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THE BREACH OF A PROMISE TO PURCHASE - LIABILITY OF THE THIRD PARTY PURCHASER

Louis-Martin Dubé

The sale of real estate assets usually starts with a preliminary contract, more specifically, a promise to purchase signed by the seller and the purchaser, which sets out most of the terms and conditions of the deed of sale to be entered into. However, it may happen that an owner will go back on his word and choose to sell to a third party whose offer for the assets is more favourable.

If the owner sells his property to the third party purchaser, what are the remedies of the original purchaser? Can he or she seek to have the sale to the third party voided? Can he or she claim damages from the third party?

In a judgment issued on September 8, 2011, the Quebec Superior Court considered the case of a company (GLS) that had signed a promise to sell assets to a purchaser (Midbec) and, a few days later, sold them to a third party purchaser (Reliable) under more favourable terms. Midbec instituted an action for damages against GLS and Reliable solidarily. As GLS had gone bankrupt, only a judgment ordering Reliable to pay damages could compensate Midbec for the harm it suffered.

Reliable invoked the absence of a legal relationship between itself and Midbec since Reliable was not a party to the first promise to purchase, which, moreover, its representatives had not read. In addition, Reliable considered that there had been no complicity or collusion between itself and GLS and that, accordingly, it was not in bad faith within the meaning of section 1397 of the Civil Code of Québec, which reads as follows: “A contract (*the sale to Reliable*) made in violation of a promise to contract (*the GLS/Midbec promise to purchase*) may be set up against the beneficiary of the promise (*Midbec*), but without affecting his remedy for damages against the promisor (*GLS*) and the person (*Reliable*) having contracted in bad faith with the promisor. ”

(The text in italics has been added and is not part of the quotation)

The evidence showed that in fact, although Reliable’s representatives had not seen the promise to

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purchase entered into between GLS and Midbec, Reliable knew of its existence and was even aware of some issues of concern for GLS. It also made sure to remedy such issues in its own promise to purchase and, at the request of GLS, agreed not to sue GLS in the event that Midbec instituted proceedings. The parties closed the transaction quickly to avoid being prevented from doing so by proceedings instituted by Midbec.

The Court came to the conclusion that Reliable had acted with full knowledge of the situation and that the facts were sufficient to demonstrate its bad faith. Reliable was ordered to pay Midbec, for loss of profit, an amount of $784,703 in damages with interest at the legal rate plus the additional indemnity.

DUTIES ON TRANSFERS OF IMMOVABLES

REMINDER - In 2010, the City of Montreal adopted a by-law setting a rate higher than other municipalities in the calculation of the duties for the transfer of an immovable. The rate is 2% on the basis of imposition that exceeds $500,000.

This rate applies only to immovables located in the City of Montreal and therefore excludes those in demerged municipalities.

ENTIRE AGREEMENT CLAUSES

Chantal Joubert

“This contract shall constitute the entire agreement between the parties with respect to the subject matter hereof and shall not include any representation, promise or warranty other than those set out herein.”

The purpose of these clauses, known as “entire agreement” clauses, which are often found in commercial contracts, is to prevent the parties who entered into a final contract from invoking prior discussions or understandings to give a different meaning to its provisions. The reasoning underlying such a clause is simple: because the contract is supposed to reflect the final agreement between the parties as to their rights and obligations and, accordingly, their true intent, it would be dangerous to allow them to go back to discussions or understandings that preceded the contract. Such clauses basically aim to preserve the stability of contracts.

The courts have generally upheld such clauses and excluded evidence relating to verbal or written understandings that preceded the signature of the final contract. However, the Superior Court, in the case of *IHAG-Holding AG* v. *Intrawest Corporation*, put aside the “entire agreement” clause included in the final agreement to consider a prior letter of intent in order to determine the method to be used to calculate the purchase price.

The facts of the case may be summarized as follows: a letter of intent, which did not bind the parties, stipulated an elaborate formula for the calculation of the purchase price of a sports complex located in the Gatineau region. The final agreement signed by the parties reproduced this same formula but with a drafting mistake that had the effect of increasing the purchase price by $6.2 million relative to the amount that would have been obtained if the formula set out in the letter of intent had been correctly reproduced.

The Superior Court decided to set aside the formula for calculating the purchase price in the final

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contract signed by the parties and instead applied the formula set out in the letter of intent, which did not bind the parties. The Court concluded that it was justifiable to set aside the “entire agreement” clause and return to a prior understanding when it was obvious that one party was trying to rely on that clause in order to take advantage of a mistake. In fact, the drafting error, which both parties were unaware of until then, was only discovered at the time of paying the “earnout payment” element of the price. The seller had then tried to apply the “entire agreement” clause that allowed it to set aside the less favourable formula contained in the letter of intent. However, the application of an “entire agreement” clause cannot have the effect of setting aside each party’s obligation to act in good faith.

As for the letter of intent, although it did not bind the parties, the Court concluded that it could be applied since it truly represented their real agreement respecting the formula for determining the purchase price.

CLOSED HYPOTHECARY LOANS WITH A TERM EXCEEDING FIVE (5) YEARS: LEGISLATIVE CHANGE

François Martel

To the contentment of lenders and owners of commercial properties, a long-awaited amendment involving section 10 of the *Interest Act (Canada)* (the “Act”) has just been made. Indeed, on October 20, 2011, the Canadian government adopted the *Prescribed Entities and Classes of Mortgages and Hypothecs Regulations*. These regulations define the entities that will be eligible for the purposes of applying paragraph 10(2)(b) of the Act.

A brief historical reminder is called for Paragraph 10(1) of the Act, passed in 1890, provided that borrowers could repay their loans secured by hypothecs on immovables after five (5) years, even if the hypothec was a closed hypothec for a longer term, subject to paying a penalty equal to three (3) months’ interest. At that time, Parliament wished to protect individuals by means of this provision, in particular farmers. Later, to encourage commerce, particularly the railway companies attempting to structure their long-term debts, Parliament amended the Act by adding a second paragraph to section 10 that provided that the above-mentioned general rule did not apply to joint stock companies or other corporations.

From then on, the companies had access to loans for more than five (5) years secured by hypothecs on immovables.

Commercial real estate practice having greatly evolved since then, owners of commercial immovables increasingly structure themselves as limited partnerships or commercial trusts, for tax purposes.

Unfortunately, not being governed by the exception in the second paragraph of section 10 of the Act but rather by the more generous general rule of paragraph 10(1), it is difficult for these owners to access loans for more than five (5) years because lenders do not want to allow their borrowers to repay their loans in advance after the fifth year by paying a modest penalty (the general rule of paragraph 10(1) of the Act being of public order).

Therefore, structures such as holding an immovable through a nominee corporation have been conceived and implemented by these property owners in order to benefit from long-term loans. However, numerous lenders remain hesitant, with good reason, to take on this kind of loan, fearing that these structures will not be recognized by the courts.

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In the explanation of its new regulation, the government clearly states the reasons for the change: “Some business and commercial entities, not structured as corporations… have had difficulties in accessing long-term mortgage financing because the prepayment terms for their mortgages are prescribed by the Act.”

Under this new regulation, partnerships (notably limited partnerships) and trusts established for business or commercial purposes will benefit from the exception in the second paragraph of section 10 of the Act, in the same way as joint stock companies and other corporations, with respect to hypothecs on immovables entered into after January 1, 2012.

That will be the long-awaited end of convoluted property structures aimed at obtaining loans for more than five (5) years secured by hypothecs on immovables. Lenders will, from then on, be able to grant such loans to limited partnerships and trusts established for business or commercial purposes and to freely negotiate the repayment terms of their loans.

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