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Blaney McMurtry
BARRISTERS & SOLICITORS LLP

Blaneys on Business

"Investment analysts like clarity in a business. It allows them to assess the value of the business with greater certainty."

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.

IMPORTANT TAX CHANGE INVOLVING FOREIGN SPIN-OFFS GOOD NEWS FOR INVESTORS

Paul Martin's pre-election mini-budget of October 18, 2000 contained a number of widely reported tax-change proposals. One of the most attractive, which has significant implications for Canadian individuals and corporations which own common shares of U.S. companies, has received surprisingly little attention.

The measure involves so-called foreign spin-offs. Paul Schnier, Chair of Blaney McMurtry's tax group, points out that if a Canadian investor holds common shares of a US corporation trading on a US stock exchange, any dividend on those shares is subject to tax in Canada at full marginal tax rates.

"If the dividend is in the form of the common shares of another corporation, the same result applies even though the investor receives no cash. This undoubtedly causes a hardship to the investor who must pay tax on a paper gain."

American companies that want to restructure often do so partly by "spinning off" as dividends the common shares that they hold in other companies. "This is normally done without tax consequences to US investors. The poor Canadian investor however, gets hammered in Canada. The measure announced in the mini-budget will eliminate this problem and provide an added bonus, too."

Under the mini-budget proposal, the value of the spun-off shares, for all practical purposes, would be integrated with the value of the original shares and ultimately treated a capital gain rather than income. That means tax would not be owing when the spin off took place and would not be levied until the shares were sold.

Beyond that, the ultimate tax would be a capital gains tax rather than income tax. Prior to the mini-budget, two-thirds of any capital gain was subject to tax. The mini-budget proposed this be reduced to half. So, pre mini-budget, if a spun-off share was worth $10 and the investor's marginal tax rate was 50 per cent, the investor would have an immediate income tax obligation of $5. Post mini budget, the tax obligation would be $2.50 and that would only come due when the share holding was sold.

"These rules will apply to any publicly listed companies in the United States or in countries with which Canada has a tax treaty, provided the spin-off is tax free in the relevant jurisdiction," says Mr. Schnier.

"The measure will encourage investment in foreign securities. It will also create more opportunities for Canadian multinational corporations to restructure their foreign operations (by spinning off as dividends shares they own in foreign subsidiaries) without affecting their Canadian shareholders negatively."

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"...companies and their officers and directors have to be much more cautious when they enter into commercial transactions outside Canada..."

And there could be an additional benefit for these shareholders, Mr. Schnier suggests. Investment analysts like clarity in a business. It allows them to assess the value of the business with greater certainty. Shares that a business holds in other companies can muddy the value waters, diminish analysts' enthusiasm for the business, and translate into lower share prices for that business.

Conversely, spinning off holdings in other companies can provide for greater clarity and higher share prices.

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.

Paul can be reached at 416.593.3956 or pschnier@blaney.com.

CANADIANS INCREASINGLY VULNERABLE TO JUDGMENTS OF FOREIGN COURTS

A Canadian businessperson does a deal in the United States. It goes sour. He gets sued. He ignores the suit. After all, he has no assets in the States. He does not live there. He does not do regular business there. He has nothing to lose, right?

Probably wrong, actually, says Eugene Mazzuca of Blaney McMurtry's litigation practice.

"The courts in Canada have become much more open to enforcing judgments obtained against Canadians in foreign jurisdictions," he points out, "so companies and their officers and directors have to be much more cautious when they enter into commercial transactions outside Canada."

Prior to 1990, Mr. Mazzuca explains, Canadian courts usually enforced foreign judgments against Canadian citizens only if those Canadians had responded to the legal action taken in the foreign jurisdiction, agreed to be subject to it, or had been a resident or citizen of the foreign jurisdiction at the time that the proceeding was begun. If the Canadians had no assets in the foreign jurisdiction, had never been citizens or residents of that jurisdiction, and had never agreed to be bound by that jurisdiction, they could simply ignore the proceeding.

In 1990, however, the Supreme Court of Canada rendered a decision in *Morguard Investments Ltd. v. De Savoye*, which "completely changed the landscape in Canada with respect to the enforcement of foreign judgments."

Morguard involved attempts to enforce default judgments that had been obtained in Alberta against an individual residing in British Columbia. In its decision, the court recognized that nineteenth century legal theories of state protectionism no longer applied. (These theories were rooted in the idea that international distances and other obstacles to timely communication prohibited an effective defence.)

It was in *Morguard*, Mr. Mazzuca continues, that the Supreme Court introduced the 'real and substantial connection' test, which "essentially provides that if subject matter of the court proceeding has a real and substantial connection to the jurisdiction where the judgment is obtained, the judgment is enforceable in other provinces.

"While the Supreme Court of Canada's decision related only to the enforcement of judgments between provinces, it was clear from the court's language that the decision had much farther reaching implications. Following *Morguard*, lower courts throughout Canada debated whether the principles enunciated by the Supreme Court were applicable to judgments obtained outside Canada (and therefore whether Canadian courts should respect and enforce the judgements of courts that were foreign but of similar justice systems).

"Most of the lower courts agreed that the principles articulated by the Supreme Court were, indeed, applicable to judgments obtained outside Canada. In

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Eugene G. Mazzuca is a partner in Blaney McMurtry's litigation practice. He practices primarily in the area of insurance defence litigation, handling a wide range of tort matters including personal injury, occupier's liability, products liability, professional negligence, malicious prosecution, property damage, libel and slander, charter issues, inmate assaults, police pursuits, and motor vehicle accident claims. He has developed a specialization in the enforcement of foreign judgments.

Eugene can be reached at 416.593.3946 or emazzuca@blaney.com.

1993, the British Columbia Court of Appeal was the first high court in Canada to recognize this and in 1995 the Ontario Court of Appeal followed with two decisions.

"Currently, there is reciprocal enforcement legislation between most Canadian provinces, permitting the enforcement of money judgments obtained in other provinces that have implemented the legislation. Similar legislation exists with the U.K.

"Today, judgments obtained outside those reciprocating provinces are enforceable if the real and substantial connection test is met. But there are exceptions, such as meeting the rules of natural justice, or if the foreign judgment is contrary to the public policy in Ontario or was obtained through fraud. Generally, however, the courts have interpreted these exceptions very narrowly and have rarely found any of them to apply. As a result, most judgments are being enforced.

"It is very important to note that the courts in the reciprocating provinces will not review the merits of the original claim brought in the foreign jurisdiction. As a result, even where a defendant may have a defence, the courts here will not consider it unless one of the exceptions above has been found.

"As a result, foreign judgments obtained against not only companies, but their officers and directors personally, are being enforced regardless of whether the officer or director might be personally liable in the reciprocating province.

"Further, large damage awards, particularly made in the United States, have been enforced in Canada even though it is likely, given our comparatively conservative approach to damages, that awards of such size would not be made by Canadian courts. Accordingly, once a judgment is obtained in a foreign jurisdiction, the defence against the enforcement of that judgment here will be extremely limited."

PROTECTING YOUR INVALUABLE INTANGIBLE BUSINESS ASSETS, part one

As business people, most of us feel pretty comfortable in the day-to-day back and forth of commerce. None of us, whether we own an enterprise employing a number of people or a home-based business, would sell products or furnish services without an invoice, contract or other evidence of an agreement with our customer.

For that matter, it would be rare for the prudent business person to buy supplies, commit to equipment financing, or lease his or her business premises without some kind of purchase order, loan document or lease.

In fact, when it comes to those aspects of business that we can touch, see or feel - the tangible part of our business - it's pretty clear that we know enough to get it, or document it, in writing.

But have you ever asked yourself what might happen to your business if a key manager or other employee left with information about your business or your customers? What if the employee left with information about your intended marketing campaign or a new service that you were planning to introduce? Would products or services turn up in the marketplace that had a look and feel similar to your products or services?

What if someone figured out how to make your products or perform your services exactly as you do? For that matter, what if someone started to import a product or service into Canada for which you thought you owned Canadian marketing rights?

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"Most of us have a difficult time identifying, evaluating, and then properly protecting the intangible part of our business - our intellectual property."

Stephen I. Selznick is a partner in Blaney McMurtry's business law department, where his practice concentrates on corporate/commercial law; intellectual property, entertainment, advertising, media and communications law; and competition, trade and technology law. This article was originally published in *Your Office magazine.*

Stephen can be reached at 416.593.3958 or sselznick@blaney.com.

If these and other similar questions give you cause for concern, you are not alone. Most of us have a difficult time identifying, evaluating, and then properly protecting the intangible part of our business - our intellectual property.

Unlike corporeal property (a legal term for tangible property - anything you can touch or feel), intellectual property (IP) has this nasty habit of appearing and disappearing, depending upon how you treat it.

For example, a product or service name has great value when it is used to identify your particular brand of that product or service. It serves to differentiate you from the competition. You have to be careful though. If you become too successful, you run the risk of your brand name becoming generic or synonymous with the product or service itself. If that happens, your trade-mark value plummets as stores start to stock any version of that product (and not just yours). It's even worse when consumers start to accept a competitor's version of a product or service even though they ask for your brand name.

As well, and unlike tangible property, some types of intellectual property can exist in two different places at once. Thus, in some cases you can give your IP away and hold onto it at the same time.

Think of it this way: If you sell someone a narrative on a merchandising program that you have come up with, you may think you have given that person all the copies of the plan that you possess. But what about the version that stays in your memory? Didn't someone once say that the mind's eye makes the best camera? Too bad people aren't like computers whose memory you can erase!

On the other hand, other types of intellectual property are simply not capable of residing in more than one place at any given moment and in fact disappear completely if more than one person possesses that IP at the same time. A good example of this is the secret formula for Coca-Cola™. That recipe is probably worth billions of dollars, but it wouldn't be worth the paper it is printed on if somehow it was published over the Internet or appeared in a cookbook.

A good way of thinking about the issue of tangible versus intangible property is to think of your intellectual property as simply another asset category, just like your physical inventory.

WE ARE PLEASED TO ANNOUNCE

that **Jill E. McCutcheon** has joined the firm's Financial Services Group. Jill has ten years' experience as in-house counsel at various large insurance companies. Prior to joining us, she was Assistant Vice President and Senior Counsel, for Manulife Financial's Affinity Markets and ManulifeDirect.com. During her tenure at Manulife, Jill resolved the legal impediments to and facilitated the first sale in Canada of life insurance on the internet in 1998, and completed her sixth transactional web site for life insurance at www.manulifedirect.com, which launched in July, 2000.

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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Blaney McMurtry
BARRISTERS & SOLICITORS LLP

20 Queen St. West, Suite 1400
Toronto, Canada M5H 2V3
416.593.1221 TEL
416.593.5437 FAX
www.blaney.com