DAVIES

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Table of Contents

1: Background and Introduction to Canada

POLITICAL AND CONSTITUTIONAL STRUCTURE

Canada is a parliamentary democracy and constitutional monarchy, with a political system originally modelled on that of the United Kingdom. Because Canada is a federal state, legislative and executive jurisdiction is constitutionally divided between the federal government and 10 provincial governments. There are also three territories. Each provincial and territorial government is separately elected and often from different political parties.

The federal government has exclusive jurisdiction over some matters, while others are reserved for the provincial governments. In some areas, however, both levels of government may regulate different aspects of a particular activity. In addition, provincial governments delegate certain powers to local governments. A business may therefore be regulated at three levels: federal, provincial and municipal.

The federal Parliament has, for the most part, jurisdiction over issues concerning Canada as a whole, such as international trade, trade between provinces, national defence, citizenship and immigration, criminal law, currency, intellectual property, ports, aeronautics and broadcasting.

The 10 Canadian provinces have authority to make laws concerning matters such as property, contracts, natural resources, land use and planning, the administration of justice, education, healthcare and municipalities. Most general commercial law relevant to businesses is provincial law. And considerable consistency exists between most of these provincial laws across Canada.

LEGAL STRUCTURE

All the provinces of Canada, except Québec, are common law jurisdictions, which derive their legal systems from British common law. Québec is a mixed common law/civil law jurisdiction in which private law matters, such as contracts and property, are governed by a civil code.

Canada tends to look to the United States rather than Europe for its regulatory models. For example, Canadian securities laws often evolve in response to developments in the United States.

Canada’s courts of general jurisdiction are provincially administered, but the Supreme Court of Canada acts as a court of final appeal for the whole of Canada. Although Canada also has a federal court system, its jurisdiction is very limited compared with federal courts in the United States. The Canadian federal court system deals primarily with matters arising under Canadian federal statutes and claims against the federal government. Although all provincial superior court judges and Federal Court and Supreme Court judges are appointed by the federal government, the independence of the judiciary is well established, and courts are not subject to political interference or influence. Each province also has lower courts presided over by provincially appointed judges who hear cases of less importance.

TYPES OF BUSINESS ORGANIZATIONS

Corporations

A corporation is the most common form of business organization in Canada. A corporation has a legal personality distinct from its shareholders and management. A corporation’s existence is potentially perpetual, since it is not affected by the departure or death of any or all of its shareholders or managers. As a separate legal entity, a corporation has rights, powers and obligations similar to those of individuals. It can hold property, carry on a business and incur legal and contractual obligations.

Shareholders are the owners of a corporation, but they usually do not manage its business or enter into transactions on its behalf. By statute, they are protected from liability for obligations of the corporation (except in the case of unlimited liability companies, which can be established in select provinces). Generally, the authority to manage the corporation rests with the directors, who are elected by the shareholders. However, if shareholders wish to retain direct control of the corporation, they can enter into a unanimous shareholder agreement. Such an agreement effectively transfers responsibility (and liability) for the management of the corporation from the directors to the shareholders, and is common in smaller closely held private companies.

A corporation may be either public or private. Shares of public corporations are traded on stock exchanges and other public markets. The principal stock exchanges in Canada are the Toronto Stock Exchange (TSX) and its junior exchange, the TSX Venture Exchange (TSXV). Public corporations are subject to extensive regulation in order to protect investors. By contrast, the transfer of shares in a private corporation is restricted and usually requires the consent of a majority of the directors or shareholders. Private corporations are not subject to most aspects of securities regulation.

The main advantages of the corporation as a business entity are the limited liability of the shareholders, the possibility of perpetual existence and the flexibility of the corporate form for financing and estate planning purposes. The disadvantages include the costs associated with the incorporation, operation, annual maintenance and dissolution of the corporation. Since a corporation is a separate taxpayer, shareholders cannot directly access any tax losses it may generate, and it may be more difficult to use as a tax-efficient vehicle than an unincorporated entity like a partnership.

In Canada, a business corporation can be incorporated either federally, under the *Canada Business Corporations Act* (CBCA), or in any of the provinces. Ontario and Québec each has a *Business Corporations Act* (OBCA and QBCA, respectively). Recently, amendments to the CBCA were assented to, and they are expected to come into effect likely in the next 18 months to two years. Amendments to the OBCA have also been proposed, although with the recent change in the Ontario government it's unclear whether the amendments will still be pursued.

The daily operations of a corporation are normally carried out by its officers, under the supervision of its directors. Directors and officers have a fiduciary duty to act honestly and in good faith with a view to the best interests of the corporation. They must also exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.

Partnerships

Partnership is the relationship between persons carrying on business in common with a view to profit. Partners may be individuals, corporations or other partnerships. In Canada, a partnership is not regarded as a separate legal entity from its partners. There are two principal types of partnership. In a general partnership, all of the partners can participate in management of the business, but are exposed to unlimited liability for partnership obligations. In a limited partnership, the limited partners' liability is limited to their investment in the partnership, but they must remain passive investors and not participate in control of the partnership business.

In Ontario, the governing statutes are the *Partnerships Act* and the *Limited Partnerships Act*, which define the rights and obligations of the partners between themselves and in relation to third parties. Partnership law also includes non-statutory common law and equitable principles.

In Québec, partnerships are governed by the *Civil Code of Québec* and the *Act respecting the legal publicity of enterprises*, which similarly sets out the rights and obligations of partners between themselves and toward third persons, as well as conditions for the creation, operation and dissolution of a partnership.

The provisions of these statutes addressing the rights and obligations of partners between themselves can generally be altered by agreement between the partners. Because the relationships between the partners can be determined by agreement, great flexibility is possible in providing for matters such as capital contributions or other financing of the partnership, participation in profits, exit rights and governance structure.

Income and losses of a partnership, although computed at the partnership level, are taxed in the hands of the partners. This tax treatment is the primary reason for using a partnership rather than a corporation, since each partner may offset its eligible share of the partnership's business tax losses against income from other sources.

Joint Ventures

A joint venture is an agreement entered into by two or more parties to pool capital and skills for the purpose of carrying out a specific undertaking. It may or may not involve co-ownership of the project assets by the venturers. Because it is essentially a contractual relationship not specifically regulated by statute, the venturers are free to agree on whatever terms they choose. Since a joint venture is not a recognized entity for tax purposes, income and losses for tax purposes are computed separately by each joint venturer rather than at the joint venture level.

A joint venture may be difficult to distinguish from a partnership, and the parties' characterization of their relationship may not be conclusive. The most important legal distinction is that sharing of profits is essential to a partnership, whereas joint venturers generally contribute to expenses and divide revenues of the project, but do not calculate profit at the joint venture level. Equal participation in management of the business is characteristic of a general partnership, but less usual in a joint venture, where one party often operates the project, or management is contracted out.

Joint venturers who do not want their joint venture to be treated as a partnership should enter into a written agreement setting out their respective rights and obligations in detail and exercise care in dealing with third parties. In Québec, joint venturers should also file the proper declaration under the *Act respecting the legal publicity of enterprises* to avoid being characterized as a general partnership, in which case each partner would be fully liable for partnership obligations and subject to tax as a partner, rather than as a joint venturer.

Sole Proprietorships

A business owned by one person is called a sole proprietorship. This is the simplest form of business organization. The individual is responsible for all the obligations of the business. Accordingly, his or her personal assets are at risk if these obligations are not met.

There is no legislation dealing specifically with sole proprietorships; however, a sole proprietor may need to comply with federal, provincial and municipal regulations affecting trade and commerce, licensing and registration. For example, in Ontario, a sole proprietor who carries on business or identifies the business to the public under a name other than the proprietor's own name must register the name under the *Business Names Act*. In Québec, every person who uses a name or designation other than his or her own complete name must register a declaration under the *Act respecting the legal publicity of enterprises*.

A sole proprietorship may be suitable for a small enterprise because it avoids many of the costs of setting up and running a corporation and the complex regulatory scheme that governs corporations. Non-capital startup losses of the business are generally deductible against the sole proprietor's income from other sources. The disadvantages of a sole proprietorship are the unlimited liability of the owner and that the business can be transferred only by selling the assets.

2: Protecting Your Intellectual Property Rights

Generally, save for some notable differences outlined below, Canadian intellectual property rights are very similar to U.S. intellectual property rights.

TRADEMARK BASICS

New Canadian trademark laws and regulations are expected to come into force in 2019, greatly modifying the existing practice. Most notably, Canada will adopt the Nice classification of goods and services, and implement the Madrid Protocol for the international filing of applications in member countries through a single application. In addition, similarly to the practice in many European countries, applicants will be able to secure registration in Canada without the need to allege intent to use or show the mark in Canada. This is a significant change.

The Canadian *Trade-marks Act* currently defines a trademark as “a sign or combination of signs that is used by a person for the purpose of distinguishing or so as to distinguish their goods or services from those of others.” Taking from case law developed under the current definition of trademarks, the new legislation will specifically list signs to include a word, a personal name, a design, a letter, a numeral, a colour, a figurative element, a three-dimensional shape, a hologram, a moving image, a mode of packaging goods, a sound, a scent, a taste, a texture and the positioning of signs.

Trademark rights are primarily created by use of the mark in commerce in connection with goods and services. Although registration without use will create trademark rights under the new legislation, prior and continued use of a mark will remain key in assessing trademark rights. Trademarks that have not been used in Canada for three years following registration may be vulnerable to cancellation.

Registration of marks is not mandatory in Canada. However, registered marks are presumed to be valid and provide additional protection and rights against third parties. The registration of a trademark in respect of any goods or services, unless shown to be invalid, gives its owner the exclusive right to use it throughout Canada in respect of those goods or services, and prevents others from using confusingly similar marks, or depreciate the value in the goodwill in the trademark.

Trademarks are also protected from unfair competition and passing off, preventing any person from making false or misleading statements or directing public attention to such a person’s goods, services or business in such a way as to cause or be likely to cause confusion in Canada with the goods, services or business of another.

Trademarks may be registered with the Canadian Intellectual Property Office and must meet minimum registration requirements, notably preventing the registration of prohibited or confusing marks, or granting a monopoly over common names and descriptive words. Rights in a registered mark are limited to Canada.

It is permissible (but not mandatory) to use the ® symbol whenever a registered trademark is used in commerce in connection with the goods or services for which it is registered.

COPYRIGHT BASICS

Copyright provides protection for literary (including computer programs), artistic, dramatic or musical works, and other subject matter known as performer’s rights, sound recordings and communication signals.

In general, copyright provides its owner with the sole right to produce or reproduce the work or any substantial part thereof in any material form whatsoever, to perform the work or any substantial part thereof in public or, if the work is unpublished, to publish the work or any substantial part thereof, and to authorize any such acts by licence.

Copyright does not protect ideas or concepts. It protects only the material expression of such ideas or concepts in original works.

The author of an original work is the owner of the copyright to that work unless it is assigned in writing. However, for original works created by employees in the course of their employment, the employer is considered the first owner of the copyright in the work. Unless the copyright is specifically assigned in writing, contractors or any other persons (other than employees) or companies hired to create the work retain ownership of the copyright in their work.

The author of a work also retains moral rights in the work. Moral rights include the right in the integrity of the work and the right to be recognized as the author of the work, or remain anonymous. Moral rights cannot be assigned, but they can be waived in writing.

It is not mandatory to register copyright in Canada. Copyright exists upon the creation and fixation of original works. However, registration provides additional benefits, including the presumption of the existence of a copyright and its ownership.

As in the United States, a copyright notice is advisable to put others on notice of the copyright owner's rights, and may provide additional rights to its owner in litigation.

Duration of copyright protection in original works in Canada is the author's life plus 50 years. Where the identity of the author is unknown, the duration of the protection is 50 years from first publication of the work or 75 years from its creation date, whichever is shorter.

Fair dealing of works protected by copyright does not constitute violation of copyright. Under the *Copyright Act*, fair dealing is recognized only for research, private study, education, parody or satire. In certain other cases, fair dealing may also include criticism, review or news reporting. In all cases, the dealing must be "fair," taking into consideration the nature of the work, the extent taken and reproduced (quantitative and qualitative), the purpose, whether or not there were available alternatives, and the effects on the protected work.

PATENT BASICS

Canadian patents protect any new, useful and non-obvious invention, art, process, machine, manufacture or composition of matter, or any new, useful and non-obvious improvement in any invention, art, process, machine, manufacture or composition of matter. No patent may be granted for any mere scientific principle or abstract theorem.

Unlike U.S. patents, Canadian patents do not include designs, which are separately protected under the Canadian *Industrial Design Act* (discussed below).

Patent protection is subject to an application having been filed and patent issued in Canada. Any such application must be filed within 12 months following any public disclosure of the invention in Canada or elsewhere. Filing after this period of time may jeopardize the right to obtain patent protection.

The patent application must contain detailed specifications of the invention, including notably a full and clear description of the invention to enable any person skilled in the art to be able to make, construct, compound or use it; and claims defining distinctly and in explicit terms the subject matter of the invention for which an exclusive privilege or property is claimed. This full disclosure, available to the public once the application is published, is the counterpart in obtaining a monopoly on the patent.

The Canadian patent registration process is generally similar to the U.S. process, and can take several years. This process is relatively expensive and requires the payment of maintenance fees throughout the life of the patent.

Once the patent is issued, its owner has the exclusive right, privilege and liberty (but not the obligation) of making, constructing and using the invention, or preventing others from doing so. However, if the invention (or improvement) relies or uses any third party invention protected under patent, proper licences need to be obtained from such third party in order to commercialize the invention.

Subject to the regular payment of maintenance fees, the term of a patent protection in Canada is 20 years from the filing date of the patent application.

Patent protection is limited to Canada. If protection in other countries and/or territories is required, inventors must file applications and obtain separate protection in those countries or territories.

Unlike for copyrights, employees will normally retain patent rights in their inventions, unless expressly assigned in writing to their employer. However, in certain cases, and provided the circumstances meet certain criteria developed under case law, employers may own the patent rights if their employees were specifically "hired to invent" and the intent to assign was obvious. However, given the multiple possible interpretations of this principle, best practice would suggest that employers secure specific invention assignments, in writing, from all key employees.

INDUSTRIAL DESIGNS BASICS

The Canadian *Industrial Design Act* aims to protect designs that are features of shape, configuration, pattern or ornament and any combination of those features that, in a finished article, appeal to and are judged solely by the eye.

Industrial designs do not include features that are dictated solely by a utilitarian function of the article or any method or principle of manufacture or construction. The designs must not be identical with or not so closely resemble any other designs already registered as to be confounded therewith.

As with patents, protection of design is subject to an application having been filed and a registration issued in Canada. There is no protection for unregistered designs in Canada.

Design applications must be filed within 12 months of any public disclosure of the design in Canada or elsewhere. Filing after this period of time may jeopardize the rights to obtain design protection in Canada.

Registration of the design provides its owner with an exclusive right to prevent anyone, without the licence of the design's owner, from making, importing for the purpose of trade or business, or selling, renting, offering or exposing for sale or rent any article in respect of which the design or a design not differing substantially therefrom has been applied for or registered.

Subject to the payment of maintenance fees, the term of protection of the exclusive right in an industrial design is 10 years, beginning on the registration date of the design.

The creator of a design is the first proprietor of the design unless the creator has executed the design for another person "for a good and valuable consideration," in which case the other person is the first proprietor. This would include employees or contractors, although it is not certain if, in the case of employees, the design would need to be created in the course of their employment. Therefore, best practice would suggest that employers secure specific design assignments from all key employees.

Marking the design with the letter D in a circle and the name of the owner is not mandatory but may provide benefits in litigation, limiting the absence-of-knowledge defence by a third party.

TRADE SECRET BASICS

Unlike in the United States, trade secrets are not specifically defined in Canada nor are there specific Canadian trade secret laws.

Trade secrets consist generally of any valuable business information that is not known by others or registered as intellectual property and that its owner has taken reasonable steps to keep secret. These can include proprietary business information, expertise or knowhow regarding new technology, processes, formulae, marketing plans, research and analysis data, and customer data.

Misappropriation or unauthorized divulgation of trade secrets can be protected using common law principles or other specific civil laws on breach of contract, breach of confidence, loyalty, fiduciary duty, unjust enrichment or wrongful interference in agreements with others. However, this does not ensure exclusivity if trade secrets are independently discovered by other means, including reverse engineering.

In theory, trade secrets can be protected for an unlimited period of time, provided they remain secret.

To maximize protection, trade secrets should be secured by physical or electronic measures regulating access and dissemination, and by confidentiality or non-disclosure agreements with every person who has access or to whom trade secrets are disclosed.

3: Cloud Computing

Almost all of the issues that are discussed in the context of U.S. cloud computing will also be relevant in Canada. This is generally because the relevant commercial considerations and strategies for dealing with those cloud computing issues described in respect of the United States apply across both jurisdictions. However, the relevance of Canada in this landscape should not be underestimated. According to the United States Department of Commerce, Canada was the top export market for U.S. computing services in 2014, amounting to a total of $4.4 billion.[1] Though similar, the Canadian legal framework for cloud computing also raises certain Canadian-specific considerations, which are more fully set out below.

PERSONAL INFORMATION

Cloud computing poses compliance challenges in the context of Canadian privacy laws. The *Personal Information Protection and Electronic Documents Act*[2] (PIPEDA) governs how private sector organizations collect, use and disclose personal information in the course of commercial activities across Canada.[3] However, unless the personal information crosses provincial or national borders, PIPEDA does not apply within Alberta, British Columbia, or Québec, as these three provinces have enacted provincial laws that are substantially similar to PIPEDA.[4] Notwithstanding the foregoing, given that these provincial regimes are substantially similar to those provided for in PIPEDA, this section will focus on PIPEDA with the understanding that the rules in all Canadian provinces are substantially similar, regardless of whether PIPEDA or provincial legislation applies.

In general, under PIPEDA, personal information may only be collected, used and disclosed with the informed consent of the individual (though such informed consent may in certain circumstances be implied).[5] In connection with such informed consent, an individual is to be informed of what information will be collected, how it will be used and to whom it will be disclosed.[6] Therefore, the use of cloud computing imposes an additional layer of disclosure in order for an organization to comply with this requirement.

PIPEDA also requires that personal information be protected by appropriate safeguards,[7] thus creating an additional level of complexity for organizations using cloud computing. Specifically, PIPEDA provides that an organization is required to use contractual or other means to provide a comparable level of protection if information is to be processed by a third party (or service provider).[8] Further, PIPEDA provides that an organization remains responsible for personal information even when such information is transferred to a third party for processing.[9] As explained by the Ontario Privacy Commissioner, Ann Cavoukian, “The critical question for institutions which have outsourced their operations across provincial and international borders is whether they have taken reasonable steps to protect the privacy and security of the records in

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1 U.S., Department of Commerce, Bureau of Industry and Security, *2016 Top Markets Report Cloud Computing Country Case Study: Canada* (Washington: Department of Commerce, 2016) at 1

2 SC 2000, c 5

3 *Ibid*, ss 3, 4

4 *See ibid*, s 26(2)(a); *Organizations in the Province of Alberta Exemption Order*, SOR/2004-219, s 1; *Organizations in the Province of British Columbia Exemption Order*, SOR/2004-220, s 1; *Organizations in the Province of Québec Exemption Order*, SOR/2003-374, s 1

5 PIPEDA, *supra* note 2, s 5, Principle 4.3; but see *ibid*, s 7

6 *Ibid*, s 5, Principle 4.3.2

7 *Ibid*, s 5, Principle 4.7

8 *Ibid*, s 5, Principle 4.1.3

9 *Ibid*

their custody and control. I have always taken the position that you can outsource services, but you cannot outsource accountability."[10] Thus, in the event of a security breach of a service provider, the organization responsible for personal information may still be considered responsible for any unauthorized use or disclosure of personal information, notwithstanding that such organization had no involvement or responsibility in connection with the security breach. Therefore, an organization should ensure that its cloud computing contracts clearly specify the privacy protections to be implemented by the service provider and should assess whether such privacy protections are sufficient in the circumstances. This consideration becomes more pertinent in light of the amendments to PIPEDA that will come into force on November 1, 2018. These amendments will require that organizations subject to PIPEDA report data breaches to affected individuals and to the Office of the Privacy Commissioner of Canada. Further these amendments will require that organizations maintain sufficient information in a data breach record to demonstrate that they are tracking data security incidents that result in a breach of personal information.[11]

Finally, it is important to note that PIPEDA applies where a dispute is sufficiently connected to Canada. The Federal Court of Canada has determined that the Canadian Privacy Commissioner has jurisdiction over a complaint insofar as a real and substantial connection can be established between the entity or act and Canada.[12] Therefore, notwithstanding the extraterritoriality of a service provider or website server, the Canadian Privacy Commissioner may exercise its jurisdiction over the complaint if there is a real and substantial connection to Canada.

SENSITIVE INFORMATION

Cloud computing poses compliance challenges in the context of the export of sensitive information. Canada's controlled goods regime sets out which products and information are considered controlled goods and Canada's export control regime sets out the rules regarding the export of controlled goods.

Specifically, given that the transmission of information to a cloud is considered an "export,"[13] Canadian organizations should determine whether their information data are categorized as controlled goods and whether, based on the location of their service providers, additional permits are required in connection with their use of cloud technology. As a general rule, the export of controlled goods to the United States will not require an export permit, though the export of controlled goods to other countries should be analyzed on a case-by-case basis.[14] Therefore, Canadian organizations that have information data that constitute a controlled good and that use cloud computing must exercise caution to ensure compliance with applicable laws and regulations. Notably, *A Guide to Canada's Export Control List, December 2015*[15] (Guide), which describes various controlled goods for the purpose of Canadian export controls, contains a section devoted to cryptographic (encrypted) data.[16]

10 Ontario, Information & Privacy Commissioner of Ontario, *Reviewing the Licensing Automation System of the Ministry of Natural Resources. A Special Investigation Report* (Toronto: Information & Policy Commissioner of Ontario, 2012)

11 See Breach of Security Safeguards Regulations, (2017) C Gaz I, 3613

12 *Lawson v Accusearch*, 2007 CF 125 at paras 34, 43, [2007] 4 FCR 314

13 See Canada, Trade and Development Canada, Export Controls Division, *Export Controls Handbook* (Ottawa: Trade and Development Canada, 2017) at 40

14 *Ibid* at 4

15 Canada, Global Affairs, Trade Controls Bureau, *A Guide to Canada's Export Control List–December 2015* (Ottawa: Trade Controls Bureau, 2015)

16 See *ibid* at 66

In light of the foregoing, a Canadian organization that has information data that constitute a controlled good must ensure that any cloud computing contract provides sufficient information regarding the location of the service provider. Such information will be necessary for the organization to determine whether an export permit is required. Further, the cloud computing contract should require that the service provider update the organization prior to any change in its location, so that any necessary analysis under the export control regime can be conducted. Finally, given that service providers often enter into subcontracts for additional infrastructure capabilities, the cloud computing contract should either specifically prohibit such subcontracting or require that the organization be notified prior to any subcontracting – again, so that any necessary analysis under the export control regime can be conducted.

Finally, and more generally, Canadian organizations must exercise caution when their employees and/or contractors access information data that constitute a controlled good while abroad, as such access can also be considered an export under Canadian law. Therefore, Canadian organizations should limit access to information data that constitute a controlled good by their employees who are outside Canada and should ensure that cloud computing contracts prohibit employees of the service provider from accessing information data that constitute a controlled good while abroad, so as to avoid additional compliance challenges.

FINANCIAL AND OTHER REGULATED INSTITUTIONS

Cloud computing poses certain compliance challenges in the context of Canadian financial and other regulated institutions. The Office of the Superintendent of Financial Institutions of Canada's (OSFI) *Guideline B-10*[17] (Guideline) sets out expectations for federally regulated entities (FREs) that outsource (including by way of cloud computing), or contemplate outsourcing, one or more of their business activities to a service provider. For the purpose of the Guideline, FREs include Canadian banks, Canadian branches of foreign banks, insurance companies, trust and loan companies, and cooperative credit associations.

First, the Guideline provides that a service provider is expected to be able to logically isolate the FRE's data, records and items in process from those of other clients at all times.[18] Therefore, an FRE that uses cloud computing services should ensure that that the service provider is able to properly segregate data in a manner that complies with the Guideline.

Second, the Guideline provides that the contract or outsourcing agreement is expected to set out the FRE's requirements for confidentiality and security. Further, the Guideline provides that the security and confidentiality policies adopted by the service provider should be commensurate with those of the FRE and should meet a reasonable standard in the circumstances.[19] Therefore, an FRE should ensure that any cloud computing contract clearly outlines the security and confidentiality measures that will be used by the service provider to protect the FRE's information and that the security and confidentiality measures are appropriate considering the circumstances and the nature of the information. Further, given that service providers often enter into subcontracts (as explained above), the FRE should ensure that all subcontractors of a service provider are required to provide the same level of security as the initial service provider.

Third, the Guideline provides that in accordance with the federal financial institutions legislation, certain records of entities carrying on business in Canada should be maintained in Canada.[20] Therefore, an FRE

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17 Canada, Office of the Superintendent of Financial Institutions, *Guideline B10–Outsourcing of Business Activities, Functions and Processes* (Ottawa: OFSI, 2001)

18 *Ibid* at 15

19 *Ibid* at 14–15

20 *Ibid* at 15

should ensure that any cloud computing contract clearly provides that the service provider will frequently provide the FRE with readable copies of its information.

Fourth, the Guideline provides that an FRE should maintain a centralized list of all its material outsourcing arrangements. Under the Guideline, the FRE should maintain a list that contains the name of the service provider, the country where the service is provided, the expiry or renewal date of the contract or outsourcing agreement and the estimated value (dollar amount) of the contract or outsourcing agreement.[21]

Finally, the Guideline provides that an FRE engaged in material outsourcing should develop, implement and oversee procedures and policies to monitor and control outsourcing risks.[22] Particularly in the context of cloud computing where the technology infrastructure may be dispersed throughout various locations, an FRE needs to be able to identify an efficient way of evaluating the services and the service provider. Therefore an FRE should ensure that any cloud computing contract provides it with sufficient audit and review capabilities. In addition to the foregoing, the OSFI has suggested that an FRE should consider implementing “three lines of defence” in the assessment and monitoring of its outsourcing arrangements. Such lines of defence are (1) business line management to identify and manage the risks inherent in the products, activities, processes, and systems for which it is accountable; (2) independent corporation operational risk management, which can include operational risk measurement and reporting processes, risk committees, and responsibility for board reporting; and (3) independent review and challenge of the FRE’s operational risk management controls, processes and systems.[23]

BANKRUPTCY AND INSOLVENCY

Cloud computing poses certain challenges in the context of Canadian bankruptcy and insolvency laws. Under both the *Bankruptcy and Insolvency Act*[24] (BIA) and *Companies’ Creditors Arrangement Act*[25] (CCAA), once a debtor files a notice of intention or a proposal in accordance with the BIA or obtains CCAA protection, the debtor may disclaim or resiliate (terminate) certain contracts upon satisfying the prescribed conditions.[26] Unlike intellectual property licence agreements, cloud computing contracts, more aptly described as software-as-a-service agreements, are not legislatively defined and are not generally viewed to qualify for extended-use protection under the BIA or CCAA. Therefore, there is a risk that an insolvent or bankrupt Canadian service provider retains the right to disclaim or resiliate a cloud computing agreement. This means that a service provider would be freed from the obligation of providing its customers with access to the software, servers or even, in certain circumstances, the customers’ own information if it is stored off-site and held by the service provider.

Without proper controls, a customer may find itself without access to certain services or data when a Canadian service provider decides or is forced to cease operations. However, trying to import standard bankruptcy and insolvency protections granted by traditional licensors, such as source-code escrow agreements, may prove insufficient considering the customer would not have access to the service hardware, hosting servers or third-party applications that are necessary to make the software underlying cloud service function. Since the program’s infrastructure is hosted off-site, having a copy of the application’s source code will usually be insufficient to ensure a seamless continuation of operations as the customer will not have the tools or means to implement and operate the software independently. An

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21 *Ibid* at 16

22 *Ibid*

23 Canada, Office of the Superintendent of Financial Institutions, *Guideline E-21–Operational Risk Management* (Ottawa: OFSI, 2016)

24 RSC 1985, c B-3

25 RSC 1985, c C-36

26 BIA, *supra* note 24, s 65.11; CCAA, *supra* note 25, s 32.

organization (customer) should therefore ensure that any cloud computing contract contains a sufficient continuity clause, as such clause will dictate the parties' obligations in the event that a service provider goes out of business, files for insolvency or declares bankruptcy. Further, an organization should ensure, where possible and practicable, on the basis of the information stored by the cloud service provider that any cloud computing contract requires the service provider to regularly supply it with text and other readable electronic copies of its information so as to try to mitigate risks associated with the bankruptcy or insolvency of a service provider.

Lastly, a customer that is deprived of a cloud computing service has no recourse in law other than to file a claim against the service provider. However, considering the financial situation of an insolvent or bankrupt service provider, it is reasonable to assume that the customer will receive, at most, only a portion of its claim. Further, identifying the quantum of damages can be difficult considering that the harm suffered by the customer is not limited to the value of the contract, but would include the detrimental effects that such termination would have upon the operations of the customer's business.

4: Managing Your Data and Cybersecurity Risks

CASL

Canada's anti-spam law (known as CASL and pronounced "castle") is designed to be one of the strictest anti-spam laws in the world. CASL is aimed at punishing senders of electronic messages and perpetrators of activities originating in Canada or affecting Canadian residents that involve identity theft, phishing, pharming, spyware and other forms of fraud or misleading consumers. CASL prohibits the sending of commercial electronic messages (including email, text messages, instant messages and other electronic messages sent with a commercial purpose) without the prior consent of the intended recipient and unless the message complies with the form and content requirements prescribed by CASL. It also prohibits the unauthorized installation of computer programs on another's computer system, the altering of transmission data in an electronic message, and other activities that could have an impact on electronic commerce.

Under the anti-spam provisions:

- An electronic message is considered to have been sent once its transmission has been initiated and it is immaterial whether the electronic address to which an electronic message is sent exists or whether an electronic message reaches its intended destination.
- An "electronic address" is any address used in connection with the transmission of an electronic message to an electronic mail account, an instant messaging account, a telephone account or any similar account. Although spam is predominantly associated with email, the prohibition extends to virtually all forms of electronic communication, including SMS/text messages sent to mobile phones, Facebook, LinkedIn or BlackBerry Messenger messages and the like. The category of electronic accounts is not closed, and as new technologies become available or new forms of social networking develop, consideration should be given as to whether they would fall within the scope of CASL. Although telephone accounts are specifically enumerated, the anti-spam prohibition currently does not apply to a commercial electronic message that is (1) in whole or in part, an interactive two-way voice communication between individuals (e.g., telemarketing); (2) a fax; or (3) a voice recording sent to a telephone account (e.g., message broadcast auto dialers).
- A "commercial electronic message" is an electronic message that, having regard to the content of the message, the hyperlinks in the message to content on a website or other database, or the contact information contained in the message, it would be reasonable to conclude has as its purpose, or one of its purposes, to encourage participation in a commercial activity, including an electronic message that
  - offers to purchase, sell, barter or lease a product, goods, a service, land or an interest or right in land;
  - offers to provide a business, investment or gaming opportunity;
  - advertises or promotes any of the foregoing; or
  - promotes a person, including the public image of a person, as being a person who does or intends to do any of the foregoing.

An electronic message that contains a request for consent to send a message described above is also considered to be a commercial electronic message and, accordingly, such messages would be prohibited unless prior express or implied consent has been obtained and the message otherwise complies with CASL.

CASL contains detailed requirements and rules on matters such as the required form of electronic messages, exemptions from the consent requirement and inclusion of a mandatory unsubscribe mechanism in such messages.

The Act also makes it illegal to alter the transmission data of an electronic message so that it is rerouted to a destination other than that intended by the sender of the message without the express consent of the sender or the recipient.

Finally, the Act makes it illegal to (1) install certain types of computer programs onto computer systems without the express consent of the owner or authorized user of the computer system and without first providing certain disclosure regarding the computer program, and (2) having so installed a computer program, causing it to send a message from the computer system. This provision targets computer programs commonly known as "spyware" or "malware."

CASL requires express opt-in consent (in contrast to PIPEDA, discussed below, under which opt-out consent and implied consent can be permissible in some circumstances). CASL provides for administrative monetary penalties to be imposed on offenders: up to $10 million for corporations and $1 million for individuals. CASL also provides for a private right of action that will permit consumers and businesses to commence enforcement proceedings and recover damages of up to $1 million per day. Although the private right of action was scheduled to come into force on July 1, 2017, implementation has been suspended by the government pending a review of the legislation by a parliamentary committee.

A person contravenes the anti-spam provisions of CASL if a computer system located in Canada is used to send or access the electronic message. A person contravenes the anti-spyware/malware provisions of the Act if a computer system located in Canada is used to send, route or access the electronic message. CASL, therefore, has extraterritorial application as the location of the sender of the electronic message is irrelevant if a computer system in Canada is used to access the electronic message in question. As a result, foreign businesses conducting electronic marketing activities within Canada should consider the potential application of CASL to their particular circumstances.

In addition to direct liability on the part of the sender, an employer can be vicariously liable for violations committed by employees acting within the scope of their employment; directors, officers or agents of a corporation that commits a violation can be personally liable for the violation if they directed, authorized, assented to, acquiesced in or participated in the commission of the violation (whether or not the corporation is proceeded against) unless they can establish that they exercised due diligence to prevent the commission of the violation.

As a result of the potential for vicarious liability for the corporation and personal liability for its directors, officers and agents, businesses should consult with counsel to understand the highly complex provisions of CASL and its impact on their operations in Canada.

DATA PROTECTION AND PRIVACY

The *Personal Information Protection and Electronic Documents Act* (PIPEDA) is the federal legislation that applies to protection of personal information in the course of commercial activities in all jurisdictions that do not have substantially similar legislation, as well as protection of personal information held by federal works – that is, by federally regulated organizations such as banks, railways and telecommunications companies. Currently only Alberta, British Columbia and Québec have substantially similar legislation. Such provincial legislation is applicable in place of PIPEDA within the relevant province, and contains implicit or explicit accountability and security obligations similar to the PIPEDA obligations outlined below (although only the Alberta legislation contains breach-reporting requirements). The provincial legislation enacted in those provinces applies to the collection, use and disclosure of personal information by private sector businesses in those provinces that are not federal works. PIPEDA continues to apply to entities in those three provinces that are federal works. Organizations located in Yukon, Nunavut and the Northwest Territories are considered to be federal works, undertakings and businesses for the purposes of PIPEDA. PIPEDA does not apply to organizations with respect to the collection of employee information unless the relevant organizations are federal works. Employee information is protected under the equivalent provincial privacy legislation in Québec, British Columbia and Alberta. Notwithstanding that a province has substantially equivalent legislation, PIPEDA applies in that province if the data cross a border. Most provinces also have specific legislation governing the privacy of personal health information.

PIPEDA applies to the collection, use and/or disclosure of personal information in the course of any private sector commercial activity within Canada. “Personal information” means information about an identifiable individual. “Commercial activity” means any particular transaction, act or conduct or any regular course of conduct that is of a commercial character, including the selling, bartering or leasing of donor, membership or other fundraising lists. Businesses are required to establish an administrative structure to ensure that 10 “privacy principles” are implemented: (1) accountability; (2) identification of the purpose for which the information is gathered; (3) consent; (4) limitations on collection; (5) limitations on use, disclosure and retention; (6) accuracy; (7) ensuring appropriate safeguards are in place; (8) openness; (9) individual access; and (10) challenging compliance. These principles are based on the international OECD Guidelines on the Protection of Privacy and Transborder Flows of Personal Data.

Private sector businesses are required to

- implement privacy policies in respect of the collection, use and disclosure of personal information and to make those policies available;
- make the personal information collected about an individual available to that individual upon request;
- designate an individual or individuals who are accountable for compliance with the OECD principles; and
- protect personal information in their control by security safeguards appropriate to the sensitivity of the information.

Security safeguards must protect personal information against loss or theft, as well as unauthorized access, disclosure, copying, use or modification, regardless of the format in which it is held. The nature of the safeguards will vary depending on the sensitivity of the information that has been collected, the amount, distribution, format of the information and the method of storage. More sensitive information should be safeguarded by a higher level of protection. The methods of protection should include (1) physical measures – e.g., locked filing cabinets and restricted access to offices; (2) organizational measures – e.g., security clearances and limiting access on a need-to-know basis; and (c3) technological measures – e.g., the use of passwords and encryption.

PIPEDA requires informed consent to collect, use or disclose an individual’s personal information. Consent will be valid only if it is reasonable to expect that the individual providing it understands “the nature, purpose and consequences of the collection, use or disclosure of personal information” to which they are consenting.

The Act contains exceptions to the requirement to obtain consent to use and disclosure of personal information without the knowledge or consent of the individual for certain purposes, including for the purpose of a prospective business transaction. Generally, the exception would permit the use and disclosure of personal information without consent when (a) the information is necessary for the parties to decide whether to proceed with the transaction and, if they decide to do so, the information is necessary to complete the transaction; and (b) the parties have entered into a confidentiality agreement that requires the recipient to (i) use and disclose personal information only for purposes related to the transaction; (ii) use appropriate security safeguards to protect personal information; and (iii) return or destroy personal information if the transaction is not concluded. The business transaction exception also imposes further requirements once the transaction is completed, including restrictions on use and disclosure, and an obligation to notify persons whose information has been transferred as part of a business transaction.

PIPEDA provides for a data-breach notification protocol. Organizations are required to record and report to the federal Privacy Commissioner any breaches of security safeguards in relation to personal information under their control if it is reasonable to conclude that the breach creates a real risk of significant harm. “Significant harm” is defined to include bodily harm, humiliation, damage to reputation or relationships, loss of employment, business or professional opportunities, financial loss, identity theft, negative effects on the credit record and damage to or loss of property. Organizations are to consider various factors (such as the sensitivity of the personal information involved and the probability of misuse of the information) in making their own determination about whether to notify affected individuals. There is a positive obligation on organizations to notify other organizations or government institutions that may be able to reduce the risk of harm emanating from the breach. The regulations set out the requirements for content of the notice of breach. Organizations that knowingly contravene the new sections of PIPEDA regarding data-breach notification or obstruct the Commissioner in the investigation of a complaint or in conducting an audit will be liable for fines of up to $100,000. Organizations are required to maintain a record of all breaches, whether or not the breach met the threshold for reporting. The PIPEDA provisions dealing with breach reporting, notification and record-keeping will come into force concurrently with the related regulations, which are scheduled to come into force on November 1, 2018.

DATA PROTECTION

Except for the principles-based security requirements of the privacy statutes discussed above, there is not yet a government-mandated requirement to have an adequate cybersecurity regime in place. Certain regulated industries have guidelines regarding cybersecurity, including the following:

- IIROC: In December 2015, the Investment Industry Regulatory Organization of Canada published *Cybersecurity Best Practices Guide* and *Cyber Incident Management Planning Guide* to help investment dealers manage cybersecurity risks and respond to cyber incidents. In March 2018, IIROC published a notice warning investment dealers of the increasing frequency and sophistication of cybersecurity incidents, and asking dealers to voluntarily report cybersecurity incidents to IIROC.
- MFDA: In May 2016, the Mutual Fund Dealers Association of Canada published Compliance Bulletin No. 0690-C, “Cybersecurity,” to help its member dealers manage cybersecurity risks.
- CSA: In October 2017, the Canadian Securities Administrators, an umbrella organization of Canada’s provincial and territorial securities regulators whose objective is to improve, coordinate and harmonize regulation of the Canadian capital markets, published Staff Notice 33-321, “Cyber Security and Social Media” to report on a survey of cybersecurity and social media practices by firms registered to trade securities or to advise clients regarding securities, and to provide guidance regarding cybersecurity and social media practices. The Staff Notice supplemented the CSA’s 2016 Staff Notice 11-332, “Cyber Security.” The CSA notices emphasized the need for issuers, registrants and regulated entities to be aware of the challenges of cybercrime and take appropriate measures to safeguard themselves and their clients or stakeholders. This notice reminds market participants that once they determine that cyber risk is a material risk, they should provide detailed and entity-specific risk disclosure and avoid general, boilerplate disclosure. They advised that cyberattack remediation plans should address how the issuer would assess the materiality of a cyberattack to determine what needs to be disclosed under applicable securities laws, as well as when and how to make such disclosure. They further reminded registrants to remain vigilant in developing, implementing, and updating their approach to cybersecurity “hygiene and management” and urged registrants to review and follow guidance issued by self-regulatory organizations. CSA will consider cybersecurity issues in its reviews of issuer disclosure and in its oversight of registrants and regulated entities.
- OSFI: Office of the Superintendent of Financial Institutions regulates federally regulated financial institutions (FRFIs), including banks, most insurance companies and federal pension plans. OSFI does not currently have in place regulations requiring specific actions by FRFIs with respect to cybersecurity. However, Guideline B-10: Outsourcing of Business Activities, Functions and Processes sets out OSFI’s expectations with respect to technology-based outsourcing and informs of OSFI’s expectations with respect to cybersecurity risk management.

Businesses that supply to, or partner with, entities in these regulated industries should expect a heightened focus on their cybersecurity, as a pushdown effect of the foregoing guidance.

5: Building a Workforce and Canadian Immigration Issues

TEMPORARY ENTRY AND PERMANENT RESIDENCE

Anyone other than a citizen of Canada who wishes to work lawfully in Canada has two options: temporary entry or permanent residence. Every applicant for admission to Canada must meet Canadian federal government requirements. Each Canadian province and the Yukon territory has negotiated a Provincial Nominee Program with the federal government. These programs enable provinces to streamline the federal government's processing of the applications of workers and permanent residents if provincial authorities are persuaded that a local employer's need for an applicant or an applicant's professional qualifications will yield economic benefit.

The following discussion is intended primarily to outline in general terms the rules facilitating the admission of business persons to Canada, as well as cross-border movement in North America under the North American Free Trade Agreement (NAFTA) and among World Trade Organization (WTO) member nations under the General Agreement on Trade in Services (GATS). All applicants for admission to Canada (and any dependants accompanying them) are subject to general security and health restrictions, which are not discussed in this summary.

TEMPORARY ENTRY

General

An employer that wishes to employ in Canada a person who is neither a permanent resident of Canada nor a Canadian citizen must, in most cases, assist that person in obtaining an employment authorization. This is typically done by obtaining a job offer validation from an Employment and Social Development Canada (ESDC) office. In some cases, it will not be necessary to obtain a job offer validation from ESDC. For example, senior management can be admitted to Canada under the intra-corporate transfer policy, which does not require that the company obtain a job offer validation in respect of such personnel.

To obtain a validation of an employment offer, the employer will generally be required to satisfy Canadian authorities that employment opportunities for Canadians will not be adversely affected if it employs the non-resident. This will entail convincing Canadian authorities that the employer has attempted to hire Canadians for that position and either no Canadian fulfilled the job requirements or no Canadian responded.

With a few exceptions described in the next paragraph, all persons who have obtained permission to work temporarily in Canada will be issued an employment authorization document, commonly called a work permit, at a port of entry upon their arrival in Canada. Employment authorizations may be issued for an initial period of six months to one year, but may be extended for several years following the initial date of entry.

Some people need not obtain an employment authorization – for example, diplomats, "head office" employees who visit a Canadian affiliate for less than 90 days for the purpose of internal consultations, and business or government representatives who come to Canada to purchase or sell goods for that business or government for less than 90 days, provided that they do not sell directly to the general public.

International Agreements

Canada is a party to several international agreements relating to trade and commerce in general. These agreements supplement Canada's immigration legislation and policies, which have for the past several years increasingly been designed to facilitate the objectives of Canadian business interests.

NAFTA provides a streamlined procedure under which certain North American business persons who are citizens of the United States or Mexico may enter Canada to work temporarily. GATS provides similar rules for more restricted categories of citizens of WTO member nations. The procedures under GATS are similar to those under NAFTA and therefore only major differences will be noted.

Under NAFTA, there are four categories of business persons who qualify for the streamlined process:

- business visitors
- traders and investors
- professionals, and
- intra-company transferees

A “business visitor” is a business person who is seeking temporary entry into Canada for one of a series of specific purposes listed in NAFTA. Persons who so qualify need not apply for a work permit and may be admitted to Canada at a port of entry.

A “trader” is a business person who seeks temporary entry to carry on substantial trade in goods and services and who will be employed in a supervisory or executive capacity.

An “investor” is a business person who seeks entry to develop and direct operations of a business in which he or she has invested or will invest a substantial amount of capital.

A “professional” is a business person who will engage in a specified profession while in Canada temporarily (NAFTA has a much longer list of specified professions than GATS). The minimum requirements, generally speaking, are a bachelor’s degree, sometimes combined with practical experience. Under GATS, the three-month period for which a professional may be admitted cannot be extended. NAFTA has no such restriction.

An “intra-company transferee” is a person who has been employed by the employer, or its affiliate, for at least one year within the three-year period immediately before the date of the application (or, under GATS, for at least one year immediately preceding the application) and who is coming to Canada to work temporarily for the same employer, or an affiliate, in an executive or managerial capacity or one that involves specialized knowledge.

Traders, investors, professionals and intra-company transferees who are U.S. or Mexican citizens coming into Canada temporarily must obtain work permits. They need not comply with the prior approval procedures, petitions, labour certification tests and other similar procedures generally required to obtain a work permit.

PERMANENT RESIDENCE

General

A person who wants to settle permanently in Canada can be admitted under one of three main classes of immigrants: the family class, the refugee class (which will not be discussed) or the economic classes.

To be admitted under the family class, an applicant must be sponsored by a close family member who is a Canadian citizen or permanent resident. The family class includes a spouse, a common-law partner, a conjugal partner, a dependent child, a parent or grandparent, or, in some cases, another close relative. There is a yearly limit to the number of permanent resident applications that will be considered for the sponsorship of a parent or grandparent. However, qualified persons may apply for a “Parent and Grandparent Super Visa,” which is a multiple-entry visa that will allow an applicant to remain in Canada for up to 24 months at a time without the need for renewal and will be valid for up to 10 years.

The economic classes are outlined in more detail below.

The Business Immigration Program

The Business Immigration Program is a special program designed to facilitate immigration for qualified business persons or persons who will contribute significantly to Canada's cultural or athletic spheres. It applies to two categories of immigrants, "self-employed persons" and those who qualify under the "Start-up Visa" program.

"Self-employed persons" are those with relevant experience who have the intention and ability to become economically established in Canada and who have participated at a world-class level in cultural activities or athletics, or who have experience in farm management.

The Start-up Visa program seeks to link immigrant entrepreneurs with Canadian private sector funders and mentors. The program is intended to foster innovation, job creation and the establishment of companies that will be able to compete globally, by assisting such immigrant entrepreneurs in navigating the Canadian business environment and helping Canadian private sector firms to benefit from the influx of talented innovators from around the world.

In order to qualify under the Start-up Visa program, an applicant has three options: (1) securing a minimum investment of $200,000 from a designated Canadian venture capital fund; (2) securing a minimum investment of $75,000 from a designated Canadian "angel investor" group; or (3) obtaining the support of a designated Canadian business incubator through a competitive process. Designated business incubators will choose among business proposals with strong growth potential and benefit to Canada. Start-up Visa applicants must demonstrate competence in either English or French by submitting the results of language testing by an approved agency and must have completed at least one year of post-secondary education. Applicants must demonstrate that upon entry to Canada they will have sufficient funds to support themselves and any dependants accompanying them. At present, the minimum funds required range from $12,475 for a single applicant to, for example, $33,014 for a family of seven persons. These amounts are updated annually.

Provincial Nominee Programs

The Government of Canada has entered into provincial nominee agreements with Newfoundland and Labrador, Nova Scotia, New Brunswick, Prince Edward Island, Québec, Ontario, Manitoba, British Columbia, Alberta, Saskatchewan and Yukon. Such agreements allow the provinces to select immigrants to fulfill specific economic needs, or create and expand employment and business opportunities. The federal government retains the responsibility for issuing immigrant visas to provincial nominees and their accompanying dependants after they have met all federal legislative requirements, including those related to health, absent a criminal record and security.

Provincial nominee programs are primarily directed at selecting skilled workers whose qualifications are particularly suited to the needs of a particular provincial economy, although some provinces are also interested in nominated business applicants as well. Applications are made initially to provincial authorities. Each province has its own selection criteria, but in most instances a pre-arranged job offer will be essential. A major advantage of such programs is that they may offer successful applicants expedited visa processing.

Skilled Workers

Through recent initiatives, Canada has indicated that its immigration programs should select as permanent residents individuals with professional, managerial and technical expertise that is valued by Canadian employers. Persons who have worked or studied in Canada in prescribed circumstances are recognized as desirable immigrants who have shown the ability to adapt to Canadian economic realities.

Canadian Experience Class

The Canadian Experience Class (CEC) enables certain applicants to seek permanent residence under a streamlined procedure. A CEC applicant must be in a province other than Québec and must be either a temporary foreign worker with at least two years of full-time skilled work experience in Canada or a foreign graduate from a Canadian post-secondary institution with at least one year of skilled work experience in Canada. Skilled work experience contemplates occupations that are classified as managerial, professional or technical, as well as the skilled trades.

A temporary foreign worker will be assessed on only two selection criteria: work experience and ability in English or French. A foreign graduate of a Canadian post-secondary institution will also be assessed on the basis of his or her education.

Federal Skilled Worker Class

Under the Federal Skilled Worker Class (FSWC), an applicant either must have secured a valid arranged offer of employment from a Canadian employer or must demonstrate that he or she has at least one year of continuous and paid work experience within the last 10 years in National Occupational Classification Skill level 0, A or B. The FSWC uses a point system weighted to reflect that youth and competence in English or French are critical predictors of an applicant's success in the Canadian labour market. A maximum of 12 points are awarded to persons between the ages of 18 and 35. One point is deducted for each year thereafter, so that an applicant who is 47 years old or more will receive no points for the age factor. In addition, an applicant must submit to a test of English or French language skills from a designated agency and satisfy criteria with respect to work experience, education and adaptability.

International PhD students are eligible to apply under the FSWC if they are enrolled in a PhD program at a provincially or territorially recognized private or public post-secondary educational institution in Canada, have completed at least two years of study toward a PhD and are in good academic standing at the time they apply or have graduated from a PhD program no more than 12 months before the date that the application is received. However, an international PhD student will not qualify if the student has received an award requiring the student to return to his or her home country to apply the knowledge and skills acquired in Canada and has not yet satisfied the terms of the award.

Federal Skilled Trades Class

Under the Federal Skilled Trades Class (FSTC), those who are qualified in a skilled trade may apply for permanent resident status. Applicants must satisfy criteria with respect to English or French language skills, training and work experience. Applicants must have either an offer of full-time employment for a total period of at least one year or a certificate of qualification in that skilled trade issued by a provincial or territorial body.

Express Entry Program

Express entry is not a discrete immigration program. Rather, it is an online application system to streamline the selection and processing of applications within the FSWC, the FSTC, the CEC and some categories of applicants within the provincial nominee programs. The system aims to accelerate the selection and admission of immigrants with skill sets that are viewed as enabling the applicant to be more likely to achieve success in Canada.

Applicants who believe they qualify for one of the four classes mentioned above can apply online, and their application will constitute an "expression of interest." An applicant who demonstrates eligibility for at least one of the four classes will enter the express entry "pool." At periodic intervals, applicants in the pool will receive an Invitation to Apply (ITA) for immigration to Canada on the basis of eligibility under one of the four classes. The decision to issue an ITA is made by the federal or a provincial government, or by a Canadian employer.

6: Financing Your Enterprise

SUMMARY OF TYPICAL FUNDRAISING STAGES

Financing, which involves transactions relating to the raising of capital, refers to a process whereby funds are transferred from investors to businesses. The capital can then be used by the company for service or product development and production, the running of operations or business expansion.

Both the stages and types of fundraising that are typical in Canada very much resemble the U.S. experience in substance, although some of the terminology used may differ slightly on either side of the border.

Lifecycle of Company	Financing Stage	Investors	Financing Instrument
Development stage	N/A	Founders	Common shares
Beginning stage	Seed round	Friends and family Angel investors	Common shares Convertible debt
Early stage	Series A	Venture funds Other institutional investors Strategic investors	Preferred shares
Later stage	Series B Series C Series D Subsequent rounds	Later-stage investment funds Other institutional investors Strategic investors	Preferred shares

STAGES OF STARTUP FINANCING

Though the fundamental goal of financing for the company is to raise capital, different rounds of financings have different purposes for a corporation and target different types of investors. “Seed financing” is typically the first stage of financing and often used for product or service development, as further explained hereinafter. Series A and post-Series A financing rounds, which follow the initial round, may be used to fund operations or expand a business into new markets, products or services. Due to high risk and in order to advise on business decisions, investors involved in the initial stages of financing will generally look to gain additional rights, such as an equity stake in the company or a seat on the board of directors.

Seed Round

After a company receives initial funding from friends and family members of the founders, which is at the lowest price, the next financing stage typically is referred to as the "seed round." During this round, the founders seek to raise sufficient capital to focus full time on development of the product concept or on market research. The seed round is considered a high-risk investment and thus capital is often exchanged for an equity stake in the company.

During the seed round stage (which may include a number of financings), the startup typically will aim to raise between $50,000 and $1 million from so-called angel investors (who often are successful entrepreneurs that have accumulated capital from previous ventures), including those who invest full-time in early-stage ventures, commonly referred to as "super-angels."

Friends and family members of the founders also may invest during the seed round, in some cases before the startup receives capital from angel investors.

Series A Financings

After completing the seed round, a startup company often will look to begin its so-called Series A financing round, in which it will seek more substantial investments from institutional investors, particularly venture capital funds. The new capital infusions typically will be deployed for enhancement of the startup's product concept and continued build-out of the venture.

Although the size of Series A financing rounds will vary, a startup often will seek to raise between $3 million and $5 million from venture capital funds that invest in early-stage companies and, in some cases, super-angel investors. Series A financing may also include strategic investors and government agencies, such as the Business Development Bank of Canada and *Investissement Québec*.

Post-Series A Financings

Post-Series A financings include additional rounds of financing to raise capital for continued growth of the business and development of the company's customer base. Each consecutive round of post-Series A financing is commonly identified by the next letter in the alphabet – Series B, Series C, Series D and so on – to indicate its place in the order of closings.

The company may seek to raise millions (and billions, in cases of "unicorns") of dollars in these financings. The actual amount raised during each round will vary based on the relevant circumstances of each financing round, including valuation of the company.

DEBT VERSUS EQUITY CAPITAL

Corporations may raise capital in several ways, the most common of which are debt and equity financings. Both debt and equity form a part of the company's "capital" or "capital structure." In both debt and equity financing, investors will expect income and capital gain. In addition to the appreciation in the value of a financing instrument, which will give rise to a capital gain, in the case of debt, the income or returns take the form of interest payments, whereas in the case of equity, they take the form of dividend payments.

What Is Debt?

In debt financing, the funds transferred from investors to the company are loans, with all the associated legal attributes. Therefore, a debt is the borrowing of money for an agreed period of time at an agreed rate of interest. It creates a legal debtor-creditor relationship, which is generally evidenced by financing instruments referred to as debt securities or debt instruments.

Sources of debt include commercial banks, credit unions, trade credit and government sponsored programs. Debts grant creditors a fundamental right, usually contractual, to be repaid a certain sum of money that they are owed.

What Is Equity?

Equity, in contrast to debt, creates an ownership interest in the corporation for the investor. The funds transferred from the investors to the corporation are a permanent capital base for the company, in which there is no right to repayment.

Ownership interest represents a share in the company – the share being a fractional part of the capital of the corporation. The holder of the share in the company is thus entitled to either dividends when they are declared or distribution of the company's assets upon dissolution. Furthermore, shareholders acquire certain rights that are exercisable against the corporation, which vary according to the statutes under which the corporation is established and the terms and conditions attached to the shares.

OVERVIEW: DEBT FINANCING

Sources of Debt Financing

Debt financing may be provided to the corporation by the shareholders, by third parties such as banks and other financial institutions, or by offering debt securities in the capital markets. Canadian chartered banks, Canadian subsidiaries or branches of foreign banks and other financial institutions, such as merchant banks and life insurance companies, are all active in providing financing to private and public corporations in Canada. Third-party lenders may require that the corporation's shareholders maintain a certain level of equity investment. Lenders may also require personal guarantees from the shareholders of small private corporations.

Types of Debt Financing

Two principal forms of debt financing are available from third-party lenders: operating financing and term financing. Both operating financing and term financing generally bear interest at a fluctuating rate linked to market rates of interest.

Operating Financing

Operating financing, as the name suggests, usually finances the ongoing operations of the business and is generally intended for short-term financing. Forms of operating financing include self-liquidating loans, working capital loans and revolving loans.

- *Self-Liquidating Loans*: Self-liquidating loans are usually loans that will be repaid in the normal course of the business operations, generally by converting the assets it is used to purchase, such as inventory, into cash. For example, in order to supply the growing demand during the holiday season, a company may choose to finance its extra inventory with a self-liquidating loan. It will then use the revenue generated from the sale of that inventory to repay the loan.
- *Working Capital Loans*: Working capital loans provide cash for short-term operational needs. Contrary to self-liquidating loans, these loans' purpose is not to fund assets, which will provide a definite means to repay the loan. Working capital loans may, for example, be used by manufacturing companies to fund production such as accounts payable or wages during quieter months, in order to build an inventory for the busier holiday season. Note that the interest rates on working capital loans tend to be high, as the loan is considered riskier for the lending institution.

- *Revolving Loans*: Revolving loans are lines of credit, in which the amount can be borrowed, repaid and reborrowed, provided that the amount borrowed does not exceed the limit of the credit at any point in time. The corporation is not required to make payments of the principal during the allotted period of time. Revolving loans can be used by corporations to fund working capital needs and operations. For reference, credit cards are an example of revolving credit used by consumers.

Term Financing

Term financing is usually made available for capital investments or acquisitions. For example, term loans are used when a business desires to acquire assets such as real estate, machinery or equipment, but the cost of procuring such assets exceeds the company's resources. Term loans have a fixed repayment schedule and are advanced for a specific time period. The interest rate on a term loan can be fixed or floating, with a set maturity date ranging between one and twenty-five years. The loans are considered inflexible as they can usually only be used for the purpose specified in the loan agreement and will generally be repaid over time using the profits generated by the long-term use of the purchased assets.

Secured Debt Financing

Lenders providing debt financing, whether on an operating basis or on a term loan basis, may require security for their loans. The security will often consist of a charge covering all assets of the borrower, including inventory, accounts receivable, capital assets such as machinery and equipment and, in some instances, real estate. The exact nature of the security taken in each instance will depend upon the financial situation and bargaining power of the borrower and the nature of the assets available to secure the debt.

Nature of the Assets

Property is categorized in two ways in Canadian law: (1) real or immovable property (land, buildings and property that is permanently attached to land); and (2) personal or movable property (generally anything not attached to land, including vehicles, equipment, shares, inventory, accounts receivable and other intangibles).

Security may be taken in real or immovable property through a mortgage or charge or, in Québec, through a hypothec. In each case, the secured party must register its security against the property in question in order to protect its security interest and ensure its priority as against third parties.

Where security is taken on personal or movable property, the lender may have to effect registrations in a number of jurisdictions across (or even outside) Canada in order to protect its security interest, since personal property security is primarily (although not exclusively) under provincial jurisdiction.

Security in Provinces Other than Québec

Ontario's *Personal Property Security Act* is modelled on Article 9 of the U.S. Uniform Commercial Code. All other Canadian common law provinces have similar, but not identical, legislation. With some exceptions, the Act applies to every transaction that in substance creates a security interest, including a lease that secures payment or performance of an obligation, and any lease of goods with a term of more than one year. To perfect its security interest, a secured party must either take control of the property secured or register a financing statement at a searchable computerized registry, depending on the type of collateral. Further registrations are required in certain circumstances, such as a debtor name change or a transfer of collateral, and to effect a renewal.

Note that the federal government has authority to legislate over personal property security in limited areas such as shipping, railways and certain security taken by Canadian banks.

Security in Québec

The *Civil Code of Québec* generally provides for a single form of consensual security: the hypothec. A hypothec is a charge on movable (personal) or immovable (real) property (which may include future property) that is granted to guarantee the performance of any obligation (present or future) and subsists so long as such obligation continues to exist. Security interests created by hypothecs are set up against third parties by publication in registries established for that purpose or by the secured party taking delivery or control of the property secured. Further publications are required in certain circumstances, such as a debtor name change. Québec has rules relating to the timing of registration and to the execution and form of security that can differ from those applicable in the other Canadian provinces.

Procuring the Loan

Corporate Documentation

When a company wishes to obtain a commercial bank loan, the bank will generally require that the company provide the bank with corporate documentation as an initial step. The documentation required is usually for the bank to confirm that

1. the corporation has the power under its articles to borrow the amount requested;
2. a bylaw has been passed by the corporation authorizing the directors of the corporation to borrow the money on the corporation's behalf;
3. a directors' resolution has been passed providing the names of the officers who may sign the required documentation; and
4. a resolution of the board of directors has authorized the loan agreement.

Commitment Letter

Once the required corporate documents have been obtained and negotiations concerning the loan have been completed, the lending organization will send the corporation a "commitment letter" that summarizes the terms of the loan. The commitment letter sets out an overview of the terms in the loan agreement and includes (1) the term of the loan, (2) the interest rate, (3) options to alter the interest rate, (4) the terms of payment or repayment, (5) the commitment fee, (6) the security to be provided, (7) the covenants, (8) other conditions and (9) the lapsing date.

Loan Agreement

The loan agreement sets out the terms of the loan, which are more extensive and detailed than those covered in the commitment letter. The terms of the loan generally cover the following sections: definitions, description of the parties, purpose of the loan, provisions that describe the nature of the loan and interest terms, conditions precedent to making the loan, interest, covenants, representations and warranties, and provisions regarding defaults and remedies.

EQUITY FINANCING

Several instruments exist to finance companies, the choice of which will depend on the stage of financing and investment requirements of prospective investors. Equity capital, as previously mentioned, creates an ownership interest in the corporation for the investor – otherwise known as a share in the corporation. However, this ownership is not to be confused with direct ownership of the corporation's assets.

Classes of Shares

The shares of a corporation can be divided into different classes. A class of shares is a group of shares with the same rights and conditions. In Canadian corporate finance law, there are two different classes of shares: (1) common or ordinary shares and (2) preference or preferred shares.

Common Shares

Common shares usually vest in its holders the right to (1) vote at general meetings for each share that they hold; (2) receive dividends as and when they are declared, subject to prior rights or preferred shares; and (3) receive pro rata the distribution of assets upon liquidation, subject to the prior rights of preferred shares.

Advantages

Common shares do not impose on the corporation any obligation to make fixed dividend payments to the shareholders. Furthermore, unlike loans, common shares have no fixed maturity date and never have to be repaid until the dissolution of the corporation. Common shares also increase the creditworthiness of corporations and assist in obtaining loans by creating an assured capital base for the corporation. Finally, common shares are more marketable because they are simple and tend to carry a higher expected return than preferred shares or loans.

Disadvantages

Common shares open the corporation to new owners who are given the right to share in the income of the company. The cost of underwriting and distributing shares is also usually higher than the cost of obtaining a loan. Since the risk of investing in equity capital, which does not have to be repaid, is higher for an investor than a debt, investors look to diversify their portfolio. A corporation that desires to raise capital will often be forced to sell shares to more investors than if it had procured a loan.

Preferred Shares

Preferred shares are shares that are given preference over other shares in respect of certain rights. For example, preferred shares tend to have a right to receive an annual preferential dividend at a predetermined rate, before any dividend is declared on common shares. Upon dissolution, preferred shareholders also have the right to a preferential return on capital before the common shareholders.

Advantages

Preferred shares represent sources of financing with defined costs. They can be more attractive to some investors looking for higher return than debt, but having less risk than common shares. Even when dividends are fixed, there is no obligation to pay dividends though there may be consequences to not paying the dividend according to the covenants. Preferred shares are also typically, though not always, non-voting, which leaves control in the common shareholders' hands.

Disadvantages

Similarly to common shares, the main disadvantage is the higher cost of preferred shares relative to debt.

Rights, Restrictions and Privileges of Shares

A corporation may confer upon a class of shares certain rights. Typical rights afforded to shareholders are the following:

Preferential Dividends

This preference gives shareholders the right to receive a fixed dividend before any dividend is declared and paid on any other class of shares. This means the holder of the share is assured first payment out of any profits before the other shareholders. Thus, shares with preferential dividend rights have a quasi-debt feature, with the holder of the share being similar to a creditor of the corporation. However, the preferential dividend does not vest in the holder the right to demand payment from the corporation where no dividend has been declared.

Cumulative and Non-Cumulative Dividend Rights

A cumulative right means that if a dividend was not declared in a given year, or is insufficient to pay the full amount owed to the shareholder, the amount due will be carried over to the next year. Cumulative dividends also have preference over the totality of the income of the corporation. Inversely, non-cumulative dividends are lost when the dividends on the shares are not paid. Note that in the absence of any stipulation to the contrary, the presumption is that dividends are cumulative. However, dividends rarely accrue on a cumulative basis.

Preferential dividends may also be only cumulative upon the occurrence of certain contingencies. For example, a share may become cumulative only where the profits of the company reach a certain amount, or only after a certain number of years.

Participation Right

The participation right grants holders of the shares the right to participate in dividends over the fixed or preferential dividends attached to the class of shares. In the absence of any statement, preference shares are considered to be non-participating.

Right of Redemption

The redemption clause allows corporations to redeem or unilaterally call in the shares at a future date for a specified price. Subject to the share provisions, such right may allow corporations to remove dividend obligations or any rights of the shareholders in participating in the corporation. Redemption clauses tend to have certain limitations in order to protect the rights of investors. For example, a corporation may not redeem more than a percentage of the shares in a particular year.

Right of Retraction

The retraction clause allows shareholders to tender the shares to the corporation at a given date, at which point the corporation is required to buy back the shares from the shareholders. The purpose of the retraction clause is to protect shareholders against the purchase of shares having no maturity date and from having to sell their shares at a loss. Shareholders are generally required to give notice before exercising such right.

Conversion Right

Preferred shares are convertible into common shares at any time at the election of the holder of the preferred shares and upon the occurrence of specified events. Conversion can be optional or mandatory:

- *Optional conversion*: The holder of preferred shares may elect to convert the preferred shares into common shares at any time at a specified conversion ratio, subject to adjustments for share dividends, share splits, share combinations and similar events.
- *Mandatory conversion*: The preferred shares are converted into common shares on the basis of a specified vote of the holders of the preferred shares or automatically at the closing of a qualified initial public offering.

Preemptive Right

A preemptive right is a privilege that grants to certain investors the right to purchase their pro rata amount of additional shares in the company prior to their being made available for purchase by the general public. The preemptive right protects the shareholders against future dilution. Sometimes this right is granted only to "significant" shareholders and typically granted only to holders of preferred shares.

Right of First Refusal

This provision gives to the company (first) and to the preferred shareholders (second) the right to purchase founder or key employee shares before they can be sold to a third party. The right of first refusal usually applies only to sales of common shares, although some investors negotiate for extension of the right to sales of preferred shares.

Implementing an Equity Financing

- Due Diligence Investigation
  - accounting, financial and business due diligence
  - intellectual property review
  - regulatory review
  - corporate legal due diligence
  - employment matters review
- Documentation
  - Purchase or Subscription Agreement
    - This agreement between the investors and the company typically governs:
      - type of securities being purchased or subscribed for
      - purchase price/investment amount
      - single tranche or multiple tranches of investment (with subsequent investments typically at the election of investors or tied to the achievement of specified milestones)
      - use of proceeds of investment amount
      - representations and warranties of both the company (often quite extensive) and the investors (more limited)

        - indemnification in case of breach
        - closing conditions and closing deliveries
- > Shareholders Agreement
    - This agreement between the company and the investors typically governs:
        - governance rights
            - board representation rights
            - special approval or veto rights
        - preemptive right
        - right of first refusal or of first offer
        - tag-along rights
        - drag-along rights
        - information rights
        - rights in case of withdrawal of founder or key executives
        - confidentiality obligations
        - registration rights (in some cases)
- > Ancillary Agreements
    - A number of additional documents may be required in connection with the closing of the financing, including the following:
        - amendment to articles of incorporation to create new class of shares for investment
        - stock option plan or other equity incentive arrangements
        - warrants
        - employment and non-competition agreements
        - approvals for financing
        - share certificates
        - director indemnification agreements

THE CHOICE OF DEBT VERSUS EQUITY FINANCING

The table below summarizes a few key considerations in a corporation's choice between debt and equity financing.

Debt	Equity
Right to repayment of the capital	Subject to rights of retraction and on liquidation, no right to the repayment of the "principal"
Normally a clear right to receive interest	Right to receive income (dividends), which subject to certain conditions, is completely discretionary
Taxation: interest is normally taxable income for the creditor and a deductible expense for the debtor	Taxation: dividends are taxable in the hands of the shareholder, and are not a deductible expense for the corporation

Debt	Equity
Creditors are unlikely to have voting rights; management and common equity holders retain control of the corporation	Shareholders may or may not participate in control (i.e., have voting rights)
Normally, creditors do not participate in growth, though some exceptions exist	Common shares participate in the growth of the business because they have a right to the residual value of the company on liquidation
Covenants, events or default and rights of acceleration are common; a breach of a covenant can lead to the total loss of equity	Covenants are normally non-existent or limited

CORPORATE LAW CONSIDERATIONS

In Canadian corporate law, the law governing the internal affairs of a corporation is that of the jurisdiction of incorporation. Thus, the choice of incorporating federally or provincially will determine the rules that apply with regard to corporate matters, such as

- how to form a corporation
- the relationship between shareholders and the board of directors
- the powers and duties of members of the board of directors and officers of a corporation
- the issuance of shares and the rights, powers and limitations attached to shares
- approval requirements to undertake significant corporate action
- the process and requirements for acquiring another corporate entity

SECURITIES LAW CONSIDERATIONS

In Canada, securities regulation is within provincial jurisdiction, and each province and territory has securities regulatory legislation that is, broadly speaking, comparable to that of the United States. The securities laws, regulations and rules and the policies of the securities commissions across Canada are generally similar in most respects. The prospectus requirements, the exemptions from these requirements and continuous disclosure obligations of reporting issuers (that is, public companies) are substantially harmonized across Canadian jurisdictions. However, the lack of complete consistency in securities regulation across Canadian jurisdictions can complicate securities offerings that are made in more than one jurisdiction.

What Is a Security?

A “security” is broadly defined in Ontario securities legislation as, among other things, any document evidencing title to or an interest in the capital, assets, profits or property of a person or company. A number of different types of agreements and instruments involving monetary consideration are specifically included in the definition of “security,” including notes, stocks, bonds, debentures, certificates of interest, transferable shares and options, or any option, subscription or other interest in or to a security. Depending on the circumstances, both equity and debt financing instruments may come within the definition of security and may therefore be subject to applicable provincial securities legislation.

Prospectus Requirements

Generally, in each Canadian jurisdiction, a distribution of securities must be qualified by a prospectus that is cleared by the relevant provincial or territorial securities regulatory authority, unless an exemption from this requirement is available. A distribution of securities includes a trade by an issuer in previously unissued securities and a trade in securities from a person who is a “control person” in respect of the issuer. A person is presumed to be a control person in respect of an issuer if that person holds more than 20% of the voting rights attached to the securities of the issuer.

Foreign Entity Prospectus Exemptions

The most useful exemptions from the prospectus requirements for a foreign entity financing a business in Canada are the following:

- The *accredited investor exemption* permits certain qualified investors, including institutional investors and persons or companies that meet income or asset tests, to acquire securities on a prospectus-exempt basis.
- The *substantial purchase exemption* permits a person (other than an individual) to acquire securities on a prospectus-exempt basis whereby each purchaser invests no less than $150,000.

Disclosure Obligations

These two prospectus exemptions do not require purchasers to be provided with a disclosure document. However, in Canadian provinces other than British Columbia, Québec and, in respect of the accredited investor exemption, Alberta (where a disclosure document is “voluntarily” provided to purchasers), a purchaser will have a right of action against the issuer or selling securityholder for rescission or damages if the disclosure document contains a misrepresentation. There may also be a right of action against the directors of the issuer or selling securityholder or the dealer, if any, through which the sale was made. If a disclosure document is provided to a purchaser in connection with a trade under these two prospectus exemptions, a copy of the disclosure document generally must be filed with, and fees paid to, the securities regulator.

Canadian securities legislation requires continuous disclosure of any material changes in the affairs of reporting issuers and also includes provisions relating to insider trading and takeover bids.

Summary Article of Interest to Entrepreneurs and Some Practical Advice

IT CAN BE HARD TO LET GO

Issues for Entrepreneurs Taking on Equity Partners

Janet Ferrier, Partner, Davies Ward Phillips & Vineberg LLP
July 8, 2011

You've started a successful business, nurtured it through the tough early years, invested your time, energy, money and love. And now you've decided you need an equity partner to help your business get to the next level.

It's time to let go of your baby. What should you expect?

Let's start with the basics. With equity financing you are giving up a piece of the ownership of your company to one or more investors in exchange for the money your company needs to grow. There are many kinds of investment and which one is right for you depends on a number of factors, but it often comes down to how much financing your company needs and what stage your business is at. You may have started with small investments from your friends and family, sometimes called love money, but now your business needs something a little more substantial, perhaps in the form of angel investment or venture capital (VC).

Angel investors are wealthy individuals, often successful entrepreneurs themselves, who may invest smaller amounts than a VC firm but are often willing to wait longer for their reward. Venture capital firms tend to invest larger sums and want a shorter term. VC firms are responsible to their own investors, to whom they have promised a return, and they are counting on you to deliver it. You may also decide to go with a strategic investor, usually a more developed company in a similar or complementary business. Each kind of investment can involve complex legal and financial issues.

All types of investors can bring considerably more to your business than money: experience, industry knowledge, advice and access to their networks of contacts – all invaluable to a growing business, and all the more reason to ensure that you select not only the right kind of investor, but the right investor for you and your business. You are entering into a long-term business relationship and you would be well-advised to look beyond the dollars and make sure you can work together.

All investors have one thing in common: they're in it for the money. That sounds bad but it's not. After all, making money is what you hope for too. But it can get complicated. In return for their financial and other contributions, you are going to have to give your investors a few things. Most likely you will find yourself negotiating a shareholders' agreement (and/or investor rights agreement, partnership agreement, voting agreement – the name doesn't matter) that gives both you, as founder, and your investors certain rights and responsibilities. This agreement may govern your financial and business relationship for years to come and may be one of the most significant documents you ever sign. Needless to say, it is critical that you get the best, most objective financial, tax and legal advice you can find (reading an article is not enough!)

Negotiating the agreement is a rather delicate balance between hoping for the best and planning for the worst. You have expended considerable effort finding the right investor for your business, and you and your investors have common goals: to run the business responsibly and well, to grow, to succeed and to earn money. You should have started thinking of your investor as your partner, but at the same time you have to protect your company and yourself. Here are some of the key issues you will face:

– **Dilution**. You're giving your investors an ownership interest in your company, so of course your share will be reduced, or diluted. You have to think about how big a share you are willing to give up and what you're getting in return. In addition, as you and your new partners look forward to the future, you may anticipate the need for further investment down the road so you should plan for future dilution.

Early-stage equity investors generally want some form of anti-dilution protection – they took a risk by coming in early, and don't want to lose out to the new money just when the business is getting profitable. You and they will also want some dilution control, either a straight prohibition on issuing new equity without everyone's consent or the more moderate pre-emptive right, which is the ability to invest more capital in the future to maintain your percentage of ownership (and thus the balance of power) instead of allowing in new dilutive investors.

- **Decision-making**. Your investors aren't going to give you their money and disappear; they want a say in what you're doing with their money and the company that they now partly own. At the very least they will want a seat on your board. They will most likely also want, through the shareholders' agreement, a vote and sometimes even a veto on key business and financial decisions. You may have been running your business successfully for years on your own and it can be very difficult to give up control but you now have a partner and, while you are giving up some control, you may also find there is a benefit in having someone with whom to share some of the burden.
- **Liquidity and exits – theirs**. Your investors want to earn a profit on their investment or at the very least be able to get their money back. The ultimate goal may be an initial public offering or sale, but that could be years away, if at all. In the meantime, your investors may be willing to leave their money in the company for several years, especially if things are going well, but they will also want the ability to get out. Your shareholders' agreement will most certainly include some form of exit right, and usually more than one – it may go as far as the right to force you to buy them out or sell to them, such as put, call or buy-sell (shotgun) rights, or somewhat milder options such as rights of first refusal or first offer, co-sale (tag-along) and drag-along rights. Other rights related to liquidity and exits include liquidation preferences, where your investors get the first money if the company is sold or goes under.
- **Exits – yours**. You may not want to stay with the company forever, whether it's because you want to move onto new things or retire, or because it just isn't working out; so you will want exit rights that are similar to those you gave your investors. However, because you are also likely to be a key member of management, your partners may not want to let you leave too easily. Some shareholders' agreements require you to sell your shares if you leave your position with the company, and some include a non-competition clause preventing you from starting up or joining a similar business. This is another critical aspect of your negotiations as it can limit your freedom to leave the company and move on to other things.

There is much to consider when you start a relationship with a new equity partner. It may be hard to let go, but remember that you are getting something in return, and it's up to you to make sure the end result is what you want.

7: Exiting Your Venture: Sales, IPOs and M&A

Similar to practices in the United States, the United Kingdom and Europe, the principal ways in Canada for founders and other securityholders to exit a privately held company and monetize their investment are through private company share or asset sales or initial public offerings (IPOs). Those who are successful in taking a business public but retain an investment in the business can also sell their interest through share sales subject to compliance with securities laws, or in public merger and acquisition (M&A) transactions; but this option is less relevant for many entrepreneurs.

The following identifies some of the important ways in which Canadian laws regulate the sale of a business in Canada.

SELLING A PRIVATE COMPANY

There are three basic transaction structures for the sale of a business held by a Canadian company that is not publicly traded:

1. share sale
2. asset sale
3. statutory or court-approved amalgamation or arrangement.

Irrespective of the structure, all private company sales are negotiated transactions that require agreement among all of the relevant parties to the transaction. That is, unlike public company sales, "hostile" transactions are not possible.

Share and Asset Sales

A key consideration that sellers must decide early on when exiting their venture is whether to proceed by way of an asset or a share sale transaction. The primary determinants in making this decision typically relate to tax and liability issues. The following chart provides a high-level overview of the key distinguishing features of share versus asset sales in Canada.

	Share Deal	Asset Deal
What is it?	The purchaser buys all or a majority of the shares of the target company	The purchaser buys all or a majority of the assets of the target company
Negotiation process	Buyer negotiates directly with the target shareholder(s)	Buyer negotiates directly with the target board of directors
Main documents	Share purchase agreement	Asset purchase agreement
Key points	More favourable for the *seller*: – Easier for the seller to completely dispose of the business – including all assets *and* liabilities – More tax friendly for the seller – able to declare the proceeds of the share sale as capital gains at a lower tax rate than traditional income	More favourable for the *buyer*: – Buyer has flexibility to "cherry pick" the assets and liabilities it wants, while excluding those it does not want to be responsible for – Gives buyer the ability to "bump" the tax cost base of assets to fair market value, resulting in tax benefits

	Share Deal	Asset Deal
	– Share sale triggers tax year end, reduction of tax loss carry-forward period – Typically simpler in terms of timing and expense as there are less items to negotiate – Buyer may prefer share deal if the acquired business has accumulated losses	– Risk of double taxation for the seller – the selling corporation pays tax on the gain and sale of each asset *plus* the shareholder pays tax on dividends when the proceeds of sale are distributed – Generally more complex, time-consuming, and expensive to execute as there are more key points of negotiation
Key takeaways	Share sales may be suitable for a business with a relatively small number of shareholders that are willing to sell the entirety of their interests in the venture	Asset sales are beneficial for parties who want to achieve a more complex division of parts of the business, although this often comes with less favourable tax treatment for the seller(s)

Amalgamations and Arrangements

The third option that business owners may wish to consider is a statutory or court-approved plan of arrangement or amalgamation.

While a simple asset or share sale makes sense where the target business has only a few major shareholders (e.g., an early startup or family business), this is not always the case. Where the business in question has a larger number of shareholders, some of whom may not wish to sell their interests, the arrangement or amalgamation structure is useful. Structuring the deal in this way makes it possible to compel a group of minority shareholders to sell, even if they do not wish to do so, provided that a certain majority of shareholders have voted in favour of the transaction on both sides of the deal.

Amalgamations

Two or more corporations may be amalgamated to continue as one corporation (Amalco). The amalgamation process is governed by the federal or provincial corporate statute that governs each amalgamating corporation. Amalgamating corporations must be incorporated in the same jurisdiction in order to merge. In an amalgamation, the shareholders of each corporation continue as the shareholders of Amalco post-amalgamation, and the assets and liabilities of each corporation continue as assets and liabilities of Amalco. For example, litigation and court orders applicable to the amalgamating companies will continue to apply to Amalco. No court approval is required for amalgamations in Canada, although typically 66⅔% approval of the shareholders of each amalgamating company is a prerequisite. Amalgamations can be short form or long form in Canada, as summarized in the chart further below.

Short-form amalgamations do not require an amalgamation agreement or shareholder approval. Rather, they can be authorized by directors’ resolutions on behalf of the amalgamating companies. Short-form amalgamations may be vertical or horizontal. However, a short-form amalgamation structure has limited utility, as it cannot be used for change of control transactions, but rather is used where all of the shares of one company are held by another company or where two subsidiaries are held by the same parent corporation. Therefore, this structure is typically used only for reorganizations of a business.

Long-form amalgamations are more typical in sale transactions, as they facilitate change of control transactions allowing separate private companies to amalgamate. In a long-form amalgamation, the shareholders of each of the amalgamating entities exchange their shares for shares of Amalco. Accordingly, the owners of each amalgamating company become owners of the combined Amalco post-amalgamation. Thus, for owners wishing to entirely exit from the business, the amalgamation must typically be followed by some sort of distribution or buy-back of the owner's shares in Amalco. In contrast to short-form amalgamations, shareholder approval by each amalgamating company is required. Long-form amalgamations may be horizontal or three-cornered, as summarized in the chart further below.

Short-Form Amalgamation		Long-Form Amalgamation	
Vertical	**Horizontal**	**Horizontal**	**Three-cornered**
– Amalgamation of holding corporation and one or more of its subsidiaries – Directors' resolution of each company – All shares of subsidiaries must be held by parent of another of the amalgamating companies	– Amalgamation of two or more wholly owned subsidiaries of the same parent – Directors' resolution of each company – All shares of subsidiaries must be held by parent	– Separately owned/controlled companies agree to amalgamate to form Amalco – Shareholders of each amalgamating company exchange their shares for shares of Amalco – Effected by amalgamation agreement – Shareholder approval required	– Acquiring company establishes a wholly owned subsidiary (AcquirecoSub) – AcquireCoSub and Targetco amalgamate to form Amalco – Effected by amalgamation agreement – Shareholder approval required

Plans of Arrangement

Plans of arrangement can be useful to facilitate the sale of a business. Like amalgamations, arrangements are statutory structures governed by the corporate statute under which the corporation being arranged is governed. Unlike amalgamations, however, arrangements require court approval in respect of both the process and the substantive fairness of the transaction. Accordingly, they can be more cumbersome and time-consuming to complete than amalgamations or straight share or asset sales. However, the primary benefit of an arrangement is its inherent flexibility, allowing owners to complete multiple transactions (including tax planning and reorganizations) at one point in time with certainty that all transactions are completed together, or none of them are completed. The principal definitive document for an arrangement transaction is the arrangement agreement. Shareholder approval of the company being arranged is also required.

The Transaction Process

No matter which of the three principal deal structures is chosen, the general process by which the sale of a private company business is completed is relatively consistent.

Step 1: Early Discussions and Preliminary Diligence

- Key questions:
  - Who is the buyer? Who is the seller?
  - Why are they buying or selling?
  - What are the critical assets, liabilities, issues and concerns?
  - What are the critical gating items – regulatory consents, third-party consents or financing requirements?

Step 2: Letter of Intent/Term Sheet

- An LOI or a Term Sheet is typically a simple agreement between the main parties setting out the principal terms of the proposed transaction
  - It can be helpful to set out the key issues and terms in advance and establish at an early stage if there are fundamental points of disagreement.
  - LOIs/Term Sheets are also useful for
    - getting you to a legally enforceable agreement
    - identifying the legal entities and nature/structure of the transaction
    - facilitating due diligence
    - outlining timing, expectations and intentions
    - lessening the likelihood of reopening issues
  - Typically these agreements are *non-binding* and the parties are free to walk away from the transaction unless and until the definitive agreement has been signed.
  - LOIs/Term Sheets often include some binding terms relating to confidentiality and access to information, exclusivity, no shop, no talk or go shop provisions, coordination of public disclosure about the transactions, allocation of costs and expenses, governing law and the outside or termination date for completing the transaction.
  - Even if the LOI or Term Sheet is non-binding, the parties will generally find themselves “wedded” to the provisions that they set out here – so it is important to ensure that what is agreed to is not likely subject to change.

Step 3: Due Diligence

- The purchaser (although sometimes both parties) conducts a thorough investigation of the seller and its business to learn more about the company and/or the assets it plans on acquiring.
  - The buyer typically provides the seller with a checklist of key items and documents that it needs to see, which the seller will provide access to.

- Key documents subject to diligence usually include the company’s articles of incorporation, bylaws, minute books, financial statements, material contracts, details of pending litigation, intellectual property, and more.
- If the purchaser’s findings are acceptable, then the parties will proceed to negotiate the definitive agreement.

Step 4: Definitive Agreement

- The definitive purchase and sale agreement (share purchase agreement, asset purchase agreement or amalgamation/arrangement agreement) is the comprehensive agreement put in place to govern the deal and the obligations the parties owe to one another
- It is customary for the purchaser’s counsel to prepare the definitive purchase agreement, except in the case of an auction process
    - The content can vary, but it generally follows well-defined alternative precedents based on the key issues in the deal
    - Some of the most common hotly debated deal points found in the definitive agreement include
        - purchase price and form of consideration (cash, shares and/or deferred payments)
        - potential for price adjustments after closing (e.g., working capital adjustments, earn-outs)
        - closing conditions:
            - accuracy of representations and warranties
            - compliance with covenants
            - no legal prohibition regarding the transaction
            - regulatory approvals (e.g., *Competition Act*, *Investment Canada Act*, industry specific)
            - third-party consents
            - no “material adverse effect”
            - financing
            - treatment of key employees
        - representations and warranties (statements of fact on which the other party relies and serve as a basis for claims after closing)
        - covenants:
            - addresses actions of the parties between signing and closing, and post-closing
            - examples of pre-closing covenants:
                - carry on business in the ordinary course
                - access to business by the purchaser during interim period
                - level of effort to obtain regulatory and third-party consents
                - treatment of employees
            - examples of post-closing covenants:
                - third-party consents/notices
                - employee benefits
                - non-competition/non-solicitation restrictions
                - director and officer insurance coverage for outgoing principals

        - transitional services provided by the seller to the purchaser
    - indemnification (e.g., for breaches of representations and warranties and covenants, and for specific losses such as tax or environmental matters)
    - liability caps
    - holdbacks/escrows
    - "sandbagging" provisions
- In addition to the definitive purchase and sale agreement, most sale transactions include a combination of the following ancillary closing agreements and documents that must be negotiated by the purchaser and the seller:
  - non-competition and/or non-solicitation covenants given by the seller to the purchaser
  - transitional services agreement(s), whereby the seller agrees to help with transitioning of certain aspects of the business to the purchaser (e.g., information technology, customer support)
  - labour/employment agreements/arrangements
  - escrow agreement (if a portion of the purchase price is being held in escrow post-closing to cover possible indemnity claims and/or earn-outs or price adjustments
  - payment direction(s)
  - legal opinions (e.g., regarding title to assets, enforceability and/or where securities are being issued as part of the consideration paid)
  - certificates of status/good standing for the participating companies
  - officers' certificates (including "bring downs" of representations and warranties on closing)
  - third-party approvals and consents

Step 5: Closing

- Closing refers to the execution of the transaction whereby all documents are signed and consideration changes hands. There are two main methods of closing:
  - Option 1: Sign & Close:
    - The parties sign the definitive agreement and exchange consideration on the same day, meaning that all closing conditions must either be met or be waived on the day of signing, and the sale occurs on the date of signing.
    - Representations and warranties typically survive post-closing and provide comfort for the parties that they can still sue after the fact if certain matters turn out not to be true.
    - Key downside: with a simultaneous sign and close, there is a risk of losing the deal before signing.
      - Because there is usually no binding agreement ahead of time (only an LOI), if the parties cannot actually come to an agreement over the definitive agreement, then neither party is bound to proceed.
      - This is a major risk to be aware of, as significant time and money will have been spent negotiating the deal up to this point.
  - Option 2: Signing with Subsequent Closing:
    - The parties sign the definitive agreement first, locking in the price and other key points agreed upon, with actual closing of the transaction occurring at a later date.

- This tends to be more common, for various reasons. Chief among them is that it allows the parties to move forward on the basis of a binding agreement minimizing the risk of the deal falling apart, while facilitating the extra time needed to get closing conditions completed.
- If it turns out that a party made inaccurate representations or warranties, the party discovering this may still be able to walk away from the transaction without repercussions – thus providing some leeway for the parties.
- Main downside: this can extend the transaction process and timeline and often increases the parties' costs of legal fees and other expenses.

GOING PUBLIC IN CANADA

An initial public offering (IPO) is the process by which a company sells its common stock to the public for the first time, typically in an offering underwritten by a syndicate of investment banks.

Most issuers that become public companies in Canada list their securities on one of the two principal stock exchanges in Canada: the Toronto Stock Exchange (TSX), or the TSX Venture Exchange (TSXV). Through an IPO, business owners may either divest themselves of all of their equity interests in the business or a portion of their investment.

While the traditional IPO is one way in which companies can go public in Canada, it is not the only way and may not be appropriate for all situations. Companies can also go public through a direct listing on the TSX or TSXV, a reverse takeover on the facilities of a stock exchange or through the TSXV's capital pool company (CPC) program or the TSX's special purpose acquisition corporation (SPAC) program. Each of these going-public structures is summarized below.

In all cases, however, the entity going public (typically a corporation) will be required to comply with applicable provincial securities laws, corporate laws and various minimum financial, distribution and other listing standards established by the relevant stock exchange. For example, in Ontario, the *Securities Act* will apply to any offering of securities. Each province and territory of Canada has its own securities legislation and regulation, and securities regulatory authority. The Canadian Securities Administrators (CSA) has been working toward harmonization of the regulation of capital markets through adoption of various national instruments and multilateral instruments in some or all of the provinces, as well as the development of the passport system, although differences can arise depending on the jurisdictions in which the company is a "reporting issuer."

Initial Public Offering

An IPO is the traditional method for going public. It is often done together with listing an issuer on a stock exchange, which involves the issuance or distribution of securities in a public offering that are qualified by a prospectus together with an application for a public listing on an exchange. The prospectus provides potential investors with all material information related to the issuer and the securities being distributed, and its preparation is one of the reasons why the IPO is an expensive and time-consuming process.

Direct Listing

An issuer already listed on another exchange may list directly on the TSX or TSXV if it is able to meet the applicable listing standards. As well, an issuer may be eligible for certain exemptions from the regulatory and reporting requirements under applicable Canadian securities laws if it is a reporting issuer in certain foreign jurisdictions.

Reverse Takeover

A reverse takeover (RTO), also known as a back door listing or reverse merger, is a process by which a private company merges with an existing publicly listed shell company. Typically, the transaction will involve an amalgamation or issuance of shares in exchange for other shares or assets of the issuer, such that the private company becomes a subsidiary of the shell while simultaneously becoming the shell's controlling shareholder. The RTO is subject to TSX or TSXV approval, and the company resulting from the RTO must meet the original listing requirements of the TSX or TSXV.

TSXV Capital Pool Company Program

The TSXV allows an issuer to list as a capital pool company (CPC). The CPC program was designed to provide businesses with the opportunity to obtain financing earlier in their development than might be possible with an IPO. The CPC program permits a TSXV listing to be obtained by a newly created company that has no assets, other than cash, and has not commenced commercial operations. The CPC is then expected to use this "pool" of funds to identify and evaluate potential assets or businesses which, when acquired, would qualify the CPC for listing on the TSXV.

The CPC is required to complete a "qualifying transaction" (QT) by acquiring one or more businesses or assets by way of purchase, amalgamation, merger or arrangement with another company or by other means within 24 months following completion of the IPO.

Some key features of the terms, process and other requirements relating to CPC's include the following:

Key Terms	Process	Other Requirements
CPC		
– Minimum capital raise between \$200,000 and \$4,750,000 – Sell to at least 200 arm's-length shareholders, each buying at least 1,000 shares at ≥\$0.10 per share – Have at least 1 million shares in the public float – Minimum of 3 individuals with business and public company experience contribute ≥\$100,000 and 5% of total funds to be raised, up to \$500,000	– TSXV listing application – IPO prospectus – Filing statement/information circular on QT – For non-arm's-length QT, an information circular will be prepared; majority of minority shareholder approval required	– Restriction on entering into an enforceable acquisition agreement prior to using CPC program – Must retain an agent who will sign the prospectus as underwriter, whose compensation is limited to 10% of IPO proceeds – Founders' shares and certain other securities are subject to escrow requirements – CPC subject to TSXV listing requirements

TSX Special Purpose Acquisition Company

A special purpose acquisition corporation (SPAC) is a TSX-listed "blind pool" company that raises capital from the public by way of an IPO. A SPAC is similar to a CPC in that both involve the creation of publicly traded shell companies that later acquire an operating business using the initial proceeds raised. However, SPACs are much larger than CPCs and therefore involve more stringent investor protections.

A SPAC must complete its initial “qualifying acquisition” (QA) transaction, with a fair market value equal to greater than 90% of the gross IPO process within 36 months of the IPO, failing which it must return the capital raised from the IPO to its public shareholders.

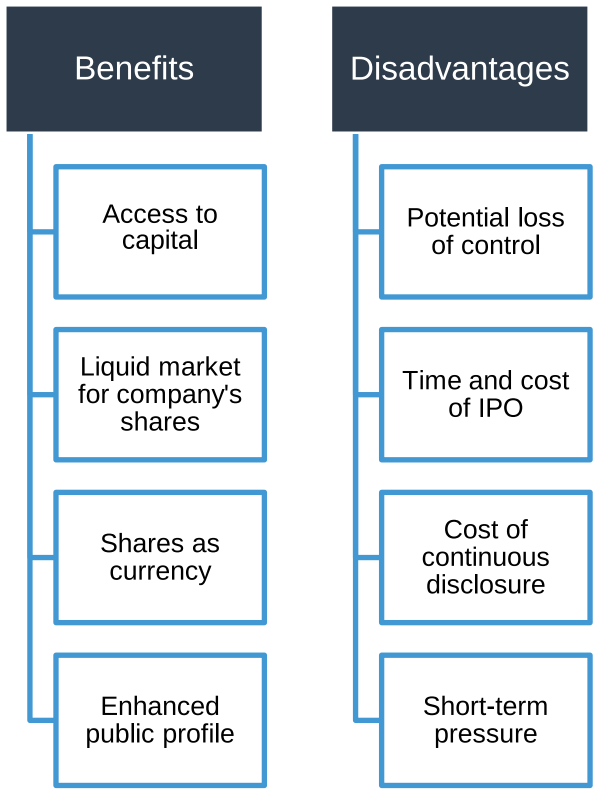
Some key features of the terms, process and other requirements relating to SPACs in Canada include the following:

Key Terms	Process	Other Requirements
SPAC		
– $30 million minimum capital raise – Sell at least 1 million securities to 300 public shareholders at a price of at least $2 per security – Founders, who must have senior management business and public company experience, must hold between 10% and 20% of the equity post-IPO – QA requires approval of a majority of directors unrelated to the QA and a majority of the SPAC securityholders, excluding founders	– TSX listing application – IPO prospectus – Information circular on resulting issuer – Non-offering prospectus on resulting issuer – Securityholder approval	– Restriction on entering into binding acquisition agreement prior to IPO – Escrow requirement: 90% of IPO proceeds and 50% of underwriters’ commissions deposited in escrow pending QA – Securities must contain a conversion feature for securityholders who vote against the QA – Resulting issuer must meet TSX listing requirements

Initial Public Offerings

What Is an IPO?

An initial public offering (IPO) is a process by which a company offers its shares to the public for the first time, typically by listing them on a stock exchange such as the TSX or TSXV in Canada, or the New York Stock Exchange (NYSE) or Nasdaq in the United States. This “going-public” process has significant ramifications for the company and its shareholders. Some of the key benefits and disadvantages to the IPO are listed below.



IPO Benefits

Access to capital: Going public allows a company to raise money from public investors, as opposed to private companies, which are generally limited to taking on debt or highly dilutive equity investments from venture capital and private equity firms. There is no limit on the number of shares a public company can issue – so long as there is demand for the company’s shares, the IPO opens the door to much more substantial capital raising than is available to privately held businesses.

Liquid market for company’s shares: The IPO results in the company’s shares being publicly listed on a regulated stock exchange. Unlike in a private company, where there are typically significant restrictions on the tradability of shares, public shares can be freely traded to other investors. Not only does this make the company’s shares more marketable and appealing for investors, but it also allows pre-existing shareholders to cash out on all or a portion of their early investment in the company.

Shares as currency: Public companies have the benefit of being able to use their own shares as currency when pursuing acquisitions. Instead of only being able to fund an acquisition entirely with cash, the public company can fund transactions entirely with its own shares, with a combination of cash and shares, or on a pure cash basis. This gives public companies the flexibility to avoid taking on extensive debt obligations to pay for an acquisition with cash if it so chooses.

Enhanced public profile: Going public should improve the perception of a company's financial stability and transparency. The IPO itself can attract significant attention to the company by analysts and the media, while focus on quarterly and annual performance can help maintain continued interest in the company. This added attention can help sustain demand for and liquidity in the company's shares.

IPO Disadvantages

Potential loss of control: Raising money through an IPO is done by selling shares to the public. In general, doing so results in the pre-IPO investors and management owning a lower percentage of the outstanding shares and thus having less control over the operation of the business. While the use of multi-class shares is a possible strategy for early shareholders to retain control of the company, this practice is typically not seen in a positive light by institutional investors and the Canadian Coalition for Good Governance (CCGG), Canada's primary corporate governance watchdog. The shareholders of public companies are generally empowered to vote on the appointment of directors, executive compensation and other important matters that management cannot unilaterally control as they can in a private business.

Time and cost of the IPO: The IPO itself is an expensive endeavour that requires significant involvement from legal counsel, underwriters, auditors and other professional services. Preparing the prospectus and financial statements is time-intensive, and larger companies can expect to pay upward of $1 million for these services. In addition, underwriters will typically take a commission of between 4% and 6% of the total funds raised by the offering. Finally, fees paid to the stock exchange itself in order to be listed can range up to $200,000 for the TSX. All told, going public via IPO requires a significant one-off cost that can be higher than what many companies expect. The IPO process is also time-gated by various regulatory approvals and other matters, so the typical IPO will take at least 12 to14 weeks to complete.

Cost of continuous disclosure: Being a public company requires ongoing expenses in addition to the original IPO cost. Securities laws require extensive reporting and disclosure on a quarterly and annual basis, as well as interim disclosure of material changes and other events that impact the company, some of which are discussed further below. Complying with these requirements means that public companies will typically need to seek the advice of external counsel, auditors, and other professional services. Public companies need to have sufficient funds to be able to afford these services on an ongoing basis.

Short-term pressure: Once a company has gone public, its quarterly and annual financial statements become the subject of scrutiny by analysts and the media. There can often be pressure on management to prioritize short-term results for the next quarter, rather than making sacrifices upfront in order to pursue a long-term strategy. Managing investor relations can also be a substantial time commitment that can distract management from its primary job of running the business itself.

Sample Timeline of IPO Process

Weeks 1–2 (Pre-filing)	• Confirm board of directors and management meet regulatory requirements • Management chooses professional advisers: underwriter / investment dealer, securities lawyers, auditor(s), etc. • Initial meeting with all participants to set out plan for the process and allocate responsibilities • Internal documentation organized to ensure due diligence and prospectus preparation are completed efficiently
Weeks 3–6 (Pre-filing)	• Underwriter begins due diligence • Underwriter's counsel distributes draft underwriting agreement • Preliminary prospectus is prepared • Preliminary prospectus and supporting documents, including financial statements, filed with stock exchange and applicable provincial securities regulators • Listing application is prepared and filed
Weeks 6–9 (Waiting period)	• "Waiting period" and marketing period begin: issuer is permitted to solicit interest in securities by forwarding copies of preliminary prospectus to prospective investors • Underwriters will set up and perform a marketing "road show" to gauge interest in the securities • Stock exchange and provincial securities regulators review the preliminary prospectus and advise of any deficiencies • Company and its counsel will address any deficiencies and file necessary amendments
Weeks 9–12 (Waiting period)	• Receive additional comments from provincial securities and/or exchange regulators and file any further necessary amendments • Final prospectus submitted
Weeks 12–14 (Post-distribution)	• Final receipt for final prospectus from provincial securities regulators • Sign underwriting agreement to agree on price • Completion of closing documents and closing • Trading begins

Key Players in the IPO

IPO Principal Documents and Tasks

Principal Documents and Tasks in the IPO Process	
Prospectus (preliminary and final)	– Both a marketing document and legal document; must balance the marketing "story" with full and accurate disclosure – Contains extensive financial and non-financial information about the issuer's business, capital structure, directors and officers, corporate governance, risk factors and other material information about the company – Must provide "*full, true, and plain disclosure*" of all material facts relating to the securities to be distributed – Statutory liability under securities legislation for a misrepresentation made in the prospectus – "Misrepresentation" includes both an untrue statement of material fact *and* an omission to state a material fact

Principal Documents and Tasks in the IPO Process	
Due diligence	– Involves research into all of the company's key documents, financials, contracts, minute books and more in order to verify the accuracy of material being put into the prospectus – *Due diligence defence* is key for underwriters – they will be shielded from liability if it turns out that there is a misrepresentation in the prospectus, so long as the underwriters performed proper and comprehensive due diligence
Underwriting agreement	– Agreement between the issuer and the underwriters governing the purchase and offering of the securities – Principal clauses include > terms of the offering > representations and warranties of the issuer/selling securityholders > covenants of issuer > conditions of closing (including legal opinions) > termination rights
Stock exchange listing	– Minimum financial, distribution and other standards must be met in order to qualify to be listed – Different listing categories depending on business of issuer (e.g., industrial, R&D, mining, oil & gas) – Must file a listing application together with supporting data demonstrating ability to meet minimum listing requirements – Exchanges may require that securities issued to principals, directors and senior officers be held in escrow following the IPO
Closing	– Closing documents include various company certificates, wire transfer instructions, legal opinions, etc. – Involves the bank wiring money, company issuing share certificates and all closing documents being released

What makes the Canadian IPO process unique?

One of the most unique features of the Canadian IPO context is the practice known as the "bought deal." In other jurisdictions, investment banks typically act as agents for the issuer whereby they commit to attempt to sell the issuer's securities on a "best efforts" basis. If the banks cannot find a market for the securities in question, the securities simply do not get sold and the issuer raises less capital than it had hoped.

While best efforts deals are used in Canada as well, the bought deal is a unique alternative that may be available to larger issuers with a stronger bargaining position vis-à-vis the underwriters. In these cases, the underwriters themselves commit to purchase all of the securities being offered before the deal is announced to the market and before commencing any widespread marketing process. If the underwriters can't find buyers to resell the securities to, then they are the ones who eat the cost rather than the issuer. The effect is twofold: (a1) the issuer gets a guaranteed amount of proceeds from the distribution that they can bank on no matter what; and (2) in exchange, they sell the securities to the underwriters at a greater discount than normal to compensate them for the added risk.

In addition to the guaranteed financing, bought deals are also attractive for issuers because of the shorter time period to complete. Whereas a traditional IPO process can take over 12 weeks to close, a bought deal typically takes about 20 days and can be done in even less time if a shelf prospectus is used.

Public Company Continuous Disclosure at a Glance

Once public, the reporting issuer will be required to satisfy various ongoing continuous disclosure obligations in each of the applicable Canadian provinces and territories in which it is a reporting issuer. Generally, corporate and securities laws require Canadian public companies to

- file annual and interim financial statements (with appropriate note disclosures), accompanied by a management's discussion and analysis (MD&A); annual financial statements must be audited by an independent auditor's report;
- other than TSXV issuers, file annually an Annual Information Form (AIF), describing the corporate and capital structure of the issuer, its business and prospects, the market for its securities, its officers and directors, and risks and other external factors that have an impact on the issuer;
- immediately issue a press release concerning any "material fact" or "material change" in the affairs of the issuer, and file a "material change report" reflecting any material change within 10 days of the event (the TSX and TSXV also require that listed companies forthwith disclose all "material information," being both material facts and material changes);
- as in the United States, avoid selective disclosures under insider trading and tipping laws (which prevent the disclosure of a material change or material fact concerning a public company that has not been generally disclosed to the investing public, unless such disclosure is made in the "necessary course of business");
- annually hold a shareholders' meeting and allow shareholders to vote in respect of each director nominated for election to the board of directors;
- annually prepare and deliver an information circular to be sent to shareholders in connection with the solicitation of proxies for use at a meeting of shareholders;
- file a "business acquisition report," if the issuer is completing a significant acquisition, describing the business acquired and the effect of the transaction on the issuer.

As in the case of a prospectus, issuers and their directors and officers are also liable for "misrepresentations" in their continuous disclosure materials filed under provincial securities laws.

IPO Trends and Developments in Canada

Last year, we witnessed a few noteworthy trends and developments in IPOs, including issuers' continued use of dual-class share structures and the use of growth outlooks to bolster valuations and ensure the successful completion of the IPO. The year 2017 also witnessed an increasing use of reverse takeovers as a means to list shares on the TSX (or TSXV), with some issuers perceiving RTOs as easier and cheaper than the traditional IPO. And finally, in 2018, Spotify Technology N.A. began trading on the NYSE after completing a direct listing offering, or DLO, an alternative approach to going public that is infrequently used in Canada and the United States.

1. Dual Class Share Structures

A significant number of the issuers carrying out IPOs in 2017, including some of the highest-profile names, offered subordinate voting shares to investors, with the founders or controlling shareholders (including often the private equity sponsors of the issuer) retaining control of the issuer through multiple voting shares carrying between 10 and 50 votes per share.

While dual-class share structures are not viewed favourably by many institutional investors and CCGG, issuers keep returning to the structure for various reasons. Most important, this structure offers a high degree of stability within the company's management by shielding it from the pressures of short-term shareholders and activist investors.

2. Growth Outlook

Forward-looking growth outlooks were also a notable feature of a significant number of IPOs in 2017. Issuers provided outlooks for many financial metrics such as revenue and EBITDA, as well as tangible objectives like store openings and same-store sales.

Canadian securities laws require certain disclosure regarding forward-looking information, including

- reasonable cautionary language identifying the forward-looking information as such,
- reasonable cautionary language identifying material factors that could cause actual results to differ materially from the forecast, and
- a statement of the material factors or assumptions that were applied in making the growth outlook.

In addition, the cautionary language and disclosure of risk factors and assumptions must appear proximate to the forward-looking information, and the issuer must have had a reasonable basis for making the outlook. An issuer must review the assumptions underlying forward-looking growth outlook and the process followed in preparing such outlook to ensure that a reasonable basis for the statements exists.

Providing an outlook can be challenging for issuers, their directors, officers and underwriters, from both diligence and liability perspectives. However, with a proper description of the assumptions relied on in developing the outlook and a reasonable basis for the expected growth, an outlook will often help an issuer achieve the expected pricing for its IPO.

3. RTOs and DLOs

Reverse takeovers (also called reverse mergers or back-door listings) have played a substantial role in widening access to Canadian capital markets in the last 20 years as an alternative to the traditional IPO. This is usually the case in the context of a slow IPO market because RTOs do not necessarily require a concurrent financing of the company, therefore offsetting or minimizing any market risk related to the listing process. Despite a more vital IPO market in 2017, RTOs have continued to be an effective alternative to going public, predominantly in industries such as blockchain and cannabis, both emerging growth industries in Canada.

Whereas traditional IPOs may sometimes seem onerous and time-consuming, RTOs are often seen as a cheaper and more expedient way to go public. One of the main advantages of an RTO is that it generally does not involve regulatory review, other than by the stock exchange. However, it involves less (or sometimes no) market validation of the business of the target.

Since rumours of the Spotify DLO began to circulate in the United States, many market participants have questioned whether direct listings will be the new trend in Canada. Although Spotify was able to complete a direct listing on the NYSE in the United States, effecting a DLO on a Canadian stock exchange can be challenging as a result of the various stock exchange listing requirements, including the requirement to have a certain number of public shareholders. In addition, going public via a DLO is a unique method that makes sense only for a limited number of companies that are not looking to raise capital and already have strong brand awareness.

SELLING A PUBLIC COMPANY

Canada has a well-established corporate and securities law framework for public M&A for owners or operators of Canadian public companies wishing to acquire or sell a business. These types of transactions can be completed in three main ways: (1) takeover bid, (2) plan of arrangement or (3) amalgamation. Public company acquisitions in Canada can occur on a negotiated (or "friendly") basis with the support of the target company or, unlike private company sales, on an unsolicited (or "hostile") basis without the support of the target company (in which case a takeover bid structure would generally be the only practical approach).

Public company acquisitions and sales are regulated by provincial corporate and securities laws, as well as the rules of the applicable stock exchange on which the subject companies are listed.

Takeover Bid

A takeover bid is an offer to purchase shares of a public company that is made by the acquirer to the shareholders and is subject to the deposit of a requisite number of shares by shareholders accepting the offer. Takeover bids are specifically regulated by Canadian securities legislation. The governing principle behind takeover bid laws in Canada is that all shareholders should be treated equally and, therefore, subject to certain exceptions, all shareholders must be offered the same consideration or choice of consideration. Key features of the Canadian takeover bid process include the following:

- *Consideration:* Acquirers of a Canadian public company by way of takeover bid can pay with cash, securities or a combination of both, provided that shareholders must be offered the same consideration. Unlike the United Kingdom and United States, Canada has a "fully financed" rule with respect to takeover bids, meaning an acquirer commencing a bid must have adequate financial arrangements in place to ensure payment of the cash purchase price to the shareholders at the expiry of the bid. If an acquirer is offering securities as consideration, the takeover bid circular must include prospectus-level disclosure regarding the acquirer.
- *Process:* A takeover bid can be commenced by mailing a takeover bid circular and offer containing the information prescribed by Canadian securities laws to the shareholders, or, in the case of an unsolicited bid, by placing an advertisement in a newspaper. The bid is required to remain open for acceptance for at least 105 days (but can be shortened to a minimum of 35 days in a friendly deal). Under Canadian securities laws, an acquirer cannot take up shares under the bid unless and until more than 50% of the outstanding shares held by independent shareholders have been deposited and, even then, the bidder must extend the bid for an additional 10 days.
- *Post-Bid:* If 90% or more shares are tendered to the bid and taken up by the acquirer, Canadian corporate law allows the acquirer to compulsorily acquire the remaining shares at the same price paid under the bid (subject to shareholders' dissent right to go to court to determine the "fair value" of their shares) by sending a notice to the non-tendering shareholders. If less than 90% but more than 66⅔% of the shares are tendered to the bid, the acquirer may proceed to a second-step statutory amalgamation or arrangement transaction, whereby the remaining shareholders are squeezed out for the same consideration as in the bid (subject again to a dissent right).

Sample acquisition timelines for both a friendly and an unsolicited takeover of a public company in Canada are attached as Appendix A.

Arrangement or Amalgamation

A plan of arrangement is a flexible statutory procedure that can include steps such as the acquisition of shares and other securities of the target company by the acquirer. A plan of arrangement is very common in negotiated M&A deals in Canada due to the flexibility of the structure. An amalgamation is a statutory combination or "merger" of two or more corporate entities. In an acquisition of a Canadian public company by way of amalgamation, a special purpose company formed by the acquirer amalgamates with the target company, and the shareholders of the target receive the acquisition consideration. Arrangements and amalgamations require approval by the shareholders of the target company (typically 66⅔% for an arrangement or amalgamation). In addition, an arrangement requires court approval.

Some additional key features of the arrangement / amalgamation process include the following:

- *Consideration:* As in takeover bids, an acquirer of a Canadian company by plan of arrangement or amalgamation can pay with cash, securities or a combination. Unlike the rules governing takeover bids, there is no "fully financed" rule; nor is there a specific prohibition on offering different consideration or providing different treatment to different shareholders.
- *Process:* Plans of arrangement and amalgamations can generally only be undertaken on a friendly basis. To implement a plan of arrangement, a target company applies to the court for a procedural order to set the level of shareholder approval for the transaction (usually 66⅔% of the votes cast at the shareholders' meeting) and the procedures for the shareholders' meeting, and then mails an information circular to its shareholders and holds a meeting to approve the transaction. The target then returns to court for a ruling on the fairness of the transaction. For an amalgamation, there is a similar shareholder meeting process, but not need to obtain court approval.
- *Flexibility:* Plans of arrangement provide parties with an enhanced level of flexibility, because stock options and other convertible securities can be dealt with and tax planning or reorganization steps implemented in the arrangement steps as part of the transaction. From a practical perspective, arrangements and amalgamations can be preferable over bids as they can be completed in one step, and lower the threshold of acceptance for acquisition in scenarios in which an acquirer is seeking to acquire 100% of a target company. However, the element of court approval in arrangements and the court hearing on the fairness of the transaction can provide some risk of execution.

Sample acquisition timelines for both a plan of arrangement and an amalgamation involving a public company in Canada are attached as Appendix B.

FOREIGN INVESTMENT CONSIDERATIONS

Any non-Canadian who proposes to establish a new business or acquire an existing business in Canada should be aware of the provisions of the federal *Investment Canada Act* (ICA). The purpose of the ICA is to provide for the review of significant investments in Canada by non-Canadians in a manner that encourages investment, economic growth and employment opportunities in Canada. The Investment Review Division (IRD), which is part of Innovation, Science and Economic Development Canada, is responsible for administering the ICA and for promoting and reviewing significant non-cultural investments in Canada by non-Canadians. Investments in cultural businesses are reviewed under the ICA by the Department of Canadian Heritage.

In general, any acquisition by a non-Canadian of control of a business carried on in Canada will be either notifiable or reviewable under the ICA. Whether such an acquisition is notifiable or reviewable will depend on the value of the assets of the Canadian business being acquired. The ICA applies even if the business is not currently controlled by Canadians. It also applies where a Canadian business is acquired indirectly through the acquisition of a foreign corporation with a Canadian subsidiary.

Notification, when required, may be made either prior to closing or within 30 days of closing and involves the filing of only very basic information concerning the investor and the acquired business. Notification does not represent an impediment to an acquisition.

However, if an acquisition is subject to review under the ICA, it may not be completed unless the Minister of Innovation, Science and Economic Development or, in the case of an acquisition of a "cultural business," the Minister of Canadian Heritage is satisfied that the acquisition is likely to be of "net benefit to Canada."

Investments to establish new Canadian businesses are always subject to notification. In certain limited circumstances, an investment to establish a new cultural business may also be subject to review.

In addition to the general requirements for notification or review, the ICA also contains broad provisions allowing the federal government to review any acquisition on national security grounds.

COMPETITION LAW CONSIDERATIONS

Like many other countries, Canada has a complex set of competition laws. These laws, among other things

- prohibit cartel behaviour;
- prohibit abuses of a dominant position;
- regulate mergers and acquisitions; and
- otherwise govern the conduct of businesses in their relationships with competitors, customers and suppliers.

Canada's competition laws are contained in a single federal statute called the *Competition Act* (CA). In contrast to jurisdictions such as the United States, Canada does not have provincial competition laws, although several provinces have fair business practice laws directed primarily toward consumer protection. With the exception of activities that are specifically exempted or actively regulated, all business activities in Canada are subject to the CA.

The CA also establishes a comprehensive framework for reviewing and controlling mergers and acquisitions in Canada. In addition, transactions that exceed certain financial thresholds and, in the case of share acquisitions, that exceed an additional voting interest threshold, may be subject to pre-merger notification requirements and corresponding waiting periods under the CA. The CA applies to all mergers in Canada, while the ICA (discussed above) targets the acquisition by non-Canadians of existing Canadian businesses and the establishment of new Canadian businesses by non-Canadians.

TAX CONSIDERATIONS

As with most other jurisdictions, tax considerations are paramount both in structuring the set-up of a new business and in the sale of public and private companies in Canada.

Income tax is imposed in Canada by the federal government and by the provincial and territorial governments. The federal government levies income tax under the *Income Tax Act* (the Tax Act). It covers federal income tax for individuals and other taxpayers, including corporations, whether resident in Canada or non-resident. A partnership is generally a flow-through entity for Canadian tax purposes and not itself a taxable entity (unless deemed to be a "specified investment flow-through" (SIFT) partnership). The Tax Act is administered by the Canada Revenue Agency (CRA).

Each provincial and territorial government also levies income tax computed on a similar basis as federal income tax, at different rates.

At a general, and very high level, Canada also imposes the following:

- *Goods and services tax:* Goods and services tax (GST or HST) is imposed on the consumption or use in Canada of most tangible or intangible property and the supply of services, subject to the availability of input tax credits and the supply of certain property or services that are exempt.

- *Other commodity taxes:* For businesses bringing goods into Canada or manufacturing and selling goods in Canada, certain other taxes and duties may be imposed. Most products imported into Canada are subject to two types of commodity taxes, in addition to GST or HST – namely, customs duties and provincial sales tax; additional excise duties may also apply on certain products.
- *Land transfer tax:* Under provincial laws, tax is imposed on the transfer of real property (including with respect to certain leasehold interests). For example, Ontario acquirers of real property are generally liable for land transfer tax at a rate of up to 2.5% of the consideration paid. Other provinces also levy land transfer taxes.
- *Municipal tax:* In the case of real property owners, municipal property taxes and levies may also apply, generally based on the assessed value of the property. Tax rates vary from one province/territory to another.

As tax considerations are complex, the above is only a very high-level overview and should not be construed or relied on as legal or tax advice. In all cases, when selling a business, specific tax advice should be sought to ensure the best structure and a review of all relevant considerations is undertaken.

Appendix A

SAMPLE TAKEOVER BID TIMELINES

Takeover Bid Timeline: Unsolicited

Prepare Takeover Bid Circular	D - 1 to 3 weeks
Announce Transaction – Commence Offer by Advertisement and Request Shareholder List	D
Target Must Provide Shareholder List	D + 10 days
Mail Takeover Bid Circular to Shareholders	D + 12 days
Target to Mail Directors' Circular	D + 15 days
Take Up Shares and Publish Notice of Extension	D + 105 days (earliest date unless Target Board reduces deposit period or enters into a competing transaction)
Pay for Shares Taken Up	D + 108 days (maximum of 3 business days after takeup)
Expiration of Mandatory 10-Day Extension if Conditions Satisfied	D + 115 days
Pay for Shares Deposited During Extension Period	D + 118 days
Commence Squeeze-Out Procedures if over 90% OR Commence Second-Step Going-Private Transaction if below (see Amalgamation Timeline)	

Takeover Bid Timeline: Friendly

Sign Support Agreement and Announce Transaction	D
Prepare Takeover Bid Circular and Directors' Circular Recommending Shareholders Tender	D + 1 to 3 weeks
Mail Takeover Bid Circular and Directors' Circular to Shareholders	D + 12 days
Take Up Shares and Publish Notice of Extension	D + 47 days (assumes target board reduces deposit period)
Pay for Shares Taken Up	D + 50 days (maximum of 3 business days after takeup)
Expiration of Mandatory 10-Day Extension if Conditions Satisfied	D + 57 days
Pay for Shares Deposited During Extension Period	D + 60 days
Commence Squeeze-Out Procedures if over 90% OR Commence Second-Step Going- Private Transaction if below (see Amalgamation Timeline	

Appendix B

SAMPLE STATUTORY ARRANGEMENT AND AMALGAMATION TIMELINES

Plan of Arrangement Timeline

Sign Arrangement Agreement and Announce Transaction	D
Prepare Proxy Circular	D + 1 to 3 weeks
Obtain Interim Court Approval	D + 33 days
Mail Proxy Circular to Shareholders	D + 34 days
Shareholder Meeting and Vote Obtain	D + 64 days
Final Court Approval File Articles of	D + 67 days
Arrangement	D + 68 days

Amalgamation Timeline

Sign Merger Agreement and Announce Transaction	D
Prepare Proxy Circular	D + 1 to 3 weeks
Mail Proxy Circular to Shareholders	D + 24 days
Shareholder Meeting and Vote	D + 54 days
File Articles of Amalgamation	D + 55 days

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