SEPTEMBER 2000

Blaney McMurtry
BARRISTERS & SOLICITORS LLP

Blaneys on Business

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This newsletter is designed to bring news of changes to the law, new law, interesting deals and other matters of interest to our commercial clients and friends. 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.

NEW PROVINCIAL LEGISLATION MAKING ELECTRONIC CONTRACTS EXPLICITLY LEGAL FOR FIRST TIME

Business law in Ontario, Saskatchewan, Manitoba and Quebec is catching up with computer technology and the rapidly increasing appetite for doing deals electronically.

In recent years, purchase agreements and other contracts made through such media as electronic mail and electronic data interchange (EDI) have become commonplace. But it has been only in recent months that provincial legislatures, which have jurisdiction over contracting, have begun to enact law to make these electronic agreements explicitly legal.

Lou Brzezinski, head of Blaney McMurtry's e-commerce group, says that up until the legislation now finding its way onto the books, the legal status of contracts made electronically has been uncertain.

"There has been no certainty about the legal enforceability of EDI or email," he says. "Everybody on line who has clicked on 'I accept' has been thought to have been making a legal and binding contract, and there has been some case law to that effect.

"But there has never been any legally clear and certain basis for saying that electronic impulses are, in effect, a binding contract. That is remarkable when you consider that research shows Canada already has the highest share of global e-commerce revenues after the U.S., with an internet economy representing $28 billion in revenues and 95,000 jobs."

With roughly 40 per cent of Canada's gross domestic product, Ontario has an annual stake in legally stable e-commerce that is $11.2 billion and growing fast.

Ontario's Electronic Commerce Act, 2000, which is expected to take effect in the last half of this year, is based on the Uniform Electronic Commerce Act adopted by the Uniform Law Conference of Canada in 1999 and is consistent in principle with the United Nations Model Law on Electronic Commerce.

According to the Ontario Bill's explanatory note, "The Bill removes barriers to the legally effective use of electronic communications…. It is not intended to require the use of particular technology or to have a large impact on the methods that people use to communicate. It does not require anyone to use, provide or accept information in electronic form."

The Bill sets out its basic principle by stating that "Information or a document to which this Act applies is not invalid or unenforceable by reason only of being in electronic form." It puts a number of measures in place to ensure that if there are legal requirements for written communication,

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Lou Brzezinski is chair of Blaney McMurtry's e-commerce group and is Editor-in-Chief of the firm's E-Commerce Canada newsletter, the country's first on-line legal publication dealing with e-commerce issues. He provides advice to Internet service providers, web designers, and insurers on the web and maintains an active commercial litigation practice.

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electronic equivalents will be allowed. One section states, for instance, that "a legal requirement that information or a document be in writing is satisfied by information or a document that is in electronic form if it is accessible so as to be usable for subsequent reference."

The Bill provides an explicit legal basis for contracts made between "electronic agents" (e.g. computers) or between electronic agents and people. But, as the explanatory note puts it, "a transaction entered into between an individual and an electronic agent is voidable if an important mistake is made, there is no opportunity to prevent or correct the error and the individual does not benefit from the transaction."

In addition, the Bill sets out rules that "determine when messages are sent electronically and when they are presumed to be received." Also, "messages are sent and received from the sender's or recipient's place of business residence, rather than from the location of the computer server or where the person happens to be when sending or receiving the message."

The Bill does not apply to wills, personal powers of attorney, or such negotiable instruments as cheques, land transfers and election documents. Mr. Brzezinski says these documents are thought to be of such importance that only ink on paper will do - for the moment.

"Because of the newness of the technology, electronic equivalents probably will be introduced only step by step."

DRAWS LITTLE NOTICE: BUDGET COULD DAMPEN FOREIGN INVESTMENT

The most recent federal budget has been praised widely, but one set of provisions that has drawn little public notice stands to make Canada less attractive to foreign investors, says Paul Schnier, chair of Blaney McMurtry's tax group.

The new provisions are not good news for foreign investors who have come to regard this country as a premier location for their capital, he cautions. Nor are they good news for Canadian-based operations trying to attract that capital or for the Canadian economy, which has reaped significant benefit from the technology transfer, jobs and income that foreign investment generates.

The budget measures in question involve a tightening of the so-called "thin capitalization" (or thin cap) rules for non-residents who hold 25 per cent or more of a Canadian company's shares.

Under the existing tax regime, says Mr. Schnier, there are two incentives for the foreign shareholder, who has a dollar in equity in a Canadian company, to lend that company up to three additional dollars. First, money coming into the foreign shareholder's hands in the form of loan interest is taxed at a maximum of 25 per cent (vs. 45 per cent for regular income); even less if the lender resides in a treaty jurisdiction. Second, the Canadian company can deduct those interest payments for tax purposes, enhancing its bottom line and shareholder value in the process.

Effective in taxation years beginning after 2000, however, the allowable debt-to-equity ratio will decline to 2:1 (vs. the current 3:1). This will mean a one-third decrease in the number of dollars that can be deducted for tax purposes. This year, for example, if an investor has $1,000,000 in equity

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Paul L. Schnier chairs Blaney McMurtry's tax group. He restricts his practice to income tax law with emphasis on tax planning and implementation and advising as to the tax consequences of proposed transactions. He has advised a variety of public and private corporations on numerous domestic and international undertakings.

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and $3,000,000 in seven per cent debt, when the Canadian company calculates its tax, it can deduct the $210,000 interest owing. Next year, the Canadian company will be allowed to deduct only $140,000. This will apply to both new and existing financial arrangements.

In addition to reducing the debt-to-equity ratio, the budget takes steps to ensure that the maximum ratio is maintained throughout the year. Today, for example, the ratio may be brought on side by a capital infusion on the last day of the company's financial year. Next year, the rules will provide for the ratio to be calculated on the basis of average monthly amounts throughout the year.

Beyond that, measures (deferred at present) are to be introduced to ensure that the rules cannot be circumvented by a non-resident shareholder guaranteeing a corporation's debt rather than being the direct lender. And finally, the budget papers state that consideration will be given to additional amendments to extend the thin cap rules to such other financing techniques as leases and such other business structures as partnerships, trusts and Canadian branches (vs. subsidiaries) of non-resident corporations.

"Only time will tell," says Blaney McMurtry's Paul Schnier, "but foreign shareholders may well be obliged to rethink the structure of their Canadian investments."

SO, YOU'RE NOT IN FRANCHISING? UNDER NEW ONTARIO LAW, YOU'D BE ADVISED TO TAKE A *VERY* CAREFUL SECOND LOOK

There is a new statute on the books in Ontario that promises to capture a much broader range of business activity than most business people might expect.

It concerns franchising, and if you think your business has nothing to do with franchising, you would be very well advised to think again.

The new law, named the Arthur Wishart Act (Franchise Disclosure), 2000 in honor of the former Ontario attorney general who advocated fuller disclosure in franchising, is designed "to ensure that small business investors … are better able to make an informed investment decision prior to signing any franchise agreement or making any payment."

Todd Greenbloom of Blaney McMurtry's corporate/commercial group says that although the Act is clearly intended to address long-standing issues in 'traditional franchising,' it defines "franchise" in ways that can apply to a much wider stage. According to the Act, "franchise" means "a right to engage in a business where the franchisee is required" to pay the franchisor "in the course of operating the business or as a condition of acquiring the franchise" and in which:

• The franchisor gives the franchisee the right to deal in goods "substantially associated with the franchisor's, or the franchisor's associate's, trademark, service mark, trade name, logo or advertising or other commercial symbol" and "exercises significant control over, or offers significant assistance in, the franchisee's method of operation, including building design and furnishings, locations, business organization, marketing techniques or training," or,

• The franchisor grants the franchisee the representational or distribution rights to sell or distribute goods or services and provides location assistance, including securing retail outlets or accounts.

"Any time you grant rights to the use of your

"The new law...is designed 'to ensure that small business investors...are better able to make an informed investment decision prior to signing any franchise agreement or making any payment' "

trademark or the distribution of your product, and you are paid a fee," says Mr. Greenbloom, "you must be mindful of the legislation."

He cites as one hypothetical example an agreement between a credit bureau and "CreditCount," a software developer that has created the respected market leader in credit-scoring software. "CreditCount" gives the credit bureau a non-exclusive right to use its program. The credit bureau, supported by "CreditCount's" widely-known logo, tells its clients it does "CreditCount" scoring and pays the software company a fee every time it uses the software.

"Distant though this may seem from traditional notions of franchising," says Mr. Greenbloom, "the fact is that this deal could be captured by the new law if there were no exemption in the yet to be drafted regulations." The regulations will set out the detailed requirements of the Act's core disclosure provisions. "If you fall offside," Mr. Greenbloom says, "the costs could be very big."

The Act requires the franchisor to provide the prospective franchisee with a "disclosure document" not less than 14 days before the franchisee signs an agreement or makes a payment. It states that the disclosure document must contain all material facts, financial statements, copies of all proposed franchise agreements, "statements as prescribed for the purposes of assisting the prospective franchisee in making informed investment decisions, and other information and copies of documents as prescribed."

A franchisee can rescind the franchise agreement "without penalty or obligation" no later than 60 days after receiving the disclosure document if the franchisor fails to make proper disclosure. The franchisee has up to two years to rescind if a disclosure document is not provided and can sue to recover whatever investment had been made already.

"To a add insult to injury," says Mr. Greenbloom, "any person signing the disclosure document and any person considered to be a franchisor's agent (e.g. a person actively involved in selling the franchise) may be personally liable and can be successfully sued by a disgruntled franchisee. So anybody who assigns rights to anybody else, provides assistance and gets a fee should watch out. They might not regard themselves as franchisors, but the new law might have another view."

H. Todd Greenbloom, a Partner in Blaney McMurtry's corporate/commercial group, has an active business law practice that includes all aspects of franchising and licensing. His clients are involved in the restaurant, food service, hospitality, recreation, trade show, retailing, manufacturing, advertising and service industries. He is a member of the Canadian Bar Association and the Canadian Tax Foundation and is an Affiliate of the Canadian Franchise Association.

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Blaneys News:

Franchising Seminar

"An overview of the new Ontario 'Franchising Disclosure' Legislation" Thursday, September 7, 2000, at the Toronto Hilton Hotel, Carmichael/Jackson room, 145 Richmond Street West, Toronto.
Continental Breakfast 7:30am - 8:00am
Seminar 8:00am - 9:30am

This session will be of interest to traditional franchisors, distributors, and any business that grants the use of trademark or the distribution of its product in return for a fee.

There is no cost to attend this seminar. To reserve your place, please call our RSVP line at 416.593.3974 or register on our website at www.blaney.com/events.htm.

Blaneys on Business is a publication of the Business Law Department 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 Chris Jones at 416 593.7221 ext. 3030 or by email to cjones@blaney.com. Legal questions should be addressed to the specified author.

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