

In Brief

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In Brief: General comments on legal developments of concern to business and individuals

In This Issue

Those who view challenges as opportunities often reap benefits and avoid calamities. The first two articles, on divergent topics, reflect that theme.

In the not-too-distant future, companies and businesses will face lawsuits alleging that their actions or inactions affect(ed) climate change! Is that a reasonable possibility? That nightmare (likelihood) in "...When the Other Shoe Drops." In the lead article, Sergio Marchi speaks of challenges and opportunities for Canadian business. His salient words: "China's economic energy and zeal will not be reversed any time soon, nor will [its impact] on the North American marketplace."

There are full articles on a number of other business concerns: PDAs, Cyber-libel, competition law issues, confidentiality agreements, "virtual" property and two articles on recent legislative changes in business law.

LAW NOTES focuses on Hong Kong, cross-border acquisitions, non-competition clauses, employee suspensions and the many concerns, costs and consequences of corruption. In TAX NOTES, an update on a tax that seems to be on the way out.

In the hard copy, catch some reflective thoughts and light moments in *Brief Life Bites* – look for the 3Cs: Connections, Civility and Currency. Finally, your *Letters and Comments* and a little bit about us.

Contents

	Page
Engaging China: Understanding the Challenges; Seizing the Opportunities	1
Liability for Climate Change: The Other Shoe Drops	2
NDA's: The Realities in Today's Information Age	4
Cyber-libel: Options for the Defamed	5
Virtual Property at Risk: Contract and IP Set to Collide	6
Ontario Modernizes its Business Law	7
What is a Control Agreement, Anyway?	8
Self-Regulated Professions Under Competition Bureau Spotlight	10
Workers Without Borders: Who's Listening to Your Business?	12
The Crucial "but for" Test in Determining Causation	13
LAW NOTES	14
TAX NOTES	16
Brief Life Bites	17
Letters & Comments	18
Lang Michener, In Brief	18

Engaging China: Understanding the Challenges; Seizing the Opportunities

Ed.: *The following are edited excerpts of an address given by the author at the "Symposium on Responses of the United States and Canada to the Economic Challenges Posed by China" in Washington D.C. The author was present in his capacity as President of the Canada-China Business Council.*



Sergio Marchi

For many years, Canadians have been proud to underline that Canada and the United States are each other's largest trade partners. So when it was announced in 2005 that for at least one month, China had surpassed Canada as the United States' largest trade partner, it was an economic signal for

Canadians. It reflected a fundamental paradigm shift in the global economy that forced Canadians to rethink their position in the North American and global economies.

Indeed, Canada-China trade has grown dramatically to the point where, today, China is Canada's second largest trade partner. However, a central concern is the growing disparity of trade levels. Between 2001 and 2005, our exports to China grew 65%, while our imports from China grew an astonishing 115%. Also of concern is that about 80% of our exports to China consist of resources.

The central lesson in dealing with China so far is that, no matter how big or small, every Canadian firm needs a China strategy. It may be active or passive, depending on the company's resources, but it is absolutely crucial to understand how China is changing the global economy and there is a need to develop an effective response.

Canadian companies also need to recognize that there may be a link between lack of foreign investment in China and Canada's lagging trade performance there. So much of international trade is now within companies. The new mantra is integrative trade.

"Integrative" encompasses all the emerging elements of international business: exports, imports used in exports, FDI, use of foreign affiliates for sales, and globalized production and distribution. Indeed, more than half of Chain's exports originate from multinational firms operating in China. In an attempt to remain globally competitive, many foreign firms are investing in China so as to integrate China into their global supply chains.

But despite an increasingly global economy, the main priority for Canadian companies remains focused on the U.S. market and U.S. customers.

China – The Opportunity

As much as the changes have created new challenges, China has also brought new opportunities. Massive economic reforms and obligations under the WTO, for instance, have created new openings in China. Those that are able to understand these changes and adapt successfully will be well placed to take advantage of these

ever-changing circumstances. There is also significant symbiosis between Canada and China. China is a resource-hungry nation, and Canada is well regarded and blessed as a resource country, with both resources to explore and the expertise to do it.

Chinese firms have taken some initial investments in Alberta's oil patch and it is no secret they are looking for more, as well as to secure sources of other commodities. In addition, major Canadian financial services and insurance companies have long and established histories in China, and have successfully penetrated the Chinese market.

In China, Canada has a strong reputation as a source of environmental technologies and alternative energy sources. Further, we have had notable successes in construction products and services, transportation, infrastructure, and education. Finally, there are also opportunities for Canadian and Chinese companies to work in both directions. Nortel, for example, has secured numerous contracts in China building up its communications infrastructure and at the same time, has tentatively agreed to work on a joint venture based in Canada with Huawei, one of China's leading global firms.

China's economic energy and zeal will not be reversed any time soon, nor will its impact on the North American marketplace. Our challenge is to fully understand what the changes mean, and to embrace the new economic opportunities that are being created. Our history in Canada, including our trade history with the U.S., is rich with examples of our nation's economic resilience and the ability of our private sector leadership to adapt to changing economic forces. I remain hopeful that this spirit of entrepreneurship will continue to shape our future as a country, at a time in our history when China takes its place within the economic elite of the world.

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Ed.: *The more complete text of this edited address appeared in the Winter 2007 issue of International Trade Brief.*

Liability for Climate Change: The Other Shoe Drops

Ed.: *Not many decades back, the notion of a lawsuit against tobacco manufacturers for tobacco-related illnesses was unheard of, if even conceived. Not unlike then, the issue today of legal liability for climate change may jar and seem novel, if not bizarre. Yet, in the United States, climate change is already a serious legal concern and, as is often the case, things American, in one form or another, end up here.*



Sunny Pal

It is as inevitable as the dropping of the other shoe, and it should not take anyone by surprise. The "other shoe" is the legal fall-out from climate change.

While climate change is a new and expanding field of knowledge (although some may still deny its existence), the laws defining related issues of respon-

sibility, obligations and legal duties are inevitably a step or two behind – the lag being typical whenever society comes to grips with new knowledge. The challenge for business remains always to anticipate consequential societal and legal demands, and that is daunting, especially if there is any hint of retroactive liability.

Canadian companies are aware of the northward migration of U.S. corporate governance standards in the past, especially those inter-listed on U.S. stock markets. Climate change will likely create similar (migratory) patterns and standards.

Investor Pressure

Reaction in the U.S. to legal liability aspects of climate change has overtaken the political debate. The *Directors Monthly* (“DM”), the journal of the National Association of Corporate Directors, asserts: “Shareholders and institutional shareholders are pressuring companies to address green-house gas (“GHG”) emissions and publicize those efforts through corporate disclosure.” Major U.S. public companies were faced with at least 32 climate-related resolutions at their annual meetings by mid-2006, demanding disclosure of risks and strategies. The primary focus has been the electric power and oil and gas sectors, but the automotive, banking, insurance, construction and even retail and shopping mall sectors were also targeted. Regardless of the actual outcomes of the resolutions, it is the attention those resolutions require at the highest levels of legal and business management that is noteworthy.

In a February 2006 survey, a group of 225 institutional investors (managing assets of US\$31.5 trillion) queried 2,100 companies (including 500 of the world’s largest, the “FT 500”) as to their emissions, remedial actions and risks to the bottom line. Of the FT 500 companies, a substantial majority recognized that climate change provided risks as well as opportunities, while over one third felt that regulatory measures represented financial risk.

While the disclosure regulations of the U.S. Securities and Exchange Commission do not specifically require it, more than 90% of the largest U.S. public companies have recently started to include climate change in their discussions of issues “reasonably likely to have a material effect” on their financial condition or operating performance.

The DM review notes that more than 1,000 companies, including General Motors, Sunoco and Nike, are already using guidelines issued by the *Global Reporting Initiative* for measuring and reporting on their energy, water and materials consumption, as well as on their GHG emissions.

In October 2006, 14 major institutional investors (representing trillions of U.S. dollars) joined forces with the *Global Reporting*

Initiative and others to publish a Framework for companies to determine what information should be provided to investors concerning the financial risks posed by climate change. Is this the shape of things to come?

Insurance and Other Pressures

The DM review notes that the insurance industry, reacting to the devastating hurricane losses in 2004 and 2005, is now pressuring companies to consider global climate change and GHG as risks, just as any other material financial risks the companies face.

The DM review advises board members of U.S. companies that have possible climate change exposures to be aware of increasing court litigation efforts – some “novel” – by plaintiffs to hold those companies liable.

There is also a proliferation of legislative initiatives pending at various U.S. levels, even though the U.S. does not subscribe to the Kyoto Protocol. Control in Congress has changed, while individual states like California have enacted their own GHG laws. This strongly suggests vigilance, careful monitoring and planning.

The challenge for business remains always to anticipate consequential societal and legal demands, and that is daunting, especially if there is any hint of retroactive liability.

Business opportunities

On the positive side, the DM review also suggests “the challenges of climate change ... present unprecedented opportunities [such as] cost savings, growth, generation of positive public relations and green product branding.” Emissions trading is a new dynamic, and pro-active companies can join 175 others like AEP, Ford, Motorola,

DuPont and IBM at the Chicago Climate Exchange to gain real-time experience in this field. Separately, billions of U.S. dollars in funding are available for research into alternative fuels and GHG reduction.

Some Final Notes

U.S. boards recognize the long-term risks and concerns arising from climate change issues, but the DM review sees opportunities for minimizing those risks while maximizing energy efficiencies and “ultimately improving the bottom line.”

Undoubtedly, Canadian business, as well as the legal and financial professions, will and should be interested in what our southern neighbours are doing in this new area of corporate governance.

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Ed.: *The author wishes to extend his appreciation for the consent granted by the Washington-based Directors Monthly to refer to the article in its December 2006 issue: “Feeling the Heat: Boards Face Increasing Pressure to Address Climate Risks” by David van Hoogstraten and Jim Rubin.*

NDA: The Realities in Today's Information Age



Karl Gustafson

Most lawyers feel comfortable and confident in pulling out a well-used precedent when drafting an agreement. Every once in a while, however, circumstances change that render the tried-and-true completely inappropriate.

Almost daily we see confidentiality or non-disclosure agreements (“NDAs”) that impose obligations that are not possible to meet, but which business people, nevertheless, happily agree to, apparently oblivious to the potential consequences. Fortunately, it seems that the party that stands to benefit from those obligations is equally unaware of the fact that the other party will not likely perform its contractual obligations. As a result, the breach generally goes undetected and both sides proceed in blissful ignorance.

NDAs are utilized in a great variety of circumstances, including covering the exchange of information in merger and acquisition transactions, private equity and debt financing due diligence, and joint venture agreements. In almost all cases, confidential information is provided by one party to another on the critical condition that it will be used for certain limited purposes and then either returned or destroyed. The problem in this age of electronic data transfer and storage is that the return or the destruction of the confidential information is not practicable on any sort of commercially reasonable basis and may be, therefore, virtually impossible. Yet senior executives routinely sign documents in which they certify that all confidential information received by them has been either returned or destroyed.

The reason for this discrepancy between theory and reality lies in the fact that information transmitted and stored in electronic form is exceedingly difficult to contain and control. The most obvious example, at least one that will be obvious after some reflection, is that most businesses routinely create backup copies of all data on their servers on a daily or even hourly basis. Data is archived in secure offsite facilities, sometimes in “hotsites” that provide almost immediate access to the data and sometimes in “coldsites” where access requires a disk to be physically installed in a server. Nevertheless, confidential data that is provided in electronic form is routinely copied and saved outside the immediate control of the recipient and probably without their knowledge. As a practical matter, when parties seek to destroy copies of confidential information, rarely do they consider destroying the copies that are stored

in these archived files. Moreover, even if they were to consider doing so, the task would be daunting and unlikely to be successful.

A less obvious example occurs when information is stored on hard drives, floppy disks, recordable compact discs or DVDs, flash cards, smart sticks and data management systems. Merely executing a delete function in most major operating systems, such as Windows, only means deleting the file system’s “pointer” to a file’s contents. The underlying data is not actually destroyed; it is merely more difficult to access. The well-meaning executive seeking to comply with an obligation to destroy confidential information will likely believe the obligation has been satisfied once the data is deleted.

The more diligent will go a step further to execute a “wipe” function which actually overwrites the contents on the disk with random or dummy data. However, even that step is not likely to be completely effective in destroying the data.

It is important to consider this issue from the perspective of both the recipient of the confidential information and the disclosing party. If the disclosing party truly is concerned to ensure that all confidential information is either returned or

destroyed, the NDA should contain terms that very strictly control the media on which the information is copied. Hard copies are relatively easy to track and control but in many cases not a practical solution. Providing a limited number of identifiable DVDs, floppy disks, smart sticks or flash cards might be a better option. Another alternative may be to post data to secured virtual data rooms and to prohibit any copying. Of course, these options will not be effective to prevent cheating if a party is inclined to be dishonest. However, it does at least allow the party who wishes to honour its obligations to do so.

If the recipients of confidential information are bound by an obligation to return or destroy that information, they need to be vigilant in ensuring that electronic copies do not find their way into various desktop hard drives or corporate data management systems where backup copies are likely to be made. Failure to do so could expose them to significant expense if the disclosing party wishes to insist on strict compliance with the letter of the NDA.

In this age of electronic data transfer and storage, the return or destruction of the confidential information is not practicable on any sort of commercially reasonable basis.

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Cyber-libel: Options for the Defamed



Michael L. Bromm

The Internet continues to revolutionize global communication. A single message, whether posted by e-mail or to a website, can instantly reach essentially limitless numbers of recipients all over the world. Whether that is a boon or a hazard depends largely on what is being communicated to whom, and for what purpose. Like any powerful tool, discourse over the Internet can be put to ends both lofty and base.

One of the more base uses arising with increasing frequency is defamation, or so-called cyber-libel – statements published on the Internet that tend to lower a person in the estimation of reasonable members of society. The fundamentals of defamation law have not changed with the advent of the Internet. The common law has long recognized that a person’s right to free speech does not extend to damaging the reputation of another by disseminating falsehood and that a person whose reputation is injured in this way is entitled to a legal remedy.

One forum where cyber-libel currently appears to be enjoying a surge in popularity is on bulletin boards dedicated to the discussion of the stock of various public corporations. These sites are often free to use, and even if they require users to register before posting, usually do not authenticate the personal information provided in the registration process. In that sense, the users of such sites are anonymous, and may behave as if they cannot be held to account.

However, even in cases where the person posting the offending messages uses a pseudonym, a defamed party is not without a remedy. If the libel warrants legal action, it is possible initially to sue the party as John or Jane Doe. Once the action is commenced, a series of court orders can usually be obtained to identify the poster by IP addresses and similar electronic trails. When the identity of the person has finally been ascertained, he or she is then sent a “package” welcoming him or her to the wondrous new world of legal proceedings. Sometimes, the very fact that the person realizes that he or she has been caught is sufficient to stop the postings.

Two recent cases, *Barrick Gold v. Lopehandia* and *Vaquero Energy v. Weir*, dealt with defamation on such stock bulletin boards. *Vaquero* was a case from Alberta in which the court awarded damages of \$75,000, \$25,000 of which were punitive, in con-

nection with defamatory internet postings over a four-month period. *Barrick* was a similar case from Ontario, in which vicious messages alleging various immoral and illegal behaviour on the part of Barrick were posted by a B.C. resident. The court in that case awarded \$125,000 in damages to Barrick, \$50,000 of which were punitive, and issued an injunction prohibiting the defendant from posting similar messages in the future.

It was not clear in advance how seriously courts would treat defamation published on the Internet. However, these cases have established that, all other things being equal, cyber-libel will be treated as *more* damaging than conventional defamation. In the words of the majority of the Ontario Court of Appeal in *Barrick Gold*, “[C]ommunication via the Internet is instantaneous, seamless, interactive, blunt, borderless, and far-reaching. It is also impersonal, and

the anonymous nature of such communications may itself create a greater risk that the defamatory remarks are believed.... [T]he mode and extent of publication is therefore a particularly significant consideration in assessing damages in Internet defamation cases.”

Not every libel necessarily warrants litigation. Engaging the machinery of the judicial system should not be done lightly, and each situation should receive special consideration on its facts. It is important to gauge whether the statements are genuinely harmful to one’s reputation, as opposed to merely being offensive. Paradoxically, there are situations where the mere fact that a lawsuit is commenced may give an air of legitimacy to the allegations, as if the only purpose of the action is to keep skeletons in the closet. On the other hand, inquiries or comments about the

offending postings from members of the community or from investors may indicate that the defamatory message is getting around and should be taken seriously. Such considerations should carefully be weighed in advance of commencing an action.

The message, though, is that there are powerful legal tools available to a person who is defamed on the Internet to identify even an apparently anonymous poster and obtain an appropriate legal remedy.

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Virtual Property at Risk: Contract and IP Set to Collide



Kevin E.
Holbeche

From foundations laid in the 1960s, through the birth of the Worldwide Web in the early '90s, to the subsequent bursting of the dot-com bubble, and beyond, the Internet has taken on a life of its own. Today, with the recent rise and popularization of on-line social networking communities, from the MySpace™ hosting service to the hugely popular World of Warcraft® game, people on the Internet are now reaching out, connecting and meeting up with one another in virtual environments.

In these and other Internet communities, computer users interact with one another and gain reputations for their virtual identities. The effects are starting to be felt in the real world. Illustrative of this fact was the May 1, 2006 cover of *Business Week*, which featured a picture of Anshe Chung, the first virtual person to become a real millionaire. Chung, who is the virtual identity of a real-world person by the name of Ailin Graef, achieved a net worth in excess of US\$1 million entirely through transactions involving virtual property in the Second Life® on-line world – a virtual space where “residents” can exchange the world’s virtual money (Linden™ dollars) for real-world U.S. currency.

The Second Life® on-line community is out-of-the-ordinary even when compared to other virtual worlds, since its users are afforded a measure of ownership over, and even encouraged to trade in, the intellectual property (“IP”) that they help to create on-line. On the other hand, most on-line game providers, for example, Blizzard Entertainment, Inc. (the company behind the World of Warcraft® game), have taken steps to restrict real-world sales of the virtual property that exists solely within such games (e.g., in-game currency and other virtual items). Perhaps as a result of such efforts, the eBay® listing policy now requires a seller to be the owner of the underlying IP in any virtual items, or to be authorized to distribute the virtual items by the IP owner.

No longer confined to the pages of sci-fi novels, therefore, virtual property interests are ones that are starting to receive some serious attention. As might be expected, the emerging rules which govern IP trade on the virtual frontier are set by the service providers; that is, by the hosts of the virtual worlds. Users must indicate that they agree to the rules set by the host, that are usually proffered in the form of a click-through agreement in order to gain access to the virtual space.

The host of a virtual space will typically maintain server-side computing power, and their IP (whether protected by patents, trademarks, and/or copyright) may include software, as well as certain templates and other environmental content that underlies the virtual space. At the other end of the information superhighway, users frequently input and upload their own IP (including their previously copyrighted works, trademarks, etc.) into the virtual space, or they may create new and original works based on the host’s IP. In this way, the users and the host may together be co-authors of the newly created work. In fact, IP in virtual worlds can be co-authored by the host, by multiple users, and/or by outside content providers.

Virtual property can take any number of forms, including virtual characters (“avatars”), virtual objects (e.g., clothing, cars, buildings, trees) and virtual landscapes, among other things. Frequently, real-world programming scripts may underlie the virtual property.

Other forms of virtual property may include performances taking place in the virtual space, such as dramatic, musical and spoken word (or type-written) performances, as well as the cinematographic rights associated with a user-recorded “walk-through” of the virtual space.

In clicking through the terms of use, visitors traveling down the virtual rabbit hole to Wonderland will typically be asked to (1) grant the host a licence to use any

uploaded IP; (2) represent they are authorized to upload the IP and provide the licence, and (3) undertake to indemnify and hold the host harmless against any claims of IP infringement.

Visitors to the virtual space may, nonetheless, be exposed to liability for IP infringement as a result of purchasing or using virtual property which is provided by others. For this reason, it is important for service providers and for the users of virtual spaces to ensure that the terms of service and any associated IP licences provide adequate assurance and protection against claims for IP infringement, both from other users and from outside IP owners. Users of virtual spaces, in particular, should keep in mind that privacy of contract may bar them from relying upon any obligations, representations, and/or licences that may have been ostensibly provided by other users under the terms of service.

For the present time, it would seem that many virtual worlds are enjoying a calm period of relatively lax IP enforcement. The trade in virtual property is bustling. Residents regularly contribute value to these virtual spaces by creating and/or uploading IP con-

In some Internet communities, computer users interact with one another and gain reputations for their virtual identities.

tent. Unfortunately, these halcyon days may not last forever. While some real-world IP owners are still oblivious to potential infringement in virtual spaces, an increasing number of players with large IP portfolios are entering the fray. Virtual property owners and hosts may soon find an increased pressure to scrutinize and validate the underlying IP ownership in commercially traded virtual properties so as to better ensure against IP infringement.

Users in violation of a host's click-through IP policies and terms of service could find their virtual property interests seized or dissolved. Consider, for example, the ongoing case of *Bragg v. Linden*

Research et al. That case arose after Linden Research (the host of the Second Life® on-line community) suspended Bragg's account for violating their Terms of Use and liquidated virtual property for which Bragg claims to have paid about US\$8,000 in real-world currency. Bragg, an attorney in the United States, sued for damages.

That case, like much of the law on virtual property at the convergence of contract and IP, remains to be decided.

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Ontario Modernizes its Business Law



Eric Friedman

As part of the Ontario government's continuing efforts to update and modernize business law, more than 30 provincial statutes have been amended by *An Act to modernize various Acts administered by or affecting the Ministry of Government Services* (formerly Bill 152) (the "Act").

The *Personal Property Security Act* ("PPSA") is one of the statutes substantially amended by the Act. In this abridged article, a few of the key changes that have practical, everyday significance will be briefly canvassed.

Definition of "Debtor"

The Act expands the definition of "debtor" to include a person who "owns or has rights in the collateral, including a transferee of or a successor to a debtor's interest in collateral."

Of significance, the new definition expressly contemplates that the person who owes payment or other performance of the obligations secured may be different than the person owning or having rights in the collateral. From a practical perspective, this will obviate the need to obtain a guarantee from a person owning collateral where the sole reason for such guarantee is to enable the secured party to obtain a valid security interest in such collateral.

For example, when a shareholder of a borrower is required to pledge shares as security for a loan to the borrower but is not otherwise required to guarantee the indebtedness, we often obtain a "limited recourse guarantee" to create an obligation that can be secured by the share pledge. With the extension of the definition of debtor contained in the Act, such shareholder will simply be able to grant a pledge without having to give a limited recourse guarantee.

Since all leases (regardless of type) with a term of more than one year will be subject to the PPSA, lessors (or their counsel) will be required to file financing statements.

Leases for a Term of More Than One Year

Another important change to the PPSA made in the Act is that the PPSA will apply to leases for a term of more than one year. The PPSA will apply to such leases "even though the lease may not secure payment or performance of an obligation."

The issue of whether a lease is a "true lease" or a "financing lease" has been the subject of considerable litigation over the years. Since all leases (regardless of type) with a term of more than one year will be subject to the PPSA, lessors (or their counsel) will be required to file financing statements and otherwise comply with

the provisions of the PPSA in respect of such leases. Counsel will no longer have to analyze factors such as the identity of the lessor, the value of any purchase options and intention of the parties in determining whether registration of a financing statement is necessary to protect the lessor's interest.

It is important to note that the term "lease for a term of more than one year" includes, in certain circumstances, leases for one year or less. For example, if a lease

provides that it is renewable for one or more terms at the option of one of the parties or by agreement of all of the parties and therefore could extend beyond one year, it will be deemed to be a lease for a term of more than one year for purposes of the PPSA.

Despite this amendment, however, the Act adds new section 57.1 to the PPSA, which provides that the rights and remedies on default, as set out in Part 5 of the PPSA, only apply to leases that secure payment or performance of an obligation. Therefore, where there is a "true lease," the rights and remedies of the parties after default will continue to be determined outside the PPSA.

Transactions in the Ordinary Course of Business

Section 28 of the PPSA sets out various provisions to protect a buyer of goods who purchases from a seller who sells the goods in the ordinary course of business. Such a buyer receives the goods free of any security interest granted by the seller, even a perfected security interest of which the buyer is aware. The Act will add to this protection by providing that it applies whether or not (i) the buyer takes possession of the goods, (ii) the seller was in possession of the goods at any time, (iii) title to the goods passed to the buyer, or (iv) the seller took a security interest in the goods. These changes are reflective of the Ontario government's policy of protecting consumers over secured parties.

Inventory PMSIs

The Act makes a significant change to the provisions and procedures relating to purchase-money security interests ("PMSI") in inventory. One of the sources of conflict under the existing PMSI rules is between inventory financiers and receivables financiers. Since a secured party which follows the rules relating to inventory PMSIs gets a priority in respect of such inventory *and the proceeds thereof*, a secured party which finances the accounts receivable of such debtor could lose its priority with respect to accounts receivable purchased or financed by it. More troubling, this could happen without its knowledge. Since the inventory financier is only required to send a PMSI notice to prior secured creditors who have checked the "inventory" box on the financing statement, receivables financiers are not necessarily notified of the PMSI being claimed in the inventory and its proceeds (including the receivables arising from the sale of such inventory).

Under the Act, a secured party seeking to obtain a PMSI with respect to inventory will be required to give notice to all secured creditors with a prior registered security interest in inventory and accounts. This will be a fundamental change in the manner in which inventory financiers protect their interests.

The Act makes a significant change to the provisions and procedures relating to purchase-money security interests in inventory.

Service of Notices

As another illustration of the Act's modernization of business law, Section 68 of the PPSA will be amended to update the means by which notices and documents may be sent, and will include the sending of notices by fax or electronic transmission (in addition to personal service, prepaid courier and registered mail). Section 68 will also be amended to provide for the deeming of receipt of notices; of significance is the fact that the amendments will deem inventory PMSI notices to be delivered upon expiry of a 10-day period following registration of registered mail, if delivered in that fashion, or upon actual receipt or the first business day after, whichever is earlier, of transmission by fax or electronic transmission. This amendment will create certainty for inventory financiers as to when the priority of the PMSIs will commence.

Registrations

There are a number of additional changes to the PPSA in the Act, including amendments to the conflicts of laws provisions, and the fact that registration will no longer be permitted in paper form; only electronic registrations will be accepted. Furthermore, the commentary from the government that accompanies the Act indicates that the system for registration in Ontario of "checking the boxes" on a financing statement will be replaced with a system requiring the secured party to describe the collateral in which it has a security interest (as is the case will all other provinces and territories in Canada). The timing for this change is not yet known and depends, in large part, on the government ensuring that its computer system is able to handle this change.

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Ed.: *For a more complete overview of changes to the PPSA, the unabridged version of this article is available on our website.*

What is a Control Agreement, Anyway?



Jeff Heimbuch

As new provincial statutory requirements come into play, lenders need to re-evaluate their approach to taking security over shares and other securities, and borrowers and their CFOs need to understand how to respond to new requests and considerations.

In Ontario, the *Securities Transfer Act* (Ontario) (the "STA") and related amendments to the *Personal Property Security Act* (Ontario) (the "PPSA") are now in force.

Substantially similar legislation now exists in Alberta and it is anticipated that the rest of the provinces will follow suit soon.

This legislation, once fully implemented, will provide harmonized rules for the transfer and pledging of securities across Canada that better reflect and deal with market practices that have moved away from the issuance of certificates for publicly-traded securities to various book-based systems. Since the STA and PPSA amendments are based on Articles 8 and 9 of the *U.S. Uniform Com-*

mercial Code, the Canadian laws will also ultimately be harmonized with those in the United States.

Holding Systems

In North America, securities are held under two systems: the “direct holding system” and the “indirect holding system.” The direct holding system is characterized by direct relationships between issuers and investors, such as the relationship between a private company and its shareholders. The indirect holding system is characterized by indirect relationships between issuers and investors, where the securities are held through a securities intermediary, such as a bank or trust company acting as a custodian, a broker, or Clearing and Depository Services Inc. (“CDS”).

Although the terminology used in the PPSA has changed slightly, the STA has not substantially changed the relevant rules applicable to secured transactions in the direct holding system. The most important changes relate to the indirect holding system, where secured parties have a new ability to perfect their security interest by way of a tripartite “control agreement” between the securities intermediary, the secured party and the pledgor.

PPSA Amendments – New Terms and Concepts

The changes to the PPSA resulting from the STA introduce several new important terms and concepts which are not fully canvassed in this abridged version of the article, except to note that “investment property” is now a PPSA term establishing a broad new category of collateral including securities, securities entitlements, securities accounts, futures contracts and futures accounts.

“Control” as a New Method of Perfection and New Priority Rules

The new method of “control” for perfecting security interests in investment property and the adoption of new rules to determine priorities among secured creditors who have perfected by control and those who have simply registered against the pledgor dictate best practices for taking a pledge of securities.

For secured creditors, obtaining control of pledged securities is made essential by the new priority rules. In all but a few instances, registration alone will not be adequate to obtain and maintain priority over other creditors. Under the new regime: (i) a secured creditor having control will take priority over a secured creditor who merely registers against the pledgor; (ii) a secured creditor who obtains control first will take priority over a secured creditor who obtains control afterwards; and (iii) the securities

intermediary itself (which is deemed to have control in many circumstances) will take priority over secured creditors.

As can be deduced from the new priority rules, control is not necessarily an exclusive arrangement. For certain types of investment property, like book-based securities, more than one secured creditor (as well as the securities intermediary) can have control over the same securities.

For different types of investment property, control means different things. In the case of a certificated security, control requires endorsement as well as possession of the certificate, except for a bearer certificate. In the case of book-based securities, control involves having the securities transferred into an account that is owned by the secured creditor or, more commonly, by entering into a tripartite “control agreement” among the pledgor, the securities intermediary who holds the book-based securities for the pledgor and the secured creditor.

The Control Agreement

The control agreement is not a substitute for a security agreement, which will continue to be entered into separately between the lender/secured party and the borrower/pledgor to grant the required security interest in the securities. Rather, the control agreement is a method of perfecting the security interest and, in its most basic form, is a contract made among a secured creditor, a pledgor and the securities intermediary of the pledgor in which the securities intermediary grants “control” over

the pledged securities to the secured creditor.

Essentially, having control means that the secured creditor has the right to give “entitlement orders” to the securities intermediary in certain circumstances (such as upon default by the borrower/pledgor) and the securities intermediary has agreed that it will comply with such instructions from the secured creditor without further consent of the borrower/pledgor. An entitlement order is the terminology under the STA for an order given to a securities intermediary instructing it to transfer or redeem a security or security entitlement. The borrower/pledgor will be precluded from giving, and the securities intermediary from accepting, any conflicting instructions.

Control Agreements – Potential Problems and Drafting

As noted, a control agreement need not give exclusive control to the secured party. Further, a borrower/pledgor can retain rights to give (non-conflicting) instructions and other secured parties can obtain (or may already have) a concurrent right to give instructions. Especially in light of such facts, lenders, borrowers and other

This legislation, once fully implemented, will provide harmonized rules for the transfer and pledging of securities across Canada that better reflect and deal with market practices.

parties need to be cognizant of various potential problems in respect of control agreements and certain issues which may arise in the negotiation and preparation of control agreements.

Although not discussed in this abridged article, there are potential problems and issues in respect of control agreements that are likely to be encountered.

Some Final Remarks

The STA and PPSA amendments have provided more certainty to the law related to pledges of securities and are bound to greatly facilitate and increase the use of book-based securities as collateral,

thereby bringing value to borrowers and lenders alike and the market as a whole. However, the new regime has ushered in new challenges: Lenders need to re-evaluate their approach to securities pledge transactions and borrowers/pledgors need to understand how best to respond to the new requests and considerations.

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Ed.: *The unexpurgated version of this article may be obtained without cost or obligation by contacting the author directly.*

Self-Regulated Professions Under Competition Bureau Spotlight



Steve Szentesi



Sandra Knowler

The Commissioner of Competition (“Commissioner”) recently announced that the new advocacy and enforcement efforts of the Competition Bureau (“Bureau”) are a priority with reference to self-regulated professions.

That is not new ground for the Competition Bureau as, indeed, a wide spectrum of professionals and professional bodies have been involved in competition law investigations and proceedings in the past. What is new is the increased scale and scope of the Bureau’s current initiative, which involves an extensive review of the regulation of lawyers, real estate agents, accountants, optometrists, opticians and dental hygienists.

The Commissioner has stated that the principal rationales for the Bureau’s heightened examination of the self-regulated professions are their increasing significance to the economy, the Bureau’s revised approach to the regulated conduct defence and the example of other jurisdictions.

Competition Law and the Professions

Originally, Canada’s competition law did not apply to services. However, since amendments in 1976, the *Competition Act* (the “Act”) has applied to professionals and services in general. While regulation of professional services may have a variety of legitimate policy objectives, including consumer protection, from an economic perspective, excessive regulation can operate as a barrier to

entry and discourage innovation. This may, in turn, lead to higher prices, poorer services and less consumer choice.

Bureau’s Revised Approach to the RCD

The Bureau’s renewed scrutiny of the self-regulated professions is partly based on its revised approach to the regulated conduct defence (“RCD”). The Bureau recently issued a new *Technical Bulletin on “Regulated” Conduct* (“RCD Bulletin”) that outlines its position on the enforcement of the Act where conduct is regulated by other legislation. The RCD Bulletin replaces its earlier Bulletin that was criticized as insufficiently reflecting existing RCD caselaw.

The RCD is a common law doctrine developed as an exception to the doctrine of federal paramountcy. Under the RCD, where conduct is mandated or authorized by valid provincial or federal legislation, the conduct may be immune from the application of the criminal and, possibly, civil “reviewable matters” provisions of the Act.

A key issue regarding the RCD in relation to self-regulated professions is whether it applies to immunize conduct from the civil provisions of the Act (the majority of RCD cases have involved conduct under the Act’s criminal provisions). The Bureau states that as RCD caselaw is “extremely limited in respect of the reviewable matters provisions,” and, absent further judicial guidance, it “cannot responsibly limit its statutory mandate by the general application of the RCD to the reviewable matters provisions of the Act.” This is a significant policy shift for the Bureau and reflects a willingness to pursue civil cases involving regulated entities.

The Commissioner has stated that the principal rationales for the Bureau’s heightened examination of the self-regulated professions are their increasing significance to the economy.

Another key aspect of the RCD is whether it applies to so-called “regulatees” (those subject to regulation). While the Bureau states that the RCD may be invoked by regulators and regulatees, its view is that the conduct of regulatees may be subject to greater scrutiny given the potential for self-interest.

Targeted Restrictions

Restrictions the Bureau is examining in relation to professional services include mandatory or “suggested” fee schedules, as well as restrictions on advertising, entry and type of practice.

Fees

Fee regulation can take many forms, including fee tariffs established by regulatory bodies or professional codes of conduct that mandate minimum fees. Some professional bodies have argued that fee regulation is necessary to maintain quality services, provide consumers with information regarding fees for services or prevent overcharging. However, such restrictions may also raise issues under the criminal conspiracy or price maintenance provisions of the Act.

On the other hand, fee schedules that are something less than an agreement between competing professionals may be permissible. For example, the Bureau recently issued an advisory opinion on the application of the Act to a real estate services fees schedule for Ontario lawyers, concluding that the “recommended” fee schedule, without more, would not provide sufficient grounds for an inquiry.

Advertising

In theory, advertising is pro-competitive because it informs consumers about different products, allowing them to make informed purchasing decisions. Arguments that have been made for restricting professional advertising have included “information asymmetries” (i.e., restrictions are needed because consumers cannot fully assess information about professional services), and preserving professional integrity and independence. However, advertising restrictions may also reduce competition by increasing the costs of gaining information about different products.

One of the most significant Canadian competition cases involved a prohibition on professional advertising. In a 1982 case, *Canada (Attorney General) v. Law Society of British Columbia*, provincial legislation authorized Benchers of the Law Society of British Columbia to prohibit lawyers from engaging in “conduct

unbecoming” the profession. They used this authority to prohibit lawyers’ advertising. The Supreme Court of Canada held, however, that the regulated conduct defence immunized the Benchers’ activities from the application of the Act’s criminal conspiracy provision.

Entry

Entry restrictions may protect consumers by ensuring that professionals are suitably qualified; however, they can also limit competition by reducing the number of service providers and consumer choice. In the trade association context, restricting entry into an association or concerted refusals to provide association services may also raise criminal conspiracy issues.

An example of the Bureau’s recent efforts in this area relates to dental hygienists. The Bureau recently sent letters to the governments of Alberta, Nova Scotia and New Brunswick supporting provincial initiatives to create independent colleges of dental hygiene. The Bureau’s view is that allowing dental hygienists to self-regulate would make the market for dental hygiene services more efficient, allowing more consumers to receive dental hygiene care and improving consumer welfare. The objective of such efforts is to unbundle professional services based on the theory that this will increase choice of professional services and reduce cost.

Conclusion

The Bureau’s recent focus on self-regulated professions highlights the tension between competition and competing policy objectives. Professional bodies and their members may find that they are the subject of increased pressure from the Bureau to remove restrictions on professional services or direct antitrust enforcement. Accordingly, professional bodies may wish to examine the regulation of their members in advance of possible action by the Bureau. However, the extent to which competing policy objectives will ultimately trump the Bureau’s “competition lens,” that sees restrictions on competition as “an extreme regulatory response,” remains to be seen.

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Restrictions the Bureau is examining in relation to professional services include mandatory or “suggested” fee schedules, as well as restrictions on advertising, entry and type of practice.

Workers Without Borders: Who's Listening to Your Business?



Howard Levitt

The workplace no longer has borders. The ubiquity of Personal Digital Assistants (“PDAs”), such as Blackberries, have made employees accessible anytime and everywhere that they may be.

But few employers, thrilled with their employees’ newfound, “round the clock” availability and heightened productivity, have considered *their* new liabilities.

Employees use PDAs while driving, walking on the street, at restaurants, bars, and even at the gym. They often don’t know who is listening or peering over their shoulders. Their employers should be concerned! They are ultimately responsible for their employees’ work actions. Any leaks of information can expose them to liability for a multitude of infractions. Betraying a client’s confidentiality, violating privacy rights, even damaging misstatements or defamation can easily result from a PDA “slip.” Employers will be making large payouts as result of those indiscretions.

Some employees feel the irresistible urge to immediately respond to the beep of a pending message. Hence, the reference to “CrackBerrys.” Common sense seldom prevails for some employees who abandon all discretion with their newfound toy. They use their PDAs to respond to work e-mails while driving. It will not be long before the first million-dollar damage award against an employer from another driver or pedestrian injured by one of their e-mailing employees occurs.

With PDAs, employees feel pressured to respond instantly. This is when mistakes occur. Often, when the message comes in, their minds are far from the job. They could be in a fight with their spouse or [feeling less inhibited] at a dinner party. They may have just been complaining about their boss to their friends. Their minds and emotions may not be appropriately constituted to provide critical information to their employer, customer or work colleague. Not being in their office, with access to files and co-workers, there is also a likelihood of overlooking important issues necessary to provide the information sought. If their advice is incomplete or negligent, employers are liable for the work product.

The same rules for office communications apply to PDAs. But because of the speed of PDA communications, the language tends to be less formal and professional. Spelling mistakes are easily made while fervently typing on the tiny keyboard. Also, there is an increased risk of copying an e-mail to the wrong person.

Employers should reinforce that office rules for e-mail and internet use apply to PDAs. The PDA is the employer’s property.

Employees should not expect them to be private. If any personal use is permitted, it should be limited. Employees should never e-mail inappropriate jokes or access pornographic websites. These rules are necessary to minimize an employer’s exposure to discrimination or sexual harassment complaints.

This is not a call to prohibit PDAs. They provide the flexibility and accessibility requisite to achieving the work-life balance that many employees crave. But while PDA use is rampant in the workplace, few employers have thought about its management. The following guidelines will assist employers:

- Remind employees that the same rules that apply to the use of office telephones, computers and the Internet, also apply to PDAs. Any workplace policies should be revised to reference PDAs. Permitted and prohibited uses should be defined. Also, any policies should clearly state that employers have the right to access and inspect employees’ e-mails and Internet use.
 - All telephone and e-mail communications are confidential. Employees should be reminded to exercise discretion when using PDAs away from the office. Any e-mail communications sent from a PDA should have a tag line that identifies the communication as such.
 - PDA passwords should be activated. Also, it should be turned off when not in use. This will prevent unauthorized use or improper viewing of important confidential business information.
- Establish a protocol for PDA “etiquette.” For example, during meetings, clients deserve the employee’s undivided attention and PDAs should be turned off.
- Your policy should require that PDAs not be used when the employee is driving. That will minimize the risk that the employer will be found to have been negligent if there is a PDA-induced accident.

PDAs are an example of employers and their law firms developing solutions to the problems of the past while blithely ignoring new risks. For reasons... difficult to understand, few have yet addressed these issues [and must do so].

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Ed.: *This edited article, under a different title, appeared in Howard’s weekly column on the first page of the Working section of the National Post.*

The Crucial “but for” Test in Determining Causation

The case of *Resurfice Corp. v. Hanke* involves a tragic injury to a young man who placed a water hose into the gasoline tank of an ice-resurfacing machine rather than the water tank. Vaporized gasoline was released into the air and was ignited by an overhead heater, causing an explosion and fire. Ralph Robert Hanke was badly burned. He sued the manufacturer and distributor of the ice-resurfacing machine, contending that the gasoline tank and the water tank were similar in appearance and placed close together so as to make it easy to confuse the two.

Upheld by the Supreme Court of Canada, the trial judge found that it was not reasonably foreseeable that an operator of the ice-resurfacing machine at issue would mistake the gas tank and the hot water tank. The trial judge based his conclusion on the evidence, including the different size of the two tanks (and that one was taller than the other), and on the fact that the gas tank had a label on it and that Mr. Hanke admitted knowing the difference between the two tanks.

The unanimous judgment of the Supreme Court, written by Chief Justice McLachlin, clearly analyzes the facts and law with reference to foreseeability and causation. Below is an edited portion of her lucid remarks on the “but for” test:

Much judicial and academic ink has been spilled over the proper test for causation in cases of negligence. It is neither necessary nor helpful to catalogue the various debates. It suffices at this juncture to simply assert the general principles that emerge from the cases.

First, the basic test for determining causation remains the “but for” test. This applies to multi-cause injuries. The plaintiff bears the burden of showing that “but for” the negligent act or omission of each defendant, the injury would not have occurred. Having done this, contributory negligence may be apportioned, as permitted by statute.

This fundamental rule has never been displaced and remains the primary test for causation in negligence actions.

The “but for” test recognizes that compensation for negligent conduct should only be made “where a substantial connection between the injury and defendant’s conduct” is present. It ensures that a defendant will not be held liable for the plain-

tiff’s injuries where they “may very well be due to factors unconnected to the defendant and not the fault of anyone”: *Snell v. Farrell*, at p. 327, *per* Sopinka J.

However, in special circumstances, the law has recognized exceptions to the basic “but for” test, and applied a “material contribution” test. Broadly speaking, the cases in which the “material contribution” test is properly applied involve two requirements.

First, it must be impossible for the plaintiff to prove that the defendant’s negligence caused the plaintiff’s injury using the “but for” test. The impossibility must be due to factors that are outside of the plaintiff’s control; for example, current limits of scientific knowledge. *Second*, it must be clear that the defendant breached a duty of care owed to the plaintiff, thereby exposing the plaintiff to an unreasonable risk of injury, and the plaintiff must have suffered that form of injury. In other

words, the plaintiff’s injury must fall within the ambit of the risk created by the defendant’s breach. In those exceptional cases where these two requirements are satisfied, liability may be imposed, even though the “but for” test is not satisfied, because it would offend basic notions of fairness and justice to deny liability by applying a “but for” approach.

These two requirements are helpful in defining the situations in which an exception to the “but for” approach ought to be permitted. [Emphasis added.]

The Supreme Court then gave two examples to assist in demonstrating the twin principles it had enunciated and found that, in this case, the Court of Appeal erred in applying the material contribution test in circumstances where its use was neither necessary nor justified, and

found that the court below erred in failing to recognize that the basic test for causation remains the “but for” test.

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Ed.: *Both a summary and the full text of this case (Resurfice Corp. v. Hanke) appeared in Lang Michener’s S.C.C. L@wletter, edited by Eugene Meehan, Q.C., Issue No. 8, 2007. That and other Lang Michener publications are available on-line at langmichener.ca.*

For multi-cause injuries, the plaintiff bears the burden of showing that “but for” the negligent act or omission of each defendant, the injury would not have occurred.

Compensation for negligent conduct should only be made “where a substantial connection between the injury and defendant’s conduct” is present.

This section offers a brief note or comment on an area or point of law (or information source) that may be of interest.

1 Hong Kong Poised to Introduce Cross-Sector Competition Law

More than 80 countries now have competition laws. Recent entrants include Singapore, which introduced competition law in 2005, and China, which introduced a merger clearance regime in 2003.

Now the government of Hong Kong is preparing to introduce general competition legislation, recently issuing its *Report on Public Consultation on the Way Forward for Hong Kong's Competition Policy* (the "Consultation Report") and briefing the Economic Services Panel of the Hong Kong Legislative Council on changes to its competition policy. Currently, Hong Kong only has competition regulation in the broadcasting and telecommunications sectors.

The government indicated that it would proceed to enact a cross-sector competition law. Hong Kong's Secretary for Economic Development and Labour, Stephen Ip, in his presentation to the Legislative Council, indicated that the government's recent consultation process showed widespread support for a cross-sector competition law, and that the government would begin drafting legislation with a view to presenting a bill to the Legislative Council this year.

Proponents of competition law in Hong Kong have argued that there is a need to ensure a level playing field for Hong Kong businesses, discourage anti-competitive behaviour in the economy and avoid discrimination against certain business sectors through sectoral regulation. There have also been specific allegations of anti-competitive behaviour in specific sectors, including auto fuel, supermarkets and port-related fees.

Opponents of a new law argue that Hong Kong is already a free and competitive market with few entry barriers. Competition can be enhanced in other ways and introducing cross-sectoral competition law could increase the cost of doing business locally and affect Hong Kong's regional competitiveness. Some larger corporations have also expressed concern that competition legislation may be used to target existing market structures.

Ed.: *The above is the introduction to an article which appeared in Lang Michener's Competition and Antitrust Alert (March, 2007) discussing the current state of competition policy in Hong Kong, some*

noteworthy aspects of the recent debate and potential future developments. The full text is available on our website.

—**Steve Szentesi** and **François Tougas**,
Lang Michener LLP (Vancouver)

—**James Musgrove**, Lang Michener LLP (Toronto)

2 Exchangeable Shares in Cross-border Acquisitions – Tax Deferral

Exchangeable shares were developed to allow a tax deferral for Canadian shareholders when selling shares of a Canadian corporation ("Canadian Target Co.") to a non-resident corporation ("Non-Resident Co.") wholly or partly in consideration for shares of the Non-Resident Co.

A tax deferral is available under Canada's *Income Tax Act* when a Canadian corporation ("Resident Co.") acquires shares of a Canadian Target Co. in consideration for shares of the Resident Co. This tax deferral is not available, however, where the acquiring corporation is a Non-Resident Co.

To allow selling Canadian shareholders to access the tax deferral where a Non-Resident Co. acquires a Canadian Target Co., the transaction is structured such that, instead of issuing shares of the Non-Resident Co., a Canadian subsidiary of the Non-Resident Co. issues shares that can be exchanged for shares of the Non-Resident Co. and which have substantially the same economic and voting rights as shares of Non-Resident Co.

Because the consideration for shares of the Canadian Target Co. is shares of a Canadian corporation, selling Canadian shareholders can access the tax deferral, subject to compliance with applicable statutory requirements.

—**Greg McIlwain**, Lang Michener LLP (Toronto)

3 Non-competition Clauses and Notional Severance

There appears to be a very marked change in the law with respect to the courts' authority and willingness to, in effect, rewrite restrictive covenants that might be found to be otherwise unenforceable because they were not reasonable with respect to scope, geography or time. It may be recalled that the judge in *Prostar* rewrote a non-competition clause in an employment contract by substituting a two-year prohibition for a five-year prohibition.

The British Columbia Court of Appeal recently issued a decision where it applied this type of reasoning and the concept of

“notional severance” to save a non-competition clause. Although the decision is not a complete parallel to *Prostar*, it does follow the line of reasoning and expands somewhat on the application of the doctrine of “notional severance.”

In *KRG Insurance Brokers (Western) Inc v. Shafron*, the restrictive covenant in question precluded the employee/vendor from competing for a period of three years following his termination with the business of insurance brokerage “carried on within the Metropolitan City of Vancouver.” He had operated and sold his insurance agency located in South Granville and stayed on as an employee. He signed successive employment contracts incorporating the non-competition clause.

The problem, of course, with the use of “Metropolitan” in reference to Vancouver is that there is no “fixed, recognized meaning” to the phrase and, in fact, the suggested meanings simply reinforced the ambiguity in the language. The court noted the clause was drafted by Toronto lawyers for whom the expression “metropolitan” does have clear meaning.

The court then had to consider whether it could interpret the language as it is to give effect to the parties’ intentions or to “proceed by way of notional severance.” The court applied notional severance to save the bargain and construed “Metropolitan City of Vancouver” to mean the City of Vancouver and municipalities directly contiguous to it.

—**Michael J. Weiler**, Lang Michener LLP
(Vancouver)

4 Employee Suspensions – Employer Caution is Crucial

The recent decision of the Ontario Court of Appeal in *Carscallen v. Fri Corporation* has caused concern about when non-unionized employees can properly be suspended without creating a right for the employee to sue and claim damages for termination. Each particular employment relationship needs to be examined to assess whether or not the employer has the right to suspend an employee without pay and what result will flow from attempts by a company to discipline an employee short of termination. The following are useful questions which employers should ask in all instances:

1. Is the potential discipline being considered proportionate and reasonable in the circumstances?
2. How have similar types of misconduct been treated in the past?
3. What company policies are there which might authorize paid or unpaid suspension?
4. What is the historic discipline record of the employee?

5. Is the potential discipline clear? Will the employee understand whether or not they will be paid through the suspension from start to end?
6. Has the case been properly investigated or is the discipline decision a “need to compensate reaction”?
7. What is the employer’s intent with the discipline?
8. Is the suspension punitive or mean spirited? Will the employee be embarrassed or humiliated?
9. Is the discipline connected to the employer’s business objectives?

For each of the above questions, the employer will need to back up its consideration of these points with evidence. The increasingly employee-friendly courts are continuing to look at further ways to expand the scope of employee claims, with damages increasingly being paid even if the employee was expressly terminated.

—**George Waggott**, Lang Michener LLP (Toronto)

5 Facing Corruption

The World Bank estimates international corruption at a trillion U.S. dollars annually. That’s \$2.7 billion a day, or about double the value of all Canada-U.S. trade!

It’s a big market – oil and natural gas, defence contracting, public contracting, even emergency relief, not to mention drug trafficking and arms smuggling.

Corruption is a hidden cost, coming from various sources and perhaps from those least likely to protest, like shareholders, consumers, or users. Food and medicines are delivered sub-standard or under-weight, bridges and houses collapse, highways disintegrate, and plants/utilities fail to produce. Worse, where emergency relief is targeted, those hurt once are hurt again when the promised aid is deficient.

Transparency International (“TI”) (Berlin, Germany) reports regularly on the perceptions of international bribery demand and supply. Poorer nations with scant resources or weak legal systems are the most affected by the corruption plague, but TI’s unpleasant revelation is that the perpetrators are the advanced and booming countries which take advantage of those weaknesses.

Complex anti-corruption standards are being imposed internationally, and paying bribes to gain the business edge is no longer that simple. Thirty member-countries of the Organization for Economic Cooperation and Development (“OECD”), (of which Canada is one), and six non-member countries have made the bribing of foreign public officials a criminal offence even if committed

abroad. Pressure is mounting on other non-OECD exporters (such as the BRIC nations) to follow the lead of those six.

The World Bank now imposes a devastating sanction and publicly debars those it finds guilty of having indulged in corruption. Export credit agencies of the OECD countries, including Canada's Export Development Corporation, now deny financial support to new and existing clients if they are found, or are suspected, to have engaged in bribery.

Compounding this, is the varying intensity with which countries enforce their anti-corruption laws. Political will can affect

enforcement, as recent actions by the UK government in the Saudi arms scandal enquiry have shown.

Still, for exporters, it is a legal jungle out there! Be aware and beware!

—**Sunny Pal**, Lang Michener LLP (Ottawa)

Ed: *The above note is a condensed and edited portion of a fuller paper on the subject. The full text may be obtained without cost or obligation from the author at pkpal@langmichener.ca.*

TAX NOTES

Ed.: *TAX NOTES, while not advice, are designed to comment on tax law and developments which may affect our readers. Contributors are members of the our National Tax Practice Group.*

Non-resident Withholding Tax on Interest – On the Way Out

One of the issues which has long been a source of frustration for both borrowers and lenders in cross-border loan transactions relates to the imposition of withholding tax on non-resident interest payments. The existence of such a tax has often forced parties to structure their deals in specific (and limited) ways; worse still, this tax has often served as a roadblock for certain lenders and borrowers to enter into deals together. With certain proposals made in the March 19, 2007 Federal Budget (the "Federal Budget"), relief may be on the way.

Currently, Canada's domestic rate of withholding tax on interest paid to non-residents is 25%. This rate is generally reduced to 10% for residents of countries with which Canada has tax treaties, such as the United States. Canadian cross-border debt financings are generally structured to take advantage of an exemption from non-resident withholding tax, which is available if the borrower is not obliged to repay more than 25% of the principal amount of the loan within five years except in the event of default (the "5/25 exemption"). The 5/25 exemption cannot be used for a loan with a term of less than five years and requires compliance with constantly evolving administrative policies of the Canada Revenue Agency ("CRA") with respect to acceptable terms and conditions in loan agreements.

The Federal Budget announced that an agreement in principle has been reached between Canadian and U.S. negotiators regarding changes to the Canada-U.S. Income Tax Convention (the "Canada-U.S. Treaty"), which include the elimination of withholding tax on interest paid on both arm's length and non-arm's length debt. It is expected that the final negotiations will conclude in the "very near future." The Federal Budget indicates that with-

holding tax on interest payments on arm's length loan transactions would be eliminated at the start of the calendar year following the coming into force of the changes to the Canada-U.S. Treaty, while withholding tax on non-arm's length interest payments would be phased out over a period of three years.

Taking it one step further, the Federal Budget proposes that Canada will unilaterally eliminate withholding tax on interest on all arm's length debt, regardless of the recipient's country of residence. Such elimination will be made effective when the Canada-U.S. Treaty exemption comes into effect.

Also of importance to U.S. lenders is the announcement in the Federal Budget that the benefits of the Canada-U.S. Treaty will be extended to U.S. limited liability companies ("LLCs"). The CRA's administrative position is that LLCs are generally not entitled to the benefits of the Canada-U.S. Treaty, with the result that amounts such as interest, dividends and royalties paid to an LLC are subject to Canadian withholding tax at the rate of 25%. This change should encourage a flow of capital into Canada from U.S. venture capital firms which operate as LLCs.

The elimination of withholding tax on arm's length interest payments is dependent on the successful conclusion of the Canada-U.S. Treaty negotiations and the legislative implementation of the changes to the Canada-U.S. Treaty.

These proposed changes are welcome news to borrowers and lenders, who will be more able to structure their transactions in ways that are aligned with the business objectives of the parties, rather than being dictated by the legislative framework. Furthermore, the changes may result in new sources of capital becoming available for companies on both sides of the Canada-U.S. border.

—**Kalle Soomer and Eric Friedman**,
Lang Michener LLP (Toronto)

Ed.: *This segment offers colleagues and readers an opportunity to briefly comment or read about a life experience, an accomplishment, an acknowledgement, a powerful image, an incredible experience or a simple “slice of life.” I would be most pleased to consider publishing one of yours or one that pertains to a friend, family member or colleague. (I am always open to suggestions.)*

1 Connections

Honeywell Wotherspoon was founded in 1905 and became the genesis of the Ottawa office of Lang Michener in 1990. Albert (Bert) Lawrence, M.C. joined the Honeywell firm in 1948 when he was called to the Bar. He continued as a member of the firm, as a partner and then counsel, until 1983. In late March of this year, Bert passed away. The *Ottawa Citizen* carried a lengthy obituary article and noted his many achievements: in the Canadian army (Military Cross), in his profession (Queen’s Counsel), in public life (Ontario Cabinet Minister in the John Robarts’ and Bill Davis’ government), and in so many other pursuits as husband, father, music enthusiast and poet.

2 Civility

In a recent issue of Canadian Lawyer, **Eugene Meehan, Q.C.** discusses tactical tools to fight incivility in the litigation process. Here are only a few edited excerpts:

The law is an adversarial profession and gladiators for justice do not always follow the motto in the movie *Gladiator*: “Strength and honour.” Rather, some lawyers use litigation as a flamethrower. While it may be true that those who do that cannot be changed, what can be changed is your attitude in dealing with such people and also your strategy....

Patience is idling your engine when you feel like stripping your gears.

When you get a letter full of dictated invective...don’t respond the same way. Indeed, a personalized attack letter from an attack-dog lawyer has all the credibility of a disbarred lawyer on a book tour. Don’t join the book tour.

If called down with a remark like, “I have read your material and...I am none the wiser,” reply gingerly, with something like, “But, perhaps,...better informed.”

Respond to extreme hostility and baiting in a way similar to that used by an Alberta judge. When the accused called him a dastardly name, he responded simply, “Lucky guess.”

3 Currency for Rent?

Ed.: **Les Vandor** writes a legal column in the *Ottawa Citizen*. He often concludes his column with legal trivia. In late March of this year, he had this to say about rent:

Rent paid [with] money was once called “white rent” due to the color of some silver coins. Rent paid [in exchange for] goods, services or lesser quality coin, was called “reditus nigri” or “blackmail.” Since tenants hated paying rent, the latter term came to mean extortion.

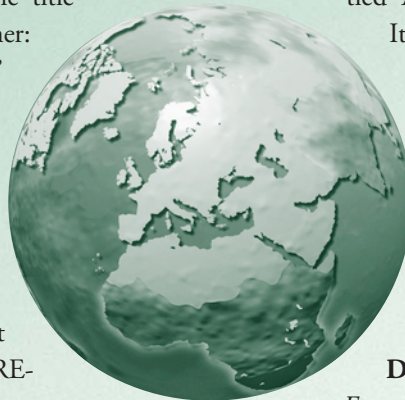
Ed.: *Les and I have tried to value trivia. Not to debase his skills but rather to achieve a good bargain and exchange, I suggested that in the days of silver money, his trivia writing would fetch no more than a half day’s rent. Les argued that this was not a trivial pursuit, and undertook to engage in exhaustive historical research to ascertain a more exact evaluation.*

Letters & Comments

1 The article by **Celia Hitch** “Hurricanes, Terrorists, Pandemics and Force Majeure: Have You Looked at Your Lease Lately?” published in *In Brief* (Fall 2006) also appeared in *Canadian Corporate Counsel*, under the same title and in *Canadian Property Management* under the title “US Disasters Impart Lessons on Lease Provisions.” Also, Celia’s article “Why Should Canadians Care About Presidential Order 13224?” which appeared in *In Brief* (Winter 2006) was reprinted in *Canadian Property Management*, under the title “Check the List and Know Your Customer: Presidential Order 13224 Has a Long Reach.”

2 The article by **Frank Palmay** entitled “New York, September 11: One Occurrence or More?” previously published in *In Brief* was reprinted with permission in the *Canadian Insurance Law Reporter*, a monthly newsletter complement to the CANADIAN INSURANCE LAW REPORTER by CCH Canadian Limited. The newsletter reproduced a series of four articles written by Frank that previously appeared in *In Brief*. Also, CCH Canadian Limited will include Frank’s article, “Insurance Lessons for 911 Continue,” in its upcoming *Legal eMonthly*.

3 Referring to the article about unfair inter-corporate transactions by **Susan Goscoe** in *In Brief*, these kind words from a practicing lawyer in Edmonton, Alberta: “I often find the *In Brief* publication useful – this is another good example. Many thanks for your assistance.”



4 We were pleased to oblige with requests from various places in Canada, including one from Burnaby, B.C., for the full text of the article by **Patrick Westaway** entitled “Taxation of Intellectual Property in a Nutshell.”

5 Similarly, **Ron Petersen** satisfied requests from numerous sources including one from a newspaper columnist in Saskatchewan for the unabridged version of his article entitled “A Warning to Refereeing Associations Before It’s Game Over.” Another request from Queen’s Counsel in Alberta included the following: “Thanks Ron. I intend to circulate this to amateur Soccer Associations in Calgary. [Also] I think Lang Michener has the finest newsletter of its type...”

6 From a member of the judiciary, a ringing endorsement of the book by **David Debenham** entitled, *The Law of Fraud and the Forensic Investigator*:

“I just returned from a [brief vacation and] took your book with me for reading... It is a first-rate book which is well researched and organized in a very user-friendly manner. I have no doubt that it will be of great assistance to the profession and to the judiciary. I intend to refer to your text to assist me in this rather difficult field. There is no doubt that the judiciary will be looking for help in the area of expert evidence when dealing with electronic documents and your book will be of great assistance.”

Lang Michener, In Brief...

News

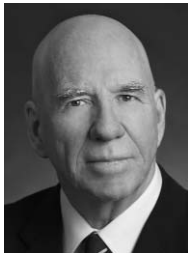
Lang Michener Tops *Business in Vancouver's* BC's Biggest Deals of 2006

We are pleased to announce that Lang Michener represented 14 of the transactions in *Business in Vancouver's* BC's Biggest Deals of 2006. This annual publication lists the 50 biggest deals in Vancouver in three cat-

egories, Mergers & Acquisitions, Stock & Debt, Real Estate. Congratulations to our lead partners and their clients: **Desmond Balakrishnan** (Great Canadian Gaming), **David Cowan** (Eastern Platinum), **Barry Finlayson** (Glamis), **Tony Knight** (Columbia National Investments, Georgia Basin Ventures, Investors Group), **Larry Hughes** (West Fraser Timber), **Steve Mathiesen** (Continental Minerals) and **Bernhard J. Zinkhofer** (Farallon, Northern Dynasty).

Announcements

John Kelly Joins Lang Michener's Toronto Office



John Kelly joined Lang Michener's Commercial Litigation Group in the Toronto office as Senior Counsel in April 2007. John brings over 32 years' experience in his practice areas of banking litigation, commercial litigation and fraud. John is a founding chairperson of the Alternative Dispute Resolution Section of the Canadian Bar Association – Ontario. He has attended advanced courses in mediation and negotiation at the Harvard Law School and has been certified as a Fellow of the Chartered Institute of Arbitrators.

Lang Michener Welcomes Eight New Associates

The Toronto, Ottawa and Vancouver offices of Lang Michener are all welcoming new associates to the firm. We are pleased to announce the following recent additions to the Toronto office: **Benjamin M. Bathgate**, Litigation, April 2007, **Howard Simkevitz**, Insurance, May 2007 and **Parminder Batra**, Corporate Finance/Securities, February 2007. The Ottawa office welcomed **Lisa Vatch** to the Business Law Group in April 2007. We are also happy to announce these additions to the Vancouver office: **Sandy Wong**, Securities, May 2007, **Marnie Foster**, Business, May 2007, **Josh Schmidt**, Securities May 2007 and **Peter E. Torn**, Securities, June 2007.

Karl Gustafson, Q.C. Appointed to the Board of Directors, World Chambers of Commerce Network Consortium (WCN)

On April 19, 2007, The World Chambers of Commerce Network Consortium (WCN, based in Paris, France) announced the appointment of Karl E. Gustafson to its board of directors. Mr. Gustafson joins the four-member board of the WCN in the position of Director, Global Strategic Partnerships.

Mr. Gustafson's long and distinguished association with the chamber of commerce network includes his appointment as Fellow and lifetime Governor of the BC Chamber of Commerce. Mr. Gustafson has been active with the World Chambers since the summer of 2006.

Events

Lang Michener is the Summit Partner of ACETECH Ontario

June 6–9, 2007
Deerhurst Resort
Muskoka, ON

Lang Michener is proud to be the Summit Partner at the 3rd Annual ACETECH Symposium in Ontario. ACETECH brings a lineup of leaders of world-class companies dedicated to sharing the lessons they've learned while building their companies.

Negotiating Restaurant Leases

July 11–12, 2007
The Affinia Manhattan Hotel
New York, NY

This event offers a practical discussion of real-world issues that arise in restaurant lease negotiations and offers winning and workable strategies to resolve these issues. **Celia Hitch** will be speaking on "Making Sure It Runs Smoothly: Tackling Operations Issues."

Lang Michener Morning Break Sponsor of the 6th Annual RealLeasing Conference

October 4, 2007
Metro Toronto Convention Centre North Building
Toronto, ON

The Lang Michener Real Estate Group is a proud sponsor of RealLeasing 2007. This conference provides an opportunity for high-level executives to analyze and enhance their leasing strategies and to gain greater insight into the trends, challenges and issues that permeate the industry.

Deals

Great Basin Gold Completes C\$149.5 Million Financing

Effective April 19, 2007, Great Basin Gold Ltd. (TSX: GBG; AMEX: GMN; JSE: GBFGOLD) completed its public offering of 57.5 million units at a price of C\$2.60 per unit, raising gross proceeds of C\$149.5 million. Each equity unit comprises a common share and half of one common share purchase warrant. The transaction involved a public offering in every Canadian jurisdiction, plus U.S. registration with the shares being approved for listing on three separate exchanges – TSX, AMEX and JSE – and the war-

rants being listed on the TSX and JSE. The use of proceeds from the financing included the purchase of the remaining interest in Hollister Property in Nevada from Hecla Ventures Corp. for US\$45 million (plus US\$15 million shares in Great Basin).

Lang Michener represented Great Basin on this transaction with a team led by **Bernhard J. Zinkhofer** (corporate/securities) that included **Barbara Collins** (securities), **Michael H. Taylor** and **Anita B. Kagna** (U.S. securities) and **Farzad Forooghian** (corporate).

West Fraser Completes Acquisition of U.S. Lumber Business

On March 31, 2007, West Fraser Timber Co. Ltd., headquartered in Vancouver, B.C., completed the acquisition of 13 sawmills located in the southern United States from International Paper Company for approximately US\$325 million. As a result of the acquisition, West Fraser is now the second largest lumber producer in North

America with approximately 9,100 employees. West Fraser's U.S. business will be operated by a wholly-owned U.S. subsidiary.

The acquisition was structured as an asset purchase of operating facilities in North and South Carolina, Georgia, Florida, Alabama, Arkansas and Texas and involved the negotiation of long- and short-term fibre supply arrangements including agreements with certain third party timberland owners. In addition, West Fraser entered into a new syndicated credit agreement with a C\$600 million revolving credit facility and a C\$100 million term facility.

Lead counsel for West Fraser was Lang Michener led by **Larry S. Hughes** and **Tom Theodorakis** (M&A/forestry), including **François Tougas** and **Steve Szentesi** (competition), **Peter Botz** and **Christine Man** (tax), **David Ross** (bank finance), **Rubina Jamal**, **Shanah Ali** (corporate and commercial) and **Marnie Foster** (articled student).



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Lang Michener publishes newsletters on current developments in specific areas of the law such as Competition and Marketing, Employment & Labour, Insurance, Intellectual Property, International Trade, Mergers & Acquisitions, Privacy, Real Estate, Securities and Supreme Court of Canada News.

InBrief offers general comments on legal developments of concern to business and individuals. The articles in *InBrief* are not intended to provide legal opinions and readers should, therefore, seek professional legal advice on the particular issues which concern them. We would be pleased to elaborate on any article and discuss how it might apply to specific matters or cases.

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