



SETTING UP SHOP IN CANADA

What U.S. Retailers Need to Know

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As consumer spending in their domestic market tightens, a number of U.S. retailers are looking to Canada for expansion and acquisition opportunities. Generally less saturated than its U.S. counterpart, the Canadian retail sector has benefited from bullish consumer sentiment following several years of robust economic growth that has only recently begun to slow. The perception that the Canadian market—which is slightly smaller than California’s in terms of population and GDP—offers room to grow, has led to Canadian rollouts in recent years by such significant U.S. retailers as Best Buy, Whole Foods, Lowe’s Home Improvement Centers, and Lord & Taylor, whose parent company acquired Canada’s 338-year-old Hudson’s Bay Company department store chain in mid-2008.

Among the attractions of Canadian expansion for management of U.S. retailers is the cultural and geographical fit between the two countries. Similarly, their legal counsel—both internal and external—will find themselves dealing with what appears to be a comfortably familiar legal landscape. While that first impression is largely correct, it is usually the case that the devil is in the details, and

there is enough that is distinctive about Canada’s legal and business cultures to make it wise to involve Canadian legal, tax, and accounting advisors at an early stage in order to avoid potential stumbling blocks.

The precise issues that arise will vary according to the nature and scope of investment (e.g., acquisition vs. greenfield expansion), the particular retail sector involved, and even the region or regions of Canada into which expansion is contemplated. However, in the authors’ experience, the legal issues most frequently encountered by U.S. retailers expanding into Canada are typically the products of (1) the particular characteristics of Canadian foreign investment and antitrust laws; (2) distinctive employment, consumer protection, privacy, and packaging regimes; and (3) French-language requirements relating, among other things, to labeling and advertising.

Foreign Investment/Antitrust Review

It is no coincidence that the recent period of growth in U.S. retail investment in Canada dates approximately from the signing of the Canada-U.S. Free Trade Agreement (FTA) in 1988, which was largely subsumed in 1994 into the trilateral (U.S.-Canada-Mexico) North American Free Trade Agreement (NAFTA). The FTA and NAFTA marked the end of the moderately protectionist economic policies that had dominated Canada during the postwar

period and that included nationalistic regulations giving the Canadian federal government extensive powers of review over proposed foreign investments.

This shift toward trade liberalization opened the U.S.-Canada border to increased levels of trade and investment, further augmenting what remains—at a volume of US\$1.5 billion per day—the world’s largest bilateral trading relationship. For the retail sector, the result was not only the arrival in Canada of U.S.-based retailers such as the chains mentioned above, but an expansion of Canadian investment in the United States—e.g., Jean Coutu Group Inc.’s purchase of the Brooks and Eckerd drugstore chains in 1994 and 2004, respectively, and the acquisition of Circle K Corporation by Alimentation Couche-Tard Inc. in 2003. Nevertheless, the most visible cross-border retail investment has been predominantly from the United States into Canada.

In spite of the historic cultural and political shift in favor of trade liberalization, however, significant foreign investment rules continue to apply to U.S. and other foreign investments in Canada, particularly where a firm plans to expand through the acquisition of an existing Canadian business. In most such cases, the Canadian authorities will review the transaction where the asset value of the Canadian business being directly acquired (rather than indirectly through the acquisition

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of a U.S. parent company) exceeds an annually adjusted threshold that currently stands at C\$295 million. (As of December 10, 2008, the Canadian dollar traded at approximately US\$0.80.)

The foreign investment authorities generally take between 45 and 75 days from the time a reviewable application is made to decide whether the proposed investment would constitute a net benefit to Canada, which is the statutory test under the Investment Canada Act.

It should be noted that a considerably lower threshold applies to acquisitions in a small number of sensitive sectors, including cultural businesses. A “cultural business” is defined to include a number of sectors, including those that publish, distribute, or sell books, magazines, newspapers, music, audio, film, and video or music-video recordings, as well as broadcasting. In such cases, the notification threshold is either C\$5 million (in the case of a direct acquisition) or C\$50 million (in the case of an indirect acquisition). While this might not seem especially significant for most retailers, it is important to be prepared for an unexpected classification as a cultural business. For example, where the target is a general merchandiser, even a relatively small in-store display of magazines or DVDs would bring it within the cultural business category. That is, there is no minimal cultural threshold.

Expansion into Canada—particularly through acquisition—also can raise notification requirements under Canadian competition (antitrust) law that may affect the timing of the completion of a transaction. Analogous to the Hart-Scott-Rodino Act, Canada’s federal Competition Act sets out financial (size-of-transaction and size-of-parties) thresholds that trigger a premerger notification filing requirement. Specifically, premerger notification is required where both of the following conditions are satisfied: (1) the proposed transaction involves the acquisition of assets in Canada that either have a book value greater than C\$50 million or generate revenues from sales in or from Canada greater than C\$50

million and (2) the parties to the proposed merger, including affiliates, collectively exceed C\$400 million in size (defined in terms of either assets or revenues from sales in, from, or into Canada). Furthermore, Canada’s anti-trust body, the Canadian Competition Bureau, may challenge a transaction where it is believed to raise substantive competition issues, regardless of whether it is subject to premerger notification. When a premerger notification filing requirement is triggered, a statutory waiting period commences. This is either 14 or 42 days depending on whether the parties submit a short- or long-form filing.

In the retail sector, potential anti-trust delays to closing are typically a minor concern, given the multiplicity of competitors in most retail categories. However, where significant retail players are involved, and it appears that there are no significant antitrust issues in a transaction that are notifiable, an acquirer wishing to minimize possible delays will often find it advantageous to apply for an Advance Ruling Certificate (ARC) with a view to expediting the process. An ARC will be issued only in the clearest of circumstances where the Commissioner of Competition is of the view that a transaction will not or will not be likely to substantially lessen or prevent competition in any relevant market. However, even if an ARC is not granted, the Commissioner may alternatively issue a No Action letter. This generally allows the parties to close the transaction without delay, although the Commissioner in this case will reserve the right to challenge the transaction for three years after closing. To the authors’ knowledge, however, no such challenge has ever occurred pursuant to an unqualified No Action letter.

Real Estate Acquisition and Leasing

In contrast with those retailers who intend to enter Canada by way of an acquisition, “greenfield” entrants—particularly those that operate through stand-alone locations—may find that many of their practical and legal challenges lie in the area of real estate

assembly and zoning approvals. In Canada, like the United States, such matters are largely regulated by local municipal governments. In the case of large-format merchandisers, Canadian counsel with expertise in land use issues will be able to advise about the likelihood of local objections to big box developments as well as municipal development priorities that might make one potential location more acceptable to planning authorities than another.

Depending on the Canadian province in which they take place, acquisitions of real property will often attract a land transfer or recording tax. While some Canadian jurisdictions formerly imposed restrictions on the sale of real property to non-Canadians, these have been repealed in nearly all cases.

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However, U.S. retailers planning to lease shopping mall or power center locations may find that the relatively small commercial retail real estate market in Canada affords them fewer options than they are accustomed to—a difference that is reflected in the correspondingly greater leverage that is often exercised by Canadian commercial landlords.

For the most part, laws relating to real estate acquisition, leasing, and development are similar in most Canadian provinces. While there are minor differences in detail from U.S. real property law, the concepts and terminology used in Canada will generally be familiar to U.S. counsel. The lone (but very important) exception to this is the province of Quebec, which is a civil code jurisdiction with a property law regime that is conceptually similar to those found in continental Europe (as opposed to the common law model followed in England,

the United States, and elsewhere in Canada). Retailers whose Canadian expansion plans include Quebec—the second largest Canadian market—will find that experienced Quebec-based counsel are able to bridge the practical and conceptual gaps between the two systems.

Regulatory Authority of the Provinces

Differences in provincial laws are significant in a number of areas beyond property law. In fact, one of the aspects of doing business in Canada that tends to surprise U.S. companies and their counsel is the relatively large degree of authority accorded under Canada's federal constitution to provincial governments. This is perhaps most notably the case in the area of securities regulation, in which the federal government plays almost no part. However, the provinces also dominate several areas of law that are more directly relevant to a retail expansion, including environmental, privacy, consumer protection, employment standards, and labor law. Practically speaking, the result is that in executing a nationwide retail expansion plan, it will often be necessary to ensure compliance with a multiplicity of provincial laws and regulations. Because these are often similar or identical, the hurdles involved are generally easy to surmount, but it is important to be fully informed of any significant regulatory differences among the jurisdictions into which a retailer is proposing to expand.

Laws relating to the use of the French language are an example of the interplay between federal and provincial jurisdictions in Canada. French and English are the official languages of Canada, and federal legislation establishes certain minimum requirements for bilingual consumer product labeling that are applicable across the country. However, the province of Quebec imposes additional requirements relating, among other things, to labeling, signage, and advertising within that province. Thus, for example, a retailer intending to enter the Quebec marketplace will need to ensure that

KNOW YOUR CANADIAN TERMS

Advance Ruling Certificate (ARC). The highest form of premerger clearance that can be obtained from the Commissioner of Competition (see below). See also No Action Letter, below.

Commissioner of Competition. The head of the Canadian Competition Bureau, the federal competition law (antitrust) authority.

Criminal Code. Canada's comprehensive criminal offenses statute. The Criminal Code includes offenses relating to "games of chance" that affect the structuring of retail promotional contests. Canadian criminal law falls into the federal jurisdiction and is therefore uniform across the country.

Cultural Business. A classification under Canada's foreign investment review laws that, if applicable to the target of a potential acquisition, substantially lowers the statutory monetary thresholds that trigger a foreign investment review. Businesses in this category include those that distribute or sell books, magazines, newspapers, music, audio, film, and video or music-video recordings, as well as broadcasting. There is no minimum threshold of activity required to be classified as a cultural business.

Goods and Services Tax (GST). Canada's 5 percent federal value-added tax, which is levied on most consumer goods and services. Several of Canada's provinces have integrated their Provincial Sales Taxes (see below) with the GST to form a single 13 percent value-added tax known in those provinces as the Harmonized Sales Tax (HST).

Greenfield Expansion. In this context, a term applying to the expansion of a business enterprise into a new territory by means of the development from the ground up of the business by the establishment of new locations in that territory, rather than by purchasing an existing business (or real estate portfolio) in that territory and integrating it into the acquirer's business.

No Action Letter. Where an Advance Ruling Certificate (see above) is refused, the Commissioner of Competition will often be willing to issue a No Action Letter, which allows parties to close without delay while reserving to the Commissioner the right to challenge the transaction for three years after closing. Transactions regularly close on the basis of this clearance.

Provincial Sales Tax (PST). A tax levied on the sale of goods by the government of any of Canada's 10 provinces. Some of these provincial taxes are similar to U.S. state taxes, while others generally mirror the federal Goods and Services Tax. PST rates vary from 5 percent to 10.5 percent depending on the province, with the exception of Alberta, which does not have a PST. The range of goods to which the PST applies differs from province to province. As noted above with respect to the GST, several provinces have integrated their PST with the GST to create a single 13 percent value-added tax, the Harmonized Sales Tax (HST), revenues from which are divided between the federal and provincial governments.

advertising and promotional materials distributed in that province comply with its French-language requirements. Although French-language materials are generally not legally required outside Quebec (except for the minimum federal labeling requirements, as already noted), sensitivity to local

communities may make it advisable to provide bilingual signage and services in other regions with significant French-speaking populations, such as the province of New Brunswick and eastern and northern Ontario. Consequently, as a practical matter, almost all consumer packaging and

labeling in Canada is fully bilingual.

Consumer protection legislation in Canada also lies primarily within the provincial jurisdiction, although the regulation of advertising and promotions falls partly under federal law. U.S. retailers should be aware, for example, that promotional contests that award prizes must comply with provisions of Canada's federal Criminal Code that strictly regulate games of chance. Accordingly, retailers must require winners of such contests to answer a skill-testing question, typically a relatively simple arithmetic problem, in order to claim their prize. Because these provisions target the sale of opportunities to enter a contest, it is also the prevailing practice in Canada (similar to the United States) to specify that "no purchase is necessary" in order to enter a promotional contest. At the provincial level, consumer protection laws regulate sales to consumers, establish mandatory disclosure requirements for certain types of consumer agreements, and limit the retailer's ability to exclude statutorily implied warranties. More recently, there has been a movement in some provinces to regulate gift cards, notably by prohibiting expiration dates and capping associated fees.

Aspects of Canadian Employment Law

As the above examples show, the general similarity of the Canadian and U.S. legal landscapes can obscure some substantial differences of detail. For retailers, employment and labor law can sometimes be the most significant instance of this. Legislation in most Canadian provinces tends to be more favorable to trade unions than is typically the case under U.S. federal and state law. While overall only about 14 percent of Canadian retail jobs are unionized, there is a considerable tradition of unionization in some sectors, notably supermarkets. Several unionization drives have targeted the Canadian division of Wal-Mart, although to date these have met with only very limited success. Even for the majority of retail employees who are not unionized, however, provincial employment standards legislation

often provides protections exceeding those found in most U.S. jurisdictions. For example, entitlement to vacation time (or pay in lieu) tends to be more firmly established in Canada and the exemptions from overtime entitlements are more narrowly drawn. Random employee drug testing is permissible only in exceptional circumstances, while preemployment drug testing is permitted only in some jurisdictions and even then only with respect to safety-sensitive positions. Dismissal of employees in Canada also can be more costly than in the United States because

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at-will employment is not recognized in Canadian law—meaning that adequate notice (or pay in lieu) is required where employment is terminated without cause. Finally, because Canada has a publicly funded health-care system, the provision of health-care benefits is not as significant an issue for employers in Canada as it is in the United States, although employer-sponsored extended health, dental, and drug plans are not uncommon.

Impact of Privacy Law Developments

As in the United States, privacy law is rapidly developing into a major concern for Canadian retailers. Recent incidents involving the theft of consumer credit card information have aroused considerable public concern on both sides of the U.S.-Canadian border. In Canada, privacy matters are generally dealt with by both federal and provincial agencies. While recognizing that it may be impossible to prevent every conceivable breach of customer privacy, Canadian privacy legislation establishes significant procedural benchmarks for retailers and other businesses in connection with the collection, storage, and use of the personal information of

customers and employees, including the appointment of a compliance officer and the development of a responsive complaints process.

The practical impact of Canadian privacy legislation includes, among other things, the discontinuation of the formerly common practice of recording and storing customer driver's license numbers as part of a check acceptance or product return procedure. In addition, U.S. retail businesses expanding into Canada also should be aware of negative publicity that has occasionally arisen in the media with respect to the storage of Canadian customer data in the United States, primarily because of public concerns about the susceptibility of such data to examination or seizure under the USA PATRIOT Act. More generally, U.S. businesses operating in Canada must be mindful of the impact of privacy laws in relation to the cost and time of developing compliant IT systems and protocols.

IP, Immigration, and Taxation Issues

Safeguarding intellectual property is an essential goal for most retailers, most notably with respect to trademarks and Internet domain names. In the latter case, it is particularly important to act early, prior to any public announcement of an intention to expand into Canada, before squatters have a chance to reserve the domain name with the intention of reselling it to the new entrant. In the case of trademarks, it will be necessary to allow sufficient lead time to deal with any conflicts in Canada. Because Canada's intellectual property laws fall within the federal jurisdiction, it is uniform across the country.

Immigration issues also should be considered in the course of planning a retail expansion into Canada, particularly during the exploration and set-up phases. U.S. retailers often decide to send some of their employees to Canada, either on a temporary or a fixed-term basis. In order to avoid delays and complications, it is important to ensure that the arrangements are properly structured so that any requisite visas or work permits are applied for and obtained in advance.

Canadian federal and provincial tax legislation will inevitably be relevant to any U.S. business entering the Canadian market. In the case of retail businesses, retail sales tax requirements will be particularly relevant. In Canada, a 5 percent national value-added tax known as the Goods and Services Tax (GST) is levied on the vast majority of goods that would typically be sold in a nongrocery retail setting. The GST is in addition to provincial sales taxes (PST) that range from 5 percent to 10.5 percent, depending on the province (other than Alberta, which has no sales tax). The GST and PST do not necessarily apply to identical ranges of products, although several provinces have moved to harmonize the two taxes. Unlike the United States, however, there are no city or county-level sales taxes in Canada.

Because customs duties also may be payable on goods imported by the retailer into Canada, it is important to establish the relevant rates, if any, on any stock that the retailer would intend to import into Canada, as in some cases these could affect the retailer's price structure. However, the various free trade agreements into which Canada has entered have substantially reduced or eliminated many of the traditional tariff impediments to the free cross-border flow of goods between Canada and a number of other countries, including the United States.

Conclusion

In addition to addressing these specific legal concerns, seeking the assistance of experienced Canadian advisors

at an early stage can help to avoid the cultural and political stumbling blocks that present themselves from time to time to new entrants in any market. Because of the significance of provincial regulation as discussed above, and particularly the distinct legal character of the province of Quebec, legal counsel with national platforms in Canada will be especially useful in facilitating a well-planned and coordinated Canadian expansion. The past and continued success of U.S. retailers in the Canadian marketplace confirms that a carefully planned and executed expansion strategy is well worth the investment.