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Minden
Gross
Grafstein &
Greenstein LLP

A CLIENT OVERVIEW OF LEGAL TRENDS AND ISSUES

BARRISTERS & SOLICITORS

SUMMER 2001

The Insolvency Practice Group of Minden Gross has extensive expertise in financial reorganizations, debt restructurings, debtor and creditor rights, forbearance/standstill arrangements and receivership matters. Our Insolvency Group is fully integrated with the firm's financial services, corporate/commercial and litigation practices. This multi-disciplinary approach allows the group to provide clients with business oriented, creative and practical approaches to problem solving and developing solutions that are consistent with our clients' needs and interests. We pride ourselves on our reputation for delivering quality legal services with speed and in a cost effective manner. Minden Gross acts for lenders, debtors, trustees, receivers, and other insolvency practitioners. We have acted in many of the largest insolvency related proceedings and workouts which have occurred in the Canadian business community. Recently, we acted in the successful restructuring of a major retail client under the *Companies' Creditors Arrangement Act*.



E-Commerce Insolvencies ~ *New Privacy Legislation Reduces Realization Options*

The natural fallout of the dot.com bubble bursting is that several dot.com companies find themselves in the throws of insolvency.

As the creditors of these dot.com companies arrive on the scene to recover the funds they

have lent, they are presented with a series of unusual and unfamiliar assets. A dot.com company does not generally have heavy machinery, established accounts receivables or tangible assets which can be realized upon by a receiver or trustee in bankruptcy.

On the contrary, the majority of the dot.com companies' assets are less tangible such as:

1. outbound contract and license agreements;
2. inbound contract and license agreements;
3. employee contracts;
4. intellectual property;
5. website;
6. domain name; and
7. Internet use, data and membership information.

Each of the above assets requires a different approach in order for a creditor to obtain the highest possible realization.

One of the assets which had previously been looked on as a possible source of recovery for creditors in many e-commerce companies was the company's Internet use information and membership information.

Despite the common perception, an Internet user leaves a trail behind at the websites through which he passes in the course of his surfing and Internet use. At each website, that user leaves behind a certain amount of information about him, such as where he has been and where he is likely to go. From this information sophisticated models have been designed to extrapolate what kind of a person that user is and what that person's interests are. The process of collecting this information has been dubbed "data-mining." When data-mined information can be matched with a name or email address it can be sold to parties who wish to sell products or services to that type

of person.

However, given the recent concerns about privacy and protecting the information collected by companies, data-mining results are proving to be not so saleable an asset.

Recently in the United States an insolvent e-commerce company known as Toysmart.com took out an advertisement in the Wall Street Journal to sell the data base of information it had collected during the term of its operation. Objecting to this, 42 separate U.S. states and the U.S. Federal Trade Commissions sued Toysmart to stop the sale. In the end, Wednesday Inc., a Walt Disney Company subsidiary, agreed to pay Toysmart \$50,000 in exchange for Toysmart agreeing to destroy the data instead of selling it.

The result to the secured and unsecured creditors? One less major asset from which to recover their indebtedness. The \$50,000 price tag was substantially less than creditors had hoped for or expected from the asset.

Can this happen in Canada? It seems certain that given the recent attention privacy law has received in Canada, (particularly with the introduction of the Personal Information Protection and Electronic Documents Act which came into force in January of 2001) an attempt by a creditor to sell the data-mined information could run into similar problems.

David T. Ullmann

Avoiding (or at least minimizing) the Frustration Experienced by a Landlord on the Insolvency or Bankruptcy of its Tenant

Frustration. This is perhaps the most common sentiment expressed by a landlord who has experienced the insolvency or bankruptcy of a tenant. This sentiment is easy to understand. One minute the landlord can rely upon the carefully crafted provisions of its lease to protect itself and its premises – the next minute the landlord is served with notice that the tenant has obtained an order protecting itself from action by its creditors or, even worse, that it has already become a bankrupt and a trustee in bankruptcy has been appointed to administer its estate. In either case,

unless proactive steps have been taken by the landlord to protect itself against this alarming turn of events, frustration is sure to follow.

It is fair to say that the greatest source of frustration for a landlord when faced with the insolvency or bankruptcy of a tenant is the fact that it is unable to resort to its usual remedies of distraint or termination. When a tenant seeks protection from its creditors pursuant to the provisions of either the *Bankruptcy and Insolvency Act* (Canada) or the *Companies' Creditors Arrangement Act*, or if the tenant becomes a bankrupt, the landlord will be prevented from

distraining and/or terminating the lease by either a stay provision contained in the creditor protection order or pursuant to the provisions of the BIA which provides, among other things, that when a tenant becomes a bankrupt a landlord and all other creditors of the bankrupt are stayed from taking any steps to enforce whatever rights they may have against the assets of the bankrupt.

The making of a proposal or plan is akin to the negotiation of a new contract between the tenant and its creditors. Patience and attention to detail should be the watch words for a landlord and its counsel engaged in the proposal process. The landlord has two principal interests:

- (1) maximizing recovery in respect of the indebtedness owing to it; and
- (2) securing a solid tenant for its premises on a long term go forward basis.

If the tenant's proposed "new contract" does not adequately address these interests, it is open for the landlord to vote against the plan/proposal. The overriding question for the landlord is whether the plan/proposal offers the landlord more than would be gained in a bankruptcy. On a positive note, the landlord is entitled to receive rent from the tenant during the proposal/plan process on the terms set forth in the lease.

In the event that a tenant's proposal/plan is rejected by its creditors, the tenant will become a bankrupt – adding a whole new layer of frustration.

On bankruptcy, the trustee has a 90 day period from the date of the bankruptcy to decide whether to disclaim the lease. Worse still for the landlord, if a trustee does not take possession of the premises, the landlord is not entitled to receive any occupation rent during this 90 day period. However, if a trustee does take possession of the premises, it is personally responsible for occupation rent at the same rate as would have been payable by the tenant under the terms of the lease. It comes as a great shock to many landlords to discover that the BIA allows a trustee, subject to certain prerequisites, to assign the existing lease to a third party assignee without obtaining the landlord's consent. Indeed, it is entirely possible for a trustee to obtain an order of the court assigning an existing lease to a third party over the objections of a landlord provided that the assignee meets certain criteria which include the ability to honour its financial obligations under the lease and that the premises will not be used for a business more hazardous or objectionable than the business previously conducted by the bankrupt tenant.

As in all commercial transactions, forward thinking and decisive action will usually serve to eliminate, or at least reduce, the frustration experienced by a client. For example, a landlord may protect its interests prior to the tenant taking possession of the premises by:

(1) insisting upon (depending upon its relative bargaining power) the posting of a letter of credit by a third party which may be drawn upon by a landlord in the event of the insolvency and/or bankruptcy of a tenant. It is important to note that the language of this letter of credit must be precise and not limited to damages arising from non-payment of rent by a tenant. The language should be broad enough to include all damages incurred by the landlord resulting from the early termination of the lease on the default by a tenant with draw down satisfied simply upon the presentation of a certificate by an authorized officer of the landlord indicating the quantum of damages. Even in these circumstances, however, given the current state of the law, it is possible for a third party, such as a trustee in bankruptcy or secured creditor of the tenant, to challenge the right of the landlord to draw on the letter of credit;

(2) taking a security deposit in a substantial sum to cover a default by a tenant; and

(3) obtaining one or more indemnities. A third party indemnity must be carefully crafted to avoid characterization as a guarantee. If characterized as a guarantee of the obligations of a tenant under the lease, upon disclaimer of the lease, no obligations remain and recourse will then not be available. Consideration should also be given to taking a letter of credit as security for the indemnity.

Above all, as is the case in most medical ailments, the financial ill health of a tenant rarely occurs out of the blue and it is important that a lease contain financial reporting covenants which will provide a diligent landlord with forewarning of a tenant's impending financial difficulty.

In November of last year, we were asked by one of our landlord clients to represent its interests following the demise of the King's Health Centre. At the time of our retainer, no notice of receivership or bankruptcy had been served upon the landlord but it was widely believed that it was only a matter of time before the same was forthcoming. Accordingly, in keeping with the importance of being practical and decisive, we advised the landlord to initiate a distraint upon all assets of King's Health Centre. The distraint process requires the posting of a warrant of distraint for a period of 5 days to allow the tenant an opportunity to repay the indebtedness owing to the

landlord. In the event that a tenant is unable to repay its debt, a landlord then obtains at least two appraisals and sells the assets for the best possible price. King's Health Centre was unable to pay its indebtedness to the landlord, which was considerable, and the landlord promptly sold all of its assets. Interestingly enough, on the day of the sale, BACC Capital Corporation (the parent company of King's Health Centre) was petitioned into bankruptcy. Although King's Health Centre has not yet been placed into receivership or bankruptcy, it could easily have been and then our client would have been stayed from taking any steps to recover the indebtedness owing to it.

The insolvency or bankruptcy of a tenant can be a very frustrating experience. Counsel for a landlord would be well advised to minimize the frustration experienced by its client by making more transparent the insolvency process to facilitate the taking of proactive protective steps and thus avoid any misunderstanding as to the recourse available to a landlord on the insolvency or bankruptcy of its tenant. Indeed, with the economy taking a downturn, it is likely that landlords will find themselves in recovery mode with increasing frequency over the course of the next year.

Timothy R. Dunn



New Money Laundering Legislation: Challenges in Compliance

On June 20, 2000 Royal Assent was given to new federal legislation, the *Proceeds of Crime (Money Laundering) Act*, (the "Act") which targets money laundering, an activity which is estimated to involve \$25 billion each year in Canada from drug trafficking alone. The object of the Act is to implement specific measures to detect and deter money laundering and to facilitate the investigation and prosecution of money laundering offenses. The *Criminal Code* contains provisions constituting the laundering of the proceeds of crime an offense.

What is Money Laundering

Money laundering is the conversion or transfer of property, knowing that such property is derived from criminal activity, for the purpose of concealing the illicit nature of the property from government authorities. The key objective is to

conceal the criminal origin of profits by using legitimate businesses and institutions in a variety of ways.

The Rationale for this Legislation

The international community has recognized the fact that money laundering, unabated, is destructive to the global economy. In certain countries, money laundering has established itself as a parallel monetary system to the legitimate system. Accordingly, the Financial Action Task Force for Economic Co-operation and Development has addressed the issue of money laundering on a global basis. It has established standards and has requested all countries to accept and adopt these standards. In response, Canada has passed the Act to facilitate combating the laundering of proceeds of crime.

Key Provisions

This legislation, and the regulations which will accompany it, impose significant compliance obligations including record-keeping and reporting to a central agency, FINTRAC, not only on Canadian financial institutions, as did earlier legislation, but now also upon other businesses and certain professionals, specifically lawyers and accountants.

Central to the new regime is the requirement to report “prescribed transactions” which it is proposed in the regulations be any cash transaction of \$10,000 or more, and

accountants, real estate brokers and sales persons; casinos; and departments and agents of Her Majesty in right of Canada or of a province that are engaged in the business of accepting deposit liabilities or that sell money orders to the public.

It appears that the overriding purpose of the Act is to cause those persons and firms referred to above to submit reports to the Centre in order that this information may be disseminated to authorities in Canada and elsewhere in their efforts to search out and investigate activities that constitute “money laundering offenses” as defined in the Act. The Act



also “suspicious transactions”, where there are reasonable grounds to suspect that the transaction is related to a money laundering offense.

Timing of Implementation

The proposed regulations, which include the required reporting, record-keeping, and client identification procedures, were published for comment in mid-February, 2001. It is expected that after the 90 day period allowed for public comment, the regulations will be implemented in a phased approach beginning later this summer.

It is crucial that affected businesses and professionals implement compliance procedures to meet the impending regulatory regime.

Application of Act

The Act applies to the following persons: banks, including foreign banks with respect to their business in Canada; credit unions; life insurance companies; loan and trust companies; dealers in securities; investment advisors; foreign exchange dealers; persons engaged in a business, profession or activity described in the regulations, including lawyers,

accordingly imposes obligations on persons to report various transactions which facilitate the movement of monies and securities which are or may be the proceeds of crime. The Act refers to “financial activities” and reporting obligations which have yet to be established in regulations under the Act. The persons to whom the Act is addressed, including their officers and directors, must ensure that they are not accomplices to criminal action and thus exposed to legal sanctions.

What Must be Reported

Two types of financial transactions that occur in the course of business must be reported:

- (i) ***suspicious transactions***
where there are reasonable grounds to suspect that the transaction is related to the commission of a money laundering offense: and
- (ii) ***prescribed transactions***
which involve receipt of \$10,000 or more in the course of a single transaction... unless the amount is from a financial entity or a public body.

Two or more cash transactions on the same day are considered to be a single transaction if known to be on behalf of the same person or corporation.

The Act requires every person or entity to report to the Centre every “financial transaction” that occurs in the course of their activities and in respect of which there are reasonable grounds to suspect that the transaction is related to the commission of a money laundering offense. Financial transactions are not defined in the Act, nor is there any definition as to what constitutes reasonable grounds to suspect that the transaction is tainted. In due course the regulations and case law will establish the acceptable norms.

When Must Reports be Made

Suspicious transactions must be reported to FINTRAC within 30 days after the organization or individual first becomes suspicious of the transaction.

Prescribed, large cash transactions, (+\$10,000) must be reported within 30 days after the transaction during the first year after the regulations come into force, and within 15 days thereafter.

Every person shall report to the Centre stipulated financial transactions that occur in the course of their business activities unless prescribed conditions to be established by the regulations are met. Such person is relieved from the reporting obligations if the subject transaction meets certain prescribed conditions. Such person shall however maintain a list of such clients without the necessity of reporting the information to the Centre. The reporting person shall however have the right in lieu of maintaining a list to report the transaction to the Centre.

The recipient and processor of funds should make proper enquiry to satisfy herself/himself on a reasonable basis that the source and use of funds are legitimate failing which such person should have nothing to do with the transaction and should report it to the Centre. If such a person does not make the proper enquiries for fear of annoying their client or customer, they assume the risk of liability because they do not make such enquiries.

FINTRAC – The Centre

The Act establishes the Centre at arm’s length from law enforcement agencies and other entities to which it is authorized to disclose information with the purpose of collecting, analyzing, assessing and disclosing information in order to assist in the detection, prevention and

deterrence of money laundering. The head office of the Centre will be in the National Capitol Region in Ottawa. It will act as an agent of Her Majesty in Right of Canada and will be headed by a Director.

The Director under the Act shall report to the Minister from time to time, and keep the Minister informed of any matter that could materially affect public policy or the strategic direction of the Centre. The Director shall not disclose any information reported to the Minister that would directly or indirectly identify an individual who provided a report or information to the Centre or a person or entity about whom a report or information was provided under the Act.

Disclosure and Use of Information

The Centre shall not disclose information received by or prepared by it except as follows:

If the Centre has reasonable grounds to suspect that designated information would be relevant to investigating or prosecuting a money laundering offense it shall disclose the designated information to:

- (a) the appropriate police force;
- (b) the Canada Customs and Revenue Agency if the Centre also determines that the designated information is relevant to an offense of evading or attempting to evade paying taxes or duties under an Act administered by the Minister of National Revenue;
- (c) the Canadian Security Intelligence Service if the designated information is relevant to the security of Canada; and
- (d) the Department of Citizenship and Immigration.

The Minister is empowered to enter into agreements with governments of foreign states regarding the exchange of information between the Centre and such foreign states, institutions or agencies. The information exchanged must relate to investigating or prosecuting a money laundering offense or a substantially similar offense.

Compliance Measures

An authorized person may examine the records and enquire into the business and affairs of those persons or entities referred to above and in so doing may enter on to any premises, view any computer system or data processing system, reproduce any record and use any copying equipment. The owner or person in charge of the premises where these documents are situated is obliged to furnish any information that the authorized person may reasonably require.

Legal Counsel Claiming Privilege

If an authorized person is about to examine a copy of a document in the possession of a lawyer who claims that a named client or former client has a solicitor/client privilege then the authorized person shall not examine or make copies of the document. The document shall be placed in a package, sealed or if the authorized person or lawyer agree, allow the pages of the document to be initialed and numbered so that these documents are retained and preserved by counsel until produced to a Judge and an order is issued in respect of these documents.

Lawyers are particularly vulnerable to the possibility of unknowingly participating in money laundering because they have the necessary skills, contacts, experience and credibility when it comes to facilitating the movement of large sums of money. Indeed, movement of money is the legitimate stock-in-trade of many legal practices and is subject to the client's right to solicitor-client confidentiality. Reference should be made to the Rules of Professional Conduct which state that when advising a client a lawyer shall not knowingly assist in or encourage any dishonesty, fraud, crime or illegal conduct or instruct the client on how to violate the law and avoid punishment.

Information relating to the receipt, use and transmission of monies or property related to the commission of an offense or the perpetration of a fraud does not come within the ambit of solicitor-client information.

Others susceptible to involvement in the movement of illegal funds are accountants, bankers, financial institutions, stock brokers, money managers and real estate brokers. The source of tainted money and the use to which the money is put may appear to be proper; nothing may appear to arouse concern. The test however is what enquiry was made to reasonably determine that the source of the funds after the layering has been removed is legitimate and did not result from the proceeds of crime.

Offenses and Punishment

The Act provides severe penalties with respect to contraventions of the Act. Provision is made upon summary conviction for fines running from \$50,000 up to \$1,000,000. Where there is conviction on indictment, the fines run from \$500,000 to \$2,000,000. In addition, terms of imprisonment may be applied for periods from six months to five years.

A person or entity is not subject to conviction if they exercise due diligence in respect of the reporting obligations imposed upon them pursuant to Section 7 of the Act.

Compliance

In order to give full measure to the Act, it is important that those persons to whom the Act applies, and their regulatory bodies, ensure full compliance with the spirit and intent of the Act. This will require the development of a culture of compliance as a basis of business conduct and not of crisis management.

No doubt compliance will be costly, and will of necessity slow down the course of dealings with clients, but as time progresses and as acceptable business norms are established, the process of establishing and enforcing reasonable tests will become routine. Financial institutions and governing bodies of professionals are best suited through their own regulatory powers to ensure compliance as a discipline of the service that is provided by their members.

The Act has been criticized in that it will turn people into "snitches". The rebuttal to this is that if your clients or customers understand what the ethical expectations are, they will not bring questionable deals to you.

No criminal or civil proceedings lie against a person who makes a report in good faith. Legal counsel is not obliged to disclose any communication that is subject to solicitor/client privilege. This relates to communication but does not likely protect a solicitor who participates in or has knowledge of the movement of funds or monetary instruments where there are reasonable grounds to suspect that the transaction is related to the commission of a "money laundering offense".

Conclusion

The Act is very aggressive and invasive, but in fairness addresses the matter of implementation in a most effective way.

It is the responsibility of those persons engaged in the business and profession of money handling to establish compliance guidelines that both recognize and implement the provisions of the Act. The persons to whom the Act is addressed, including their officers and directors, must ensure that they are not accomplices to criminal action and that they are not exposed to legal sanctions.

Jules N. Berman, Q.C.

For further information, please contact a member of our Insolvency Practice Group.

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FIRM NEWS

We are pleased to welcome to the firm

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The firm is pleased to advise that at the recent Annual Meeting of Commercial Law Affiliates ("CLA"), Kenneth L. Kallish was elected to the Board of Directors of CLA for a three year term. Ken was also appointed to the Executive Committee of CLA, in the capacity of Chair, Canadian Council. The Canadian

Council is charged with developing and implementing regional tactics to support the institutional goals and strategies of the global CLA organization.

CLA is the world's largest legal service delivery network, comprising over 200 law firms and 5,000+ lawyers in 70 countries (with representation in each Province of Canada through a network of 9 law firms and over 480 lawyers situate in 15 Canadian cities). Minden Gross is the sole Toronto affiliate of CLA.

Lou Natale has been appointed member of the steering committee of the soon to be established Huronia Chapter of Canadian Condominium Institute which will service the condominium industry throughout the Barrie/Collingwood/Georgian Bay district and surrounding areas.

PROFESSIONAL NOTES

Jules N. Berman, Q.C. spoke and presented papers at a forum conducted by the Canadian Institute entitled "Financing and Securing Commercial Loans". The papers presented by Jules were "New Money Laundering Legislation", "Eligible Financial Contracts", "Issues Regarding the Appeal of Decisions Approving Receivership Sales", "New Developments in the Law of Set-Off" and "New Case Law Dealing with Equitable Subordination".

Howard S. Black was recently quoted in the April edition of the Investment Executive newspaper in an article entitled "Death and Taxes Hard to Avoid".

Ian J. Cantor co-chaired a roundtable discussion at an ICSC conference entitled "A Litigator's Perspective on Commercial Lease Disputes".

Kenneth L. Kallish and Catherine Francis recently presented a seminar to the Group Risk Management – Ontario, Royal Bank of Canada senior risk managers on the topic of Guarantees and the Super priorities available to Canada Customs Revenue Agency.

Lou Natale wrote an article entitled "Resort Condominiums: Big City Problems in Cottage Country" which appeared in the spring edition of "The Condo Voice", a publication of the Canadian Condominium Institute. Lou also participated as an instructor for a condominium course offered by CCI for property managers and condominium directors, and spoke at a CCI seminar on the topic of directors' and officers' responsibilities and standard of care under the new Condominium Act.

Stephen Posen, with the assistance of Robyn Kestenberg, Neil Sigler and Marc Bissell, wrote a chapter entitled "The Tenant's Remedies for Wrongful Distress" which appears in the book "Distress, A Commercial Landlord's Remedy" published by Canada Law Book Inc.

Reuben M. Rosenblatt, Q.C. presented a paper "Time is of the Essence" at a LSUC-CLE program called the "Six Minute Lawyer". As well, Reuben conducted a CBAO seminar entitled "(Mostly) Real Property Cases That Have Scared Me" and together with Jeffrey Lem of Heenan Blaikie conducted a CBAO seminar entitled "Important Real Estate Issues".

Daniel Sandler spoke at the Institute for Fiscal Studies Tenth Residential Conference "Encouraging Enterprise" held in Oxford, U.K. Daniel's presentation was entitled "Financing the New Economy, North American Style".

Monty Warsh was a member of the program planning committee as well as the moderator of the session entitled "Operating Costs: What's In – What's Out?" at the ICSC Canadian Shopping Centre Law Conference held in Toronto.