"Come on in … We're *Still* Open for Business" Canada Remains Fertile Ground for US Retailers

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1. Introduction.

A steady stream of American and international retailers continue their march across the border and into the Great White North, lured by the appeal of economic stability, an underserved retail market, consumer enthusiasm for American brands and healthy sales per square foot, and other retail industry metrics. This influx of American and international retailers has led to a drastic reshaping of the Canadian retail industry. Examples abound of formerly ubiquitous Canadian retailers having found themselves forced to downsize, reposition or outright exit the Canadian market as a result of the increased competition. Even large chains like Zellers and Sears Canada have not been immune, with Zellers having recently sold 189 of its leasehold interests to Target for over C$1.8 billion (effectively ending its operations in Canada) and Sears Canada surrendering four locations in Toronto, Ottawa, Calgary and Vancouver that provided Nordstrom with the opportunity to move in and prepare for a planned 2014 Canadian launch.

The industry was most recently abuzz with Lowe's Home Improvement's attempt to accelerate its Canadian expansion with an unsolicited (and ultimately withdrawn) C$1.8-billion take-over bid for Québec-based rival Rona, a home improvement retailer facing its share of struggles, in part due to the competition from its American rivals. These transactions and others like them reflect attempts of opportunistic retailers to address the principal challenge facing new entrants to Canada, namely, the creation of a real estate platform of critical mass in the face of limited supply of, and high demand for, premier locations across the country. Although there appears to be some new retail development on the horizon (including the product of joint ventures by Tanger and Simon Properties with Canadian developers), it remains that acquisitions of existing platforms or strategic efforts to back-fill space vacated by downsizing or exiting retailers is the most viable option for a retailer seeking to quickly establish a national real estate platform.

This article examines some of the material considerations that US retailers will need to address when looking north. While Canada and the US resemble one another in many respects, quite apart from the distinct spelling traditions and the use of metric and imperial measurement units, the course of political, social, and economic history in each nation has resulted in business laws and practices that are rather different on each side of the border. Many of these differences are relevant to the flow of cross-border retail business into Canada and accordingly retailers and their US advisors would be wise to consult experienced Canadian legal counsel and business advisors at the outset of planning their retail expansion.

2. Culture and Language.

Canada's most often cited cultural differentiator is its bilingualism, with French predominating in the province of Québec (together with the application of civil law) and English predominating elsewhere (together with the application of common law). Language laws in the marketplace apply extensively in the province of Québec, but to a lesser extent in other Canadian provinces. An important consequence of these dual-language laws as they pertain to a retailer are the obligations under the federal *Consumer Packaging & Labelling Act*, which requires that specific information on pre-packaged consumer products sold outside of Québec be labeled in *both* English and French. In Québec, there are also extensive laws about how retailers may publicly communicate within Québec's marketplace. For example, billboards and signs visible from a public highway, on a public transport vehicle or in a bus shelter must be exclusively in French, while other commercial advertising may include English provided that the French text predominates. Given the unique challenges that Québec poses, it is not unusual for retailers to first test the waters in Toronto, Vancouver and other western cities where the English language and geographic proximities to US borders make these attractive entry points. However, given that bilingualism remains part of the fabric of Canada, that Québec is a large market relative to other Canadian markets and that Montreal has historically been the epicenter of the fashion and apparel industry in Canada, retailers should be aware of these cultural sensitivities when crafting their expansion plans.

The level of authority granted to provinces under the Canadian constitution can be surprising for US retailers. Provinces are accorded governing authority in various areas of law that directly impact retailers, including employment standards, labor law and securities regulation. As such, the implementation of a country-wide expansion will necessitate compliance with a patch-work of provincial laws and regulations. Although Québec has its substantive differences and challenges, the variations in laws from province to province, while important to be aware of and address, are generally not so significant that they impose a barrier to entry to any provincial marketplace.

3. Real Estate.

The practical challenges of establishing a national real estate platform often result in it becoming the most influential factor in determining when, where and how a retailer's entry will be made into Canada. US retailers entering into Canada will quickly find the real estate landscape to be different from that which they are used to in the US (although the types of documentation, transaction structures and terminology used in Canada will be familiar). In particular, the ownership of prime retail developments tends to be far less diversified than in the US, with fewer shopping centers, limited new developments on the horizon and ownership thereof concentrated in the hands of a small group of institutional landlords, generally REITs or entities financed by pension funds. As a result, new retailers face a landlord-centric marketplace where tenants (even anchors) are competing for the attention of landlords and quickly discover that they may not have the level of clout that they may enjoy in the US. Although most Canadian landlords are experienced with the requirements, procedures and negotiating styles of US retailers, it remains that retailers' expectations as to "must have" contractual provisions may need to be tempered early on in the process to remain competitive and avoid jeopardizing the consummation of a deal. In this regard, experienced Canadian real estate brokers and legal advisors who specialize in representing international retailers in such negotiations can assist with the strategic considerations of establishing a national real estate platform. For example, given the concentration of ownership of the most desirable shopping centers, taking the additional time and effort at the initial stage of a retailer's expansion to carefully and thoroughly negotiate a lease template with a landlord that will form the basis for future transactions with such landlord generally will prove to be a wise investment that pays dividends for years thereafter.

A notable difference between Canadian and US leasing practices is the use in Canada of binding offers to lease or letters of intent which precede the negotiation of the fulsome lease agreement. Absent carefully crafted conditions, these offers generally afford the tenant very little latitude, if any, to revisit or renegotiate material financial or contractual terms of the offer or to terminate the transaction. Accordingly, it is prudent from the retailer's perspective to address all critical terms and conditions (whether financial or non-financial in nature) at the outset. This "pre-negotiation" of the lease terms often results in more time spent on the offer to lease than a US retailer may be accustomed to, but is an inherent aspect of the way leasing is undertaken in Canada. Upon execution of the lease, the landlord-tenant relationship in the provinces (with Québec being the notable exception) is predominantly governed by the contract itself and the parties can opt out of the limited rights prescribed by landlord-tenant statutes in many respects.

There are a variety of provincial and municipal laws that a retailer will need to be aware of that regulate the use and disposition of lands and premises. Municipal laws prohibiting or limiting the use of lands are commonly known in Canada as land use control bylaws or zoning bylaws and retailers will need to consider whether their specific uses are permitted by such bylaws. Depending on the province in which the property is located, leases which have lengthy terms and renewal periods (21 years in Ontario, but 10 years in Saskatchewan, for example) may be subject to subdivision control regulations that will necessitate the consent of a governmental authority in order to validate the full term and renewals of the lease. Such laws as they pertain to retail locations are most commonly engaged where a tenant has a long-term ground lease, single-tenant-building lease or in connection with the retailer's purchase of a piece of land forming part of a larger retail development (such as in a "shadow anchor" scenario). With limited exceptions, there are no restrictions in Canada on the ownership or leasing of real estate by foreign entities. Acquiring real property and leases with lengthy terms (50 plus years in Ontario, for example) will attract a land transfer or recording tax in most provinces and in some cities (such as Toronto) there is an additional municipal tax.

There are a variety of issues for a retailer to consider in the context of the acquisition of an existing lease or real estate portfolio, although most issues will be familiar to US retailers who have American experience in this context. For rights in favor of a tenant (and if so, only upon the payment of a penalty) which quite often renders an assignment of the lease or sublet of the subject premises as the primary exit strategy for a struggling retailer. Canadian retail leases will typically provide that a landlord's consent is required for any assignment, sublet or change of control of the tenant, together with any changes in the use of the premises. Furthermore, it is typical for the original tenant (and any indemnifier) to remain liable to the landlord ("on the covenant") post-assignment. In addition, a transfer may trigger the landlord's entitlement to revisit certain terms of the lease, such as rent escalations and the cancellation of rights personal to the original tenant. New retailers can also expect to be required by landlords to provide the indemnity of their US parent and/or some form of security deposit for their ongoing obligations and as a condition of the landlord's consent to the proposed transfer. Each of these implications will need to be carefully considered by the acquiring retailer on a lease-by-lease basis.

4. Employment and Labor.

Canadian employment and labor laws can be one of the most challenging issues for retailers expanding into Canada. US retailers will find, in particular, that there are substantial differences when it comes to the hiring and termination of employees in Canada. The biggest difference is that there can be no employment "at will" in Canada, with termination of employees governed by provincial employment standards legislation and common law requirements. Each province has its own employment standards legislation, which sets out base minimum employment standards for hours of work, overtime, vacation, minimum wage, and leaves of absence, together with minimum requirements for notice of termination based on an employee's length of service. These standards differ in each province, but generally include a three-month probationary period and are capped at eight weeks of notice for employees with eight or more years of service. Ontario also imposes statutory severance pay obligations for employers with annual payroll in Ontario of C$2.5 million or more, which requires that employees with five or more years of service be paid one week of severance pay per year of service, to a maximum of 26 weeks (subject to exceptions where an employee is dismissed for wilful misconduct or neglect of duty, but this threshold is high). Superimposed on these statutory minimums is the common law regarding termination of employment. This law applies in all provinces of Canada, with some variation in Québec and addresses, in particular, the advance notice required for the employer to terminate the contract without just cause. If there is no written contract, or if the contract is silent on notice of termination, the courts will imply an obligation to provide "reasonable notice" determined with reference to factors that might affect how long it will take the employee to find a comparable job. As these "reasonable notice" periods can be quite generous (up to 24 months in the case of long service, managerial employees) it is recommended that express notice terms be included in all contracts to limit this potential liability.

Successor rights are also important considerations should expansion into Canada be accomplished through the acquisition of an existing business. Although the specific application of successor rights varies across Canada, in general, buyers of all or part of a business must recognize the past services of employees that they hire, whether the purchase is by way of shares or assets. Further, any existing union certifications and collective agreements will bind the buyer. Under US law, an acquiring employer does not necessarily inherit the predecessor collective agreement or its duty to bargain. In Canada, on a sale or transfer of a business, the default position in light of successor laws is to assume the union has the right to carry over the collective agreement and the bargaining rights to the acquiring employer.

If it is necessary for retailers to send head office employees to Canada to assist with the planning and expansion phases over an extended period, they will also need to consider the Canadian immigration process, which has its complexities. In order to avoid delays and complications, it will be important to consider all immigration options, processes and requirements so that any required visas or work permits are obtained in advance.

5. Franchising Laws.

While some franchisors choose to enter the Canadian market by either incorporating in Canada or franchising directly from their non-Canadian head office, many find it easier to contract with master franchisees or area developers and license them to expand their franchise system throughout Canada (which allows them to avoid a variety of thorny issues such as the employment laws hereafter discussed, tax and corporate structuring issues). However, this route is still subject to a number of important Canadian laws and regulations, in particular, franchise disclosure laws. While there is no federal legislation governing franchise disclosure, or registration requirements and no national industry regulator like the US Federal Trade Commission, each of Alberta, Manitoba, New Brunswick, Ontario and Prince Edward Island have enacted their own legislation with direct implications for foreign franchisors. In Québec, a franchisor's obligations are largely a function of the *Civil Code* (in addition to French language laws noted above) and generally favours a franchisee where the franchise agreements are "contracts of adhesion" and generally non-negotiable. A principal element of the legislation in these common law provinces is the obligation of the franchisor to prepare and deliver to prospective franchisees a disclosure document (often referred to as an FDD) setting out all material facts prior to any sale of a franchise. While the disclosure prescribed by the provincial legislation is less defined than what is set out in equivalent US laws, the FDD must be delivered to franchisees in one document at one time (with limited exceptions) and must set out all facts material to the franchisee's decision to purchase the franchise, including all material agreements relevant to the franchise and the franchisor's latest financial statements in audited or review engagement format. There is a growing body of Canadian caselaw and precedent, which interprets the requirements of the relevant statutes – including the their financial disclosure requirement – which emphasizes the need to hire qualified Canadian franchise counsel for any foray into the Canadian franchising marketplace.

6. Sales Taxes and Duties.

Sales taxes are levied by federal and provincial governments in Canada on most retail goods. Retailers, including non-residents who carry on business in Canada, are generally required to register for sales tax purposes and charge the federal Goods and Services Tax ("GST"), at a rate of 5 per cent, on taxable sales of goods and services made in Canada. As a value added tax, the GST is ultimately borne by the consumer. An input tax credit mechanism enables intermediate participants in the commercial supply chain to recover the tax paid or payable on the acquisition or importation of taxable goods and services. With the exception of Alberta, all Canadian provinces also impose a provincial sales tax. In British Columbia, Ontario, New Brunswick, Nova Scotia and Newfoundland and Labrador, the provincial sales tax is formally combined with the GST to form a single blended HST (harmonized sales tax). In 2013, Québec and Prince Edward Island will harmonize their provincial sales tax systems with the federal GST and British Columbia will revert back to its former provincial retail sales tax system. Saskatchewan and Manitoba continue to maintain their respective provincial retail sales tax regimes.

Customs duties, including GST, also apply to goods imported by a retailer into Canada. The amount payable will depend on the nature of the goods imported and their classification under the Canadian Customs Tariff, the valuation of the goods under one of the methods mandated by the *Canadian Customs Act*, and whether the goods originated in a country that has a free-trade agreement with Canada (*e.g.*, NAFTA). The Canadian customs regime imposes certain rules relating to transfer pricing. From a customs perspective, the transfer price of goods sold by a non-resident parent to a Canadian subsidiary can affect the customs value of the imported goods. Management services and licenses supplied by a non-resident parent to a Canadian subsidiary can likewise affect the value of imported goods.

Accordingly, it is important to address transfer pricing considerations on all cross-border transfers of goods so as to minimize duties payable and ensure compliance with customs laws and regulations. Whether a retailer intends to carry on business in Canada through retail locations or through online sales (or both), opportunities exist at the planning stages to minimize liability for taxes and duties and ensure full compliance with applicable Canadian sales tax and customs laws. These include choosing an appropriate business structure, addressing issues related to supply chain management, and structuring corporate and commercial transactions in a manner that will achieve these goals.

7. Foreign Investment Rules.

Foreign businesses or foreign-controlled Canadian businesses (collectively, non-Canadians) must be mindful of the application of the *Investment Canada Act* (the *ICA*) in respect to their investments in Canada. The *ICA* and its regulations prescribe the legal responsibilities of non-Canadians investing in Canada and the information which they are required to submit. The *ICA* applies to every acquisition of control of a Canadian business by a non-Canadian, as those terms are broadly defined in the *ICA*. In these cases, the *ICA* will apply and the non-Canadian will be required to file either (i) a notification form; or (ii) an application for review. The former involves the completion of a simple notification while the latter involves a detailed filing of materials, including a plan document which sets out the non-Canadian's intentions with respect to the acquired business. More importantly, in the latter circumstances, the proposed transaction may not be completed until the non-Canadian has received a "net benefit to Canada" ruling from either the Minister of Industry and/or the Minister of Canadian Heritage, where the Canadian business is involved in a cultural activity. A proposed acquisition would only give rise to an application for review if certain financial thresholds are exceeded. For example, if the purchaser is deemed a WTO Investor under the *ICA*, an application for review in the context of a direct acquisition would be required if the value of the assets of the Canadian business being acquired exceeds C$330 million (this figure is adjusted annually). It is important to note, however, that where the Canadian business is engaged in cultural activities (which includes, among other things, the production, distribution and sale of books, magazines, CDs or DVDs), a much lower threshold applies, even for WTO Investors. In these circumstances, the threshold for review drops to C$5 million for direct acquisitions and C$50 million for indirect acquisitions. This is particularly important for retailers to note given that the ancillary sale of such merchandise by the subject business could result in its characterization as a culturally sensitive business.

8. Anti-Trust Regulation.

While a ground-up (or "greenfield") entry into or expansion within Canada seldom raises substantive competition (anti-trust) law issues, entry or expansion plans through acquisition can raise potential pre-merger filing obligations under the federal *Competition Act* (the Canadian anti-trust statute). These filing obligations are only triggered where certain financial and, where applicable, voting or ownership interests are exceeded. In such cases, the parties to a proposed transaction will have a legal obligation to notify the regulatory authority of the proposed transaction and will be precluded from closing the proposed transaction until the applicable statutory waiting period has expired or been waived or the parties have been exempted from their notification obligations. In the context of an acquisition of assets, a pre-merger filing obligation would be triggered where the parties to the proposed transaction, along with their respective affiliates, collectively have assets in Canada or gross annual revenues from sales in, from or into Canada in excess of C$400 million; and, the value of the targeted assets in Canada or the gross annual revenues from sales in or from Canada generated from those assets, exceed C$77 million. That said, given the nature of the Canadian retail landscape and the number of competitors in the marketplace, the potential impediment to the closing of a retail acquisition as a result of these laws is generally perceived to be low.

9. Advertising and Consumer Protection.

Canada and its provinces have a robust regulatory environment for marketing, advertising and consumer protection. The federal *Criminal Code* contains anti-lottery provisions that regulate certain aspects of contests while the *Competition Act* prescribes the general content requirements of contests/sweepstakes. In addition, the *Competition Act* sets out prohibitions on misleading representations to consumers about products and services and both civil and criminal streams of liability for non-compliance. The *Canada Consumer Product Safety Act* applies to retailers advertising consumer products in Canada and includes obligations for stringent record keeping to track where consumer products are bought and sold, as well as mandatory reporting of incidents involving such products. Provincial consumer protection laws regulate sales, prevent retailers from excluding statutorily implied warranties and create disclosure obligations. Ontario's *Consumer Protection Act, 2002* ("*OCPA*"), for example, establishes that any false, misleading or deceptive consumer representations, as well as any "unconscionable" representations, constitute unfair practice. Retailers from the US looking to expand into the Canadian market should be particularly wary of compliance with the *OCPA*, as it applies even in situations where the retailer is not located in Ontario, as long as the consumer is.

10. Privacy.

The federal *Personal Information Protection and Electronic Documents Act*, as well as provincial legislation (which differs between provinces), regulates privacy matters in the private sector. Both federal and provincial legislation have introduced rules with respect to the collection, storage and use of customer and employee personal information by retailers. There are also substantial procedural requirements for retailers in the collection, storage and use of this information. Requirements include, for example, the appointment of an individual to act as a compliance officer, open and easily accessible privacy policies, security safeguards to protect personal information against loss, theft or unauthorized use, and the development of a simple and easily accessible complaints procedure. Canadian privacy legislation generally requires that the collection of personal information be limited to that which is reasonably necessary for the undertaking of the retailer's business and that it not be used or disclosed for purposes other than those for which it was collected, except with the consent of the individual or as required by law. Practically, new retailers will need to ensure that their privacy policies accord with the applicable legislation in Canada and that their employee training processes and IT systems infrastructure are developed with such compliance in mind.

11. Intellectual Property.

Retailers operating in Canada can seek a variety of intellectual property protections and it is important for retailers to act as early as possible to identify any potential issues and take steps to avoid opportunistic challenges to their entitlements. Aspects of a brand, such as a name or any logo associated with the brand can be protected as trade-marks within Canada, including by registration which will have the effect of providing the owner with a right to exclusive use of the trade-mark in association with specific wares and/or services within the whole of Canada. It is also possible to have common law rights in a trade-mark. Such rights arise from use of the mark in a specific jurisdiction in association with particular wares and/or services and those rights are limited to the jurisdiction where such use of the mark is made. Trade-mark protection is generally granted in Canada for a term of 15 years, and is renewable. In general, copyright subsists in Canada, without registration, for every original literary, dramatic, musical and artistic work. In this regard, logos that are part of any trade-marks utilized by a retailer may have copyright protection as a drawing, as well as trade-mark protection. There is no requirement in Canada to file any application or seek any registration of copyright works (although it should be noted that copyright can be registered in Canada). Copyright protection is generally granted for the life of the creator of the work plus 50 years, although there are some variations on this term depending on the nature of the work.

12. Conclusion

The rapid pace of change in the Canadian retail industry continues, with exiting or downsizing incumbents providing new opportunities for market entry beyond the traditional ground up or "greenfield" path of expansion, including via acquisition of existing lease portfolio. Although many aspects of carrying on business in Canada will be familiar to US retailers and their US counsel, it remains that there are many material differences that, while not a barrier to entry, are significant enough to make engaging experienced Canadian advisors a wise choice at the very outset of the decision to cross the border and open for business. ■

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