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MILLER THOMSON LLP

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TO OUR CLIENTS AND FRIENDS:

We are pleased to release our third issue of the Miller Thomson Review, highlighting some of the most significant Canadian legislative changes, court decisions and legal matters in Canada over the past two years.

With articles contributed by lawyers from 23 of our areas of practice, the Review continues to reflect the growth and expansion of our firm.

We thank you for your continued confidence in us and look forward to serving you in the years ahead. Enjoy the Review!

Jud Whiteside
Chairman & CEO

LITIGATION

ELECTRONIC SPOLIATION
A LEGAL MINEFIELD

Brave New Electronic World

On any given day, literally billions of e-mails are sent and received in North America alone. In today's world, we communicate electronically.

Of course, it was not always that way. Gone are the days of the typewriter and handwritten drafts. We now have data files (*e.g.* electronic documents, spreadsheets and databases), e-mail attachments, voice mail, websites and usage records. Moreover, many of these files will be kept in multiple electronic formats, including back-ups and archives. These electronic records are also produced by a variety of sources, ranging from personal computers to hand-held PDAs, cell phones, Blackberries and digital dictation devices.

When a party is involved in litigation, it is obliged to produce, for the opposite party's review, all relevant and material records. In the past, this often meant merely making copies of all various papers and documents in a party's possession. Today, with the advent and widespread usage of the personal computer and other electronic devices, document discovery may now also involve the production of "electronic documents," stored in electronic or computerized form.

This "e-discovery" can create a great many complex and challenging issues for the parties, which previously did not have to be addressed. For example, in contrast to more traditional forms of documents, electronic documents are often:

- More spontaneous and casually created;
- Easier to alter, yet more difficult to destroy;
- Much more complicated to access and review in a comprehensive and methodical way; and
- Extremely voluminous.

However, because it is thought that perhaps as much as one-third of all electronically stored data is never printed or produced in a physical form, electronic records often contain information that simply cannot be found elsewhere. This can render the production of such records a necessity. Furthermore, it makes the preservation of such evidence all the more important.

What is Spoliation?

Spoliation means, in its most general sense, the destruction or loss of evidence. It is a well-established legal principle that the destruction of evidence may carry with it a presumption that the evidence destroyed would have been unfavourable to the party who destroyed it. Where the destruction of the evidence renders it impossible for a claimant to prove its case, some courts in Canada have even reversed the onus of proof, placing it instead squarely on the defendant. In addition, courts have demonstrated a willingness in certain cases of spoliation to impose significant costs on parties, and even their counsel personally, for the loss or destruction of evidence. A party may even face an order for contempt of court or, in the most egregious circumstances, the ultimate sanction of having judgment entered or their action dismissed, as the case may be.

The consequences of loss or destruction of evidence can therefore be extremely serious. With the explosion in recent years of electronic documents, the obligation to preserve this voluminous and often fertile ground of evidence is becoming an ever-increasing focus of litigation. While Canadian jurisprudence regarding the obligations imposed on parties with respect to the preservation and production of electronic documents is still in its infancy, recent high-profile cases in the United States have attracted considerable attention, and may serve as cautionary tales for Canadian business and Canadian legal counsel. Our courts may very well look to these American decisions for guidance in developing Canadian case law relating to e-discovery issues.

Zubalake

Of all the American decisions in this area, the New York case of *Zubulake v. UBS Warburg* is perhaps the most high-profile. Over the course of a lengthy and contentious lawsuit, the United States District Court issued five opinions that may be viewed as the first comprehensive decisions on a broad range of issues relating to production of electronic records.

Zubulake was an action for discrimination brought against UBS Warburg by one of its equity traders. Ms. Zubulake had requested that UBS produce all documents with respect to any communication by or between UBS employees concerning her. When she reviewed the production, Ms. Zubulake noted that a number of e-mails were missing. She knew this to be the case since she herself had copies of some of these e-mails. She requested that UBS produce their e-mails by way of their archival media, to ensure full production. During the restoration effort that followed, in which UBS' archival media was accessed, the parties discovered that a number of back-up tapes were missing and that some e-mails had even been deleted.

The Court in *Zubulake* made the following important findings:

1. UBS had a duty to preserve the missing evidence, *which arose some months prior to the actual commencement of the action*, since UBS should have known at that time that the e-mails might be relevant to future, reasonably-anticipated litigation.
2. UBS failed even to comply with its own retention policy, which would have preserved all of the back-up tapes at issue.

As a result, the court granted sanctions against UBS for failing to produce back-up tapes in a timely manner. Most notably, it drew an adverse inference against UBS and ordered payment of a portion of Ms. Zubulake's costs.

The Court also held that UBS' defence counsel was partly to blame for the document destruction because it had failed in its duty to locate relevant information, to preserve that information, and to produce that information in a timely manner. The Court declared that litigation lawyers are obligated to ensure that relevant documents are preserved by placing a "litigation hold" on the documents, communicating to clients the need to preserve them, and arranging for safeguarding of relevant archival media.

In the final result, Ms. Zubalake was awarded $29 million in damages, a full $20 million dollars of which constituted an award of punitive damages.

What can your business do to avoid a Zubulake debacle?

In order to better manage and reduce the risks associated with electronic discovery and possible spoliation, it is recommended that all organizations review their practices with respect to the following:

1. **Educate Employees on Email Use**

   Email is an invaluable tool in modern business. However, because e-mail is a rapid and informal way to communicate, ill-advised and imprudent correspondence is more common than it was in the past. Moreover, some employees may believe that a deleted email is permanently erased. Employees must be advised to avoid hasty and informal communications using their email.

2. **Create or Review Policies Regarding Retention Of Electronic Data**

   Written policies should be in place, and must be followed, by all persons within the organization. The periodic and cautious destruction of electronic documents in accordance with such a policy may reduce the ammunition of an opposing party intent on bringing a claim for spoliation. Legal counsel should be sought in developing such policies. It should be noted, of course, that policies which are intended to destroy information on a frequent basis so that it will not be producible in litigation will not likely be acceptable to the Courts.

3. **Systematically Organize Electronic Information Preservation**

   It is recommended that there be a physical segregation of back-up copies of an email system. Such records should be carefully and properly labelled, and safely stored. This will ensure that responding to discovery requests is easier, and more effective.

4. **Develop an Electronic Discovery Process**

   Organizations may wish to develop an established procedure for handling e-discovery requests. Many corporate IT departments are designed primarily to support the day-to-day operations of the company. Consequently, they may not be prepared to handle electronic discovery requests. Organizations may wish to form a committee to respond to e-discovery requests. Such a committee could be comprised of a number of individuals within the IT, administrative and legal services departments of the organization.

5. **Be Prepared to Issue a Litigation Hold**

   As soon as litigation is anticipated, the regularly scheduled destruction practises *must cease*. Legal counsel should be sought before re-implementing any document destruction. These directives should be periodically reviewed so that all new employees become aware, and existing employees are reminded, of the policy.

Taking these steps should assist in reducing the risk of some of the more serious consequences associated with the spoliation of electronic evidence. Although there is currently an absence of binding Canadian case law on the subject, it appears from the more developed American jurisprudence that litigants in Canada will soon be forced to likewise sit up and take notice, to ensure that electronic documents are properly preserved and produced.

BY DARIN J. HANNAFORD AND MONIQUE M. PETRIN NICHOLSON

FINANCIAL SERVICES

SECURITIES TRANSFER ACT REFORMS COMMERCIAL LAWS

January 1, 2007 marked an important date in the evolution of the commercial laws of the Provinces of Ontario and Alberta. On that date, the *Securities Transfer Act*, 2006 (Ontario) and *Securities Transfer Act* (Alberta) (STA) came into force.

The modernization of commercial laws under the STA has been long overdue. Although not widely publicized, Canadian laws governing the transfer and pledging of securities have consisted of a non-uniform patchwork that had fallen badly out-of-step with practices in modern securities markets and with the relevant laws in other jurisdictions, most notably the United States. The uncertainty created by this situation has resulted in real economic costs and competitive disadvantages for Canadian securities and financial markets. To respond to this, a law reform project to develop a Canadian *Uniform Securities Transfer Act* (USTA) was established at the request of the Uniform Law Conference of Canada (ULCC) and led by the Task Force of the Canadian Securities Administrators (CSA).

The USTA was approved in 2004. The Provincial governments of Ontario and Alberta then followed in May, 2006 by passing nearly identical STA's together with consequential amendments to their respective *Personal Property Security Acts* (PPSA), *Business Corporations Acts* (BCA) and civil enforcement legislation. Because uniformity and comprehensiveness are the ideals of the ULCC and CSA in this regard, it is hoped that other provincial jurisdictions will pass similar legislation in the near future. To date, British Columbia, Saskatchewan and Quebec have taken steps to prepare or table *Securities Transfer Act* legislation, but none of those laws have yet been proclaimed into force. Consequential amendments to certain Canadian federal laws would also be desirable as part of the overall legislative reform in this area.

What is the STA and Why is it Needed?

The STA is commercial law that governs the transfer of securities and interests in securities and, through corresponding PPSA amendments, also applies to use of securities as collateral (by way of granting of a pledge or other security interest in securities). As the STA is property transfer law, it should not be confused with corporate laws dealing with the creation and issuance of corporate shares or securities regulatory laws which regulate the capital markets aspects of the issuance and trading in securities such as registration and continuous disclosure requirements.

To understand the significance of the introduction of the STA it is first necessary to appreciate the historical perspective.

Prior to the implementation of USTA reforms, Canadian commercial laws governing the transfer and pledging of securities dealt primarily with the transfer and holding of securities in the *direct holding system* in which the owner of securities had a direct relationship with the issuer of securities. The *direct holding system* is also characterized by the traditional concepts of the delivery and possession of paper security certificates as the means of the transfer of securities and perfecting security interests in securities as collateral.

To the contrary, today the billions of dollars of publicly traded securities that change hands in the global markets on a daily basis are held almost exclusively in the *indirect holding system* (also known as the tiered holding system) which is an integrated network of intermediaries including clearing agencies, brokers and financial institutions acting as custodians. In the *indirect holding system* an investor's interest in securities is not represented by a paper certificate but rather by a computerized book entry in the records of the investor's intermediary. In this case, the investor's intermediary may hold the underlying securities directly, however it is much more likely that the intermediary's interest in those securities will, in turn, also be represented by a computerized book entry in favour of the investor's intermediary on the records of a higher level intermediary (thus, the so-called tiered holding system). At the highest level in this system are the centralized depositories and clearing agencies such as The Canadian Depository for Securities Limited and the Depository Trust Company in the United States. At the lower levels are the securities brokers and dealers and financial institutions acting in a custodial capacity.

The unfortunate fact, however, is that Canadian securities transfer laws have not kept pace with the domestic and international development of the *indirect holding system* resulting in increased risk and competitive disadvantage in the Canadian markets. Because the current laws are rooted in the corporate statutes (as apposed to commercial statutes dealing with the transferring and securing of property interests) the rules generally only addressed holdings and transfers in the *direct holding system* and were almost completely inadequate in dealing with securities other than corporation shares, such as debt securities or interests in business trusts or partnerships.

The introduction of the STA has brought welcome relief in addressing these deficiencies in the commercial laws of Ontario and Alberta. The STA is based closely on the *Revised Article 8 of the Uniform Commercial Code* (UCC) of the United States and the corresponding provisions of *Article 9* of the UCC dealing with secured transactions. *Revised Article 8* was approved in 1994 and has since been adopted in all 50 states and is generally recognized as the most advanced securities transfer legislation in the world. The STA achieves the important objective of harmonizing Canadian securities transfer legislation with the *Revised Article 8* of the UCC in recognition of the high degree of integration between Canadian and U.S. securities markets and the settlement of large volumes of cross-border trades.

While the STA adds a great deal of legal certainty to the rules for the settlement of securities transactions, particularly with respect to the *indirect holding system*, it is not intended to make significant changes to the existing substantive laws. For example, the STA will continue to govern transactions in the *direct holding system* in much the same way that they were governed under the corporate statutes.

On the other hand, the STA introduction does add new terminology and concepts, including those created as a result of the consequential PPSA amendments. Examples of these include:

- **Security** – This definition is broader than the existing definitions in the corporate statutes which envision securities as instruments. The STA definition recognizes the underlying intangible interest in a security. Related definitions are "Certificated Security," "Uncertificated Security" and "Security Certificate."
- **Securities Intermediary** – Means a clearing agency or a person including a broker, bank or trust company, that in the ordinary course of business maintains securities accounts for others and is acting in that capacity. The Securities Intermediary is one of the building block concepts in connection with the *indirect holding system* in identifying the participants that maintain securities accounts for others, the securities account being another fundamental concept.
- **Securities Account and Financial Asset** – Means an account to which a Financial Asset is or may be credited in accordance with an agreement under which the person maintaining the account undertakes to treat the person for whom the account is maintained to exercise the rights that constitute the Financial Asset. The Securities Account is another key concept in the *indirect holding system* as the account in which book entries are made recognizes an investor's interest in the underlying Financial Asset. The concept of a Financial Asset (which includes Securities and any other type of property that can be credited to a Securities Account) is primarily important for purposes of the STA only to the extent that the Financial Asset is credited to a Securities Account. The STA and the consequential PPSA amendments do not purport to govern Financial Assets held outside of a Securities Account.
- **Security Entitlement** – The Security Entitlement is a new and core concept introduced by the STA which recognizes the rights and property interests of a person who holds a Financial Asset in a Securities Account maintained by a Securities Intermediary. The Security Entitlement does away with the fiction under the book-based system that the investor has direct rights against the issuer of the Financial Asset and replaces it with what is essentially a bundle of rights that may be exercised only against the investor's Securities Intermediary that maintains the Securities Account in which the underlying Financial Assets are held.

Of particular interest to lenders and secured transactions lawyers are the following new PPSA concepts:

- **Investment Property** – This term is used only in the PPSA and describes a new general classification of collateral that encompasses Securities, Security Entitlements, Securities Accounts and related property.
- **Control** – Provides a new means of perfecting a security interest in Investment Property. In general terms "Control" means a secured party has taken the steps necessary to be able to sell the property without further action by the owner. Specific types of control mechanisms are prescribed for assets in the *direct holding system* and the *indirect holding system*. It is particularly important to note that under new PPSA priority rules, the person having Control will generally have priority over all other interests, including prior registered PPSA security interests. Therefore the concepts of establishing and maintaining control are of critical importance to secured lenders taking Investment Property as collateral.

As a result of these and other changes brought about by the STA, it is recommended that participants in these markets, including Securities Intermediaries and secured lenders, review and update their standard documents including account agreements and securities pledge agreements to address various post-STA transition and conformity matters. The requirement for secured parties and Securities Intermediaries to enter into "Control" agreements in certain circumstances will also present new issues to be addressed that were not pertinent under the PPSA prior to the STA coming into force.

Next Developments

Ontario and Alberta having taken leading roles in proclaiming their STA's are moving ahead to realize the benefits of the post-STA environment. Unfortunately, the goal of uniform legislation across Canada is not yet achieved and it will continue to be necessary to deal with a patchwork of rules, at least for the time being. If the three provinces with *Securities Transfer Acts* in the works (British Columbia, Quebec and Saskatchewan) come on board quickly, this will hopefully provide the momentum for the remaining provinces and the federal government to similarly reform their laws soon after that.

BY JAMES A. PROSKURNIAK

CHARITIES AND NOT-FOR-PROFIT

2006 was another significant year for the regulation of charities in Canada. There is no mistaking the fact that charities in Canada are today subject to increased regulation and public review. The major developments in 2006 serve to promote charitable giving and signal an increase in that regulation and public review.

Capital Gain Tax Relief to Encourage Donations

The best news for the charitable sector last year was the Federal 2006 budget announcement that donors will not have to pay tax on the capital gain realized when publicly listed securities are gifted to charitable organizations and public foundations. A similar exemption now applies to gifts of ecologically sensitive land to approved conservation charities. These changes became law on June 22, 2006 and apply to gifts made after May 2, 2006. The provinces have supported this change.

The impact of these measures was seen almost immediately. In May, two very large donations were publicized. Larry and Judy Tanenbaum gifted $50 million in securities to the endowment arm of the UJA Federation of Greater Toronto. Mr. Tanenbaum stated that he hoped the gift would inspire others since the philanthropic funds are desperately needed and have meaningful impact on the community. Second, Peter Munk donated $37 million to the Toronto General Hospital. The hospital stated that Mr. Munk's gift will go to a facility that will "revolutionize the diagnosis and treatment of cardiovascular disease." In October, Joseph and Wolf Lebovic made a $50 million gift to Mount Sinai Hospital to help to address the hospital's highest priorities – quality of care, patient experience, and its academic mission.

For years, the charitable sector had requested these changes in order to encourage donations. While the tax relief does not yet extend to such donations made to private foundations, the Conservative government stated it intends to enact similar relief for gifts to private foundations provided a suitable regime can be developed to prevent inappropriate self-dealing transactions involving individuals who control public corporations and who exercise control over the private foundations to which the shares are donated.

Charities have been taking advantage of these new rules by educating donors and ensuring they have policies in place to accept gifts of securities. While this measure has encouraged large donations, all donors of appreciated securities will benefit from this tax effective giving strategy.

Income Trusts

Charities are not always at the top of the government's mind when drafting legislation. The announcement on October 31, 2006 regarding income trusts had a profound effect on the charitable sector. Before the announcement income trusts were a natural investment for charity, since payments flowed through the trust were not taxed at either the level of the trust or the charity. However, the gross-up mechanism provided to compensate investors for the new level of tax at the trust level does not provide any compensation to charities. Investment Committees will have to now consider whether such investments fit with the organization's investment policies.

Increasing Audits

The charitable sector faced increased audit activity in 2006. The Canada Revenue Agency Charities Directorate estimated that 1% of the over 82,000 registered charities in Canada would be audited last year. The Charities Directorate stated that it hoped the increased audit activity would lead to enhanced compliance with the requirements of the *Income Tax Act* by educating charities.

Unfortunately, the audit program is no longer under the direct control of the Charities Directorate. The local Canada Revenue Agency Tax Services Office tax auditors now conduct charity audits. These auditors may not have as much background in this sector and seem to take the approach that taxpayers (*i.e.* the charities) under audit have been chosen for a reason and are likely to be non-compliant. Therefore, these auditors are proposing to revoke charities in situations that would not have resulted in revocation in the past.

Despite the fact that most charities are resolutely focusing their efforts on fulfilling their charitable purposes, few organizations come through an audit with a clean slate. Historically 25% of organizations have issues with record keeping, 25% have incomplete information, 10% have gifted to non-qualified donees, 10% have lost touch with their original charitable purpose and the remainder face a variety of other issues.

Upon receiving notification of audit, organizations should obtain legal advice on how to approach the audit and issues which may arise.

Tax Shelters – Charitable Giving Scrutinized

Tax shelters using charitable donations have also been the focus of increased audit activity. Tax shelters are defined in the *Income Tax Act* to include any property acquisition or gifting arrangement where it is represented that a purchaser or donor may claim tax benefits and deductions that are equal to or exceed the net cost of the property or entering into the arrangement. An example of one type of tax shelter that has come under attack from the Canada Revenue Agency ("CRA") in recent years is that involving buy-low, donate-high charitable giving. This type of tax shelter involves a situation where a taxpayer buys a quantity of goods, such as artwork or comic books, without taking possession of them, through a promoter. The promoter arranges to have the goods appraised and locates a registered charity to which the taxpayer can donate the goods. The charity issues a tax receipt for an amount considerably higher than what the taxpayer paid for the donated goods, and the result is a tax credit to the taxpayer greater than the price paid. CRA is of the view that because such donations are generally made soon after the purchase of the goods, there is little justification for claiming the substantial increase in value based on appreciation or a change in supply and demand. This view was accepted by the courts in a series of "art-flip" cases heard in 2005 and 2006.

Of particular note is the April 2006 decision of the Supreme Court of Canada to dismiss two applications to hear an appeal of the Federal Court of Appeal decisions involving "art flipping" arrangements. The cases of *Klotz v. R.* [2005] 3 CTC 78, and *Quinn v. R.*, *Tolley v. R.*, and *Nash v. R.* (these latter three all heard as Canada *(Attorney General)* v. *Nash et al.* 2005 FCA 386, (2005), 344 N.R. 152) involved situations where the taxpayers bought and donated art through tax shelter promoters and claimed tax credits that far exceeded the purchase price paid by the donors. The Federal Court of Appeal held that the best evidence of the fair market value of the art is what the donor paid for it.

2006 also saw CRA taking a more active role in warning taxpayers about the risks related to participating in certain tax shelter gifting arrangements since November 2003. In an October 31, 2006 news release and November 2006 "Taxpayer Alert," CRA reminded taxpayers that there are financial risks inherent in gifting trust arrangements, leveraged cash donations and buy-low, donate-high arrangements. CRA also warned taxpayers that although donation arrangements that are tax shelters must have tax shelter identification numbers issued by CRA before promoters can sell them, the existence of a tax shelter number was not a guarantee that taxpayers will receive the proposed tax benefits. The tax shelter number simply allows CRA to identify all tax shelters and their investors.

CRA reviews all tax shelters to ensure that they comply with the *Income Tax Act.* Prior to 2002, CRA disallowed about $490 million in donations from 6,700 taxpayers and for 2002, $360 million from 5,700 taxpayers. For the 2003 tax year, CRA reports that it has so far disallowed $66 million in donations from 1,800 taxpayers.

BY KATE LAZIER AND MONIQUE P. TRÉPANIER

SPORTS LAW

CHANGING THE FIELD OF PLAY: OLYMPIC BRAND PROTECTION VS. AMBUSH MARKETING

In 2010, the Olympics return to Canada for a spectacular celebration of sport, culture, and – most lucratively – marketing. With the Vancouver 2010 Olympic and Paralympic Games less than 3 years away, the pace of Olympic-related marketing efforts is accelerating. Games Organizers continue to sign up selected official sponsors and licensees, while those sponsors' competitors work on marketing strategies to stay in the game.

Of the many values promoted by the Olympic movement, the greatest value of the Games for the sponsors and licensees is the exclusivity of association with the best known and best loved brand in the world. Their commercial interest in having the public associate their corporate brand with the Olympic brand provides Games organizers the funding necessary to carry out a successful event. In turn, sponsors and licensees demand extensive protection of the exclusivity of their intellectual property rights.

In Canada, brand protection is primarily based on protection of trade-marks. Use of a word, phrase or logo, for example, in association with particular wares or services extends a degree of exclusivity to the user of such a mark in the marketplace. A greater scope of protection is available through registration of such trade-marks under the *Trade-marks Act*. Certain entities which can show a government affiliation also have available an even broader range of protection through acquisition of official marks, which are available regardless of pre-existing confusingly similar trade-marks owned by others, and which need not be limited to particular wares and services. Apart from trade-mark protection, the *Competition Act* includes measures against deceptive marketing practices, which may be asserted in the protection of a brand.

Whenever a major sporting event occurs, non-sponsor companies reveal ever more creative ways to associate themselves with the event. This attempt to create in the minds of consumers an association between a company's business and a sporting event such as the Olympics, without paying for the privilege, has become known as "ambush marketing." One example of a creative use of ambush marketing took place at the 2006 World Cup of soccer, where the non-sponsor airline Lufthansa painted the noses of its planes in the universally recognized pattern of a soccer ball.

In the Olympic context, ambush marketing is the unauthorized association by a corporation of its name, trade-marks, products or services with an Olympic event, athlete or sport. In most cases, ambush marketing does not contravene existing Canadian brand protection legislation. However, as it can reduce the value of the Olympic brand for sponsors, suppliers and licensees, it is discouraged by Olympic organizers. As the practice has developed, the International Olympic Committee ("IOC") has responded by requiring candidate cities for the Olympic Games, including Vancouver for 2010, to ensure that effective controls are in place to avoid or prevent ambush marketing.

Prior to being awarded the 2010 Games, Vancouver 2010 organizers assured the IOC they had received guarantees from the federal government that federal legislation was in place to effectively prohibit, reduce and penalize ambush marketing. Organizers also pointed out that the federal government has authority to enact additional legislation should it conclude the legal measures available must be strengthened to ensure Olympic sponsor advertising rights are well protected. It would seem that the Canadian government has concluded such additional legislation is necessary. In June 2007, the Olympic and Paralympic Marks Act (the "Act") was enacted.

The Act provides two primary avenues of expanded protection of trade-mark rights for Games organizers, sponsors and licensees. The first expansion is in section 3, which prohibits the unauthorized commercial use of an Olympic or Paralympic Mark or of a mark which is likely to be mistaken for an Olympic or Paralympic Mark (collectively, "2010 Marks"). 2010 Marks include words and phrases such as "Olympic," "Paralympic Games," and the Olympic motto "Faster, High, Stronger," as well as the 5-rings design, among numerous others. Perhaps more surprisingly, 2010 Marks also include words and phrases such as "Vancouver 2010," "Canada's Games," and "Games City," The prohibition extends to any translation of the 2010 Marks in any language. S.3 does not affect the rights of a user of a trade-mark in association with particular wares or services where the use in association with the same general class of wares or services occurred before March 2, 2007, nor does it affect official marks granted before March 2, 2007. Further, the use of one's own address, business location, or name, or of words which describe one's wares or services, is not prohibited.

Use of 2010 Marks for news reporting, criticism or parody related to the Games is permitted. Use of the 2010 Marks in artistic works is also permitted, provided such works are not produced on a commercial scale.

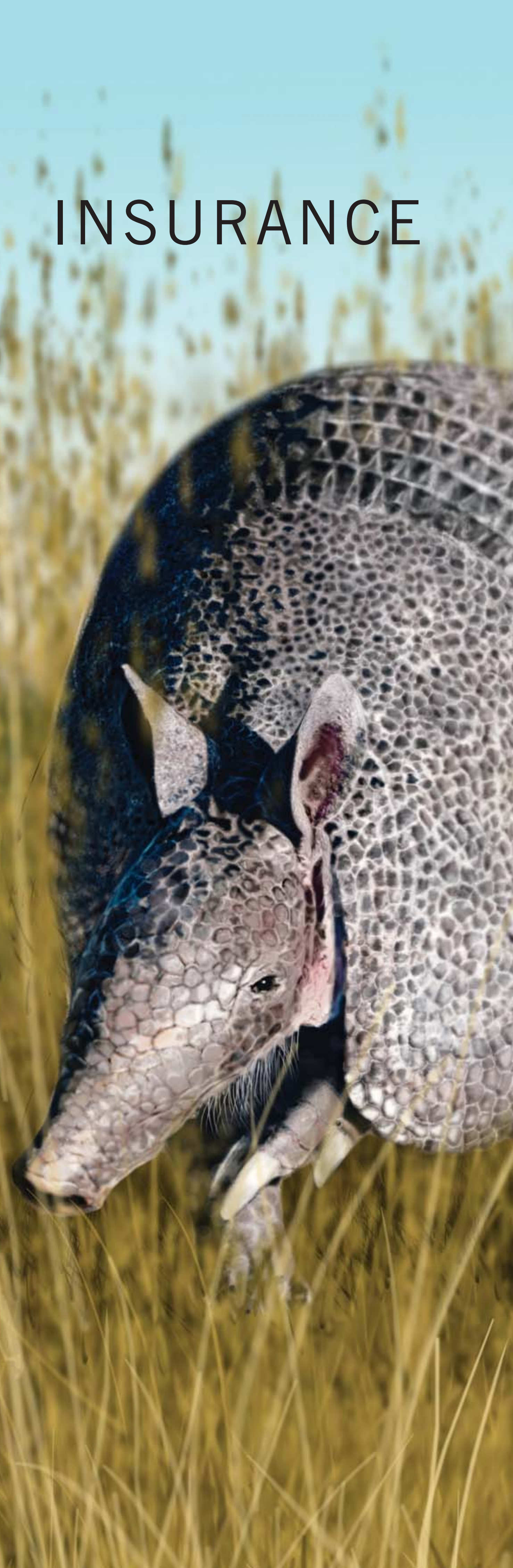
The second area of expanded brand protection is in s.4(1), which prohibits anyone from promoting or directing public attention to their business, wares or services in a manner which misleads or is likely to mislead the public into believing that such business, wares or services are approved, authorized or endorsed by Games organizers, or that a business association exists between the business and Games organizers. In making a determination of contravention of s. 4(1), a court must consider any evidence that the person used certain combinations of proscribed words and phrases. For example, the use of any of the ten words "games," "2010," "twenty-ten," "21st," "twenty-first," "XXIst," "10th," "tenth," "Xth" or "medals," in combination with another of these ten words or with one of the words "winter," "gold," "silver," "bronze," "sponsor," "Vancouver" or "Whistler," would be evidence of contravention of s. 4(1).

The Act also provides for later additions to the list of 2010 Marks, with users of any such added marks unaffected only if their use of such marks pre-dates their addition. Accordingly, it would be advisable for anyone considering use of a mark which might become one of the 2010 Marks through a later addition, to commence use and seek registration of such marks without delay. Otherwise, they may find themselves barred by expansion of the list of 2010 Marks.

Similar legislation was enacted in Australia, Greece, Italy, China and the United Kingdom for other Olympic Games, and has been met with criticism that it interferes with freedom of expression or caters to a special interest group. Similar criticisms are being made of the Act in Canada.

As the Vancouver 2010 Games approach, many companies will find opportunities to support the Games and enjoy the benefit of the media exposure associated with the Olympics. Companies engaged in marketing wares and services to an Olympic audience in Canada are advised to seek legal advice to ensure compliance with Canadian laws regulating the use of trade-marks.

BY STEPHEN BURRI



INSURANCE

EXEMPLARY DAMAGES IN TORT ACTIONS

On September 13, 1996, Andrea McIntyre, a promising first-year student at McMaster University, attended at a campus bar known as The Downstairs John. She was walking home after an evening with friends, when she was struck by a vehicle operated by Andrew Grigg, a Hamilton Tiger-Cat football player.

After football practice, Grigg attended two drinking establishments, before ending up at The Downstairs John with some friends. After he left, one of his passengers realized that she had forgotten her purse. He turned around and returned to the pub. In the course of doing so, he failed to stop at a stop sign, made a reckless turn, and sheared off a lamp post which struck Ms. McIntyre.

It is extremely rare for plaintiff's solicitors to pursue claims for punitive and aggravated exemplary damages in tort actions. The foundation of a tort action, such as a motor vehicle accident, is the negligence of the driver, and not an intentional act. There are few, if any, cases in Canada in which such damages have been allowed in a tort claim.

The case of *McIntyre vs. Grigg* proceeded to trial before a jury in Hamilton. The jury awarded the plaintiff general damages of $250,000.00, aggravated damages of $100,000.00 and punitive damages of $100,000.00, in addition to compensation for other losses. The case was appealed to the Ontario Court of Appeal, and heard by the court in May, 2006.

The evidence at trial revealed that Grigg was charged with "over 80," impaired driving causing bodily harm and dangerous driving. As a result of the failure of the investigating officers to properly advise Grigg of his right to counsel, the Crown Attorney elected only to proceed on a charge of careless driving and withdrew the other charges. Grigg was convicted and fined $500.00. There was no license suspension. The Crown Attorney testified in the civil action, and explained that if he proceeded on the other charges, he would have asked for and expected to receive a period of incarceration for Grigg.

As a result of the accident, McIntyre sustained a closed head injury leaving her with ongoing cognitive impairment, multiple fracture injuries, and developed major depression.

The Court of Appeal was asked to address a number of issues, but the decision is most notable for its review of the claims for exemplary damages.

Aggravated damages are awarded to compensate a plaintiff for additional harm caused to the plaintiff for reprehensible or outrageous conduct on the part of the defendant. Aggravated damages are part of general damages. The jury awarded general damages of $250,000.00. At the time of trial, the upper limit allowed in Canada was $299,000.00. The Court of Appeal concluded that the assessment was at the upper end for a case of this type. As such, it should not have been increased by an award of aggravated damages. Moreover, if aggravated damages were to be awarded in a case such as this, a figure of $100,000.00 was considered by the court to be excessive. The Court of Appeal withdrew this award from the judgment.

The court then considered the award of punitive damages in the amount of $100,000.00. The court noted that this is a novel case, in the sense that such damages are typically not considered in tort actions, although they are routinely awarded in the United States. Punitive damages are awarded to punish the wrongdoer. They are also awarded when there is a need for general deterrence, to send a message to the public that the actions of the defendant offend the ordinary standards of decent conduct in the community.

The court observed that the deliberate decision by Grigg to drink to excess and drive his motor vehicle was misconduct that went beyond mere negligence. It represented a conscious and reckless disregard for the lives and safety of others. The court noted that the breath tests following the accident were at two to three times the legal limit. The consumption of alcohol to excess, and the manner in which he operated his vehicle, was sufficient grounds for the jury to award punitive damages.

However, the court noted that the defendant had already been punished with a $500.00 fine for careless driving. This was to be considered in the assessment of the punitive damage amount. Ultimately, the court reduced the award to $20,000.00.

This decision represents what appears to be the first tort action arising from a motor vehicle accident in which an award of punitive damages has been upheld at the appellate level. It raises a number of issues.

The court noted that the award of punitive damages should be governed, in part, by the measure of criminal punishment. In this case, the defendant was fined $500.00 for careless driving. One of the reasons for an award of punitive damages is to punish the wrongdoer. If so, this raises the question of how the court is to assess the measure of damages if the defendant is convicted of a more serious offence such as impaired driving causing bodily harm. If the defendant is convicted and serves a period of incarceration, does that mean that the award of punitive damages will be closer to $0, or is some measure of deterrence still required in the circumstances. Further cases will need to address this issue.

The second issue is one of general public policy, in relation to the coverage available under a policy of automobile insurance. Policies of automobile insurance, as in the case of most insurance policies, are designed to compensate the insured for unforeseen losses. They are not designed to compensate the insured for intentional acts. Punitive damages are generally awarded for intentional acts. The Court of Appeal did not address the question of whether a policy of automobile insurance can be called upon to pay for the award of $20,000.00 in punitive damages against Grigg. That too will have to be addressed in another case.

One of the issues the court did address, however, is the question of whether an award of punitive damages in a motor vehicle accident cases truly punishes the defendant. If the policy of automobile insurance pays for the claim, then the defendant suffers no loss and is not punished. Indeed, if the policy of automobile insurance indemnifies Grigg for the punitive damage award, then the public suffers as a result of a potential increase in insurance premiums. This would completely undermine the purpose of punishment which is one of the policy reasons for an award of punitive damages.

The *McIntyre vs. Grigg*` decision represents an expansion of the law of damages arising from motor vehicle accidents. Typically, such claims award compensation for negligent acts. It would now appear that further damages are available for conduct which goes beyond negligence, and requires a measure of punishment and deterrence. The court took away the award of aggravated damages, but, in an appropriate case, aggravated damages are arguably available to a plaintiff where the award of general damages is insufficient to compensate the plaintiff for the additional harm he or she has suffered as a result of the conduct of the defendant. It remains to be seen in further decisions whether the policy of automobile insurance will be called upon to respond to awards of aggravated and punitive damages.

BY CHRIS T. J. BLOM

INSOLVENCY AND RESTRUCTURING

THE DECISION OF THE SUPREME COURT OF CANADA IN *TCT LOGISTICS* AND THE FUTURE OF RECEIVERSHIPS IN CANADA

The receivership process has long been at the core of the insolvency process in Canada.

Typically, receiverships are initiated by secured creditors when a commercial debtor defaults under its loan arrangements. The appointments can be made either privately (pursuant to a power in a security agreement) or (as has been the case more commonly in recent years) by court appointment. Indeed, other stakeholders (in addition to secured creditors) can, and often do, initiate court appointed receiverships.

Traditionally, the receivership system in Canada has functioned well and has, among other things, served to preserve the "going concern" value of insolvent businesses (for the benefit of *all* stakeholders) at a level better than has been the case in some other major countries.

Of course, one of the by-products of a receiver being able to preserve the going concern value of an insolvent business is that the jobs of the employees are maintained to the greatest extent possible. Often, a receiver can "keep the lights on" – and thereby keep the employees employed – for the period of time necessary to see whether a buyer can be found who will continue the business, and offer employment to the employees, on a long term basis.

However, the receivership process has been under siege by unions for some time. Among other things, unions have sought to have receivers declared to have the status of "successor employer" for purposes of Labour legislation. That status means that the Receiver has responsibility for things like termination and severance payments as if it had been the employer of the employees in question since they began working for the company (*i.e.* maybe twenty years earlier).

Arguably, the unions have landed a "knockout punch" in the form of the recent decision of the Supreme Court of Canada in the case of *TCT Logistics*. Sadly, however, as many have commented, this "victory" for unions will probably have the effect of destroying many jobs in Canada.

The Trial Decision

The *TCT Logistics* case – which began in January, 2002 – involved the court-appointed receivership of a company, based in Calgary, with wide-spread operations across North America in a number of industries, including trucking, logistics and warehousing.

The original order of the Ontario Superior Court of Justice appointing the receiver was made on the application of GMAC Commercial Credit Corp. of Canada, the main secured creditor, and contained what was then a typical clause indicating that the receiver was insulated from any claims based on an allegation that the receiver was a successor employer (and thereby, among other things, bound by the collective agreement).

In litigation arising in connection with the sale of the warehousing business, Mr. Justice Ground essentially upheld the validity of that clause, although he amended it to provide that "the receiver could not be deemed as a successor employer so long as it acted only as a realizer of the assets of the debtor and not as an employer operating the business."

The Court of Appeal Decision

Somewhat to the surprise of the insolvency bar, Madam Justice Feldman of the Ontario Court of Appeal held that such orders could not validly be made. She held that only the Ontario Labour Relations Board continues to have jurisdiction to determine the issue of whether a receiver is a "successor employer." However, Madam Justice Feldman also held that the Ontario Superior Court (the "Bankruptcy Court") retains a critical "gatekeeper function" through its jurisdiction to lift the stay so as to grant leave (or to deny leave) to a union to bring an application before the Ontario Labour Relations Board to determine the issue. In that regard, a noteworthy comment that she made in her decision is as follows:

> If the receiver can show that by operating the business for a short time it can maximize the value of the business to the benefit of the creditors and, at the same time, thereby save as many jobs as possible, it will make sense for the court [i.e. the bankruptcy court] to deny leave, particularly where the OLRB will, if appropriate, determine that the purchaser is a successor employer, obliged to carry out the collective agreement.

Based on that proposition, it seemed possible for a court-appointed receiver to avoid successor employer liability in "the right case." Of course, however, Madam Justice Feldman's decision still left a difficult level of uncertainty surrounding the receivership process.

Madam Justice Feldman's decision went on to state that the Superior Court "will be positioned to assist" if a consensual resolution cannot be reached between the receiver and the employees in advance. Of course, time is always the enemy in these types of situations and, realistically, there may not be enough time to pursue an agreement with the union in advance and then to also pursue some kind of court-supervised agreement/order that would deal with the matter. Also, the history of agreements between receivers and unions has been a troubled one. In one prominent case (*St. Mary's Paper)*, the receiver and the union reached an agreement with respect to certain limited payments to be made by a receiver of an insolvent company with serious deficits in its pension plan. It seemed clear that the spirit and intent of this agreement was to limit the receiver's overall exposure in that regard. However, when an insolvency firm was appointed to wind-up the pension plan, they successfully advanced a claim to hold the receiver fully liable as an "employer" for purposes of responsibility for the pension shortfalls, even though that position clearly seemed to fly in the face of the original agreement between the receiver and the union.

Madam Justice Feldman also held that the standard for lifting the stay (so as to grant leave to, for example, a union to apply to the Labour Relations Board for a ruling on successor employer status) should be higher than the relatively low threshold test laid out by the Ontario Court of Appeal in an earlier 1993 bankruptcy case called *Mancini (Bankrupt) v. Falconi*. In the *Mancini* case, the court held that the standard as to whether leave should be granted is simply whether the evidence provides the required support for the cause of action sought to be asserted. If the evidence discloses a *prima facie* case, the *Mancini* case held that leave should be granted. The court also held in *Mancini* that leave should not be granted if the action is frivolous or vexatious.

In the *TCT* case, Madam Justice Feldman held that the *Mancini* test represented too low of a threshold when the proposed proceedings involved successor employer applications. In her view, an approach was required that took more account of the impact of such litigation on the bankruptcy process. Madam Justice Feldman's higher test added a requirement to consider factors such as:

- the complexity of the receivership
- the availability of suitable purchasers
- the potential duration of the receiver's operation of the business pending a sale
- any arrangements the receiver had made with the union to accommodate the employees
- the likelihood that a subsequent purchaser would be declared a successor employer bound by the obligations under the collective agreement
- the timeliness of the Labour Board hearing relative to the receiver's temporary occupation and ultimate sale of the business

The Supreme Court of Canada Decision

The Supreme Court of Canada decision in this matter was released in August 2006.

The Supreme Court ruled, rather succinctly, that the Court of Appeal was right to hold that a bankruptcy judge cannot determine successor rights issues.

As such, the Supreme Court upheld the decision by the Court of Appeal to strike the clause in the initial appointment order which protected the receiver from successor employer liability.

However, the Supreme Court of Canada went beyond that to also hold that Madam Justice Feldman's test for whether the stay should be lifted to seek a determination of successor employer status at the Labour Board was too onerous. The Supreme Court of Canada held that the relatively low level test set out in the *Mancini* case was suitable even for an issue such as this one.

Some of the initial commentary about the *TCT* case has been to the effect that it signals the end of attempts to be made to save the jobs at companies with unionized labour forces. Certainly, it is correct that the Supreme Court of Canada decision contains many direct references to the collective agreements negotiated by unions and the protections that unions offer to employees. For example, Justice Abella states, in part:

> To impose a higher … threshold (for lifting the stay to proceed with a Labour Board hearing as to successor employer status) when it is a Labour Board issue is to read into the *Bankruptcy and Insolvency Act* a lower tolerance for the rights of employees represented by unions than for other creditors. I see nothing in the Act that suggests this dichotomy …

However, it would seem that the Supreme Court of Canada's decision will apply to the same effect where the workforce is not unionized. In other words, in a given situation, the issue of whether a receiver will be held to be a successor employer of an insolvent company with non-unionized employees could be just as important (and costly) an issue as if those employees were unionized.

Again, of course, what all of this case law amounts to is that while the *TCT* case may in and of itself have represented a "win" for unionized labour, ultimately the decision is going to be detrimental to employees everywhere. In simple terms, this decision now makes it much harder to save jobs of an insolvent company. Certainly, it seems more likely that in some situations secured creditors will proceed with pure liquidations (which, of course, entail the abrupt termination of employment) rather than attempt to save the jobs for a brief period of time while a potential purchaser is sought, which, again, has long been the preferred approach in Canada.

It will be interesting to see exactly how the insolvency process in Canada unfolds following the *TCT* decision.

It seems likely that under certain conditions, secured creditors will be willing to support sales of a business and/or a liquidation which occur under the protection of the *Companies' Creditors Arrangement Act* or under the commercial proposal provisions of the *Bankruptcy and Insolvency Act*. Of course, that approach is only an option when the lender still trusts the management of the debtor on a fundamental level. Where that management has been "at the helm" as the debtor moved from solvency to insolvency, sometimes (maybe often) some or all of that trust may have been lost. It may be possible, in circumstances where the secured creditor no longer trusts the debtor's management to introduce a chief restructuring officer or some other skilled professional to manage the company during a liquidation supervised by the court pursuant to the *Companies' Creditors Arrangement Act*.

Of course, however, even where the *Companies' Creditors Arrangement Act* can be used, the cost of that approach will likely be much higher than was the case under the old receivership approach. Once again, it seems that the employees and other smaller creditors will lose in relative terms.

The proverbial "bottom line" seems to be that while the old classic receivership system in Canada worked well and was largely fair and considerate of employees – and served to protect their jobs to the greatest extent possible – the future looks less bright for preserving and protecting such jobs through an insolvency process.

BY JEFFREY C. CARHART

INTELLECTUAL PROPERTY

LEGAL PROTECTION FOR FAMOUS TRADE-MARKS

Famous trade-marks are marks which, through extensive usage and longevity, promotion, and in many cases, notoriety, have become so well known to the public that they deserve a wide scope of protection from an enforcement perspective. That wide scope of protection extends to prevent not only those free riders who want to use famous marks for their own goods and services, but also those free riders who, without any intention of doing so, nevertheless use such distinguishing marks in their businesses with the effect that they create marketplace confusion or depreciate the value of the goodwill associated with the famous marks.

Examples of such famous trade-marks are Coca Cola, McDonalds, and Budweiser.

The rationale for extending trade-mark protection to holders of famous marks beyond the traditional goods and services for which the famous marks are used is two-fold. First of all, extended protection is intended to prevent free riders from using a famous mark for unrelated goods or services, where such usage would leave the consumer with the mistaken impression that the famous trade-mark holder had gone unto that unrelated business, when that was not the case. Secondly, and perhaps more to the point for advocating extended protection for famous trade-marks, even where a free rider's usage of a famous trade-mark for unrelated goods or services has little or no prospect of confusing the public into thinking those goods and/or services are those of the famous trade-mark holder, such usage nevertheless erodes the goodwill associated with that famous mark.

The United States has enacted specific legislation in the *Lanham Trademark Act* to deal with what features a trade-mark must have to enjoy the protection accorded a famous trade-mark, and the specific remedies that a famous trade-mark holder enjoys against free riders.

Canada has not enacted any specific legislation to deal with famous trade-marks or the extended protection to deal with such marks, leaving such matters to the Courts and the provisions of the *Trade-marks Act* relating to trade-marks in general. The Federal Court in a series of decisions has generally been willing to confer a broad ambit of protection on famous trade-marks, and find a likelihood of confusion even where a free rider uses a famous trade-mark, in association with goods and/or services that are unrelated to those of the famous trade-mark owner, so long as the court could find some *connection* between the free rider's wares and/or services and those of the famous trade-mark owner. Examples of the connecting factors identified by the courts are whether the free rider and the famous trade-mark owner performed similar functions, or whether one's goods were used in conjunction with the other's, or whether others in the industry had extended the use of their well known marks into goods or services similar to those of the free rider, and so on.

The legal problem with applying the connection test mentioned above is that there is no statutory basis that one can point to requiring a connection between the parties' goods and/or services, in order for there to be a likelihood of confusion, as prescribed by the *Trade-marks Act*. In other words, *the Trade-marks Act* does not say that the goods and/or services of the parties have to be connected in some way in order for a likelihood of confusion to arise, even where those goods or services are unrelated. The *Trade-marks Act* sets out a number of factors for the courts to consider in determining whether a likelihood of confusion has arisen, including allowing the courts to have regard to all the surrounding circumstances, but none of the enumerated factors specifically refers to connection.

Two recent decisions of the Supreme Court of Canada have now laid the issue to rest, and have expressly overturned the test laid down in the various Federal Court cases dealing with the scope of protection for famous trade-marks. The Supreme Court of Canada found the limitation that a free rider's goods/services had to be connected in some way to those of the famous trade-mark owner, even though they may be quite different, in order for a likelihood of confusion to arise, to be incorrect.

In *Mattel, Inc. v. 3894207 Canada Inc.*, the Supreme Court held that the registration of Mattel's famous BARBIE trade-mark did not preclude the registration of a BARBIE'S logo for restaurant services. While it was clear from the evidence that BARBIE was indeed a famous trade-mark, that reputation did not transcend dolls and doll accessories. In coming to that conclusion, the court reasoned that while the difference in the goods and services of the two parties was an important consideration in determining likelihood of confusion, it was not always dominant, and in any event there was no specific requirement that the goods/services had to be *connected*, as Federal Court decisions had previously determined. The fame or notoriety of the trade-mark in question was but one factor, but not the determining factor. All the surrounding circumstances referred to in the *Trade-marks Act* should be taken into account in considering likelihood of confusion.

In *Veuve Clicquot Ponsardin v. Boutiques Cliquot Ltee*, an infringement case and companion to the *Mattel* case, released on the same day, the Supreme Court ruled that the defendant's use of the trade-mark CLIQUOT as a name for a chain of women's clothing shops did not infringe the plaintiff's famous trade-mark VEUVE CLICQUOT, registered in association with champagne. While the court found the plaintiff's mark to be famous, and that such fame transcends to some extent the wares for which the mark is normally used, as in Mattel, such fame is but one factor to consider in determining likelihood of confusion.

Even though the famous trade-mark owners in both cases were unsuccessful before the Supreme Court, both decisions serve to clarify the law to a large extent in terms of the scope of protection afforded famous trade-marks, and unshackle the owners from the connection test, which could in many cases be quite limiting for those wishing to enforce their famous marks. Both cases reinforce a reliance on the factual record of evidence before the court, with all the relevant factors referred to in the *Trade-marks Act* given their due consideration, rather than upholding the connection test which had no readily apparent statutory basis for determining confusion. The Court summed up its analysis in *Mattel* by stating: "Each situation must be judged in its full factual context."

M. STEPHEN GEORGAS

OPEN SOURCE SOFTWARE AND WHAT IT MEANS TO YOUR BUSINESS

Traditionally, software has been protected by copyright as well as confidentiality and trade secret law. Developers and publishers of software programs have guarded the source code zealously and have licensed only the object code for the program.

By contrast, the open source movement is based upon the "free" sharing of source code. In the context of open source software (OSS), "free" refers to the freedom to do certain things with the software, not price. A user of free software has the right to distribute copies of the software (and charge for this service), obtain the source code and change the software or use pieces of it in new free programs. The use of open source code allows developers to avoid "reinventing the wheel."

The open source movement is supported by non-profit organizations such as the Free Software Foundation and the Open Source Initiative. These organizations approve acceptable Open Source licenses, of which there are many. See the list of approved licenses at www.opensource.org.

Typically, open source licenses are of two basic varieties: – those which license the source code for distribution without imposing terms for distribution of modifications, additions or integrations; and those which require any code which is modified, added to, or integrated to be made available under the terms of the same open source license. The second category is known as "viral" or "copyleft" licenses in that the source code of the derived works must be made available to recipients.

The most prevalent copyleft license is the GNU General Public License (GPL), version 2, June 1991. The key provision of this license is found in Section 2(b) which reads as follows:

> "You must cause any work that you distribute or publish, that in whole or in part contains or is derived from the Program or any part thereof, to be licensed as a whole at no charge to all third parties under the terms of this License."

The use of OSS must be considered in light of the user's business model. If part or all of the user's business is based on a proprietary software model, the user must consider the risk of OSS finding its way into a proprietary development project, with the "viral" effects described above. Publishers of commercial software who have elected to use OSS may have to create two distinct product streams, one for products containing OSS and one for products which do not, each category being subject to separate licensing regimes. Whether or not any part of the user's business is based on a proprietary software model, the user must consider the risk that upstream parties in the licensing chain have infringed upon or misappropriated the intellectual property rights of third parties.

With respect to the risk of third party IP infringement, note that the GPL includes a general disclaimer of representations and warranties unless otherwise stated in writing in the license. In other words, OSS is typically provided on an "as is" basis. Furthermore, the GPL includes a general disclaimer of any liability for damages, whether direct or consequential. Typically, vendors of proprietary software will provide some form of protection against third party claims of IP infringement. In addition, these vendors are usually in a better position to provide IP indemnities because they usually developed the software themselves or are knowledgeable about the origins of the software. OSS may represent the collaborative efforts of numerous developers and it is difficult to trace the origins of the software to any particular developer. Some of the larger OSS vendors including Novel, Red Hat and Hewlett-Packard have begun to offer intellectual property indemnities. Nevertheless, the purchaser must still examine the terms of these indemnities carefully as there are dollar limits and coverage restrictions.

OSS raises additional due diligence issues in the context of M&A transactions. An acquiror will need to make appropriate inquiries with respect to the possible use of OSS in the target company's products and make an appropriate assessment of the impact on value and the risk of third party IP claims.

The GPL is currently undergoing review and a draft GPL version 3 has been published for comment. On the whole, version 3 does not effect any substantial changes. Some of the changes of interest are the following:

1. Digital Restrictions Management (DRM): – This is the practice of inserting a feature in a software program designed to restrict the ability to use or modify the program. DRM is viewed as conflicting with the goals of the OSS movement as it violates the user's ability to freely use and modify the code. GPLv3 prevents users from imposing DRM restrictions and then forbidding the users to remove them.
2. Intellectual Property Infringement Claims: – GPLv3 provides that each person who receives a program under the license also receives a covenant from each author and conveyor of the program that such person will not assert any patent claims such person may have against subsequent users. This probably does not grant the user any meaningful protection over and above the implicit license not to sue found in GPLv2.
3. Sale of a Business: – Some concern has been expressed in the context of M&A transactions as to whether a purchaser of assets including GPL-covered software would obtain the rights of the vendor to obtain source code for software which had been used and modified internally. This is due to the requirement for "distribution" as a trigger for the right to obtain source code. With a view to eliminating this uncertainty, GPLv3 provides that a party to a control transaction who receives any part or form of the GPL-covered work automatically receives, in addition to all upstream licenses in the chain of propagation, a license and a right to possession of the corresponding source code from the predecessor in interest.

OSS is becoming increasingly common, particularly in the server and back office markets. While the developer community may be anxious to encourage greater use of OSS, corporations and their counsel need to be attuned to the potential risks and ramifications of utilizing OSS or acquiring businesses which have utilized OSS in their operations.

BY PAUL E. BRACE

HEALTH

GOVERNMENT CANNOT BE SUED FOR FAILING TO PREVENT THE SPREAD OF WEST NILE VIRUS

In 2004, for the first time in Canada, the Ontario Superior Court of Justice found that a public authority could potentially be held liable in negligence for failing to prevent the spread of a disease. In doing so, the Court refused to strike out a claim that the government owed specific individuals a private law duty to take reasonable steps to prevent the spread of West Nile Virus (WNV). Further, it refused to strike out a claim that the province had failed at the operational level to implement the plan it developed for the expected outbreak. The case garnered a great deal of public attention as it appeared to widen the scope of potential law suits against the government.

This decision was overturned on November 3, 2006, when the Court of Appeal held that the Ontario government did not owe such a duty of care to individuals, but rather, any duty was to the public at large. The case, *Eliopoulos v. Ontario (Minister of Health & Long-Term Care)*[1], held that to impose a duty of care on the government would create an unreasonable and undesirable burden on the province that would interfere with decision-making in the sphere of public health.

Background

The case involved George Eliopoulos, who was bitten by a mosquito in Mississauga and became infected with WNV in 2002. He was treated in hospital and released, but died in 2003 from complications following a fall. His estate and family members (the "respondents") sued the Government of Ontario ("Ontario"), as represented by the Minister of Health and Long-Term Care (the "Minister") in negligence. The respondents alleged that Ontario could and should have prevented the outbreak of WNV in 2002.

This action was one of approximately forty similar actions brought by Ontario residents who contracted WNV in 2002. Ontario brought a motion to strike the respondent's statement of claim on the grounds that it disclosed no cause of action. Both the motions judge[2] and Divisional Court[3] rejected Ontario's submission. The motions judge held that Ontario failed to establish that it was plain and obvious that the estate could not succeed at trial. She held that once Ontario created and decided to implement a plan to prevent WNV and promote awareness in Ontario, it owed Mr. Eliopoulos a duty of care to act without negligence. Ontario appealed this decision at the Divisional Court; however, the Divisional Court agreed with the motions judge and dismissed Ontario's appeal as well.

Decision of the Ontario Court of Appeal

Did the Ontario Government owe Mr. Eliopoulos a duty of care?

The Court of Appeal found that while the Ontario government owed a duty to the public at large, there was not sufficient proximity between the public authority and Mr. Eliopoulos to give rise to a duty of care. As such, it struck out the claim for negligence.

The Test

In determining whether a public authority owes a private law duty of care to an individual or class, the court must apply a two-part test, which was first introduced in *Anns v. Merton London Borough Council*[4], and subsequently refined by the *Supreme Court of Canada in Cooper v. Hobart*[5]. The test is as follows:

1. Was harm that occurred the reasonably foreseeable consequence of the defendant's act?
2. Are there reasons, notwithstanding the proximity between the parties established in the first part of this test, that tort liability should not be recognized here?

The test requires that reasonable foreseeability of the harm be accompanied by proximity to establish a duty of care. The *Eliopoulos* action considered whether there was sufficient proximity between Ontario and Mr. Eliopoulos' estate to establish that a private law duty of care existed. According to *Cooper*, proximity is determined by looking at expectations, representations, and reliance as well as evaluating the closeness of the relationship between the plaintiff and the defendant. The respondents asserted that proximity was established due to Ontario's statutory duty to safeguard the health of its residents. They relied upon the provisions of the *Health Protection and Promotion Act*[6], ("the Act") the purpose of which is stated in s. 2:

> The purpose of this Act is to provide for the organization and delivery of public health programs and services, the prevention of the spread of disease and the promotion and protection of the health of the people of Ontario.

Based on this statement of purpose and the general implications of the Act, the Court of Appeal held that a general public law duty is owed which requires the Minister to endeavour, to promote, safeguard, and protect the health of Ontario residents and prevent the spread of infectious diseases. However, the Court limited this duty stating that it does not extend to a private law duty. The Act provides for a discretionary power that if exercised, must be exercised by the Minister for the general public interest. It is not to be directed towards the protection of the private interests of the specific individuals.

In applying the second branch of the test, the Court held that policy considerations existed which were not favourable towards imposing a private law duty. The risk of contracting a disease spread by mosquitoes is one that all Ontarians are exposed to and is not a risk created by the government, nor is it a risk arising from the use of a public facility provided by Ontario. The government must be able to allocate the resources available in a manner that protects the health of its residents. The Court stated that public health priorities should be based on the best interest of the public. Implementing a private law duty would interfere with such decisions. The government should be free to make its decisions concerning allocation of resources without the fear or threat of potential future legal action.

Implementation of a Policy

The Court of Appeal disagreed with the respondent's assertion that the province's WNV prevention and surveillance plan (the "Plan") was a policy decision that triggered a common law duty of care. The Plan was prepared by the Public Health Branch of the Ministry and provided information about WNV, and encouraged members of the public and local authorities to undertake surveillance and preventative measures. The strategy for implementing this preventative action was through public education.

The respondents relied upon the proposition that there is no private law duty on a public authority until it makes a policy decision to do something. At that point, and only at that point, does a duty arise at the operational level to use due care in carrying out the policy.

The Court reasoned that the Plan for WNV awareness was not a policy decision which would engage the province at an operational level given that the province was only responsible for providing information. The implementation and operational duties were the responsibility of the local authorities and local boards of health. Justice Sharpe for the Court of Appeal noted that "...the Plan falls well short of the sort of policy decision to do something about a particular risk that triggers a private law duty of care to implement such policy at the operational level in a non-negligent manner."[8]

As such, the respondents' assertion that the Plan was a policy decision that imposed a private law duty on the government failed.

Implications

The decision of the Court of Appeal follows a number of other decisions which have considered whether public authorities owe a duty of care to a particular individual. For example, in another recent case, the Ontario Divisional Court dismissed an action against the Government of Ontario[9], and certain government servants, including the Minister of Health. The plaintiffs claimed that their daughter died as a result of hospital overcrowding, and commenced a claim against the Government alleging that decisions to reduce health care funding had contributed to the overcrowding and the resultant delay in treatment.

In dismissing the claim, the Court found that although the Minister had a duty to the public as a whole, there was no duty owed to a particular individual. In looking at the statutes governing the duties of the Minister, the court found that the Minister had a wide discretion to make policy decisions about the funding and restructuring of hospitals. The Minister was required to act in the public interest, which in and of itself did not give rise to a duty of care to a specific patient.

In *Eliopoulos*, the court recognized the distinction between policy decisions which are not actionable and operational decisions or actions which may give rise to an actionable claim and which give rise to a duty of care. A private law duty of care arises when the Government is carrying out its policy decisions at the operational level. Once the Government has made its policy decisions, it has a duty to exercise reasonable care in carrying out those actions. If it does not, it may be liable in negligence.

While the court held that the Government's WNV Plan was not operational in nature, to the extent that the government is taking on a greater operational role in resource allocation and other types of decisions, it may be exposed to potential liability. The government has an obligation to exercise reasonable care in carrying out its policy direction.

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1 2006 CanLII 37121 (ON C.A.) <<access at http://www.canlii.org/on/cas/onca/2006/2006onca10745.html>>
2 [2004] O.J. No. 3035 (S.C.J.) (QL)
3 [2004] O.J. No. 4396 (Div. Ct.) (QL)
4 [1978] A. C. 728.
5 [2001] 3 S.C.R. 537.
6 R.S.O. 1990, c. H. 7.
7 Swinamer v. Nova Scotia (Attorney General), [1994] 1 S.C.R. 445 at 450.
8 Eliopoulos v. Ontario (Minister of Health & Long-Term Care), [2006] O.J. No. 4400 at para 25.
9 Mitchell (Litigation Administrator of) v. Ontario (2004), 71 O.R. (3d) 571

BY KATHRYN M. FRELICK

PRIVATE CLIENT SERVICES

COMMON CAUSES OF ACTION IN FAMILY BUSINESS LITIGATION

The most bitter and protracted litigation has its genesis in family disputes over business succession and the division of wealth.

It is helpful to highlight some common causes of contentious proceedings in family businesses. In almost all situations, the dissension can be obviated by selecting proper planning tools, giving more specific directions in the Will of the owner-operator or by securing the liquidity of the estate through the purchase of life insurance.

Improper Selection of Planning Tools

1.Types of Trusts

Many family businesses are the subject of an estate freeze, whereby the owner-operator exchanges common shares in the business for preference shares. New common shares are then issued to a family trust or to children's trusts. The intent of the estate freeze is to cap the capital gain of the owner-operator and to permit future growth to accrue for the benefit of the next generation.

While it is possible to effect an estate freeze without a trust, by permitting children to subscribe for shares individually, this is not recommended since placing share ownership in a child without an intervening trust often leads to problems.

(a) Individual Children's Trusts

Individual children's trusts provide less planning flexibility in that each child has a fixed interest. They know that, eventually, their interest will vest and they need not fear being "disinherited." Their trust is theirs.

A family trust is less likely to attract problems for matrimonial purposes than where the child is a beneficiary of an individual trust. Further, the residence of the beneficiary is often critical for tax planning purposes and is most critical where there is an individual trust. Finally, in a family business enterprise, flexibility is desired; the individual children's trust does not afford much flexibility.[1]

(a) The Family Trust

The conventional family trust provides for discretionary payments of income to a class of beneficiaries, usually the children and grandchildren of the owner-operator. Some forms of trust provide that the Trustees are to divide the trust property equally among the children. The more flexible form provides the Trustees with discretion, including the ability to benefit disproportionately or to exclude a beneficiary altogether. This form of trust is useful where the trust holds an interest in an active business and it is anticipated that one of the beneficiaries will eventually accede to ownership of the business.

Trusts which do not have this flexibility often fail to achieve the original purpose of deferral of capital gains. If the trust does not permit unequal distribution, the consolidation of ownership by the successor will mean that each beneficiary will have to sell shares to the successor or have the corporation redeem the shares. Each of these results in a premature realization of the gain sought to be deferred. If the trust had a discretionary distribution, the shares could be transferred to the successor on a tax-free basis and the non-involved children could be equalized through a hotchpot clause in the Will, where the other children would benefit in the non-business assets usually to the exclusion of the business successor.

(b) Evenhandedness Between Children In and Out of the Business – Redundant Assets

A principal cause of dissension among family members occurs where the bulk of assets are tied up in one entity which supports the family business. This arises where real estate which is not critical to the family business is held in the same entity as the family business. Because the value of the real estate separately is often disproportionate in value to the business, the business owner-operator should take steps to segregate the real estate in a separate holding corporation or to make it clear that the real estate ought to be sold for its highest and best value in order to accommodate the non-active children who will not share in the business.

Insufficient Insurance

Life insurance is an integral part of every estate plan, yet it is frequently neglected. A large life insurance payout often provides the necessary liquidity to do the following:

1. Provide a method of equalizing active and non-active children by allocating to the non-active children the cash proceeds of the life insurance proceeds;
2. Provide a corporation with the necessary funds to redeem preference shares held by the spousal trust or to facilitate a buy-out of the shares owned by the estate;
3. Provide a spouse with sufficient capital to permit him or her to be less reliant on distributions from a business, particularly when it is anticipated that the business will not be not be sold to a third party but rather inherited by one or more members of a family.

Too frequently the critical cash is not available. Much litigation could be avoided by significant amounts of insurance at least equal to the value of the business enterprise.

Options to Purchase

Often, an owner-manager of a business will provide for an option in his or her Will to permit one or more of the children to purchase the shares.

An option is a commercial agreement. It is unusual to place options in a Will and those that appear in Wills are frequently less than complete. Nevertheless, they are sufficiently common to have given rise to a great body of jurisprudence. The fact that there is such a body of jurisprudence is sufficient reason to avoid such a tool. Typically, a parent who wishes to grant an option to a child is vague about the details and it takes a determined solicitor to insist on specificity and details.

The issues which regularly arise in connection with these options are as follows:

- What is the outside time limit by which the optionee must exercise his option to purchase the shares?
- What is the basis to be used as the method of valuation?

The Purchase Price

When the Will sets out the mechanism for setting the purchase price of the shares, there ought to be no issue as to the method of valuation.[2] However, where the break-up value of the business is greater than the going concern value of the business problems arise. This frequently arises where real estate forms a significant component of the family business. As a result, the testator must specify the method of valuation to be used or an issue will arise as to the method of valuation.

The Exercise Date

An option given in a Will remains open until accepted. Nevertheless, the option must be exercised "within a reasonable period of time."[3] While there is little judicial guidance of what constitutes a reasonable period of time, the cases are clear that the holder of an option is not required to exercise that option "blindly" or until he has received a valuation and settled the other terms of the purchase price. The courts have noted that no optionee is required to "buy the pig until they take it out of the poke."[4]

What Happens to the Assets Pending the Exercise of the Option Date?

The holder of an option becomes entitled to the option by way of gift under the Will. Theobald observes that "the option is enforceable in equity by the grantee who takes a beneficial interest in the property at the testator's death." What is the significance of this? From a tax perspective, the business assets will not vest in the spousal trust at any time and therefore there will be a deemed disposition at the date of death. No "reserve" will be available. This is to be contrasted with the deferral available where shares may be transferred to the spousal trust subject to a right or option in a Shareholders' Agreement.

The Spousal Trust and Shares of the Business

An owner-manager who leaves a surviving spouse often has the bulk of his or her estate tied up in shares of the business. He or she often neglects to specify in the Will how arrangements are to be made for the surviving spouse by way of dividend or distribution where shares are being held in the spousal trust. Typically, the shares of the owner-manager will have a large accrued capital gain. To defer tax on the capital gain, the shares will be held in the spousal trust, so that the estate will be entitled to defer taxes until the later of the sale of the shares or the death of the spouse.[5] Under the terms of a qualifying spousal trust, all income from the trust property must be paid to the spouse and no person other than the spouse may receive any part of the income or capital while the spouse is alive.[6]

A well drafted Will generally provides that the Trustees shall exercise their discretion to elect themselves to the Board of Directors and to exercise their discretion as Directors to declare dividends sufficient to generate a minimum amount of income for the benefit of the spouse, subject to the solvency and other tests set out in the corporate statute governing the corporation. This information is not always contained in the Will. As a result, following the death of the owner-manager, the spouse has an interest in a trust or which owns shares entitled to a dividend at the discretion of the Directors.

Without specific directions from a testator in the Will as to the income of a minimum nature that ought to be generated by this business for the benefit of the spousal trust, family problems frequently arise.

The issues relating to the conflicting fiduciary duties between Trustees of an estate which owns shares in an inactive business and the Directors of the active business are exceptionally complex. Too often, the spouse is left with no comfort as to a minimum rate of return on the investment represented by the active business, which often forms the bulk of the estate.

There are no Canadian cases which have specifically addressed the obligations of Trustees who have voting control of a corporation with respect to their obligations as directors to declare dividends. There is a large body of law in the U.S. but it is inconsistent. At present, the most efficient way to proceed is by pursuing a shareholder oppression remedy litigation, given that there is a considerable body of law dealing with oppression of family members in the context of family businesses.

Mediation

It is often best in family disputes to consider mediation instead of litigation.

There are times when families have gone through the mediation process only to see it fail because they are still too convinced of the rightness of their position. When all else fails, an action will have to be commenced. Generally, it is only after spending large amounts on legal fees that a family will realize that mediation may be the best way to proceed. As well, in mediation, the parties can craft a solution with tax effective results and a benefit for all sides. Litigation does not afford that benefit; someone will win and someone will lose.

In the meantime, it is best to remember that many of the seeds of potential litigation are easily observed in advance and can be avoided by careful planning and detailed attention to the proper tools of succession planning.

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1 The same drawbacks apply equally with respect to the retention of shares of a family business by a child who has direct ownership without the use of a trust.
2 *Re Rudderham* [1971] 21 D.L.R. (3d) 457; *Re Martin; Martin v. McNabb* [1981] 9 E.T.R., 28.
3 See the discussion in chapter 25 of *Theobald on Wills*.
4 See *Talbot v. Talbot* [1967] 2 All E.R. 920.
5 *Income Tax Act*, 70(6).
6 *Income Tax Act*, 70(6).

BY ROSANNE T. ROCCHI

REAL ESTATE

THE CANADIAN REAL ESTATE MARKET TODAY

In the past few years we have seen growth of the Canadian real estate market and in the past year we have seen some changes to real estate related legislation. This article will discuss and highlight these trends in the Canadian real estate market and changes in real estate related legislation.

Market Trends

"What goes up must come down" has been the mantra of many who are looking at the Canadian real estate market, but amidst the fear of a down turn in the Canadian real estate market, the Canadian real estate market continues to grow as housing starts and the national averages for new and existing home prices, while not as high at the same point last year, continue to climb.

Booming western provinces are home to most of the active markets, but growth in urban markets still continues. This is due largely in part to similar demand characteristics for real estate in the western provinces and urban cores, where employment opportunity has attracted population inflows from other provinces and other countries, boosting income and in turn reducing the availability of residential and non-residential real estate in these real estate 'hot spots'.

The strength of the Canadian real estate market is also evidenced by the continued growth of various large US retailers, such as The Home Depot and Wal-Mart. Their continued growth has had a significant impact on the real estate landscape, from the introduction of the big-box retail format to changes in the way landlords consider their approach to leasing and lease forms. In particular, there is a movement away from the landlord's typical requirement for execution of its standard form of lease towards the accommodation of different lease forms, recognition of the individuality and marketability of large tenants and the reluctance of these tenants for long-term leases, percentage rents and operating covenants.

Falling vacancy rates in Canada's largest office market in the last few years, Toronto, has resulted in a new wave of office construction in the downtown core for the first time in many years, with substantial downtown office projects having been announced and already under construction. Calgary, booming from interest and investment in the oil sands, has experienced phenomenal growth in office, industrial and residential development.

There has been increased interest in brownfield redevelopment and the marketplace is now occupied by a number of private developers and limited partnership funds actively seeking out opportunities for redevelopment of otherwise derelict sites. This activity shows no sign of abating as available land for redevelopment in the downtown core continues to shrink as a result of the proliferation of development over the past number of years and the curtailment (in Ontario) of urban sprawl through greenbelt legislation.

The continued strength and diversity of opportunity in the Canadian real estate market is particular impressive in contrast to the relative market slow down in the US in the past year, where housing starts and resale volumes have slumped and average prices of homes have flattened. While a slow down in the Canadian real estate market is likely (as all markets go through periods of growth, rest, decline and re-growth) it is unlikely that the Canada will have the same experience as the US as the Canadian real estate market has seen less high risk lending, speculative investing and overbuilding.

Legislative Changes

In 2006 we saw amendments to several pieces of real estate related legislation, the most significant of which were the amendments to the *Planning Act*. Amendments to the *Planning Act* were given royal assent on October 19th, 2006 and make significant changes to the land use planning process, provide additional devices for provincial land use planning and give additional support for sustainable development and brownfield development.

The most noteworthy of these amendments has been the empowerment of municipalities to define and require 'complete applications' at the beginning of the land use planning process. These amendments were designed to end the 'file and flip' practice, whereby applicants would submit an application with minimal information to a municipality, wait for the statutory period for filing an appeal and then file an appeal with all the required materials to an objective adjudicator under the Ontario Municipal Board. The municipalities felt that they were being left out of the land use planning process and lobbied for amendments under the *Planning Act*.

Under the amendments, municipalities now have authority through their official plans to prescribe requirements for what constitutes a 'complete application'. The consequence of not completing a complete application is to delay the applicant's appeal period until a complete application has been submitted. The purpose of the amendment has been to ensure early consultation between the applicant and the municipality and for the municipality to have all information with respect to the application prior to a decision being made by the municipality.

2006 also saw the replacement of the *Tenant Protection Act* with the *Residential Tenancies Act*. Significant changes under the *Residential Tenancies Act* include elimination of the five-day default eviction process, the annual rent increase guideline is the Ontario Consumer Price Index and above guideline rent increases are based on real and necessary investment.

Changes to the *Limitations Act, 2002* also went through significant amendments in 2006. Ontario's *Limitations Act, 2002*, which came into force on January 1, 2004, fundamentally changed how arm's-length business parties may negotiate the allocation of risk and cost in commercial deals in Ontario. Until the enactment of this statute, the limitation period for breach of contract and tort was six years from discovery of the claim for most tort claims and from the date of breach for most contract claims. Generally, the new limitation period is now two years from discovery of the claim, with the outside limitation date being 15 years from the happening of the event, down from the prior outside date of 30 years.

Amendments to the *Limitations Act, 2002* under Schedule D to Bill 14 (the *Access to Justice Act*) which came into force on October 19, 2006 provides new exceptions to the previous rule that limitation periods under the *Limitations Act, 2002* applied despite any agreement to the contrary. A notable exception to the rule has been business agreements.

Conclusion

While we have seen marked growth in the Canadian real estate market in the last couple of years, we have also seen some significant changes in the real estate landscape – from how leases are being negotiated with national retailers, the growth of brownfield development and changes in the land use planning process. In our view, the leading industry lawyers who add value to their clients will be familiar with the trends, practices and legislative changes that shape and affect the real estate market. This will allow them to seamlessly integrate the trends and changes in the real estate market with their client's interests.

BY LEONARD A. GANGBAR AND LUXMEN ALOYSIUS

LABOUR AND EMPLOYMENT

UPDATE ON DRUG AND ALCOHOL TESTING IN THE WORKPLACE

Drug and alcohol testing in the workplace continues to be a contentious issue for Canadian employers and employees. In addition to health and safety concerns, Canadian employers also face pressure from third parties and foreign governments who may require testing as a condition of doing business or as a legal requirement to operate outside Canadian jurisdictions.

In Canada, some forms of testing are more controversial than others. For example, arbitrators have tended to find that employers have the right, subject to any express provision to the contrary, to require employees to undergo testing when there are reasonable and probable grounds to test (*e.g.*, following a workplace accident or near accident or when an employee reports for work while appearing to be under the influence of drugs or alcohol). Similarly, the Ontario Court of Appeal has held that random breathalyzer testing in safety sensitive workplaces does not offend the provincial *Human Rights Code*. On the other hand, arbitrators continue to take a restrictive approach to random drug and alcohol testing, typically finding that the employer's right to manage does not confer an unfettered right to apply such measures.

These issues were recently explored by Arbitrator Picher in *Imperial Oil Ltd. v. Communications, Energy and Paperworkers Union of Canada Local 900 ("Imperial Oil")* which considered whether the company's policy of random and post-incident drug testing with oral swabs at its oil refinery in northern Ontario violated the collective agreement. In other words, could the employer, pursuant to its implied right to manage, maintain a policy of random and post-incident drug testing? Arbitrator Picher found that "given the nature of the materials, processes and products involved, the work of the refinery and the employees within it represents a highly safety sensitive endeavour." He concluded that the employer's random drug testing policy violated the collective agreement, but that the post-incident and post-accident components were reasonable and valid. Arbitrator Picher reasoned as follows:

> …a key feature of the jurisprudence in the area of alcohol or drug testing in Canada is that arbitrators have overwhelmingly rejected mandatory, random and unannounced drug testing for all employees in a safety sensitive workplace as being an implied right of management under the terms of a collective agreement. Arbitrators have concluded that to subject employees to an alcohol or drug test when there is no reasonable cause to do so, or in the absence of an accident or near miss and outside of the context of a rehabilitation plan for an employee with an acknowledged problem is an unjustified affront to the dignity and privacy of employees which falls beyond the balancing of any legitimate employer interest, including deterrence and the enforcement of safe practices. In a unionized workplace, such an extraordinary incursion into the rights of employees must be expressly and clearly negotiated. It is not to be inferred solely from general language describing management rights or from language in a collective agreement which enshrines safety and safe practices.

The decision in *Imperial Oil* must be contrasted with the Ontario Court of Appeal's decision in *Entrop v. Imperial Oil Limited ("Entrop")* holding that the employer's policy of random alcohol testing by way of a breathalyzer in safety-sensitive workplaces does not offend the Ontario *Human Rights Code*. The Court held that identifying employees who are impaired was a *bona fide occupational requirement* and that the form of testing (*i.e.*, breathalyzers) could achieve this requirement because it immediately identifies actual impairment. The Court struck down the random drug testing policy, in part, because the testing used could neither detect impairment nor produce immediate test results.

Arbitrator Picher in *Imperial Oil* distinguished the approach in *Entrop* on the basis that the Court in that case had not been engaged in a determination of whether such testing complied with the terms of the collective agreement. Arbitrator Picher noted that "it is important to remember that that which is permissible under human rights legislation may not be permissible under a collective agreement." The Arbitrator held that employers and employees could, by way of a collective agreement, create a set of rights and obligations greater than the minimum requirements of the *Code*.

The distinction drawn by Arbitrator Picher between the human rights and collective agreement analysis is open to criticism and it remains to be seen whether other Canadian arbitrators will adopt such an analysis. Imperial Oil has applied to the Ontario Superior Court of Justice (Divisional Court) to have Arbitrator Picher's decision judicially reviewed.

Drug and Alcohol Addiction as Disability

Drug and alcohol addiction is considered a "disability" under human rights legislation in Canada. Employers have an obligation to accommodate addicted employees to the point of undue hardship. As such, zero-tolerance policies that require automatic termination following a positive drug or alcohol test may run afoul of this obligation. Human rights legislation also protects individuals who are "perceived" to be suffering from a substance addiction. Two notable recent decisions are discussed below.

In *Alberta (Human Rights and Citizenship Commission) v. Kellogg Brown and Root (Canada) Company ("Chiasson")*, the claimant was a recreational user of marijuana. His new employer required him to submit to a pre-employment medical and drug screening test. The claimant voluntarily submitted to the test and ten days later commenced employment. Nine days after he started work his results came back positive for cannabis and he was immediately terminated. In determining whether the claimant was terminated on the basis of a perceived disability, *i.e.*, drug addiction, the Court adopted a "multidimensional analysis." The Court considered evidence of both actual subjective belief on the part of the employer and its employees and objective evidence to determine whether the claimant was perceived to have a disability.

According to the Court in *Chiasson*, the fact that the employer's policy called for immediate termination following a positive drug test indicated that the employer perceived, objectively, that the claimant suffered from a disability. The Court ultimately concluded that Mr. Chiasson was terminated on the basis of a perceived disability. The employer's policy created a class of people (*i.e.*, those who tested positive) and then denied them employment on the basis that a positive test increased the risk that the individual will one day be impaired at work. The Court found that, although the claimant may not have been discriminated against on the basis of an actual disability, he was sanctioned as a result of his being perceived by the company as having a disability. The employer was not entitled to automatically terminate in such circumstances without first attempting to accommodate the claimant.

In its recent decision in *Chornyj v. Weyerhaeuser Company Limited ("Weyerhaeuser")*, the Ontario Superior Court of Justice (Divisional Court) adopted the approach of the Alberta Court in *Chiasson*. The complainant was an employee who was a recreational marijuana smoker. He claimed that he was discriminated against on the basis of a "perceived disability" when his conditional offer of employment was revoked. The employer had in fact revoked the offer because the complainant had lied about having smoked marijuana before being tested. Both the Human Rights Commission and the Human Rights Tribunal refused to dismiss the complaint. However, the Court held that the Tribunal was prohibited from proceeding with the complaint.

In adopting the *Chiasson* approach, the Court found that there was no evidence that Weyerhaeuser or its employees held a subjective belief that Mr. Chornyj was drug dependent. In fact, as the Court noted, "[a]ll of the evidence of Weyerhaeuser's representatives indicates that they did not perceive Chornyj as having a disability, but rather that they perceived him to be dishonest." The fact that Weyerhaeuser's policy did not provide for automatic termination and that employees who tested positive could return to work subject to conditions rebutted the inference that the employer perceived Mr. Chornyj to be disabled. The Court accepted that the withdrawal of the offer of employment was based on Mr. Chornyj's dishonesty and not on an actual or perceived disability.

BY DAVID C. DANIELS, KENT H. DAVIDSON AND LAURA CASSIANI

TRAVAIL ET EMPLOI AU QUÉBEC

L'OBLIGATION D'ACCOMMODEMENT RAISONNABLE OU LE RESPECT DES DROITS DE CHACUN

L'obligation d'accommodement raisonnable, voilà une expression qui fait beaucoup parler au Québec, au Canada et même en Europe. Mais voilà surtout une expression bien mal comprise.

Cette obligation est une pure création des tribunaux ; vous ne trouverez aucun texte législatif l'édictant. La Cour Suprême, puis le Tribunal des droits de la personne du Québec, ont élaboré cette obligation, dans un premier temps, à l'égard de la discrimination indirecte, ou la discrimination par suite d'effet préjudiciable, puis à l'égard de la discrimination directe afin d'évaluer la proportionnalité des exigences professionnelles imposées par un employeur.

L'article 10 de la *Charte des droits et libertés de la personne du Québec* définit les motifs de discrimination :

10. Toute personne a droit à la reconnaissance et à l'exercice, en pleine égalité, des droits et libertés de la personne, sans distinction, exclusion ou préférence fondée sur la race, la couleur, le sexe, la grossesse, l'orientation sexuelle, l'état civil, l'âge sauf dans la mesure prévue par la loi, la religion, les convictions politiques, la langue, l'origine ethnique ou nationale, la condition sociale, le handicap ou l'utilisation d'un moyen pour pallier ce handicap.

Il y a discrimination lorsqu'une telle distinction, exclusion ou préférence a pour effet de détruire ou de compromettre ce droit.

En matière d'emploi, l'article 20 de cette Charte permet en effet de nuancer la rigueur de l'article 10 en permettant à l'employeur de faire des distinctions, sur un des motifs de discrimination prévus à l'article 10, si une telle distinction s'appuie sur une exigence professionnelle :

20. Une distinction, exclusion ou préférence fondée sur les aptitudes ou qualités requises par un emploi, ou justifiée par le caractère charitable, philanthropique, religieux, politique ou éducatif d'une institution sans but lucratif ou qui est vouée exclusivement au bien-être d'un groupe ethnique est réputée non discriminatoire.

L'obligation d'accommodement raisonnable deviendra le guide permettant aux tribunaux de juger de la proportionnalité de l'exigence professionnelle.

Dans un premier temps, le tribunal aura à se prononcer sur le critère de la rationalité : l'exigence posée par l'employeur est-elle rationnellement liée à l'emploi sous étude ?

Dans un deuxième temps, le tribunal s'interrogera sur les efforts raisonnables d'accommodement.

Bien sûr, cette obligation d'accommodement raisonnable s'impose avant tout à l'employeur, à celui qui établit les exigences pour accéder à un emploi ou pour s'y maintenir. L'employeur devra alors convaincre le tribunal qu'il a examiné toutes les possibilités afin d'accommoder le travailleur concerné.

Et cela ne se fait pas par l'application d'une règle générale, quand bien même cette règle aurait été convenue entre un employeur et un syndicat dans une convention collective. Il faudra plutôt étudier la situation particulière du travailleur concerné : compte tenu des capacités de ce travailleur, de sa situation ou de ses limitations, l'employeur peut-il l'accommoder, d'une façon raisonnable ?

Cet aspect « raisonnable » est évidemment le plus difficile à juger. Les tribunaux nous enseignent que pour être raisonnable, l'accommodement ne doit pas imposer à l'employeur une contrainte excessive. Mais, selon les circonstances, selon le type d'entreprise, selon sa taille ou ses ressources financières, une même contrainte peut être excessive pour une entreprise et non pour une autre. Le tribunal devra donc faire les nuances qui s'imposent et tenir compte de l'entreprise concernée.

Ainsi, les tribunaux ont élaboré un certain nombre de questions qui leur servira de grille d'analyse afin de se prononcer sur le caractère excessif ou non de la contrainte requise de l'employeur afin d'accommoder raisonnablement le travailleur.

L'accommodement impose-t-il à l'entreprise une contrainte financière excessive, par exemple en frais d'adaptation d'un poste de travail? Est-ce qu'il crée une atteinte trop grande aux droits des autres employés, par exemple en augmentant sensiblement leur charge de travail afin de pallier à la diminution de celle du travailleur accommodé ou en modifiant de façon importante leur horaire de travail ? Est-ce qu'il implique une trop grande atteinte aux dispositions contenues à la convention collective, par exemple en modifiant substantiellement les règles d'attribution des emplois ou les règles d'ancienneté et de mouvement du personnel ? Dans la recherche d'une réponse à ces questions, le tribunal recherchera l'équilibre, eu égard à l'ensemble des circonstances.

Les tribunaux reconnaissent également que cette obligation d'accommodement raisonnable ne peut pas signifier la création d'un nouvel emploi ; ils s'assureront donc que l'employeur a bien rempli son obligation d'examiner toutes les possibilités d'accommoder le travailleur en vérifiant la possibilité de l'accommoder dans son emploi ou dans un autre emploi disponible dans l'entreprise.

Bien que nous écrivions plus haut que l'obligation d'accommodement raisonnable était avant tout l'affaire de l'employeur, cela ne signifie aucunement que les syndicats ou les travailleurs n'ont pas, eux aussi, un rôle à jouer.

Dans une entreprise syndiquée, l'employeur peut difficilement accommoder un travailleur sans contrevenir à l'une ou l'autre des dispositions de la convention collective. Une modification à l'horaire de travail, une répartition différente des tâches entre les travailleurs, le droit à des pauses supplémentaires sont des formes d'accommodement qui contredisent des règles impératives de la plupart des conventions collectives. Si un syndicat décidait de s'en tenir strictement aux dispositions négociées de la convention collective, l'obligation d'accommodement pourrait rapidement devenir un exercice purement théorique, sans chance de succès. Les tribunaux ont, en conséquence, imposé aux syndicats une obligation de collaborer avec l'employeur dans la recherche d'un accommodement raisonnable. Les syndicats ont l'obligation de participer de façon active à la recherche, avec l'employeur, de la mesure adaptée aux circonstances propres au travailleur concerné afin de l'accommoder.

Cette obligation de collaborer s'applique également au travailleur concerné. Le travailleur ne peut pas se limiter à exiger que l'employeur trouve une solution : il doit collaborer à la recherche de cette solution. Les tribunaux lui imposent de plus l'obligation d'accepter toute solution raisonnable qui lui est proposée par son employeur, même s'il ne s'agit pas de la solution qu'il privilégiait.

L'obligation d'accommodement raisonnable, dans un contexte de droit de l'emploi, reste un sujet délicat, à manier avec précaution. Elle impose aux parties d'analyser chacune des situations, selon les caractéristiques qui lui sont propres. Mais n'est ce pas là la véritable mesure du respect des droits d la personne ?

BY ALAIN BOND

REMEMBER HONG KONG?

From 1949 until at least the early 1990's, Hong Kong was clearly recognized as the place where East met West. From the perspective of the West, it was *the* gateway to China, and from the East, it was China's window to the world.

On July 1, 1997, Hong Kong ceased to be a British possession and became the Hong Kong Special Administrative Region of the People's Republic of China ("PRC"). By international agreement, although now a part of China, Hong Kong was to remain separate and distinct, with its legal system, based upon English common law, to remain in full force and effect.

The tenth anniversary of the turnover to China has now passed. Though there had been some minor issues during that period the terms of the transition would appear to have been honoured, and Hong Kong remains a stable and viable economic centre. Indeed, according to the latest results in the 2007 MasterCard Worldwide Centres of Commerce Index, Hong Kong ranks as the world's top "business centre" and fifth in the world among cities in global commerce.

Since the early 1990's, the PRC has dramatically opened up to western businesses. Hong Kong is by no means the only window for China. There are numerous direct gateways to China via Beijing, Shenzhen, Shanghai and others. As a result, a tendency has developed to overlook Hong Kong. Yet in doing so, businesses with plans to enter Asia, and particularly the PRC, may forego potentially significant legal benefits. Hong Kong has an important and often unappreciated role to play in any plan to do business in the PRC.

Businesses in China with a foreign element often involve a form of joint venture, which are manditorily governed by the laws of the PRC. Since there are significant legal obligations and liabilities which potentially may arise, a Canadian corporation contemplating entering into a joint venture agreement should consider incorporating a separate corporation to hold the interests of the Canadian corporation in the joint venture. Hong Kong is a particularly appropriate jurisdiction. For such purposes, Hong Kong is not considered to be part of the PRC, yet due to its relationship with the PRC it enjoys significant benefits over other jurisdictions.

To incorporate in Hong Kong is relatively simple and inexpensive. Documentation can be in the English language. The corporate structure, being based upon English law, will be recognizable to Canadians.

Although a joint venture agreement in the PRC must be governed by PRC law, contractual arrangements outside of the joint venture agreement itself between a Hong Kong company and a Chinese entity may be governed by Hong Kong law under a number of circumstances.

Since the law of Hong Kong is based upon English common law, there are significant similarities to Canadian law and practice. The law of the PRC, however, is based upon a civil code, which can best be described as evolving. Courts in Hong Kong are well established, and attuned to commercial disputes, and deliver consistent predictable results.

Dispute resolution in China can be problematic. Commercial law, as we know it, has only developed in the past quarter century. Roughly nine out of every ten judges in the PRC civil courts are not legally trained. To compound matters, since the system utilized is based upon a civil code, the common law doctrine of *stare decisis*, being the reliance upon legal precedent, is not recognized. To compound matters further, the courts in the PRC lack the authority to enforce their own judgments. Recourse must be had to a separate bureaucracy which is in turn limited by provincial boundaries. Hong Kong does not suffer those difficulties.

Arbitration is a preferred method of dispute resolution in the PRC. It should be noted, however, that unless there has been prior agreement between the parties, the arbitration must be conducted in one of the Chinese languages, Mandarin or Cantonese. However, if the parties have agreed that the dispute be arbitrated before the Hong Kong International Arbitration Centre ("HKIAC"), the arbitration can be conducted in the English language with all documentation and the award likewise produced in that language. The HKIAC's arbitration rules incorporate the UNCITRAL rules, which were promulgated by the United Nations Commission on International Trade Law in 1976.

Legal services in Hong Kong are of a high standard. Most of the larger firms are well connected in the PRC, and several have offices in the PRC.

It is also worth noting that Hong Kong is recognized as a special economic area within the PRC, and thus there are minimal currency restrictions on movement of funds from the PRC to Hong Kong for business purposes. By Canadian standards, taxation levels in Hong Kong are extremely low – 15% of net company profits.

Hong Kong being a key financial centre, has well established banks and financial services, which deal easily with Canadian banks and PRC banks.

The PRC is developing rapidly, as are its various financial centres. Hong Kong may no longer be the gateway to the PRC, but cannot be ignored. Remember Hong Kong when structuring agreements or business in Asia.

Miller Thomson LLP is well positioned to assist its clients in structuring their transactions in both Hong Kong and the PRC.

BY DAVID B. BUCHANAN

INTERNATIONAL TRADE, CUSTOMS AND COMMODITY TAX

Over the past year there have been many new laws, policies and court decisions which have affected international trade, customs and commodity tax laws in Canada.

International trade, customs and commodity tax laws and policies have been the subject of rapid change and expansion. Rapid change has presented planning opportunities and compliance risks. The following is a brief discussion of some recent decisions, agreements, laws and policies which raise planning opportunities and possible compliance risks in three distinct areas, namely: (1) trade disputes, (2) customs and import tax planning; and (3) protection against imported goods which infringe intellectual property rights.

Trade Disputes

Over the last year, importers, exporters and domestic producers of goods have been affected by trade disputes and the settlement or determination of trade disputes. In the fall of 2006, Canada and the U.S. reached a settlement of the softwood lumber dispute by signing the Canada-US Softwood Lumber Agreement. The result of this agreement was the return of billions of dollars of U.S. anti-dumping duty deposits which had been collected from Canadian softwood lumber producers. In connection with the settlement of the softwood lumber dispute, Canada agreed to impose a new taxation scheme relating to the export of softwood lumber. The *Softwood Lumber Products Export Charge Act* was brought into force in December of 2006.

It now appears that the signing of the Canada-US Softwood Lumber Agreement and the introduction of the *Softwood Lumber Export Charge Act* has not resolved all disputes between the Canadian and the U.S. lumber industry. In fact, it has set the stage for a new dispute between Canada and the U.S. The heart of the new complaint is whether or not British Columbia producers must pay an additional tax if they ship too much lumber when prices are low. At issue is approximately $20 million per month in extra taxes for B.C. producers alone. It is expected that this dispute will eventually be considered and determined by members of the London Court of International Trade.

Another issue of focal concern to importers, exporters and domestic producers over the last year has been the production and importation of relatively inexpensive goods from China. Special anti-dumping or countervailing duties may be levied on imported goods that have been unfairly traded. Unfairly traded goods include goods that have been below the normal market price, or below cost.

Canada has established a scheme for determining the issue of whether goods have been unfairly traded and should be subject to anti-dumping or countervailing duties pursuant to the *Special Import Measures Act* ("SIMA"). The inquiry and investigation into Canadian dumping allegations is often commenced as a result of a compliant from a domestic producer under the SIMA.

An investigation is first carried out by Canada Border Services Agency ("CBSA") officials who gather facts to calculate whether dumping has occurred. The CBSA must make a preliminary and then a final determination. Next, the Canadian International Trade Tribunal ("CITT") must carry out an inquiry to determine whether or not dumping is the cause of material injury to Canadian producers of like goods or retardation to the establishment of a domestic industry. At the end of the inquiry, the CITT may order the imposition of duties (equal to the margin of dumping) on dumped goods.

Customs and Import Tax Planning

The right to plan to minimize duties and taxes has been confirmed in a series of cases delivered by the Supreme Court of Canada and the Federal Court of Appeal in recent years. The courts have clearly stated that companies have the right to plan and structure their affairs in order to minimize customs duties and taxes. Where formal structures and agreements have been created, the result of which is to receive favourable tax treatment, then government officials have an obligation to respect those formal structures and arrangements. Examples of strategies that may be employed in order to minimize import duties and taxes include the following:

1. Tailoring supply contracts to provide evidence of value for duty calculations (including the price paid or payable, and amounts that may be deducted).
2. Establishing conditions precedent for deductions (tailoring distribution and sales agreements to establish conditions precedent for adjusting out royalties and licence fees).
3. Using CBSA and/or Canada Revenue Agency ("CRA") policies in order to avoid or defer the payment of customs duties on certain types of goods (for example, temporary importations or goods imported for manufacturing and export).

Protection of Intellectual Property Rights

The degree to which Canadian companies can protect against importations which infringe a domestic distribution has been the subject of judicial consideration. Recently the Federal Court of Appeal delivered a decision impacting the importation of goods that are produced outside the distribution system of a Canadian intellectual property owner. These goods are referred to as "parallel imports." The term parallel imports refers to goods:

(a) sold in the country of export (the "Export Country");
(b) imported and sold into the country of import (the "Import Country"); and
(c) imported without the permission of the intellectual property owner in the Import Country.

The key concerns of intellectual property owners respecting parallel imports is the protection against unlawful distribution of those imports. Canadian intellectual property distribution rights are protected under the *Copyright Act* and *Trade-Marks Act*. Subsection 27(2) of the *Copyright Act* indicates that it is an infringement of copyright to import into Canada or to distribute a copy of a work (*e.g.*, brand designs) if the person doing the act knew or ought to have known that the copy would infringe copyright if it had been made in Canada by the person who made it.

The Federal Court of Appeal decided that parallel imports of branded goods may be controlled where an exclusive distribution system has been registered. Importers should exercise due diligence with respect to the distribution of branded goods. They may do so by:

(a) Identifying registered license arrangements with respect to the distribution of branded goods in Canada;
(b) Entering into appropriate distribution license arrangements and registering them where appropriate; and
(c) Enforcing distribution license arrangements in the Federal Court to restrain the importation of parallel imports pursuant to Subsection 27(2) of the *Copyright Act*.

Under the *Copyright Act* and *Trade-marks Act*, the owner of exclusive distribution licences may make an *ex-parte* application for an order directing the CBSA to detain infringing goods.

Summary

The following has provided an outline respecting three different areas which have been the subject of recent decisions, legislation or policy changes. Members of Miller Thomson's International Trade, Customs and Commodity Tax Group assist businesses in dealing with these and other changes, for example, by planning opportunities, managing compliance risks and handling trade disputes. Many businesses find that regular legal updates, together with periodic self-audits are indispensable in helping to identify ways and means to save duties, taxes, penalties and interest.

Examples of the types of services that are provided are listed below:

International Trade Law

We regularly make representation to and appear before Canada's trade regulation bodies and Tax Courts, including the CBSA, the Department of Finance, the CITT, the Tax Court of Canada, Binational Panels established under Chapter 19 of NAFTA, and the Federal Court of Canada. In addition, we have successfully represented clients seeking changes to Canada's trade legislation, including the *Special Import Measures Act*, the *Canadian International Trade Tribunal Act*, the *Excise Tax Act* and related rules and regulations.

Customs

Our lawyers have extensive experience at handling a variety of customs law matters. We provide legal advice and representation for a variety of businesses, including importers, exporters, customs brokers, freight forwarders, transportation and insurance companies. We advise our clients on customs compliance matters, including tariff classification, preferential access rules of origin, the calculation of value for duty (*e.g.*, the treatment of royalty payments, buying commissions, other fees paid by the importer or post-importation charges), as well as representing clients in customs seizures and Administrative Monetary Penalties ("AMPS").

Commodity Taxes (GST, PST, Excise and Fuel Taxes)

Commodity tax issues in Canada are not only important for domestic businesses but can have a considerable impact on non-resident entities with no physical presence in Canada. GST and PST can significantly affect funding and business and liability decisions in fields outside the typical income tax realm. This includes entities such as charities, non-profit organizations, municipalities and pension funds. We advise and represent clients on all commodity tax transaction planning and dispute resolution (appeals) matters.

BY DANIEL L. KISELBACH

A THIRD CANADIAN PROVINCE ENACTS FRANCHISE LEGISLATION

A COURT CANNOT REWRITE A CONTRACT

The world of franchising has seen some interesting developments in the last year both on the legislative side and before the Courts.

The Province of Prince Edward Island ("PEI") approved the Province's *Franchises Act* and its Regulations (the "PEI Act") on April 24, 2006. The Act came into force on July 1, 2006 excepting the disclosure obligations which came into force on January 1, 2007. The legislation, and in particular the disclosure obligations, follow the format of the Ontario Act while incorporating certain of the improvements such as (i) the right to deliver disclosure documents electronically; (ii) the right to use another jurisdiction's disclosure document, such as a UFOC, with a "wrap-around" addendum; and (iii) the inclusion of a "substantial compliance" of disclosure obligations provision similar to Alberta's legislation.

In New Brunswick, the Provincial Legislature had proposed a new *Franchises Act*, Bill C-6, which passed first reading on December 7, 2005. Second Reading was expected to occur earlier in 2006 as the Province's 55th legislature had resumed sitting on March 28, 2006. The legislature's Law Amendments Committee solicited public comments to the Bill until July 31, 2006. However, the legislature dissolved in the fall of 2006 for elections and the opposition Liberals were victorious. The Bill then died on the order table, although it was supported by the former opposition, now the ruling party, and may be picked up by the new legislature although possibly embodied in a new Bill.

In Quebec, where there is no specific franchise legislation, franchisors and franchisees' obligations were considered once again by the Courts.

On August 23, 2006, the Quebec Court of Appeal, the Province's highest Court, rendered a unanimous and key decision in a case[1] opposing an automobile dealership to BMW Canada Inc. ("BMW").

Essentially, BMW was looking to terminate one of its dealers' franchise agreements because the dealer had failed to comply with a number of requirements formulated by BMW over the years. The dealer argued that the reasons invoked by BMW were pretexts and that the real reason for termination was the dealer's refusal to be pressured into selling its franchise at a loss to a buyer proposed by BMW.

One of the difficulties of the case lied in the lack of clarity found in certain provisions of the franchise agreements and in particular, the provisions dealing with the term of the agreements.

A Decision in first instance was rendered in December 2004, by the Superior Court of Quebec, in favour of the dealer. The Court held that BMW had not complied with its obligation of good faith and fair dealing to the dealer. In light of the lack of clarity of the term of the agreements, the Court extended the franchise agreements to December 31, 2012, where BMW had argued that they had terminated on December 31, 2002. The Court also condemned BMW to pay damages to the dealer totalling some $6,000,000.

Both parties appealed the Superior Court Decision before the Court of Appeal mainly on the basis of the term of the agreements. BMW argued that the Superior Court had erred in extending the agreements to 2012 where the dealer argued that BMW could not terminate the agreements without a serious reason because of its obligation of good faith and because the agreements had no termination provisions except for those specific reasons stipulated in the agreements.

In its Decision, the Court of Appeal set out certain significant principles which can be summarized as follows:

- Where there is no termination clause in an agreement of indefinite term, unless a provision specifically prohibits a party from terminating the agreement without a serious reason, a party can always terminate the agreement by giving to the other party a reasonable prior notice of its intention to do so.
- The criteria to determine the reasonableness of a notice includes:
  - the length and type of relationship between the parties;
  - the extent of the sales force employed by the party whose distributorship was terminated;
  - the importance of the exclusive distributorship to the party terminated;
  - the acquisition of inventory; and
  - time needed by the terminated party to acquire a replacement line of products and to re-establish a viable business.

Consequently, notwithstanding the more than thirteen year relationship between the parties in the particular case at bar, a notice of one year was deemed to be reasonable in the circumstances.

- If a party fails to comply with its obligation of good faith and fair dealing, the appropriate remedy is an award for damages and not the rewriting of the contract. Thus, a Court cannot create an obligation that did not exist beforehand on which the parties never agreed.
- It is possible, even probable, that the principle of good faith in contractual relations may implicitly force a franchisor, under penalty of damages, to renew short term agreements for a certain period when the franchisee has invested significant amounts of money in its business. However, this principle was not applicable in the particular case at bar.

For these reasons, the Court of Appeal held that the franchise agreements had expired on December 31, 2005, and further ordered a transition period of one year until December 31, 2006, to allow the parties to terminate their contractual relations. The Court further reduced the damages to $2,000,000.

The case can be considered a landmark decision in that it is one of the very few Court of Appeal cases where the obligations of both franchisors and franchisees have been discussed and clarified.

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1 *BMW Canada Inc.* v. *Automobiles Jalbert Inc.* and *Denis Jalbert,* C.A.M. 200-09-005070-054, August 23, 2006.

BY STÉPHANE TEASDALE

CONSTRUCTION

ONCE IN A WHILE

Once in a while, a Court decision transforms. And, transformative is the least one can say about *R. v. Ron Engineering & Construction (Eastern) Ltd.*

To refresh, *Ron Engineering* elevated stipulated price bidding from mere dating to the institution of marriage. The Supreme Court of Canada read into the actions of the parties the intention to create the "bidding contract" it named "Contract A." *Ron Engineering* not only changed owner/contractor and contractor/subcontractor bidding, it infiltrated procurements of all kinds, creating shock and surprise as it went.

As *Ron Engineering* has now passed the age of 25, it seems appropriate to consider its ancestry, the circumstances of its birth and its career path. Besides, after five return trips to the Supreme Court of Canada, all resulting in robust affirmations, *Ron Engineering* seems at the top of its game.

Life Before Ron Engineering: Ancestry

Construction bidding before Ron Engineering was an ingredient in contract formation. The recipe was simple. Take an offer (the bid). Add acceptance. Blend with consideration. Avoid mistake. The parties have a contract.

The wildcard is mistake. The recipe fails if the acceptor knows that the offeror made a mistake.

Before Ron Engineering, a bid thwarting mistake took one of two forms.

Form 1 was an obvious mistake.

Form 2 was more subtle. No mistake was obvious at bid opening but, after opening – and before acceptance – the bidder communicated its mistake.

Ron Engineering was not about an obvious mistake. That kind of mistake was a prophylactic before *Ron Engineering* and still is. No, the problem was the "invisible" mistake.

A case typifying the "invisible mistake" is *Belle River Community Arena Inc. v. W.J.C. Kaufmann Co. Ltd*. Here, Kaufmann submitted an irrevocable bid with bid security. Shortly after the bids were opened, Kaufmann discovered it had made an error – invisible on the face of the bid. Kaufmann advised the owner of its mistake and asked to be released. The owner awarded to Kaufmann – who refused to sign. The owner contracted at a higher price and sued Kaufmann for the spread. The Court of Appeal for Ontario found for Kaufmann. The owner could not accept the bid once it knew of Kaufmann's mistake.

Why bother with the bid process if the bidder can declare a mistake and walk?

The industry studied the problem. When a solution was not forthcoming, the Court moved in.

The Solution: Birth

Ron Engineering was a replay of *Belle River*. On bid closing, there was no error on the face of the bid. Because its price was significantly lower than the second bidder, Ron Engineering reviewed its bid papers and discovered it had omitted an entire division of the specification – worth about $750,000. The owner was notified of the mistake and Ron Engineering requested withdrawal of its bid.

Her Majesty, the owner, had no sympathy for Ron Engineering and awarded it the contract. Supported by the Court of Appeal for Ontario – and decades of mistake law – Ron Engineering refused the award. Safe, it thought.

At both the trial and at the Court of Appeal, Ron Engineering was successful. The surprise came at the Supreme Court of Canada where Mr. Justice Estey, writing for the Court, inferred that the parties intended by their conduct to create binding obligations. Then, His Lordship invented "Contract A" which has ruled bid evaluation/contract award from that day forward.

A shocked Ron Engineering – and a more shocked industry – learned that Contract A bound the contractor to its mistake – never mind that Her Majesty knew. Contract A comes into being immediately upon the opening of a compliant bid. At that moment, the bidder is contractually bound to keep its bid open for the period of irrevocability and to sign the contract if it is awarded.

So, when Ron Engineering refused to sign the contract, it breached Contract A.

Initially, owners were ecstatic. Bidders were right where they wanted them. The ecstasy was transient.

As with all contracts, Mr. Justice Estey pointed out that the owner, too, had obligations under Contract A. Those obligations were defined in the bid documents.

So, *Ron Engineering* was based on an inference which was probably not well founded – that the parties intended a contractual relationship upon the submission of a compliant bid. Chances are neither Her Majesty nor Ron Engineering ever dreamed of Contract A – not that it matters any more.

Consequences: Career Path

Ron Engineering was decided in 1981. Some thought – or maybe hoped – that the Contract A construct would be undone the next time the Supreme Court of Canada had a chance to reconsider. And, reconsider the Court did – in 1987 – when it unanimously affirmed a decision of the Alberta Court of Appeal. In *Calgary (City) v. Northern Construction Co. Ltd.*, the contractor made the same kind of "invisible" mistake as Ron Engineering had. Finding itself low by $395,000, Northern discovered a mistake to the tune of $181,000. When its request to withdraw its bid was denied, Northern argued that Calgary had a duty to mitigate its damages by allowing Northern to increase its bid by the amount of the mistake – which would still be the low bid. No dice said the Alberta Court of Appeal; ditto said the Supreme Court of Canada. Because, allowing Northern to increase its bid would be a breach of Contract A with the other bidders. Similar mitigation arguments have been made since – and failed.

It didn't take long after Ron Engineering for contractors to become live to owner obligations under Contract A. Before Contract A, bidders had no legal remedies against owners if shabbily treated. Now, contractors saw the possibility of a remedy – a real one: a contractual one.

(i) The First Decade: Fairness v. Privilege

By the late 1980's, the Courts experienced an increasing volume of bid litigation. Few of those cases involved an "invisible mistake" – which seemed more or less settled. Cases like *Elgin Construction v. Russell Township, Best Cleaners v. Her Majesty and Chinook Aggregates v. Abbotsford* began to shape owner obligations under Contract A.

Elgin held that the privilege clause ("lowest or any bid not necessarily accepted") was a complete answer to the complaint of the jilted low compliant bidder. On the other hand, Best and Chinook held that owners had a duty to treat bidders fairly. And that, when they breached that duty, the privilege clause would not save them. However, these decisions flowed from Courts that were a notch lower than the Supreme Court of Canada.

(ii) The Second Decade: The Rise of Compliance

By the early 1990's, an uneasy tension had developed between the privilege clause and an owner's implied duty to treat all bidders fairly. Different courts came to different conclusions and owners were treading risky ground when they ignored their own bid rules and treated bidders unfairly.

In 1999, the Supreme Court of Canada had another chance to reprise *Ron Engineering in MJB Enterprises Ltd. v. Defence Construction (1951) Ltd.* MJB challenged the right of Defence Construction to use the privilege clause to defend itself after it awarded a contract to a non-compliant bidder. The Court held that the bid documents created an implied term obliging the owner to award the contract only to a compliant bidder. So, if there is at least one compliant bid, Contract A usually blocks an award to a non-compliant bidder. As low compliant bidder, MJB argued that Contract A also included an obligation to award the project to it. The Court rejected MJB's argument; the privilege clause means what it says. An important subtext in *MJB* is that *Ron Engineering* – having been looked over – was not overlooked.

Not long after *MJB*, the Supreme Court heard another bidding case – *Martel Building Ltd. v. Canada.* Her Majesty called for competitive bids from landlords wishing to rent to the Crown. Martel claimed that the Crown's unfair and uneven conduct during the bidding process was a breach of Contract A. The Supreme Court of Canada confirmed what lower Courts had been saying for fifteen years – Contract A gives rise to an implied duty on the part of the owner to treat all bidders fairly. Unfortunately for Martel, it lost the case because – even if the Crown had been fair – Martel would not have won. Martel also argued that the owner had a duty of fairness outside Contract A. The Court – not wanting to interfere with robust commercial negotiations – efused to create a freestanding duty of fairness.

(iii) The Third Decade: It's Mostly About Compliance

While *Martel* confirmed what most believed – fairness is a term of Contract A – it was *MJB* which shifted bid dynamics.

If Contract A includes an implied duty to award only to a compliant bidder, why not modify the terms of Contract A? So, owners began to use a discretion enriched version of the privilege clause to create more latitude to award as they saw fit.

Contractors reacted differently. If compliance is the keystone, then why not attack the compliance of competitors. Discretion clause or no, owners found themselves faced with competing allegations around compliance with accompanying threats. If you award to X, Y will sue; if you don't award to X, X will sue.

Self declared non-compliance presented a potential exit strategy for a bidder with an invisible mistake. Since compliance is the threshold to Contract A, and, since Contract A must exist to bind the bidder to its bid, bidders scoured their own bid documents for flaws serious enough to render their invisibly mistaken bids non-compliant. This behaviour developed an interesting tug-of-war between an owner with a broad discretion clause and a bidder desperately seeking an exit ramp.

An example of an owner with a clause and a bidder with an invisible mistake is *Graham Industrial Services Ltd. v. Greater Vancouver Water District.* When bids closed, Graham was $5 million low with a bid of $21.5 million. When it reviewed its bid, it discovered a $2 million error. Knowing invisible mistake was a problem, Graham pointed at its own failure to submit an environmental remediation plan to claim non-compliance. The owner's "discretion" clause allowed it to waive defects in the bids it received. Graham wanted out; the owner wanted the $5 million price advantage. The British Columbia Court of Appeal decided that Graham's bid was non-compliant: the owner's discretion clause could not bring Contract A into being. Other cases with other discretion clauses have gone the other way. Fun, eh?

The Future

The case law developed in the wake of *Ron Engineering* is robust. Witness the January 25th, 2007 decision in *Double N Earthmovers Ltd. v. City of Edmonton and Sherway Construction of Alberta Limited.* Once again, Ron Engineering has been affirmed while new dimensions and extensions of Contract A were argued and decided. We will write about the decision in Double N but not in these pages.

Some may wonder whether we are any better off than the "good old days" when a bid was merely an offer. And, when a wronged bidder had no legal recourse.

We could debate the proposition at length. But why? Until the Supreme Court of Canada says otherwise, *Ron Engineering* will remain a dominant feature on the procurement landscape.

So, we give up? Not at all. Bid litigation thrives because it pays. One way to modify litigious behaviour (apart from avoiding Contract A altogether) is to lower the stakes. Treat Contract A like a contract and limit both the bidder's and the owner's liability. Another tool is a Contract A arbitration process for bid disputes.

So far, there is little case law on the attitude of the Courts to limitation of liability clauses. One case, *Elite Bailiff Services v. British Columbia* held that a limitation of liability provision in Contract A was effective.

If a limitation of liability is good, then a clause which excludes liability altogether must be better. Not necessarily. In *Tercon Contractors Ltd. v British Columbia Ministry of Transportation*, the trial Court worked very hard to avoid applying the exclusion clause and ultimately did. That case is on appeal so the jury is – as they say – out.

Our sense is that a properly constructed limitation of liability clause has a good chance of being upheld. For the contractor, the limit of liability for breaching Contract A would be a fixed sum – high enough to keep it serious when it bids. For the owner, the limitation would be the lower of the same fixed sum and the reasonable cost to the bidder of preparing its bid.

So far as we know, no Court has yet opined on an arbitration clause in Contract A. But, if Contract A is a real contract, the Court should not have a problem. What may be tricky about an arbitration clause is the perception of owners that contractors – being assertive by nature – will invoke arbitration even when they have no chance of an award. So, consider an arbitration clause which can be triggered at the sole option of the owner.

Back to back, an arbitration provision and a limitation of liability clause might themselves be – if not transformative – at least calming.

BY WILLIAM M. PIGOTT

TAXATION

INCOME TRUSTS: A NEW TAX REGIME FOR PUBLICLY-LISTED FTES

On December 15, 2006, the Department of Finance provided further guidance on the new tax regime to close down income trust conversions and to shore up the existing tax base.

As part of the Tax Fairness Plan announced by Finance Minister Flaherty on October 31, 2006, a "Distribution Tax," equal to the general combined federal/provincial corporate income tax rate, will apply to certain non-deductible distributions by publicly-listed income trusts and be payable by them. Publicly-listed partnerships will have to pay tax on certain earnings, regardless of allocation, at a rate comparable to the Distribution Tax. Distributions and allocations will be taxed a second time as taxable dividends to their individual investors. Canadian residents will be deemed to receive "eligible dividends" and thereby qualify for the enhanced dividend tax treatment beginning in 2006. Publicly-listed income trusts and partnerships are collectively referred to as flow-through entities ("FTEs").

The new regime will not apply to existing FTEs until 2011. Such FTEs will be able to enjoy "normal growth" over this grandfathering period so long as new equity capital growth does not exceed the sum of $50 million and an objective "safe harbour" amount. This grandfathering maintains the significant tax advantages of income trusts for four more years. FTEs that begin trading after October 31, 2006 will be subject to the new tax starting in 2007. No such FTEs are anticipated.

Draft legislation was released on December 21, 2006. More changes are expected to deal with technical and policy concerns, particularly avoidance strategies that may frustrate the Government's objectives and guidance.

Three other changes were also announced as part of the Government's Tax Fairness Plan:

- Half point reduction in the general corporate income tax rate to 18.5% as of 2011;
- $1000 increase in the age credit amount to $5,066, effective in 2006; and
- Permissibility of pension income splitting between spouses or common-law partners, effective in 2006.

Objectives of the new regime

Despite proposed lower taxation of corporate dividends first announced by former Finance Minister Goodale on November 23, 2005, conversions to FTEs continued because significant tax advantages remained for non-resident and tax-exempt investors (see Table 1). The new regime is designed to remove tax as a consideration for operating as either a FTE or a corporation.

Table 1: Simplified comparison of proposed investor tax rates in 2011

	New Dividend System		New Income Trust System	
Investor	FTE (Income)	Large Corporation (Dividend)	FTE (Non-Portfolio Earnings)	Large Corporation (Dividend)
Taxable Canadian	46%	46%	45.5%	45.5%
Canadian tax-exempt	0%	32%	31.5%	31.5%
Foreign investor	15%	42%	41.5%	41.5%

Details of the new regime

Specified investment flow-throughs

The new regime will apply to specified investment flow-throughs ("SIFTs"). An income trust or partnership is a SIFT, if the following conditions are satisfied:

	Trusts	Partnerships
1.Residency	• Resident in Canada	• A "Canadian partnership" (i.e. all of its members are resident in Canada); • Central management and control are in Canada; • Formed under the laws of Canada or a province; or
		• Would, if it were a corporation, be resident in Canada
2.Listing	• Units listed on a stock exchange or other public market	
3.Holdings	• Holds one or more "non-portfolio properties"	

Taxable amount

SIFT trusts will be required to pay the Distribution Tax on distributions of non-portfolio earnings. Such trusts can no longer deduct distributions. Non-portfolio earnings of SIFT partnerships will be taxable at a rate comparable to the Distribution Tax. Non-portfolio earnings include:

- Income from the businesses a SIFT carries on in Canada;
- Income from non-portfolio properties; and
- Taxable capital gains from dispositions of non-portfolio properties.

Non-portfolio property holdings refer to investments in "subject entities" (such as Canadian-resident corporations, trusts and partnerships) with fair market value (FMV) that:

- exceeds 10% of the entity's issued and outstanding shares or interests; or
- together with the FMV of securities held in affiliates of the entity, exceed 50% of all issued and outstanding shares or interests of the investor itself.

SIFTs qualify for all deductions for taxable dividends provided to corporations under the *Income Tax Act.*

Distribution Tax

The Distribution Tax rate will be the general federal corporate rate plus 13% in lieu of provincial tax (see Table 2).

Rate	2007	2008	2009	2010	2011
Federal*	21.0%	20.5%	20.0%	19.0%	18.5%
Additional	13.0%	13.0%	13.0%	13.0%	13.0%
Total	34.0%	33.5%	33.0%	32.0%	31.5%

Table 2: SIFT tax rates on distributed non-portfolio earnings

* All federal rates are enacted, except the 2011 rate.

Normal growth

Following consultations with many publicly-traded trusts and partnerships, Finance decided that the sum of $50 million dollars and a "safe harbour" amount will be the benchmark of "normal growth" for grandfathered SIFTs. Expansion in excess of this benchmark will result in loss of grandfathering.

Safe harbour

A grandfathered SIFT's market capitalization as at market close on October 31, 2006 establishes the benchmark for the safe harbour calculation. Market capitalization is the value of a SIFT's issued and outstanding publicly-traded units including debt, options or other interests that were convertible into units of the SIFT. The safe harbour amount will be determined as a percentage of market capitalization for the periods specified in Table 3 and will allow growth of up to 100% over the four-year transition period.

Table 3

Safe Harbour Amount (as a % of market capitalization)

Nov. 1/06 to Dec. 31/07	2008	2009	2010
40	20	20	20

SIFTs may carry-over their annual safe harbour amounts into following years throughout the transition period; however, the $50 million dollar amounts are not cumulative. New equity broadly covers units, debt and any other interest convertible into units. Outstanding debt as of October 31, 2006 replaced with new equity will not be considered growth for these purposes. Although issuing new non-convertible debt will not affect the safe harbour, converting such new debt with equity will be counted as growth.

If another person or partnership exercises a right that existed on October 31, 2006 to exchange an interest in a partnership or a share of a corporation into new equity, the resulting issuance of new equity will not be considered growth. As long as net equity remains unchanged, mergers or reorganizations of SIFTS, publicly trading on October 31, 2006, will not be considered growth.

Real estate investment trusts ("REITs")

The new regime does not apply to REITs, which otherwise qualify as SIFTs, if:

- Real property situated in Canada is the only non-portfolio property held throughout the year;
- At least 95% of yearly income derives from domestic or foreign properties including dividends, interest, rents and taxable capital gains from dispositions of real property;
- At least 75% of yearly income derives from rents from, mortgages on, or gains from the disposition of, real properties situated in Canada; and
- FMV of real properties situated in Canada and cash debt or other obligations of Governments in Canada (including Crown corporations, etc.) held throughout the year is at least 75% of equity value.

"Real property situated in Canada" includes securities issued by any entity that itself satisfies the above conditions; thus, a REIT can hold Canadian real properties through intermediaries. Depreciable property with a capital cost allowance rate greater than 5% does not qualify.

Return of capital

The new regime does not affect the treatment of "return of capital." Return of capital is neither deducted by trusts nor included in income by unitholders – it reduces the unitholder's cost of investment.

Taxation of investors

Under the new regime, both trust distributions and partnership allocations of non-portfolio earnings will be taxed as dividends to investors as follows:

Recipient	Tax treatment of distribution or allocation
Canadian-resident individual	Deemed "eligible dividend" benefiting from enhanced dividend tax credit
Canadian-resident corporation	Included in income with corresponding deduction
Canadian tax-exempt	Neither taxed nor entitled to any refundable dividend tax treatment
Non-resident	Subject to non-resident withholding tax before receipt

Implications of the new regime

Distributions to unitholders

- For most Canadian individual unitholders, in 2011 the combination of the Distribution Tax and the enhanced dividend tax credit will match the status quo. However, the Distribution Tax will be an absolute cost for tax-exempts and foreign investors.

Tax-exempt entities

- Tax exempts (*e.g.* pension plans, RRSPs) will incur significant double taxation under the new regime because the Distribution Tax will apply and a second level of personal tax will eventually apply upon distribution to pensioners or annuitants, as is the case with corporate investments. Large pension funds may prefer to invest directly in private FTEs instead of those publicly-listed. Likewise, public income trusts may be targets for acquisition and privatization.

Current and future tax accounting

→ Going forward, SIFTs will have to account for income taxes beginning in 2011. This will affect stated earnings and various financial ratios.

Debt covenants of SIFTs

→ Financial measures, around which debt covenants are structured, stand to change under the new regime. This will influence any renegotiation of terms.

Strategic and economic issues for existing entities

→ The new regime forces businesses to revisit strategies, tax planning and cash-flow predictions. Existing FTEs may consider proceeding as-is (although beyond 2010 this will be a questionable alternative), restructuring, directly issuing debt to the public or privatizing.

Conversion of Trusts to Corporations

→ The Department of Finance intends to allow SIFTs to convert to corporations without any tax consequences to investors and to remove any impediments to conversion under the current income tax rules.

Capital dividend account

→ Such trusts and partnerships can no longer distribute one-half of capital gains from the disposition of non-portfolio property tax-free.

Conclusion

The new regime dramatically changes the landscape for publicly-listed FTEs and their investors. Feel free to contact any member of the Miller Thomson Tax Group, if you have any questions about the implications of the new regime, or for an update on the status of the draft legislation.

BY MARTIN J. ROCHWERG AND JAMES A. FRASER

FIRST NATIONS AND RESOURCE DEVELOPMENT

DUTY TO CONSULT WITH FIRST NATIONS APPLIES TO LANDS SURRENDERED UNDER TREATY

A recent Supreme Court of Canada finding that the obligation of governments to consult with First Nations may extend to activities taking place on lands that were surrendered under treaties has significant impacts on those areas of Canada that are covered by treaties.

Prior to the Supreme Court of Canada's decision in *Mikisew Cree First Nation v. Canada (Minister of Canadian Heritage)* in November 2005, some believed that the duty to consult only applied to unsurrendered lands in areas of the country where no treaties had been entered into with First Nations. They were of the view that, for the vast tracts of lands that were surrendered under various treaties, no duty to consult was triggered because the First Nations had released their rights in the lands.

However, that view can no longer be sustained given the Supreme Court of Canada's decision in *Mikisew*. In that case, the Court held that the Crown had a duty to consult with the Mikisew First Nation in relation to the construction of a winter road through surrendered lands over which the Mikisew hunted and trapped.

The Court reached this conclusion because Treaty No. 8, which covers approximately 840,000 square kilometres of northern Alberta, recognizes the rights of Treaty No. 8 First Nations, including the Mikisew, to continue to hunt, trap and fish throughout the lands surrendered, except on those lands taken up from time to time for settlement, mining, lumbering, trading or other purposes. The creation of the winter road would have resulted in a 200 metre wide corridor in the Wood Buffalo National Park within which the use of firearms would have been prohibited and also would have disrupted Mikisew trap lines running through the area. The Mikisew objected to the loss of their hunting and trapping lands and the negative impact the project would have on their culture and traditional lifestyle.

Since the lands to be used for the winter road were Federal Crown lands, not yet "taken up" for other purposes, the Mikisew had rights under Treaty No. 8 to hunt, trap and fish in the area. The Court found that, even though the Crown had a right to "take up" surrendered lands for transportation purposes, including the construction of a road, the Crown was still bound by its duty to act honourably when taking up the lands. The Court held that Treaty No. 8 gave the Mikisew procedural rights (*i.e.* the right to be consulted) in addition to substantive rights (*i.e.* hunting, fishing and trapping rights). In this case, the proposed road would clearly have had adverse effects on the Mikisew's hunting and trapping rights. Accordingly, the Court found that the duty to consult had been triggered.

The circumstances, including the minor nature of the winter road, as well as the fact that it was on surrendered land on which the Mikisew's treaty rights were expressly subject to a "taking up" limitation, led the Court to conclude that the Crown's duty to consult was at the lower end of the spectrum. The Crown was required to provide the Mikisew with notice of the project, engage directly with them in good faith, and attempt to address any concerns that might arise. However, notwithstanding that the duty to consult was at the lower end of the spectrum, the Court set aside the Minister's approval of the road given that the Crown had not satisfied even these basic requirements and therefore failed to discharge its obligation to consult.

The Supreme Court of Canada's decision requires governments to now consult with First Nations in several areas of the country that are covered by treaty. Many treaties in Canada contain clauses similar to those contained in Treaty No. 8 which preserve the rights of First Nations to hunt, fish and trap on surrendered lands that have not been "taken up" for other purposes. As a result, activity such as resource development that takes place on Crown lands in those parts of the country will trigger governments' obligation to consult with local First Nations.

Given the Court's findings in the *Mikisew* case, it would be prudent for resource development companies to consider and assess First Nation consultation issues before planning any projects on Crown lands, including in provinces like Alberta, Saskatchewan, Manitoba and Ontario, where most of the lands are covered by treaties.

BY ROSANNE M. KYLE

ENERGY / ELECTRICITY

Until perhaps a dozen years ago, electricity was largely a separate industry from the fossil fuel industry. However, as the deregulation and restructuring of these markets took place, particularly in Alberta and Ontario and more recently British Columbia, the convergence of these two segments of the energy industry made possible entry into new areas of business.

When the Canadian gas industry was restructured into regulated pipelines and unregulated commodity supply, the unregulated affiliates of traditional pipeline companies began to explore opportunities in what was for them new and unrelated areas of energy. Traditional "gas" companies such as Consumers Gas were permitted to enter into new businesses. Consumers Gas evolved into Enbridge, and purchased the electricity system in Cornwall, Ontario, its first foray into the electricity market. TransCanada Pipelines evolved from its traditional network of approximately 41,000 kilometres of pipelines into what has also become a large independent power producer, owning or having interests in approximately 7,000 megawatts of power generation in Canada and the United States[1]. Even primarily non-energy companies such as Brookfield (formerly Brascan), with over $10 billion in real estate assets, expanded its (mostly) Canadian hydroelectric portfolio from $2,951 million in 2004 to $3,568 million in 2005.

This diversification of some of the major players has resulted in substantial growth in investment, particularly in new electricity projects. In many parts of Canada the electricity infrastructure is both aging and in need of rapid replacement, as there is insufficient capacity to supply the rapidly growing demand. Continued large-scale growth in electricity investment will be required for at least the next two decades, particularly in British Columbia, Alberta and Ontario. Despite the relatively low price of electricity in Quebec, large-scale capacity expansion will also be ongoing, primarily to supply high-priced electricity to Quebec's capacity-strapped Canadian and US neighbours.

Formerly local companies such as TransAlta (which owns transmission and generation in Alberta) expanded both internationally (into New Zealand, which assets it later sold) and into a major joint venture with Shell in Sarnia, Ontario. Epcor (the City of Edmonton owned utility) has also become involved in large power projects in Ontario.

Provincial governments across Canada are now actively encouraging construction of new power generation projects, particularly with generation technology that is referred to as "green power". For example, the Ontario Power Authority, Hydro-Quebec, and BC Hydro have been issuing periodic RFP's, with the winners receiving long-term contracts.

But for many local residents' groups demonstrating the "NIMBY (Not In My Back Yard) Syndrome," no green power is green enough. There are objections to wind power on the ground that wind generators are noisy neighbours that also kill birds coming into contact with their blades. Unlike Alberta, Ontario is closing down coal plants and refusing to permit new ones to be constructed, on the basis that such plants release significant quantities of greenhouse gases and carbon dioxide into the air (even though new sequestration technology permits such emissions to be greatly reduced). Gas-fired plants, which emit relatively little of anything, are as subject to NIMBYism as any other sources of generation, with the possible exception of new nuclear generation. Hydroelectric generation that involves flooding land is always strongly resisted, and even run-of-river facilities, which require little or no flooding, are opposed.

Not surprisingly, governments and their energy and environmental regulators are caught between the broad public demand for adequacy of electricity supply in a country that is becoming increasingly energy intensive and local demands for preservation of the environmental status quo. In some cases, where the location of the generation or transmission will impact upon traditional aboriginal territories, issues of aboriginal law will add a whole new level of complexity to the already complex mix of energy and environmental law applicable to power development.

Despite these difficulties, new power projects will continue to earn good returns for power developers who can manage the particular risks facing the industry. A long list of municipal, provincial (and sometimes even federal) approvals (land use, construction, environmental and energy regulatory) must be obtained in the proper sequence and without unduly onerous conditions. While these approvals are based on certain statutory frameworks, those with the authority to grant or withhold approval are generally given a broad discretion, subject to relatively little binding case law.

Construction costs are often underestimated, as is the time required to work through the approval process, and then to complete the construction. For fossil-fuel plants, volatility in fuel costs can also have a significant impact between the time the project is planned and when its construction is completed. For these reasons appropriate long-term power purchase agreements are necessary, in most jurisdictions, to obtain financing for new power generation plants of any significant size. The time required for environmental approvals for substantially similar projects, in similar locations, can vary greatly depending upon the province and the local political climate.

Whenever an industry is subject to extensive and overlapping regulatory requirements, with each set of regulators being given broad discretion, the law itself plays only a small role. Discretion largely replaces law. As a result, the role of advocacy in seeking timely and favourable exercise of discretion become crucial in minimizing risk and cost.

1 According to the most recent annual report, between 2004 and 2005 the value of the pipeline assets depreciated from $18.7 billion to $18.2 billion, while the value of the electricity assets increased from $2.8 billion to $4.9 billion.

BY ANDREW J. ROMAN

OIL AND GAS

CONFIDENTIAL INFORMATION: PIRACY ON THE CARBONIFEROUS SEAS

Confidential information has been a valuable asset from the beginnings of our commercial society when routes to lucrative spice islands were closely guarded secrets. In modern times, confidential information is central to our economy. This is especially the case in high tech industries and the resource sectors.

Unfortunately, the piracy, intrigue and espionage that plagued the high seas remain with us today. Well known examples include the alleged misappropriation of Air Canada's flight information by WestJet, and the recent arrest of employees of Coca Cola for attempting to disclose confidential information to arch-rival Pepsi.

While confidential information has long been considered a valuable asset, it is only in recent decades that the law has begun to offer protection of that asset by way of granting relief for a breach of confidence.

In *Lac Minerals Ltd. v. International Corona Resources Ltd.*[1], the Supreme Court of Canada outlined the test for breach of confidence:

1. Was the information confidential?
2. Was the information imparted in circumstances which gave rise to an obligation of confidence?
3. Did the recipient of the information misuse the information?

The *Lac Minerals* decision involved a situation where information was acquired during the course of a business relationship between the parties. The question left unanswered by *Lac Mineral* was whether confidential information was protected by law without any relationship between the parties. The answer was recently supplied in a decision of the Alberta Court of Queen's Bench in *Murphy and Apache v. Predator*[2], in which Apache Canada Ltd. was represented by David Cichy, Q.C. and Kent Anderson of Miller Thomson LLP.

The *Murphy and Apache v. Predator* decision represents a major development in the law in that the Court granted relief to the owners of confidential information against third parties who wrongfully obtained and used the confidential information.

The facts are relatively simple. In 2000, Apache, Murphy Oil and Beau Canada drilled a very successful wildcat discovery well in the Ladyfern area of British Columbia. In the course of evaluating the well, they employed the services of Bonnett's Wireline Services to run a series of down hole pressure tests of the well. The pressure data showed the well to be highly prolific, and more importantly, confirmed that the reservoir discovered by the wildcat well extended well beyond the boundaries of the land held by Apache and Murphy and onto the neighboring lands.

Predator learned of the discovery well and a principal of Predator requested the test results from a principal of Bonnetts. By reason of "a misguided allegiance to [a] friend, together with the obvious possible future business possibilities," Bonnetts provided the pressure data to Predator. By using the confidential pressure data to demonstrate the value of the adjoining lands and to reduce the risks associated with drilling in this difficult area, Predator was able to enlist the financial support of an American investor. While Murphy and Apache bid huge sums for the adjoining lands, Predator successfully obtained the lands by making record setting bids in relation to the lands (the "Disputed Lands").

Once Apache and Murphy learned of Predator's acquisition of the confidential information, they sued Predator on the basis that Predator had acquired the Disputed Lands using their confidential pressure data. The Court, using the test outlined in *Lac Minerals v. Corona* found that the pressure data was indeed confidential information, that Predator had obtained it through a breach of confidence, and that Predator had used the confidential information to the detriment of Murphy and Apache.

The Court considered whether "the reasonable man (here the reasonable engineer) standing in the shoes of the recipient of the information …[would] have realized that upon reasonable grounds the information was being given to him in confidence, or in a breach of a confidence …to the owner." The Court concluded that in the circumstances, Predator knew the information was confidential and that it was being obtained in breach of the duty of confidence. It further held that the press releases which had been issued in connection with the discovery well did not make it "open season" on the other well information-in particular the down hole pressure data. The Court concluded that Apache and Murphy had been detrimentally impacted by the loss of their competitive advantage in obtaining the Disputed Lands.

As a result of Predator's actions, the Court imposed a constructive trust over the Disputed Lands and revenues earned from those lands (exceeding $30 million) in favor of Apache and Murphy.

In the course of the Court's reasons, the Court commented on scouting practices in the oil and gas industry by stating:

> [82] … There was no reason unique to the industry or its practices to explain why the concept of breach of confidence should not be applied to this situation, or to suggest that the concept of breach of confidence should be inapplicable to scouting.

Further,

> [83] … Participants in the oil and gas industry, whether they are scouts, small edge shooting companies, or large multinationals, have to conduct their business in the awareness that if they commit a breach of confidence as understood by Canadian law, appropriate remedies will flow.

This decision provides a clear message that the Court will protect confidential information, that there are rules to the game of commerce, and that integrity and honesty have now found an ally in the law.

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1 [1989] 2 S.C.R. 574
2 2006 ABQB 680

BY DAVID J. CICHY, Q.C. AND PHILIP CARSON

ENVIRONMENTAL

GETTING A BREAK ON YOUR PROPERTY TAXES FOR CONTAMINATED LAND WHAT YOU NEED TO KNOW: VALUATION AND PROPERTY TAX IMPLICATIONS

Most people's reaction to contamination found on their property is negative and represents yet another cost and liability that must be dealt with. However, there may be some silver lining in this discovery in that this same contamination may lead to a reduction in property taxes, thereby offering the owner tax savings.

The Basics

Various assessment legislation in force throughout Canada provides for an annual assessment roll for the purpose of levying property taxes by local governments and other taxing jurisdictions in the following calendar year. Assessors in each jurisdiction are required to establish the assessment roll by assessing land and improvements at their actual value as at a fixed date and in their condition based on the preceding year. Classes of real property are prescribed which attract a different rate of tax, namely whether they be residential, utility, major or light industry, business or commercial, managed forest land, recreational, non-profit organizations or farm properties.

In brief, there is a two level appeal process. Ordinarily, the first level is to a Property Assessment Review Panel (the "Panel"). The second level is to a Property Assessment Appeal Board (the "Board"). All appeals must be filed before a set date specified in the applicable statute. In British Columbia, for example, all appeals must be filed on or before January 31st, 2007. Panels hear complaints from early February to March 15th in each year providing a filter for complaints that eventually flow through to the Board. Appeals to the Board from Panel decisions must be filed by April 30th of each year. An appeal of a Board decision is to the Supreme Court of British Columbia.

Contaminated Lands

So where does the valuation of contaminated land enter into the assessment realm? The answer is that various parties have been successful in obtaining a reduction in property value thereby lowering the amount of property tax paid for a given property. The number of Board decisions is growing. Examples of circumstances where reductions in assessment value has occurred include the presence of metals, contaminated ground water,"lusts" (leaking underground storage tanks), decommissioned service stations, petroleum hydrocarbons, landfills and more generally, proximity to the same. There has also been recognition of UFFI, radioactive waste, asbestos and issues of stigma. To a certain extent, U.S. decisions have set the framework for appeals of assessments of contaminated lands.

Legislation provides that assessors must determine the actual value of land and improvements and enter the actual value on the assessment roll. Most use a mass appraisal approach, collecting and analysing market data generated through computer programs and various other databases to estimate value before applying that data to individual properties. In Ontario, valuation of land is assessed based on "current value," meaning the amount of money the fee simple interest, if unencumbered, would realize if sold at arm's length by a willing seller to a willing buyer.

In British Columbia, valuations are assessed based on "actual value," meaning the market value of the fee simple interest in land and improvements, where "market value" is the price the property might reasonably be expected to realize when sold by a willing vendor to a willing purchaser. Present use, location, original cost, replacement cost, revenue or rental value, selling price of the land and improvements and comparable land and improvements, economic and functional obsolescence, and any other circumstances affecting the value of the land and improvements are all considered within this definition.

Valuation Principles

The three traditional approaches to calculate value include replacement cost, income approach and market data. There are several issues raised when valuing contaminated land that warrant a reduction in property value as follows:

- lack of marketability;
- liability for clean-up;
- impairment of use;
- lack of availability of typical financing;
- quantification of costs to cure; and
- stigma.

So what are assessors saying and why are their decisions being challenged? Typically, assessors treat all taxpayers in a similar fashion the end result of which is to ignore contamination. Alternatively, assessors take the view that contaminated property should not be "rewarded" with lower assessments and that no reduction should be made where no expenditure has been affected to remediate the contamination. Finally, the level and extent of the impact, impairment and costs are often either overstated or understated, or unproven. The onus of proof is on the taxpayer seeking relief.

Counsel have been able to successfully appeal assessor decisions resulting in a reduction of assessment value often through detailed evidence and the use of expert testimony. Various direct evidence including, testing, environmental and other reports, financial information and analysis, appraisals, insurability, marketability, and financing, or lack thereof, is sometimes required. Despite the upfront investment, the overall reduction in assessment value and tax represents a potential long-term savings for a contaminated property and may be a means of redirecting funds towards the eventual remediation of the site.

Case in Point

One example of a case in British Columbia where an Appellant was able to reduce the assessed value of a contaminated property is the *Vancouver Chinatown Merchants Association v. Assessor of Area # 09 – Vancouver* [2002] BCSC 721 case. The case concerned the assessed value of Chinatown Plaza; a mixed-use commercial development. The site was previously used as a coal gasification plant between the late 1800s and early 1950s, and, as a result, significant quantities of hazardous wastes were generated, and either spilled or disposed of at the site. One of the issues raised on appeal was whether the actual value should be adjusted to account for contamination. While there were evidentiary and other issues raised in the case, in the end, the Board applied an adjustment rate to the value of the land and improvements to recognize the contamination. Accordingly, the case stands for the proposition that the Board may adjust the capitalization rate upwards due to contamination to reflect the risk and lack of marketability associated with such properties.

When Should a Taxpayer Pursue Property Assessment/Tax Relief?

An appeal should be considered if you have a contaminated property that you think has been assessed at a value that does not reflect the fact that it is contaminated. Miller Thomson LLP is a leading firm in Environmental Law with offices across Canada. We also have expertise in buying, selling and developing contaminated land generally, including:

- Environmental Due Diligence;
- Addressing environmental issues in Purchase and Sale Agreements;
- Planning and Development Issues;
- Dealing with Environmental Consultants; and
- Valuation of Contaminated Land: Property Tax Implications.

Any one of our legal experts would be pleased to assist you. For further information on our services, or if you need help in appealing a valuation of a contaminated site, please contact Mr. Peter Milligan in our Toronto office or Ms. Sarah Hansen in our Vancouver office.

BY PETER A. MILLIGAN AND SARAH D. HANSEN

SECURITIES

SECONDARY MARKET STATUTORY CIVIL LIABILITY

Canada's first secondary market statutory civil liability regime celebrated its first birthday on December 31, 2006. It was not much of a celebration. Few people have taken notice that an entire year has passed since the amendments to the *Ontario Securities Act* under Bill 198 came into force. These new laws were the end product of almost three decades of academic deliberation by government and industry. The amendments themselves took three years to come into force. One of the key concerns from public companies on the legislation was that secondary market statutory civil liability would facilitate U.S. styled "strike suits" against Canadian public companies. The first year of secondary market liability in Ontario did not vindicate that prediction. Instead of the clatter of apocalyptic horsemen's hooves on Bay Street, there was eight months of pregnant silence.

First Blood – IMAX Corporation

It was not until early September, 2006, that the Bill 198 amendments were pleaded for the first time in class proceedings commenced against a Canadian public company – Toronto-based IMAX Corporation ("IMAX"). Since its first giant film exhibition at Montreal's Expo '67, IMAX has grown substantially. Its shares began trading publicly in 1994. By 2005, IMAX had 266 theatres operating in 38 countries. Its shares trade on the Toronto Stock Exchange (TSX) and in the United States on Nasdaq. Initially two separate class actions were brought: *Silver v. IMAX Corp.* (filed September 6, 2006); *Cohen v. IMAX Corp.*, (filed on September 5, 2006). Rather than competing for sole carriage of the action, the two plaintiffs' law firms reached a co-representation agreement and on September 20, 2006, a third action was filed to replace the original two. The claim is on behalf of all persons who purchased or acquired IMAX securities on or after February 17, 2006 and continued to hold some or all of the securities at the close of trading on the TSX and Nasdaq on August 9, 2006. The three individual defendants named in the action are the Co-Chairman of IMAX's Board of Directors and its Co-Chief Executive Officer, Richard Gelfond, the Co-Chief Executive Officer, Bradley Wechsler, and IMAX's Chief Financial Officer, Francis Joyce.

The February 17, 2006, start date for the proposed class period coincides with an IMAX press release which stated that it had completed fourteen new theatre systems in the fourth quarter of 2005. The press release further announced that IMAX expected to meet or exceed the guidance provided to investors which predicted $0.35 to $0.38 per share in net earnings for the 2005 fiscal year. It also stated that IMAX expected to report revenues in the range of $145 to $150 million. The plaintiffs allege that ten of the fourteen theatre systems did not actually open in the fourth quarter. They argue that IMAX engaged in improper accounting ("revenue recognition") practices and that the company's announcement of an earnings increase for its fiscal year end was false and misleading.

The February 17th press release sparked a 9% increase in IMAX's stock price. IMAX's share price continued to rise and, by March 8th, it had gained 19% from the day before the press release. Another press release on March 9, 2006, announced that the 2005 fiscal year earnings were US$0.40 per share. This was accompanied by IMAX's 2005 Annual Report and audited financial statements which confirmed this representation. In a second March 9th press release, the company announced that it intended to seek out a possible sale or merger of the business with "another entity offering strategic opportunities for growth." The press release stated that the company had received "unsolicited inquiries" for a sale or merger. The company stated that, given the strong earnings in 2005, it was an opportune time to expand and explore other opportunities for growth. With such further good news, the boom period for IMAX shares continued. Between March 8 and March 13, 2006, the share price increased 14%.

It all came to a precipitous and abrupt end on August 9, 2006. On that date, IMAX issued a press release revealing the existence of a U.S. Securities and Exchange Commission investigation into the company's timing of revenue recognition, specifically with regard to the reported theatre installations in the fourth quarter of 2005. The market reacted sharply and the share price plummeted 40% in a single day of trading. On August 21, 2006, IMAX's Chief Financial Officer, Francis Joyce, resigned.

The Significance of Statutory Liability

Traditional common law principles discourage the recovery of pure economic loss except where there is a direct relationship or other type of close proximity between a plaintiff and a defendant. The rule is based upon a pragmatic concern over imposing liability in an indeterminate amount, to an indeterminate class and for an indeterminate time. There are no closely proximate relationships in modern secondary securities markets. The relationship between shareholders and issuers is one of distance and relative anonymity. For this reason, common law actions are poor vehicles for remedying misrepresentations in the secondary market.

Bill 198 abridges the common law proximity constraints by simply declaring that where a public company releases a document that contains a misrepresentation, anyone who buys or sells its shares before the misrepresentation is corrected has a right of action for damages. If the document is one that is centrally important to the efficiency of capital markets (*i.e.*, a "core document"), liability is imposed without regard to whether the company and its management knew or ought to have known of the misrepresentation. This is an important distinction in the IMAX case. Although the audited financial statements released on March 9th are "core documents" under Bill 198, the press release of February 17 is not. To successfully recover damages under Bill 198 for the February 17 to March 8, 2006, period, the plaintiffs will have to prove that IMAX's management knew of the misrepresentation, or deliberately avoided acquiring knowledge of it, or engaged in some manner of gross misconduct.

Liability Limitations

The pleading in the original *Cohen* action sought $500 million in compensatory damages and $100 million in exemplary, punitive and aggravated damages. Presumably, similar damages are sought in the consolidated action filed on September 20, 2006.

The liability limit applicable to corporate issuers under Bill 198 is the greater of $1 million or 5% of its market capitalization just prior to the alleged misrepresentation. Therefore, the maximum liability exposure of IMAX under the Ontario *Securities Act* is roughly $18 or $19 million (assuming an approximate float of 40 million shares and a February 2006 share price of $9.00 to $9.50). The maximum liability of the individual officers named as defendants is *relatively* insignificant (50% of annual compensation).

What then is the representative plaintiffs' legal theory and strategy for recovering the remaining $580 million of the $600 million claim for compensatory and exemplary damages? There are two obvious avenues. First, the action also pleads negligence, negligent misrepresentation and breaches of sections 36 and 52 of the *Competition Act*. These causes of action have been available to potential class plaintiffs for many years and they remain separate and independent from the Bill 198 amendments. Such pre-Bill 198 causes of action have traditionally failed to support the development of secondary market securities class actions in Canada. The second avenue is the moral culpability exception under Bill 198, which eliminates the damages cap for a misrepresentation made, authorized, permitted or acquiesced to by a corporate officer "while knowing that it was a misrepresentation." The IMAX action does plead that the named defendants knowingly misrepresented revenues. However, given that this moral culpability exception applies only to individual defendants and not the corporation itself, it is probably not an effective practical strategy for the recovery of damages in the range of $580 million. All of this tends to suggest that there is an unbridgeable gap between the amounts claimed in the IMAX action and the practical reality of what is achievable under Ontario (and Canadian) law.

Protecting yourself against Secondary Market Liability Claims

In its first year, the secondary market liability amendments under Ontario's Bill 198 resulted in only one class action. However, history suggests that it is wise to reserve judgment on the extent and manner in which Bill 198 will be used in the future. In the United States, it took two decades from the time that the courts formulated the key doctrine of "fraud on the market" before federal securities class action filing rates accelerated to the epidemic proportions that prompted Congressional reform in the mid-1990s. In Canada, the general use of class action legislation for any type of case started slowly and took a number of years to develop.

At the end of 2006, Alberta joined Ontario to implement statutory civil liability for secondary market disclosure. Amendments to Alberta's *Securities Act* came into force on December 31, 2006. Other provinces such as British Columbia are also planning to introduce similar legislation. Public companies and their directors and officers should take measures to ensure they can mitigate the risk of claims. The following are examples of steps that can be taken to help potentially limit your exposure to liability:

Keeping yourself informed

To state the obvious, it is essential now more than ever for directors and officers to remain informed about the business, affairs, and developments in the public companies they serve. Directors should insist on being advised of material changes in an issuer's affairs and should request detailed and regular updates from senior management. Directors and officers should review all disclosure documents carefully. This includes reviewing an issuer's public disclosure record and website disclosure.

Implementing and maintaining a compliance system

Secondary market liability legislation provides that a person is not liable for misrepresentations of an issuer if that person proves that before the release of the document or the making of the public oral statement containing the misrepresentation, the person conducted a reasonable investigation and at the time of the release of the document or public oral statement, the person had no reasonable grounds to believe that the document or statement contained a misrepresentation. In determining whether an investigation was reasonable, the courts will consider "the existence, if any, and the nature of any system designed to ensure that the responsible issuer meets its continuous disclosure obligations." As a measure of protection, issuers should implement and follow a compliance system that does, at a minimum, the following:

- educates management, employees and consultants of what constitutes material information and the issuer's continuous disclosure obligations under securities legislation;
- ensures that members of senior management and those primarily responsible for the issuer's continuous disclosure record are fully apprised of material developments relating to the issuer in a prompt manner;
- ensures that disclosure documents are drafted for each specific situation and do not just include boiler plate language;
- implements procedures to maintain confidentiality and prevent misuse and inadvertent disclosure of undisclosed material information;
- implements a procedure to verify the accuracy of news releases, material change reports, financial statements and other disclosure documents;
- ensures timeliness of dissemination of material information;
- limits the number of spokepersons for the issuer and provides training to such spokespersons regarding the appropriate response to media inquiries;
- implements a process for maintaining and updating the issuer's website;
- implements restrictions (such as blackout periods) to prevent insider trading; and
- regularly monitors the effectiveness of the system.

Maintaining Written Records

The *Securities Acts* of Ontario and Alberta will impose civil liability upon officers and directors based upon what was known at the time of a misrepresentation and what steps were taken by directors and officers in relation to the misrepresentation. Ensuring that you keep accurate and complete written records of actions taken may provide good evidence to strengthen a defence.

Obtaining an Indemnity

Canadian corporate statutes permit a company to indemnify directors and officers from judgments, penalties, fines and settlements in actions where the director or officer is liable as a result of his or her role as a director or officer of an issuer. An indemnity would only be available, however, if a director or officer acted honestly and in good faith with a view to the best interests of the company. Directors and officers should consider negotiating a provision for indemnification in their management or employment contracts.

Purchasing Insurance

Insurance companies have policies that will cover the liability of directors and officers when they are faced with an action for misrepresentation. Premiums for these policies, however, have become increasingly expensive and exclusions for coverage can be broad. Directors and officers may wish to investigate the possibility of obtaining insurance but should always be aware of the exact terms and limits of their coverage.

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