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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 Corporate/Commercial Group, Stanley Kugelmass at 416.593.3943 or skugelmass@blaney.com.

LETTERS OF INTENT - BE VERY CLEAR AND CAREFUL ABOUT WHAT YOU MIGHT WISH FOR

Sundeep Sandhu

The Court of Appeal for Ontario has issued an important caution to business people who regard a letter of intent (LOI) as only an "agreement to agree" to a proposed deal and not as a binding commitment to that deal.

The caution is this – be *very* careful, not only about the wording of the LOI, as such, but about what you say and how you behave in relation to it. If you are not careful, you may discover that phrases in the LOI itself and accompanying words and actions can essentially serve to turn what you look upon as a provisional document into a binding one.

This caution flows from the appeal court's reversal earlier this year of the superior court decision in *Wallace v. Allen*, ("*Wallace*"), which was discussed in Blaneys on Business last autumn.

Trial Decision

If you recall, it was in *Wallace* that the trial judge found that the sellers of an environmental services business, Graham and Gayle Allen, and the buyer, Kim Wallace, who were friends and neighbours, were not bound to complete the sale of shares of Allen's companies, even though the parties had nearly concluded the transaction.

After Mr. Allen refused to sign two early drafts of an LOI because "there remained too many things up in the air", the parties eventually did enter into an LOI setting out almost all of the essential terms of their agreement. Shortly thereafter Mr. Wallace began to attend the business premises daily with a view to learning the business, getting to know the customers and staff and doing everything necessary to provide a smooth transition in the company's ownership. The parties had also met after a draft of the share purchase agreement was circulated to expressly deal with any outstanding issues.

The trial judge found that all the issues between the parties to form part of the share purchase had been dealt with prior to the closing. In fact, Mr. Allen admitted that he felt obliged to complete the transaction on the day of the closing and was there to sign the necessary paper work. However, he refused to close after he was told that Mr. Wallace had not signed the necessary documentation and had not placed any money in trust to close.

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The LOI included a clause requiring that the terms be reduced to a binding agreement of purchase and sale within 40 days, and a clause stating that "there will be much legal work to be done… and that the wording of this agreement may alter somewhat." This is not unusual, as LOIs are typically used as an initial means of establishing a relationship without having the parties commit to legally binding obligations until the details of those obligations have been negotiated. They are simply "agreements to agree" and postpone any legal liability until the details of the final agreement have been negotiated. As a result, the courts have historically refused to enforce LOIs.

The trial judge concluded that, from the perspective of an objective, reasonable observer, considering (a) the circumstances giving rise to the LOI, (b) the wording of the LOI, and (c) the conduct of the parties, that while the LOI contained all the essential terms, it did not constitute a binding contract. The parties had merely entered into an agreement to agree and, as such, had not yet demonstrated that they intended to be bound by the LOI. As the parties did not sign the final form of the purchase and sale agreement that they had negotiated, no final agreement had been made.

Court of Appeal

The Court of Appeal set aside the trial judge's decision, concluding that, read as a whole the parties did, indeed, intend to be bound by the LOI. The court concluded that the trial judge had essentially failed to apply the presumption in law that an individual who executes a commercial document intends to be bound by it, and that the judge's construction of the LOI defeated the parties' expectations and was contrary to the weight of evidence presented at trial.

The court found that the LOI plainly expressed an intention on the part of the parties to be bound by its terms, which were to be incorporated into a more formal document. It pointed out that the language in the LOI referenced "this agreement," suggesting that the substance of the LOI was acceptable to the parties and that only the wording would be altered in the drafting of a binding agreement of purchase and sale. Mr. Wallace further explained that "the need for much work to be done", as referenced in the LOI, meant that, as learned through his previous purchase experiences, the actual formal agreements in purchase transactions tend to be lengthy and numerous in nature.

Furthermore, the court concluded, the conduct of the parties after the signing the LOI clearly demonstrated that they intended to be bound by its terms. Mr. Wallace had started work in the business, going beyond simple due diligence. In addition, at a special meeting of employees and at the company Christmas party, Mr. Allen had announced his retirement and the sale of business and had introduced Mr. Wallace as the new owner. All outstanding issues had been addressed in a meeting set up for that express purpose prior to the closing date.

The Court of Appeal's reversal of the trial court's decision in *Wallace* emphasizes the value in seeking advice from counsel as to whether it is, first, desirable to have a legally enforceable LOI; second, whether the specific LOI in ques-

"The Ontario Court of Appeal however, took a different view of the interplay between the conflicting statutes. In its judgement, section 4 (1)(c) of the PPSA was never intended to address priority disputes."

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tion is, in fact, a legally enforceable agreement; and third, what words and behaviours, post-signing, will serve to reinforce the intentions of the parties to the LOI. ■

UPDATE: FINANCING THE PURCHASE OF VEHICLES - A NEW TAKE ON AN OLD CASE

Diane Brooks

Last year, Blaneys on Business brought to your attention the Ontario Superior Court of Justice decision which awarded the salvage and proceeds from two trucks to ING Insurance Company of Canada, in priority to the rights of the lender in those same trucks, GE Canada Equipment Finance G.P. That decision just didn't ring true to us and now, the Ontario Court of Appeal has agreed.

To refresh your memory on the background, GE financed two highway tractors for Brampton Leasing and Rental Inc. by conditional sales contract, properly registering its interest in the tractors under Ontario's Personal Property Security Act (PPSA) and reserving title to them until they were fully paid for.

Brampton leased the vehicles to a third party, or sublessee, who obtained insurance from ING, naming itself as lessee and Brampton as lessor, but not naming GE.

The vehicles were stolen and ING made payment to cover the total loss to Brampton, on Brampton's false declaration that no one else, other than the third party sublessee and Brampton had a secured interest in the vehicles. When the salvage of the trucks were recovered, ING took possession of them. GE commenced an action against ING claiming that GE was entitled to the salvage and any proceeds of sale.

The Ontario Superior Court held that ING was entitled to the salvage and any proceeds, effectively holding that section 4(1)(c) of the PPSA, which provides that the Act does *not* apply to a transfer of an interest in an insurance policy, and section 9, which states that a security agreement is effective against third parties "except as otherwise provided by this *or any other Act,*" made room for statutory condition 6(7) of the Insurance Act to prevail.

The Ontario Court of Appeal however, took a different view of the interplay between the conflicting statutes. In its judgement, section 4 (1)(c) of the PPSA was never intended to address priority disputes. The only purpose of the section was so that insurance companies did not have to file financing statements under the PPSA to validate their security interests taken in insurance policies. So, while title to the salvage of the trucks was transferred to ING pursuant to statutory condition 6(7), that transfer of title was NOT free and clear of encumbrances and the title that ING took was subject to GE's prior lien. Statutory condition 6(7) puts the insurer in the same position as the insured - their title is subject to GE's lien. The court's logic is quite compelling - if a debtor wanted to defeat a secured creditor's lien, he/she could purchase insurance and in the event of a total loss of the vehicle, the secured creditor's lien

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could be extinguished at the option of the insurance company. That is not a reasonable conclusion and cannot be what the legislators intended.

Having dealt with the issue above, the Court of Appeal had to continue and consider another argument advanced by ING at trial that the trial judge found unnecessary to consider. Section 28(1) of the PPSA provides that a purchaser for value of collateral sold in the ordinary course of business takes free and clear of liens created by the seller. In dispensing with this argument, the Court of Appeal found that (1) a transfer of title pursuant to statutory condition 6(7) was not a sale and (2) even if it were a sale, it was most certainly not in the ordinary course of Brampton's business.

ING was also permitted to raise another argument at appeal, that section 25(1) of the PPSA prevented GE's security interest from attaching to the vehicles in ING's hands. Their argument was based on their view that GE had "impliedly" authorized dealing with the collateral free of their security interest and accordingly, their lien was released upon the transfer of title. ING argued that by authorizing Brampton to deal with insurance related matters and by classifying their collateral as inventory, GE implicitly authorized Brampton to deal with the vehicles and hence, the GE lien would not continue after an intervening event such as a sale or transfer of title for insurance purposes. The Court of Appeal disagreed with ING on this point as well and ultimately decided that the dishonest acts of Brampton should be born by ING.

A Comforting Conclusion

The Court of Appeal decision should be of great comfort to secured lenders. It upholds, again, the sanctity of Ontario's personal property security regime by noting that secured creditors should not lose priority as a result of a debtor misleading its insurers because to lose such priority would undermine normal good faith financings.

It also makes clear that any title acquired by insurers is subject to prior liens and that now insurance companies are advised to conduct PPSA searches prior to paying out claims or they risk taking a salvage that is already encumbered. ■

NEW ONTARIO SALES TAX REGIME NET GOOD NEWS FOR BUSINESS

Mona Taylor

The 2009 Ontario Budget proposes that the existing provincial retail sales tax system be replaced with a single harmonized sales tax that will apply to most purchases and transactions occurring in the province after July 1, 2010. In general terms, the harmonization will result in the combination of the 8 per cent Ontario retail sales tax with the 5 per cent federal goods and services tax to form a 13 per cent harmonized sales tax.

On balance, this appears to be positive news for business, although several sectors stand to be affected negatively. And while consumers will have concerns about direct near-term impacts,

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the province contends there will be longer term overall economic benefits because of lower business costs and enhanced competitiveness.

The new harmonized sales tax is expected to apply in the same manner as the GST to goods and services provided in Ontario. The difference that will be noticed by Ontario residents is that they will be paying the provincial portion of the harmonized tax on products and services that are not currently subject to Ontario retail sales tax, such as gasoline, home heating fuel, rent, real estate fees, professional fees (such as legal, accounting and consulting fees) and personal services (such as haircuts, beauty treatments and dry cleaning).

New homes worth more than $400,000 will be subject to an additional 8 per cent tax when the harmonized tax is implemented. Both the purchase and the leasing of commercial property will be subject to a similar increase in the incidence of tax. Businesses that qualify for input tax credits will not feel the effect of the increase. However, those businesses involved in exempt activity (ie. banks and insurance companies) will feel the increase on their bottom line.

Similarly, certain services associated with a real estate transaction currently attract GST and not PST. After the harmonization, consumers will be required to pay 8 per cent more for things like legal fees, home inspection fees, mortgage insurance premiums, moving costs and real estate commissions.

Another industry very concerned with the concept of harmonization is the investment management industry. If the proposed harmonized sales tax is applied to the same items as the GST, it would result in an additional 8 per cent tax being applied to investment management services, including mutual funds, segregated funds and other managed investment accounts, which are part of many registered savings plans, registered income funds, locked-in retirement accounts and defined contribution pension plans.

To soften the initial blow, many consumer goods will be exempt from Ontario's 8 per cent portion of the new harmonized sales tax. For example it is currently proposed that books, children's clothing and footwear, car seats and car booster seats and feminine hygiene products will be exempt. Purchasers of new homes worth up to $500,000 would receive a housing rebate on the provincial portion of the single sales tax. The proposed provincial rebate rate would be more than twice as generous as the GST housing rebate rate. The effect of the housing rebate would be to ensure that, on average, new homes under $400,000 would not be subject to an additional tax burden.

Families earning less than $160,000 a year will get three cheques totalling $1,000 annually to offset the higher prices. Single people earning under $80,000 will receive $300 under a similar schedule.

Despite the anticipated unhappiness of the general public – some Liberal back benchers, apparently, are so concerned that they reportedly want the government to hide the tax from the consumer by "burying" it in the overall price of

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a good or service – many industries favour harmonizing the taxes. It completely eliminates the compliance costs associated with the existing provincial sales tax and it will allow most businesses to recover money currently lost to retail sales taxes. Presently, most businesses recover GST paid on inputs necessary for their business through the input tax credit system. No similar refund currently exists for businesses that pay RST.

It is important to note that, under the proposal, large businesses (those with annual taxable sales in excess of $10 million) and financial institutions would not be able to claim input tax credits in certain areas (ie. expenditures related to energy, certain telecommunication services, certain road vehicles, food, beverages and entertainment). These restrictions would be temporary, during the initial implementation of the single sales tax, and would apply only to the provincial portion of the tax. After the first five years of single sales tax implementation, full input tax credits on their taxable supplies would be phased in over a three-year period.

It is also expected that the 8 per cent provincial portion of the harmonized tax would still apply to certain types of insurance. ■

EXPECT THE BEST

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