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Blaney McMurtry
BARRISTERS & SOLICITORS LLP

Blaneys on Business

With this newsletter, Blaney McMurtry LLP initiates a service designed to bring news of changes to the law, new law, interesting deals and other matters of interest to our commercial clients and friends. The articles will be short, to the point, and written in a non-legal style. We hope you will find it interesting, and welcome your comments.

Feel free to contact any of the lawyers who wrote or are quoted in these articles for more information, or call the head of our Business Law Department, Steven Jeffery at 416.593.3939 or sjeffery@blaney.com.

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NEW LAW PROMISES TO REDUCE COSTS OF OBTAINING "FINANCIAL ASSISTANCE"

The complexities and resulting costs of some business borrowing seem destined to decrease because of the Ontario Legislature's overhaul of Section 20 of the Business Corporations Act. The section was amended by pre-Christmas passage of the Red Tape Reduction Act, 1999, an omnibus bill that is part of an ongoing Ontario government effort to streamline regulation across all areas of provincial jurisdiction.

The old Section 20, enacted in the early 1980s, prohibited a corporation, in certain instances, from providing loan guarantees, loans, or other forms of "financial assistance" to its officers, directors, shareholders, employees and their associates, and to any other companies in which these persons had more than a 10% (direct or indirect) interest. It also prohibited the corporation from providing financial assistance to anybody for the purpose of buying its shares or any securities convertible into shares.

The Section 20 prohibitions were not absolute. They applied only "where there are reasonable grounds for believing" that the financial assistance would leave the corporation unable to pay its obligations as they came due or would result in making the realizable value of the corporation's assets, with certain deductions, less than the aggregate of its liabilities and the amount paid to it for all of its outstanding shares. Beyond that, the corporation was allowed, explicitly, to provide financial assistance, without being off side of section 20, if lending money was part of its ordinary business; to effectively reimburse or indemnify for expenses incurred on its behalf; to a parent company which owned it 100 per cent; to a subsidiary, and to employees for living accommodation or in accordance with a share-purchasing plan. Section 20 was part of laws designed to: assure that a corporation used its property only to advance its own best interests; to prevent controlling shareholders from misappropriating its assets for their own benefit; to protect minority shareholders (and, some would argue, creditors); and to deal with fiduciary duties and conflicts of interests.

Blaney McMurtry's Todd Greenbloom indicates that the creditor and minority shareholder protections of the section were open to circumvention and in any event were unnecessary because of other legal protections. At the same time, he suggests, the section raised major barriers to transactions that were supported by all the parties to the loan, including all shareholders, and by the lenders but that, nevertheless, threatened to put the corporation in violation of the statute. The new Section 20, which becomes effective when proclaimed, basically says "you may give financial assistance if you give proper disclosure" rather than "you may not give financial assistance unless you meet some stringent conditions." This disclosure, which is not necessary if lending is part of the corporation's ordinary business or if it owns the beneficiary 100 per cent, must describe the "nature and extent" of the assistance; the terms, the initial amount, and any amount outstanding.

Depending on the circumstances, the disclosure must be made within 90 days; in management information circulars or in annual meeting financial statements. Mr. Greenbloom says the new regime means that, in some cases, financing will come together faster and related setup costs for borrowers therefore should decrease. He observes that, under the old regime, determining whether a proposed transaction would be in compliance with Section 20 could be a profession-

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Brett Tkatch, a partner in Blaney McMurtry's Corporate/Commercial practice, specialises in real estate law. He has significant experience in title searching, land boundary disputes, institutional lending, and the buying and selling of property. He can be reached at 416.593.3969 or btkatch@blaney.com.

ally time-consuming, expensive process. One major challenge, for example, was to show that the corporation could pass the section's liquidity and solvency tests or otherwise restructure to fall within an exemption Developing a case could be highly involved and, in the final analysis, there still could be considerable uncertainty about whether the corporation would be judged in compliance and, as one result, whether its directors would be free of personal liability.

Beyond that, there could be significant cost implications in researching, developing, and implementing such efforts to comply as share restructuring or moving the corporation's registration to another jurisdiction. (Saskatchewan, for example, has been operating for a number of years under what is tantamount to Ontario's new regime.) The new regime, he says, provides for "greater certainty" and that will benefit both borrowers and lenders.

ELECTRONIC REGISTRATION - SIMPLIFYING LAND TRANSACTIONS

The high-tech registration of land title and history in Ontario is beginning to take effect, making purchases, sales and financing less cumbersome for buyers and sellers and the lenders, agents, property managers and others whose businesses are real-estate based.

The province's new electronic registration system was scheduled to be implemented at the Middlesex Land Registry Office in the London area on March 7, ending the use of a 200-year-old paper-based system. (Electronic registration has been available on an optional, test basis in Middlesex since January, 1999.) The Land Registry Offices in Halton, Hamilton and Peel are scheduled to begin operating electronically on an optional basis in April, May and July respectively, and the 51 offices remaining in Ontario's county-based system will follow later. The main advantage of the new Ontario system is the ease with which participants can access and manage land title documents. According to background material published by the Canadian Bar Association – Ontario, these documents in the new electronic world "are, in the most basic sense, a series of electronic impulses…transmitted to a computer and stored as part of a database." An electronic system means "it is not necessary to manually sign a document … (in order) to create or properly deal with an interest in land… Electronic documents rely on electronic signatures comprised of encrypted algorithms identifying the party purporting to submit the document for registration."

A lawyer or a para-legal worker sitting at a computer finds the Parcel Identification Number (PIN), searches the title on the computer screen, calls up a transfer for that "PIN" (the transfer appears "pre-populated" with necessary information), inserts the new information and makes the draft document available electronically to the firm helping the other party. When the document has been viewed electronically, settled and prepared for registration, the same professional, (as authorized by the client), 'approves' the document through the use of a unique code, and the parties, together, authorize registration.

"The vendor or borrower no longer signs the transfer in ink, (and) the physical attendance of one or more individuals" at the Land Registry Office is no longer required to register a document According to Blaney McMurtry's Brett Tkatch, electronic registration will be "cleaner, more efficient, more streamlined. Forms will be standardized. Errors should be reduced." In addition, closings may be simpler. "The system should expedite the final closing sub-searches that we conduct," he says, "and it may well reduce the number of closings that now have to be carried over to the next day." Ontario's new registration system is the creation of Teranet, a partnership of the provincial government and Teramira Holdings Inc. Teramira is an investment company with approximately 45 shareholders. Its major shareholders are affiliated with venture capitalist Miralta Capital II Inc. Miralta's investors include several large Canadian pension funds, a chartered bank and an insurance company.

The government owns the land registry database, POLARIS (Province of Ontario Land Registration Information System). Teranet, under government license, owns the computer systems for accessing POLARIS and working with information from it. Teranet has made Ontario a world leader in the design of land

BUSINESS NOTES

Every major law firm in every major market has its interesting stories about resulting life in the global village, and Blaney McMurtry is no exception.

Joan H. Garson and W. Fraser McDonald are partners in Blaney McMurtry's Corporate/Commercial practice.

Ms. Garson's practice has an emphasis on secured transactions comprising a wide variety of national and international transactions; equity financing; shareholders' agreements, acquisitions, divestitures; loss recovery, insolvency and work out matters, and owner-managed businesses. She can be reached at 416.593.3925 or jgarson@blaney.com.

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information and registration services and the first jurisdiction anywhere to operate a paperless system. The Canadian Council for Public-Private Partnerships has also cited the organization as an outstanding example of a "P3."

Public-private partnerships are being viewed increasingly as effective alternatives to traditional government-only development and delivery of public services. One of their key attractions is the capital-raising flexibility that their private sector partners enjoy. In Teranet's case, this means ongoing capacity to keep Ontario's capital-intensive system at the leading technological edge.

MAJOR INTERNATIONAL DEALS CREATE COMPLEX CHALLENGES

This is the era of the global deal. Never have so many business transactions involved so many players from so many different parts of the world, and never have businesses and their professional advisers been called upon so frequently to operate across such an array of cultures, jurisdictions and time zones.

Every major law firm in every major market has its interesting stories about resulting life in the global village, and Blaney McMurtry is no exception. Earlier this year, we helped an international public company based in Western Europe conclude the eight-figure purchase of a Canadian high tech firm. The buyer was on the continent. Its accountants were in London. Its lead North American counsel was in New England and its lawyers for this transaction – Blaney McMurtry – were in Toronto. On the seller side, the target company itself was in central Ontario. Its shares were held across Canada and around the world in a number of other jurisdictions. Its financial adviser was in Australia. There were discussions and negotiations to be had; documents to be drafted, negotiated, edited and signed. The new technology – computers to support the creation and management of the information and telecommunications to move it around the world through phone, fax and e-mail – provided for all of that. And because the infrastructure was in place, the complete cast of characters — about 50 people — never met in any one physical space at any one point in real time "This truly was a virtual transaction," says Blaney McMurtry's Joan Garson. "There were no boundaries in space and time; few scheduling challenges; no getting into airplanes and racing halfway 'round the world; no breaks in contact… and no such thing as regular business hours, either. But it really did work," and it really did highlight some of the realities of the 21st century. One of these realities has to do with the fact that even though the world is increasingly seamless, and even though there is more regulatory harmony than ever before, some very definite cultural, geographic, economic and jurisdictional boundaries continue to exist. (If the last round of World Trade Organization talks in Seattle is any indication, such will be the case for a long time to come.)

As a result, transactions that must accommodate these boundaries require wide-ranging knowledge and considerable sophistication. The tax structuring involved in this deal, in order to ensure that the vendors received the most favourable tax treatment possible, according to Blaney McMurtry's Fraser McDonald, made it highly complex. That kind of complexity, and the capacity to manage it in tight time frames, has become a day-to-day reality for firms like Blaney McMurtry, that advise on large, intricate international transactions.Another reality, ironically, is that, in some circumstances, the new information and telecommunications technology may actually mean slower processes. "The transaction might not have taken so long to complete if we had been able to get the participants together to deal with the issues face to face," says Fraser McDonald. "I'm firmly of the view that to get a deal done in the most timely fashion possible, you get all the people in one room in one city which gives a sense of urgency to the transaction."

Having said that, a third reality is that there is a wide range of communication involving clients and lawyers that the new technologies enable and make more efficient and effective. "One of the most striking things to me," says Joan Garson, "is that these technologies are as accessible to most private individuals and small businesses as they are to the large corporations. That means the benefits can be realized by all of our clients, big and small alike."

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With today's volume of merger and aquisition activity, the ability to make deals happen on a tax effective basis is an important requirement.

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TAX ISSUES IN CROSS-BORDER M+As REQUIRING NEW CREATIVE SOLUTIONS

With today's volume of merger and acquisition activity, the ability to make the deals happen on a tax effective basis is an important requirement.

For domestic transactions, this issue is not too onerous because there are many provisions in the Income Tax Act (the so-called "rollovers") that allow asset purchases and share exchanges on a tax deferred basis. This is particularly the case where the deal involves simply an exchange of stock.

On the other hand, we are seeing more and more cross-border transactions where foreign corporations are buying either the assets or the stock of Canadian companies. Even in the case where the purchase price is being paid entirely in the stock of the foreign corporation, there is no rollover provision available, so the vendor becomes immediately taxable even though he receives no cash. This creates a serious problem for the deal as it puts a big hole in the vendor's pocket. A creative solution is the use of so-called "exchangeable shares". If a foreign corpo - ration wanted to take over a Canadian corporation, an exchange of stock of the foreign corporation for the stock of the Canadian corporation would be taxable.

A tax efficient alternative is to have the foreign corporation incorporate a Canadian subsidiary that would acquire the shares of the target Canadian corporation and pay for them with exchangeable shares of the subsidiary. In very general terms, the foreign corporation would enter into an agreement with its Canadian subsidiary designed to ensure that holders of exchangeable shares of the subsidiary would receive equivalent dividends and would enjoy the same liquidation rights as shareholders of the parent corporation.

In addition, and this is the key, the exchangeable shares would contain a right which would allow the holder to exchange them for shares of the parent corporation at any time. Frequently, the parent corporation is listed on a foreign stock exchange, so that the exchange would be exercised when the holder wanted to sell some or all of the stock. This mechanism also gives the holder the ability to hold the stock without paying tax if he believes that the stock of the parent company will go up in value. The deferral can extend indefinitely. In effect, the exchangeable shares are intended to mirror the parent company stock; it is also possible to provide a mechanism to allow for voting rights in the parent company as well.

And now the requisite word of caution. The provisions of the Income Tax Act governing exchangeable shares are highly complex and can lead to unintended negative results; so don't try this without engaging the services of a sophisticated professional advisor. Corporate transactions are becoming increasingly complex and the use of exchangeable shares is but one way to overcome difficulties that may stand in the way of getting intricate deals done.

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Blaneys on Business is a publication of the Corporate/Commercial Law Group of Blaney McMurtry LLP. The information contained in this newsletter is intended to provide information and comment, in a general fashion, about recent cases and related practice points of interest. The information and views expressed are not intended to provide legal advice. For specific legal advice, please contact us.

We welcome your comments. Address changes, mailing instructions or requests for additional copies should be directed to Patricia Abbott at 416 593.3973 or by email at pabbott@blaney.com. Legal questions should be addressed to the specified author.

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