JUNE 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.

GREATER VIGILANCE NOW REQUIRED: SECURED LOAD COLLATERAL MAY BE DIMINISHED BY NEW TAX LAW

Recent changes in income tax legislation now strengthen the federal government's ability to collect on outstanding employee income tax source deductions.

The revised measures have important implications for all secured lenders whose borrowers fail to meet source deduction remittance obligations to the Canada Customs and Revenue Agency (CCRA, formerly Revenue Canada).

"The amendments will be of concern to the financiers of equipment, who may find themselves with significantly decreased security value,"says Deborah Grieve, head of Blaney McMurtry LLP's business reorganization and insolvency group. "This includes lessors where the lease serves only as a financing vehicle.

"The holders of real property mortgages are not entirely safe either."

What does it all mean for secured lenders in practical, operating terms? "In essence," says Ms. Grieve, "it means that secured creditors will have to monitor the remittance of source deductions by their borrowers more closely or run the risk that the value of their security will be eroded.

"Unfortunately, there is no inexpensive, expedient and foolproof way to verify that the proper amount has, indeed, been remitted in a timely manner. However, there are certain steps the lender can and should take to minimize the risk.

"First, the lender should require the borrower to sign a form authorizing and directing the CCRA to disclose to the lender information concerning the borrower's account. The lender should conduct a search with the CCRA before advancing any funds (although they may not receive a timely and satisfactory response). Lenders should also require borrowers to issue a statement of remittances made and projected, and provide their business number and the location of the CCRA office.

"Beyond that, lenders should think carefully about what controls they should implement to satisfy themselves to the greatest extent possible that the remittances their borrowers are reporting are accurate and being made in a timely manner.

"Finally, before lenders move to realize on their security, they should determine the amount, if any, of source deduction arrears owing to the CCRA. The agency has stated it will not reimburse lenders who incur expenses

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in realizing on assets where the CCRA has priority. So a lender could be out of pocket for the privilege of collecting for Her Majesty!"

The new tax law amendments that, for all practical purposes, oblige secured lenders to become more vigilant about their borrowers' source deduction remittances, were prompted by the Supreme Court of Canada's 1997 judgment in *Royal Bank of Canada v. Sparrow Electric Corp.*

Before *Sparrow*, it was generally conceded that the claim of the income tax department for source deductions owing would take priority over the claims of secured lenders with respect to such "soft assets" of the borrower as inventory and receivables. The claims of secured lenders would continue to have priority over such fixed assets as machinery and real estate.

In *Sparrow*, the court essentially gave secured lenders priority over soft assets as well as hard assets. As a result, the government changed the law to give the CCRA priority over all interests except security interests specifically set out in regulation. This priority, retroactive to June 15, 1994, took effect June 18, 1998.

On July 28, 1999 a regulation was passed essentially protecting real estate mortgages. At the same time, however, the regulation provides that in the event that a real estate borrower is in default on source deduction remittance obligations, after January 1, 2000:

• Any advances the lender made after the default would not take priority over CCRA claims, and

• The value of the security additional to the real estate itself would decline by the amount the borrower owed the CCRA, but the lender would retain priority over the real estate per se.

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KEY ISSUE IN ELECTRONIC COMMERCE: NEW INTERNATIONAL ARBITRATION MACHINERY SPEEDING SETTLEMENT OF WEBSITE NAME DISPUTES

Electronic commerce is expanding at warp speed. The proliferation of products and ser-vices online and of computer-literate customers searching for them, has made brand strength, and the World Wide Web site names crucial to it, more basic to business success than ever.

In this context, the question of who has the right to any given domain name -- domain names have such suffixes as .com (for commercial), and .ca (for Canada) -- has become a considerable issue in global commerce. Some 100,000 new domain names are registered every month, and disputes over the right to them have become common and often highly publicized.

Blaney McMurtry business law partner Stephen Selznick says these disputes arise through domain name registrations initiated in both good faith and bad. Different corporations, products and services with similar or identical company or brand names get into disputes over legitimately competing claims. Then there is "cybersquatting," where opportunists move quickly to register predictable site names and then operate under them for profit or offer them for sale to trade and service mark owners at exorbitant prices.

Either way, until recently, protecting a name or mark against a challenging registration was a daunting task that inevitably threatened to cost tens of thousands of dollars in legal fees for decisions by courts that, in the global world of e-commerce, might not have definitive jurisdiction. Only

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the biggest corporations, or the most determined, could even think of taking action.

"It was like the Wild West out there," says Mr. Selznick. On January 1, 2000, however, new arrangements that leveled the field for smaller players took effect with the implementation of the new Uniform Domain-Name Dispute-Resolution Policy and procedure of the Internet Corporation for Assigned Names and Numbers (ICANN).

ICANN was incorporated in California in 1998 by a broad coalition of the Internet's business, technical, academic, and user communities. With directors from the United States, Canada, Mexico, the U.K., France, Spain, the Netherlands, China, Japan and Australia, the private, non-profit organization, whose creation was prompted by the U.S. government, has been recognized as the global consensus entity for coordinating the technical management of the Internet's domain name system.

Under ICANN's 21-part uniform domain-name dispute-resolution policy and process, anybody who thinks somebody else has registered and is using a web site name to which they don't have the primary right, or in bad faith, can issue a complaint and get an enforceable decision. (The world's 100 or so domain name registrars - up from just a handful only 18 months ago -- have agreed to abide by ICANN's rulings.)

Both a complainant and a respondent can choose to have their dispute decided by a single arbitrator or by a three - member panel. To win a "cybersquatting" arbitration, the complainant must establish his priority entitlement and prove that the person who registered the domain name had a bad-faith intent to profit from the registration; from trafficking in the name, or from using the name.

The whole process is supposed to take four to six weeks and cost the parties $3,000 - $5,000 each as opposed to $50,000 - $60,000 and months in the courts. Decisions can be appealed.

"Up to now," Mr. Selznick points out, "there have been many small businesses which thought they could do nothing to stop other people who had already beaten them to the punch. That is no longer the case."

ONTARIO IMPLEMENTS NEW SYSTEMS FOR MERGED TAX, CORPORATE INFORMATION FILING

The Ontario government has established a new process for the integrated filing, through the Ministry of Finance, of corporation tax and annual corporate information, such as the names of directors and officers.

The merged process was implemented April 1, 2000. Since then, companies have had the option of filing combined returns on paper or through a combination of computer diskette and paper. Electronic filing on line is anticipated by late autumn.

Nancy Tucker, one of five corporate clerks in Blaney McMurtry's business law department, says it is important that corporations realize the annual information requirement has been renewed. It was in place for three years in the early '90s; eliminated by the current government in 1995 and re-instituted effective last January 1 (minus the $50 filing fee).

Corporations are obliged to file both their tax returns and annual information within six months of their financial year-end. In addition to the names of directors and officers, their dates of appointment and resignation, and their addresses

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for the purposes of serving documents, annual information requirements include date of incorporation, Ontario corporation number, registered office address and the location of the corporation's books and records.

It is expected that, to save time and cost, many corporations will ask their accounting firms to make joint filings as part of their annual tax preparation work. In the early 1990s, when annual corporate returns were mandatory, it was the experience of the clerks at Blaney McMurtry that, when such returns were prepared by accountants, there were often mistakes made due to the technical nature of the information required. Instead of time and money being saved, this led to additional cost being expended by corporations to correct these mistakes. Therefore, in order to correctly make the new joint filings, it will be important for the accountants and lawyers to be in touch to ensure that the most up-to-date corporate information (which resides in the minute books and other records the law firms maintain) is filed.In addition to combined filing through the Ministry of Finance, corporations were to be in a position in late April to file the annual information by themselves, electronically, with the Companies Branch of the Ministry of Consumer and Commercial Relations. (The Companies Branch is not equipped to process joint tax and corporate filings.)

Penalties for failure to comply with the annual information filing requirements are to be set by next autumn. It is anticipated that the ultimate sanction will be corporate dissolution.

Nancy Tucker is one of the clerks in Blaney McMurtry's business law department. The clerks are paralegals trained in corporate law. They help the lawyers in the department prepare transactional documents, maintain the minute books of the corporate clients of the firm, perform searches and filings at government departments and agencies, coordinate responses to auditors of clients of the firm regarding claims, and provide other corporate/commercial counsel and services.
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Blaneys News:

e/COMMERCE Seminars

The 3rd in our 4 part seminar series on *"The Legal and Financial Implications of Doing Business on the Internet"* is scheduled for Wednesday, June 7, 2000.

Fraser McDonald and Linda Misetich of our Securities Group will be discussing *"Financing Internet Startup Businesses"* and Michael Penman of our Commercial Litigation Group will be speaking on *"Intellectual Property in Cyberspace: Copyright, Trademark and Domain Names"*.

For further information on this or upcoming sessions or to register, please call our RSVP line at 416.593.3974 or e-mail info@blaney.com.

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