LEGAL ALERT

February 2017 • Volume 35 • Number 11

Current Legal Developments Critical to Corporate Management

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> ***If we desire respect for the law, we must first make the law respectable.***
> **~ Louis D. Brandeis (1856 – 1941)**

A Thomson Reuters Publication

COMMERCIAL PROPERTY AND LEASES

ONCA reverses negligent misrepresentation ruling

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There are limits to the "buyer beware" principle and to the protection afforded by an "entire agreement" clause and other exculpatory clauses and statements.

Approximately a decade before Donald Trump won the American presidential election, Mr. Trump's name was used by a Toronto-based condominium developer to market an investment opportunity. For between $784,000 and $843,000 (at a time when the average home in Toronto sold for less than half that amount), purchasers could buy a condominium hotel unit in the Trump International Hotel & Tower.

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SECURITIES

Court considers fairness opinion in plan of arrangement

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The Yukon Court of Appeal held that it is the court's task to decide whether a proposed arrangement has been shown to be fair and reasonable.

The Canadian courts have recently made some important decisions regarding the use of fairness opinions in mergers and acquisitions transactions structured as statutory plans of arrangement. This article considers the recent decision of the Yukon Court of Appeal (which is made up of judges of the British Columbia Court of Appeal) in *InterOil Corp. v. Mulacek* ("InterOil").

Background

InterOil is a Yukon corporation. Its primary asset is a 36.5 percent joint venture interest in a development stage oil and gas field (the "Elk-Antelope fields") in Papua New Guinea.

In May 2016, Oil Search Limited ("Oil Search") made a share exchange offer to acquire all the shares of InterOil. Oil Search's offer was valued at approximately U.S. $40.25 per share (representing a premium over the U.S. $31.65 trading price), plus a

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Commercial Property and Leases

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The purchasers would be obligated to participate in a maintenance and operations program to cover expenses related to the hotel, and could also participate in a "Reservation Program" whereby the hotel would rent units for between $550 and $600 per night. A portion of this nightly rate would be paid to the unit owners.

Reservation program

During the marketing phase of the project, the developer ("Talon") used the Reservation Program to demonstrate potential returns on investment in the hotel units. Over time, significant inaccuracies in the estimates were discovered, and the Reservation Program became the subject of claims for rescission and damages by many purchasers who had suffered substantial losses.

Trial court dismissal

Motions for partial summary judgment against some defendants were brought by two purchasers in two separate but similar cases. The Ontario Superior Court not only dismissed the partial summary judgment motions but also dismissed the purchasers' claims in their entirety as against the individual defendants.

Court of Appeal reversal

The purchasers appealed and the Ontario Court of Appeal reversed the motion decision *in part*, but significantly. The two purchasers emerged from the Court of Appeal with partial summary judgments against Talon for rescission of the purchase contract (in the case of one purchaser), and damages (in the case of the other purchaser).

The purchasers also emerged with certain of their claims against the individual defendants that were outside the limited scope of the partial summary judgment motions left alive for future determination. The court's decision is noteworthy on a number of substantive issues (and procedural issues that are not the subject of this case comment).

OSC exemption

Before marketing the project, Talon had sought and obtained an exemption ruling from the Ontario Securities Commission ("OSC") so that securities registration and prospectus requirements would not apply to the sale of hotel units. In its application, Talon stated that units would "not be marketed or structured as investments for profit or gain" but would, instead, constitute luxury units for exclusive occupancy. The Reservation Program would operate as an opportunity to finance ownership expenses during periods of non-occupancy.

The OSC granted the exemption on the basis that the Reservation Program would operate as "merely a secondary feature." Purchasers were not to receive any forecasts, guarantees, or "any other form of financial projection or commitment."

Marketing and sales

The Trump brand was a significant feature of Talon's marketing efforts; sales staff emphasized that elevated nightly rates and occupancy predictions would flow from "buzz" about the hotel as a five-star, luxury property. Upon meeting with Talon's representatives, each purchaser received a document entitled "Estimated Return on Investment" (the "Estimates") which showed expenses and revenue for the relevant condominium unit.

In addition to quoting the anticipated room rental rate, the Estimates demonstrated occupancy rate scenarios ranging from 55 percent to 75 percent occupancy. A bottom line, showing "return on cash invested," disclosed anticipated returns of 6.46 percent to 21.57 percent. Purchasers were assured that even in a "worst-case scenario," the revenue from hotel rental income would exceed the carrying expenses for each unit. This

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document was the cornerstone of the purchasers' claims.

Worse than worst-case

Shortly before the condominium hotel units proceeded to interim occupancy closing, purchasers received a Statement of Adjustments which set out estimated monthly common expenses and taxes that were 51 percent and 68 percent higher than their respective initial Estimates. These updated statements (and other material provided by Talon at this time) also included significant additional fees such as HST; management fees; a furniture, fixtures and equipment fund fee; and a $48 nightly administration rental fee that were not disclosed in their initial Estimates.

To make matters worse, occupancy rates during the first seven months of the program fluctuated between 19 percent and 45 percent. Similarly, rental rates sunk below $400 per night. The combination of lower-than-expected revenue and much higher-than-expected expenses resulted in accumulating losses for purchasers during the interim occupancy period.

OSC refusal to act

When Talon was ready for final closing, one of the two plaintiff purchasers backed out and refused to close, and the other closed and continued to suffer accumulating losses on her unit. By November of 2012, the OSC began receiving complaints that Talon had breached its ruling.

However, the OSC decided not to act on the alleged breaches. The purchasers in these actions then sued for (among other things) breach of the OSC ruling, misrepresentation in the offering memorandum (pursuant to s.130.1 of the *Securities Act*) and fraudulent and negligent misrepresentation.

No negligent misrepresentation

The motions judge determined that four of the five requirements for an action in negligent misrepresentation were satisfied. He held that the Estimates were "deceptive documents… replete with misrepresentations of commission, of omission, and of half-truth." But, he found that the fifth requirement was not satisfied because the plaintiff purchasers' "subjective reliance was objectively unreasonable."

In addition to finding that the plaintiffs had not met the test for negligent misrepresentation, the motions judge held that the negligent misrepresentation claim was defeated by the "entire agreement clause and the other exculpatory provisions of the Agreement of Purchase and Sale and the related contracts."

Those clauses advised the purchasers that they should only rely on the agreements expressed in writing, that no representations were being made as to the projected rental income, and that there were risks that income would not be as projected.

Court of Appeal

The Court of Appeal distinguished between the inherent risks of investing that the purchasers acknowledged and accepted (e.g. that market conditions could change, that rental rates and occupancy rates could fluctuate, and that their expenses might go up) and the two actionable negligent misrepresentations made by Talon that (i) the Estimates were based on the best available information at the time, and (ii) that the hotel would be immediately profitable.

Applying the analytical approach the Supreme Court of Canada had outlined in *Tercon Contractors Ltd. v. British Columbia (Minister of Transportation & Highways)* for deciding whether to enforce exclusion clauses, the Court of Appeal found that the "entire agreement" clause (and other exculpatory provisions contained in the agreement) did not defeat the misrepresentation claim. The court held that

> in the circumstances and context in which the clauses were entered into, it would be unconscionable to enforce those clauses to bar the plaintiffs' claims.

The court expressed an overriding public policy that outweighs the very strong public interest in the enforcement of contracts as follows:

> In my view, it would be unconscionable and would shock the conscience to allow a party to use an entire agreement or other exculpatory clause to escape liability for misrepresentations made in breach of the OSC's terms for granting an exemption from the *Securities Act* requirements. The entire agreement and other exculpatory clauses would operate to negate a negligent misrepresentation claim and the misrepresentation itself was only possible in this case because Talon evaded protective requirements under the *Securities Act* by obtaining the exemption and then breaching that exemption.

Significance

The Court of Appeal's decision in this case is a salutary reminder that there are limits to the "buyer beware" principle and to the protection afforded by an entire agreement and other exculpatory clauses and statements. It remains to be seen whether the court's decision is the last word in the case; in mid-December 2016, the affected defendants filed an application seeking leave to appeal to the Supreme Court of Canada.

REFERENCES: *Singh v. Trump*, 2016 ONCA 747, 2016 CarswellOnt 16134 (Ont. C.A.) at paras. 94, 129; *Tercon Contractors Ltd. v. British Columbia (Minister of Transportation & Highways)*, 2010 SCC 4, 2010 CarswellBC 296, 2010 CarswellBC 297 (S.C.C.) at paras. 122-123.