.

While data mining can continue in Canada, it is necessary that it be conducted in compliance with the foregoing principals. This legislation applies to all commercial enterprises in Canada. Many provinces, including Ontario, are considering enacting their own parallel privacy statutes. The provinces of Alberta, British Columbia and Québec each have their own provincial privacy regimes.

Of particular concern to Canadian privacy advocates, vis-a-vis sharing information with companies in the United States, is the possibility that the U.S. entity receiving that information may be forced to disclose that information pursuant to the U.S. *Patriot Act*. Canadian companies may either seek specific assurances from U.S. companies with respect to this concern or object to disclosing private information to U.S. companies in the United States on this basis.

Defamation

Canadian common law contains torts for defamation such as slander and libel. A website that displays any content in Canada must do so mindful of the fact that any information which is found to be slanderous or libelous could result in actions being brought against the website for

its display in Canada. While Canada, under the *Charter of Rights and Freedoms*, recognizes the right to free expression, it is not as broad as that protected by the *Bill of Rights* in the United States and does not provide the same protections in the context of a defamation action. The usual remedies for defamation include damages as well as injunctive remedies such as the immediate removal of the content from the offending website.

Cybersquatting and Misappropriation of Trademarks

Canadian jurisprudence on the question of whether or not a person can register and own a domain name simply for the purpose of the sale of that domain name (a practice known as “cybersquatting”) remains unresolved. In general, Canadian courts look to American jurisprudence with respect to how cybersquatting disputes will be resolved. Some Canadian disputes have also been successfully tried before the ICANN domain name dispute tribunal. The decision of these Canadian cases, as elsewhere around the world, has not always been against the interest of the Cybersquatter. Further, there have been cases where Canadians have sold domain names for considerable sums. Issues related to the misuse of domain names, metatags and trademarks online have been recently prosecuted in the Canadian courts. Trademark law has in some cases been considered inapplicable to domain name or Internet use unless the use of the trademark on the website in question constitutes infringement of the “use” in respect of which the trademark was registered.

Foreign Investment Review and Merger/Anti-Trust Review

The *Investment Canada Act*

Until the early 1980s, Canada's Foreign Investment Review legislation imposed significant restrictions on non-Canadians seeking to invest in Canadian businesses. Since then the political climate has changed and the prevailing view in recent years has been that, with only certain exceptions, it is not desirable to erect legislative obstacles to foreign investment in Canadian businesses.

The *Foreign Investment Review Act* was superseded by the *Investment Canada Act* (the "ICA") in 1985. Only in certain circumstances does the ICA seek to review or restrict new investments by non-Canadians. In general terms, the transactions which are subject to review under the ICA are larger transactions, and transactions in certain politically and culturally significant sectors. The ICA does, however, require the filing of a simple notification form in most transactions involving the establishment of a new business in Canada or the acquisition of an existing Canadian business by a non-Canadian.

The ICA applies where a non-Canadian establishes a new Canadian business, or acquires control of an existing Canadian business. Under the definitions in the ICA, natural persons will be "non-Canadians" unless they are Canadian citizens or permanent residents (under the *Immigration Act* (Canada)) and live in Canada for not more than one year after becoming eligible to apply for Canadian citizenship. For corporations and other legal entities, the distinction between Canadian and non-Canadian is based on direct or indirect control, and the ICA contains rules for determining what will constitute control in different circumstances. "Canadian business" is broadly defined to include any business that has assets, a place of business and one or more employees or independent contractors in Canada. The ICA also contains detailed definitions and rules as to what will constitute an acquisition of control for various kinds of transactions such as asset transactions, share transactions and transactions involving the acquisition of voting interests in entities other than corporations.

There are a number of specific exemptions from the application of the ICA, which include certain securities transactions and venture capital deals, acquisitions of control in connection with the realization on security, certain financing transactions, and certain direct and indirect acquisitions of control by insurance companies.

Although the potential scope of the ICA is broad, its impact in the vast majority of transactions is relatively minor. Most transactions will require only notification under Part III of ICA and will not be subject to review under Part IV. For the vast majority of transactions which are not subject to review, the ICA requires only that the investor give notice of the transaction to the Director under the ICA and provide the prescribed information either before the transaction is completed or within 30 days afterward. The information required is straightforward, and Investment Canada publishes simple suggested forms for filing on its website. There is no filing fee.

Where a transaction is reviewable under the ICA, the investor is required to file an extensive pre-closing filing called an *Application for Review*, together with various supporting documents. The purpose of the review is to determine whether the proposed transaction should be allowed and will be of “net benefit” to Canada. The Minister is entitled to a period of up to 75 days after filing to make that determination, and in transactions that give rise to substantive issues under the ICA, that review period may be, and often is, extended by agreement between the applicant and the Minister.

A transaction will automatically be subject to Part IV review under the ICA if the applicable transaction size threshold is exceeded; \$5 million for direct acquisitions and \$50 million for indirect acquisitions. However, subject to certain exceptions, different thresholds apply where the investor is from a World Trade Organization (WTO) member country. Where that is the case, except in the circumstances referred to below, indirect acquisitions are not reviewable whatever their size and the transaction size threshold for direct acquisitions is an amount which is pre-determined by the Minister for each calendar year. The amount was \$265 million in 2006 and was increased to \$281 million for the calendar year 2007. In the following circumstances, the base level transaction size thresholds of \$5 million and \$50 million are applicable even where the investor is from a WTO member country:

- (i) where the business in question falls within the definition of a “cultural business”, which includes activities such as publishing, distribution or selling books, magazines, periodicals, newspapers, film or video recordings, audio or video music recordings or music, and activities relating to radio communication, television and cable television broadcasting, satellite programming and broadcast network services;
- (ii) where the business relates to one of the following sectors: uranium production, financial services or transportation services.

Even where a transaction is not automatically subject to Part IV review, the ICA provides that in certain circumstances a review may be required if, within 21 days after the certification of a completed Part III notification filing, an order is made requiring a review and notice thereof is sent to the investor.

Where a review is required under Part IV, the ICA prohibits the investor from closing the transaction until the Minister’s approval is obtained. An applicant/investor may request special permission to close earlier on the grounds that a delay would result in undue hardship to the investor or jeopardize the operations of the business.

Investment reviews under the ICA often proceed in tandem with reviews under the *Competition Act*. One of the factors in the net benefit determination under the ICA is the effect that the proposed transaction will have on competition. For that reason, the reviewing agencies under the ICA will typically seek input from the Competition Bureau, and will not normally approve an application for review until the transaction has been approved under the *Competition Act*.

Merger Prenotification and Review

The rules respecting merger or anti-trust review and prenotification in Canada are contained in Parts VIII and IX of the *Competition Act* (Canada). The responsible government agency is

called the Competition Bureau, and filings are made through its office in Hull, Québec. *Please note that the thresholds and fee amounts established under the Act are subject to change; the dollar amounts set out below are current as of January 2007.*

The factors which determine whether a notification filing is required in respect of a proposed merger transaction are the value of the assets in Canada and the annual gross revenues from sales in, from or into Canada of the parties to the transaction and of the target corporation itself. More specifically, for a merger transaction which takes the form of the acquisition of voting shares of the corporation carrying on the target business (or of its parent corporation), two monetary tests or thresholds are applicable and are summarized as follows:

- (i) The parties to the transaction (including their respective affiliates) together have assets in Canada with an aggregate value exceeding Cdn. \$400 million or annual gross revenues from sales in, from or into Canada exceeding Cdn. \$400 million.
- (ii) The corporation the shares of which are being acquired (and corporations controlled by it) have assets in Canada with an aggregate value exceeding Cdn. \$50 million or annual gross revenues from sales in or from Canada exceeding Cdn. \$50 million.

The first of the above tests is sometimes referred to as the “party size threshold” and the second as the “transaction size threshold”. For the purposes of the party size threshold in a share purchase transaction, the parties are considered to be the purchaser of the shares and the corporation the shares of which are being purchased.

For a merger transaction which involves an acquisition of assets, the same two tests apply, except that the transaction size threshold is applied to the value of the assets being acquired and the annual gross revenues from sales in or from Canada generated from those assets. For mergers by amalgamation, the transaction size threshold increased to \$70 million and is applied to the value of the assets in Canada of the amalgamated corporation (and corporations controlled by it) and to the annual gross revenues from sales in or from Canada generated from those assets.

A merger notification filing is required where both the party size threshold and the transaction size threshold are exceeded. Note that each of those thresholds may be exceeded either on the basis of aggregate value of assets or on the basis of annual gross revenues. Where a notification filing is required, the wording of the Act indicates that both parties are obligated to make the filing. The filing fee for merger pre-notification was increased to Cdn. \$50,000.00 in 2003.

A merger notification filing may be made in either a short form or a long form. The Act provides that where a short form filing is made, the proposed transaction shall not be completed before the expiration of 14 days after the completion of the filing. Where a long form filing is made, the proposed transaction shall not be completed before the expiration of 42 days after the completion of the filing. Where the parties elect to file a short form filing, the Competition Bureau may, within the 14 day waiting period, require a long form filing, in which event the longer waiting period will be applicable. The long form filing is very extensive, and the Competition Bureau will not usually require it unless it appears that the proposed transaction will or may give rise to substantive competition issues. After the expiration of the applicable waiting period,

the parties are free to proceed with the transaction unless the Competition Tribunal has issued an interim order preventing them from doing so.

The merger review process is initiated by an application to the Competition Tribunal for a remedial order on the grounds that the proposed transaction prevents or lessens, or is likely to prevent or lessen, competition substantially. The Commissioner of Competition may commence such an application before, or within three years after, substantial completion of the merger transaction. Note that even where a notification filing has been made and the Competition Bureau has not initiated a merger review during the requisite waiting period, the transaction is still potentially subject to merger review for the prescribed three-year limitation period.

If the parties to a proposed merger transaction desire certainty before closing, they may apply to the Competition Bureau for an Advance Ruling Certificate (an "ARC"). The fee for an ARC application is the same as the fee for a notification filing, and the supporting information that the Bureau will require in the first instance is substantially the same as well. If the Bureau issues an ARC in respect of a proposed merger transaction, it is estopped from applying for merger review in respect of that transaction as long as the transaction was fully and accurately described in the ARC application and is completed within one year after the issuance of the ARC. If the Bureau declines to issue an ARC, or if none is applied for and a notification filing is made under Part IX, the Bureau may give some measure of comfort to the parties by issuing a non-binding "no action letter" stating that in its view, grounds do not exist at the time of the letter to initiate merger review proceedings before the Tribunal.

Anti-Dumping

In order to discourage the importation of goods at prices below the price at which such goods would be sold in the exporter's home market, Canada has anti-dumping legislation which imposes duties to prevent unfair competition with domestic Canadian goods. Similar duties may be payable when imported goods are subsidized in their country of manufacture. For a more detailed discussion, see the Customs and Excise Taxes section of this paper.

Sales and Land Transfer Taxes

Goods and Services Tax

Canada has a 6 per cent value-added tax imposed on goods and services called the Goods and Services Tax (“GST”). The GST is applied to each transaction in the production and distribution chain, including most services and the importation of most goods and services into Canada. It is charged on the “value of the consideration,” or in general terms, the purchase price. In the case of imported goods, GST is based on the duty paid value (which includes customs duty). Goods exported from Canada are not subject to GST. There are limited exemptions from GST such as most financial services (including for this purpose: insurance premiums, loan interest and share purchase transactions) and specified goods including most grocery items.

All persons, including corporations, partnerships and sole proprietorships, who are engaged in a commercial activity in Canada having sales (of goods and services otherwise subject to GST) greater than \$30,000 per year must register to collect GST. The concept of “commercial activity” is quite broad and includes not only carrying on a business in Canada but also single ventures and the sale of real estate. Businesses which register for GST are entitled to input credits equal to the full amount of the GST paid by them on all business purchases. The input tax credit system effectively reduces the tax (on a net basis) on each business entity to the value added by such entity. Unregistered persons are not required to collect GST on their sales but are also not entitled to recover GST paid on their purchases as input tax credits.

Non-residents who carry on business in Canada or who are deemed to carry on business in Canada by virtue of soliciting orders in Canada or offering for sale certain goods such as books or periodicals for delivery in Canada are required to register for and collect GST. Certain non-residents who are not carrying on business in Canada may voluntarily register to collect and remit GST. Registration would be desirable if such supplier wishes to obtain input tax credits for GST paid to Canadian suppliers. A non-resident without a permanent establishment may be required to post security in connection with its obligation to collect and remit GST.

Provincial Sales Tax

With the exception of the province of Alberta, each province charges a sales tax on tangible personal property and certain services. This tax is levied only at the retail level. Sales taxes in the Canadian provinces generally range between per cent and 10 per cent. Ontario’s sales tax is currently 8 per cent.

Most provinces provide exemptions from retail sales taxes for certain goods, such as basic groceries. As well, exemptions for certain purchases of production machinery are contained in most provinces’ legislation. However, there is a variation from province to province in the services which are subject to taxation. For example, British Columbia extends sales tax to lawyers’ accounts.

In 1997, a Harmonized Sales Tax (“HST”) system was implemented in Nova Scotia, New Brunswick and Newfoundland, which harmonized those provinces’ respective retail sales tax systems with the federal Goods and Services Tax.

The HST applies to all goods and services that are otherwise subject to GST and is administered under the *Excise Tax Act*. It is applied at the single rate of 14 per cent on taxable supplies for goods and services made or deemed to be made in the participating provinces, replacing the former dual systems of provincial retail sales tax and GST. Supplies made in the non-participating provinces will remain subject to GST and the provincial retail sales tax of the particular province. Registrants are entitled to claim input tax credits for tax payable at either the 6 per cent (GST) or the 14 per cent (HST) rate.

Land Transfer Tax

A land transfer tax is payable in most provinces on the acquisition of real property in that province. In Ontario, the general rate is 0.5 per cent on the first \$55,000 of value and 1 per cent on the next \$195,000 of value and 1.5 per cent on the balance of the consideration payable for the real property. Where the real property consists of a single family residence, that portion of the consideration that exceeds \$400,000 is subject to an additional 0.5 per cent of land transfer tax.

Previously, there was a higher 20 per cent Ontario land transfer tax on non resident purchases of certain restricted land (i.e. farmland, recreation and agricultural land, woodlands and orchards). As of May 6, 1997, the sale of these lands to non residents became subject to the same rate as Canadian residents.

Income and Capital Taxes

Federal Income Tax

Canada imposes a federal corporate income tax on non-residents who carry on business in Canada or sell real property situated in Canada. In general terms, this is restricted to income derived from Canadian business activities and Canadian situated investments. In addition, Canada imposes a federal non-resident withholding tax on certain Canadian source payments such as dividends and interest paid to non-residents. In these circumstances, subject to limited statutory exemptions, the Canadian payer is required to withhold tax from the gross amount of the dividend, interest, etc. and remit this to the Receiver General for Canada as tax on behalf of the non-resident recipient. However, where the non-resident carries on business in Canada through a permanent establishment situated in Canada, a waiver from such non-resident withholding tax may be available upon application to the Canadian federal tax authority. A U.S. foreign tax credit may be available in the non-resident's own jurisdiction, depending on the tax laws of that jurisdiction, in respect of such Canadian non-resident withholding tax.

Canada has entered into bilateral tax treaties with many countries. The Canada-U.S. Income Tax Convention (1980) as amended by various Protocols (the "Convention") is an example of a tax treaty which contains certain relieving provisions. For example, in the absence of a permanent establishment in Canada (as defined in the Convention), a U.S. person (not limited to an individual) who is subject to tax in the U.S. and who carries on business in Canada will not be subject to Canadian federal income tax on business income earned in Canada. A permanent establishment is defined as a fixed place of business through which the business of the non-resident is carried on and includes, for example, an office or factory. The Convention also provides for a reduction in withholding tax rates on certain types of Canadian source income distributed to U.S. persons as described below.

A U.S. corporation may carry on business in Canada either by incorporating a Canadian subsidiary corporation or by means of a Canadian branch operation. In either case, in the absence of a "permanent establishment" in Canada as defined in the Convention, federal income tax is not exigible. It should be noted that the definition of "permanent establishment" in the Convention may differ from the definition of the same term as applicable for provincial purposes.

Canadian Subsidiary Corporation

A corporation incorporated in Canada (whether federally or provincially) will be considered to be a resident of Canada for income tax purposes and therefore will be subject to Canadian income tax on all of its worldwide income under Part I of the *Income Tax Act* (Canada) (the “Act”). The 2006 combined Federal-Ontario corporate rates of income tax, based on the 2006 federal and Ontario Budget proposals, are as follows:

Part I tax (net of provincial abatement)	21.00%
Federal Surtax (at 4%)	1.12%
Ontario tax	<u>14.00%*</u>
Total	36.12%

(Note: certain credits against tax may be available; e.g., for manufacturing and processing activities.)

In the 2006 federal budget, the government announced its intention to eliminate the corporate surtax for all corporations in 2008 and reduce the general corporate income tax rate by two percentage points by 2010. The general corporate income tax rate will be reduced to 20.5 per cent effective January 1, 2008, to 20 per cent effective January 1, 2009, and to 19 per cent effective January 1, 2010. The rate will be prorated for taxation years that include any of those dates. This tax reduction will not apply to income that benefits from preferential corporate tax treatment, such as investment income that benefits from refundable tax provisions or which already qualifies for special tax treatment, or income already eligible for the low small business rate (see discussion below). The budget also proposed to eliminate the corporate surtax for all corporations effective January 1, 2008, prorated for taxation years that include that date. Its elimination is equivalent to a 1.12 percentage point reduction in corporate income tax rates and will simplify the tax system.

The 2006 Ontario budget did not change corporate income tax rates. The basic income tax rate is 14 per cent on taxable income allocated to Ontario which is the rate that has been in effect since January 1, 2004. Currently the Ontario corporate rate, M & P rate and small business rate stand at 14 per cent, 12 per cent and 5.50 per cent, respectively.

Assuming that the Canadian subsidiary repatriates profits to its foreign parent, non-resident withholding tax under Part XIII of the Act may apply. Part XIII of the Act imposes a withholding tax rate of 25 per cent which is generally reduced by the various tax treaties. Pursuant to the Convention, the reduced rates of withholding tax on interest, dividends and royalties are as follows:

Dividends paid to U.S. parent corporation	5.00%*
Interest paid to U.S. parent corporation	10.00%
Royalties paid to U.S. parent corporation	10.00%**

* Applicable when the beneficial owner is a company that owns 10 per cent or more of the voting stock of the company paying the dividends.

** The Convention exempts certain types of royalties from withholding tax such as copyright royalties and payments for the use of computer software.

Small Business Deduction

A small business deduction may be claimed by a Canadian-controlled private corporation (CCPC) in respect of its income from carrying on an active business in Canada. Active business carried on by a CCPC in Canada does not include a “specified investment business” or a “personal services business”. The small business deduction is provided by way of an annual tax credit that is calculated as 16 per cent of the least of the corporation’s active business income for the year, taxable income for the year (subject to certain adjustments), or business limit for the year. The corporation must be a CCPC throughout the year to qualify for the small business deduction for that year.

At present, the first \$300,000 of qualifying active business income earned by a CCPC is generally subject to tax at the reduced small business tax rate of 12 per cent. Budget 2006 proposes to increase the amount of active business income eligible for the reduced tax rate to \$400,000 as of January 1, 2007. The budget further proposes to reduce the small business tax rate to 11.5 per cent beginning in 2008 and 11 per cent as of January 1, 2009. The increase to the small business limit and the rate reductions will be pro-rated for corporations with taxation years that do not coincide with the calendar year.

Canadian Branch Operation

If a non-resident carries on business in Canada through a permanent establishment and does not incorporate a Canadian subsidiary, tax under Part I of the Act will also be applicable at the rates described above in respect of income from Canadian business operations.

In addition, a so-called branch tax is imposed on the after-tax profits of the Canadian branch operations which are not, in general terms, reinvested in Canada. The branch tax is intended to be roughly equivalent to the withholding tax which would have been payable on dividends paid by a Canadian subsidiary to its foreign parent. The rate of Canadian branch tax is 25 per cent. This rate has been reduced by the Convention to 5 per cent for branches of U.S. corporations. In addition, the Convention provides for a one time exemption for the first \$500,000 of Canadian net profits. The \$500,000 exemption must be shared among associated corporations if the associated corporations conduct the same or similar businesses in Canada.

A U.S. foreign tax credit should be available in respect of Canadian income taxes paid for the Canadian branch operation, subject to the rules in the *Internal Revenue Code*.

Choosing Between a Canadian Subsidiary and Canadian Branch Operation

There are a number of considerations relevant to this issue. Non-income tax considerations such as regulatory compliance or the desirability of segregating Canadian assets and liabilities from U.S. assets and liabilities are relevant. Tax considerations include the following:

- the desirability of utilizing any Canadian start-up losses against U.S. income;
- if a Canadian branch structure is utilized, a Canadian income tax return must be filed and a certain amount of disclosure about the U.S. parent will accordingly be necessary;

- if a Canadian branch structure is utilized, the ability to subsequently incorporate the branch on a tax free basis must be considered both from a Canadian and U.S. tax perspective;
- if a Canadian branch structure is utilized, one will typically pay the higher of the two tax rates of the two jurisdictions.

Federal Capital Tax

In addition to the federal income tax, Canada used to impose a “large corporations tax”. This was essentially a federal capital tax at the rate of 0.125 per cent on capital employed in Canada by a corporation in excess of \$50 million (such threshold was shared among a related group of corporations). The federal capital tax was eliminated as of January 1, 2006.

Provincial Income and Capital Taxes

Canadian provinces impose income tax on corporations carrying on business within the province. Some of the provinces, including Ontario, have imposed a capital tax on corporations. The Ontario capital tax is imposed at the rate of 0.3 per cent on “taxable paid-up capital” employed in Ontario of corporations with a permanent establishment in the province. For this purpose, “taxable paid-up capital” is essentially a year-end balance sheet computation being the aggregate of issued share capital, certain surplus accounts and reserves, and advances to the corporation or indebtedness, less an “investment allowance” in respect of investments in or advances to other corporations and certain other bodies.

In the 2004 Ontario Budget, the provincial government announced its intention to eliminate Ontario’s capital tax by 2012. This timetable was accelerated by the 2006 Budget which proposed to reduce the rate to 0.285 per cent by January 1, 2007 – earlier than the first currently scheduled rate cut. Further, the government intends to eliminate the tax in 2010 should the fiscal position of the Province allow.

Prior to 2002, Ontario permitted exemptions from capital tax for small businesses depending on their taxable capital. In 1999, the capital tax exemption for small businesses was \$2 million of taxable capital, with reduced capital tax rates applying to taxable capital between \$2 million and \$4 million. The capital tax exemption was to be increased to \$4 million by January 1, 2003. However, in 2001, Ontario replaced the capital tax exemption with a \$5 million deduction from taxable paid-up capital which applies (on a “pro-rated” basis) after September 30, 2001. As part of the provincial government’s plan to eliminate the capital tax by 2012, the 2004 Ontario Budget proposed increasing the current \$5 million deduction from taxable paid-up capital by \$2.5 million each year starting January 1, 2005 until the deduction reaches \$15 million on January 1, 2008.

Customs and Excise Duties

Customs Duties

All goods entering Canada must go through customs inspection at the point of entry, at which time they are valued and duty, if any, is levied. Most products are also subject to federal goods and services tax and provincial sales tax (see “Sales and Land Transfer Tax” discussed above). In 1988, Canada adopted a classification system known as the Harmonized System of Tariff Classification. This system provides for classification of goods by their essential or intrinsic character, not according to their use. The importer is responsible for correctly classifying the goods. Advance rulings and National Customs Rulings may assist the importer in classifying the goods being imported.

Documentation accompanying goods must show origin, nature of the goods, their intended use and their value and/or price. The primary basis for appraisal of goods imported into Canada is the transaction value of the goods. The transaction value is the price paid or payable for the goods by the importer of the goods, subject to adjustments for elements such as royalties, shipping fees and transportation. Where the price paid or payable for the goods cannot be ascertained, the *Customs Act* provides for other methods of valuation to be used.

The valuation for goods imported into Canada is governed by the *Customs Act* and its associated regulations. The *Customs Act* dictates that where the vendor and purchaser do not deal at arm’s length, it must be shown that the relationship with the foreign importer did not influence the price paid or payable for the goods, or the importer of the goods must demonstrate that the transaction value of the goods satisfy several criteria set out in the *Customs Act*. If the transaction value is not reliable, there are a series of alternative value tests which can be applied to determine the value.

The amount of customs duty is determined by reference to the *Customs Tariff 2007* which describes the class of goods and sets out the corresponding rate of duty. There have been numerous changes to Canadian tariff classification, effective January 1, 2007, which have affected over 5,000 tariff items. The country of origin of the goods is another criterion in the determination of the appropriate duty rate. The country of origin can be generally defined as the place where specific goods are grown, extracted, produced or manufactured. Canada applies varying duty rates (preferential and non-preferential) to goods depending on the basis of their origin.

Duties on goods meeting the rules of origin under the *North American Free Trade Agreement* (“NAFTA”) and being so certified are permitted to enter Canada under the preferential duty rate accorded to American and Mexican origin goods. Effective January 1998, all goods meeting the criteria for origination in the United States are entitled to enter Canada duty-free. The duties payable on goods of Mexican origin are being phased out on a gradual basis, culminating in the anticipated removal of all duties by January 1, 2008.

In order to benefit under the application of NAFTA, goods must meet criteria establishing “rules of origin”. These complex rules dictate which goods are eligible for benefiting under NAFTA.

Goods that originate solely within a free trade area, goods with a 50 per cent or 60 per cent “regional value content” of North American content and direct assembly cost, or significant parts of which are determined to have originated in North America are considered to be ‘originating’ and are therefore able to benefit from the preferential duty treatment under NAFTA. In some cases, goods will be classified as having originated in the country of a signatory to NAFTA and benefit under NAFTA even if some parts that compose the goods were imported from outside of that party’s borders.

Canada has also entered into bilateral free trade agreements with Israel, Chile and Costa Rica. Lower duty rates typically apply to the importation of goods from these countries.

In order to promote trade and to support Canadian industries, the Canada Revenue Agency also provides a number of mechanisms for customs duty relief. For example, drawbacks on customs duty paid may be available on goods used in the manufacture of a finished product that was subsequently exported. Refunds may also be available on imported goods that are damaged or exported without being used in Canada. Whole or partial waivers of duty may also be possible through remission orders which are enacted to apply to particular products, industries or companies.

Excise Duties

Under the federal *Excise Act*, alcohol, beer, tobacco and related products made in Canada are subject to excise duties. These duties are not applicable to imported goods that are not further manufactured or processed in Canada. However, imported goods of such categories are subject to a special duty under the Customs Tariff that is equal to the excise duty.

Anti-Dumping Duties

Pursuant to the *Special Import Measures Act* (“SIMA”) there are special anti-dumping duties for imported goods sold in Canada at prices that are below the prices in the home market. In addition, where goods sold in Canada are subsidized by the exporting country, a countervailing duty may be imposed. These anti-dumping and countervailing duties may be imposed as additional charges, over and above the normal customs tariffs. SIMA is designed to provide Canadian producers with relief from unfair import competition.

In order for an anti-dumping duty to be levied, two conditions must be met:

- (i) the Commissioner of Customs and Revenue appointed under the *Canada Customs and Revenue Agency Act* (the “Commissioner”) must have found the imported goods to have been dumped; and
- (ii) the dumping of the imported goods must have been found by the Canadian International Trade Tribunal to have caused, be causing or be likely to cause material injury to production in Canada of like goods.

Accordingly, if there are no “like goods” produced in Canada, anti-dumping duties cannot be levied.

Dumping occurs when the “normal value” of the imported goods exceeds the “export price”. The “normal value” is generally the price at which the exporter sells similar goods in its domestic

market under competitive conditions at a profit to more than two arm's length purchasers comparable to the importer. Where there are no comparable purchasers (i.e., purchasers who are at the same or substantially the same trade level and who purchase the same or substantially the same quantities as the importer), the normal value may be derived by adding the goods cost of production; an amount for administrative, selling and other costs; and an amount for profit. It may also be derived by reference to the prices at which the exporter sells the goods to importers in third countries.

Generally, the "export price" means the lesser of the exporter's sale price of the goods and the price at which the importer has purchased or agreed to purchase the goods, after deducting

- (i) all costs, charges, and expenses incurred in preparing the exportation of the goods to Canada;
- (ii) import duties and taxes imposed by Canadian law; and
- (iii) every other cost, charge and expenses associated with the exportation of these goods.

If the "normal value" exceeds the "export price", the imported goods will be found to have been dumped.

Criteria utilized in determining whether or not there has been material injury to production in Canada of like goods include the following:

- price suppression and/or erosion of sales by Canadian producers of like goods,
- loss of market share by Canadian producers of like goods,
- reduced employment of persons in Canadian production facilities,
- reduced utilization of Canadian production capacity of like goods and
- inventory build-ups.

Generally, an anti-dumping duty can be triggered by the filing of a written complaint with the Commissioner.

If the Commissioner is of the view that there is evidence that imported goods are being dumped and there is a reasonable indication that such dumping has caused, or is threatening to cause injury to production in Canada of like goods. The Commissioner may then commence an investigation. Notice of the investigation must be given by the Commissioner to the Secretary of the Canadian International Trade Tribunal (the "Tribunal"), the exporter, the importer, the government of the country of export, the complainant and any other prescribed persons. If a preliminary determination of dumping is made, the Commissioner must provide an estimated "margin of dumping" for the imported goods to which the preliminary determination applies. The "margin of dumping" is the amount by which the normal value of the imported goods into Canada exceeds the export price for such goods. The importer of the impugned goods under the preliminary determination is the party liable for payment of such dumping duties. Failing that, the subsequent purchaser of those goods in Canada is liable for this penalty.

Countervailing Duties

In order for a countervailing duty to be imposed, SIMA requires that two conditions must exist:

- (i) the Commissioner must make a finding that the imported goods have been subsidized; and
- (ii) the Tribunal must find that the subsidized goods have caused, are causing, or are likely to cause material injury to production in Canada of like goods.

The definition of subsidy includes any financial or other commercial benefit to people engaged in the production, manufacture, growth, distribution, export or import of the goods in issue as a result of a scheme or program provided by or implemented by the country of export.

If subsidization and material injury have been found, the imported goods will be subject to countervailing duties in the amount of the subsidy.

Marketing and Labelling Legislation

Marketing Offences

In Canada, the federal *Competition Act* creates criminal offences with respect to certain marketing activities, which include:

- resale price maintenance
- predatory pricing
- price discrimination
- deceptive telemarketing

Under the *Competition Act*, suppliers are prohibited from directly or indirectly attempting to influence upward or discourage the reduction of the price at which anyone else supplies, offers to supply or advertises a product within Canada. However, this rule does not apply where the person attempting to influence the conduct of another person and that other person are:

- (a) affiliated corporations;
- (b) directors, agents, officers or employees of either the same or affiliated corporations, partnerships or sole proprietorships; or
- (c) principal and agent.

This exception applies to franchising relationships. Suppliers are also prohibited from refusing to supply a purchaser because of a purchaser's low pricing policy. It is lawful in packaging to have "suggested retail prices"; however, requiring any business in the supply chain to maintain a minimum resale price is unlawful.

Predatory pricing involves the practice of selling goods and services at unreasonably low prices. To be unlawful, this practice must be likely to have the effect of, or intended to have the effect of, substantially lessening competition in a market or eliminating a competitor in a market. Where specific competitors are targeted or prices are set below cost, extreme caution should be exercised.

The *Competition Act* creates an offence of selling a like quality and quantity of articles to purchasers who are competitors of each other at different prices, or offering volume rebates or other advantages to one purchaser where such rebate or advantage is not made available to its competitors at the time the goods are sold and where such conduct amounts to a "practice". Selling products in one area of Canada at prices lower than those exacted elsewhere in Canada may also be unlawful if it tends to substantially lessen competition or eliminates a competitor in that part of Canada.

The *Competition Act* mandates that anyone engaged in "telemarketing" must provide full, reasonable and timely disclosure of, among other requirements, the nature of the product or business being promoted, the purpose of the communication, the price of the product, any restrictions that may be imposed with respect to delivery of the product, as well as a prohibition against deceptive telemarketing practices. Deceptive telemarketing practices may arise where

a person offers a prize for a lottery or contest where the delivery of the prize is contingent upon the prior payment of any amount or where a product is offered at a price in excess of fair market value where delivery of the product is conditional upon prior payment.

Misleading Advertising

The federal *Competition Act* and the provincial *Consumer Protection Act* make it unlawful to make a representation to the public for the purpose of promoting a product or business interest that is false or misleading in any material respect. Representations may be deemed to be made by an importer of goods into Canada where the supplier is outside Canada. Penalties for such representations are governed by a “two track” system, whereby the Commissioner of Competition may choose to pursue criminal or civil remedies against directors or their corporations.

Representations made in the form of statements, warranties or guarantees regarding a product that are not based on adequate or proper testing constitute “reviewable trade practices” which attract administrative remedies. Making a false or misleading representation regarding the price at which goods will ordinarily be sold is also a reviewable trade practice.

Packaging and Labelling Laws

There are a number of laws directed at deceptive marketing practices and improving fairness towards consumers in the marketplace. The following review concentrates on consumer products. In the event industrial products are exported into Canada, there may be specific rules regarding a particular product.

The federal *Consumer Packaging and Labelling Act* (“CPLA”) is designed to protect consumers from misrepresentation in packaging. Retailers, manufacturers, processors and producers of a “product” are required to comply with the CPLA. “Product” is defined in the CPLA as “any article that is or may be the subject of trade and commerce.” It includes both food and non-food items.

The CPLA requires all pre-packaged products to have affixed a label declaring the net quantity of the product in the form prescribed by the Act and Regulations. Generally, information is required to be in both English and French, and must express the quantity of the product in metric units. In addition to quantity, the common name of the product and the principal place of business of the person by or for whom the pre-packaged product was manufactured must also be disclosed.

Certain products are required by the CPLA to be packaged in standardized containers. Toiletries, perfume, peanut butter, wine, cosmetics and powdered laundry detergent fit within this class of products. This requirement is intended to prevent consumers from being misled or confused by an undue proliferation of container shapes and sizes.

Contravention of the CPLA can, in the most extreme cases, lead to a fine not exceeding \$250,000 or imprisonment for a term not exceeding two years or to both.

Hazardous Products Act

The *Hazardous Products Act* (“HPA”) regulates the advertising, labelling, sale and importation into Canada of hazardous products. Schedule I to the HPA lists products which may not be imported or sold in Canada. Examples of such prohibited products are lead pigments in paint and asbestos in textiles.

The HPA also lists certain “restricted” and “controlled” products which may be imported or sold in Canada only if they comply with specified safety standards. Children’s toys, furniture and certain flammable textile products are examples of products within the “restricted” category. “Controlled” products include toxic, flammable and corrosive items. Pursuant to the HPA, importation of controlled products may be prohibited unless the supplier or importer provides a material safety data sheet on the product and labels the product as specified in the regulations. This data sheet must contain details on ingredients, risks, injury prevention and treatment procedures. In certain cases, confidential ingredient information may be exempted from disclosure to competitors or the public.

Textile Labelling Act

The *Textile Labelling Act* (“TLA”) is designed to provide consumers with information concerning the fibres contained in fabrics, clothing and other articles made from fabrics and yarns. The TLA requires a disclosure statement contained in a label indicating the name of the textile fibre (as such name is prescribed in the Textile Labelling Regulations):

- the percentage of that textile fibre contained in the product by weight,
- the name and address of the person/buyer for whom the article was imported and labelled and
- the country of origin of imported articles.

In certain cases, consumer textile articles may be imported to Canada without a disclosure label, provided that a sample of the article and certain specified information regarding the article is delivered to a federal government inspector at the port of entry on or before the importation. However, before the imported article may be sold in Canada, the dealer must apply a disclosure label, notify the federal inspector that this has been done and provide the inspector with a reasonable opportunity to inspect the article.

Regulations pursuant to the TLA exempt a number of articles from labelling requirements. As well, certain other sales are exempt where articles are made in compliance with specifications supplied by the buyer and the articles are not intended for resale.

Food and Drugs Act

The *Food and Drugs Act* (“FDA”) regulates the advertising, importation and sale of certain foods, cosmetics, drugs and medical devices. Advertising with respect to certain products listed in a schedule to the FDA is prohibited. These prohibitions relate to advertising of certain foods, drugs, cosmetics and medical devices for illnesses such as alcoholism, cancer and heart disease. The definition of food contained in the FDA is broad enough to include chewing gum and ingredients that may be mixed with food for any purpose.

In certain cases, a food may become a drug for the purposes of the FDA. This will occur if medicinal claims are being made in connection therewith. Medicinal claims must be substantiated through scientific study and a pre-approval process through the Health Protection Branch of the Department of Health and Welfare.

The FDA also contains stringent standards for the preparation of food and drugs. There are several regulations regarding the labelling, advertising and packaging of foods, drugs, cosmetics and medical devices.

Intellectual Property Legislation

Trade-Marks

The *Trade-marks Act* defines a trade-mark as “a mark that is used for the purpose of distinguishing wares or services manufactured, sold, leased, hired or performed” by the owner of a trade-mark from similar wares or services of others. Registration in Canada extends trade-mark protection to all of Canada. Unregistered trade-marks have intellectual property rights; however, such rights only extend to the geographical locations in which the trade-mark is made known in Canada. It is easier to establish the essential elements for a passing off when the trade-mark is registered.

It is often appropriate for a foreign corporation to register a trade-mark even when it is not carrying on business in Canada. If a foreign corporation grants rights to use or sell a product bearing a trade-mark, it is often prudent to have the trade-mark registered in Canada as the property of the foreign owner. Licence rights and user agreements then clarify the right of the owner to enforce its trade-mark exclusivity when the distribution arrangement is terminated.

A person seeking registration of a trade-mark can obtain registration if the trade-mark has been used or made known in Canada, has been duly registered in its country of origin (the country of origin must be a member of the Paris Convention for the Protection of Industrial Property), or is actually used in Canada after the allowance of the application but before registration of the trade-mark. As in other jurisdictions, a trade-mark will not be registerable if it is clearly descriptive or deceptively misdescriptive of the character, quality, or the place of origin of the related wares or services, or of the conditions of or the persons employed in the production of such wares or services. Trade-marks are also not registerable if they can be confused with an existing registered trade-mark.

Registration provides the owner with the right to exclusive use of the trade-mark throughout Canada for 15 years in respect of the wares and services for which it was registered. Registration may be renewed for further periods of 15 years.

There is, as yet, no amendment pending to the Canadian *Trade-marks Act* concerning the issues surrounding Internet domain names, but there have been several Canadian cases decided around that issue.

Pursuant to international agreements between Canada and the United States, a registration of a trade-mark in Canada that mirrors a registration already pending in the United States will be given priority status in the registration process in Canada provided that the Canadian application is filed within six months of the filing of the U.S. application. Other than in the foregoing case, trade-marks generally take 18 to 24 months to be registered from the date of filing. This timeline assumes that no disputes arise with the trade-mark which require further action by the registrant. In the event of such disputes, the timeline can be extended.

Copyright Law

Under the *Copyright Act* (Canada), copyright means the sole right to produce or reproduce in any material form, perform, deliver in public or publish a work, or any substantial part of the work, or authorize the doing of any of the above. Copyright arises upon the creation and fixation into a tangible form of a particular work and generally subsists for the life of the last surviving creator and for 50 years after his or her death.

A copyright owner can bring an action for infringement against any person who, without the consent of the owner, copies the whole or a substantial part of a copyrighted work, or sells, leases, distributes, exhibits by way of trade or imports for sale or hire into Canada, any work that infringes copyright or would infringe copyright if it had been made in Canada. There are statutory penalties under the *Copyright Act* for knowingly infringing a copyright. While seldom used, it can result in a prison term of up to two years.

Although registration is not a prerequisite to copyright protection, it is deemed to give a potential infringer reasonable grounds for suspecting that copyright subsists in the material. If it can be shown that an infringer was not aware or did not have reasonable grounds for suspecting the subsistence of the copyright, the owner can only be awarded an injunction. Alternatively, if it can be shown that the infringer had knowledge of the copyright, a copyright owner may be entitled to an injunction, damages, an order for the detention of imported infringing copies, an accounting for profits, recovery of infringing copies and/or costs. These restrictions are avoided when the copyright has been registered.

The *Copyright Act* was substantially amended in the late 1990's. These amendments generally strengthen the position of the creator against the user. Among these changes are a levy to be administered on the sale of blank recordable media (tapes, CDs, etc.) and the collection of performers' performance royalties, commonly referred to as "neighbouring rights".

Patent Law

Under the *Patent Act* (Canada), an inventor or assignee of the inventor who is first to file an application in respect of an invention will be entitled, subject to certain qualifications, to the grant of a patent. Invention is defined as "any new and useful art, process, machine, manufacture or composition of matter" or any new and useful improvement thereof. To be patentable, the invention must be novel and not have been obvious to a person skilled in the art or science to which the invention relates. Public disclosure of the invention bars the grant of a patent but is subject to a one year grace period for the applicant. A patent application is laid open to the public 18 months after filing.

A patent gives the patentee the exclusive right to make, construct, use and sell the invention for a period of 20 years from the date of filing the application. At the expiration of the 20 year period a new application must be filed.

The Canadian Intellectual Property Office (CIPO) maintains a searchable database of Canadian Patent bibliographic data at:

<http://patents1.ic.gc.ca/intro-e.html>

Industrial Design

Under the *Industrial Design Act*, an original design of an article may be registered. A design is defined as features of shape, configuration, pattern or ornament and any combination of those features that, in a finished article, appeal to and are judged solely by the eye. Registration gives the proprietor the exclusive right to apply an industrial design to an article for purposes of sale. In order for the industrial design to be protected, the design must be applied for within one year from the date of first publication in Canada. Offering or making the design available to the public constitutes publication.

Investment Incentives

There are several types of investment incentive programs which are designed to assist investment in new Canadian business initiatives. Various levels of government have direct and indirect assistance programs. Assistance programs can involve capital grants or loans or may involve job training supplements. Alternatively, a tax credit system has been established which may effectively permit acceleration of deductibility for capital expenses which might otherwise only be amortized over an extended period.

Program Requirements

Eligibility for most direct incentive programs is often limited to companies incorporated under federal or provincial laws. Capital grants are generally available only for manufacturing or processing projects. Various provinces have targeted industry segments such as tourism projects for eligibility for an indirect capital grant which gives a rebate to shareholders taking minority positions. Labour-sponsored venture funds provide a new source of venture capital in Ontario by providing individual investors with tax credits to encourage investment. A large pool of capital has been raised by this method for investment in Ontario. Some municipalities provide incentives for locating a new enterprise within their boundaries. These are negotiated on an individual basis.

Often government assistance is available only where it is demonstrated that traditional private sector financing cannot be obtained. Accordingly, unless a project is industry-specific or designed to be implemented in a geographical area designated as eligible for assistance, an applicant for assistance often walks the fine line of asserting a project's viability while demonstrating that no financial institution will provide the necessary funds.

Export Financing and Marketing

The Export Development Corporation ("EDC") is a federal crown corporation whose programs encourage domestic producers of goods and services to expand beyond Canadian borders. Most of EDC's programs relate to guarantees of foreign receivables. However, there are several other specialized credit products, which include the financing of foreign receivables. EDC operations are not intended to be grant programs. Accordingly, EDC charges interest and fees similar to other financial institutions. Many local banks do not like to margin or provide credit for foreign receivables and the EDC's programs are quite worthwhile.

Under another incentive program, the federal Program for Export Market Development, export feasibility studies, trade fair sponsorship and other like services are made available on a subsidized basis to Canadian businesses wishing to expand to markets beyond Canada.

Immigration Restrictions for Non-Canadians

Entry into Canada for business purposes may be facilitated under the *Immigration and Refugee Protection Act* (“IRPA”) and Regulations, the North American Free Trade Agreement (“NAFTA”) and under the *General Agreement on Trade in Services* (“GATS”). NAFTA and GATS facilitate entry for some types of applicants without requiring validation of their employment authorization. NAFTA offers more coverage than GATS and includes a “Trader and Investor” category, while GATS does not.

Temporary Entry

Every year, over 90,000 foreign workers enter Canada to work temporarily and help Canadian employers address skill shortages in Canada. To be entitled to work in Canada, a non-resident must generally become a permanent resident, or obtain a valid employment authorization commonly referred to as a work permit. Work permits are usually issued for periods of a few months to several years, but applications can be made for extensions before the work permit expires.

Three steps must be followed before an individual applies for a work permit:

- (1) an employer must first offer a job to the applicant;
- (2) Human Resources and Social Development Canada (“HRSDC”) must normally provide a labour market opinion or ‘confirmation’ of the job offer; and
- (3) after HRSDC confirms that a foreign national may fill the job, the applicant may then apply to Citizenship and Immigration Canada (“CIC”) for a work permit.

To become a permanent resident of Canada, the requirements of a permanent resident category, such as the skilled worker category, must be satisfied.

If a work permit is obtained, the applicant can receive remuneration from a Canadian source. The holder of the work permit would thereby be required to file Canadian tax returns. In addition, all workers having work permits are entitled to receive temporary Canadian Social Insurance Numbers. These Social Insurance Numbers begin with the number 9, indicating that the individual is not a Permanent Resident of Canada, and the Social Insurance Number has an expiry date.

NAFTA: Temporary Entry for Business Persons

Under Chapter 16 of NAFTA, citizens of Canada, the United States and Mexico can gain quicker, easier temporary entry into these countries to conduct business-related activities or investments. Under NAFTA, Canadian employers do not need to have a job offer approved by HRSDC to employ a U.S. or Mexican businessperson. NAFTA applies to four specific categories of businesspersons: business visitors; intra-company transfers; professionals; and traders and investors. Intra-company transferees, professionals, traders and investors generally require work permits upon entry, but business visitors may not.

a) BUSINESS VISITORS

This category applies not only to citizens of NAFTA countries but also to citizens of any country outside of Canada. Regulations under the IRPA permit non-residents to engage in certain business activities without a work permit. They may enter Canada for international business activities for up to six months, without entering the Canadian labour market. The principal source of remuneration must be from outside Canada.

Business activities covered by NAFTA include commercial activities that reflect the components of a business cycle, such as: research and design; growth, manufacture and production; marketing; and sales. Such visitors are not permitted to engage in hands-on work or directly interact with the general public for business purposes. No management or supervisory functions may be performed. Business visitors under the IRPA may also include:

- Individuals coming into Canada to purchase goods for their own country or for a corporation which carries on business outside of Canada.
- Individuals entering Canada for the purposes of acquiring training or familiarization with goods or services purchased in Canada.
- Sales representatives of a foreign business who enter Canada to sell goods for that business, but who will not be making such sales to members of the public.
- Permanent employees of a corporation carrying on business outside of Canada who are entering Canada to consult or negotiate with other employees or members or inspecting a Canadian branch office or headquarters.
- Individuals entering Canada as trainees to Canadian parent or subsidiary corporations where the trainee will not be actively engaged in the production of goods or services.

NAFTA expanded the scope of Business Visitor to include persons who work in an occupation or activity that is listed in a Schedule to NAFTA. The type of activities listed must be limited in their nature or the principal beneficiary must be foreign based.

Documentation should be provided which will satisfy the inquiries of officials at ports of entry and assure them that both the individual seeking entry, his U.S. employer and, if applicable, the Canadian corporation involved, are aware of the limitations on the services which the individual is permitted to perform. Business Visitors under NAFTA may qualify for entry without a work permit.

Where the criteria for a Business Visitor cannot be met, permission to work must be obtained. In such situations, the HRSDC may conduct a labour market opinion to verify that there are no Canadians with the necessary training and experience available to fill the job. Initial employment authorization for the job must be issued at a Canadian consulate or embassy outside of Canada or at a port of entry into Canada. Certain exemptions under NAFTA exist for employees of a related business outside of Canada who are transferred on a temporary basis to a Canadian branch to work at a senior executive level.

b) INTRA-COMPANY TRANSFEREE

Intra-company transfers occur where foreign corporations relocate individuals to a Canadian parent, subsidiary branch or affiliate. To obtain the required work permit, the individual must be a citizen of the United States or Mexico and have worked for the foreign corporation for at least one year in the three years immediately preceding seeking entry into Canada, and must be transferred to Canada to work temporarily for the same or an affiliated employer. In addition, the individual must work only at the executive or senior managerial level, or have specialized knowledge particular to the corporation.

An employment authorization issued at time of entry in this category can have a maximum duration of three years, whereas the total period of stay for a person employed in an executive or managerial capacity may not exceed seven years. The total period of stay for a person employed in a specialized knowledge capacity may not exceed five years.

In order to obtain an intra-company transfer work permit, there are a number of documents which should be prepared for review prior to entry or upon entry into Canada. They include the following:

- correspondence from the applicant's employer setting out the applicant's present position and length of service with the corporation;
- correspondence from the foreign employer's lawyer setting out the legal relationship between the current employer and the potential Canadian employer;
- correspondence from the Canadian employer setting out the position and expectations of the transferee;
- a resume or curriculum vitae of the applicant setting out his or her professional experience;
- proof of U.S. or Mexican citizenship; and
- all appropriate fees.

It should be noted that, as with all NAFTA categories, an intra-company transfer will not permit permanent entry into Canada. Similarly, the work permit issued to an applicant in an intra-company transfer will not permit his or her spouse or any other member of the immediate family to obtain employment in Canada.

c) PROFESSIONALS

Under NAFTA, certain professionals may be eligible to temporarily enter Canada for employment after obtaining an offer of employment from a Canadian employer, provided that employment is in the profession in which the professional qualifies. These professions are listed in a Schedule to NAFTA. Professionals entering Canada pursuant to this provision would normally obtain a one-year work permit, which may be extended for a further year. Such a work permit does not exempt the applicant from having all relevant Canadian qualifications, certifications and licences which are required for practice in any particular Canadian jurisdiction.

d) TRADER OR INVESTOR

Under NAFTA, a trader or investor is a business person carrying on substantial trade in goods or services principally between Canada and the United States or Mexico, or is a business person conducting substantial investment activities in Canada. The trader or investor must be in Canada temporarily and must act in a supervisory or executive capacity, or in a capacity that involves essential skills. To enter Canada, the trader or investor must meet any additional requirements under NAFTA and IRPA, and would need to obtain a work permit.

Permanent Residents

A permanent resident is a person who has immigrated to Canada, but has not become a Canadian citizen. To retain status as a permanent resident, the person must live in Canada for at least two full years out of a period of five years. Permanent residents are obligated to pay Canadian taxes and they have certain rights and privileges, even though they are not citizens of Canada. However, permanent residents may be asked to leave the country if they are convicted of a serious offence. The rights of permanent residents and their dependents include the ability to:

- receive many social benefits that Canadian citizens receive, such as health care;
- live, work or study anywhere in Canada;
- apply for Canadian citizenship; and
- be protected under Canadian law and the *Canadian Charter of Rights and Freedoms*

Permanent residents can obtain a Permanent Resident Card from CIC as official proof of the individual's status. The Card is required for re-entry to Canada.

No quota is set by the Canadian government on the number of immigrants that may be admitted each year from any particular country or region of the world. Anyone can apply to immigrate to Canada. However, in the case of married applicants, both spouses are required to complete the application for permanent residence. All dependants 22 years of age and over must complete and file a separate application.

There are three general admissible classes:

- (1) family class
- (2) skilled worker
- (3) business immigrant

a) FAMILY CLASS

The family class of admission involves sponsorship by a close relative who is at least 18 years old and currently living in Canada as a permanent resident or citizen. Individuals in the family class must meet basic standards of good health and character. The sponsoring relative must sign an undertaking of support for a period of three to 10 years. The sponsor must also establish that he or she has the financial wherewithal to provide shelter and maintenance for the applicant and his or her accompanying dependents.

Applicants who may qualify to be sponsored under the family class include spouses, common law partners, fiancés, parents (and each of the foregoing's dependent children), grandparents, and in some cases, brothers, sisters, nephews, nieces, orphaned grandchildren and children the applicant intends to adopt.

b) SKILLED WORKER

Skilled workers that are likely to become successful in Canada can be admitted under this category. The category is judged on a point system based on criteria such as education, work experience, and knowledge of French or English. The minimum requirements include one continuous year of full-time paid work experience, or the equivalent part-time employment within the past 10 years. The experience should be in a managerial, professional or technical job as defined in the Canadian National Occupational Classification.

c) BUSINESS IMMIGRANT

This class of admission is designed to encourage the immigration of business people who will support the development of a strong Canadian economy. To apply under the business immigrant category, the applicant must sub-classify under one of: self-employed persons, investors, or entrepreneurs. Each class has separate eligibility criteria, but is based on the applicant's ability to become economically established in Canada.

(i) Self-Employed Persons

The Self-Employed Persons Program admits applicants who have the intention and ability to become self-employed in Canada. A self-employed person applying under this class must have either:

- a) Two years of relevant experience that will enable them to make a significant contribution to the cultural or athletic life of Canada, or
- b) experience in farm management and the intention and ability to purchase and manage a farm in Canada.

Persons admitted as self-employed persons may be interviewed, but are not subject to monitoring or other regulatory requirements once they arrive in Canada. In addition, applicants under this category must meet certain selection criteria. The selection criteria are graded on a points system based on education, experience, age, ability to speak English or French and adaptability.

(ii) Investors

Applicants applying as an investor must be able to invest a minimum of \$400,000 in the Canadian economy. Investors must also have a minimum net worth of \$800,000 Canadian, must show that the money was legally accumulated through his or her own endeavours and must also have business experience. Business experience is evaluated based on whether the applicant has been a part-time or full-time owner of a business for more than two years, or whether the applicant has managed a business for a minimum of two years. The investment in the Canadian economy is managed by CIC, and is guaranteed by the Canadian provinces that use the funds. CIC returns the funds after approximately five years.

(iii) Entrepreneurs

The Entrepreneur Program admits experienced business persons who will own and actively manage businesses in Canada. Applicants applying as entrepreneurs must show that they have business experience, be able to show a legally obtained minimum net worth of \$300,000 in Canadian dollars and must respect the conditions placed on entrepreneurs after arrival in Canada. Entrepreneur applicants may be interviewed, and must also meet certain selection criteria. The selection criteria are graded on a points system based on education, experience, age, ability to speak English or French and adaptability.

After arriving in Canada as an entrepreneur, certain conditions must be met. If these conditions are not met, the individual's status as a permanent resident may be revoked. Within three years of becoming a permanent resident, an entrepreneur must:

- control at least one-third of the equity and actively manage a qualifying Canadian business for at least one year;
- have a business that created or maintained the employment of at least one full time job for a Canadian citizen or permanent resident other than the entrepreneur and his or her dependents; and
- have a business that is not operated primarily for the purpose of deriving investment income such as interest, dividends or capital gains.

Québec has a separate business immigration program, and has a separate set of requirements for entrepreneurs. For information related to Québec immigration see Immigration Québec's website:

<http://www.immigration-quebec.gouv.qc.ca/en/index.asp>

For additional information consult Citizenship and Immigration Canada's website:

<http://www.cic.gc.ca/>

Employment Law

Minimum Standards

For many employers in Canada, the employment relationship is governed by various provincial acts that provide minimum standards for most employees. In most cases, individual or collective agreements will be governed by these minimum standards. Accordingly, Canada cannot be considered a jurisdiction in which there is employment at will, as the minimum standards mandate that employees are entitled to receive either notice of the termination of their employment or pay in lieu of notice if their employment is terminated without cause. In addition, the legislative requirements are minimum standards only and do not restrict an employee's right to sue for breach of contract, wrongful dismissal or other damages arising from the termination of his/her employment.

The minimum standards vary from province to province. However, the following is a list of some issues regulated by the various employment standards acts and their regulations, with examples of the standards set out in the Ontario Employment Standards Act ("OESA"):

- minimum wages (currently CDN\$8.00/hr. in Ontario for most workers over 18 years old)
- method of payment of wages and recordkeeping
- hours of work (normally maximum of 48 hours per week, 8 hours per day but employees can agree to work longer hours)
- overtime (time and a half for hours in excess of 44 hours per week)
- statutory holidays (8 per year)
- vacation with pay (2 weeks' vacation with vacation pay at 4 per cent of previous year's wages)
- equal pay for work of equal value
- employment insurance funded pregnancy/parental leave (pregnancy leave of 17 weeks followed by a parental leave of 35 weeks with assurance of reinstatement to same job, if it still exists, with a 37 week parental leave also available to fathers)
- 10 days annually for job protected emergency/sick leave (where 50 or more employees)
- family medical leave of up to 8 weeks in a 26 week period to attend to a family member where there is a serious illness with a significant risk of death

Some types of employees or industries are exempted from the provincial employment standards legislation.

Under the OESA, the notice period to be given to an employee who is terminated without cause is based upon his/her length of service. An employee who has worked for at least 3 months is entitled to 1 week's notice. After 1 year, the employee will be entitled to 2 weeks' notice. After 3 years, the employee will be entitled to 1 week's notice for each year of service up to a maximum of 8 weeks. Where more than 50 employees are terminated in any 4 week period,

at least 8 weeks' notice is required, regardless of the length of service. This notice requirement is extended to 12 weeks if more than 200 are so terminated and 16 weeks where more than 500 are so terminated.

In Ontario, if 50 or more employees are terminated in any 6 month period or if an employer, having an annual payroll in excess of \$2.5 million, terminates any employee with 5 years' service or more, severance pay must be paid in addition to the provision of notice or a payment in lieu of notice. The statutory severance pay obligation is equal to 1 week's salary for each year of service (up to a maximum of 26 weeks' severance pay).

Of course, if an employee is terminated for wilful neglect of duties or wilful misconduct, the employer is not obligated to provide notice or pay equal to these standards. There are various other exceptions, i.e. fixed term contracts, frustrated contracts and temporary lay-offs.

The above notice obligations are basic minimums. In the absence of a written contract to the contrary, termination of employment without cause generally requires significantly longer notice periods than those provided by the legislation. Appropriate reasonable notice periods have been established by common law through the litigation process on a case-by-case basis. The courts look at various factors, including the employees' age, length of service, position, remuneration, how the employee came to be employed, their chance of finding replacement employment and the manner of dismissal. The judge will consider all of these factors to determine the appropriate "reasonable notice" period.

Reasonable notice established by the common law in Canada often greatly exceeds the obligations of U.S. employers to their employees. The grounds for termination for cause in Canada are also severely limited in most circumstances, i.e. where the termination results from acts of dishonesty of the employee, or where the employee has been warned in writing various times, provided with assistance and yet continues to perform below expectations.

Employment Contracts

In order to avoid the uncertainties that arise in the litigation process, it is highly desirable to have employment contracts with all personnel. In addition to a normal hire letter, such contracts should specifically address issues that arise upon the termination of employment, including termination pay and non-solicitation covenants. Without a specified term contained in a contract, an employer will be deemed to have hired the employee for an indefinite term. Similarly, if a written contract for a specified term is not formally renewed and the employee continues to work for the employer, the employment will likely be considered to be a relationship of indefinite term. Unless there is an employment contract specifying the notice period in the event employment is terminated, an employee hired for an indefinite duration may only be terminated upon the provision of reasonable notice (unless such employee is terminated for cause).

Successor Employers

According to some provincial statutes, where a business is acquired and continued in substantially the same manner and the purchaser hires the vendor's employees, the purchaser

may have various obligations towards the vendor's employees. For example, the purchaser may inherit the vendor's obligations under an existing collective agreement with a certified bargaining agent (i.e. union). Tenure with the predecessor corporation will be considered for the purposes of determining termination pay required by the employment standards legislation and may be considered for determining the amount of reasonable notice which must be given on termination of employment under the common law. A purchaser may also be responsible for the vendor's unpaid liabilities under provincial workplace compensation schemes. Thus, a detailed understanding of the nature and relationship of the employees to a business being sold must be considered so that the ongoing obligations can be quantified and factored into the negotiations on the purchase.

Human Rights

In addition to the above, Canadian workplaces are regulated by either provincial or federal human rights codes which prohibit discrimination and harassment on the basis of, among other items, race, colour, citizenship, creed, sex, sexual orientation, age, record of offence, handicap and marital or family status. These issues must be considered at all stages of the employment relationship, including decisions to hire and fire.

Labour Relations

The provincial and federal Labour Relations Acts provide employees with freedom to associate and provide bargaining agents with certain protection. As a result, employers must be careful of their words and actions during organizing drives.

Other Employer Obligations

Employers generally have the following mandatory obligations:

a) HEALTH INSURANCE

- Most employees are covered by provincial health insurance plans. These plans are partially funded by employers who pay a health tax based on the total annual gross earnings of its employees.

b) EMPLOYMENT INSURANCE

- Employers have to contribute to a federal employment insurance fund which assists employees who are laid off, terminated, become ill or take a pregnancy/parental leave. Employees also have to contribute to the fund by way of deductions from their pay which is remitted by the employer to the fund on the employees' behalf.

c) CANADA PENSION

- Again, employers and employees contribute to a fund that employees can draw on upon retirement or disability. Employers deduct the employees' contribution from the employees' pay.

d) WORKPLACE SAFETY INSURANCE

- In most cases, employers are required to have worker's compensation insurance. These plans are governed by either federal or provincial statute, depending on the nature of the employers' business.

e) PRIVACY

- Under current federal and/or proposed provincial statutes, employers have an obligation to ensure personal information about its employees is obtained, retained, disclosed and destroyed according to strict guidelines. Breaches can lead to various financial penalties.

Overall, there are great number of obvious and subtle differences that must be considered when commencing employment relationships in Canada.

Environmental Law

In recent years the Canadian public has become increasingly concerned over the protection of the environment. In response, the federal and provincial governments have enacted environmental legislation which has had a dramatic impact on business and trade. To complicate matters further, municipalities are also taking an active role in regulating and monitoring the environment. Therefore, undertaking a business venture in Canada requires information about mandatory requirements, limitations, prohibitions and penalties in relevant environmental laws at all three levels of government.

Despite the current jurisdictional overlap, the 10 provinces and three territories of Canada have typically been the most active in legislating and enforcing protection of the environment. The details of the environmental schemes in each province and territory may vary, but the general approach is consistent. As the home of Canada's largest industrial sector, Ontario's *Environmental Protection Act* ("EPA") serves as a good example of a provincial environmental scheme.

The principal provisions of the EPA prohibit the discharge of a contaminant into the natural environment that causes or is likely to cause an adverse effect. The term "adverse effect" is defined broadly and includes virtually any damage that could occur to the natural environment, people, or animals.

In an effort to enforce compliance and reduce the damage from a discharge, most environmental statutes, including the EPA, contain a requirement to immediately report a discharge or spill to the relevant authorities. To achieve compliance with environmental legislation, governmental authorities have been given the ability to issue a wide variety of orders, including: stop orders, control orders and remediation orders. In addition to these administrative orders, violation of the EPA can garner quasi-criminal charges, environmental penalties and civil action. Consequences include fines and/or imprisonment when the legislation is violated.

The EPA provides guidelines with respect to clean-up and provides for the issuance of permits relating to waste disposal and transport. The Ontario Legislature enacted the *Brownfields Amendment* to the EPA in 2001 to encourage the revitalization of contaminated land. Under the Amendment and related Legislation, people will be able to deal with contaminated land without assuming all liability for historical environmental contamination. The EPA also governs the generation and disposal of waste by requiring any business which collects, transports, treats or disposes of waste, to have a certificate of approval issued by the Ministry of Environment.

Corporations are liable by a provision in the EPA that deems any act or omission by an agent of the corporation in the course of employment to be an act or omission of the corporation. However, even if the corporation itself is not prosecuted, the directors and officers of a corporation can be liable in their personal capacity under the EPA. Directors and officers must take reasonable care to ensure the corporation is complying with the Act and all of its Regulations. If a director or officer is charged with an environmental offence, they may prepare a due diligence defense

which would show that they took all reasonable steps to prevent the environmental damage or to minimize its impact.

Regulatory orders can be issued against those who cause or permit the pollution or those “responsible for the source of the contaminant.” They can also be issued against persons having charge or control of the substance at the time of its discharge and the person who owns or occupies the land on which a discharged substance is located or was located prior to the discharge.

Under the EPA orders can be issued against former owners, former occupiers and people who were in management and control of the polluting facility. There is no requirement that the person or entity caused or contributed to the pollution of the property or the pollution created by the facility.

Thus, it can be seen that environmental law in Canada is complex and in a continuous state of growth. Businesses are advised to seek counsel to keep up-to-date on environmental issues and legislation in order to ensure compliance and to plan for change.

The Insolvency Landscape In Canada

Over the past two decades, there has been a gradual yet perceptual shift in the Canadian insolvency landscape from a system which was historically viewed as one favouring the lending community to one which now affords debtors more protection and flexibility to restructure their financial affairs.

In this regard, it can be said that Canadian bankruptcy and insolvency laws are moving closer to those found in the United States while still maintaining some distinctly Canadian traits.

Restructuring

The two most common means of restructuring the debts of an insolvent person are through the utilization of the *Companies Creditors Arrangement Act* (“CCAA”) and the *Bankruptcy and Insolvency Act* (“BIA”). Proceedings under the CCAA begin with an initial application to the Court and the entire process is supervised by the Court. Proceedings under the BIA involve the Court only when an application is made by the insolvent person and/or creditor(s) for certain remedies during the restructuring process, or to approve a restructuring which has been accepted by the requisite majority of creditors. The CCAA may only be utilized by corporations whose debts, whether individually or together with related corporations, exceed \$5 million. The BIA may be utilized by any type of legal entity (i.e., individual, corporation, partnership, etc.), regardless of the amount of debt.

Proceedings commenced under either the CCAA or the BIA will result in an automatic stay of proceedings against those with claims against the insolvent person. The initial stay under the BIA is 30 days, and may be extended in 45 day increments up to a total stay of 6 months. The Court must approve any extension, and any creditor has the right to object to an extension. In such circumstances, the Court will consider whether the insolvent person is acting in good faith, if a viable proposal would likely be made if an extension were granted and if any creditor would be materially prejudiced if the extension were granted. A creditor has the right, at any time, to request that the stay be lifted to allow it to exercise its remedies. When ruling upon such a request, the Court will be guided by similar factors to those which are considered when a request is made to extend the stay.

While the initial stay under the CCAA is also 30 days, additional stays are typically granted on the application of the insolvent person unless there is clear evidence that the insolvent person does not have the support of its major creditors. As restructurings under the CCAA usually involve more complex matters and significant debt, where the Court believes that a restructuring may be accepted by creditors, and particularly where creditors support the restructuring process, the Court typically grants extensions for periods of time exceeding the 6 month limit contained under the BIA. In fact, it is not uncommon for stays under the CCAA to exceed 1 year or more.

A restructuring under the BIA or CCAA will typically involve the supervision or monitoring of the business affairs of the insolvent person. Under the BIA, a licensed trustee (usually affiliated with an accounting firm) is appointed by the insolvent person and is required to approve a

cash flow statement prepared by the insolvent person, certifying that it is reasonable. Under the CCAA, the Court is required to appoint a monitor (usually an accounting firm) to monitor the business and financial affairs of the insolvent person. The specific functions of the monitor include examining the books and records of the insolvent person, filing with the court prescribed reports regarding the financial affairs of the insolvent person, including any material adverse changes in its projected cash flow, dealing with concerns of creditors and such other functions as the Court may direct.

In a restructuring under the BIA or the CCAA, it is rare for creditors to be required to continue to supply services or grant credit to the insolvent person. In fact, the BIA specifically states that it does not prohibit a person from requiring immediate payment for goods and services provided after the date of the filing. It should also be noted that, under the BIA (and under the CCAA, if the Court so orders), the insolvent person has the right to terminate real property leases if such termination is considered essential to its restructuring plans.

Liquidations

The rights of secured creditors in Canada are, generally speaking, far broader than those in the United States. In circumstances where the restructuring plans of an insolvent person fail, no attempt to restructure is made or, in certain other limited circumstances, a secured creditor will enforce its security and liquidate the assets of the insolvent person. This liquidation, whether on a going concern or auction basis, is usually conducted by a receiver or receiver and manager.

A receiver can be appointed privately by the secured creditor under the terms of the security agreement delivered by the insolvent person, or by the Court on application by the secured creditor. The receiver appointed under a security agreement acts as agent for the insolvent person when carrying on the business and as agent for the secured creditor in all other circumstances. A receiver appointed by the Court is an officer of the Court, with a duty to all creditors.

Whether appointed privately or by the Court, the receiver will be required to send, within 10 days of its appointment, a notice of its appointment to all creditors of the insolvent person, the insolvent person and the Superintendent of Bankruptcy, which is an arm of the federal government having general supervisory functions over all matters which are governed by the BIA. The receiver will also be required to send reports in prescribed form to the Superintendent of Bankruptcy and to any creditors requesting copies of such reports, summarizing its disposition strategy and details of its realization efforts.

The receiver has a duty, under both the common law and the personal property security legislation which is in existence in all common law Canadian jurisdictions (and which are primarily based on the *Uniform Commercial Code*) to use reasonable care in the custody and preservation of the collateral in its possession. The receiver is also required, under such legislation, to obtain the best price possible for such collateral. Typically, and prior to any sale, the receiver will obtain at least two appraisals of the collateral, on both a liquidation and going

concern basis, and advertise the assets for sale in the appropriate forum (i.e., newspapers, trade journals, etc.).

It should be noted that, in recent years, many trustees and receivers have become significantly more wary of taking on any “employer” type role as a direct result of certain judicial decisions that have clearly held that insolvency professionals are not insulated from liability as successor employees. Accordingly, there has been a general chill on operating receiverships. (See *GMAC Commercial Credit Cooperation-Canada v. T.C.T. Logistics Inc.*)

When the insolvent company in receivership is also bankrupt, the trustee in bankruptcy, who represents the interests of the unsecured creditors of the insolvent person, will scrutinize the sale process and, in the event of a private appointment, obtain a legal opinion with respect to the validity or non-validity of the security under which the receiver was appointed. If the security is not valid or enforceable against the trustee, the trustee will be entitled to the sale proceeds, and the secured creditor will rank as an unsecured creditor in the bankrupt estate. However, other than the requirement to give the 10 day notice and reports referred to above, secured creditors exercise their powers outside the parameters of the BIA.

In the bankrupt estate, unsecured creditors receive any money realized by the trustee in bankruptcy (after administration costs), including any surplus funds received by the trustee from the receiver, on a *pro rata* basis. Certain unsecured creditors, such as landlords and employees, enjoy a preferred status in the bankruptcy process and are entitled to have their claims paid (within the limits prescribed by the BIA) before ordinary unsecured creditors.

Certain creditors enjoy a special status ahead of secured and unsecured creditors in both the bankruptcy and receivership context. These creditors include:

1. federal and provincial government claims for outstanding employee source deductions (in addition, in a non-bankruptcy situation, unremitted provincial sales tax and unremitted federal goods and services tax also enjoy a super-priority status above all secured and unsecured creditors);
2. suppliers who deliver goods to the insolvent person within 30 days of the receivership or bankruptcy, provided the supplier files a claim within 30 days of delivery of the goods, the goods are identifiable, are in the same state and have not been sold or subject to a sale; and
3. in Ontario, persons who have repaired or stored the property of an insolvent person may claim either a possessory or non-possessory lien on such property provided such persons have complied with the provisions of the *Repair and Storage Lien Act*.

International Insolvencies

Amendments to the BIA and CCCA in 1997 reflected the desire of the Canadian government to, in appropriate circumstances, give recognition to foreign insolvency proceedings.

The highlights of these amendments are as follows:

- A certified copy of an Order made in respect of the bankruptcy, insolvency or reorganization of a foreign debtor is, in the absence of evidence to the contrary,

proof that the foreign debtor is insolvent and proof of the appointment of the foreign representative.

- The Court may limit the property to which the authority of the foreign representative extends to the property of the foreign debtor situated in Canada.
- A stay of proceedings that operates against creditors of the foreign debtor in a foreign proceeding does not apply in respect of creditors who reside or carry on business in Canada with respect to property in Canada unless the stay of proceedings is the result of proceedings taken in Canada.
- The foreign representative is now granted standing to apply to the Canadian courts for relief to, among other things, appoint an interim receiver against all or any part of the foreign debtor's property in Canada, to take possession of such property and to exercise such control over the property and the debtor's business as the Court considers appropriate, or for a stay of proceedings against the debtor or the debtor's property in Canada, all on such terms as the Court considers appropriate.
- The foreign representative may also apply to the Court for authorization to examine under oath the debtor or persons who have knowledge of the business and affairs of the debtor.
- An application to the Court by a foreign representative does not submit the foreign representative to the jurisdiction of the Court for any other purpose except with regard to the costs of the proceedings; however, the Court may make any order conditional on the compliance by the foreign representative with any other order of the Court.
- Where any payments are made to the creditors of a foreign debtor under the Canadian legislation, the amount that the creditor receives or is entitled to receive outside Canada and the value of any property of the debtor that the creditor acquires outside of Canada which could be set aside or reviewed in Canada (ie. a fraudulent transfer) is to be taken into account in the distribution of dividends to that creditor.

It should be noted that, notwithstanding some similarities with U.S. law, the Canadian insolvency regime remains distinct in many ways. For example,

- (i) neither the CCAA nor the BIA has any specific provisions which authorize a Court to consolidate the assets or liabilities of distinct entities. However, Canadian Courts have exercised their equitable jurisdiction under both statutes to consolidate the assets of related debtors;
- (ii) the doctrine of equitable subordination is an accepted and often applied legal doctrine in the U.S. but the Canadian Courts have not, as yet, adopted the same; and
- (iii) the concept of DIP or "debtor in possession" financing is not specifically provided for in either the CCAA or the BIA but Canadian Courts have approved the same in appropriate circumstances in order to allow a restructuring entity access to desperately needed working capital during the restructuring process.

Proposed Insolvency Law Amendments

Bill C-55 (now Bill C-47), which created the *Wage Earner Protection Plan Act* and introduced a number of amendments to the CCAA and BIA, was passed by the House of Commons and Senate in late November 2005. However, the amendments were not proclaimed into force due to certain concerns expressed by a Senate committee respecting various flaws in the proposed legislation. The 2005 amendments have been under review since their introduction and a draft package of further revisions was released in December, 2006.

The central components of the 2005 amendments remain unamended by the proposed revisions. Specifically:

- The creation of a wage earner protection plan to fund the payment of certain unpaid wages owing to employees at the time a business becomes bankrupt or goes into receivership.
- The creation of two super-priority charges:
 - (a) over the current assets of the debtor to secure unpaid wages owing to employees of up to \$2,000 per employee and
 - (b) over all of the debtor's assets to secure unpaid pension contributions. Both of these super-priority charges would rank ahead of all pre-existing security.
- The codification of much of the case law that has developed in restructurings under the CCAA, including provisions to specifically outline the authority of the Court to authorize debtor-in-possession (DIP) financing, authorize the sale of assets in a restructuring proceeding and allow the debtor to disclaim or assign certain contracts.
- Protection for collective bargaining agreements and licenses of intellectual property in insolvency situations.
- Provision to allow the appointment of a receiver with powers that are exercisable throughout Canada and not just in the province where the appointment order is issued.
- Provisions to limit the rights of equity claims in a restructuring.
- The adoption of procedures for dealing with cross-border insolvency proceedings based on an UNCITRAL model law already adopted in several countries, including the U.S.

The proposed revisions to the 2005 amendments include:

(i) **PRIORITY CLAIMS FOR WAGES AND PENSIONS**

- The scope of the charge for unpaid wages over the current assets of the debtor has been clarified. Specifically, there was concern expressed by some commentators that the definition of current assets in the 2005 amendments was overly broad. The proposed revision would amend the definitions to refer to cash; cash equivalents, including negotiable instruments and demand deposits; inventory and accounts receivable; and any proceeds of the same.
- Require the debtor to satisfy the Court that wage and pension claims will be paid before any sale of the assets in a restructuring will be approved.

(ii) PAYMENT OF WAGES DURING RECEIVERSHIP OR BANKRUPTCY

- A receiver or trustee that operates a business as a going concern will be permitted to pay employees their unpaid wages for the period prior to the insolvency proceedings in the ordinary course. The priority claim for wages owed as of the date of the receivership or bankruptcy will be reduced to the extent the wages are paid by the receiver or trustee.

(iii) PROTECTION OF INSOLVENCY PROFESSIONALS

- As a result of recent case law culminating with the Supreme Court of Canada decision in the TCT Logistics case, concern has arisen that receivers and trustees in bankruptcy could become personally liable for certain obligations of the debtor as employer. Such potential liability includes the risk that a receiver or trustee would be deemed a successor employer under provincial or federal labour and employment legislation. If this were the case, the receiver or trustee could become liable for the debtor's obligations under a collective bargaining agreement or pension plan. Under the proposed revisions, a receiver or trustee of an insolvency business will *not* be personally liable for a liability, including as a successor employer, in respect of employees or former employees of the debtor or a predecessor of the debtor, or in respect of a pension plan for such employees, that exists before its appointment or that is calculated by reference to a period before the appointment.
- This protection will not extend to a successor employer other than the trustee or receiver, so a purchaser of an insolvent business will still need to review these potential liabilities as part of its due diligence.

(iv) DIP FINANCING

- Advance notice to the secured creditors who could be affected by a priority charge for DIP financing will be required in all cases. The 2005 amendments would have required advance notice only for financing that took place after the first 30 days of the case. The proposed revisions also provide that the priority charge for DIP financing can only secure new loans made after the commencement of the proceedings.

(v) ELIGIBLE FINANCIAL CONTRACTS

- The exemption of "eligible financial contracts" from most provisions of the CCAA and the BIA will be clarified, to make it clear that the exemption of eligible financial contracts from the stay of proceedings and other provisions of the CCAA and BIA is not overridden by other aspects of the amendments. The definition of what qualifies as an "eligible financial contract" will be made more flexible, as the definition will be set out in regulations to the BIA and CCAA. Regulations are implemented by the federal cabinet, with the result that they can be modified from time to time without the need for amendment to the legislation itself.

(vi) NATIONAL RECEIVERS

- Provisions in the 2005 amendments permitting a court to appoint a national receiver have been expanded to elaborate on the powers the Court can give to the receiver, including taking possession of the debtor's assets, exercising control over its business and taking any other action the Court considers advisable. Another change will provide that the Court may not appoint a receiver at the request of a secured creditor unless the debtor has received a 10 day notice of

the secured creditor's intention to enforce its security (comparable to the notice that would be required for the private enforcement of the security). The Court can act before the end of the 10 day period if the debtor consents or if the Court considers it appropriate to appoint a receiver before the expiration of such period.

(vii) EQUITY CLAIMS

- The 2005 amendments stipulated that certain equity claims would be subordinated to creditor claims in a restructuring and that these claims would not have voting rights. The proposed revisions expand the description of "equity claims" to include a claim for a dividend or similar payment, a return of capital, a redemption or retraction obligation, a monetary loss resulting from the ownership, purchase or sale of an equity interest or from the rescission (or in Québec, the annulment) of a purchase or sale of an equity interest, or for contribution or indemnity in respect of any such claim. The proposed revisions also clarify that a CCAA plan or BIA proposal can become effective without requiring a vote of the holders of equity claims.

(viii) EXECUTORY CONTRACTS

- Provisions in the 2005 amendments giving a debtor the right to disclaim a contract in a CCAA case or in a proposal under the BIA have been modified. Under the amended terms, before disclaiming the contract the debtor must obtain the approval of the monitor or proposal trustee, or approval of the Court. If requested by the counterparty, the debtor must provide an explanation of the business reasons for wanting to disclaim the contract. If the disclaimer is disputed, the Court may approve the disclaimer, but is directed to consider a number of factors, including whether the disclaimer will enhance the prospects of a viable proposal or arrangement being made, and whether the disclaimer is likely to cause significant financial hardship to the counterparty. The debtor does not have the right to disclaim certain types of contracts, such as an eligible financial contract or a financing agreement where the debtor is the borrower.

(x) INTELLECTUAL PROPERTY

- Broader protection is provided for rights of a licensee of intellectual property. A licensee's right to enforce an exclusive license and to retain a license during the term of the agreement, including any period for which the party extends the agreement, will be explicitly protected.

(ix) ASSIGNMENT OF AGREEMENTS

- The debtor will not be permitted to ask the Court to order an assignment of an agreement entered into after CCAA proceedings are commenced. The requirement that the debtor cure all defaults under the agreement prior to the assignment will be limited to a requirement to cure all monetary defaults and related cross-defaults.

(x) INCOME TRUSTS

- An income trust will be permitted to commence insolvency proceedings under the BIA or under the CCAA if it is listed on a prescribed stock exchange at the time the proceedings begin, or if its units are owned by a trust that is listed on a prescribed stock exchange on that date. The prior wording would not have permitted filings of both levels of the "trust on trust" structure commonly used by many income trusts.

(xi) TRANSFERS AT UNDERVALUE

- The 2005 amendments replaced several technical remedies with a general power to challenge “transfers at undervalue” by the debtor. The proposed revisions provide that these remedies will be available in CCAA proceedings as well as in bankruptcy proceedings under the BIA and may be assigned to creditors.

(xii) NEXT STEPS

- The 2005 amendments were passed by the House of Commons and Senate very quickly in late November 2005, just prior to the last federal election, after minimal public hearings. As a result of the concerns expressed by the Senate, the former government promised that the amendments would not go into effect until the Senate had an opportunity to conduct a more complete review of the amendments and consider any necessary changes. Depending on the legislative timetable and the timing of a possible federal election, the revisions may be introduced in Parliament later this year.

French Language Requirements In The Province Of Québec

French is the official language of Québec. The *Charter of the French Language* (the “Charter”) guarantees French language rights and requires the use of French in virtually every field of human, government and business activity within that province.

The Office de la Langue Française (the “Office”) is an entity that was established to define and conduct Québec policy on linguistics research and terminology and to ensure that the French language becomes, as soon as possible, the language of communication, work, commerce and business in the civil administration and enterprises.

Contracts and Forms

Contracts pre-determined by one party, contracts containing printed standard clauses and the related documents, must be drawn up in French. Similarly, application forms for employment, order forms, invoices and receipts must also be drawn up in French. These documents may be drawn up in another language as well, at the express wish of the parties.

Labour Relations

Written communications between an employer and employee must be in French and job offers or promotions must be offered in French. Collective agreements and the schedules attached to them must be drafted in French.

Product Labelling

In general, every inscription on a product, its container or on its wrapping, or on a leaflet, brochure or card supplied with the product, including such things as directions for use and warranty certificates, must be in French. This rule also applies to menus and wine lists.

The French inscription may be accompanied with translations, provided that no inscription in another language is given greater prominence than that in French.

There are, however, situations where an inscription on a product and the documents supplied with a product do not have to be in French. For example, inscriptions on products intended for a market outside Québec may be exclusively in a language other than French; inscriptions on cultural or educational products, such as books, magazines, publications, disks, films or tapes, may be exclusively in a language other than French if the content is in a language other than French or if the cultural or educational product has no language content. Other exceptions are set out in the relevant regulations.

Catalogues, Brochures, Etc.

In general, catalogues, brochures, folders, commercial directories and any similar publications must be in French. However, catalogues, brochures, folders, commercial directories and other similar publications available to the public or distributed to the public by way of mass mail or door-to-door delivery, may be in two separate versions (one exclusively in French and the

other exclusively in the other language), provided that the material presentation of the French version is available under no less favourable conditions of accessibility and quality than the version in the other language. The version exclusively in another language may, however, be inserted in a news publication published exclusively in that language; it may also be sent to an individual who has made a written request to receive such documents in that other language.

Public Signs and Posters and Commercial Advertising

In general, most public signs, posters and commercial advertising may be in both French and another language, provided the French is “markedly predominant”, as defined by Regulation. There are two situations where commercial advertising must be *exclusively* in French:

- (1) a firm’s commercial advertising, displayed on billboards, signs, posters or on any other medium having an area of 16 m² or more and visible from any public highway (unless the advertising is displayed on the very premises of an establishment of the firm), and
- (2) a firm’s commercial advertising on or in any public means of transportation and on or in the accesses thereto, including bus shelters, must be exclusively in French.

Websites and Commercial Advertising

While the Charter does not specifically mention the words “fax”, “e-mail” or “Internet”, the Office has taken the view that such media of advertising are subject to the same rules and exceptions as those concerning commercial advertising. English media websites could thus use English exclusively without violating the Charter. In addition, products of a cultural or educational nature may be advertised exclusively in the language of the product, without a French version.

Aware of the fact that the Internet is now used by companies as a means of advertising products on the global market, the Office has indicated that it will apply a simple rule whereby products available in Québec stores must be advertised in French on the website of a company or dealer which has a place of business or an address in Québec.

Computer Software

All computer software, including game software and operating systems, whether installed or uninstalled, must be available in French unless no French version exists.

Software can also be available in languages other than French, provided that the French version can be obtained on terms (except price where it reflects higher production costs) that are no less favourable and that has technical characteristics that are at least equivalent.

Firm Names

A French corporate name is required for a company’s incorporation in Québec; an English name may be used in addition to the French name. Under the Charter, a firm’s name must be in French, but a version in another language may accompany it, so long as the French version appears at least as prominently.

When another language is permitted to be used in public signs, posters and commercial advertising, the use of a firm name in a language other than French is also permitted. When texts and documents are drawn up in a language other than French, the firm name may appear in the other language, without the French version.

Francization of Enterprises

Enterprises employing 50 or more people in Québec for a period of six months must register with the Office de la Langue Française. The Office will then issue a certificate of registration to the enterprise. Within a year of the issuance of the registration certificate, the enterprise must provide the Office with an analysis of its linguistic situation. The Office will issue a francization certificate if it concludes that the use of French is generalized at all levels of the enterprise. If the Office considers that the use of French is not so generalized, the enterprise must adopt and implement a francization program.

Enterprises employing 100 or more people must form a francization committee composed of six or more people. The committee's responsibilities include analyzing the linguistic situation in the enterprise, devising and supervising the implementation of a francization program, and ensuring that the use of French remains generalized at all levels of the enterprise.

Conclusion

Globalization of the economy in the era of free trade with the U.S. and Mexico and freer trade with other countries has lowered many of the barriers to entering into the Canadian market. However, proximity to the United States and similarities in lifestyle and economic aspirations should not fool the unwary investor. The political framework of Canada is more volatile than the United States and the social safety net can be significantly more supportive in health, education, welfare and other areas. Accordingly, Canadian legislation and common law provides significant protection for individuals and attempts to preserve cultural heritage groups. For example, individuals' protection under employment standards legislation is generally more exhaustive than most jurisdictions. The entrenchment of bicultural and multicultural ideals is manifested in laws running the gamut from packaging and labelling to education and the judicial system. Sensitivity to the cultural, administrative and legislative differences will assist an enterprise's entrance into the Canadian market. The foreign investor must explore the differences and the competitive advantages of Canada. There are signposts and guides readily available for assistance. Do not hesitate to use them to your advantage.



Firm Members

<u>NAME</u>	<u>PRACTICE AREA</u>	<u>DIRECT DIAL (416)</u>
Yosef S. Adler	Corporate/Commercial	369-4158
Leonard E. Baranek	Real Estate	369-4160
Robert W. Beattie	Corporate/Commercial	369-4119
Jules N. Berman, Q.C.	Insolvency	369-4122
Phillip G. Bevans	Corporate/Commercial	369-4102
Monica E. Bianchini	Real Estate	369-4104
Howard S. Black	Wills	369-4332
Mordecai L. Bobrowsky	Commercial Leasing	369-4129
Geoffrey D. Brown	Corporate/Commercial	369-4319
Ian J. Cantor	Litigation	369-4314
Lauren M. Corber	Leasing	369-4167
Timothy R. Dunn	Insolvency	369-4335
Melodie D. Eng	Real Estate	369-4161
Catherine Francis	Insolvency	369-4137
Ryan Gelbart	Corporate/Commercial	369-4172
Michael A. Goldberg	Tax	369-4317
Rachel Goldman	Wills & Estates/Tax	369-4105
Senator Jerry S. Grafstein, Q.C.	Corporate/Commercial	369-4108
Aaron S. Grubner	Corporate/Commercial	369-4318
Arnie Herschorn	Litigation	369-4134
Michael S. Horowitz	Commercial Leasing	369-4121
Sharona Ishmael	Litigation	369-4171
Joan E. Jung	Tax	369-4306
Kenneth L. Kallish	Insolvency	369-4124
Tracy A. Kay	Employment & Labour Law	369-4330
C. Robyn Kestenber	Commercial Leasing	369-4313
Christina Kobi	Commercial Leasing	369-4154
David M. Kutner	Real Estate	369-4113
Laurence A. Lebovic	Real Estate	369-4107
William B. Lehun	Real Estate	369-4338
Glen O. Lewis	Insolvency	369-4133
Alan D. Litwack	Corporate/Commercial	369-4146
David Louis	Tax	369-4111
Martin Maierovits	Real Estate	369-4128
Stephen J. Messinger	Commercial Leasing	369-4147
Ronald J. Molson	Real Estate	369-4114
Rachel Moses	Litigation	369-4115
Stephen C. Nadler	Litigation	369-4162
Hartley R. Nathan, Q.C.	Corporate/Commercial	369-4109

<u>NAME</u>	<u>PRACTICE AREA</u>	<u>DIRECT DIAL (416)</u>
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Adam L. Perzow	Commercial Leasing	369-4132
Stephen Posen	Commercial Leasing	369-4103
Samantha A. Prasad	Tax	369-4155
Reuben M. Rosenblatt, Q.C., LSM	Real Estate & Banking	369-4110
Daniel A. Rothberg	Corporate/Commercial	369-4112
A. Irvin Schein	Litigation	369-4136
Carl Schwebel	Real Estate	369-4309
Raymond M. Slattery	Litigation	369-4149
Brian J. Temins	Corporate/Commercial	369-4169
Jack B. Tannerya	Corporate/Commercial	369-4145
David T. Ullmann	Insolvency	369-4148
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