2019

Legal Year in Review

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

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Introduction

As the second decade of the 2000's comes to an end, we present, for the benefit of our clients and friends, what we think are some of the most important legal developments from the past year that are likely to be of interest to business. Some of these developments are in their infancy or are looming on the horizon.

Corporate: Public M&A, private equity, mining, governance and compensation

In relation to public M&A activity, hostile bid activity continues to be lower than expected, continuing a recent trend of sparse unsolicited offers since the 105-day minimum deposit period and mandatory minimum 50% tender condition were introduced in May 2016. It is unclear whether the 2016 bid amendments have caused the decline, but they may be a contributing factor. Other factors may include a decrease in the number of listed companies and economic challenges in the natural resources sector.

Over the past year, mini-tenders (i.e. an offer to acquire less than 20% of the shares of a class of an issuer) have been used by dissident shareholders to disrupt two high-profile M&A transactions – namely, Catalyst's acquisition of Hudson's Bay Co. shares at a premium to a proposal to take the company private, and the Mach Group's offer to acquire Transat shares in an attempt to vote against Air Canada's proposed acquisition of Transat. The latter was subsequently ruled to be abusive by the Quebec regulator, but properly structured, a mini-tender can be a legitimate tactic for challenging a transaction or attempting to win a proxy contest.

Meanwhile, we are awaiting the results of an appeal from the Yukon trial court's decision in *Carlock v. ExxonMobil Canada Holdings ULC*, which awarded dissenting shareholders a 43% premium to the negotiated deal price in ExxonMobil's 2017 acquisition of InterOil. If the lower court decision is not overturned, we may see more shareholder dissents in future.

Finally, the use of soliciting dealer arrangements in Canada – where issuers pay fees to investment dealers to get securityholders to vote in favour of or support certain actions – was the subject of a Guidance Note from IIROC. The Guidance Note provides welcome clarity on the use of such arrangements in the context of takeover bids, plans of arrangement, proxy contests and other transactions involving various types of solicitation fees.

In the private equity space, 2019 year-to-date activity levels in Canada are strong, exceeding 2018 levels for the same period. Sponsors participated in a range of private offerings and capital raising transactions. A number of new offerings raised fresh capital from first-time funds. Co-investment arrangements continued to be attractive. Requirements for enhanced fee and fund expense disclosure in the US became a focus. Infrastructure investments remained a staple for institutional investors. Deals were completed quickly, with fewer surviving indemnity obligations for sellers. Given the levels of capital still requiring deployment, the environment is favourable for another active year in 2020.

In the mining sector, 2019 started off with two of the largest Canadian mining M&A deals in recent memory (Barrick/Randgold and Newmont/Goldcorp). However, despite this strong start, global economic uncertainty persists and capital has not returned to the mining industry. Public financings in 2019 were generally limited to capital raising by producing issuers or royalty/streaming issuers. Exploration companies had limited financing opportunities. In addition, global M&A activity for the year was materially down compared to prior years and the anticipated mid-tier consolidation remained elusive. In such a challenging market environment, creativity was often critical to getting deals done.

In 2019, a number of ongoing developments in Canadian corporate governance moved forward. These include environmental, social and governance (ESG) matters, such as board diversity initiatives and climate change disclosure. The Ontario Securities Commission's (OSC) delivered its long-anticipated report on regulatory burden reduction. Developments in the U.S. regarding the regulation of proxy advisory firms may also lead to further consideration of that issue in Canada.

Several 2019 developments will have a significant impact on executive compensation practices in 2020. These include proposed changes to taxation of stock options, the enactment of the federal *Pay Equity Act*, amendments to the *Canada Business Corporations Act*, new U.S. hedging disclosure rules and a review of automatic securities disposition plans.

Public policy and regulatory

In the area of white collar and capital markets regulatory enforcement, Ontario announced the launch of its Serious Fraud Office, as well as a review of its *Securities Act*. British Columbia announced that a number of new enforcement tools will be added to its *Securities Act*. Enforcement activity levels were slightly lower relative to last year, with a slight increase in fines and administrative penalties, and a notable increase in restitution and disgorgement orders. In contrast, the effective use of the newly introduced "remediation agreement" has been threatened by high profile events involving SNC-Lavalin.

Financial services regulatory reform is continuing to focus on market conduct and consumer protection across the financial services sector. Policy makers have been actively promoting not just changes in law, but significant reform to the regulatory framework and approach to regulation. Two new regulators in Ontario and BC commenced operations, each with a mandate to foster consistent and effective regulation across Canada. We see a trend towards regulatory harmonization among jurisdictions, financial service providers and financial services and products.

Newly-appointed Competition Commissioner Matthew Boswell's priorities are emerging: enforcement in the digital economy and the detection and review of non-notifiable mergers. The Competition Tribunal recently confirmed in the *Vancouver Airport Authority* case that business justification for conduct is the paramount consideration in an abuse of dominance case. And, in *Godfrey*, the Supreme Court of Canada (SCC) revisited and reset the ground rules governing collective relief for consumers in Canada seeking damages for anti-competitive harm.

Amendments to the Ontario *Construction Act (formerly the Construction Lien Act)* took effect in October 2019, introducing a prompt payment and mandatory adjudication regime in an effort to alleviate perceived payment delays down the construction pyramid. The development industry in Ontario is revising internal processes and re-drafting contracts to address the new rules, and will be grappling with the inevitable growing pains for some time. A growing number of other jurisdictions in Canada, including the federal government, are following Ontario's lead.

In other news, Canada finally made good on its promises to modernize its intellectual property (IP) rights registration system through key amendments to the *Trademarks Act*, the *Patent Act* and their respective regulations. The government's objective is to make investing in Canadian IP as competitive and frictionless as possible. The next step is for the Canadian government to implement an ambitious experimental IP strategy.

Cannabis also continues to be a big story on both sides of the border. In Canada, the newly-legalized market experienced some growing pains, including initial distribution and supply chain issues. Provinces and territories considered changes to the age of consumption, as well as their retail licensing, distribution and wholesale models. Federally, Canada legalized three new classes of cannabis products: edibles, topicals, and extracts. Product liability and securities litigation began to emerge in the wake of adverse events allegedly relating to consumers vaping illicit cannabis products and of declining share prices. M&A activity and market consolidation are likely in 2020.

U.S. and cross-border

In the United States, cannabis is legal for medical use under state law in more than 30 states, and even for adult recreational use in more than 10 states. However, cannabis continues to be illegal under federal law in all states. Hemp is no longer prohibited under the federal *Controlled Substances Act* but may be regulated by the federal Food and Drug Administration. We are monitoring several legislative initiatives that may bring greater clarity to this issue.

In 2019, the U.S. Securities and Exchange Commission continued working to simplify public company disclosure requirements. The popular "test-the-waters" rules for emerging growth companies are now available to all companies, and there was focused attention on the role of proxy advisory firms in the U.S. proxy process.

Global efforts towards international tax reform moved forward. The Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI) entered into force in Canada. The MLI amends many of Canada's bilateral tax treaties. Additionally, if adopted, proposals from the OECD to alter the manner in which global profits are allocated among countries – "BEPS 2.0" –will expand the taxing rights of market jurisdictions (Pillar One) and impose a global minimum tax on multinational enterprises (Pillar Two).

Litigation and key cases

Growing tensions between federal and provincial legislators in relation to the power to regulate the environment are coming to a head in two court proceedings. The B.C. Pipeline Reference Case raises questions about the scope of a province's power, in the guise of protecting the environment, to regulate a federal undertaking (an interprovincial pipeline). And, amid concerns about impacts on provincial economies, the Carbon Tax Challenges by certain provinces seek to invalidate the federal carbon pricing regime. Both disputes are headed to the SCC in 2020.

The SCC heard and/or granted leave to appeal in a number of other cases that could have a significant impact on Canadian business. Three will address the developing doctrine of good faith performance in contract. Others deal with diverse matters such as arbitration clauses, the application of the Canadian Charter of Rights and Freedoms to corporations and the enforceability of provisions that impose penalties triggered by the insolvency of a contracting counterparty. The law in each of these areas could be clarified by Canada's top court in 2020.

The Ontario Court of Appeal's decision in *Chevron Corporation v Yaiguaje et al* confirmed the very high test under Canadian law for disregarding the separate legal personality of a parent corporation and its direct or indirect subsidiaries. The Court rejected attempts to introduce into Canadian law either a general equitable test for piercing the corporate veil or a form of group enterprise liability. The SCC's determination not to hear an appeal from this decision effectively brought an end to a lengthy Canadian proceeding seeking to seize the assets of an indirect subsidiary to satisfy a judgment obtained (fraudulently) against its parent. This may be welcome news for defendants in other cases pending before the Canadian courts that seek to pierce the corporate veil to render one member of a corporate family accountable for acts of another.

Technology, innovation and privacy

Privacy continued to be at the forefront of regulators' and business-leaders' minds alike. Reports of data breaches increased exponentially in the first year following mandatory breach notification, as did efforts by businesses to develop breach incident response plans. Regulators are re-examining privacy protections in the context of the "digital age", as all levels of government call for regulatory reform. International regulators committed to increased cooperation, affirming their view that privacy is a fundamental human right. And California became one of the first States to enact its own privacy statute, leading to renewed lobbying for a federal regime in the US.

The development and adoption of new technologies in mainstream businesses continued to accelerate in many vertical markets. Opportunities relating to innovation in artificial intelligence (AI), and machine learning in particular, continue to grow, spawning increasingly active debate about regulation to ensure the ethical use of AI. The adequacy of Canada's privacy regime in this context is also under scrutiny. Strategic alliances for the introduction of new products and services are rapidly forming, raising novel considerations regarding how to address risk allocation in these innovative arrangements. In the financial services sector, efforts are underway to modernize the payments system and to move forward with open banking. Clients in bricks-and-mortar businesses such as real estate and infrastructure are starting to recognize and embrace the opportunities presented by new technologies. Interest in public blockchain, however, is declining.

Cryptoassets made headlines in Canada in 2019, and not always for the best reasons. Early in the year, the QuadrigaCX cryptoasset trading platform went bankrupt, leaving 75,000 customers facing a collective loss of potentially more than C$200 million. Investigation revealed a complete absence of financial controls, apparent misappropriation and misuse of customer assets, and other questionable business practices. Shortly afterwards, Canadian securities regulators proposed a framework for regulating cryptoasset trading platforms. In July 2019, the federal government published final regulations that will subject dealers in virtual currency to Canada's primary anti-money laundering legislation. In October 2019, a panel of the Ontario Securities Commission (OSC) directed the issuance of a prospectus receipt for The Bitcoin Fund, which could become the world's first publicly traded bitcoin investment fund.

Other big issues do not feature as prominently in this year's publication as they have in past years – climate change and international trade, for example – but you will almost certainly hear more about them next year.

With all of this in the mix, 2020 is poised to be an eventful year. We will monitor developments as they unfold and would be happy to discuss them with you.

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M&A

Top public M&A and proxy contest legal developments in 2019

This article sets out some of the most notable Canadian legal developments in public M&A and proxy contests in 2019.

Mini-tenders

A mini-tender is an offer to acquire less than 20% of the shares of a class of an issuer that is not subject to the formal take-over bid rules. Mini-tenders are not subject to specific take-over bid regulation under securities laws. Accordingly, offerors in theory have considerable latitude as to how mini-tenders are structured.

During the past year, mini-tenders were used as a tool by dissident shareholders in attempts to disrupt two high-profile M&A transactions. In August 2019, The Catalyst Capital Group Inc. (Catalyst) acquired nearly 18.5 million common shares of Hudson's Bay Co. (HBC) under a mini-tender, representing approximately 10.05% of the issued and outstanding common shares of HBC. Catalyst's offer was made for approximately 19.8 million shares at a price of $10.11 per share.

The Catalyst offer price was at a premium to a proposal to take HBC private at $9.45 per share made by a group led by Richard Baker, HBC's Executive Chairman, which owned approximately 57% of HBC. The Baker group has since entered into an agreement to take HBC private at a price of $10.30 per share.

Group Mach Acquisition Inc. (Mach) also made a mini-tender in August 2019 to acquire 19.5% of Transat A.T. Inc.'s class B voting shares at a price of $14.00 per share. Mach made its offer in an express attempt to vote against Air Canada's proposed acquisition of Transat at a price of $13.00 per share.

Under the terms of Mach's offer, the offer was only made to shareholders as of the record date for the Transat shareholders meeting to approve the Air Canada transaction and was only open for acceptance for 11 days. If the offer was over-subscribed, then the shares would be taken up pro rata based on the number of shares tendered. Interestingly and more controversially, the offer also provided that Mach would have the right to vote and exercise dissent rights in respect of all shares tendered, without pro ration. In addition, Mach had the right to withdraw its offer and not take up shares, even if it had already voted the shares against the Air Canada transaction or exercised dissent rights.

Transat made an application to the Quebec Financial Markets Administrative Tribunal (the "Tribunal") challenging Mach's mini-tender on the grounds that it was abusive and contrary to the public interest. A majority of the Tribunal ruled that the mini-tender was abusive and prohibited Mach from acquiring any shares under the offer and from using any proxies given to Mach pursuant to shares tendered under the offer. Shortly after the Tribunal's decision, Air Canada increased its offer to acquire Transat to $18 per share, and the transaction was subsequently approved by shareholders.

The fact that the Catalyst mini-tender was allowed to proceed indicates that mini-tenders are not illegal or contrary to the public interest when properly structured. Mini-tenders can be a legitimate tactic in challenging a transaction or in attempting to win a proxy contest. That said, in circumstances where mini-tenders are used to accomplish an objective that would not be permitted under a formal bid and that could be perceived as abusive, the Mach case shows that regulators are prepared to take action.

Dissent rights – *InterOil* decision

In an extraordinary decision, the Supreme Court of Yukon (the Court) in *Carlock v. ExxonMobil Canada Holdings ULC (ExxonMobil)*, awarded dissenting shareholders a 43% premium to the negotiated deal price in ExxonMobil's 2017 acquisition of InterOil. The Court's US$71.46 per share award is particularly surprising given ExxonMobil's price of US$45 plus a contingent resource payment valued at just under US$5.00 per share was itself a topping bid to a prior board-supported transaction with Oil Search, and the fact that the transaction was approved by a significant majority of shareholders not once but twice due to disclosure-related litigation.

The decision has since been appealed. If the ruling is not overturned, the award of such a significant premium to the negotiated purchase price puts market participants on notice that the process undertaken by transaction participants in negotiating a merger may come under scrutiny by courts in the context of a shareholder dissent. The decision also diverges from recent authority on the issue in Delaware, where deal price has been accorded deference as an indicator of fair value. If the decision stands, it may encourage increased levels of shareholder dissent.

For more information on the decision, please see our Osler Update entitled "Court rejects deal price as indicator of fair value in dissent decision" on osler.com.

Soliciting dealer arrangements

The use of soliciting dealer arrangements in Canada – where issuers pay fees to investment dealers to incent securityholders to vote in favour or support certain corporate actions – has been subject to scrutiny for a number of years. The 2013 proxy contest involving JANA Partners and Agrium and the 2017 proxy contest involving PointNorth Capital and Liquor Stores N.S. raised a number of questions concerning the use of one-sided fees paid to soliciting dealer groups for votes cast in favour of the management slate in contested director elections. Some critics alleged that these arrangements amounted to "vote buying" and created investment dealer conflicts of interest. Soliciting dealer arrangements are also used in a number of other contexts, such as supported and uncontested take-over bids, where the conflicts of interest are not as acute.

In 2018, the Canadian Securities Administrators (CSA) issued a Staff Notice seeking information and feedback on the use of, and regulatory approach to, soliciting dealer arrangements. In response, the Investment Industry Regulatory Organization of Canada (IIROC) – the investment dealer self-regulatory organization – published a Guidance Note in 2019 to address management of conflicts of interest concerning such arrangements. The Guidance Note provides some welcome clarity on IIROC's views on the use of soliciting dealer arrangements in the context of takeover bids, plans of arrangement, proxy contests and other transactions involving various types of solicitation fees.

While not having the force of a rule change or a change in law, given the CSA's endorsement of the Guidance Note and the lengthy consultation with the dealer and issuer community, we expect the Guidance Note will have an impact on the way that soliciting dealer arrangements are structured going forward. One-sided fee arrangements in contested director elections will almost certainly be precluded, though a number of questions still remain about how practice will evolve.

For more information on the Guidance Note, please see our Osler Update entitled "New guidance on soliciting dealer arrangements" on osler.com.

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Fewer hostile bids

There have been only **two** hostile take-over bids in 2019, continuing a recent trend of sparse unsolicited offers since the 105-day minimum deposit period and mandatory minimum 50% tender condition were introduced in May 2016. There were only five hostile bids in 2018 and three in 2017. It is unclear whether the 2016 bid amendments have caused the decline, but they may be a contributing factor. Other factors may include a decrease in the number of listed companies and economic challenges in the natural resources sector.

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PRIVATE EQUITY

Private equity continues to drive deal activity

The 2019 year-to-date activity levels in the Canadian private equity (PE) space are strong, exceeding 2018 levels for the same period. In this article, we explore a number of key trends we observed.

Strong private equity market

According to Refinitiv, there was a total of $35.3 billion invested in 377 deals during the first three quarters of 2019. This represented an increase in deal value of 41%, compared to the same period in 2018. Buyout and related funds in Canada raised over $17 billion in the first three quarters, up 169% year over year.

Fundraising trends

Fundraising remained active in 2019. As reported by Prequin, there is now estimated to be approximately $2 trillion in capital under management or "dry powder" globally, with over half that amount targeting North America. Despite the need for sponsors to deploy that capital, the private capital markets showed continuing strength as sponsors continued to participate in a range of private offerings and capital raising transactions. Several sponsors returned to market and a number of new offerings raised fresh capital from first-time funds. This strong level of fundraising demonstrates sponsors' ability to effectively deploy capital in recent years, allowing them to move on to raise successor funds. It also speaks to the continued focus of pension funds and other institutional investors on increasing exposure to the alternative assets space by investing in these PE funds. The glut of newly committed capital and the corresponding need for sponsors to deploy that same capital can be expected to foster the M&A markets and investment activity in 2020.

No significant changes in fundraising terms. The basic economic bargain between limited partners (LPs) (investors) and the general partner (GP) (PE sponsor) remained largely unchanged over the past year. However, there is a general trend toward incorporating terms which are more GP-friendly, echoing terms found in U.S. agreements.

In addition, some of the more successful funds have sought to include increased flexibility in their fund documents around how their investing program is implemented. For example, in some recent private equity funds we have seen a **longer fund life**. Although investors will generally pay more in aggregate fees if the fund life is extended, there is at the same time a recognition that compelling a sale of assets at the wrong time, due to the end of a fund's term, is not desirable, particularly in economic cycles which are not following traditional historical patterns. Occasionally, investors will benefit from reduced annual fees for those years where the GP has elected to extend the life of the fund. Institutional investors such as pension funds often accept funds with a longer duration, as it aligns with their long-term liability profile.

Co-investment rights remain a major focus for many institutional LPs. Such institutional players seek to enhance returns by investing in desirable assets alongside a trusted PE sponsor. Fund sponsors with a track record of offering co-investment opportunities are able to use the prospect of future co-investment to attract investors for whom this is important. PE sponsors often prefer to maintain flexibility as to which LPs will be offered these rights, and on what terms. It is critical that co-investors are able to act quickly to meet deal timelines and, for this reason, our experience is that the most active co-investors are sophisticated institutional investors with deep pockets.

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Enhanced **disclosure about fees and fund expenses** is a general trend. This development has been imported from the U.S., where the SEC's continued scrutiny of this area – and resulting enforcement actions in respect of inadequate disclosure – has made fulsome disclosure of the components of fees and expenses prudent. Lengthy definitions outlining all possible expenses that can be incurred by a fund, as well as enhanced disclosure about allocation of expenses, fee offset provisions and related party fees, may well become the norm for funds in Canada.

The Institutional Limited Partners Association (ILPA) has produced a model limited partnership agreement for use by the industry. The ILPA's stated goal in publishing this model is to provide transparency and to reduce the complexity, cost and resources required to negotiate the terms of a PE fund. The model is investor-friendly, which is not surprising considering its source. It remains to be seen whether the ILPA model will have an impact on fundraising and negotiations among GPs and LPs. While it may prove to be a useful tool for comparison purposes, we expect that adoption of the model, or parts of it, will take some time (if it occurs at all), particularly as the norm has been for a fund sponsor to largely re-use the fund documents from its prior funds, which have already been negotiated with its investor base.

Deal climate

Canadian deal-making in the private equity arena sustained very active levels, driven by several factors including: cross-border inbound M&A flows; take-private transactions; sponsor-to-sponsor transactions; active deployment of capital by private equity funds; "buy and build" strategies by sponsor-backed portfolio companies; and facilitative debt capital markets. In 2019, examples included

- Blackstone's announced $6.2-billion acquisition of Dream Global REIT
- Onex Corporation's announced $3.5-billion acquisition of WestJet Airlines
- BC Partners' $5.2-billion acquisition of GardaWorld from Rhône Capital
- Platinum Equity's acquisition of Livingston International from Canada Pension Plan Investment Board (CPPIB) and Sterling Partners
- KKR's acquisition of Corel Corporation from Vector Capital

A noteworthy trend has also been the ongoing proliferation of co-investments, team-ups and consortiums involving Canadian pension funds and global private equity sponsors in their pursuit of foreign outbound transactions. In 2019, examples included

- CPPIB's participation in a consortium led by Hellman & Friedman, and including Blackstone, GIC and JMI Equity, to acquire Ultimate Software in a transaction valued at $11 billion
- Ontario Teachers' Pension Plan and CPPIB teaming up with private equity sponsored funds, including Apax Partners and Warburg Pincus, to acquire Inmarsat plc in a transaction valued at $3.5 billion

Infrastructure continues to attract significant interest from PE investors. Attraction to this asset class has been a long-term trend for institutional investors and pension funds. Infrastructure assets are generally perceived as less risky (they are often supported by a concession agreement or other secure income stream) and less affected by economic cycles, in addition to aligning well with the long-term liabilities of many pension funds. Sponsors (as well as pension funds directly) have seized the opportunity and are filling a funding gap where governments are reluctant to invest public funds.

Deal times are often faster than real times. Due to the robust transaction environment, the competitive market and high levels of "dry powder" chasing a finite number of deals, private equity players need to differentiate themselves – by speed of execution capability, track record and transaction certainty, for instance. Sellers have been able to shorten the period during which an auction is conducted and to demand shorter exclusivity periods, forcing buyers to act nimbly. In the same vein, sellers continue to look for deal certainty and limited recourse; more and more deals are being completed on the basis that there are no surviving indemnity obligations for sellers – even for fundamental representations – and buyers are expected to look only to representation and warranty (R&W) insurance for coverage. Competition for deals means that PE buyers are willing to take this approach, as well as to limit conditions requiring third-party consents to only the most material ones.

The use of R&W insurance continues to be prevalent in private equity deal-making. Although R&W insurance is becoming the accepted norm as the primary method of protecting buyers from misrepresentations, deals still get done in the Canadian market without it. As use of R&W insurance grows, it continues to be refined. Insurers have become increasingly comfortable insuring "no indemnity" deals. Insurers are also more willing to insure risks that have traditionally been the subject of policy exclusions such as environmental, tax and product liability, although these are fact-specific. This reflects the maturation of the product, as well as increased competition within the R&W insurance industry.

The financing environment remains highly competitive. Canadian banks are continuing to compete against both Canadian and U.S. banks on M&A financings. Deals are highly competitive, resulting in competition between banks on pricing and overall deal terms. The influx of U.S. alternative sources of credit into the Canadian market, including the credit arms of sponsors, has also resulted in the adoption of certain U.S. concepts in Canadian deals. These include a push for limited conditionality (known as "SunGard" provisions) by sponsors, as well as the right of sponsors to choose the counsel that acts for the lenders on the financing. Given the current market financing conditions, we expect these trends to continue into 2020.

Financing for deals is highly competitive, resulting in competition between banks on pricing and overall deal terms. The influx of U.S. alternative sources of credit into the Canadian market, including the credit arms of sponsors, has also resulted in the adoption of certain U.S. concepts in Canadian deals.

M&A remains the preferred method of exit from PE investments, as in past years. While we have seen PE sponsors continue to pursue a "dual track" process on exit (i.e., preparing for a public offering while also marketing the asset through an auction process), very few Canadian IPOs were undertaken in 2019. This reflects the fact that public markets are not generating a premium to enterprise sales and demonstrates PE's bias toward a clean exit at a price certain.

We are seeing more sponsor-to-sponsor deals. This in part reflects an evolution in the PE industry; as more funds come to market and mature, they are compelled to find exits for their portfolio companies. Along with strategic buyers, other sponsors are a natural source of potential buyers. This trend may also demonstrate that assets are being sold prior to a PE sponsor extracting full value, suggesting that there is indeed a rationale for longer life funds.

Conclusion

We anticipate another strong year in Canadian private equity markets in 2020. The large amount of capital requiring deployment, together with favourable credit markets, should lead to significant deal activity. Although the medium- and long-term economic climates remain uncertain, the ability of private equity buyers to act quickly and opportunistically, in all phases of the economic cycle, can be expected to result in sustained levels of deal-making.

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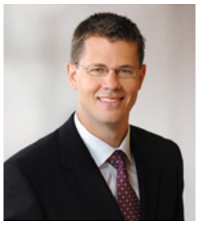

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MINING

Continued uncertainty fuels creativity in mining sector transactions

Although 2019 started off with significant fanfare with two of the largest Canadian mining M&A deals in recent memory (Barrick/Randgold and Newmont/Goldcorp), ultimately these deals did not serve as a catalyst for additional deal making and capital raising.

Amid an environment of global economic uncertainty, capital has not returned to the mining industry despite a strong gold price which traditionally benefits the Canadian mining sector. Public financings in 2019 were generally limited to capital raising by producing issuers or royalty/streaming issuers. Exploration companies, in particular, had limited financing opportunities, either publicly or through private financing. In addition, for much of the year global M&A activity for the year was materially down compared to prior years and the anticipated mid-tier consolidation remained elusive, despite a pick up in gold activity late in the year. In such a challenging market environment, issuers had to consider other alternatives to public capital and traditional M&A activity. Creativity was often critical to getting deals done.

Several market themes were evident in some of the more creative and innovative transactions we saw this year.

Preserving optionality

One key theme involved positioning issuers for future opportunities, whether they be triggered by stronger commodity prices or stronger operating conditions. A number of transactions enabled issuers to realize their near-term objectives while also maintaining optionality going forward that will (hopefully) enable them to benefit from improved market conditions in the future. Two such transactions are

- **TMAC Resources and Maverix Metals:** TMAC increased its existing net smelter return (NSR) royalty owing to Maverix from 1% to 2.5% in consideration for a payment of US$40 million. Maverix also completed a US$3-million private placement of equity. The royalty amendment included buyback rights for the increased royalty that locked in a return for Maverix and provided certainty for TMAC. The structure allowed TMAC to repay the increased NSR in shares such that, if TMAC's share price improves in a higher gold price environment, the dilution to take out the royalty through an equity raise could potentially be significantly less than the dilution from an equity offering at the time of the transaction. (Osler acted for Maverix Metals.)
- **Pretium Resources and Osisko Gold Royalties:** Although Pretium had an option to reduce its offtake obligations owing to Osisko, its repurchase right was limited to 75% of its outstanding refined gold obligations. Following negotiations, the parties agreed to a buyout of the entire offtake obligation for the same price as under the buyout right. The transaction eliminated a low market offtake for Osisko and allowed Pretium to obtain the full benefit of its production and repay its construction financing.

In such a challenging market environment, issuers had to consider other alternatives to public capital and traditional M&A activity. Creativity was often critical to getting deals done.

Sharing risk

Another key theme was an increase in joint ventures and partnerships to share risk, especially with development stage assets. Joint ventures and earn-ins have always been a foundational basis for deal making in the mining sector. However, persistent difficulties in accessing capital provided opportunities for investors to combine forces. A number of transactions resulted in financing arrangements that one or both issuers would not have been able to do themselves. Two such transactions are

- **Lithium Americas and Ganfeng Lithium:** In October 2018, Lithium Americas replaced SQM, its JV partner for its principal project, the Cauchari-Olaroz project, with LAC's largest shareholder, Ganfeng Lithium, and increased its stake from a 50% to a 62.5% holding, with Ganfeng Lithium holding the other 37.5%. In August 2019, Ganfeng Lithium invested a further US$160M in the holding company for the Cauchari-Olaroz project to increase its holding to 50%. The transaction significantly increased the valuation for the Cauchari-Olaroz project and derisked development of the project by providing substantial funding towards construction. (Osler acted for the Special Committee of Lithium Americas.)
- **Argonaut Gold and UrbanGold:** Argonaut and UrbanGold signed an option agreement granting the other party the right to earn a 50% interest in the other's claims – effectively combining the properties to form a single project.

UrbanGold has an option to earn a 50% interest in Argonaut's claims in consideration for 750,000 common shares of UrbanGold over the first two years of the agreement and an expenditure commitment of at least $300,000 until the third anniversary of the agreement. On completion, Argonaut may earn-in to UrbanGold's projects. Combining assets allows for efficient use of both parties' limited exploration dollars in a prospective area.

Restructurings using capital structure

Many mining issuers face a conundrum: lower market valuations make it difficult to aggressively acquire new assets, while at the same time they are unable to generate near-term value appreciation with their current asset mix and financial resources. Many shareholders share this frustration. In 2019, a number of issuers creatively used their capital structure to restructure their asset base and shareholder base. Three such transactions are

- **Osisko Gold Royalties and Orion Mine Finance:** Osisko had previously purchased a royalty portfolio from Orion in consideration for Osisko equity, with Orion holding approximately 19.48% of Osisko. Orion wished to exit and Osisko wanted an orderly sale process. The parties negotiated a blended transaction including a public secondary offering by Orion, a repurchase of shares in consideration for equity securities of certain Osisko portfolio companies and cash, and a sale of other equity securities to an affiliate of Orion for cash. The transaction allowed Orion to exit its investment in Osisko Gold Royalties for cash and new portfolio investments and allowed Osisko to clear the overhang on its shares from the Orion investment. (Osler acted for the underwriters on the secondary offering by Orion.)
- **Calibre Mining and B2Gold:** B2Gold and Calibre entered into a transaction pursuant to which B2Gold agreed to sell to Calibre all of B2Gold's interest in the producing El Limon and La Libertad Gold Mines, the Pavon Gold Project and additional mineral concessions in Nicaragua for consideration consisting of cash, Calibre shares, a debenture and a deferred cash payment. In connection with the transaction, Calibre was able to complete a significant subscription receipt financing, with the result being that B2Gold increased its interest in Calibre to 28%, new investors held 57% of the combined company and pre-existing Calibre shareholders (who held an interest in an exploration company with limited access to capital) held 12% of the outstanding equity. The transaction allowed B2Gold to separate itself from Nicaragua to focus on optimizing production at other existing mines in Mali, Namibia and the Philippines, as well as to advance its pipeline of development and exploration projects. It further allowed Calibre to consolidate its interests in Nicaragua and immediately move from an exploration company to a producing issuer.
- **Newmont Goldcorp and Arcus Development Group:** Newmont Goldcorp has agreed to acquire the Dan Man property (near Newmont Goldcorp's Coffee gold project in the Yukon Territory) from Arcus in consideration for the return to Arcus of a 19.9% interest in Arcus (previously held by Goldcorp). Arcus will also receive a 1% NSR on future commercial production from Dan Man, although Goldcorp Kaminak, a Newmont Goldcorp subsidiary, will have the right to repurchase the royalty at any time for C$1 million. For Newmont Goldcorp, this

transaction allows an efficient expansion of its Coffee project by consolidating prospective lands in the area in consideration for a non-core junior mining investment. For Arcus, the transaction removes overhang on its common shares, reduces the overall float outstanding and allows it to reduce costs and reallocate scarce resources to other projects in the company's portfolio.

These transactions present a sampling of inventive structures we saw in 2019 that have enabled parties to achieve their commercial objectives in a period of persistent difficulty for the mining sector. They make use of assets in a way that takes advantage of market conditions and existing opportunities. To the extent financing and M&A difficulties continue, we expect to see more of these types of transactions into 2020.

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GOVERNANCE

Corporate governance: Evolution of existing trends in 2019

Canadian corporate governance developments in 2019 reflected the evolution of a number of existing trends. These include an ongoing focus on environmental, social and governance (ESG) matters, including diversity and climate change, together with the delivery of the Ontario Securities Commission's (OSC) long-anticipated report on regulatory burden reduction. Developments in the U.S. regarding the regulation of proxy advisory firms may also lead to further consideration of that issue in Canada.

Diversity

As reflected in our fifth annual comprehensive report on diversity disclosure practices by TSX-listed companies, Canadian companies this year achieved some key diversity benchmarks. Women accounted for over one-third of the total of newly created or vacated board seats. A majority of all companies disclosing whether or not they have adopted a written diversity policy now state that their policy specifically targets the identification and nomination of women directors.

Over three-quarters of all companies have at least one female director and over one-third have two or more. As a result, women now hold 18.2% of all board seats, and hold over 30% of the available board seats among the S&P/TSX 60 companies – aligning with the goal of the 30% Club.

However, the rate at which women are being added to boards is declining year over year and there is little change in the representation of women at the executive officer level.

Investors continue to be interested in diversity and are reflecting their interest by voting against or withholding from voting for directors on boards that have not taken steps to increase the proportion of women serving on the board.

Legislative initiatives related to diversity picked up pace this year. In 2019, Canada became the first jurisdiction in the world to require diversity disclosure beyond gender. Effective January 1, 2020, publicly traded corporations governed by the *Canada Business Corporations Act*, including venture issuers, are now required to provide shareholders with information on the corporation's policies and practices related to diversity on the board of directors and within senior management. Such information includes the number and percentage of members of the board and of senior management who are women, Aboriginal persons, members of visible minorities and persons with disabilities. In addition, the State of California passed legislation to mandate quotas and the State of Illinois now requires diversity disclosure, in each case by corporations organized under or operating in the state.

Investors continue to be interested in diversity and are reflecting their interest by voting against or withholding from voting for directors on boards that have not taken steps to increase the proportion of women serving on the board.

Climate change

On August 1, 2019, the Canadian Securities Administrators concluded its two-and-a-half-year review of climate change disclosure by issuing CSA Staff Notice 51-358 on Reporting of climate change-related risks. The CSA opted to provide guidance rather than changing existing disclosure requirements. The Staff Notice not only confirms that the test for determining whether climate change disclosure is material is the same as for other disclosure items (i.e., likely to influence or change a reasonable investor's decision whether to buy, sell or hold the issuer's securities), but also provides guidance on how to assess materiality for long-term risks like climate change that are difficult to quantify. The Staff Notice also reiterates that voluntary disclosure should be subject to the same rigour as mandated disclosure.

Regulation of proxy advisory firms

In August, the U.S. Securities and Exchange Commission (SEC) issued guidance – as described in our Osler Update entitled "SEC issues guidance regarding activities of proxy advisory firms" on osler.com – in which it expressed the view that voting advice communications from proxy advisory firms is a "solicitation" that is subject to SEC rules prohibiting the making of materially false or misleading statements. The SEC also provided guidance on the responsibilities of investment advisers which use the services of proxy advisory firms to provide research or voting recommendations, including their responsibility to assess the capacity, competency and methodology of the proxy advisors they use, and the proxy advisory firm's policies and procedures respecting conflicts of interest.

In October, Institutional Shareholder Services (ISS) commenced an action in the District Court for the District of Columbia challenging the SEC's authority, arguing that its activities are not solicitations and that the SEC guidance was a substantive change that should have been subject to notice-and-comment review.

On November 5, 2019, the SEC issued proposed amendments to its proxy rules to regulate certain of the activities of such firms which are summarized in our Osler Update entitled "SEC proposes amendments to proxy rules applying to proxy advisory firms" on osler.com. The proposed amendments would change the definition of "solicitation" to expressly include the activities of proxy advisory firms and require such firms to

- disclose conflicts of interest in each of their reports
- provide issuers and certain proxy soliciting persons with an advance draft of their proposed advice and an opportunity to review and comment on it before it is finalized (a review period of five business days if the circular was filed at least 45 days prior to the meeting date, three business days if filed at least 25 days prior to the meeting date and no review period if filed less than 25 days prior to the meeting date)
- provide issuers and certain proxy soliciting persons with a copy of the final advice at least two days prior to issuance and, if requested by the issuer or proxy soliciting person, to include in the proxy advisor's report a hyperlink or equivalent to a written statement by the issuer or proxy soliciting person setting out its views on the advice by the proxy advisory firm

The SEC's guidance and regulatory approach to proxy advisory firms are likely to influence practices by proxy advisory firms and their investment adviser clients in Canada as well as the United States. If the SEC's proposed amendments are adopted, the CSA may choose to revisit the guidance it provided in National Policy 25-201 – *Guidance for proxy advisory firms* and/or adopt measures to regulate the activities of proxy advisory firms which align with any final rules adopted by the SEC.

OSC burden reduction initiative

In November 2019, the OSC published a report summarizing over 100 specific actions it has or will be undertaking to reduce the regulatory burden of Ontario issuers. This report stemmed from a previous OSC Staff Notice published in January 2019 and follows a consultation of market participants by the OSC's Burden Reduction Task Force established in November 2018. The consultations focused on registration, compliance, investment funds, trading, marketplaces, issuer requirements and derivatives rules.

As we have noted in our Osler Update entitled "OSC issues anticipated Report on the Burden Reduction Task Force" on osler.com, the OSC indicated that the report's recommendations were guided by the principle of "proportionate regulation," which it defines as regulation where the costs imposed on stakeholders are commensurate with the benefits. "Proportionate regulation" avoids a "one-size fits all" approach (taking into account how regulations affect entities of different sizes), recognizes there are multiple ways to achieve objectives, includes stakeholder input and is frequently updated to support innovation. The OSC also confirmed that its ideal regulatory approach involves "combining and balancing principles-based rules, prescriptive rules and guidance."

The report summarizes a variety of initiatives that have been completed, that have been published for comment, that are under consideration or that the OSC has committed to studying in the future. Highlights include

- the establishment of a clearer set of service standards for compliance reviews
- a study of the harmonization of requirements relating to the financial statements that must be included in a long-form prospectus relating to an issuer's "primary business"
- the OSC's request for the ability to issue "blanket orders" (i.e., broad exemptive relief orders applicable to all industry participants, rather than only issuing orders personal to individual issuers)
- the option for registered firms to hire a Chief Compliance Officer from another registered, external and unaffiliated firm
- the introduction of streamlined nationwide crowdfunding rules for emerging companies
- the provision of confidential prospectus review services prior to a company announcing an IPO
- the elimination of redundant filing requirements for investment funds

Whistleblower awards

In February 2019, the OSC announced that it had paid out the first-ever whistleblower awards by any Canadian securities regulator under its Whistleblower Program. The OSC disclosed that in three separate matters, three whistleblowers received a combined total of $7.5 million for providing the OSC with "high quality, timely, specific and credible information, which helped advance enforcement actions resulting in monetary payments to the OSC." Ontario is the only Canadian jurisdiction that offers an economic incentive to individuals to come forward with information on securities-related misconduct, subject to certain limitations. Now that the OSC has a track record of having made payments under its program, other whistleblowers may be encouraged to come forward and report concerns directly to the regulator.

In February 2019, the OSC announced that it had paid out the first-ever whistleblower awards by any Canadian securities regulator under its Whistleblower Program.

CBCA amendments

In addition to the CBCA amendments relating to diversity, additional amendments to the CBCA were approved this year. One such amendment requires private companies governed by the CBCA to establish and maintain a register of individuals with significant control. It was effective June 13, 2019. This register must be made available to the police, Canadian taxing authorities and prescribed investigatory bodies if relevant to an investigation. The provinces of British Columbia and Manitoba adopted similar requirements to maintain such a register.

Certain additional amendments passed this year are not yet in force, but could have a potentially significant impact in the future, including

- disclosure respecting the well-being of employees, retirees and pensioners
- disclosure respecting compensation clawback arrangements
- mandatory say-on-pay advisory vote requirements
- amended director fiduciary duty provision that will expressly permit directors to consider specified interests, including the interests of shareholders, employees, retirees and pensioners, creditors, consumers and governments, and the environment and the long-term interests of the corporation. It remains to be seen whether this change will increase the likelihood of a court concluding that any such stakeholders are claimants entitled to the benefit of oppression and derivative action remedies

In Canada, changes in 2019 reflect a grab bag of issues predominantly favouring shareholders and other stakeholders. Changes and proposed changes for CBCA companies and proxy advisory firms, in particular, lay the groundwork for what should prove to be an interesting year ahead.

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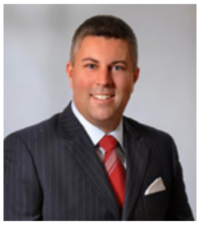

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Executive compensation: On the cusp of change

The past twelve months saw several developments that will have a significant impact on compensation practices in 2020. These include proposed changes to taxation of stock options, the enactment of the federal *Pay Equity Act*, amendments to the *Canada Business Corporations Act* (CBCA), new U.S. hedging disclosure rules and a review of automatic securities disposition plans.

Proposed changes to taxation of stock options granted on or after January 1, 2020

On June 17, 2019, proposed amendments to the *Income Tax Act* (Canada) were introduced which would apply to employee stock options granted by corporations and mutual fund trusts on or after January 1, 2020. See our Osler Update entitled "Canadian government introduces tax legislation applying to employee stock options granted on or after January 1, 2020" on osler.com. The tax treatment of options granted before 2020 is unaffected.

Generally,

- for options granted by employers that are Canadian-controlled private corporations (CCPCs) or other non-CCPC corporations that are "start-ups, emerging or scale-up companies," employees will continue to be entitled to a 50% tax deduction in respect of the option benefits (i.e., only one-half of the tax benefits realized on the exercise of the stock options is included in income)

- for options granted by other corporations and mutual fund trusts
  - the ability of the employee to take the 50% tax deduction will be subject to a $200,000 annual vesting cap and is not available if, at the time the options are granted, the employer designates the options as not being qualified for such 50% tax deduction
  - an employer deduction may be available for the option benefits realized by employees, but only in respect of options which do not qualify for the employee 50% tax deduction benefit, subject to certain conditions being met

Final amendments, including guidance for determining whether a non-CCPC is a start-up, emerging or scale-up company, are expected in 2020.

While the use of stock options by publicly traded companies has declined over time, there has been a reluctance to eliminate stock options entirely, due to the financial benefit to employees of the favourable tax rate. However, a change in the tax rate may further increase the use of performance-based full value awards.

Federal pay equity

The federal *Pay Equity Act* (the Act) received royal assent on December 13, 2018. A federal pay equity commissioner was appointed to lead the administration and enforcement of the Act in September 2019. We therefore expect that the Act will come into force in 2020. By contrast, implementation of Ontario legislation to provide for pay equity and transparency which was introduced by the former Liberal government and received royal assent in 2018 has been indefinitely delayed.

The *Pay Equity Act* applies to federally regulated workplaces, including the federal public and private sectors, parliamentary workplaces and the Prime Minister's and Ministers' offices. It is designed to proactively reduce the gender wage gap attributable to the undervaluation of traditionally female positions. While the right to equal pay for equal work has been in the *Canadian Human Rights Act* since 1977, the burden is on the employee to file a complaint with the Canadian Human Rights Commission. The Act, by contrast, will place the onus on covered employers to identify and remedy pay gaps.

Covered employers with 10 or more employees will be required to establish a pay equity plan within three years from the date the Act comes into force, and to review and update progress against the plan every five years thereafter. The pay equity plan must

- indicate the number of employees of the employer
- identify job classes within their workplace
- indicate whether each job class is female- or male-predominant or gender neutral, based on the historical and stereotypical profile of employees who hold the role
- evaluate the value of work performed by each job class

The federal *Pay Equity Act* now puts the onus on employers subject to the Act to identify and remedy pay gaps.

- identify the compensation associated with each job class (compensation includes salary, commissions, vacation pay, bonuses and employer contributions to employee benefit plans)
- compare the compensation associated with female-predominant and male-predominant job classes of similar value
- set out the results of the comparison and identify which female-predominant job classes require an increase in compensation
- identify when the increases in compensation are due
- provide information on the dispute resolution procedures available to employees

Amendments to CBCA

As noted in Corporate governance: Evolution of existing trends in 2019, certain proposed amendments to the CBCA impose compensation-related disclosure requirements for prescribed corporations. Prescribed corporations would be required to provide annual disclosure with respect to compensation clawback arrangements applicable to directors and senior management. The proposed amendments also include an annual say-on-pay vote on the approach to director and senior management remuneration.

New U.S. hedging disclosure rules

New U.S. hedging disclosure rules became effective for fiscal years beginning July 1, 2019. Previously, U.S. executive compensation disclosure rules required disclosure in the compensation discussion and analysis of material compensation policies. Policies respecting hedging of risks relating to the ownership of securities received as compensation are cited as an example of a potentially material compensation policy. In the upcoming year, companies subject to U.S. proxy circular disclosure rules also will be required to provide a fair and accurate summary of their practices or policies regarding hedging transactions relating to securities of the company, its parent and any subsidiary of the company or its parent, including the persons covered and the types of hedging transactions which are restricted or permitted. The SEC chose not to define the meaning of “hedge,” preferring to leave it to companies to provide disclosure with respect to any arrangement which may limit or offset a decline in the value of securities.

Under Canadian executive compensation disclosure rules, companies are required to disclose whether or not named executive officers (generally, the CEO, CFO and next three highest paid executive officers) or directors are permitted to purchase financial instruments for purposes of hedging risks associated with ownership of equity securities held, whether or not granted as compensation. In making their recommendations on a say-on-pay vote, ISS and Glass Lewis consider the adequacy of the company’s disclosure regarding its compensation risk management practices, including anti-hedging policies. Although Canadian companies which are foreign private issuers under U.S. securities laws are not subject to the new U.S. disclosure requirement, they may wish to consider whether to modify their approach to hedging in light of the increased disclosure now being provided by companies subject to U.S. proxy circular disclosure rules.

Automatic securities disposition plans under review in Canada

In October, the Canadian Securities Administrators announced that automatic securities disposition plans (ASDPs) are under review. ASDPs allow insiders to sell securities of an issuer through an arm's length administrator pursuant to predetermined instructions. While provincial and territorial securities laws provide an insider trading defence for trades made under ASDPs, there is currently no national framework governing ASDPs.

Companies will need to be ready to respond as the legislative and regulatory changes initiated in 2019 start to come into effect.

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CAPITAL MARKETS REGULATORY

Key developments in capital markets regulatory and white-collar defence

The year was marked by regulatory, legislative and political activity that significantly impacted the white-collar and capital markets regulatory enforcement landscape. The establishment of new enforcement structures and legislative action demonstrate the political desire to enhance enforcers' ability to combat white-collar crime. In contrast, the effective use of the newly introduced "remediation agreement" has been threatened by events surrounding high profile events involving SNC-Lavalin (SNC).

Ontario establishes a Serious Frauds Office

In August 2019, the Government of Ontario announced the launch of its Serious Fraud Office (the Ontario SFO), a combined task force of both investigators and specialized Crown prosecutors with the mandate and resources to pursue complex white-collar crimes. The Ontario SFO follows in the footsteps of similar structures in the United Kingdom and the United States. It will primarily focus on serious or complex fraud, bribery and corruption, and will have the power to seek criminal penalties. It is expected that the Ontario SFO will work alongside existing law enforcement agencies in Ontario and will follow a similar integrated approach to complex investigations as is adopted by the RCMP's Integrated Market Enforcement Team and Québec's Unité Permanente Anticorruption.

At this early stage, details regarding the Ontario SFO are limited. No guidelines or other materials have yet been published.

The Ontario SFO will be limited in its mandate by jurisdictional constraints. As complicated financial fraud is rarely confined to provincial boundaries, a national enforcement strategy would provide a more coherent and comprehensive approach and would enhance the global reputation of our markets with respect to white-collar and regulatory enforcement.

OSC Burden Reduction Task Force

In January 2019, the Ontario Securities Commission (OSC) announced the formation of a Burden Reduction Task Force aimed at minimizing regulatory burdens and enhancing competitiveness. As part of this initiative, the OSC launched a public consultation process comprised of three roundtables – held in March and May 2019 – where interested stakeholders provided suggestions on ways to reduce regulatory burdens.

On November 19, 2019, the Burden Reduction Task Force delivered its final report. The report outlines over 100 different initiatives addressing 34 underlying concerns identified by staff and stakeholders during the public consultation process. The OSC confirmed that burden reduction initiatives that fall entirely within the OSC's purview will be implemented within a year. Other changes – those that require legislative amendments, harmonization with other regulators or long-term investments in technology, systems or expertise – will be addressed over a longer time frame.

In implementing the initiative, there has been significant market support for moving away from rules-based regulation towards a principle-based approach. In line with a general trend in Canadian law and regulation, a departure from a "checklist"-based approach to regulation in favour of a more principled one is perceived to be in the interests of increased efficiency, flexibility and innovation.

Review of the Ontario *Securities Act*

In its Fall 2019 Economic Statement, the Government of Ontario announced that it would undertake a broad review and modernization of the Ontario *Securities Act*, which has not been reviewed for the past 15 years. Ontario's stated aim is to create a modernized securities regulatory framework which is responsive to innovation and rapid changes in the marketplace. A securities modernization task force will be established, which will seek input from stakeholders and provide policy recommendations on critical areas identified by the government, such as boosting competitiveness, regulatory structure, efficient regulation and investor protection.

In addition, the Government of Ontario announced that it would introduce legislation to repeal the *Toronto Stock Exchange Act* and amend the Ontario *Securities Act* to, among other things, "allow the OSC to issue blanket orders supporting greater efficiency in capital markets."

New enforcement powers for B.C. Securities Commission

In October 2019, the Government of British Columbia introduced amendments to the B.C. *Securities Act*, which will significantly enhance the powers of the British Columbia Securities Commission (BCSC) to combat white-collar crime. The reforms will also establish a modern system for regulating derivatives and financial benchmarks that is harmonized with other jurisdictions across Canada. In announcing the reforms, the B.C. Minister of Finance stated that the new legislation will ensure that the BCSC has the "strongest protections in Canada for people who are investing and tough penalties for those who are abusing the system."

In announcing the reforms, the B.C. Minister of Finance stated that the new legislation will ensure that the BCSC has the "strongest protections in Canada for people who are investing and tough penalties for those who are abusing the system."

The proposed legislation will add a number of new tools to the BCSC's investigative and collection toolbelt, including new powers to obtain information and compel witnesses to testify; increased maximum fines and jail terms for securities offences (five years in prison and $5 million in fines); minimum sentences for repeat offenders (at least one year in prison for repeat violators and for fraud over $1 million); an ability to order administrative monetary penalties without a hearing for contraventions of regulations or decisions; strengthened obligations and sanctions regarding the preservation of records (including computer data); protection for whistleblowers; and enhanced powers for the BCSC to freeze and seize property, including RRSPs.

Enforcement activity

(a) Snapshot of recent white-collar enforcement proceedings

A number of developments in white-collar and regulatory enforcement activity occurred over the past year.

Canadian prosecutors secured two convictions under the *Corruption of Foreign Public Officials Act* (CFPOA) in *R. v. Barra and Govindia.* The case arose out of the same facts as a 2013 case in which Nazir Karigar was convicted for conspiring to pay bribes to Air India officials and the Indian Minister of Civil Aviation to secure a major contract. It represents Canada's first convictions under the CFPOA since that time. Both Barra and Govindia were convicted of violating section 3(1) of the CFPOA, which prohibits paying or agreeing to pay bribes to foreign public officials. In its decision, the Court provided helpful guidance on what constitutes a "continuing conspiracy" to pay bribes under the CFPOA. Each defendant was sentenced to 30 months in prison.

Prosecutors also secured a notable conviction in connection with the bribery scheme through which SNC secured a $1.3 billion contract to build the McGill University Health Centre (MUHC). On February 1, 2019, former SNC CEO Pierre Duhaime pleaded guilty to breach of trust for his role in the scheme. Duhaime was sentenced to 20 months of house arrest and 240 hours of community service, and is required to make a $200,000 charitable donation to victims of crime. Duhaime's conviction follows that of Yenai Elbaz, a former senior manager of the MUHC who was sentenced to a three-year prison term for his involvement in the scheme.

(b) Developments in whistleblowing

In February 2019, the OSC announced that it had paid out its first-ever whistleblower awards under its Whistleblower Program launched in 2016. Three whistleblowers in separate matters received a total of $7.5 million for, according to the OSC, providing "high quality, timely, specific and credible information, which helped advance enforcement actions resulting in monetary payments to the OSC." However, one of the major deficiencies with the program is the lack of transparency about who the payments were made to and in respect of what matters, as well as the nature of the information.

(c) Developments in capital markets regulatory enforcement

The Canadian Securities Administration (CSA) released its annual Enforcement Report for the 2018/2019 fiscal year, which reflected enforcement statistics as well as a discussion of CSA priorities. The spotlight this year was on enforcement action in the digital world, with a focus on deterring misconduct particularly in relation to cryptocurrency.

The report highlights that CSA members are developing and leveraging new technologies that enhance the ability to examine, with greater detail, the way markets function. This includes the Market Analysis Platform which is intended to help CSA members better identify and analyze market misconduct through a central data repository and analysis system.

The Enforcement Report also sets out enforcement statistics for the fiscal year: CSA members concluded a total of 94 matters, involving 177 respondents. This is slightly lower than what the CSA reported in 2018. The vast majority of these matters related to illegal distributions (72 matters) and fraud (32 matters), which is consistent with the respective proportions set out in the 2018 report.

Fines and administrative penalties imposed in the fiscal year were up slightly from the previous year (rising from $65 to $77.5 million), with a notable increase in orders for restitution and disgorgement.

Various matters in 2019 reflect the ongoing pursuit by regulators of enforcement actions, and the court's willingness to uphold significant penalties:

- The OSC accepted a $30-million settlement payment in the Katanga Mining Limited matter, which is one of the most significant monetary penalties in the OSC's history. In December 2018, an OSC Panel approved the settlement, which related to misstatements in Katanga's financial statements, as well as disclosure violations and internal controls failures in relation to its operations in the Democratic Republic of the Congo.
- The BCSC Criminal Investigations Branch launched an investigation against Ayaz Dhanani, and subsequently charged Dhanani with offences under the *Criminal Code* and the B.C. *Securities Act*. Dhanani was found to have

fraudulently solicited nearly $200,000 in investments from B.C. residents and directed the funds to himself. This was in contravention of a BCSC Order, resulting from Dhanani's earlier fraudulent conduct, which prohibited him from engaging in investment-related activity. Dhanani received a lengthy prison sentence of 36 months plus an order requiring restitution to the five victims.

- The Ontario Court of Appeal upheld the decision of an OSC panel in relation to Sino-Forest Corporation. The OSC panel found that executives of Sino-Forest orchestrated an elaborate fraud to overstate the assets and revenue of the corporation. The Court of Appeal upheld some of the most severe penalties ever ordered by the OSC, including administrative penalties, the disgorgement of profits and lifetime bans on market participation.
- The OSC approved settlement agreements with two Canadian banks regarding supervision and controls in the banks' foreign exchange trading businesses from 2011 to 2013. Both banks were recognized to have cooperated with the OSC and voluntarily agreed to payments to advance the OSC's mandate of protecting investors, and payment for the cost of OSC staff's investigation. Both banks were also recognized to have subsequently enhanced the systems of supervision and controls over their FX trading businesses.

Adventures in cryptocurrency

Canadian securities regulators continue to investigate and take enforcement action against alleged wrongdoers in the cryptoasset space:

- In February 2019, the OSC obtained a permanent order prohibiting trading in securities by a Dubai-based company offering cryptocurrency-related financial products within Ontario.
- In July 2019, the OSC reached a settlement with CoinLaunch Corp., which carried on business as a "crypto consultant," offering marketing and promotional services to prospective cryptoasset token issuers. CoinLaunch was found to have violated the dealer registration requirements of Ontario securities laws, and agreed to pay approximately $50,000 in penalties, disgorgement and costs. Although the monetary penalty was, in the OSC's words, "relatively modest," the OSC emphasized that firms in the cryptoasset sector that ignore registration obligations were "on notice" and "can reasonably expect to face more stringent consequences" in the future.
- In British Columbia, the BCSC initiated investigations into two cryptoasset trading platforms. It obtained a court order appointing an interim receiver over one of them after it failed to comply with the BCSC's demands for information.

Similar enforcement actions have also been taken in the United States by the *Securities and Exchange Commission* against participants in the cryptoasset space. Read our Emerging clarity on cryptoasset regulation article for more information on cryptoassets.

Canadian securities regulators continue to investigate and take enforcement action against alleged wrongdoers in the cryptoasset space.

Status of remediation agreements

Canada's remediation agreement regime is off to a rough start. In September 2018, deferred prosecution agreements (DPAs) were introduced under Canadian law. A remediation agreement – a voluntary agreement between the Crown and an organization accused of certain economic crimes such as fraud and bribery – is an alternative to the prosecution of criminal offences against an organization. The effect of a remediation agreement is to suspend the outstanding investigation or prosecution while simultaneously establishing specific undertakings that the organization must fulfill in order to avoid facing the potential criminal charges. Once the accused corporation has fulfilled the terms of the remediation agreement, the charges are dropped. Remediation agreements must be approved by a judge, who must be satisfied that the agreement is in the public interest and the terms of the agreement are fair, reasonable and proportionate.

The purposes underlying the DPA regime include incentivizing companies to proactively self-report wrongdoing and reducing the negative consequences of such wrongdoing on innocent third parties, including innocent employees of the accused organization. Notwithstanding this, with respect to offences under the *Corruption of Foreign Public Officials Act*, the Crown cannot consider the national economic interest, the potential effect on relations with a state other than Canada or the identity of the organization or individual involved in its decision whether to offer a DPA.

No remediation agreements have been announced in Canada since the DPA regime came into force. One of the first applications seeking to benefit from the new DPA regime led to a political firestorm. The Director of Public Prosecutions (DPP) declined to invite SNC to negotiate a remediation agreement in connection with ongoing foreign bribery and fraud charges. Subsequently, the then Minister of Justice and Attorney General accused the Prime Minister's Office of attempting to politically interfere in the exercise of her prosecutorial discretion by pressuring her to reconsider the DPP's decision. SNC applied for judicial review of the DPP's decision to the Federal Court, which confirmed that the decision whether to enter into settlement discussions falls within the ambit of the DPP's prosecutorial discretion and, consequently, is not reviewable by the courts except where there is an abuse of process.

Conclusion

The year's enforcement activity reflects ongoing efforts to reform and enhance enforcement tools and approaches, sharpen the focus of enforcement agencies and to sidestep some fall out from controversies that may have unintended consequences.

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FINANCIAL SERVICES REGULATORY

Financial services regulation: Toward integrated consumer protection initiatives

In the decade that immediately followed the financial crisis, financial services regulatory reform largely focused on solvency and capital adequacy. Over the past few years, there has been a notable shift in focus as market conduct and consumer protection has become a point of regulatory convergence across the financial services sector. At the same time, policy makers have been actively promoting not just changes in law, but significant reform in the regulatory framework and approach to regulation. Regulators (perhaps at long last) seem to be becoming more modern, nimble, responsive and collaborative. Consequently, we are seeing a trend towards regulatory harmonization among jurisdictions, financial service providers and financial services and products. This means that best practices in market conduct and consumer protection compliance are not necessarily industry-specific but can and should be derived from a broad range of sources on an enterprise-wide basis across the sector.

Below we highlight in more detail notable recent developments in the market conduct and consumer protection space that reflect these themes of regulatory harmonization and collaboration. These developments highlight the need for integrated compliance measures.

New regulatory authorities in Ontario and British Columbia

In 2019, two new regulators, the Financial Services Regulatory Authority of Ontario (FSRA)[1] and the British Columbia Financial Services Authority (BCFSA), commenced operations and assumed the regulatory duties of their provincial predecessors. The mandates of the two new regulators are similar and include fostering effective and consistent regulation across Canada, promoting the adoption of industry codes of market conduct and enhancing regulation of insurance intermediaries and mortgage brokers.

FSRA launches its business plan

FSRA assumed the regulatory responsibilities of the Financial Services Commission of Ontario (FSCO) and the Deposit Insurance Corporation of Ontario on June 8, 2019 (see our blog post on this topic). These bodies formerly oversaw insurance products and provincially regulated insurers, credit unions, loan and trust corporations, pension plans, mortgage brokers and certain auto insurance service providers. Based on FSRA's published statements and remarks to the industry, as well as our experience with FSRA to date, stakeholders can expect a more collaborative, flexible, principles-based approach to regulation than was the norm under FSCO. FSRA's mandate includes fostering effective and consistent regulation across Canada. With this in mind, FSRA has stated that it may press upon other regulatory authorities to act, if the entity or individual in question is under the jurisdiction of more than one regulator. This could occur across provincial boundaries (e.g., a mortgage broker may be registered in both Ontario and British Columbia) or across industries (e.g., an individual who deals in more than one regulated product).

Current regulatory trends mean that best practices in market conduct and consumer protection compliance are not industry-specific but can and should be derived from a broad range of sources on an enterprise-wide basis.

FSRA's 2019-2022 business plan, as approved by the Ontario Ministry of Finance, has two over-arching priorities:

- **Burden reduction:** FSRA will review all 1,100 pieces of regulation and guidance inherited from its predecessors and streamline or remove unnecessary material where possible. This is consistent with the Ontario government's 2018 plan to cut regulatory red tape by 25% by 2020.
- **Regulatory effectiveness:** FSRA will aim to achieve legislative objectives and protect the public interest through enhanced consumer, industry and regulatory expertise; through collaboration, transparency and efficient processes; and by using technology and enabling innovation.

In addition to its general mandate, FSRA's business plan sets out regulatory initiatives with respect to specific sectors.

1 Osler partner Lawrence Ritchie is on the FSRA Board.

- **Credit unions:** FSRA intends to integrate prudential conduct supervision, modernize the regulatory framework and adopt an industry code of conduct, which could be identical to or based on the Market Conduct Code recently released by the Canadian Credit Union Association. FSRA further intends to ensure an appropriate resolution and deposit insurance reserve fund (DIRF) framework for credit unions.
- **Insurance:** FSRA's goal in this sector is to adopt effective conduct standards and improve licensing effectiveness and efficiency. A further goal is to harmonize the *Treating Financial Services Consumers Fairly Guideline* with national direction such as the guidance document from the Canadian Council of Insurance Regulators and the Canadian Insurance Services Regulatory Organizations, *Conduct of Insurance Business and Fair Treatment of Customers*.
- **Mortgage brokering:** In this sector, FSRA intends to provide oversight of syndicated mortgage investments, but will transfer oversight responsibility for non-qualified syndicated mortgages to the Ontario Securities Commission (OSC). FSRA will also work to improve licensing effectiveness and efficiency, and to adopt an industry code of conduct.

Further to these goals, the Ontario government noted in its fall economic statement, released November 6, 2019, that it will conduct a legislative review of the *Credit Unions and Caisses Populaires Act, 1994*, the *Mortgage Brokerages, Lenders and Administrators Act, 2006* and the *Co-operative Corporations Act*.

Review of the credit union legislative framework is already underway, as comments on the consultation document, *A Modern Framework for Credit Unions in Ontario: Reducing Red Tape and Increasing Investment*, were due by August 16, 2019. Among other things, the consultation asked for input on: how to make it easier for credit unions to do business and compete in Ontario; dispute resolution processes and the need for an ombudsperson; regulatory treatment for centrals and leagues, noting that most Ontario credit unions are members of Central 1, a British Columbia central; a securitization and funding framework; business and investment powers, particularly in respect of investments in FinTechs; access to capital; improving the consumer experience and consumer protection; unclaimed deposit framework; corporate governance; and enabling innovation.

Review of the mortgage broker legislation is also underway. The *Report on Legislative Review of the Mortgage Brokerages, Lenders and Administrators Act, 2006* (Report), which is the outcome of the five-year statutory review of the Act, was released on September 30, 2019. The Report notes that the creation of FSRA represents an opportunity to "right-size" regulation for the sectors it oversees. The Report included a recommendation to require specialized licensing education for brokers who deal and trade in areas of practice that demand added knowledge and skills.

We expect to see themes emerge across the credit union, insurance and mortgage broker industries as FSRA works to modernize legislation, harmonize and consolidate its guidance, and develop or adopt industry codes that reflect the common issues that arise in regulating all of these sectors.

BCFSA assumes responsibilities

On November 1, 2019, the BCFSA started operations and assumed the responsibilities of the Financial Institutions Commission of British Columbia (FICOM), including overseeing credit unions, trust companies, insurance providers and intermediaries, and mortgage brokers, and administering the Credit Union Deposit Insurance Corporation.

Like FSRA, the BCFSA is also tasked with taking a more modern approach to regulation and ensuring consistency with other regulators. The creation of the BCFSA resulted from a 2017 independent review which followed the B.C. auditor general's report of deficiencies at FICOM, including a failure to keep up with international industry standards. As a result, we expect to see the BCFSA undertake similar modernization and harmonization initiatives to those announced by FSRA.

Also on the horizon are changes proposed by *The Financial Institutions Amendment Act, 2019* (Bill 37), which received Royal Assent on November 28, 2019. These include

- new rules for the online sale of insurance in B.C. that will be set out in the regulations (not yet released), as well as in additional rules adopted by the BCFSA
- a requirement for insurance companies to adopt and comply with a code of market conduct that will be established by the BCFSA
- a requirement for credit unions to adopt a code of market conduct, which, as in Ontario, may be derived from the Canadian Credit Union Association's Market Conduct Code, that must be filed with the BCFSA
- a requirement for credit unions to establish complaints resolution procedures, which must be published on the credit union's website and made available upon request
- the introduction of a regime for restricted insurance agent licensing for parties such as lenders that sell specific types of insurance that are incidental to their business activities (e.g. credit insurance). This regime may be similar to the restricted agent licensing regimes in Alberta, Manitoba and Saskatchewan. The rules and requirements of this regime will be established by the Insurance Council of British Columbia

A new FCAC Commissioner

Ms. Lucie Tedesco stepped down as Commissioner on June 3, 2019 after 11 years with the Financial Consumer Agency of Canada (FCAC). After a brief interim period, Ms. Judith Robertson was appointed Commissioner effective August 19, 2019 for a five-year term. At the time of her appointment, Ms. Robertson sat on the FSRA Board as one of its founding Board members and was previously a Commissioner of the OSC from 2011 to 2017. Prior to that, she had extensive experience as an executive in the capital markets and financial services industry.

As of November 2019, the FCAC had not posted any new decisions for the period following former Commissioner Tedesco's final Decision #134, posted on June 4, 2019. Consequently, we do not have any published evidence as to how the FCAC may approach decisions differently under Ms. Robertson. Given the breadth of the new Commissioner's experience, and in particular her experience with the OSC, it will be interesting to see how the FCAC evolves under her tenure.

Notable developments in consumer protection laws

Customer suitability – which has traditionally been the focus of insurance intermediary and securities advisor regulation – has been more broadly adopted within the financial services sector. A particular focus has been on enhanced regulation to protect vulnerable consumers such as seniors and high cost of credit borrowers. We discuss four developments on trend below.

Customer suitability – which has traditionally been the focus of insurance intermediary and securities advisor regulation – has been more broadly adopted within the financial services sector.

Code of Conduct for the Delivery of Banking Services to Seniors

After numerous consultations, the Canadian Bankers Association released the *Code of Conduct for the Delivery of Banking Services to Seniors*. This voluntary code of conduct applies to banks when delivering banking products and services to Canada's seniors and is overseen by the FCAC. The term "seniors" is defined in the code as an individual in Canada who is 60 years of age or older and who is transacting for a non-business purpose. While some aspects of the code will not come into effect until January 1, 2020 or January 1, 2021, as of July 25, 2019, banks should: take into account market demographics and the needs of seniors when proceeding with branch closures (Principle 6); and endeavor to mitigate potential financial harm to seniors (Principle 5). Principle 5 may be challenging, as it requires front line staff to balance security with autonomy and many providers report difficulties in convincing seniors of the reality of romance scams and other types of financial scams and abuse aimed at seniors.

New high-cost credit regimes

Alberta followed Manitoba's lead and implemented a high-cost credit regime on January 1, 2019, while Québec's regime came into force on August 1, 2019. We are still waiting for regulations to be published that will implement the proposed high-cost credit regime in British Colombia (set out in *Bill 7 – 2019: Business Practices and Consumer Protection Amendment Act, 2019*). This regime will impact lenders and lessors in British Columbia who charge rates that meet or exceed the "high-cost" threshold. If British Columbia follows Alberta and Manitoba's lead, this threshold will be an effective rate of 32% or above per year.

Implementation of Bill 134 in Québec

Financial services providers operating in Québec were extremely busy in the first half of 2019 as they worked to implement the numerous changes set out in Bill 134, *An Act mainly to modernize rules relating to consumer credit and to regulate debt settlement service contracts, high-cost credit and loyalty programs* and the accompanying regulations. The most significant changes set out in Bill 134 came into force on August 1, 2019. Among the most challenging to implement were the new requirements regarding credit cards. Controversial changes include higher mandatory minimum payments, a subject which was widely covered by the Québec media. Credit grantors and lessors are also required to assess the consumer's capacity to repay a loan or make their lease payments, which is not required under any other provincial lending legislation.

Bill C-86

Industry consultations regarding the regulations under the new federal consumer protection framework introduced in October 2018 (*Budget Implementation Act, 2018, No. 2*) took place over the course of 2019. Federally regulated financial institutions continue to grapple with the wide-ranging implications of the Bill, including the enhanced sales practices provisions.

Final thoughts

With so many developments in progress, 2020 will be a busy year. In addition to following these developments closely, we are also interested to see if and how governance and compensation frameworks will converge across the sector to align with these market conduct objectives and themes.

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COMPETITION

Competition law developments: Enforcement priorities and notable cases

In March 2019, Matthew Boswell was appointed as the Commissioner of Competition for a term of five years. Since Commissioner Boswell's appointment, two clear enforcement priorities have emerged that are likely to shape his tenure: enforcement in the digital economy and the detection and review of non-notifiable mergers.

This year also saw two significant developments in competition law jurisprudence. In *Commissioner of Competition v. Vancouver Airport Authority*, the Competition Tribunal confirmed that business justification for conduct is the paramount consideration in an abuse of dominance case. In *Pioneer Corp. v. Godfrey*, the Supreme Court of Canada revisited and reset the ground rules governing the availability of collective relief for consumers in Canada, particularly in respect of class actions that seek damages for anti-competitive harm.

Digital economy

The Commissioner's interest in the digital economy aligns with antitrust enforcement trends globally, as antitrust agencies grapple with the application of antitrust principles and economic tools to the rapidly changing and developing digital marketplace. Indeed, the Competition Bureau has in recent years increased its focus on the digital economy, as evidenced by the release of its September 2017 paper "Big data and innovation: Implications for competition policy in Canada," its February 2018 report "Big data and innovation: Key themes for competition policy in Canada" and its hosting of a Data Forum in May 2019. More recently, the Bureau hired IBM associate partner George McDonald in July 2019 to be its first Chief Digital Enforcement Officer.

In September 2019, the Bureau announced that it will engage with market participants to address potential competition concerns in certain core digital markets (e.g., online search, social media, display advertising and online marketplaces). In connection with its focus on these core digital markets, the Bureau has requested that market participants provide information on a confidential basis relating to: (a) potential explanations for why certain digital markets have become highly concentrated; (b) identification of prior or ongoing conduct that may be anti-competitive; and (c) the impact of such conduct on competitors. Whether the Bureau's "call out" to the market will result in future enforcement action or guidance remains to be seen.

Non-notifiable mergers

The Bureau must be notified of merger transactions that satisfy certain financial thresholds in advance of closing. The transaction size threshold – based on the target's assets in Canada or gross revenues from sales in or from Canada – is indexed to inflation and therefore subject to annual adjustments. The transaction size threshold was set at $96 million for 2019, with the adjustment for 2020 expected to be announced in early 2020.

The Bureau has the authority to review and challenge any merger until one year after closing regardless of whether it was subject to mandatory notification. In practice, voluntarily notifying the Bureau of a potential transaction in order to avoid this risk has been unusual. As a result, the Bureau may only become aware of a potentially problematic transaction (often as a result of complaints) after the transaction has closed and the parties' operations have already been combined.

In September 2019, the Bureau announced enhancements to its information-gathering efforts on non-notifiable mergers, including the re-branding of the Merger Notification Unit as the Merger Intelligence and Notification Unit. Leading up to this formal announcement, the Commissioner announced in May 2019 that the Unit detected in its first two months two potentially problematic transactions in which there was no indication that the merging parties had intended to voluntarily engage with the Bureau prior to closing.

The Bureau's new focus on non-notifiable mergers may reflect at least in part a concern that the annual upward adjustment to the transaction size threshold increases the risk each year that transactions that raise competition concerns may escape detection or may only be detected after closing. At this time, it is

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unclear whether drawing greater attention to non-notifiable transactions will create a greater incentive for parties to voluntarily engage with the Bureau prior to closing. It also remains to be seen whether the Bureau will send a strong signal to the legal and business communities by showing an increased willingness to seek to block or challenge non-notifiable transactions that were not brought to the Bureau's attention voluntarily.

Commissioner of Competition v. Vancouver Airport Authority

In September 2016, the Commissioner filed an application with the Tribunal for an order under the abuse of dominance provision seeking relief against the Vancouver Airport Authority in respect of its decision to allow only two in-flight caterers to operate at Vancouver International Airport and its refusal to grant licences to two new providers of in-flight catering services at the airport. In October 2019, the Tribunal dismissed the Commissioner's application, finding that while the Vancouver Airport Authority had substantial control of in-flight catering services, it had not engaged in a practice of anti-competitive acts and its conduct did not have, nor was it likely to have, the effect of preventing or lessening competition *substantially* in a market.

Notably, the Tribunal affirmed that when determining whether a firm has engaged in a practice of anti-competitive acts (a key element of an abuse of dominance finding), it must assess and weigh all relevant factors, including the "reasonably foreseeable or expected objective effects" of the conduct and any legitimate business justifications advanced by the respondent, in attempting to discern whether the "overall character" or "overriding purpose" of the conduct was anti-competitive in nature. The Tribunal stated that a legitimate business justification must be a credible efficiency-based or pro-competitive rationale that is linked to the firm. This link can be established by demonstrating the types of efficiencies that are likely to be attained as a result of the conduct, showing how the conduct establishes improvements in quality or service, or otherwise explaining how the conduct is likely to assist the firm to better compete.

The Tribunal's decision is also significant in that it provides, for the first time, a detailed assessment of the potential application of the regulated conduct defence to the civil provisions of the *Competition Act*. The Tribunal held that the defence does not apply to the abuse of dominance provision and, while not explicit, the Tribunal's reasoning strongly suggests that the defence would not be available to shield conduct from scrutiny under any of the civil reviewable practices provisions of the *Competition Act*.

Pioneer Corp. v. Godfrey

In conjunction with the Bureau's enforcement activities, the plaintiffs' class action bar has continued to act as an aggressive "private" enforcer of Canada's competition laws. In addition to filing a number of new significant claims, the plaintiffs' bar secured a significant victory before the Supreme Court of Canada in September 2019 that has reshaped the landscape for private enforcement in Canada. In a decision involving a twin set of appeals in *Pioneer Corp. v. Godfrey*, the Supreme Court has provided critical new guidance and resolved appellate conflict on four fundamental issues relating to class certification and the scope of private relief for damages under the *Competition Act*. These include: the evidentiary standard for class certification; the ability of "umbrella purchasers" to assert a claim for damages; the ability of class members to pursue parallel claims in tort or restitution that fall outside the statutory remedy under the *Competition Act*; and finally, the operation of the statutory limitation period governing private damage claims under the *Competition Act*.

In its decision, the Court dismissed the two appeals, and upheld the certification of a class action in British Columbia that included direct, indirect and umbrella purchasers of optical disk drives and products containing such drives. (An optical disk drive is a form of storage media contained in a range of consumer and business electronic products.) In a majority ruling, the Court held that the class plaintiffs had satisfied the evidentiary threshold for certification of an indirect purchaser class (i.e., those whose purchase was made through an intermediary rather than directly from a defendant) by adducing an expert methodology that could demonstrate the existence of some loss to some purchasers at the "indirect purchaser level" – a standard far lower relative to the standard of certification that exists in other areas of law in Canada or in U.S. courts. The Court also found that section 36 of the *Competition Act* is not a "complete code" for civil claims seeking compensation for anti-competitive conduct. In other words, the Court found that class plaintiffs may assert parallel claims in tort and in restitution that rely on a violation of the *Competition Act* – thereby accessing remedies in the form of disgorgement of profits and punitive damages.

In addition, the Court held that the class plaintiffs could assert claims on behalf of a broader class that included "umbrella purchasers" – namely, purchasers who had purchased the disputed product from suppliers/competitors who were **not** involved in the alleged price-fixing conspiracy. The Court acknowledged that the inclusion of "umbrella purchasers" could increase the exposure of defendants, but the Court concluded that such an interpretation would advance the deterrence functions of the *Competition Act*.

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And, in another favourable ruling for the plaintiffs' bar, the Court found that the two-year limitation period in section 36 of the *Competition Act* incorporates a principle of discoverability – namely, it remained open for a class plaintiff to assert claims under the *Competition Act* in respect of historical conduct, provided that the class plaintiff could establish that the disputed conduct could only reasonably have been discovered within the two-year window.

Finally, and perhaps most importantly, the Court underscored that the certification of a class and the identification of a number of common issues did nothing to diminish the class plaintiffs' significant burden to establish liability to a class at the common issues trial. In a helpful ruling, the Court noted that, in order for individual class members to be entitled to a remedy at trial, "the trial judge must be satisfied that each has actually suffered a loss where proof of loss is essential to a finding of liability." In summary, the Court has provided important direction on a number of key issues relating to the certification of competition class actions in Canada. And while a number of those rulings favoured the plaintiffs' bar, the Court strongly signalled that the fate of many of these cases will have to be determined at trial.

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CONSTRUCTION

Prompt payment movement hits Canadian construction and infrastructure sector

Prompt payment and mandatory adjudication legislation is being enacted across Canada in an effort to alleviate perceived payment delays down the construction pyramid. A watershed moment came in 2019 when such legislation came into force in Ontario through amendments to the *Construction Act* (formerly the *Construction Lien Act*). The development industry in Ontario is consumed with revising internal processes and re-drafting contracts to address the new rules, and will be grappling with the inevitable growing pains caused by the new legislation for some time. In the meantime, a number of other jurisdictions in Canada, including the federal government, are following Ontario's lead.

What changed on October 1, 2019 in Ontario?

Mandatory prompt payment

The prompt payment regime introduces swift payment deadlines that were inspired by similar reforms introduced over 20 years ago in the United Kingdom. The clock starts ticking once the owner receives a "proper invoice" from its general contractor, either on a monthly basis or as otherwise agreed in the contract. The owner must either pay within 28 calendar days (Figure 1) or dispute within 14 calendar days, describing the reasons for non-payment (Figure 2). In turn, the contractor must either pay its subcontractors within seven calendar days of receipt of payment (Figure 1) or send notices of dispute within seven calendar days (Figure 2).

FIGURE 1: PROMPT PAYMENT TIMELINES

- **DAY 0** Owner receives proper invoice from contractor
- **DAY 28** Owner must pay contractor
- **DAY 35** Contractor must pay subcontractor
- **DAY 42** Subcontractor must pay its subcontractor

> The clock starts ticking once the owner receives a "proper invoice" from its general contractor.

Figure 2 illustrates the cascading notices of non-payment starting from the owner to the contractor and subcontractors down the construction pyramid.

FIGURE 2: TIMELINES FOR NOTICE OF NON-PAYMENT

- **DAY 0** Owner receives proper invoice from contractor
- **DAY 14** Owner must give notice of non-payment to contractor
- **DAY 21** Contractor must give notice of non-payment to subcontractor
- **DAY 28** Subcontractor must give notice of non-payment to its subcontractor

Owners, in particular, must align their internal processes to consult, complete and articulate the results of their invoice review within 14 days of receipt. This is because any failure of the owner to object to the invoice by issuing a notice of non-payment to the contractor within this time period will result in the owner being obliged to pay the contractor the full amount of that proper invoice within the required 28-day timeframe, despite any subsequent objections. To avoid this unfortunate situation, owners should also have their external consultants shorten their invoice review periods, and negotiate appropriate amendments to any credit or funding agreements, to minimize any impediments to objecting or funding within these timeframes.

Contractors must also be aware of the operation of applicable flow-down/flow-up provisions. For example, unpaid contractors who issue a notice of non-payment to a subcontractor must also include an undertaking from the contractor to refer the matter to adjudication within 21 calendar days of issuing the notice of non-payment. If the contractor was not already planning to do so, this provision therefore forces the contractor to initiate an adjudication against the owner within this timeframe, as discussed below.

Mandatory adjudication

Introduced by the *Construction Act*, adjudication is a quick interim method to resolve disputes on a construction project. An adjudication must begin prior to completion of the contract or subcontract, unless the parties agree otherwise.

Any party to a contract or subcontract may refer a dispute to adjudication by giving a written notice of adjudication to the other party to the dispute. The notice of adjudication initiates the process and extremely tight timelines follow, culminating in the adjudicator's determination. The adjudication regime in Ontario will be administered and overseen by a new entity called the Ontario Dispute Adjudication for Construction Contracts (ODACC).

The parties may agree to an adjudicator or request ODACC to appoint an adjudicator. If the adjudicator selected by the parties does not consent to adjudicate the matter within four calendar days after the notice of adjudication is given, it is mandatory for the referring party to request ODACC to appoint an adjudicator. Somewhat strangely, neither the *Construction Act* nor the regulations prescribe a timeframe for making this request, though presumably the referring party will have an interest in doing so as quickly as possible. On receiving a request for appointment from the referring party, ODACC must appoint an adjudicator within seven days.

ODACC has prepared four pre-designed adjudication processes, with flat adjudicator fees ranging from $800 to $3,000, to assist the parties and the adjudicator in determining the best process for a particular dispute. Interestingly, three of the four processes are to be conducted in writing only, while the fourth process allows oral presentations. The oral presentations under that process will be conducted by either videoconference or teleconference, but not in person. Further, each oral presentation is limited to 30 minutes per party. Each process also sets out page limits for the parties' submissions and the adjudicator's determination. Alternatively, the adjudicator has the power to conduct the adjudication in the manner he or she considers appropriate. This will permit flexibility for more complex disputes.

The adjudicator must give his or her determination within 30 days of receiving the required documents. If a party fails to make a payment within 10 days of the adjudicator's determination, the contractor or subcontractor, if it is the successful party, is entitled to suspend further work under the contract or subcontract.

Other amendments

Ontario is the only jurisdiction with a prompt payment and adjudication regime layered on top of an existing construction lien regime. To a large degree, the intersections with liens have been considered. Lien periods have been extended to allow for disputes to be resolved before liens are used to enforce payment. As a result, starting July 1, 2018, the deadline for preserving a lien was extended from 45 days to 60 days, and the deadline for perfecting a lien was extended from 45 days to 90 days. Interestingly, the *Construction Act* allows an extension to the time for the preservation of a lien, if the issue that is the subject matter of the lien is also the subject matter of an adjudication; this may lead to unexpected results when the owner attempts to determine when a lien period expires.

What's happening elsewhere in Canada?

At the federal level, the *Federal Prompt Payment for Construction Work Act*, which addresses the non-payment of contractors and subcontractors performing construction work for federal construction projects, was first introduced and passed as part of a larger budget bill on June 21, 2019. However, it is not yet in effect. Once in force, it surprisingly will not grandfather existing contracts; instead, it will provide for a one-year deferral period before it applies to existing contracts. At that point, it may be imagined that the sudden application mid-performance of the new law to existing contracts drafted before the Act came into effect may be quite disruptive to those contracts.

As described in our Canadian prompt payment and construction law reforms page on osler.com, some other provinces, such as Nova Scotia and Saskatchewan, have just passed legislation of their own that follows Ontario's approach. Similar to the *Construction Act* amendments in Ontario, Québec adopted Bill 108 in December 2017, authorizing the implementation of pilot projects to test construction law reforms aimed at facilitating public contract payment. In August 2018, the "Pilot project to facilitate payment to enterprises that are parties to public construction work contracts and related public subcontracts" was implemented, which established a prompt payment and adjudication scheme that is similar to Ontario's, but limited its scope to the public sector. This project is being implemented in two phases, the first of which is underway and affects contracts relating to the Société Québécoise des Infrastructures and to the Ministry of Transport, and the second of which will extend to contracts in the education, healthcare and social service sectors.

Still other provinces, namely New Brunswick, Manitoba, Alberta and British Columbia, are either implementing other initiatives in relation to prompt payment, or considering what form prompt payment and adjudication should take in their provinces. Such provinces are having some interesting discussions regarding whether the "Ontario model" is right for them.

Some other provinces, such as Nova Scotia and Saskatchewan, have just passed legislation of their own that follows Ontario's approach.

What will the federal law mean for federal construction projects located in provinces that have passed prompt payment legislation, such as Ontario, Nova Scotia and Saskatchewan, and others who plan to do so in the future? At present, it is not clear, although the federal government may choose to exempt federal projects from the federal regime either individually or on a province-wide basis in cases where equivalent provincial legislation has been adopted. However, given the constitutional considerations regarding jurisdiction, it will be interesting to see what approach the federal government chooses to take in such situations.

Conclusion

Across Canada, all actors in the construction pyramid are adjusting to the new reality of prompt payment and adjudication. In the coming months, it will be interesting to see what rules are adopted in provinces outside Ontario and how the new regimes are implemented in practice.

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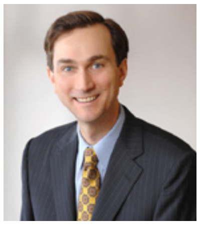

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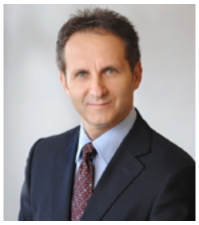

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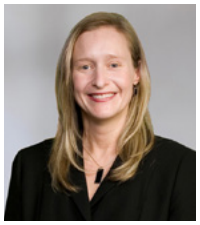

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INTELLECTUAL PROPERTY

Game changer: Canada overhauls key intellectual property statutes

In 2019, Canada finally made good on its promises to modernize its intellectual property (IP) rights registration system, bringing into force key amendments to the *Trademarks Act*, the *Patent Act* and their respective regulations. The laudable goal of these changes is to further harmonize Canadian and foreign IP prosecution practice and fulfil the government's objective to make investing in Canadian IP as competitive and frictionless as possible. The next step is for the Canadian government to implement an ambitious experimental IP strategy.

Overhaul of the *Trademarks Act* and Regulations

In June 2019, myriad legislative amendments came into force, together with significant practice changes at the Canadian Intellectual Property Office (CIPO). Many of these changes had been anticipated for some time as they stem from the implementation of three important trademark treaties, first announced in 2014: (1) the *Protocol Relating to the Madrid Agreement Concerning International*

Registration of Marks; (2) the *Singapore Treaty on the Law of Trademarks*; and (3) the *Nice Agreement Concerning International Classification of Goods and Services*. Key changes include

- the elimination of grounds for filing
- the elimination of the requirement to file a declaration of use to obtain a registration
- the implementation of the Nice classification and charging of per class government fees
- changes to the definition of "trademark" to permit registration of new categories of non-traditional trademarks, including 3D and holograms
- the shortening of the Canadian trademark registration term, from 15 to 10 years
- procedural changes to the trademark opposition regime
- the introduction of examination for distinctiveness

Initial criticisms of these amendments included concerns that eliminating proof of use would precipitate widespread trademark squatting and increase contentious proceedings. Some of these concerns were addressed in 2018 with the introduction of a "bad faith" ground of opposition into the proposed amendments. Case management provisions and costs awards were also added, as well as a requirement to demonstrate use in cases where a registrant seeks to enforce trademark rights in the first three years following registration. Provisions were also included to limit the scope of official marks no longer active or in existence.

Many changes were designed to simplify the trademark registration process and encourage more brand owners to protect their marks in Canada. Paradoxically, prior to the amendments coming into force, many brand owners rushed to file their mark in Canada to avoid paying "per class" filing fees, which now apply.

While the 2019 amendments have brought a welcome simplification of the registration of trademarks in Canada, the new regime is also likely to subject brand owners to increased costs and added pressure to be vigilant in monitoring CIPO filings for potentially conflicting third-party marks. The *Trademarks Act* changes are therefore likely to result in more opposition and cancellation proceedings. What remains to be seen is whether the elimination of the use requirement for Canadian trademark applicants will precipitate speculative filings and other types of objectionable behaviour.

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Long-awaited changes to the *Patent Rules*

On October 30, 2019, new Canadian *Patent Rules* and amendments to the *Patent Act* also came into force. These amendments have brought significant changes to Canadian patent practice. Although the details of these technical amendments go beyond the scope of this publication, their overall effect is to shorten delays and enhance procedural certainty in the prosecution of Canadian patent applications. For example, the *Rules* include a number of changes:

National phase entry of PCT application: Previously, a Patent Cooperation Treaty (PCT) application could enter national phase in Canada, as of right, as late as 42 months from the priority date on payment of a late fee. For international applications filed after October 30, 2019, late entry will no longer be permitted as of right, with the national phase deadline being set at 30 months, subject to exceptions.

Direct Canadian filing: Previously, to obtain a filing date, a Canadian patent application had to include a description of the invention in English or French and be accompanied by the payment of a filing fee. Under the new *Rules*, a description can be filed in any language, and the filing fee and a translation into English or French can be deferred.

Examination request: Formerly, the deadline for filing a request for examination was five years from the Canadian filing date, with related rules for divisional applications. Under the new *Rules*, the deadline for requesting examination is shortened to four years from the filing date, with correspondingly shorter deadlines for divisional applications.

Official action deadlines: The standard deadline for responding to official actions is now shortened to four months, from six. Extensions of up to two months can be obtained at the discretion of the Patent Office on payment of an extension fee and by submitting reasons for the request.

Allowance and amendments after allowance: Under the new *Rules*, patent applicants will have four months after the Notice of Allowance to pay their final fee. Moreover, prosecution of an application may be reopened, and an application amended by requesting withdrawal of the Notice of Allowance within four months of its issuance and before payment of the final fee.

Third-party rights: Under the new *Rules*, third-party rights may arise when an application is deemed abandoned because of a failure to request examination or pay a maintenance fee by the prescribed deadlines or after non-payment of a maintenance fee for an issued patent. The period during which third-party rights are applicable starts six months from the original maintenance fee or examination request due date.

With these and numerous other technical amendments, the *Rules* aim to make obtaining Canadian patents faster, more certain and generally more attractive for all applicants.

Canada's experimental IP strategy

Over the last five years, Canada has committed to increasing protection for intellectual property rights in a series of international trade agreements. These commitments have put the onus on Canadian businesses to capitalize on these IP protections by developing market-leading IP positions, notably in strategic industries, such as artificial intelligence and green energy.

With this overarching goal in mind, the Canadian government released a novel IP strategy in 2019, which includes pilot initiatives designed to make IP more accessible. For example, ExploreIP is a government-administered IP marketplace designed to demystify and provide access to patents awarded to Canadian public sector entities. In addition, the federal government announced a $30-million investment in the Innovation Asset Collective, a new non-profit patent collective that will hold strategic cleantech patents for the benefit of Canadian small and medium-sized enterprises.

These experimental measures aim to be first steps toward building a Canadian IP ecosystem that will foster the growth of IP in Canada. These measures are also intended to complement the recent legislative changes to Canada's key IP statutes and to encourage Canadian businesses of all sizes to invest in, and benefit from, registered intellectual property rights.

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CANNABIS

Cannabis in Canada: No longer just getting started

The legalization of the recreational or “adult-use” cannabis market in 2018 brought with it some growing pains, including initial distribution and supply chain issues, as well as the effect of the illegal market, which continues to thrive. Through 2019, provinces and territories were looking to overcome these challenges by considering changes to their age of consumption, as well as their retail licensing, distribution and wholesale models. At the federal level, Canada legalized three new classes of cannabis products: edibles, topicals and extracts. These additions are expected to change the legal cannabis landscape significantly. However, before these new classes are even available for legal sale, the market has been affected by adverse events allegedly relating to consumers vaping illicit cannabis products. These events have created some cautious attitudes towards cannabis companies’ risk profiles.

In addition, declining share prices appear to have slowed the pace of public offerings by cannabis companies in the later part of the year and may lead to increased M&A activity and market consolidation in the industry in 2020. Enterprises that were early and fast movers in the sector and that successfully executed strategic partnerships, cornerstone investments, take-privates and capital raising transactions that resulted in strong balance sheets can expect to prevail in the industry. The cannabis industry is here to stay, notwithstanding the current market climate.

Purported supply issues and continued illegal sales

Following legalization, the Canadian media reported rampant consumer complaints about national supply shortages of legal cannabis for the adult-use market. The reality is that despite cannabis being legally available for adult use, many Canadians continue to purchase cannabis through illegal sources. According to results from Statistics Canada's National Cannabis Survey, as of the third quarter of 2019, a large percentage of Canadians surveyed continued to report obtaining cannabis from illegal sources in 2019 (42%).

The reality is that despite cannabis being legally available for adult use, many Canadians continue to purchase cannabis through illegal sources.

The Ontario provincial government cited federal supply shortages as the cause for consumers' inability to access legal cannabis, resulting in the illegal market continuing to flourish. Health Canada, however, has maintained that the supply of cannabis is not the cause of Canadian consumers' hampered access to legal cannabis. Perhaps substantiating this claim, Health Canada also published data based on the information compiled from the Cannabis Tracking System which demonstrates that cannabis inventories (i.e., cannabis held in stock by a licensed cultivator, processor, distributor or retailer that is packaged, labelled and ready for sale) exceeded cannabis sales (both medical and non-medical) in each month from October 2018 to August 2019.

Provinces implement and adjust new legislation

The federal *Cannabis Act* confers on provinces and territories the authority to regulate a variety of aspects of adult-use cannabis in Canada, including retail and online sales and minimum age requirements.

(a) Ontario retail stores

Prior to legalization, each province and territory established its own legislative regime to permit the operation of retail and online stores. However, in Ontario, it was not until April 1, 2019 – a number of months after federal legalization of cannabis for adult use – that consumers were able to purchase cannabis from a licensed brick-and-mortar retail store.

The *Cannabis Licence Act* (Ontario) initially restricted the retail store allocation in Ontario to just 25 stores. Persons wishing to apply for a retail licence did so by submitting an expression of interest. The Alcohol and Gaming Commission of Ontario (AGCO) then ran a lottery to select 25 prospective licencees. Approximately 17,000 expressions of interest were submitted to the AGCO in January 2019 for these 25 coveted retail licences.

On July 3, 2019, Ontario announced that a second lottery would be held for an additional 42 licences to be allocated to private retailers in Ontario. Eight more licences were made available for retailers on First Nations reserves in the province.

Some of the larger publicly-listed cannabis licence holders have stated that the lack of retail stores in Ontario has played a role in earnings results being lower than anticipated. We expect that the Ontario government will make changes to the licensing regime to remove the cap on the number of retail stores in Ontario in the near future to open the retail store market.

(b) Proposed age restrictions for adult-use cannabis in Québec

In late 2018, proposed legislation was tabled in Québec to increase the minimum age requirements for cannabis use from 18 to 21. With the adoption of Bill 2, the change in legal age of consumption will come into effect on January 1, 2020. Québec's provincial law society, the Barreau du Québec, previously warned lawmakers that legislation setting the minimum age above 18 (the legal drinking age in Québec) would be susceptible to legal challenge under section 15 of the *Canadian Charter of Rights and Freedoms* which prohibits discrimination on the basis of age.

Bill 2 also introduces a ban on consumption in public spaces such as parks and on sidewalks. Municipalities however will be allowed to authorize the consumption of cannabis in certain public areas where there are no children present.

New classes of cannabis – edibles, topicals and extracts become legal

As described in more detail in our Osler Update "Health Canada releases final regulations for new classes of cannabis," on October 17, 2019, the federal *Cannabis Act* and Cannabis Regulations were amended to add three new classes of cannabis: (a) edible cannabis, (b) cannabis extracts and (c) cannabis topicals. However, given that the Cannabis Regulations require federal licence holders to provide 60 days' notice to Health Canada before any new cannabis product can be made available for sale, the earliest legal sales of such products can occur is mid-December 2019.

Each of these new classes of cannabis are subject to limitations on the amount of tetrahydrocannabinol (THC) that may be contained in the product. THC is a phytocannabinoid that produces the "high." In addition, products that mix cannabis with either alcohol or tobacco will not be available for legal sale.

(a) Edible cannabis

Under the Cannabis Regulations, edible cannabis means a substance or mixture of substances containing any part of a cannabis plant, including the phytocannabinoids produced by or found in such plant and any substance identical to any such phytocannabinoid, and that is intended to be consumed in the same manner as food.

There are a number of restrictions on edible cannabis products, including (a) the requirement to meet general food safety standards, and (b) the prohibition on the addition of vitamins, minerals and caffeine (other than at naturally occurring levels).

There is also a restriction that provides that cannabis licence holders must not produce, package, label or store edible cannabis at a site if food that is for retail sale is also manufactured at that site unless the food for retail sale is manufactured in a different building.

(b) Cannabis extracts

Cannabis extracts are products produced by (a) subjecting cannabis to extraction processing, or (b) synthesizing a substance found in a phytocannabinoid produced by or found in a cannabis plant.

Cannabis extracts cannot contain (a) ingredients that are sugars, sweeteners, sweetening agents, amino acids, caffeine, colouring agents, essential fatty acids, glucuronolactone, probiotics, taurine, vitamins or mineral nutrients, and (b) ingredients that may cause injury to the health of the consumer when the product is used as intended.

(c) Cannabis topicals

Cannabis topicals are substances that are intended for use, directly or indirectly, exclusively on external bodily surfaces (e.g., lotions or creams). Cannabis topicals are not permitted to contain any ingredients that may cause injury to the health of the consumer when the product is used as intended or in a reasonably foreseeable way.

Potential litigation

Adverse events, allegedly related to consumers vaping illicit products containing THC, have served as a reminder of the potential product liability litigation risks for the cannabis industry. Indeed, the Nova Scotia Court of Appeal's decision in *Downton v. Organigram* marked the first certification of a cannabis product liability class action in Canada.

As might be anticipated when a public company suffers a decline in its share price over a period of time, several securities class action lawsuits have been filed against some of the larger cannabis companies in the wake of falling share prices.

Looking forward

Although the legislative landscape has evolved significantly over the past year and growing pains have been felt in several areas, we expect that the cannabis industry will continue to grow and progress. Looking forward to 2020 and beyond, we are monitoring several areas:

- further changes to provincial retail sales, distribution and wholesale models in Canada to expand the role of private participants and potentially permit more vertical integration within the Canadian cannabis industry
- the introduction of new cannabis edible, topical and extract products as additional partnerships are formed in the industry and research continues to advance, both in Canada and internationally

Although the legislative landscape has evolved significantly over the past year and growing pains have been felt in several areas, we expect that the cannabis industry will continue to grow and progress.

- potential litigation and its effect on cannabis companies' risk profiles – particularly, potential product liability or securities class action claims
- the continued evolution of the United States market, as discussed in Cannabis in the United States – The Laws of the Land in 2019, and its likely impact on Canadian companies and in particular, Canadian companies' ability to continue to lead the marketplace
- the likely continuing uncertainty and confusion in the marketplace relating to products containing cannabidiol (CBD), as Canada continues to regulate the sale of CBD products the same way as other cannabis products and the United States takes a more lenient approach to CBD products derived from industrial hemp

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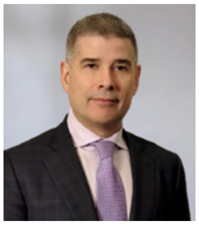

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CANNABIS

Cannabis in the United States: The laws of the land in 2019

Canada made history in October 2018 by becoming the first major country in the world to legalize the "adult use" of cannabis for recreational purposes at both the federal and provincial government levels. That watershed development in Canada was all the more significant in contrast to the regulatory morass in the United States, where state laws legalizing cannabis for medical or recreational use continued to be overshadowed by the U.S. federal law decreeing the cultivation, sale and use of cannabis to be a federal crime across every state in the land, even for the most compelling medical purposes.

This progress continued in Canada in 2019, as we discuss in our article on Canadian cannabis developments.In the United States, as 2019 draws to a close, cannabis is legal for medical use under state law in more than 30 states, and is even legal for adult recreational use under state law in more than 10 states. However, cannabis continues to be illegal under U.S. federal law in all states – unless it is hemp.

CBD is everywhere!

It is impossible to walk down the streets of most major U.S. cities these days without losing count of the number of stores selling CBD in one form or another. But what is CBD? Cannabidiol, or CBD, is a cannabinoid that does not intoxicate the user. It is showing up everywhere in the United States – in food, drinks, capsules, tinctures, balms, vapes, oils, creams, gels, lotions and potions. While it does not make you high, CBD has become something of a health fad, with its proponents pointing to its value for pain management, reduction of anxiety and depression, and other health and wellness benefits.

CBD is the white sheep in the cannabinoid family. Its more rambunctious sibling tetrahydrocannabinol (THC) is the cannabinoid that makes you high.

Since the end of 2018, following the signing into law of the federal *Agriculture Improvement Act of 2018* (the 2018 Farm Bill), the U.S. cannabis market is now divided in two, as far as the federal *Controlled Substances Act* is concerned. One of the prohibited substances listed in Schedule I to the *Controlled Substances Act* is "marihuana." Under the definition of that term prior to the 2018 Farm Bill, all types of cannabis were a federally prohibited illegal substance, just like heroin and morphine. However, the 2018 Farm Bill changed the definition of "marihuana" to exclude cannabis that has not more than 0.3% THC on a dry weight basis, which is now called "hemp."

As a result, in the United States, hemp is no longer marihuana, even though both hemp and marihuana are cannabis. Only marihuana is federally prohibited under the *Controlled Substances Act*, while hemp, and CBD products made from hemp, are not. And to add to the mix from a cross-border perspective: in Canada, although there is a separate regime regulating industrial hemp, the *Cannabis Act* itself makes no such distinction. This means that most of the CBD products now being sold in the United States are subject to the same regulations in Canada that apply to cannabis with more than 0.3% THC.

Unfortunately, however, it is not quite as simple as removing hemp from the definition of marihuana in the *Controlled Substances Act*. While CBD products made from hemp are no longer federally illegal in the United States under the *Controlled Substances Act*, they are still subject to the U.S. federal *Food, Drug and Cosmetic Act*, which makes them subject to regulation by the Food and Drug Administration (the FDA). If a CBD product is sold with a claim that it can cure or prevent a disease, it is a "drug" and must be approved by the FDA before it can be sold in the United States in compliance with U.S. federal law.

Moreover, if a CBD product is sold as a food additive, it must be approved by the FDA as a food additive by regulation, or fit within the FDA's criteria for a substance that is "generally recognized as safe" (GRAS). However, a food additive cannot qualify as GRAS if it is an active ingredient in an approved drug or a study drug, unless it was sold for use in food before being investigated as a drug in clinical trials. For this reason, a number of CBD products being sold in the United States are labelled as "hemp oil" rather than CBD, since CBD arguably was studied as a drug before being used in food.

So the legality of CBD under U.S. federal law actually depends on your view of whether improper claims are being made about its usefulness, whether the active ingredients are sufficiently dissimilar to anything previously studied as a drug without having been used in food before then, whether the FDA will take the same view that you do, and whether a judge hearing an enforcement proceeding will take the same view as the FDA.

And, ironically, while federal law is the source of the problem with selling cannabis that has enough THC to qualify as marihuana in the states where it is legal under state law, there are a handful of states where the problem is the opposite, and all THC, CBD, marihuana and hemp products remain illegal at the state level.

Nevertheless, CBD products are being sold all across the United States, and if they are made from hemp instead of marihuana, and legal under state law, and do not violate the U.S. federal *Food, Drug and Cosmetic Act*, they just may in fact be legal, or close enough to being legal to avoid a successful prosecution by the FDA.

Marijuana is still federally illegal! (but we're working on it)

If a cannabis plant has more than 0.3% THC by dry weight, then under the U.S. federal *Controlled Substances Act* it is marihuana, not hemp, and it remains a federally prohibited substance just like cocaine. It does not matter what state law has to say about it, or whether it is being used for recreational or medical purposes.

And yet, marihuana – cannabis with enough *intoxicating* THC to make it federally illegal, is a multibillion-dollar industry in the more than 30 states where it is legal under state law. What keeps the wheels of that industry turning is a fairly high degree of confidence that the risk of enforcement of the federal law prohibition is relatively low, at least for those who are not tied to organized crime, or other unsavoury characters.

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There are, however, many financial industry participants, professional services providers and others who find it especially challenging to participate in an industry that runs afoul of U.S. federal law. While more than 550 banks and 150 credit unions are already providing banking and financial services to the cannabis industry, the vast majority do not. Those that do must file "suspicious activity reports" (SARs) routinely with the U.S. Financial Crimes Enforcement Network (FinCEN), and demonstrate to their prudential regulators that they are following prescribed guidelines when dealing with cannabis companies. Most major federal financial institutions still will not deal with U.S. cannabis growers (at least not those growing marihuana), nor will most investment banks, or the U.S. stock exchanges. And while politicians almost never agree about anything, almost all of them agree that the current disconnect between state and federal law when it comes to marihuana is untenable.

There are three separate legislative proposals underway in an effort to untangle this knot: SAFE, STATES and MORE:

- **SAFE:** The *Secure And Fair Enforcement (SAFE) Banking Act* is a bill to protect banks working in the marihuana industry from enforcement action by federal banking regulators. While financial institutions would still have to comply with FinCEN guidance, there would be express protections from liability for providing financial services to the industry, the bank would be protected against having its deposit insurance cancelled, and proceeds from the sale of marihuana would be deemed not to be proceeds of crime under federal money laundering laws. SAFE was passed by the Democrat-controlled House of Representatives in September 2019, but despite some cautious optimism, its chances of being passed by the Senate remain unclear.

- **STATES:** The *Strengthening the Tenth Amendment Through Entrusting States Act* (the STATES Act) would amend the U.S. federal *Controlled Substances Act* to exclude activities involving marihuana taking place in states where those activities are legal under state law. Proceeds of state-law-compliant sales of marihuana would not be proceeds of crime for money laundering or other purposes. The bill was introduced in April 2019, but does not appear to be going anywhere quickly.
- **MORE:** The *Marihuana Opportunity Reinvestment and Expungement Act of 2019* (the MORE Act) was introduced in July 2019. It would remove marihuana entirely from Schedule I to the federal *Controlled Substances Act*, putting an end to its illegality under U.S. federal law as a controlled substance, even in states where it was not legal under state law. But wait, there is more to MORE – in the form of more taxes. The bill would impose a national 5% tax on cannabis products (excluding hemp) that are manufactured in or imported into the United States, with the funds raised from this tax to be used to fund a number of social justice programs. The bill was passed by the House Judiciary Committee in November 2019 and is heading to a full House vote, but there is little optimism for Senate approval.

These legislative attempts to resolve the current conflict between federal and state laws are valiant, but SAFE, which is considered the most likely of the three to have a chance of becoming law, would only ease the tension in the financial industry and not resolve all of the problems faced by marihuana growers themselves. And while STATES may have some prospect of surmounting the challenges to passing both the House and Senate eventually, the chance of Senate approval seems less for MORE.

Conclusion

CBD seems to be everywhere in the United States this year, thanks to the 2018 Farm Bill. While there are still questions about the extent of its legality under federal law, we have made significant progress of a sort, as those issues are now within the purview of the FDA under the *Food, Drug and Cosmetic Act* instead of the Drug Enforcement Administration (DEA) under the *Controlled Substances Act*. Marihuana, or cannabis with more than 0.3% THC, continues to be illegal under the *Controlled Substances Act*, putting federal law at odds with the law in a majority of U.S. states. Will STATES, MORE or some other legislative initiative finally resolve that problem in 2020? While it is too soon to say, we can certainly have high hopes.

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U.S. CAPITAL MARKETS

Less is more: SEC works to simplify disclosure and other U.S. developments

In 2019, the U.S. Securities and Exchange Commission (SEC) continued working to simplify public company disclosure requirements, broadened the popular “test-the-waters” rules for emerging growth companies to make them available to all companies and focused attention on the prominent role of proxy advisory firms in the U.S. proxy process.

Rolling with the times – SEC moves to modernize and simplify disclosure requirements

In March, the SEC took steps to modernize and simplify the disclosure requirements for registration statements and periodic reports, with new rules becoming effective in May. The changes were aimed at reducing compliance costs for public companies, providing more useful and less repetitive information to investors and curbing some requirements to include non-material information.

Notable changes include

- **Confidential treatment process:** Registrants may now redact confidential information in material contracts filed as exhibits to registration statements and periodic reports, provided that the redacted information is not material and would likely cause competitive harm to the registrant if publicly disclosed, without having to first submit a confidential treatment request to the SEC for review and approval.
- **Exhibit requirements:** Registrants may now omit immaterial schedules and attachments from all filed exhibits, rather than only from exhibits that are material acquisition or reorganization agreements.
- **MD&A disclosure:** In periodic reports, registrants may now omit from discussion in their MD&A the earliest of the three fiscal years covered by the financial statements included in the periodic report, if any prior filings with the SEC already contained a discussion of that year and the discussion of that year is not necessary for investors to understand the registrant's current financial condition.
- **Physical property descriptions:** The requirement to describe physical properties now only requires disclosure of physical properties that are material to the registrant, and no longer requires disclosure of properties that are not material to the registrant.

In August, the SEC also announced proposed amendments to modernize the business, legal proceedings and risk factor disclosure requirements in Regulation S-K, which is the regulation that prescribes most of the SEC disclosure requirements applicable to U.S. domestic registrants.

The SEC is proposing amendments to the disclosure requirements regarding the general development and description of the registrant's business:

- **Principles-based disclosure:** Instead of prescribing specific "line item" disclosure points, the new requirements would be based on the principle that a registrant should disclose information that is material to an understanding of the general development of a registrant's business. The rules would provide examples of the types of information that may be appropriate to disclose (including material changes to a previously disclosed business strategy), but not be limited to those examples or require that disclosure be provided regarding any of the examples that are not actually material to the registrant.
- **Focus disclosure on developments:** In filings made after a registrant's initial filing, the registrant may provide only an update of the general development of its business that focuses on material developments during the reporting period, with an active hyperlink to the registrant's most recent filing that, read together with the update, will provide a full discussion of the general development of the registrant's business.

Disclosure requirements for legal proceedings would be simplified and modernized by

- allowing required information about material legal proceedings to be provided by including hyperlinks or cross-references to legal proceedings disclosure located elsewhere in the document in order to avoid duplicative disclosure

- revising the US$100,000 threshold for disclosure of environmental proceedings involving the registrant to which the government is a party to US$300,000 to adjust for inflation

Risk factor disclosure requirements would be revised by

- providing guidance discouraging the inclusion of generic risk factors and requiring summary risk factor disclosure at the beginning of the risk factors section if that section exceeds 15 pages
- refining the principles-based approach to risk factor disclosure by changing the disclosure standard from the "most significant" factors to the "material" factors required to be disclosed
- requiring risk factors to be organized under relevant headings, with any risk factors that may generally apply to an investment in securities being disclosed at the end of the risk factor section under a separate caption

Corresponding changes would also be made to corresponding items in Form 20-F, which is the form of annual report used by non-MJDS companies qualifying as foreign private issuers.

Generally, the adopted and proposed changes will not have a significant impact on Canadian registrants using MJDS because those companies are primarily subject to prescribed disclosure requirements under Canadian securities laws instead of Regulation S-K or Form 20-F. However, the adopted and proposed changes have applicability to Canadian registrants that report on U.S. domestic forms (such as annual reports on Form 10-K and quarterly reports on Form 10-Q) or that file annual reports on Form 20-F.

The changes will not have a significant impact on Canadian registrants using MJDS and primarily affect Canadian registrants that report on U.S. domestic forms or that file annual reports on Form 20-F.

It's okay to M&A – SEC proposes to ease disclosure requirements relating to business acquisitions and dispositions

In May, the SEC proposed amendments to the financial statement disclosure requirements for business acquisitions and dispositions.

Among the significant proposed changes to these rules are amendments

- reducing the maximum period for which historical annual audited financial statements for an acquired business are required, depending on significance, from three fiscal years to two fiscal years (eliminating the current requirement to include three years of historical financial statements of the target for an acquisition that exceeds 50% significance)
- eliminating the requirement for financial statements of an acquired business to be separately presented once the results of the acquired business have been reflected in the acquiring company's audited financial statements for a complete fiscal year, regardless of the significance of the acquisition
- revising the "investment" test and "income" test used to determine the significance of an acquisition or disposition to more closely align with the actual economic significance of the transaction to the registrant and expanding the use of filed pro forma financial information when measuring significance

- increasing the threshold under the significance tests for dispositions to only require pro forma financial information if the disposition is significant at the 20% level rather than the 10% level (to conform to the required significance threshold for acquisitions) and to otherwise conform the tests used to determine significance of a disposed business to those used to determine significance of an acquired business
- amending the pro forma financial information requirements to permit additional "management adjustments" to reflect reasonably likely effects of the transaction, in addition to the currently permitted and required adjustments

Although the SEC's requirements for financial disclosures under Regulation S-X will not apply to Canadian registrants using MJDS forms, there are many cases where MJDS forms cannot be used in certain types of M&A transactions, such as those in which a Canadian registrant is acquiring a U.S. domestic public company through a merger or a share exchange. As a result, the proposed changes, if adopted, could significantly benefit Canadian registrants undertaking those types of M&A transactions.

Opening the test-the-waters floodgates

Traditionally, securities laws in the United States made it difficult to test the waters before a public offering. Meetings with prospective investors to discuss their possible interest in a securities offering could be viewed as unlawful offers of the security, which were historically prohibited as "gun jumping" before a registration statement relating to the offering had been filed with the SEC.

Since 2012, the traditional rules have been changing. Under the *Jumpstart Our Business Startups Act* (the JOBS Act), the ability to test the waters with institutional investors first became available for an IPO or any subsequent public offering by an emerging growth company (EGC), as that term is defined by the JOBS Act, through the introduction of Section 5(d) under the U.S. *Securities Act*. In September, the SEC adopted a new rule to provide a second means of testing the waters with potential institutional investors that is available to all companies (Rule 163B), with an effective date of December 3, 2019.

Under new Rule 163B, any company and any person authorized to act on its behalf is permitted to engage in testing the waters communications. The result of the introduction of Rule 163B is that a broader range of issuers, not just EGCs, can more effectively consult with prospective institutional investors, better identify information that is important to prospective investors prior to embarking on a securities offering and, as a result, increase the likelihood of a successful offering.

Section 5(d) of the *Securities Act* remains available, in addition to Rule 163B, for any qualifying emerging growth company, and there may be advantages and disadvantages associated with using one rather than the other. Also, it is important to remember in the context of a cross-border securities offering that the Canadian test the waters rules work very differently from either Section 5(d) of the *Securities Act* or Rule 163B. Most notably, testing the waters in Canada can only be carried out by an issuer that has not yet completed an IPO, there are fairly formalistic requirements for obtaining confidentiality undertakings from prospective investors and no testing the waters meetings can be held in the fifteen-day period preceding the IPO preliminary prospectus filing.

For more information, please refer to the Osler Update entitled *"Testing the waters" before a public offering of securities: Navigating the rules, without getting all wet* on osler.com.

Amendments to proxy rules relating to proxy advisors

In November, the SEC proposed amendments to its proxy rules designed to help investors using proxy voting advisory services to receive more accurate, transparent and complete information from proxy advisory firms. The proposed amendments would require proxy advisory firms to make disclosure of their actual or potential conflicts of interest and introduce new procedures to provide registrants with an opportunity to review and provide feedback on proxy advice before it is disseminated to investors.

In explaining the background to its proposed amendments, the SEC noted that proxy advisory firms provide voting advice to thousands of clients that exercise voting authority over a significant number of shares voted annually. It is therefore vital that proxy voting advice be based on the most accurate information possible and that proxy advisory firms be transparent with their clients about the processes and methods used to formulate their advice.

Under the proposed amendments, proxy advisory firms would be required to prominently disclose in their advice

- any material interests, direct or indirect, of the proxy advisory firm (or its affiliates) in the matter or parties concerning which it is providing the advice
- any material transaction or relationship between the proxy advisory firm and the registrant, another soliciting person or a shareholder proponent, in connection with the matter
- any other information regarding the interest, transaction or relationship of the proxy advisory firm that is material to assessing the objectivity of the proxy voting advice in light of the circumstances of the particular relationship
- any policies and procedures used to identify, as well as the steps taken to address, any material conflicts of interest arising from such interest, transaction or relationship

The SEC also noted concerns that there could be factual errors, incompleteness or methodological weaknesses in the information and analyses of proxy voting firms that could materially affect the reliability of their voting recommendations and affect voting outcomes. The SEC stated that many registrants have also expressed concern that they lack an opportunity to review proxy voting advice before it is disseminated, as well as meaningful opportunities to engage with proxy advisory firms and to correct factual errors or methodological weaknesses in their analyses. Once voting advice is delivered to clients, which often occurs

The proposed amendments are designed to help investors receive more accurate, transparent and complete information from the proxy advisory firms which provide voting advice to thousands of clients annually, making transparency vital.

very shortly before a significant percentage of votes are cast, it is not possible for registrants to inform investors on a timely basis of their contrary views or to point out errors they have identified in the analyses.

As a result, the SEC is proposing measures intended to facilitate improved dialogue between proxy advisory firms and registrants and other proxy soliciting persons before voting advice is disseminated to clients. The proposed measures are also designed to provide a means for registrants and other proxy soliciting persons to provide their views about the advice before proxy advisory firm clients vote.

Under the proposed amendments

- if a registrant subject to the SEC's proxy rules files its definitive proxy statement with the SEC less than 45 but at least 25 calendar days before the date of its shareholders meeting, proxy advisory firms would have to provide the registrant (or other proxy soliciting person) at least three business days to review the proxy advice and provide feedback
- if the registrant files its definitive proxy statement 45 calendar days or more before its shareholders meeting, the advance review period would increase to at least five business days
- if, however, the registrant files its definitive proxy statement less than 25 calendar days before the shareholders meeting, proxy advisory firms would have no obligation to share their advice in advance of its dissemination to their clients

Proxy advisory firms would also be required to provide registrants and other proxy soliciting persons with a final notice of their voting advice no later than two business days prior to the dissemination of advice to clients, regardless of whether or not the registrant or other proxy soliciting person provided feedback during the review and feedback period.

In addition to the review and feedback period and final notice requirements, registrants and other proxy soliciting persons would also have the option to request that proxy advisory firms include in their advice a hyperlink directing the recipient of the advice to a written statement that sets forth the registrant's or other proxy soliciting person's views on the advice.

The SEC's proxy rules do not apply to Canadian companies that qualify as a "foreign private issuer," which is the case for most Canadian companies that are SEC registrants. However, the SEC's proposed amendments would apply directly to any Canadian registrant that does not qualify as a foreign private issuer and may also be indirectly significant in influencing the practices of Canadian proxy advisory firms.

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TAX

International tax: A year of transition

In 2019, global efforts towards international tax reform – spearheaded by the G20 and the OECD – continued to move forward. Two developments in particular are expected to have a major impact in Canada.

First, on December 1, 2019, the Multilateral Instrument (MLI) entered into force in Canada. The MLI – formally the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting – makes significant amendments to many of Canada's bilateral tax treaties. Chief among these is the adoption of the OECD-agreed mandatory "minimum standards" on tax treaty abuse. Also significant is Canada's choice to opt into mandatory binding arbitration for tax treaty disputes.

Second, recent proposals from the OECD to alter the manner in which global profits are allocated among countries – "BEPS 2.0" – would expand the taxing rights of market jurisdictions (Pillar One) and impose a global minimum tax on multinational enterprises (Pillar Two). If adopted, these measures will fundamentally change Canada's existing international tax framework. These proposals are currently being reviewed by Canada and other members of the G20 and the OECD, as well as the more than 130 countries comprising the Inclusive Framework on BEPS.

Some countries have already adopted unilateral measures to impose new taxes on digital services providers without waiting for a broader consensus on the OECD's proposals. In Canada, the governing Liberal Party – re-elected with a minority government in October 2019 – proposed a new 3% value-added tax on the income of businesses engaged in targeted advertising and digital intermediation services. This proposed new tax (included in the Liberal Party's election platform) would apply to such businesses with global revenues of at least C$1 billion and Canadian revenue of at least C$40 million, and would be eliminated once an international consensus is reached on the OECD's Pillar One proposals.

International tax treaties – Multilateral Instrument

The MLI entered into force in Canada on December 1, 2019 and operates to integrate tax treaty measures arising from the OECD/G20 BEPS Project with many of Canada's bilateral tax treaties. The MLI modifies a bilateral tax treaty where the MLI has been ratified by each treaty partner. A tax treaty to which the MLI applies is referred to as a "covered tax agreement." The coming-into-force provisions of the MLI are complex: the OECD's website features a "toolkit" – including a matching database – which assists in determining whether or not a bilateral tax treaty is a covered tax agreement, which provisions apply and when it comes into force. In Canada, the MLI will apply to covered tax agreements (a) on January 1, 2020 for withholding taxes, and (b) for other taxes (including capital gains taxes), for tax years beginning on or after June 1, 2020 (which for calendar year taxpayers would be January 1, 2021).

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Most significantly, the MLI adopts the OECD-agreed mandatory "minimum standards" on tax treaty abuse and international tax dispute resolution. In addition, Canada has chosen to opt into mandatory binding arbitration for tax treaty disputes, which has the potential to transform the manner in which Canada and its tax treaty partners resolve disputes about their rights to tax the profits of multinational enterprises.

The MLI contains two measures to address tax treaty abuse: (a) an amended tax treaty preamble which states that the affected treaty is intended to eliminate double taxation without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance; and (b) a broad anti-avoidance rule aimed at "tax treaty shopping," referred to as the "principal purpose test" (PPT). Under the PPT, a tax treaty benefit may be denied where it is reasonable to conclude that one of the principal purposes of an arrangement or transaction is to obtain the treaty benefit, unless granting the benefit would be in accordance with the object and purposes of the relevant provisions of the treaty.

In the tax treaty context, dispute resolution may be necessary where more than one country asserts a right to tax the same portion of a multinational enterprise's income. In order to avoid double taxation, the relevant tax authorities of each treaty country (called the "competent authorities") negotiate with a view to reaching an agreement about an appropriate allocation of taxing rights. The MLI includes a Mutual Agreement Procedure (MAP) that requires the competent authorities of each country to attempt to resolve certain disputes in a timely manner (within three years of being notified of the dispute).

Canada has chosen, under the MLI, to opt into the mandatory binding arbitration provisions. Canada has had similar mandatory binding arbitration in its tax treaty with the U.S. since 2008, which has proven successful in resolving cross-border tax disputes involving the U.S. Under the MLI regime, mandatory binding arbitration applies when a case remains unresolved through the MAP for a prescribed period of time. The default under this rule is "baseball-style" final offer arbitration: each country presents its position, and the arbitration panel – whose decision is binding and final – has to choose one or the other. Mandatory binding arbitration will apply where a bilateral tax treaty partner has also chosen to opt in; to date, tax treaty partners including Australia, Austria, Barbados, Belgium, Finland, France, Ireland, Italy, the Netherlands, New Zealand, Singapore and Spain have opted into mandatory binding arbitration under the MLI.

The MLI will not affect Canada's tax treaties with the U.S. (which has not signed the MLI), or Germany and Switzerland (with which Canada has announced bilateral treaty negotiations).

BEPS 2.0 – OECD Program of Work

In May 2019, the OECD published its *Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalization of the Economy* (Program of Work). The Program of Work proposed sweeping changes consisting of two principal measures: (a) Pillar One, which allocates additional taxing rights to market jurisdictions (for example, by revising the "permanent establishment" nexus for establishing source country taxing rights and revising the "arm's length" standard for allocating profits), and (b) Pillar Two, which introduces a global minimum tax to prevent the shifting of profits to low-tax jurisdictions.

The Program of Work has been endorsed by Canada and other G20 countries. The OECD intends to recommend core elements of both pillars in early 2020, and plans to deliver a final report by the end of 2020, in accordance with the timeline endorsed by the G20.

Pillar One originally focused on highly digitized businesses, and explored three separate proposals based on "user participation," "marketing intangibles" and "significant economic presence." However, after consultations, it was apparent that a consensus on any of the three proposals was unlikely to be reached, particularly since they appeared to disproportionately impact U.S.-based multinational enterprises operating highly digitized businesses.

The OECD Secretariat released a proposal for a "Unified Approach" under Pillar One in October 2019. If adopted, the Unified Approach will introduce a revised profit allocation rule applicable to all multinational enterprises that are "in scope" based on a yet-to-be-determined revenue or other threshold, with potential carve-outs for certain sectors such as extractive industries, commodities and possibly financial services. The profit allocation rule adopts a taxation nexus to a jurisdiction that no longer depends on physical presence in the jurisdiction. A sufficient nexus will instead be determined based on revenue thresholds, which is assumed to indicate sustained and significant involvement in the market jurisdiction. For taxpayers in scope with a sufficient nexus to particular jurisdiction(s), an appropriate return for routine activities will be excluded from overall profit. The remainder will be deemed to be non-routine profits, a portion of which will be allocated amongst different eligible market jurisdictions based on variables such as sales.

While Pillar One is intended to allocate new taxing rights to market jurisdictions based on a new nexus rule, Pillar Two is intended to ensure that businesses which operate internationally are subject to a minimum global rate of tax, thereby increasing the global tax collected on significant multinational enterprises. While some jurisdictions are expected to lose tax revenue under Pillar One because of the allocation of new taxing rights to market jurisdictions, they may recover such lost tax revenue under Pillar Two.

The OECD Secretariat released its Global Anti-Base Erosion ("GloBE") proposal under Pillar Two in November 2019. The GloBE proposal addresses unresolved BEPS issues through the development of a number of rules:

- An income-inclusion rule imposing current taxation on the income of a foreign-controlled entity (or foreign branch) that is subject to an effective tax rate below a certain minimum rate.
- An "undertaxed payments" rule for source countries which either denies a deduction or imposes a withholding tax on base eroding payments not subject to tax at a specified minimum rate in the recipient jurisdiction.
- A "switch-over" rule in bilateral tax treaties which permits the residence country to switch from an exemption system to a credit system where the profits attributable to a permanent establishment in the source country or derived from immovable property in the source country are subject to an effective rate below the minimum rate.
- A "subject-to-tax" rule ensuring that treaty benefits (particularly benefits applicable to interest and royalties) are granted only in circumstances where income is subject to tax at a minimum rate in the recipient jurisdiction.

If adopted, the OECD's GloBE proposal will require significant changes to Canada's bilateral tax treaties and to domestic rules relating to foreign affiliates and non-resident withholding tax.

According to the OECD, the combined effect of Pillars One and Two will lead to a "significant increase in global tax revenues." As a result, the proposals are expected to adversely affect many multinational businesses. We will continue to monitor the progress of the proposals in 2020 and detailed proposals on these issues should be monitored closely by multinational enterprises.

According to the OECD, the combined effect of Pillars One and Two will lead to a "significant increase in global tax revenues". As a result, the proposals are expected to adversely affect many multinational businesses.

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ENERGY LITIGATION

Legislative powers, division and discontent: The provinces jostle to lead

The division of legislative powers between the federal parliament and the Canadian provinces is like a dance in which each partner has a sphere of influence and a role, and cooperation and interaction are required to succeed. However, when the tempo changes unexpectedly, the dancers can be left uncertain (and unaligned) as to their respective roles and response.

Sections 91 to 95 of the Canadian *Constitution Act, 1867* divide legislative powers between the provinces and the federal parliament. Canada dances solo in relation to certain classes of subjects that are squarely federal: interprovincial undertakings (like pipelines and railways); legal tender; the military; currency; navigation and shipping (among many others). The same is true of provinces in relation to matters that are more local, like property and civil rights in the province. At times, however, what are in theory exclusive legislative competencies spill over their respective boundaries and interact, such that doctrines of overlap have developed. Section 95 further creates a handful of concurrent powers. Finally, the courts have found that Canada enjoys a residual legislative power under the "peace, order and good government" (POGG) doctrine. This complex ecosystem can lead to confusion and dispute about which level of government has the constitutional authority to legislate.

Not surprisingly, a federation where legislative jurisdiction is delineated in this way will give rise to both moments and protracted periods of disagreement about the delineation, which can result in disunity. When policy preferences of one order of government appear to another as antithetical to their interests, as is the case currently, the natural jurisdictional tensions between federal and provincial governments increase in intensity. During these periods, the focus of the tension plays out in courts and quasi-judicial disputes.

In 2019, two such disputes – and the politics surrounding them – occupied the courts and the media headlines: the B.C. Pipeline Reference Case and the Carbon Tax Challenges. Both are headed to the Supreme Court of Canada in 2020.

In 2019, two disputes – and the politics surrounding them – occupied the courts and the media headlines: the B.C. Pipeline Reference Case and the Carbon Tax Challenges. Both are headed to the Supreme Court of Canada in 2020.

(1) The Pipeline Reference Case: *Reference re Environmental Management Act (British Columbia)*, 2019 BCCA 181

It is rarely acknowledged that the Province of British Columbia *approved* the Trans Mountain Pipeline Expansion Project (TMX Project) when it issued an Environmental Assessment Certificate in January 2017, after the close of the NEB Hearings. Despite this provincial approval, shortly after forming a minority government with the support of the Green Party in May 2017, NDP Premier John Horgan vowed that he would use "every tool in the tool box" to stop the TMX Project.

Within months, Premier Horgan announced proposed amendments to B.C.'s *Environmental Management Act* to require provincial "hazardous substances" permits for the transport of "heavy oil" in the Province (the Proposed Amendments). Critics of the draft legislation accused B.C. of targeting Alberta oil and, in particular, the TMX Project.

Alberta and Saskatchewan (among others) expressed anger at B.C.'s tactics to stop a federal project that had been declared to be in the national interest. On May 29, 2018, Kinder Morgan, the TMX Project proponent, announced the sale of the project to Canadian federal government. Then, Kinder Morgan began its speedy exit from Canada. A national crisis was born.

B.C. referred three constitutional questions to the B.C. Court of Appeal (BCCA):

1. Are the Proposed Amendments within the legislative authority of British Columbia?
2. If yes, would the Proposed Amendments be applicable to hazardous substances brought into British Columbia by means of interprovincial undertakings?
3. If yes, would existing federal legislation render all or part of the Proposed Amendments inoperative?

On May 24, 2019, the BCCA unanimously opined that the Proposed Amendments were beyond the legislative authority of the Province. The matter has been appealed to the Supreme Court of Canada and will be heard on January 16, 2020.

The BCCA opinion

The Court found that the essential character (or "pith and substance," in constitutional terms) of the Proposed Amendments was to regulate an interprovincial undertaking – i.e., the TMX Project – which is intended to carry heavy oil from Alberta to tidewater. Interprovincial undertakings fall squarely within federal jurisdiction under section 91. Accordingly, the Court answered "no" to the first reference question and deemed it unnecessary to answer the latter two questions.

While the Court agreed that federal undertakings are not immune from provincial environmental laws, it rejected B.C.'s argument that it had a "superior" or "presumptive" claim to jurisdiction over the environment by reason of its jurisdiction over property and civil rights in the province (a section 92 power). The Court concluded that environmental protection is too important and diffuse to belong exclusively to one level of government.

Although the Proposed Amendments are framed as a law of general application, the Court concluded that their intent (and their sole *effect*) was to set conditions for or prohibit the possession and control of volumes of heavy oil in the Province. Such volumes enter the Province only via the TMX Project and railcars destined for export. Even if not intended to single out the TMX Project, the Court noted that the Proposed Amendments have the potential to affect (and indeed "stop in its tracks") the entire operation of Trans Mountain as an interprovincial carrier and exporter of oil. In pith and substance, therefore, the Proposed Amendments relate to matters that make the pipeline a federal undertaking under federal jurisdiction.

The BCCA also held that it is neither practical nor constitutionally appropriate for different laws and regulations to apply to an interprovincial pipeline (or railway, or communications infrastructure) every time it crosses a border. The operation of an interprovincial pipeline would be "stymied" by the necessity to comply with different conditions governing its route, construction, cargo, safety measures, spill prevention and the aftermath of any accidental release of oil. Jurisdiction over interprovincial undertakings was allocated exclusively to Canada to enable a single national regulator to consider interests and concerns beyond those of the individual province(s).

The Proposed Amendments would also prohibit the operation of the TMX Project in the Province until such time as a provincially-appointed official decided otherwise. This alone "threatens to usurp" the role of the National Energy Board (now, the Canadian Energy Regulator). The TMX Project is not a British Columbia project; it affects the entire nation and must be regulated in a manner consistent with the national interest.

In short, the BCCA concluded that the Proposed Amendments were dressed up as a legitimate expression of provincial power but instead, represented a targeted attack on a federal pipeline approved by the federal regulator to carry oil from Alberta through the Province of British Columbia. B.C. was not permitted to use its environmental legislation to interfere with or obstruct this federal work and undertaking.

(2) The Carbon Tax Challenges

What is the practical case against the carbon tax?

For some provinces in Canada, federal policy focused on pricing or punishing carbon emissions has become a favourite target. First Saskatchewan, and subsequently Ontario, Alberta, New Brunswick and Manitoba, have rallied against a policy that they regard as definitionally hard on trade-exposed, extractive, remote and resource base sectors, not to mention consumers – no matter what mitigating rebate scheme is proposed. Proposed rebating schemes have failed to placate opponents, as examples have shown their inefficacy. A very wet autumn in the prairies has required again the extensive use of crop dryers, which are heavy users of natural gas. Costs of drying crops have soared, thereby confirming existing biases that a carbon tax is particularly damaging to the prairie economy.

A federally imposed carbon tax, in isolation, is deemed worthy of a policy challenge by these provinces. However, it must also be considered in the context of other federal policies regarded as harmful to the economic interests of at least Saskatchewan and Alberta. With the benefit of this larger context, the motivation of these provinces to continue the court challenge to the federal carbon tax to finality is better understood.

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The Act

The federal *Greenhouse Gas Pollution Pricing Act* (the Act, or colloquially, the Carbon Tax) is the product of the federal government's efforts to meet Canada's international commitments to reduce greenhouse gas (GHG) emissions and mitigate climate change under the *Paris Agreement*.[1]

In broad terms, the Act allows the provinces and territories to design their own policies to meet emission reduction targets. Its purpose is to impose a single price on carbon throughout Canada using a "backstop": the federal government will introduce its own carbon pricing system in any province in which Cabinet finds the local regime insufficiently stringent.

The Act has two mechanisms to enforce the federal "benchmark" carbon price:

- A "fuel levy," imposed on distributors and producers, that is typically passed on to consumers (Part 1 of the Act).
- An output-based pricing system (OBPS) levy on heavy industrial facilities on the basis of their GHG emissions above an industry standard (Part 2 of the Act).

1 The *Paris Agreement* was ratified by Canada at the 21st Conference of Parties in 2015 under the *United Nations Framework Convention on Climate Change*.

The federal executive branch or federal Cabinet determines the provinces in which the Act will apply, the manner in which it will apply in those jurisdictions and then enacts detailed regulations to support the Act, including quantification, reporting and verification requirements.

Several provinces lined up to challenge the Carbon Tax in court (most notably, Saskatchewan and Ontario). These challengers have recently been joined by Alberta, after a newly elected UCP government scrapped Alberta's own carbon tax and sought to intervene in the ongoing court proceedings.

The Ontario and Saskatchewan Carbon Tax References

On May 3, 2019, a narrow majority (3:2) of the Saskatchewan Court of Appeal (SKCA) upheld the Carbon Tax as a valid exercise of Parliament's legislative authority.[2] The majority and dissent were separated by a single vote. On June 28, 2019, a majority of the Ontario Court of Appeal (ONCA) followed suit (3:1:1), with one dissenting and one concurring opinion.

The arguments in both cases were similar, but the reasons for judgment among the 10 jurists varied. Strong dissents/alternative reasons in the ONCA and SKCA, together with the fact that Alberta is pursuing a Carbon Tax reference in its Court of Appeal and that Manitoba has applied for judicial review of the federal backstop issue at the Federal Court of Canada, suggest that Carbon Tax challenges are far from settled. The matters are tentatively set to be heard by the Supreme Court of Canada on March 18 and 19, 2020.

The legal opinions in the SKCA and ONCA

Pith and substance: National standards for carbon pricing/reduction of GHG emissions?

The SKCA majority upheld the Carbon Tax by characterizing its pith and substance very narrowly. Instead of finding that the Act broadly relates to reducing GHG emissions, or mitigating climate change, the majority held that its pith and substance is to establish a *minimum national standard* for carbon pricing. Similarly, the ONCA majority characterized the Act as "establishing minimum national standards to reduce greenhouse gas emissions," while the concurring reasons of Justice Hoy advanced the following characterization: "establishing minimum national greenhouse gas emissions pricing standards to reduce greenhouse gas emissions."

Pith and substance: A tax or a regulatory charge?

The Provinces of Saskatchewan and Ontario argued that the Act is, in pith and substance, a tax and not a regulation. Although such a tax would fall under federal jurisdiction, the federal taxation power is subject to specific constitutional limits that do not apply to other powers. Specifically, under section 53 of the *Constitution Act, 1867*, federal taxation power cannot be delegated to the executive branch of government. All taxes must be authorized by the House of Commons. The Act, they asserted, breaches this requirement.

2 *Greenhouse Gas Pollution Pricing Act (Re)*, 2019 SKCA 40; online: https://sasklawcourts.ca/images/documents/CA_2019SKCA040.pdf

The SKCA dissenting opinion agreed with this view, finding that the fuel levy was a tax (and, an unconstitutional exercise of Parliament's taxation power) and the OBPS was a regulatory charge. The majority opinions held that both charges were regulatory, not taxes.

Canada has exclusive POGG power to supervise carbon pricing

As in the Pipeline Reference, the Courts recognized that the environment is, broadly, an area of shared jurisdiction, and sought to characterize the narrower subject matter within which carbon pricing would fall. The Courts concluded that the federal government enjoys the exclusive POGG power, under the "national concern" doctrine, to enact minimum national carbon pricing standards.

The Provinces argued that Canada could not have exclusive power to regulate GHG emissions because this power would intrude on nearly every dimension of local life over which the provinces are empowered to govern. Traditionally, the theme of POGG jurisprudence is restraint. POGG powers are, by definition, powers that encroach on provincial jurisdiction and autonomy. This means that courts can only recognize POGG powers if they are "compatible with the basic division of powers between Parliament and the legislatures under the Constitution."[3]

The Provinces argued that Canada could not have exclusive power to regulate GHG emissions because this power would intrude on nearly every dimension of local life over which the provinces are empowered to govern.

In the Saskatchewan reference, Canada and several intervenors argued that the federal government has jurisdiction over "the cumulative dimensions of GHG emissions." The intervenor Canada's Ecofiscal Commission expressed the argument this way:

> *Global climate change, caused by GHG emissions, is the quintessential example of a serious, international environmental problem. If it is not a matter of National Concern, it is difficult to imagine what kind of trans-boundary pollution problem ever would be.*[4]

The SKCA majority rejected this approach, recognizing that "the production of GHGs is [...] intimately and broadly embedded in every aspect of intra-provincial life."[5] A general authority in relation to GHG emissions would allow Parliament's legislative reach to extend very substantially into traditionally provincial affairs.

Instead, the SKCA majority recognized POGG jurisdiction over the more narrow matter of establishing "minimum national standards of price stringency for GHG emissions."[6] The SKCA reasoned that this formulation strikes the best balance between the potentially disruptive impact of the national concern doctrine, on one hand, and the major threat of climate change to Canada and the planet, on the other.[7] The ONCA majority concluded that no "one province acting alone or group of provinces acting together can establish minimum national standards to reduce GHG emissions. Their efforts cannot be dealt with in a piecemeal manner. It must be addressed as a single matter to ensure its efficacy. The establishment of minimum national standards does precisely that."

3 At para 10; *R v Crown Zellerbach Canada Ltd*, [1988] 1 SCR 401.
4 Factum of the Intervenor Canada's Ecofiscal Commission at para 4.
5 At para 128.
6 At para 139.
7 At paras 143-144.

This analysis is interesting because a central element of the national concern doctrine is the concept of "provincial inability." The federal government can override provincial jurisdiction where the provinces independently cannot effectively govern the subject matter. The majority opinions in both the SKCA and ONCA held that "provincial inability" applies to establishing a minimum carbon pricing standard. Not only are the provinces vulnerable to the climate change effects of other provinces' carbon pricing, but also to what is known as "carbon leakage." Carbon leakage occurs where GHG pricing increases the cost of production and affects competitiveness, leading businesses to shift jobs or investments to lower GHG cost jurisdictions.

Provincial inaction: Political disagreement or provincial inability?

In addressing the POGG argument, the Saskatchewan dissent found that neither levy could be upheld as a matter of national concern under the federal POGG doctrine.

The dissenting position is that the Act is not a mechanism to establish a minimum national carbon pricing standard, but a federal response to a substantive policy dispute with some provinces. The Act is premised on the federal government's evaluation of the manner in which a province exercises its own, acknowledged exclusive jurisdiction. To enact federal law based on "value judgments"[8] about provincial policies and actions is the very definition of federal overreach.

Further, the Act's broad effects have the potential to have even broader effect than its current terms. Due to the extensive delegation of power, the Act can be expanded in any way the federal Cabinet determines is necessary or expedient.[9] As noted by Justice Huscroft in the ONCA dissent, the majority characterization left matters of national concern "too vague" to limit the reach of Parliament's authority into provincial jurisdiction.

These arguments will next be made at the Supreme Court of Canada in March 2020.

Osler acts for the Intervenors, Trans Mountain Pipeline ULC and Enbridge Inc. in the BC Pipeline Reference.

8 At para 245.
9 At para 468.

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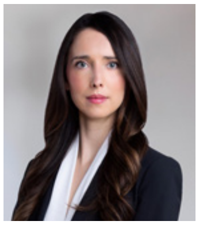

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We would like to thank Brynne Harding who also contributed to this article.

KEY CASES

What businesses should watch for from the SCC in 2020

In 2019, the Supreme Court of Canada (SCC) heard and/or granted leave to appeal in a number of cases that could have a significant impact on Canadian business. Three such cases will address the developing doctrine of good faith performance in contract. Other cases deal with arbitration clauses, insolvency restructurings, the application of the *Canadian Charter of Rights and Freedoms* to corporations and the enforceability of provisions that impose penalties on the insolvency of a contracting counterparty.

Good faith trilogy

The SCC's 2014 decision in *Bhasin v. Hrynew*, 2014 SCC 71 (*Bhasin*) recognized a duty of honest contractual performance, which was presented as an incremental change to the common law. The decision left considerable scope for further development in this area of law. The SCC has clearly determined that the time is ripe to advance the doctrine, as evidenced by the fact that no fewer than three cases are pending before the Court.

In these three cases, the Court will consider several key aspects of the contractual duty of good faith. The guidance in these three cases could profoundly impact the standards of contractual performance for contracting parties.

i) *David Matthews v. Ocean Nutrition Canada Limited* (NS)

Status: Heard on October 8, 2019; under reserve.

Mr. Matthews worked for the respondent from 1997 to 2011. In 2011, he resigned and sued Ocean Nutrition for wrongful dismissal, seeking damages for breach of his employment contract and the loss of a Long Term Incentive Plan (LTIP). Under the LTIP, Matthews would have been entitled to a portion of the proceeds of the sale of the company if a sale occurred during Mr. Matthews' employment. Ocean Nutrition was sold in 2012, after his employment ended.

The trial judge agreed that Mr. Matthews had been constructively dismissed and awarded him substantial damages. Most of the damages were related to the loss of the LTIP because the rights under the LTIP would have crystallized if Mr. Matthews had remained employed throughout the 15-month notice period. The Court of Appeal upheld the finding of constructive dismissal but held that the trial judge erred in awarding damages pursuant to the LTIP where that plan, by its plain wording, precluded any such payment.

Avoidance of contractual limitations: The SCC is considering whether the doctrine of good faith precludes an employer from constructively dismissing an employee and then escaping its obligations under the LTIP during the required notice period. This case may have broader significance if the SCC accepts that the doctrine of good faith limits the ability of an employer to rely on the express terms of the employment contract or related agreements governing the employment relationship.

ii) *Wastech Services Ltd. v. Greater Vancouver Sewerage and Drainage District* (BC)

Status: Heard on December 6, 2019, under reserve.

Wastech Services Ltd. and Greater Vancouver Sewerage and Drainage District (Metro) were parties to a 20-year contract for the disposal of solid waste. Allocation of waste was at Metro's sole discretion. Metro's allocation negatively impacted Wastech's contractual profit margin. An arbitrator found Metro did not exercise its discretion capriciously or arbitrarily and Metro was honest and reasonable from its own perspective; however, Metro breached its duty of good faith because it lacked appropriate regard for Wastech's legitimate expectations.

On appeal, the Supreme Court of British Columbia determined that a contracting party has no free-standing obligation to exercise its discretionary power in good faith. The British Columbia Court of Appeal dismissed the subsequent appeal, holding that because the arbitrator did not find an implied term in the agreement, the duty of good faith did not apply.

Contractual discretion: Before *Bhasin*, a line of lower court and appellate cases held that the doctrine of good faith precluded a contracting party from exercising contractual discretion in a way that effectively deprives the other party of the benefit of the bargain and/or is contrary to the other party's reasonable expectations. The SCC now has the opportunity to determine whether, even though a party is exercising express rights under the contract, the doctrine of good faith limits that party's freedom to act solely in its own commercial interest.

iii) *C.M. Callow Inc. v. Tammy Zollinger, et al.* (Ontario)

Status: Heard on December 6, 2019, under reserve.

Callow provided maintenance services to condominium corporations managed by a Joint Use Committee (JUC). The JUC entered into two separate two-year maintenance contracts with Callow. The winter contract, which ran from November 2012 to April 2014, allowed the JUC to terminate it on 10 days' notice. In March or April of 2013, the JUC decided to terminate the winter contract, but did not disclose its decision. The JUC gave Callow the impression that the renewal was not yet decided. During the summer of 2013, Mr. Callow performed extra "freebie" landscaping work, hoping to convince the JUC to renew the contracts. In September 2013, the JUC gave notice of termination. Mr. Callow sued for breach of contract.

The trial judge held that the JUC breached its contractual duty of honest performance and acted in bad faith. The Court of Appeal disagreed, holding that the trial judge improperly expanded the duty of honest performance established in *Bhasin*. The duty of good faith does not impose a unilateral duty to disclose. The JUC owed Mr. Callow nothing beyond the 10-day formal notice period.

Duty of disclosure: The SCC will consider the circumstances in which the deliberate silence of a contracting party can constitute bad faith. Although the SCC in *Bhasin* held that the doctrine of good faith does not impose fiduciary-like obligations of disclosure, this case may lead the Court to conclude that there are some circumstances where disclosure of material facts is required.

The Supreme Court's guidance in the good faith trilogy could profoundly impact standards of contractual performance for contracting parties.

Other cases of interest

A number of other cases will provide the SCC with the opportunity to consider disparate themes with potentially significant implications for commercial contracting, corporate restructurings and the regulation of corporations.

i) *Uber Technologies Inc., et al. v. David Heller* (Ontario)

Status: Heard on November 6, 2019; under reserve.

At issue in this case is the enforceability of an arbitration clause in a standard-form licence agreement that mandated that disputes connected to the agreement be resolved by arbitration in Amsterdam, upon payment of a $14,000 non-refundable fee. The motion judge stayed a proposed Ontario class action alleging violations of the Ontario *Employment Standards Act* in favour of arbitration pursuant to this clause. The Ontario Court of Appeal held that the arbitration clause was unconscionable at common law and invalid as an illegal contracting-out of the basic employment entitlements established under the *Employment Standards Act*.

Enforceability of arbitration clauses: In *Seidel* (2011) and *Wellman* (2019), the SCC considered the enforceability of arbitration clauses in light of provincial consumer protection legislation and arbitration legislation. Here, the SCC has the opportunity to consider how arbitration clauses interact with provincial employment legislation, as well as the enforceability of standard form contracts with arguably onerous terms. If Uber can require disputes with its Canadian drivers to be resolved in the Netherlands, the plaintiff (who works for minimum wage) will likely have no effective remedy.

Moreover, this case could have broader significance for companies who conduct business in multiple jurisdictions and who seek to avoid the implications of local laws through carefully crafted arbitration provisions.

ii) *9354-9186 Québec inc., et al. v. Callidus Capital Corporation, et al.* (Québec)

Status: Tentatively scheduled to be heard in January 2020.

The applicants obtained protection under the *Companies' Creditors Arrangement Act* (CCAA). They sold all their assets, which were bought by Callidus, their secured lender. The purchase extinguished Callidus' secured claim against the applicants; however, it did not extinguish the applicants' litigation claims for damages against Callidus for its predatory lending practices that were alleged to have contributed to the applicants' demise, nor did it extinguish the unsecured portion of Callidus' claim.

The applicants sought court approval for a litigation funding agreement to allow them to sue Callidus. In response, Callidus sought to convene a creditors' meeting to vote on a plan of arrangement. Certain creditors, whose legal fees were to be paid by Callidus, requested that Callidus be entitled to vote the unsecured portion of its claim. This would allow it to achieve the necessary voting thresholds for plan approval, which would release Callidus from the litigation.

The Superior Court refused to order a creditors' meeting. Callidus had acted in bad faith and it should not be entitled to use its vote for an improper purpose. The Court of Appeal allowed the appeal, disagreeing that the lower court had the jurisdiction to deprive Callidus of its vote.

Creditor classification and voting in restructuring: The SCC only rarely considers cases under the CCAA. The Court has not recently considered principles of creditor classification, which arise in both CCAA plans and plans of arrangement under other statutes such as the *Canada Business Corporations Act*. A number of recent cases have raised the question of whether a creditor with specific economic or self-interested motives should be allowed to vote in the same class as other creditors, and to potentially determine the outcome of a restructuring.

The Court will also consider when a CCAA court can disallow a vote by a creditor with alleged ulterior or bad faith motives. The SCC's guidance on this point may be particularly valuable in light of the recent amendments to the CCAA imposing an express duty of good faith on any interested party in a CCAA proceeding (CCAA, s. 18.6).

iii) *Attorney General of Québec, et al. v. 9147-0732 Québec inc.* (Québec)

Status: Tentatively scheduled to be heard in January 2020.

The respondent, a private company, was charged under the Québec *Building Act* for carrying out construction work as a contractor without a licence. Under the Act, the penalty for such an offence is a mandatory minimum fine. The respondent argued that the fine violated its right to be protected against "any cruel and unusual treatment or punishment" under s. 12 of the *Canadian Charter of Rights and Freedoms*.

The Court of Québec held that it was not necessary to rule on whether s. 12 of the *Charter* applies to legal persons because the mandatory minimum fine was not cruel and unusual. The Québec Superior Court held that legal persons such as the respondent could not benefit from the protection of s. 12 of the *Charter*. A majority of the Québec Court of Appeal disagreed.

Corporate "cruel and unusual punishment": A decision by the SCC that s. 12 of the *Charter* is available to corporations could open the door to challenges under other regulatory statutes, particularly those that impose mandatory minimum fines. The application of mandatory minimum fines can give rise to large total fines that are arguably "grossly disproportionate" relative to the offender's conduct and the fine that would be imposed in the absence of the mandatory minimum.

iv) *Chandos Construction Ltd. v. Deloitte Restructuring Inc. in its capacity as Trustee in Bankruptcy of Capital Steel Inc., a bankrupt* (Alberta)

Status: Tentatively scheduled to be heard in January 2020.

A construction contract between Capital Steel Inc. and Chandos Construction Ltd. provided that Capital Steel was to forfeit 10% of the total contract price if Capital Steel became insolvent. Capital Steel became bankrupt prior to completing its contract. The issue was whether this clause was enforceable and capable of giving rise to a set-off.

At trial, the provision was held to be enforceable as a genuine pre-estimate of damages, rather than a penalty. As such, it was a bona fide commercial transaction and it was not invalid as an impermissible attempt to deprive Capital Steel of property on bankruptcy. The majority of the Alberta Court of Appeal disagreed, and held that the clause was invalid.

Penalties vs. liquidated damages; anti-deprivation rule: Provisions similar to the one at issue in this case exist in many construction and other commercial contracts. The SCC has not considered whether provisions that impose payment requirements triggered by insolvency are unenforceable because they deprive the debtor of property that should be available to creditors.

Moreover, the general common law doctrine invalidating so-called "penalty" clauses is also ripe for consideration by the SCC. A number of lower court cases have suggested that courts should no longer invalidate so-called penalty clauses that are entered into between sophisticated contracting parties. Guidance from the SCC on this point may be of considerable value to commercial contracting parties across industries.

A decision by the SCC that s. 12 of the Charter is available to corporations could open the door to challenges under other regulatory statutes, particularly those that impose mandatory minimum fines.

More to come

Also watch for the reasons of the SCC in *Nevsun Resources Ltd v. Gize Yebeyo Araya, et al.* (currently under reserve), and for the *BC Pipeline Reference* and the Carbon Tax cases (likely to be heard in 2020), discussed in more detail in our articles Chevron: High threshold for piercing corporate veil affirmed and Legislative powers, division and discontent: The provinces jostle to lead.

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KEY CASES

Chevron: High threshold for piercing corporate veil affirmed

The Ontario Court of Appeal's decision in *Chevron Corporation v Yaiguaje et al* confirmed the very high test under Canadian law for disregarding the separate legal personality of a parent corporation and its direct or indirect subsidiaries, rejecting attempts to introduce into Canadian law either a general equitable test for piercing the corporate veil or a form of group enterprise liability. The Supreme Court of Canada's determination not to hear an appeal from this decision effectively brought an end to a lengthy Canadian proceeding seeking to seize the assets of an indirect subsidiary to satisfy a judgment obtained (fraudulently) against its parent. This may be welcome news for defendants in other cases pending before the Canadian courts that seek to pierce the corporate veil to render one member of a corporate family accountable for acts of another. At a minimum, the plaintiffs in those cases may be driven to place greater reliance on alternative theories of liability.

Chevron Corp. v Yaiguaje et al

An almost seven-year long saga in the Canadian courts seeking recognition and enforcement of a US$9.5 billion judgment fraudulently obtained in the Ecuadorian Courts against Chevron Corporation came to an end in 2019. The plaintiffs – 47 residents of Ecuador – commenced an action in 2012 in the Ontario Superior Court of Justice, seeking an order that the assets and/or shares of Chevron Canada Limited, a seventh-level indirect subsidiary of Chevron Corporation, were exigible to satisfy the Ecuadorian judgment. In the face of several key losses in the Canadian courts – as well as overwhelming findings in international tribunals that the Ecuadorian judgment was obtained as a result of a massive fraud perpetrated by the plaintiffs' own lawyers – the plaintiffs consented to the dismissal of their Ontario action with costs in June of this year, thereby abandoning their quest to satisfy the judgment from Canadian assets.

The only judgment debtor, Chevron Corporation, had no assets in Canada, did not carry on business in Canada, and had an avowed intention never to do so in future. However, the plaintiffs were precluded from enforcing the fraudulent judgment in the United States, where Chevron Corporation is headquartered and has assets. In 2014, after a lengthy trial, the Southern District of New York (SDNY) held (as subsequently affirmed on appeal to United States Court of Appeals for the Second Circuit, *certiorari* denied by the United States Supreme Court) that the Ecuadorian judgment had been obtained by fraud, corruption, bribery, *Foreign Corrupt Practices Act* violations, and more, and enjoined the plaintiffs from seeking to enforce or profit from the fraudulent judgment in the United States. Among other findings, the SDNY held that the plaintiffs' lawyers had ghostwritten the judgment and promised a US$500,000 bribe to the Ecuadorian judge to sign it. The plaintiffs therefore came to Canada, seeking to seize the assets and/or shares of Chevron Canada Limited.

Under well-established corporate law principles, the assets of a corporate subsidiary are not exigible to satisfy the debts of a corporate parent or shareholder, absent circumstances that would justify piercing the corporate veil and disregarding the separate legal personality of parent and subsidiary.

The plaintiffs' Ontario action sought to challenge well-established principles of separate corporate personality under Canadian law. Chevron Canada is an operating business that carries on an oil and gas exploration and extraction business in Canada, and has Canadian assets. However, the shares of Chevron Canada were only indirectly owned by Chevron Corporation through multiple other subsidiaries. And Chevron Canada had no connection to the Ecuadorian judgment: it had never carried on business in Ecuador, it was not involved in any Ecuadorian activities leading up to the judgment, and it was not a defendant in the Ecuadorian proceeding.

The Supreme Court of Canada held in 2015 that the Ontario court could take jurisdiction over the plaintiffs' action, even in the absence of assets against which to enforce it. (The Supreme Court of Canada did not consider the merits of the case in determining the issue of jurisdiction). However, the plaintiffs were unsuccessful in their subsequent motion for summary judgment seeking a determination that the assets or shares of Chevron Canada were exigible to satisfy the judgment debt of Chevron Corporation.

Under well-established corporate law principles, the assets of a corporate subsidiary are not exigible to satisfy the debts of a corporate parent or shareholder, absent circumstances that would justify piercing the corporate veil and disregarding the separate legal personality of parent and subsidiary. Leading judicial authority, including Supreme Court of Canada case law, has affirmed this principle on countless occasions, and has recognized only narrow circumstances that could justify piercing the corporate veil between a corporation and its subsidiary. Under the "*alter ego*" doctrine, expressed most notably in the Ontario *Transamerica* decision, it is necessary to demonstrate: (1) complete domination and control by the parent of the subsidiary such that the subsidiary has effectively no independent existence; and (2) conduct akin to fraud in the establishment or use of the corporation.

A major difficulty for the plaintiffs was that the voluminous evidence produced by both Chevron Corporation and Chevron Canada did not and could not establish complete domination and control of Chevron Canada by Chevron Corporation. To the contrary, as Justice Hainey of the Ontario Superior Court of Justice held at first instance, the evidence demonstrated the ordinary indicia of oversight, control and financial accountability expected from a public company in relation to its direct and indirect subsidiaries.

Moreover, there was no evidence whatsoever that the Chevron corporate structure was designed or used as an instrument of fraud. The structure had been in place for decades and predated the Ecuadorian judgment. The plaintiffs also expressly disavowed any allegation of wrongdoing against Chevron Canada. This was fatal to their attempt to rely on the *alter ego* doctrine, as Justice Hainey concluded. As a result, the assets and shares of Chevron Canada were not exigible to satisfy the judgment.

On appeal, both Hourigan J.A. and Huscroft J.A., for the majority of the Ontario Court of Appeal, upheld Justice Hainey's determination. They rejected the argument that separate corporate personality is a "legal fiction", stating instead that it is a "bedrock principle" of corporate law. These judges further confirmed that strong policy reasons underlie this principle, including the reasonable expectation that stakeholders doing business with a corporation need only consider the liabilities of that corporation, and not every other related corporation.

The majority judges affirmed that the *Transamerica* test for piercing the corporate veil will be rigorously applied. They rejected the plaintiffs' argument that the corporate veil can be pierced where it would be just or equitable to do so, that a different test should apply in enforcing a judgment debt, or that a form of group enterprise liability should be recognized in Canada. Although the majority recognized that the corporate law can evolve, the plaintiffs had put forward no principled basis for this to occur. Their action was essentially an attempted "end run" around the findings of the SDNY.

Nordheimer J.A. concurred in the result, but he would have entertained the possibility that, in rare circumstances, the principles of separate corporate personality could be disregarded where it is necessary on equitable grounds to permit a judgment creditor to realize on a judgment that would otherwise go unsatisfied. In such circumstances, he would be prepared to depart from the Transamerica test. However, in light of the SDNY findings that the judgment was obtained by fraud, he concurred in the majority's conclusion that this was not an appropriate case to develop or apply such an exception.

The plaintiffs invoked various policy reasons in order to tempt the Ontario courts to revisit principles of separate corporate personality. However, a key obstacle to the plaintiffs' argument was the mounting evidence and determinations in other forums that the Ecuadorian judgment was the product of a corrupt scheme and was thus incapable of recognition in Canada, in any event.

The findings of the SDNY, as affirmed by the Second Circuit, formed the backdrop to the conclusion by all of the judges of the Ontario Court of Appeal that the separate corporate personality between Chevron Corporation and Chevron Canada could not be disregarded in this case. The Court of Appeal appropriately recognized that "What we are really being invited to do is to assist the appellants in doing an end-run around the United States court order by breaking with well-established jurisprudence and creating an exception to the principle of corporate separateness."

The Court of Appeal appropriately recognized that "What we are really being invited to do is to assist the appellants in doing an end-run around the United States court order by breaking with well-established jurisprudence and creating an exception to the principle of corporate separateness."

Moreover, just after the plaintiffs sought leave to appeal to the Supreme Court of Canada from the decision of the Ontario Court of Appeal, a unanimous international arbitral tribunal hearing Chevron Corporation's complaint against Ecuador under the United Stated-Ecuador Bilateral Investment Treaty, released its award in Track II of the arbitral proceeding. The tribunal included a nominee of Ecuador, as well as a nominee of Chevron Corporation. Based on its independent review of the evidence, the tribunal came to the same conclusion as the courts of the United States, finding that the Ecuadorian plaintiffs' team had engaged in "prolonged, malign conduct" that "almost beggars belief in its arrogant contempt for elemental principles of truth and justice". In a telling summary of its findings, the tribunal stated: "[s]hort of a signed confession," the evidence "'must be the most thorough documentary, video, and testimonial proof of fraud ever put before an arbitral tribunal'".

All of these findings were before the Supreme Court of Canada when it subsequently denied the plaintiffs' application for leave to appeal from the decision of the Ontario Court of Appeal on April 4, 2019. As a result, the plaintiffs could no longer pursue their action against Chevron Canada and they were left with the prospect of pursuing their action to recognize the Ecuadorian judgment in the absence of Canadian assets against which to enforce it.

Chevron Corporation then brought a motion seeking final dismissal of the plaintiffs' action on the basis that it would be an abuse of process for their action to consume Canadian judicial resources in the absence of exigible assets and in light of the overwhelming findings that the judgment was the product of a fraudulent and corrupt scheme. The plaintiffs consented to the dismissal of the action shortly thereafter. (Osler acted for Chevron Corporation.)

It remains to be seen whether Canadian courts will be more receptive to eroding the principle of separate corporate personality on different facts, in the interests of enhanced corporate responsibility and accountability. The Ontario Court of Appeal's reasons in the *Chevron* decision, and the Court's affirmation of the rigorous *Transamerica* test, could make such evolution unlikely, at least in the absence of legislative amendment.

Several other cases before the Canadian courts may provide opportunities to consider these or similar issues in the near term, although one such notable case settled in 2019.

Litigation against *Hudbay Mining* still pending

Hudbay Mining and certain of its subsidiaries continue to be subject to three civil lawsuits arising out of wrongdoing alleged to have been perpetrated on the plaintiffs by Guatemalan security personnel. The Guatemalan plaintiffs allege that personnel working for Hudbay's subsidiaries, allegedly under the control and supervision of Hudbay, committed human rights abuses, including murder and gang-rape.

This litigation relates to incidents allegedly occurring in 2007 and 2009 and has been ongoing for a number of years. It is notable as the first in a series of lawsuits seeking to hold a Canadian parent company accountable for acts of a subsidiary in a foreign jurisdiction.

In 2013, the Ontario Superior Court of Justice dismissed Hudbay's motion to strike the claims of the plaintiffs as having no reasonable chance of success and permitted all three cases to proceed to trial. The plaintiffs advanced certain direct claims against Hudbay, including a claim based on negligent oversight of its subsidiary by Hudbay. This claim, while novel under Canadian law, would not require the separate legal personalities of Hudbay and its subsidiaries to be disregarded.

The plaintiffs' claim that the Guatemalan subsidiary acted as Hudbay's agent was also not struck. As a theoretical matter, a number of authorities have recognized that a finding of agency does not require the separate personalities of parent and subsidiary to be disregarded. Nonetheless, agency is frequently described – including in this case – as a basis for piercing the corporate veil. The 'agency' concept may essentially be a legal fiction in these circumstances. In the motion to strike, the Ontario court held that a finding of agency did not depend on the rigorous *Transamerica* test. The claim was not "patently ridiculous" and could be a basis for liability, if proven at trial.

According to its public disclosure, Hudbay disposed of its Guatemalan interests in 2011, but as of the time of writing, the litigation remains pending in the Ontario court. It will be interesting to see, if it does come to trial and if the Court does find that Hudbay should be liable on the facts, whether the Court will base its findings on the direct claim for negligent oversight, or whether the Court will pierce the corporate veil. While the *Chevron* decision could have an impact on the corporate veil argument, the trial court could agree with the motions judge that the agency theory for piercing the corporate veil (which was not raised in *Chevron*) raises different considerations.

Imposing liability on either of the two bases raised by the plaintiffs could have significant future implications for corporate accountability in Canada.

Nevsun Resources Ltd v. Gize Yebeyo Araya, et al.

The Supreme Court of Canada recently heard an appeal in the *Nevsun* matter. The appeal seeks to resolve several specific issues in an ongoing lawsuit brought by three refugees from Eritrea, who claim they were subjected to forced labour at a mine in Eritrea owned jointly by the state of Eritrea and an indirect subsidiary of Nevsun. The plaintiffs say that Nevsun, through its subsidiary, was complicit in their cruel, inhumane or degrading treatment as conscripts in Eritrea's National Service Program. They claim Nevsun is liable for private law torts, as well as new causes of action: breach of customary international law prohibitions on slavery, forced labour, torture, and crimes against humanity. Nevsun unsuccessfully moved in the B.C. courts to strike the plaintiffs' customary international law claims.

The only issues raised in the appeal to the Supreme Court were (a) whether the plaintiffs' claims for breach of customary international law should go to trial, and (b) whether the "acts of state" doctrine applies in Canada and if so, whether the plaintiffs' action improperly seeks to penalize Nevsun for the actions of the Eritrean government, i.e., the National Service Program.

At the time of writing, the Supreme Court had not released its reasons in the appeal. The Supreme Court will not address all of the pleaded bases for Nevsun's ultimate liability (including whether to pierce the corporate veil between Nevsun and its indirect Eritrean subsidiary). However, if the plaintiffs' case proceeds to trial, the court will likely have to consider the basis on which a Canadian corporate parent can (or cannot) be held legally accountable for wrongful acts occurring at the level of an indirect subsidiary. The *Chevron* case could be persuasive to a BC court both in its affirmation of the strict *Transamerica* test and in its rejection of group enterprise liability.

Tahoe proceeding

In 2014, seven Guatemalan men commenced a lawsuit against Tahoe Resources Inc., claiming battery and negligence as a result of an incident in which Guatemalan security guards opened fire at a mine site during a peaceful protest. The mine was owned by Tahoe's indirect subsidiary, and the allegations against Tahoe, as indirect parent, were based on its express or implicit authorization of the conduct of the Guatemalan security forces.

In a 2017 decision, the British Columbia Court of Appeal held that the B.C. Courts had jurisdiction over the lawsuit because it would be difficult for the plaintiffs to obtain a fair trial in Guatemala. Leave to appeal to the Supreme Court of Canada from this decision was denied.

Tahoe was acquired by Pan American Silver Corp in early 2019. Four of the plaintiffs had already settled with Tahoe. It was announced in July 2019 that Pan American had settled with the remaining plaintiffs, that the lawsuit had been resolved and that Pan American had apologized, on behalf of Tahoe, to the victims and the community. The terms of such resolution are not publicly available.

As a result of this settlement, the B.C. courts will not have the opportunity to rule on the extent to which a Canadian parent company should be liable in relation to its oversight of foreign subsidiaries. The settlement may, however, demonstrate how such proceedings can create leverage and compel Canadian businesses – or acquirors of those businesses – to propose resolutions that may benefit the foreign claimants.

As a result of this settlement, the B.C. courts will not have the opportunity to rule on the extent to which a Canadian parent company should be liable in relation to its oversight of foreign subsidiaries.

As 2020 unfolds, we will be watching these and other cases that seek to challenge principles of separate corporate personality or to advance other novel theories of corporate accountability.

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PRIVACY

Data breaches and law reform capture international attention in 2019

Organizations faced a continuing crescendo of complex privacy and data governance issues through 2019, making it another highly eventful year in privacy law.

Mandatory breach notification after one year

November 2019 marked the first full year of mandatory breach notification under the federal *Personal Information Protection and Electronic Documents Act* (PIPEDA).

The privacy regulator blogged about a 600% increase in data breaches reported to the Office of the Privacy Commissioner of Canada (OPC) over the past twelve months. According to the OPC, more than 28 million Canadians were affected by these reported data breaches, 58% of which involved unauthorized access and a quarter of which involved social engineering attacks.

These statistics certainly correspond with a trend we saw unfolding with our clients. Many of Canada's largest corporations reached out for assistance in responding to harrowing experiences with ransomware and data extortion attempts that threatened to undermine their reputations, not to mention their operations. Many other organizations reached out proactively to seek assistance in developing agile breach incident response plans so they could be well prepared in advance if and when they fall prey to similar attacks.

Data transfers to third parties

The kerfuffle surrounding the rules applicable to data transfers to third parties for processing finally settled down after a tumultuous year. This upheaval was triggered by a change in OPC's longstanding policy position when it found, in the context of an investigation into a data breach matter, that Equifax Canada should have obtained consent from its customers prior to sending their data to its U.S. parent company for the purposes of processing their requests for certain direct-to-consumer products.

The OPC subsequently launched consultations to seek input from a broader range of stakeholders on whether this consent requirement should be generalizable to others. The OPC received 87 submissions from stakeholders (see Osler's AccessPrivacy submission here). The vast majority took the view that the current law does not require consent for transfers for processing, and that imposing such a requirement would create "enormous challenges" for organizations' business processes.

Clearly influenced by all the compelling counterarguments it received, the OPC decided to adopt a "flexible, common-sense and pragmatic approach" and restored its earlier 2009 Guidelines for processing personal data across borders that did not require consent for processing. Maintaining its view that existing privacy protections are "clearly insufficient," the OPC vowed to make recommendations to strengthen these protections in the context of PIPEDA reform.

If privacy was in the public eye in 2019, it promises to be an even more glaring issue in 2020 as Canada looks to modernize its privacy laws while the rest of the world ratchets up the stakes.

PIPEDA reform

On the subject of PIPEDA reform, stronger enforcement, enhanced accountability and possible consent exceptions were among the topics garnering much attention. Together with the unveiling of Canada's Digital Charter, Innovation, Science and Economic Development (as it was then called) released its white paper "Strengthening privacy for the digital age" (PIPEDA White Paper) containing a number of reform proposals for PIPEDA. In parallel, Justice Canada released another series of discussion papers proposing a significant "rethink" of Canada's public sector privacy law as well.

However, in the weeks leading up to the 2019 federal election in October, all consultations were suspended out of respect for the caretaker convention. Interestingly, the 2019 federal election itself further elevated the pressing nature of privacy and data security issues in the minds of Canadians. For the first time, the protection of Canadians' personal information made its way explicitly into the electoral platforms of all the major parties.

A unanimous resolution of Canada's federal, provincial and territorial commissioners calling for privacy and access law reform is likely to reignite the sense of urgency under the new minority government as this file competes for attention among many other priorities. In the Speech from the Throne 2019, the Government vows to advance "the development and ethical use of artificial intelligence" and to review current rules "to ensure fairness for all in the new digital space". What compromises will have to be made, and with which other political parties, remains to be seen in the months ahead. Early statements by the Minister of Innovation, Science and Industry indicate a firm commitment to press forward on privacy law reform. Should a legislative proposal indeed be tabled in this next Parliamentary session, stronger enforcement will almost inevitably form part of the package.

Increased international enforcement

Ramped-up enforcement was certainly a major theme internationally as well. International data protection authorities made major commitments to collaborate more closely on enforcement action and to facilitate cooperation with regulatory authorities in related fields of competition and consumer protection to ensure more consistent standards of data protection in the digital economy.

The International Conference of Data Protection and Privacy Commissioners (ICDPPC) met in Tirana, Albania in October 2019. The ICDPPC adopted a number of international resolutions reflecting their converging perspectives on some of the most pressing data protection issues of the day. They called on relevant stakeholders to address the need for appropriate safeguards to reduce the role of human error in data breaches and urged social media providers to take steps to stop the dissemination of extremist online content using their platforms, while continuing to protect freedom of expression.

Most interestingly, an OPC-sponsored resolution urged governments around the world to reaffirm their strong commitment to privacy as a fundamental human right, vital to the protection of other democratic rights. Businesses were urged to show demonstrable accountability by actively respecting privacy and other human rights as a key aspect of legal compliance, corporate social responsibility and an ethical business approach.

The EU General Data Protection Regulation

Continuing on the international theme, the EU General Data Protection Regulation (GDPR) settled into its second year of existence. Many global companies refined their privacy compliance frameworks, while EU Data Protection Authorities eased more comfortably into their enforcement role by unleashing hefty fines against those companies that didn't.

California's new privacy measures

All the hype around GDPR gave way this year to the California Consumer Protection Act (CCPA). Scheduled to come into effect January 1, 2020, the CCPA overtook much of the global attention this year not only because of the law itself, but also as a result of the strong influence it is having on many other U.S. states that are following California's lead and adopting and/or proposing similar state laws. This has prompted a strong lobby by some of the world's largest Internet giants for a more consistent, unified, U.S. federal privacy law.

New self-regulatory initiatives

Finally, this past year saw a growing number of stakeholders taking proactive steps themselves in the absence of law reform to find more innovative ways of protecting data. Some have taken up the invitation by regulatory authorities to participate in regulatory sandboxes, while others have developed ethical frameworks for the use of artificial intelligence and innovative privacy enhancing technologies.

Among these was the official launch of the Canadian Anonymization Network (CANON), a registered not-for-profit corporation co-founded by AccessPrivacy and several other leading organizations across public, private and health sectors. CANON supports the common mission to promote anonymization as a privacy-respectful means of innovating with data for socially- and economically-beneficial purposes.

As one of its first deliverables, CANON responded to ISED's request for comments on the deidentification issues and opportunities raised in its PIPEDA White Paper. In its Submission, CANON called for consistency of standards and definitions. CANON also advocated for a balanced legislative framework which: recognizes the contextual aspects of anonymization; adopts a more risk-based approach; clarifies the role of consent; and allows room for industry codes of practice that enable flexible, innovative and beneficial uses of data, while reasonably protecting against foreseeable privacy risks.

If privacy was in the public eye in 2019, it promises to be an even more glaring issue in 2020 as Canada looks to modernize its privacy laws while the rest of the world ratchets up the stakes.

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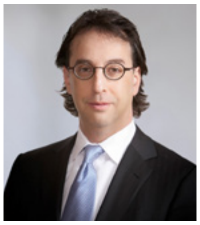

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TECHNOLOGY

Technology highlights: AI, financial services, PropTech and blockchain

Over the past year, the trends we wrote about in 2018 have continued. We have also seen the development and adoption of new technologies in mainstream businesses continue to accelerate in many vertical markets, both in the business-to-business and business-to-consumer contexts. As opportunities relating to innovation in artificial intelligence (AI), and machine learning in particular, continue to grow, debates regarding the need for a regulatory framework to ensure the ethical use of AI and the adequacy of Canada's privacy regime have become more active. In parallel, unique strategic alliances for the introduction of new products and services are forming at a rapid pace, raising novel commercial considerations regarding the appropriate way to address risk allocation and other terms in these innovative arrangements.

As in previous years, innovation in the financial services sector in Canada continues unabated. Developments in payments modernization and open banking are leading Canada towards a fundamentally different, and more complex, financial services ecosystem comprised of both incumbents and new FinTech entrants.

Over the past year, we have also seen the rise of new buzzwords, including "PropTech" and "UrbanTech," as clients in bricks-and-mortar businesses such as real estate and infrastructure, led by initiatives like Sidewalk Toronto, start to recognize and embrace the opportunities presented by new technologies.

One final trend of note for 2019 has been declining interest in public blockchain. Secure private blockchain implementations, by contrast, continue at a steady pace, but are no longer accelerating.

Increasing adoption of AI technologies

Of the many technological advances over the past year, AI continues to take centre stage. In 2019, the number of public and private sector organizations embracing initiatives to implement machine learning within key parts of their business increased significantly. As expected, this activity was particularly pronounced in sectors that possess the high volume of relevant and structured data required to power machine learning algorithms, as well as the data governance practices necessary to effectively employ the data. Activity is high in sectors such as financial services, telecommunications, supply chain, transportation and retail.

Increased prevalence of ethics principles and standards

As AI in the mainstream has continued to grow, the debate regarding the need for regulation of AI has also accelerated. Given the slow pace at which legislation or regulations are developed and introduced, we have seen an increasing role for non-legislative standards and principles designed to establish a common language and framework for commerce and, as noted by the CIO Strategy Council, to act as a proxy for regulation.

Within Canada, the following directives and standards are particularly noteworthy

- On April 1, 2019 the Government of Canada published its Directive on Automated Decision Making (the Directive), which will take effect on April 1, 2020. The Directive sets out minimum requirements for federal government departments that wish to use an automated decision system (i.e., technology that either assists or replaces the judgment of human decision-makers). The objective of the Directive is to ensure that such technology is deployed in a manner that reduces risks to Canadians and federal institutions, leading to more efficient, accurate, consistent and interpretable decisions. The Directive is now in its operationalization phase. Further guidance is anticipated in 2020 that will provide details about how organizations can comply with specific requirements, such as those related to transparency or explainability.
- On October 2, 2019, the CIO Strategy Council published a new National Standard of Canada, the CAN/CIOSC 101:2019 - Ethical design and use of automated decision systems, designed to help organizations design and implement responsible AI solutions. This standard provides a framework and process that can be both measured and tested for conformity. The framework is intended to offer consumers confidence in the technologies that are providing information, providing recommendations or making decisions using AI and machine learning.

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On the international front, the following standards and principles have attracted attention

- In February, the ISO/IEC JTC 1/SC 42, tasked by the International Standards Organization with carrying out standardization activities for AI, published the ISO/IEC 20546:2019 standard that sets forth a set of common terms and definitions to promote communication and understanding of big data.
- In May, OECD member countries approved the OECD Council Recommendations on Artificial Intelligence, which sets out principles for the stewardship of trustworthy AI. Shortly thereafter, in June, the G20 adopted G20 AI Principles that were drawn from the OECD principles. Given the profile of the OECD and G20, we expect many regional or sector-specific standards will make reference to these principles.

As we head into 2020, we expect that novel and complex legal issues will continue to surface. AI-specific regulations will emerge (e.g., in the area of copyright, factoring in the report of findings from the parliamentary review of the *Copyright Act*), and numerous ethics standards and principles will converge. Advising clients within such an unpredictable regulatory framework presents unique challenges. Practitioners in this area will need to be creative and nimble, with a focus on ensuring clients have preserved the flexibility in their commercial arrangements needed to adapt to regulatory requirements as they evolve.

Privacy compliance, data security and data use are becoming more complex than ever

The Privacy Commissioner of Canada has stated that, while AI solutions have the potential to foster significant societal benefits, they also present challenges to privacy and data protection rights and should be developed with “privacy by default and by design.”

As machine learning solutions reach the mainstream and move beyond simpler data analytics, the issues relating to data security, data use and data quality become more pronounced. The business models of many AI solution providers depend on their ability to use customers’ data to “train” their solutions and to deliver the value promised. As a result, discussions regarding data use rights and regulatory compliance have become more complex, with a need to focus on data use, data quality, de-identification standards and processes, data security and incident management, as well as valid consent. All of this must be addressed within an increasingly complex ecosystem where the achievement of data privacy compliance is often a shared responsibility among multiple stakeholders.

For lawyers advising clients in connection with AI-based commercial arrangements, it is often necessary to unpack broad definitions of data found in more traditional services agreements in a way that has not previously been required. It is necessary to consider its constituent elements, including customer input data, prediction data, a provider’s pre-existing data and generated data. This unpacking is increasingly essential to ensure that each party’s rights and responsibilities with respect to data use, data security and privacy compliance are appropriately addressed.

In recognition of the need for a common licensing framework for data in the machine learning context, a multi-disciplinary team of lawyers and Canadian researchers from the AI community collaborated to publish the Montreal Data License with the goal of reducing the ambiguity found in common data licenses. While it is not yet clear whether a significant number of organizations will adopt the Montreal Data License, the concepts set out in it serve as a useful framework for engaging in data licensing discussions.

Financial services evolution: Payments modernization and open banking

The financial services industry in Canada continues to be a key leader in embracing innovation and new technologies. FinTech start-ups are emerging within the Canadian market at a swift pace. New entrants are seeking to compete with and disintermediate the incumbents or partner with the incumbents (and in many cases both simultaneously). At a macro level, in addition to an increase in the adoption of AI, the developments outlined below are continuing. Over time, they will contribute significantly to the transformation of the financial services sector in Canada.

Payments modernization

Payments Canada continued its efforts to modernize the Canadian payments system to enable fast, secure, flexible, data-rich payment and settlement capabilities. Specifically

- On June 24, 2019, Payments Canada published a case study that evaluated the benefits of adopting ISO 20022 (the global payments messaging standard). The study concluded that adoption of this standard resulted in greater insight into treasury and cash management, the reduction of manual processes and increased visibility into the value chain. All of these benefits have the potential to increase productivity while reducing costs.
- On October 9, 2019, Payments Canada requested feedback on Lynx Policy Framework (the Framework) that will inform the drafting of by-laws for Canada's new high-value payments system. The Framework sets out policies regarding (1) access to the system; (2) finality of payment; and (3) service charges.

Financial institutions and payments solution providers are monitoring these developments closely, as they will require large scale implementation of new payment systems.

Open Banking

Open banking refers to an initiative that will enable customers to securely share their banking data with third parties through digital channels, with the goal of promoting innovation and improved access to novel financial products and services.

In January, the federal government released a consultation paper, "A Review into the Merits of Open Banking," as part of its efforts to undertake a review of the merits of open banking. Later in June, the Standing Senate Committee on Banking, Trade and Commerce released its report entitled, "Open Banking: What it Means for You" (the Report), where it called for "decisive action from the federal government to move forward with an open banking framework." The Report makes many recommendations to the federal government, including

- designating the Financial Consumer Agency of Canada (FCAC) as the interim oversight body for screen scraping and open banking activities
- providing immediate funding to consumer protection groups to help them conduct and publicize research on the benefits and risks of screen scraping and open banking activities
- facilitating the development of a principles-based, industry-led open banking framework

Notwithstanding the Report's call to action, progress has been slower than expected. Regulatory efforts are taking place globally, with particularly significant progress being made in the EU, U.K. and Australia. However, it remains to be seen whether Canada will follow suit in 2020.

PropTech and UrbanTech

The potential for innovation in the bricks-and-mortar world beyond the retail industry has been recognized for years. In 2019, this potential began to become a reality. Clients are starting to embrace technologies such as cloud computing and robotic process automation to vastly improve business processes and efficiency. They are also pursuing digital strategies to leverage data that they had not historically recognized as a valuable asset.

Perhaps spurred by initiatives such as Sidewalk Labs, the transformation of the real estate and infrastructure sectors also appears to have begun. Industries that have not historically focused on technological innovation will face challenges in unlocking the value of data or intellectual property as an asset. Industry players that are successful in making this transformation will, in our view, have a meaningful competitive advantage over those that are not.

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The slowing of blockchain and distributed ledger technologies activity

The pace of commercial activity in the blockchain space has decelerated due, in part, to the maturation of the innovation lifecycle and the lack of viable and economical use cases. Continued data privacy and security concerns have also contributed.

Security and privacy concerns remain a common theme in enterprise applications of blockchain and distributed ledger technologies (DLT). For instance, in August, the Privacy Commissioner of Canada released a joint statement with representatives from the global community of data protection and privacy enforcement authorities in five other countries (Albania, Australia, Burkina Faso, the U.K. and the U.S.) in respect of the Libra network (i.e., the permissioned blockchain digital currency proposed by Facebook Inc. that is targeted for launch next year). The statement emphasized the need to incorporate good privacy governance and privacy by design principles, as they are "key enablers for innovation and protecting data."

To address these concerns, we have seen organizations deploy private blockchains, such as Hyperledger Fabric, within the organization's secure private network that is not accessible to the public. These private blockchains often enable the organization to set access controls to further mitigate against the risks associated with security and privacy of personal or sensitive data. In cases where public blockchains are used, such as Ethereum, organizations are now increasingly raising concerns about storing private or sensitive information directly on the blockchain. Where the storage of information is required, often a pointer or hash is stored on the blockchain that references data that is stored off the blockchain or DLT. The data is secured by other means and is not publicly accessible.

A number of new standards seeking to assist with the proliferation and adoption of blockchain technology were published in 2019. Most notably, in September, the ISO/TC 307 Committee, approved by the International Standards Organization to develop blockchain and DLT-related standards, published the ISO/TR 23455:209 standard. This standard focuses on the technical aspects of smart contracts. It describes what smart contracts are and how they work, including various technical methods of establishing interaction between multiple smart contracts. We find this type of standard to be a helpful framework for engaging in discussions about smart contracts.

Conclusion

Heading into 2020, we do not see the pace of digital innovation, growth in AI or transformation abating. We expect that 2020 will be a year in which the regulatory and technological environments will continue to evolve, accompanied by more transformation and disruption in key industries. For lawyers advising clients in this area, it is an exciting time to innovate and create new market standards to keep pace with clients' evolving businesses.

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CRYPTOASSETS

Emerging clarity on cryptoasset regulation

Cryptoassets made headlines in Canada in 2019, and not always for the best reasons. Early in the year, a media hurricane swirled around the QuadrigaCX cryptoasset trading platform, whose founder apparently died while on honeymoon in India, allegedly taking with him the private keys for the platform's cryptoasset reserves. The platform attempted to restructure under court protection but was soon put into bankruptcy. Now, 75,000 customers face a collective loss of potentially more than C$200 million. Further investigation revealed a complete absence of financial controls, apparent misappropriation and misuse of customer assets, and other business practices that were particularly dubious for an enterprise that customers entrusted with hundreds of millions of dollars of assets.

Regulation may yet rein in the unrulier parts of the cryptoasset sector. Shortly after QuadrigaCX's collapse, Canadian securities regulators proposed a framework for regulating cryptoasset trading platforms, which would include provisions relating to custody, internal controls and business continuity. In July 2019, the federal government published final regulations that will subject dealers in virtual currency to Canada's primary anti-money laundering statute, the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* (the PCMLTFA). These regulations will require many cryptoasset businesses to introduce compliance programs, appoint compliance officers and make reports to the Financial Transactions and Reports Analysis Centre of Canada (FINTRAC). Finally, retail investors seeking exposure to bitcoin may soon have a regulated alternative to platforms like QuadrigaCX. In October 2019, a panel of the Ontario Securities Commission (OSC) set aside an earlier decision by OSC staff and directed the issuance of a prospectus receipt for The Bitcoin Fund, which could become the world's first publicly traded bitcoin investment fund.

Proposed regulatory framework for cryptoasset trading platforms

In March 2019, the Canadian Securities Administrators (CSA) and the Investment Industry Regulatory Organization of Canada (IIROC) published *Consultation Paper 21-402 Proposed Framework for Crypto-Asset Trading Platforms*, which proposes a regulatory framework for platforms that trade cryptoassets.

The proposed framework draws upon requirements applicable to securities and commodity futures exchanges, alternative trading systems, clearing agencies, custodians and dealers. The framework contemplates various operational requirements intended to protect participants from the counterparty and other risks associated with platforms, such as requirements for market integrity, market surveillance, fair pricing, custody, clearing and settlement, disclosure of conflicts of interest, and systems and business continuity planning. The framework would apply to platforms located in Canada, as well as foreign platforms with Canadian participants, though foreign platforms may be exempt if they are appropriately regulated in their home jurisdiction.

A key threshold issue is how Canadian securities regulators can assert jurisdiction over platforms that trade cryptoassets such as bitcoin that are not, in and of themselves, securities or derivatives. CSA/IIROC acknowledged that some cryptoassets are analogous to fiat currency and precious metals and are more appropriately characterized as commodities. Nonetheless, CSA/IIROC proposed to apply securities legislation to platforms that offer trading in these cryptoassets where the legal arrangement between the platform and its users may itself be a security or derivative.

Currently, however, the framework is only for discussion. CSA/IIROC received numerous comments in response to the consultation paper, and IIROC formed a Crypto-Asset Working Group in October 2019 to recommend how best to tailor securities regulatory requirements for cryptoassets. We expect that the next phase in this process will be publication by the CSA of a draft National Instrument which will be subject to a public comment period.

Long-awaited amendments to the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* published in July 2019 will require "dealers in virtual currency" that offer services to Canadian clients to register as money services businesses with FINTRAC as of June 1, 2020.

AML regulation now applies to dealers in virtual currency

Long-awaited amendments to the PCMLTFA published in July 2019 will require "dealers in virtual currency" that offer services to Canadian clients to register as money services businesses (MSBs) with FINTRAC as of June 1, 2020. MSBs are subject to customer due diligence, record-keeping, monitoring and reporting requirements under the PCMLTFA.

Regulatory guidance states that "dealing in" activities include virtual currency exchange services and value transfer services, which would likely include cryptoasset trading platforms and brokerages/intermediaries for virtual currency transactions. Less clear is whether emerging platforms for cryptoasset-secured lending will be considered "dealing in" activities.

Many Canadian cryptoasset exchanges adopted know-your-client (KYC) procedures consistent with regulations made under the PCMLTFA prior to publication of the final amendments for the purpose of addressing various business risks, including risks identified by potential banking partners. However, FINTRAC generally declined to register these businesses as MSBs or supervise their activities due to lack of jurisdiction. On November 22, 2019, FINTRAC announced that virtual currency dealers are permitted to voluntarily register as MSBs in advance of the June 2020 deadline, which is likely to be welcome news for many Canadian cryptoasset trading platforms seeking to demonstrate compliance to prospective service providers and customers.

Foreign cryptoasset platforms that direct services to Canadians will be subject to the same compliance requirements as domestic platforms, with slightly less onerous record-keeping requirements. Regulatory guidance indicates that targeting, or advertising to, Canadian clients or having a Canadian domain name are indicia that a foreign platform is "directing services" to Canadian clients.

OSC allows first publicly traded bitcoin investment fund

On October 30, 2019, a panel of the OSC released a decision that will allow 3iQ Corp., a Canadian investment manager, to offer the world's first publicly traded bitcoin investment fund. The fund is intended to offer retail investors a regulated alternative to purchasing and holding bitcoin.

Since late 2016, 3iQ has been developing The Bitcoin Fund, a proposed non-redeemable investment fund that would invest substantially all of its assets in bitcoin. In February 2019, the Director of the Investment Funds and Structured Products Branch of the OSC declined to issue a receipt for The Bitcoin Fund's preliminary prospectus. The Director concluded that bitcoin was an illiquid asset and therefore the fund could not comply with regulatory restrictions against holding illiquid assets. In addition, the Director concluded that it was not in the public interest to issue a prospectus receipt because of concerns about the integrity of the market for bitcoin, the security and safekeeping of the fund's bitcoin, and the fund's ability to file audited financial statements.

Following a hearing in July 2019, an OSC commissioner set aside the Director's decision. After reviewing the evidence, the commissioner found that there was a liquid market for bitcoin. The commissioner also found that there was insufficient evidence to show that any price manipulation was preventing price discovery for bitcoin, that the fund's custodial arrangements for its bitcoin were inadequate, or that the fund would be unable to comply with requirements for audited financial statements.

In making the decision, the commissioner observed that the fund was innovative and could mitigate risks for investors:

> *The notion of professionalizing investing in risky assets to mitigate risks should be encouraged, not discouraged. Ontario capital market participants should be encouraged to engage with the Commission, and not incentivized to avoid doing so. Pooling of investor funds under a professional management structure to address and mitigate risks in an underlying asset market is innovative and should be encouraged, especially when it provides an alternative to investors acquiring bitcoin through unregulated vehicles.*

The decision directs the issuance of a receipt for a final prospectus of the fund. Upon the issuance of a receipt for the final prospectus and acceptance for listing on a Canadian securities exchange, The Bitcoin Fund would be the first publicly traded bitcoin investment fund in the world. Overall, the decision is encouraging for the development of new fund products that invest in new asset classes and sends a strong message in support of innovation in capital markets in Canada.

Osler represented 3iQ and The Bitcoin Fund before the OSC.

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Looking ahead to 2020

One likely effect of new cryptoasset regulations under securities and anti-money laundering laws will be the exit of cryptoasset businesses that are unable to absorb growing compliance costs, particularly when cryptoasset markets are down significantly since the highs of 2017. On the other hand, new compliance requirements will require surviving incumbents and new entrants to ensure they have proper controls in place that will mitigate many of the inherent risks of existing cryptoasset platforms.

Even as regulators take steps to mitigate these risks, new challenges lie ahead. In 2019, we saw rapid growth in asset-backed tokens (often referred to as stable coins), highly leveraged cryptoasset derivatives and cryptoasset-based lending. There is every reason to think these trends will accelerate in 2020. The development of sophisticated financial instruments built on new and rapidly evolving technology and traded on a global scale through unconventional platforms with uneven regulatory oversight suggests there will be more failures of major cryptoasset businesses before regulation becomes firmly established.

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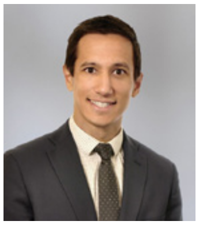

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