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North American Free Trade & Investment Report

Biweekly report on legal & financial issues affecting direct investment and cross-border trade in Mexico, the U.S., and Canada

NAFTA Export Planning

Trading on Borrowed Time
How Not Solving the U.S.-Mexico Trucking Problem Could Crash NAFTA

By Bryan A. Elwood
(Curtis, Mallet-Prevost, Colt & Mosle LLP)

Of all the trade disputes between the United States and Mexico since the North American Free Trade Agreement ("NAFTA") took effect, the most serious is the trucking dispute. The problem—by which the United States blocks all access into its territory to Mexican trucks—has gone on for so long and affects so much of the region's trade that North America currently cannot be considered a "free-trade area" as this term

See ***Borrowed Time****, page 6*

Canada: M&A

Deal Postcard from Canada: Wish You Were Here!

By Richard Steinberg, Tony Baldanza, Dan Batista and Mark Magro
(Fasken Martineau)

Canada fared better than most in the recent global economic recession. Still the M&A market slowed and recently the much-anticipated bounce back remains subdued. *National Post*, a major Canadian daily newspaper, reported:

"Canada's mergers and acquisitions market in its second quarter is better off than it was last year, but the pace has slowed since the beginning of 2010 as companies become more and more cautious in an uncertain global economic environment." [July 14, 2010]

See ***M&A****, page 9*

HIGHLIGHTS

Vol. 20, No. 15
August 15, 2010

NOTE TO READERS:

Only one issue is published in August. We will resume our twice monthly schedule with the September 15, 2010 issue.

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North American Free Trade & Investment Report is published biweekly (once in August and December) by WorldTrade Executive, a part of Thomson Reuters, P.O. Box 761, Concord, MA 01742 USA. Tel: (978) 287-0301; Fax: (978) 287-0302; E-Mail: info@wtexec.com; Website: http://wtexecutive.com. Subscription rate is $794 per year U.S./$844 per year non-U.S.
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UNITED STATES

Customs

CBP Identifies Most Common Reasons for Outbound Detentions and Seizures

By David Hardin and Daniel Wendt
(Miller & Chevalier Chartered)

On June 10, 2010, U.S. Customs and Border Protection ("CBP") held a webinar focusing on CBP's front-line enforcement of U.S. export controls rules and regulations. [1]

Although much of the webinar covered basic information familiar to the seasoned exporter, even the most sophisticated exporters may be interested in the common reasons identified in the presentation for outbound detention and seizures (as quoted directly from the presentation):

- The absence or late filing of the Electronic Export Information in the Automated Export System (AES). Late filing of AES commodity data subjects the shipment to seizure. CBP has found that many times the USPPI has submitted the information to a third party for completion of the AES transmission. The third party, in turn, "batches" the transactions and they are filed on a daily basis. This process causes the AES filing to be either not in the system or late.
- If the commodity has been declared as under $2500 and invoicing or other documents show that it clearly is over $2500, the cargo is subject to seizure.
- Exporters who fraudulently declare cargo as under $2500 in order to avoid completing AES filing will be referred to fraud investigators for criminal prosecution.
- Claiming an ITAR exemption rather than getting a Department of State License.
- Failure to file AES on USML goods.
- Failing to obtain DSP-61 licenses for USML in-transit movements through the U.S.
- Paperwork for a licensed commodity is not transmitted within the correct time frame and the commodity is at the dock.
- Failure to claim a license or license exemption.
- Parties to the movement of the cargo not listed on the license.
- Indicating a license on the EEI that has nothing to do with the shipment.
- For licensable cargo, using a forwarder that is not an approved freight forwarder.
- Exporters using the ITAR exemptions in situations where they do not apply.
- Using the AES Canadian exemption on CCL/USML exports.
- Failing the submit AES filing on DSP 61/ 73 exports. Failing to submit ECCN # on AES submissions.

License exemptions also continue to be a focus of CBP, with four out of the 16 reasons identifying exemptions as a basis for detention and seizure.

- Submitting the wrong mode of transportation.

To be sure, many of these reasons are not new. But it is certainly worth reminding ourselves of several overarching themes. First, defense articles controlled under the ITAR continue to be a focus of CBP, for obvious reasons. Five of the 16 reasons above relate solely to ITAR-related issues. Thus, as for all controlled exports, exporters should continue to be mindful of the requirements for exporting defense articles.

Second, errors committed by or related to freight forwarders continue to be a reason for outbound detention and seizures, thereby reinforcing the need to select and monitor your forwarders carefully.

Finally, license exemptions also continue to be a focus of CBP, with four out of the 16 reasons identifying exemptions as a basis for detention and seizure. Although a few of the reasons suggest that mere use of an exemption may lead to detention and seizure, detention or seizure most likely requires at least an indication that an exemption is being used improperly. In any event, exporters should ensure that an exemption truly applies before citing it as a basis for a controlled export.

With all of this in mind, exporters should tailor their business processes, compliance programs, and export transactions to avoid the common reasons outlined above. Consider using the reasons as a checklist or as a supplement to your existing list. Although no single compliance measure will eliminate the risk of detention or seizure, an eye towards the above reasons is likely to reduce that risk.

1 A copy of the PowerPoint presentation can be found at http://www.millerchevalier.com/portalresource/Outbound_webinar.

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Trade

U.S. Congress Finally Passes a Miscellaneous Tariff Bill

By Richard Abbey, Jay Eizenstat and Saskia Fronabarger (Miller & Chevalier Chartered)

On August 11, 2010, President Obama signed H.R. 4380, the U.S. Manufacturing Enhancement Act of 2010 into law. Also referred to as the Miscellaneous Tariff Bill (MTB), the U.S. Senate -by unanimous consent and with the support of over 130 businesses and associations- passed the law on July 27, 2010, following passage in the U.S. House of Representatives on July 21, 2010.

Passage of the MTB had been widely supported in the U.S. business community and by major pro-business associations including the National Association of Manufacturers, the U.S. Chamber of Commerce and the Business Roundtable.

The previous MTB (P.L. 109-280 and P.L. 109-482) expired on December 31, 2009. Until recently, the Congressional Republican leadership successfully blocked Democrats' efforts to reauthorize the expired MTB bill -- which included products that had been vetted by the House, Senate and ITC -- by asserting that the duty suspensions were "earmarks". In the end, pressure from the U.S. business community helped to spur over 100 House Republicans to support the reauthorization of the MTB which assured its passage in the House by a large bipartisan margin (378-43).

The MTB aims to protect and create American jobs and cut the cost of doing business in the U.S. manufacturing industry by suspending duties on imported products that are not available in the United States or where there is no domestic opposition. Specifically, the MTB eliminates the duties on a wide variety of products including, certain types of reusable grocery bags, automobile parts, digital camera lenses, fibers, yarns, chemicals, microwaves, plastic fittings, herbicides and other inputs used by U.S. manufacturers.

The MTB will become effective on the fifteenth day after its enactment and it expires on December 31, 2012. Section 3002(b) provides for retroactive application of its duty suspension provisions. As a result, an importer may request liquidation or reliquidation of any entry covered by the MTB made between January 1, 2010 and the fifteenth day after its enactment for which there would have been no duty or a reduced duty if the MTB applied at the time of entry. Importers must request such liquidation or reliquidation from U.S. Customs and Border Protection no later than 180 days after the enactment of the MTB and the U.S. must pay any amount owed to the importer without interest within 90 days of liquidation or reliquidation.

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Trade

Export Controls: Commodity Jurisdiction Requests

By Alan W. H. Gourley (Crowell & Moring)

While we await the President's promise to reform the export control system and specifically to address (and perhaps abandon) the outmoded "specifically designed for military use" criteria for determining commodity jurisdiction, the Department of State has taken a baby step to streamlining and making more transparent the current process.

On August 4, 2010, the Directorate of Defense Trade Controls ("DDTC") published (75 Fed. Reg. 46843) a final rule formally adopting the DS-4076 Commodity Jurisdiction ("CJ") Determination Request Form, revised from the earlier draft version available through D-TRADE. The new rule requires electronic submission of CJ requests (after a 30-day transition period). While the new form is similar to the earlier version, there are some differences that suggest DDTC is continuing its efforts to address more appropriately commercial products that may have been modestly modified for use in a military platform or system. Perhaps most importantly, the form (and introductory statement of the new rule) indicate that DDTC has decided to return to its mid-1990s practice of publishing some information about the CJ determination, including make and model number and ultimate disposition (withholding only that which is expressly identified as proprietary by the submitter).

Meanwhile, in an apparent reaction to reported instances where prosecution for unlicensed export of a defense article has been undermined because the exporter had obtained a commodity classification ("CCATS") from the Bureau of Industry and Security ("BIS") indicating that a particular product was covered by a specific Export Control Classification Number, BIS published an interim final rule (75 Fed. Reg. 45052 (August 2, 2010)) to add language to EAR § 748.3 clarifying that neither a CCATS nor an advisory opinion establishes, or can be relied upon to establish, that a particular product is "subject to the EAR." Moreover, BIS will include a similar cautionary statement on each CCATS it issues. While not directly advancing the President's goal of a single licensing system, it does serve to educate the uninformed and to defeat those who may have sought previously to game the commodity jurisdiction system.

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UNITED STATES/MEXICO

***Borrowed Time**, from page 1*

is defined by the World Trade Organization's ("WTO") rules. North America's failure to attain "free trade area" status eventually will lead to the suspension of NAFTA benefits. This article explains how the trucking dispute puts NAFTA in violation of WTO law and the reasons why, to keep NAFTA on a safe track, this problem needs to be resolved quickly.

How We Got Here

When NAFTA was signed in 1993 the parties envisioned that, after seven years of adjustments, trucks from both countries would be able to enter each other's territories and deliver their loads anywhere in North America. NAFTA Article 1202 specifically provides that each NAFTA country shall accord to transportation "service providers of another Party treatment no less favorable than that it accords, in like circumstances, to its own service providers". Article 1202 effectively requires all NAFTA governments to treat all North American trucking service companies the same.[1] Today, 17 years later, Mexican trucks cannot cross the U.S. border, much less deliver a load at their desired international destination. Instead, upon reaching the border, products must be moved to a different domestically approved truck, adding substantial cost and time to almost all U.S.-Mexico trade.[2]

The trucking dispute has gone on for far too long, to the point of jeopardizing NAFTA's status as a free-trade area under WTO rules.

The United States originally blocked Mexican trucks claiming that they were unsafe for U.S. roads. Mexico disagreed and retaliated by blocking U.S. trucks from entering Mexico. In 1995, soon after NAFTA took effect, Mexico requested consultations with the United States to resolve the issue but the consultations went nowhere. In September 1998, Mexico tried again, this time requesting the formation of a NAFTA Chapter Twenty Arbitral Panel to address the problem. In February of 2001, the Arbitral Panel unanimously determined "that the U.S. blanket refusal to review and consider for approval any Mexican-owned carrier applications for authority to provide cross-border trucking services was and remains a breach of the U.S. [NAFTA] obligations". The Panel recommended that the United States lift its restriction against Mexican trucks.

The Panel's decision was followed by civil litigation in the United States seeking to keep the border closed, an effort which ended unsuccessfully in 2004. It was not until 2007, however, that the United States took a first step to open its border and initiated a "pilot" program that allowed up to 100 Mexican trucking companies to provide services in the United States. Interestingly, during the program's brief period, Mexican trucks averaged equal or better safety rates than U.S. trucks.[3] Even though the program was successful, the U.S. Congress shut it down in early 2009 due to lack of funds. In March 2009, Mexico retaliated by imposing $2.4 billion in additional tariffs on U.S. products, but the measure, although damaging to some U.S. exporters, has had little effect on the border, which remains closed to all truck transportation services with no signs of it opening any time soon.

NAFTA: Not A Free Trade Area?

Signatories of the General Agreement on Tariffs and Trade ("GATT") (which later formed the WTO) first allowed for the existence of regional trading blocks or "free-trade areas" within GATT's trading system in the belief that said areas facilitate regional commerce, which in turn promote international trade. For this reason "free-trade areas", as defined by GATT, are exempt from Most-Favored-Nation ("MFN") treatment obligations. The exemption allows members in a regional trading block to offer each other exclusive advantages—such as preferential tariffs and rules of origin—that they otherwise would be required to offer to all GATT/WTO members.

GATT/WTO members, however, understood that the benefits of regional trade blocks on global commerce happen only if all or substantially all of the trade in the free-trade area is in fact free of any cross-border trade restrictions. Article XXIV of GATT specifically provides that regional free trade areas must *eliminate* all "duties and other restrictive regulations of commerce" on "*substantially all* trade" among its signatories.[4] WTO/GATT members generally have agreed that, to meet the "substantially all trade" criteria, at least 80% of trade has to be restriction-free,[5] and no major economic sector can be excluded.[6] Further, said elimination of restrictions must occur within a "reasonable length of time" which shall normally not exceed 10 years after the establishment of the free trade area.[7]

In NAFTA's case, because of the trucking dispute, more than 10 years have gone by and trucking restrictions remain a hefty burden to a substantial part of U.S.-Mexico trade. Quantitatively, over 65% of all U.S-Mexico trade is affected by trucking restrictions[8] which puts restriction-free trade far from being "substantially all trade", as required by Article XXIV of GATT. Furthermore, qualitatively, land transportation is a major economic sector because the service is essential to North American commerce and can raise the overall cost of doing trade. Placing a restriction on this sector is akin to levying a blanket import tax or duty. Whichever method is used—quantitative or qualitative—North America falls short of meeting its WTO requirement of being fundamentally restriction-free after 10 years of NAFTA.

What Can Happen If We Stay On This Road

The seriousness of the trucking dispute lies on the fact that, unlike other NAFTA disputes that have focused predominantly on industry issues, this dispute encroaches on the very essence of what a free-trade area must be, according to the WTO. The failure to fix the problems for so many years with no end in sight makes it difficult to argue that NAFTA is—or at a minimum will be in the near term—a legitimate free-trade area as NAFTA members first assured the WTO.

The longer the situation prevails, the more vulnerable to attack NAFTA becomes. At this point, any foreign nation could bring NAFTA's failure to attain a "free-trade area" status to the WTO either in the form of a dispute against or involving NAFTA or its members, or during a WTO periodic trade policy review of Mexico, the United States or Canada. The threat of WTO action could be used by countries now less competitive in North America because of NAFTA. Central American nations, for instance, rejected by the United States in their effort to sign their own agreement, may use this opening to try to level the playing field with Mexico. Arguably, also, any WTO member nation concerned or affected by the unrestrained and unchecked growth of free-trade agreements could showcase NAFTA (presumably the largest free-trade area in the world) to put some limits on the current free-trade agreement frenzy the world is experiencing.

Should a dispute be brought at the WTO to address NAFTA's inability to reach "free-trade area" status, North American governments would need to tackle a complex public relations and political environment both at the WTO and within the region. Such a dispute also could lead potentially to a reduction in bilateral trade flows and investment, and to commercial litigation. Of course, if such a case was brought, the United States and Mexico could opt to lift their trucking restrictions and bring the agreement back into compliance, but the mere act of having to defend NAFTA in a WTO dispute procedure in a time of growing public resentment over free-trade policies no doubt would lead to a more difficult debate over the region's free-trade objectives and could open an exit door for any politically motivated government to leave the agreement.

What To Do?

Businesses that benefit from NAFTA should give special and active attention to the trucking problem. More pressure must be placed to open borders to trucks and free up trade. Removing the trucking restriction will reduce costs and speed up deliveries, making the region more competitive, which would benefit all, as NAFTA originally intended. Further, it is wrong for countries to have agreed to open borders only to discover after 17 years that this was never their express intention. The countries that promised free trade instead have engaged systematically in restricting the very means that allow trade to flow across their borders. NAFTA cannot deliver as promised until this problem is fixed.

The trucking dispute has gone on for far too long, to the point of jeopardizing NAFTA's status as a free-trade area under WTO rules. NAFTA-based businesses would do well in insisting that their governments take concrete action to make the agreement reach its full potential and its objective of at last establishing a legitimate free-trade area.

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1 The United States made an express reservation in NAFTA to suspend Interstate Commerce Commission approval to allow persons of Mexico to provide trucking services. The reservation expired in 1997 to allow trucking services in border states, and in 2000 to allow trucking services throughout the United States.

2 According to Katie Zaunbrecher of the Council on Hemispheric Affairs, "the cost associated with transferring cargo to U.S. trucks is estimated at US$739 million a year, a price born primarily by U.S. consumers. These additional costs are making it increasingly difficult for Mexican exports to remain competitive in the U.S. market". *See* U.S.-Mexico Trucking Dispute Rolls

On: Sixteen Years and Counting, Katie Zaunbrecher, *Council on Hemispheric Affairs*, http://www.coha.org/u-s-mexico-trucking-dispute-rolls-on-sixteen-years-and-counting/. Further, according to Cesar Castro—president of the National Council for the Exporting, Maquiladora and Manufacturing Industry—trucking companies today must "pay about 120$ per trailer for a transfer service that hauls cargo across the border. Delays compound those costs because shippers must drop the trailers on the Mexican side of the border, hook them up and deliver them to the U.S. side, where an American trucking company picks them up". Stephen Russel, Chief Executive Officer of Celadon Group Inc., an Indianapolis trucking company that operates in the U.S., Mexico and Canada, comments that "the delays can last as long as a day as the three trucks complete their maneuvering. The system puts North America at a disadvantage to the European Union, where trucks travel freely among member nations." Thomas Black, Carlos Manuel Rodriguez, GE, 3M Freight Costs May Rise After U.S. Bars Mexican Trucks, *Bloomberg*, http://www.bloomberg.com.

3 According to the Council on Hemispheric Affairs, "the Pilot progam was surprising in several respects. First it showed that the widely cited fears regarding highway safety were largely unfounded. A 2009 Congressional Research Service report declared that 'the safety of Mexican trucks … is now comparable with U.S. trucks,' thereby derailing the highway safety argument. The U.S. Department of Transportation Inspector General's 2009 report on the program also found that Mexican trucks were just as safe as U.S. vehicles". *See* U.S.-Mexico Trucking Dispute Rolls On: Sixteen Years and Counting, Katie Zaunbrecher, *Council on Hemispheric Affairs*, http://www.coha.org/u-s-mexico-trucking-dispute-rolls-on-sixteen-years-and-counting/.

4 Emphasis added. Article XXIV of GATT provides as follows: "A free trade area shall be understood to mean a group of two or more customs territories in which the duties and other restrictive regulations of commerce (except, where necessary those permitted under Articles XI, XII, XIII, XIV, XV and XX) are eliminated on substantially all the trade between the constituent territories in products originating in such territories." The Articles listed do not provide exceptions to allow the restrictions on transportation services currently being applied at the U.S.-Mexico border.

5 Analytical Index of the GATT, Co-published by the *World Trade Organization* and *Brennan Press*, 1995, Sixth Edition, p. 824, citing the Report of the Sub-group of the Committee on the European Economic Community at L/778, adopted on November 29, 1957, 6S/70, 99, ¶ 30.

6 *Ibid*., p. 825, citing the Report of the Working Party on the European Free Trade Area – Examination of the Stockholm Convention at L/1235, adopted on June 4, 1960, 9S/70, 83-85, ¶¶ 48-49, 51, 54.

7 Understanding on the Interpretation of Article XXIV of the General Agreement on Tariffs and Trade 1994, ¶ 3, provides that "'[t]he reasonable length of time' referred to in para. 5 (c) of Article XXIV [the 'interim agreement' period] should exceed 10 years only in exceptional cases."

8 Using data from the U.S. Bureau of Trade Statistics (BTS). *See* January 2010 Surface Trade with Canada and Mexico Rose 19.5 Percent from January 2009, http://www.bts.gov/press_releases/2010/bts016_10/html/bts016_10.html. Furthermore, it must be considered that this number could be higher if no restrictions on trucking were in place.

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CANADA

***M&A**, from page 1*

This caution likely stems from the global recession which has tempered foreign demand for certain Canadian businesses, including most notably Canadian natural resources companies.

Adding up the Numbers

In the first quarter of 2010, Crosbie & Company Inc.'s analysis of Canadian M&A activity reported a 14% decline compared to the previous quarter. Yet the 246 announced transactions (worth $19.7 billion) was a 40% increase over the first quarter of 2009.

Fast forward to the second quarter of 2010 and PricewaterhouseCoopers reported "a 15% increase in the number of announced Canadian M&A deals and a 26% increase in the aggregate value of announced deals" over the same period in 2009.

While many had hoped for a sharper bounce back, at least the trend line is pointing upward again. But PwC's forecast is less encouraging for Canada's third quarter results, which predicts that "the M&A recovery will be shallow and slow, dominated by well-capitalized corporations and large pension funds."

Hot Button Issues in Canada

For investors looking to profit from the rebound in Canadian M&A markets, it's worth paying attention to the current hot button issues. Armed with "home advantage" insights, investors can better decide how to spend their dollars north of the border.

M&A

Canada's M&A landscape is in the midst of a shake-up. Rules governing disclosure and the use of "poison pills" are being rewritten in regulatory hearings across the country. As in other jurisdictions, Canada is considering changing securities regulations with new controls on credit rating agencies and the possibility of a new national securities regulator.

Rights Plans

Another deal making recent headlines was the unsolicited take-over bid instigated by Carl Icahn for Vancouver-based Lions Gate Entertainment Corp. The deal gave market participants yet another in a series of recent opportunities to hear from Canadian securities regulators on the use of "poison pills" to block unsolicited or hostile take-over bids. Target companies have long used securityholder rights plans (known colloquially as "poison pills") as a tactical defensive response to hostile bids. Canadian regulators traditionally allowed this tactic to be used for a limited period of time and for the limited purpose of buying the target board of directors additional time to seek out value enhancing alternatives.

Armed with a little knowledge, smart investors may be able to benefit from Canada's general "open for business" approach to foreign investment.

But in a pair of recent decisions, securities regulators in Alberta and Ontario allowed target boards to effectively use poison pills to block hostile bids indefinitely.

In Lions Gate, the regulator in British Columbia once again reaffirmed the more traditional view that rights plans should not deprive shareholders of a choice indefinitely, noting the public interest in ensuring that *shareholders* ultimately can decide whether or not to tender into an unsolicited or hostile bid.

This schism among securities regulators in Canada has created confusion in the marketplace and highlights the need for a coherent approach to regulation.

Disclosure

One story in recent months attracting significant attention from investors, analysts and other commentators has been the proposed transaction involving Magna International Inc. and its founder, Frank Stronach, which was announced in May. The C$1.1 billion deal would eliminate Magna's dual class share structure. Originally approved by shareholders in 1978, the structure has allowed the Stronach family to control the auto-parts giant for more than 30 years. The proposed transaction is unique when compared to other Canadian transactions involving the collapse of a dual class share structure, with most attention being focused on the size of the proposed payment to eliminate the structure. Given the size of the proposed payment when compared to similar Canadian transactions, the Magna board was unable to make a recommendation to shareholders as to how they should vote notwithstanding the potential significant benefits that could arise as a result of the proposal.

Canada's M&A landscape is in the midst of a shake-up. Rules governing disclosure and the use of "poison pills" are being rewritten in regulatory hearings across the country.

Certain institutional investors have challenged the deal both in the press and in the courts, claiming the deal is too generous and taking issue with the fact that the board did not make a recommendation. Following proceedings before the Ontario Securities Commission (OSC) at which commission staff and the objecting investors challenged the proposal on a number of grounds, Magna was permitted to continue with the proposal and produced a sizeable amount of supplemental disclosure in response to the OSC's order to, in effect, place before shareholders substantially the same information that was before the board in light of the fact that the board had made no recommendation. After the initial vote was delayed due to the issuance of the supplemental disclosure, minority shareholders approved the proposal by a three-to-one majority at a meeting held in late July. Final approval now hinges on a fairness hearing before a court, which is being asked to approve the deal, in mid-August.

Our firm has been advising the Special Committee of Magna's Board of Directors in the transaction.

National Regulator

All of which has added an element of timeliness to the most recent attempt to breathe life into an old "initiative" creating a national securities law regulator in Canada. A government-appointed review panel called the current system (one regulator for each province and territory) "a domestic and international embarrassment for Canada."

Even though two provinces (Alberta and Québec) are currently opting out of the plans for a national regulator, a recent editorial in *The Globe & Mail*, a Canadian daily newspaper, likely echoes the views of many market participants: "a change from 13 Canadian securities commissions to only three would be a great improvement."

In the ongoing saga of where to locate the national headquarters, the quintessentially Canadian compromise seems to be to create a headless body with a "virtual" head office.

Credit Rating Agency Regulation

Another regulatory change afoot is Canada's decision to introduce securities regulatory oversight of credit rating organizations. Prompted by the asset-backed commercial paper (ABCP) crisis, which crippled the country's commercial credit market in 2007-08, Canada now seems to be adopting measures similar to those adopted recently by the USA and the EU, making the shift away from self-regulation as recommended by the International Monetary Fund in a report published last year.

Incidentally, our firm played a key role in advising the issuers in the ABCP crisis, which became Canada's largest and most complex restructuring deal.

Competition & Foreign Investment

In March 2009, Canada's minority Conservative government enacted significant amendments to both the *Competition Act* and *Investment Canada Act.* These significance changes to the law have not, so far, led to a radical shift in Canada's treatment of mergers in general or foreign investment in particular.

Competition

The *Competition Act* pre-merger notification regime was replaced in March 2009 with a notification regime similar to the regime in the U.S. In particular, during an initial 30-day waiting period, the Competition Bureau may issue a "supplementary information request" (SIR) that would trigger a second 30-day waiting period upon satisfaction of the SIR. The change was controversial, in large part because of concerns that it would lead to enormously expensive requests similar to the "second request" experience in the U.S. Yet, to date, the issuance of SIRs has not been particularly widespread. Also, the regime for advance ruling certificates (ARCs) and "no-action" letters remains intact.

The March 2009 amendments left unaltered the mechanism for determining whether a transaction is notifiable (i.e., both a size-of-parties and size-of-transaction threshold must be exceeded). However, the size-of-transaction threshold was increased to C$70 million, and thereafter will be adjusted annually based on a GDP-based index. (Nevertheless, the threshold amount was not changed for 2010.) The amendments also give the Commissioner only one year (as opposed to the previous three years) to challenge a transaction after it has closed.

Since the March 2009 amendments, the Competition Bureau has issued new merger-related guidelines, including guidelines on hostile transactions (June 2, 2010) and merger review process guidelines (September 18, 2009). Also, regulations under the *Competition Act* were updated to reflect the change from the short/long form regime to the single notification form regime (which essentially requires short form information, with some additional information requirements).

In 2010, the Competition Bureau continued its practice of cooperating with competition authorities in other jurisdictions in the review of international mergers and, where appropriate, relied on remedies agreed upon in such other jurisdictions to resolve competition concerns in Canada. Recent examples include the acquisition of MDS Inc.'s Analytical Technology business by Danaher Corporation and the acquisition of AH Marks Holding Limited by Nufarm Limited.

Foreign Investment

The Canadian government also amended the *Investment Canada Act* in March 2009. "Non-Canadian" investors acquiring either direct or indirect control of a Canadian business, or establishing a new Canadian business, remain subject to the *Investment Canada Act*. Direct acquisitions by "WTO investors" (i.e., those controlled by nationals of World Trade Organization member countries) are subject to review and approval (according to a "net benefit to Canada" test) where the gross book value of the assets of the Canadian business being acquired is C$299 million or more (this monetary threshold is subject to a GDP-based annual adjustment mechanism). An exception is where the Canadian business is engaged in "cultural activities," in which case the review threshold remains C$5 million. Acquisitions of Canadian transportation, uranium or financial services businesses are no longer subject to lower thresholds under the Act. Moreover, the already high WTO investor threshold will, once certain regulations are passed, change to a threshold based on "enterprise value." The initial threshold amount will be C$600 million and will rise in stages over a number of years to C$1 billion.

A further significant change that came into force with the March 2009 amendments was the establishment of a national security review regime. In a nutshell, the Governor in Council (in essence, the federal Cabinet), on the recommendation of the Minister of Industry, may order a review of an investment where the investment could be injurious to national security. Industry Canada appeared to first exercise this national security control in August 2009 when it sent an unsolicited letter to George Forrest International Afrique S.P.R.L. (GFI), advising that it was prohibited from acquiring Forsys Metals Corp. (a uranium mining company) pending further notice. GFI ultimately abandoned the deal.

With one exception, foreign investments subject to "net benefit to Canada" review under the *Investment Canada Act* are invariably permitted to proceed, usually subject to certain undertakings given by the investor. Indeed, the recent recessionary environment has arguably increased Canada's receptiveness to foreign investment. For example, earlier this year, despite vocal opposition by certain stakeholders, Amazon's proposal to open a Canadian distribution centre, considered to be a "cultural business," was approved by the Minster of Canadian Heritage, subject to certain reasonable commitments by Amazon regarding net benefit to Canada. One of the very few known formal rejections of an investment came in 2008, when the Minister of Industry rejected U.S.-based Alliant Techsystems Inc.'s bid to acquire the space and information systems business of Canada's MacDonald Dettwiler and Associates Ltd.

With respect to state-owned enterprises (SOE), the *Investment Canada Act* does not contain provisions specifically dealing with SOEs (or sovereign wealth funds). But the Canadian government issued SOE guidelines in December 2007, in recognition that investments by SOEs may pose unique challenges for the "net benefit to Canada" test in terms of, among other things, governance and commercial orientation. It is noteworthy that since the issuance of the SOE guidelines, there have been a number of investments in Canadian businesses by SOEs. Examples include the 2009 acquisition of Nova Chemicals by International Petroleum Investment Corporation (Abu Dhabi government) and the 2009 acquisition of a 60% share in Athabasca's Oil Sands Corporation's oil sands project by PetroChina Co.

As an ongoing development, the issue of *Investment Canada Act* undertakings is currently before the Federal Court of Canada. In July 2009, the Canadian government filed an application against U.S. Steel asking the Court to order remedies in respect of U.S. Steel's failure to satisfy certain undertakings provided to the government in connection with its acquisition of Stelco Inc. Subsequently, U.S. Steel challenged the constitutionality of certain provisions of the *Investment Canada Act* relating to the government's ability to enforce undertakings. In June

2010, the Federal Court dismissed U.S. Steel's constitutional challenge, although it may appeal that decision. The government's action against U.S. Steel is significant, as it represents the first court action under the applicable enforcement provisions of the *Investment Canada Act* to enforce undertakings by a foreign investor, including the remedy of divestiture, which one of the successful interveners has raised.

Looking Ahead

With many Canadians still stinging from the global economic meltdown of 2008 and the ensuing "great recession," Canada's M&A landscape offers hope for the future. Thanks to Canada's rich natural resources, investment dollars have continued to flow (though at more of a trickle) even during the global recession. And demand now seems to be increasing.

Anecdotally we can report that our M&A team is seeing positive signs of the market bouncing back and we anticipate an even busier second half for 2010. Particularly promising is the investment activity across a wide range of industries, from mining and forestry to business IT services and health care.

Canadians may be cautious by nature. But investors in the US looking for positive returns might consider looking for opportunities north of the border. Armed with a little knowledge, smart investors may be able to benefit from Canada's general "open for business" approach to foreign investment.

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MEXICO

Taxation

Tax Simplification in Mexico

By Ignacio Sosa and Luis Beristain
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For the last several years, the Mexican tax authorities have significantly increased the administrative burdens on taxpayers to pay their taxes and to comply with their tax obligations, converting the Mexican tax system into a complex regime and causing taxpayers to incur a myriad of administrative expenses.

Derived from the foregoing, on June 30, 2010 in the Official Gazette, the Federal Executive Power published certain administrative procedures aimed at simplifying the tax regiment, so as to continue to make progress in offering measures that permit taxpayers to comply with their tax obligations more easily and more quickly, as well as to reduce their administrative costs.

The most important of the administrative procedures are the following:

The option of not filing monthly, the concepts that served as the basis of determination of the flat-rate business tax (FRBT)

Upon taking effect, the FRBT Law established the obligation to make monthly prepayments on account of the annual tax, instructing taxpayers to file the monthly statement for such tax along, with the "List of concepts that served as the basis of calculation of the FRBT", information that must also be filed annually.

Considering the aforementioned, the obligation for taxpayers to file the information corresponding to the concepts that served as the basis of determination of FRBT prepayments is eliminated; it is now required to file only the information corresponding to the fiscal year, provided such information is filed within the month immediately following the last month of such year.

With the benefit described above, the administrative burden that the taxpayers had is reduced at the monthly level, but remains in place at the annual level.

Option of not filing the information corresponding to the value added tax (VAT) in the annual income tax return

Among the obligations to be fulfilled by VAT payers is that of filing the Informative Return on Operations with Third Parties (IROTP), which consists of providing the Tax Administration Service (TAS) with monthly information on the operations with the VAT payers' suppliers.

In addition to such obligation, the taxpayers must also file the information on the determination of the VAT, in their annual income tax return.

In this sense, the obligation for taxpayers to file their VAT information in their annual income tax return was eliminated, subject to compliance with the obligation of filing the monthly IROTP.

Option of not issuing the tax audit report corresponding to fiscal year 2010 and subsequent years

The option is established for those taxpayers required, as stated in the Federal Fiscal Code, to have their financial statements audited by an authorized public accountant, not to file the tax audit report corresponding to fiscal year 2010 and subsequent years, provided they file the information within the time limits and means that will be published by the Mexican tax authorities through administrative rules.

Note must be taken that such option is not applicable to authorized donees or to companies participating in a merger or in a spin-off, which must continue to have their financial statements audited for tax purposes, as indicated by the Mexican tax provisions.

The aforementioned benefit would also not be applicable to companies that have elected to determine their tax result in a consolidated manner, in terms of the Income Tax Law (ITL) - the above, considering that the obligation for this type of taxpayers (to audit their financial statements for tax purposes) is expressly stated in the referenced Law.

Elimination of the obligation to file the tax audit report to request the refund of the tax on cash deposits (TCD)

A new tax, designed to control cash flow and in addition to the income tax, is created, so as to increase the level of tax collection and to avoid the increase in tax evasion practices; this contribution directly taxes cash deposits. The aforementioned tax became effective on July 1, 2008.

The tax is levied on cash deposits at the rate of 3% on amounts exceeding Ps. 15,000 monthly.

In accordance with the Tax on Cash Deposits Law (TCDL), taxpayers may offset the tax paid in the month, against the income tax prepayment, as well as against the income tax withheld from third parties, or even against federal contributions. The refund of any remainder can be requested, provided the transaction is audited for tax purposes by a registered public accountant.

In this regard, it is established that those taxpayers who request the refund of such tax do not have to get the transaction audited for tax purposes by a registered public accountant, provided they file the information within the timeframes and in the means established by the TAS through administrative rules.

This benefit will take effect as of September 1, 2010.

Notice of Offsetting

In addition to the aforementioned administrative benefits, it should be mentioned that through administrative rules, taxpayers were informed that the obligation to file the notice of the offsetting of favorable federal taxes against the federal contributions they must pay is eliminated, provided they file (or have filed) their tax prepayment and definitive returns through the TAS' Returns and Payments Service, in which the favorable balance is (or was) shown, and they opt to offset such balances against payments they make by the same means.

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Environment

Why Should You Go Green In Mexico?

By Mauricio Hurtado de Mendoza, Jose Luis Olvera Salcedo and Martha Elias Villazcan (PricewaterhouseCoopers)

Current State of Play

As stated by Von Moltke[1], when international efforts to address climate change expand, the distinction between climate-related project investments and other types of investments will become increasingly blurred.

This is expected to occur in countries such as Mexico, which has increasing economic links with various environmentally-friendly countries. These economic relations may derive in investment opportunities in the area of carbon emissions despite the fact that Mexico is not an Annex 1 country of the United Nations Framework Convention on Climate Change (UNFCCC) and is therefore not obliged to meet domestic greenhouse gas (GHG) targets.

At a federal level, Mexican tax legislation grants benefits to companies that invest in green technology. However, these benefits may seem limited considering the wealth of possibilities that can be used to stimulate green investments.

Mexico is currently ranked among the top 20 countries in the GHG emission rankings. It has committed to significantly reduce its total CO2 annual emissions by 2012, and aims to reduce them to 50% below 2002 levels by 2050[2].

Additionally, on June 5, 2009, President Calderon launched the Special Climate Change Program (*Programa Especial de Cambio Climático* or PECC) as part of the 2007–2010 National Development Plan (NDP), which is expected to stimulate sustainable-related investments. The PECC establishes a low-carbon development scenario for Mexico which identifies domestic and international priorities and financing sources.

Government Activity on Cap and Trade Systems

Despite these new government proposals, there is no clear plan for an Emission Trading System (ETS) in Mexico. The possibility has been raised by government officials in the Ministry of Environment, in discussions about carbon trading or taxes as possible tools to meet the ambitious reduction goals set by the President. The national carbon market proposed in the PECC consists of the development and implementation of a carbon market between state-owned energy companies Comision Federal de Electricidad (power) and Petroleos Mexicanos (oil and gas), with the gradual incorporation of private companies from key sectors. The goal set for the initiation of this carbon market is 2011.

Also, in accordance with Articles 22 and 116 of the General Law of Ecological Equilibrium and Environmental Protection (*Ley General de Equilibrio Ecológico y Protección al Ambiente* or LEGEEPA) various benefits derived from the environmental outcome of economic activities have been implemented in order to motivate taxpayers.

Tax System and Sustainability

Given the current economic climate and the Mexican Tax Authorities' focus of generating government revenues through taxes there is a very complex environment that makes it difficult to establish a tax system that on one side generates revenues for the government and on the other stimulates sustainable investments.

At a federal level, Mexican tax legislation grants benefits to companies that invest in green technology. However, these benefits may seem limited considering the wealth of possibilities that can be used to stimulate green investments. At a state and local level, rather than granting benefits, the authorities aim to change behavior by levying taxes or fines and penalties on companies that perform activities that damage or pollute the environment.

Key Fiscal Benefits for Green Support

In accordance with Articles 22 and 116 of the LEGEEPA, fiscal incentives are granted to those who:

- Acquire, install or operate equipment for GHG control.
- Manufacture install or provide maintenance to filter, combustion, control or any other equipment which reduces GHG emissions
- Carry out research and development activities which derive in a reduction of GHG.
- Locate or relocate their facilities to avoid the contamination of urban areas.

The most renowned of these incentives, is the "zero tariff", which places a 0% tariff on all imports of environmentally-friendly equipment, as long as the technology implemented is not manufactured in Mexico. The equipment must preferably improve air, soil or water conditions.

The Mexican tax rules also provide benefits to new investments in green technology, such as immediate depreciation deduction for the amount of the investment, or accelerated depreciation rates depending on the type of investment. Other benefits include the exemption of the Tax on Acquisition of New Cars to taxpayers that acquire hybrid or electric cars.

Why Invest Now?

Companies are placing special emphasis in renewable resources and corporate responsibility and are looking to take advantage of the new programs which allow them to improve their performance. By planning for medium and long-term investments, and taking advantage of the Mexican government's proposals and incentives, companies may find important benefits which would also place them ahead of their competitors in Mexico.

1 Von Moltke, Konrad, presentation for "Hemispheric Trade and Sustainable Development", International Institute for Sustainable Development, Quebec, April 2001. Winrock International. February 1997. "Biomass-fueled electric energy generation in Mexico." Mimeo.

2 The World Bank. Updated on June 15, 2009. Consulted on June 30, 2009.

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Insurance

Insurance Policies Purchased Outside of Mexico

By Rene Cacheaux
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Is it possible to acquire insurance outside of Mexico for property casualty, life, health and medical expenses and any other type of coverage for risks or casualties arising in Mexico? This question often surfaces and the answer can be a bit complex. The general rule is that all insurable risks arising in the Mexico must be covered through insurance policies issued by insurance companies authorized to do business and sell insurance in Mexico. Nevertheless, this general rule has a few exceptions, which are similar to those that apply to international reinsurance coverage.

The general rule is that it is illegal for foreign insurance companies to issue insurance policies covering risks arising in Mexico or for a casualty that may occur in Mexico. Article 3 of the General Law for Insurance Institutions and Mutual Insurance Companies (*Ley General de Instituciones y Sociedades Mutualistas de Seguros* or "LGISMS") does not allow foreign companies to "exercise any active insurance operations in the Mexican territory" and, additionally, it forbids individuals or entities from contracting with foreign insurance companies to cover losses that can occur in Mexico. It is also forbidden for the insurance applicant to contract health and life insurance with foreign insurance companies while the applicant is in Mexico at the moment of executing the insurance agreement. So long as the insured is outside of Mexico when executing such agreements, such activity cannot be penalized in Mexico.

There is a secondary market, in which foreign insurance companies cover some risks that arise in Mexico, which mostly involve life and medical insurance. The purpose of such insurance often arises from the need or preference of individuals to obtain medical and hospital services outside of Mexico, so Mexican citizens often seek insurance through one company for medical insurance with coverage both within and outside Mexico. In the countries where such insurance policies are issued, generally speaking, such coverage and insurance policies are legal and valid so long as the coverage is contracted while the insured is outside of Mexico. It is important to note that the LGISMS applies only in Mexico; in other words, it cannot govern activities outside of Mexico. The only means of control is to forbid individuals or entities from contracting with foreign insurance companies for coverage as to losses occurring in Mexico.

Additionally, it is important to mention that if these policies are purchased and such purport to cover losses in Mexico, in case of a breach by the insurance companies under the policies, no claims for default or breach of the terms of such insurance policies can be filed in Mexico. A person acquiring an insurance policy issued in a foreign country will be subject to the existing legal provisions in that country, and, if there is a default, such individual should consider hiring attorneys licensed in the country where such insurance policy was issued.

Another relevant topic in the insurance industry pertains to the issuance of global insurance policies for international companies, especially those insurance policies that cover property casualty and liability as to third parties.

In these instances, a foreign insurance company covers casualties in Mexico and other parts of the world by issuing a global policy, which provides coverage in Mexico though a policy issued by a Mexican subsidiary or affiliate or through international agreements with insurance companies based in different countries. Therefore, when seeking such coverage, it is important to verify that the brokerage company or the foreign insurance company offers and delivers an insurance policy issued by an insurance company that is authorized to sell insurance in Mexico.

There are also certain foreign investment restrictions for foreign insurance companies doing business in Mexico, whether directly or indirectly through subsidiaries or joint ventures. Mexico protects its insurance industry through such restrictive legislation. Nevertheless, trade agreements that Mexico has signed with other countries include some exceptions to the mentioned restrictions and allow foreign insurance companies to create affiliated entities in Mexico.

For example, the North American Free Trade Agreement currently allows U.S. or Canadian insurance companies to create Mexican affiliated insurance companies with 100% foreign investment, so long as the U.S. or Canadian insurance company is engaged in the same general type of services outside Mexico that will be rendered in Mexico.

This is a good opportunity for foreign insurance companies to offer their services in Mexico directly by creating affiliated Mexican insurance entities based on their expertise in the market. The *LGSIMS* was amended to allow the creation of affiliated insurance companies in response to the international agreements executed by Mexico.

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