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MORTGAGE AND REAL PROPERTY LAW REPORT

A Legal Newsletter for the Mortgage and Real Estate Industries

Vol. 11, No. 2 **Autumn 2005**

"TIME SHALL BE OF THE ESSENCE" - DO IT OR LOSE IT!

When a party to a contract does not meet his or her obligations within stipulated time frames, should a court intervene to rewrite the contract to relieve the party in breach of consequences that could be seen to be harsh or inequitable?

The Ontario Court of Justice, in the recent decision of 1473587 Ontario Inc. v. Jackson, (July 22, 2005) by refusing to dilute the strict effect of the clause "time shall be of the essence," has sent a message that failure to meet stipulated time periods in contracts containing the clause will continue to have serious consequences.

In the decision, Mr. Justice Rutherford held that Loblaws' payment of a deposit under an agreement for the purchase of land after the expiry of the time period for payment allowed the vendors to unilaterally terminate the contract. In 2003, Loblaws had entered into an agreement to purchase 12 acres of a 56-acre parcel of land near Fergus, Ontario for $1.8 million, based upon a price of $150,000 per acre. Through inadvertence, the $75,000 deposit was paid seven days after the date stipulated in the agreement, and, unfortunately for Loblaws, the vendors had received another, more attractive, offer to sell the entire parcel for $125,000 per acre. The vendors' lawyer did not deposit Loblaws' deposit when it arrived in his office, but returned same pending receipt of instructions from his clients. The instructions, which came later that day, consisted of terminating the contract. Multiple suits arose, and the matter came before Mr. Justice Rutherford on a motion for summary judgment.

In making its decision, the Court refused to accept the argument that, though the requirement for the deposit may have been a fundamental term of the contract, late payment was not a fundamental breach, especially where no harm or prejudice had been incurred by the vendors. Loblaws argued that, if failure to pay the deposit on time was intended by the parties to amount to a fundamental breach entitling the vendors to treat the contract at an end, then clearer, more explicit language was required.

The contract provided that:

"21. This offer, when accepted, shall constitute a binding contract of purchase and sale, and time in all respects shall be of the essence of this Agreement.

22. Time shall be of the essence of this Agreement, but no extension of time for making any payment or doing of any acts hereunder shall be deemed to be a waiver or modification of or affect this provision."

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Mr. Justice Rutherford noted that the expression is a well known and well understood term found throughout the commercial world, and that the agreement was drawn by a professional agent of Loblaws and "entered into by sophisticated people of business acumen."

"How much more clearly could contracting parties make conditions as to the timing of performance being essential than by simply saying, *time in all respects shall be of the essence of this agreement*?" The Court also quoted with approval the English decision of Union Eagle Ltd. v. Golden Achievement Ltd. to the effect that "[t]he fact is that the purchaser was late. Any suggestion that relief can be obtained on the ground that he was only slightly late is bound to lead to arguments as to how late is too late, which can only be resolved by litigation ... [I]n cases of rescission of an ordinary contract of sale of land for failure to comply with an essential condition as to time, equity will not intervene."

The Court refused to accept the argument that the vendor needed to assert its right to treat the contract at an end as soon as the deposit became overdue, or at least as soon as Loblaws, realizing its default, asserted an intention to remedy the default.

This decision is a clear reaffirmation by Ontario Courts that will hold parties to a contract "to their bargain", at least in land purchase agreements containing a time shall be of the essence clause.

Those entering agreements containing this common and often over-looked clause should keep in mind its power and reach, and should consider incorporating grace periods to protect against inadvertent or minor breaches.

LEE HUTTON KAYE MALOFF & PAUL DENRIKSEN V. R.

A recent tax case may have a significant influence on the way commercial real estate is practised in Canada. In *Lee Hutton*, a vendor sold a commercial building to a purchaser it thought was registered for the purposes of GST under the *Excise Tax Act* (R.S.C 1985, c. E-15) (the "Act"). The purchaser had notified the vendor that it was a GST registrant, provided a GST registration number, and agreed to self-assess and remit any GST owing on the purchase. However, it was later determined that the purchaser's GST registration had been cancelled before the completion of the transaction. The vendor was reassessed for the uncollected and unremitted GST, plus penalties and interest.

The Tax Court of Canada held that section 221(2) of the *Excise Tax Act* requires, as an absolute precondition of relief from a vendor's obligation to collect and remit GST, that the purchaser be a registrant under the Act at the time of the sale. Non-compliance by the purchaser deems the vendor liable to GST plus penalties and interest. With this ruling, the Court effectively established a higher threshold for compliance with the GST legislation than that under section 116 of the *Income Tax Act* (R.S.C. 1985, c.1 (5th Supp.) (the "ITA"). The ITA also deems a party liable for tax, and requires purchasers of property from a non-resident of Canada at the time of the sale to withhold and remit income tax for the vendor's capital gains. The difference lies in the wording of the two statutes, since the ITA holds a purchaser liable "unless ... after reasonable inquiry the purchaser had no reason to believe that the non-resident person was not resident in Canada.," which allows the purchaser a defence of due diligence. The GST section of the *Excise Tax Act* allows for no such defence.

After *Lee Hutton*, vendors and the lawyers who represent them will have to verify a purchaser's GST registration status before closing, at least until amending legislation is passed introducing a due diligence defence in these cases. Note that the decision in Lee Hutton was made pursuant to the "informal procedure" of the Tax Court of Canada, which is intended to bind only the litigants and not act as precedent, but even so, it is unwise to underestimate the impact that these decisions could have.

OMERS REALTY CORP. V. SEARS CANADA INC. (Feb 18, 2005)

Overturning the decision of a panel of arbitrators, the Ontario Superior Court of Justice recently ruled that when a commercial landlord tries to recover part of the shortfall between what it pays in property tax and what it can charge to tenants, the landlord has some discretion over which tenants from which it recovers the shortfall.

In 1997 and 1998, Ontario abolished business property taxes but increased realty taxes for commercial and industrial properties. A new scheme was introduced under sections 447.24 and 447.25 of the *Municipal Act* (R.S.O. 1990, c.M.45) which limited the amount a landlord could charge a tenant for property taxes, thereby creating shortfalls for many landlords. Under the new scheme, however, landlords were permitted

to recover at least part of the shortfall from two classes of tenants: (a) "Protected tenants not at cap", tenants whose pre-December 21, 1997 leases were below a certain threshold, and (b) "Uncapped shortfall tenants", tenants whose tenancies commenced between January 1 and December 17, 1998.

Omers Realty Corporation ("**Omers**") was the landlord of a mall in Guelph, and Sears Canada Inc. ("**Sears**") was one of the mall's biggest tenants. Omers decided that it would recover its property tax shortfall from its protected tenants not at cap – among them, Sears – rather than from its uncapped shortfall tenants.

Claiming that it had been overbilled approximately $189,000, Sears served Omers with a Notice of Arbitration. A majority of the arbitral panel ruled in favour of Sears, concluding that the landlord was obliged to recoup the shortfall from all eligible tenants. Omers appealed.

The Ontario Superior Court of Justice held in Omers' favour on the appeal, stating that there was nothing in the legislation requiring the landlord to recover shortfall from all eligible tenants. The arbitral panel had erred in expanding the legislation, when in fact the legislation conferred on landlords some discretion as to how they would recover the shortfall. If Parliament had wanted to limit this discretion, it could have done so, but the legislation used the word "may" rather than "shall" to describe the landlord's ability to recover taxes in amounts over those set out in the leases.

While much of the decision in *Omers* focuses on the analytical methodology employed by the arbitral panel and the standard of review to which the arbitrators' decision could be held, the Court also spent some time considering to what standard an arbitrator or panel of arbitrators can hold a landlord's decisions. The arbitrators could only overturn the landlord's decision if it was "patently unreasonable", but the arbitrators had overruled the landlord without even addressing the question of the reasonableness of its decision. Judge Pepall scolded the majority of the arbitrators, writing "the presence of the arbitration provision in the lease does not clothe the arbitrators with the ability to ignore (the) standard of review analysis and to replace the Landlord's decision with their own view of what is reasonable."

The landlord had made its decision based on what it considered was the fair share of taxes borne by different classes of tenants, on the total obligations (lease costs plus shortfall recoup) of all the tenants, and on industry practice. Therefore the landlord's discretion had been exercised reasonably, and the decision should not have been interfered with at arbitration, Judge Pepall concluded.

CREDITOR MUST BE CAREFUL IN ALLEGING FRAUD AGAINST DISCHARGED BANKRUPT

Over four years after a debtor was discharged from his bankruptcy a major creditor brought a motion to have the trustee in bankruptcy re-appointed for the purpose of conducting an investigation to determine whether the bankrupt had committed bankruptcy offences.

The Bank of Montreal alleged that the discharged bankrupt, an Ottawa solicitor, Frederick Cogan had failed to disclose to his trustee two appraisals relating to two properties in which he had an interest with his brother. The bank submitted that if Cogan's trustee had been provided with these appraisals it might have valued at a higher price his interest in the properties which had been released back to Cogan, in consideration of a payment to the trustee of $175,000. It was later alleged that there was also a "no-bid agreement" with the brother.

Mr. Cogan disputed the allegations of fraud and for tactical reasons the bank abandoned its initial motion to annul the discharge and proceeded on different grounds on a motion to re-appoint the trustee to conduct investigations to determine whether bankruptcy offences had been committed. The Court was critical of the bank's actions in this regard and was of the view that strong evidence is required and here the bank provided no evidence to contradict that of Cogan.

In a January 13, 2005 decision, Justice Hackland of the Ontario Superior Court of Justice, expressed the view that Mr. Cogan's estate had already been fully administered and was not satisfied that there were unrealized assets.

The *Bankruptcy and Insolvency Act* provides that the re-appointment of a trustee in bankruptcy for conducting investigations to determine whether bankruptcy offences had been committed is to be used only if a court is satisfied that there are assets that have not been realized or distributed. Furthermore, the Court was of the view that even if a trustee could be re-appointed to assess and to pursue an action for bankruptcy fraud, as an unrealized asset for the bankruptcy estate, the court must first be satisfied that there is a substantial issue to be tried as to whether the bankrupt has committed a fraud. The Court was not satisfied that either the appraisals or the alleged no-bid agreement with the brother was a substantial issue to be tried.

In the end, the motion to re-appoint the trustee was denied.

MANULIFE V. CONLIN RATIO EXTENDED

On December 19, 1994, we reported to you on the landmark court decision in Manulife Bank of Canada v. Conlin by which the Supreme Court of Canada ruled that the failure to get a guarantor to sign a mortgage renewal agreement was sufficient to allow the guarantor to be released from the guarantee and have no liability with respect to the mortgage debt.

Since this time, this decision has been cited numerous times in litigation between financial institutions and borrowers and guarantors.

In January of 1997 we reported to you on the decision in Bank of Montreal v. Negin which restricted the scope of the Manulife decision. In the Spring 2005 edition of our Newsletter we advised you of the decision in AGF Trust Co. v. Muhammad which distinguished Manulife and Conlin, relied on Bank of Montreal v. Negin and held a guarantor liable.

The Court of Appeal in Citadel General Assurance Co. v. Iaboni has rendered a decision which may extend the ratio of the Manulife decision.

Citadel's mortgage was granted in 1986 and had a five year term. In 1987 the mortgagor sold the mortgaged property. In 1991 when the five year term expired, Citadel agreed with the transferee to renew the mortgage for a further five years at a reduced rate of interest. The original mortgagors were not notified of the renewal. When the transferee defaulted, Citadel sold the property under power of sale and sued the original mortgagors for the deficiency.

The mortgage contained a "no prejudice" clause as follows:

> *"Provided further that no sale or other dealings by the Mortgagor with the equity of redemption in the said lands or any part thereof shall in any way change the liability of the Mortgagor or in any way alter the rights of the Mortgagee as against the Mortgagor or any other person liable for payment of the moneys hereby secured"*.

On a motion by the original mortgagors for summary judgement dismissing Citadel's claim, the motions court judge held that the agreement between Citadel and the transferee was a renewal (and not an extension) and that the renewal clause in the mortgage did not bind the mortgagors to an agreement to which they had no notice.

The Court of Appeal agreed with the motions court judge. In holding that the original mortgagors remained liable to Citadel as mortgagee on the covenant during the term of the mortgage, notwithstanding any sale of the equity of redemption, but that they were relieved from liability when their purchaser entered into a renewal agreement with Citadel without their notice or consent, the Court of Appeal, remarkably, refused to give effect to the express wording of the "no prejudice" clause.

In light of this decision, it is imperative that lenders ensure that all mortgage clauses whether relating to defaults, renewals, extensions or sales, are consistent, failing which courts may be inclined to interpret any inconsistency in the favour of the borrowers.

NEW LAWYERS

We are pleased to announce the additions of H. Paul Beyer and David Kelman to our Firm.

Paul graduated *magna cum laude* from the University of Ottawa in 1983 and was called to the Bar in 1985. In the course of his legal career, Paul has been in-house counsel for Confederation Life Insurance Company, has been Vice-President and General Counsel to a publicly-traded hotel company and private finance company and has written numerous articles for and has been the digest editor of The Lawyers Weekly. His practice consists of commercial mortgage lending, acting for both borrowers and lenders.

David Kelman graduated from the University of Toronto Law School in 2000 and was called to the Ontario Bar in 2002. His practice areas include real estate acquisitions and financings and residential and commercial land development.

BAKER SCHNEIDER RUGGIERO LLP is engaged in various areas of law with particular emphasis on the following:

* Commercial Lending
* Subdivision and Condominium Development
* Mortgage Enforcement (Commercial and Residential)
* Debt Restructuring
* Real Property Litigation
* Commercial Litigation
* Corporate/Commercial/Leasing

The comments contained in this Newsletter are of a general nature only. Prior to applying these comments to any specific problem, please obtain appropriate legal advice.

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