APRIL 2013

Blaney McMurtry
BARRISTERS & SOLICITORS LLP

Commercial Litigation Update

Editor:

John Polyzogopoulos
416.593.2953
jpolyzogopoulos@blaney.com

This newsletter is designed to bring news of changes to the law, new law, interesting decisions and other matters of interest to our commercial litigation 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 Commercial Litigation group:

Lou Brzezinski
416.593.2952
lbrzezinski@blaney.com

IN THIS ISSUE:

"...s.50 of the Act allows..a landlord to pursue a claim as against the principals of the tenant (or any others who assisted in the surreptitious removal of goods and chattels from leased premises) for double the value of all such goods and chattels removed."

THE CASE OF THE VANISHING TENANT

Bradley Phillips

In the middle of the night, a commercial tenant removes all its goods and chattels of value and, without prior warning, ceases operating its business from its leased premises prior to the end of the term of its lease.

In many cases the tenant's business has been failing and the principals of the tenant (a corporation) may be well aware that the tenant's "midnight run" is in breach of its lease. In considering the pros and cons of a surreptitious exit from the leased premises, the principals of the tenant may believe that the worst that can happen is that if a judgment is obtained against the corporate tenant, it will be unenforceable as the corporation will no longer have any assets from which the landlord will be able to seek recovery.

Conversely, in the face of this economic reality, the landlord may be resigned to suffering the loss without seeking legal recourse and may instead focus solely on finding a replacement tenant as soon as possible rather than incur costs to obtain a "paper judgment".

In considering their options, however, both landlords and tenants should be mindful of section 50 of the *Commercial Tenancies Act* (the "Act").

Pursuant to the Act, a landlord has the right to distrain (i.e. seize and sell) goods or chattels (i.e. equipment, machinery, displays, tenant's fixtures etc.) owned by a tenant in order to recover arrears of rent owing under a lease, *prior to the termination of the lease*.

However, where a tenant fraudulently or clandestinely removes goods and chattels from the leased premises, thus preventing the landlord from exercising its right of distraint, s. 50 of the Act allows the landlord to seek damages *for double the value* of all goods and chattels removed.

The real key to this provision however is from whom this remedy may be sought. It is not limited to the tenant, which is often a shell corporation with limited or no assets, but rather to "any person" who "willfully and knowingly aids or assists the tenant" in the removal.

In other words, this section enables a landlord to pursue a claim as against the *principals* of the tenant (or any others who assisted in the surreptitious removal of goods and chattels from leased premises) for double the value of all such goods and chattels removed.

For example, in *1268227 Ontario Ltd. (c.o.b. Seamus O'Brien's) v. 1178605 Ontario Inc.*, the Court of Appeal upheld a trial decision in which the principals of a numbered corporation/tenant (which

COMMERCIAL LITIGATION UPDATE

"From the perspective of a landlord, a claim... may result in at least some viable financial recovery arising from a tenancy gone bad, even if the tenant's assets are long gone."

Bradley Phillips is a litigation partner at Blaney McMurtry. His diverse practice involves commercial and insurance litigation and focuses on commercial landlord and tenant litigation and professional negligence claims against lawyers, real estate brokers, financial advisors and insurance brokers. He has appeared before all levels of court in Ontario. He has acted as lead counsel at trials and on appeals before the Ontario Court of Appeal.

Brad may be reached directly at 416.593.3940 or bphillips@blaney.com.

itself no longer had assets) were found to have conducted themselves with the intent to defeat the rights of the landlord to the rent then in arrears in breach of s. 50 of the Act. The Court of Appeal upheld the trial judge's award of double the value of the goods and chattels the landlord was able to prove had been removed from the leased premises against the principals of the company *personally*.

Of note, in *1268227 Ontario Ltd.* there was in fact little direct evidence linking the principals of the tenant to the actual removal of goods, but the trial judge found that there was *circumstantial evidence* pointing to their responsibility for the removal and to their intent to defeat the landlord's entitlement to rent. Based upon these factual findings, the Court of Appeal saw no basis upon which to interfere with those conclusions.

From the perspective of a landlord, a claim under s. 50 of the Act may result in at least some viable financial recovery arising from a tenancy gone bad, even if the tenant's assets are long gone.

Landlords may wish to consider photographing all its tenants' businesses at regular intervals during the course of their tenancies to create a documentary record of what the premises looked like when in full operation. Should one of its tenants later attempt to abandon the leased premises and remove goods and chattels, such evidence will assist in proving what was removed and its value.

Conversely, the principals of a corporate tenant should be aware that if the goods and chattels removed from the leased premises do in fact have some value, they may find themselves exposed to personal liability for actions they (erroneously) believe can only result in a "paper judgment" as against their shell corporation. Even if the value of the goods and chattels is relatively modest, the principals of a tenant should be mindful that they may still find themselves embroiled in litigation which could adversely impact upon their credit rating.

Given this, tenants will want to carefully weigh the risk/reward of such conduct and may wish to instead pursue negotiations with the landlord for the early surrender of their tenancy, which agreement (while likely being more costly) would ensure that the principals of the tenant will not face any personal exposure to liability, rather than risk the potential consequences of a "midnight run".

Where a tenant is considering ceasing operations prior to the end of its lease term, in addition to s. 50 of the Act, there are many other strategic considerations and options that could impact upon both landlords and tenants. It would be advisable for both parties to seek legal advice in considering an appropriate course of action in these circumstances. ■

TIPS FOR SERVICE PROVIDERS: YOUR STANDARD FORM CONTRACT SHOULD BE MORE THAN AN AFTERTHOUGHT

Varoujan Arman

Are you a small service provider that does not have a written contract with your customers or a one pager you drafted yourself? Counsel can suggest a few simple improvements to your standard

COMMERCIAL LITIGATION UPDATE

"...a few simple improvements to your standard form contract... may go a long way to improving your relations with customers and minimizing your risk."

Varoujan Arman, a graduate of The University of Windsor law school, completed his articles in June 2011 and is currently a member of Blaney McMurtry's commercial litigation, insurance defence litigation and architectural, Construction, and engineering services (ACES) groups. Varoujan has been published in the Advocates' Quarterly, and appears regularly in the Ontario Superior Court of Justice, having also appeared before the Divisional Court.

Varoujan may be reached directly at 416.596.2884 or varman@blaney.com.

form contract that may go a long way to improving your relations with customers and minimizing your risk. Budgeting a modest up front cost for this purpose is a sound investment for any service provider.

Limitation of Liability

A major consideration for any service contract is a provision which sets out the maximum possible exposure in the case of any claim. There are a few general categories for such clauses. The most restrictive form limits the liability of the service provider to the amount paid for the service. Another form limits the liability to the amount of insurance coverage the service provider has in place to cover certain claims. A third form is a hybrid of the prior two, where liability is limited to the lesser of the amount paid for the service or the available insurance coverage.

Courts generally treat limitation of liability clauses as onerous provisions that must be specifically drawn to the attention of the other party. A reasonable, well-worded and prominent limitation of liability clause may stop a disgruntled party from even suing and if not, should limit the service provider's exposure.

Scope of Services

Although it may seem like a basic point, service providers should precisely define what services are being offered. This will protect from claims that something more is deliverable to the customer after performance. This section of a contract may even state that certain additional services are *not* included, particularly where the "add on" service is an ancillary service that could be reasonably expected by the purchaser. Consider a basic example: a purchaser of services for the development of a website may assume that the price paid includes the initial launch costs and hosting fees for the website, particularly where the developer also has those capabilities. If the inclusion of those ancillary services was not intended, the contract should indicate that they are excluded.

Similarly, contracts for services of an ongoing duration should clearly set out the length of the engagement, how the contract will expire and if applicable, the means by which either party may terminate or renew the relationship.

Default and Curative Provisions

In order to minimize the risk of customers terminating a contract for alleged non-performance and then refusing to pay for services rendered, the service provider should include a clause requiring customers to provide notice of any complaints and a reasonable opportunity to cure the defect before the customer can terminate the contract.

Guarantees and Warranties

Contracts should also be clear as to what guarantees or warranties, if any, are offered for the service provided. If none are offered, then they should be excluded by use of an "exclusion clause". Businesses that offer services to individual consumers should also be aware of the application of *Ontario's Consumer Protection Act* ("*CPA*"), which imposes a basic guarantee, which may not be waived in writing, that the services be of a reasonably acceptable quality. The *CPA* also contains rules governing estimates, unfair practices and imposes additional rules on agreements for specific categories of services. Care should be taken to ensure that contractual provisions do not conflict with the *CPA*.

"In some cases, good contractual language may make a disgruntled customer think twice before commencing legal action."

Copyright

Providers of services which include the creation of original artistic works, such as written text, designs, artwork for promotional materials, photographs, sound, video and other media should consider what rights are being transferred to the purchaser. In Canada, copyright protection arises automatically upon creation of the work, regardless of whether the author includes the copyright symbol. Under a contract of service, the purchaser normally becomes the owner of the copyright. However, unless expressly waived in writing, the author of the work retains the right of attribution - to be identified as the author or to remain anonymous. Parties should ensure that what is intended is set out in the contract to avoid future ambiguity and disputes.

Goals and Results

A simple but well-drafted service agreement will achieve a number of goals. First and foremost, it will convey a professionalism and attention to detail to the customer, helping strengthen new or growing business relationships. It will make it clear to customers what they should expect to receive and what obligations their service provider is or is not prepared to assume so that they can plan accordingly or seek to negotiate additional terms. In some cases, good contractual language may make a disgruntled customer think twice before commencing legal action. In the event of a lawsuit, a strong contractual defence will assist in achieving a more favourable settlement earlier on in the litigation (thereby saving the time and expense of a trial) or will enhance the chances of success at trial. ■

BLANEYS IN THE NEWS:

BLANEYS PARTNERS REPRESENT INTERVENER IN CASE BEFORE SCC

Blaney McMurtry LLP

Blaneys' partners Lou Brzezinski and John Polyzogopoulos made submissions to the Supreme Court of Canada on Thursday, March 21, 2013, on behalf of The Financial Advisors Association of Canada (Advocis), which had been granted Intervener status in the case of *McLean v. British Columbia Securities Commission.*

The case involved Patricia McLean, an Ontario resident and director of an Ontario reporting issuer, who reached a settlement agreement with the Ontario Securities Commission (OSC) in 2008, resulting in an order made by the OSC that same year. The OSC proceeding related to improper conduct that occurred at McLean's company in 2001, which McLean herself had brought to the attention of the OSC. The OSC had commenced proceedings in 2005 — four years later but well within the six-year window for public interest prosecutions to be commenced.

In 2010, almost nine years after the underlying misconduct, and two years after the OSC agreement and order, the British Columbia Securities Commission (BCSC) commenced its own proceedings in respect of the same 2001 misconduct, relying exclusively on the details disclosed in the OSC agreement and the terms of the OSC's order.

The BCSC argued that the limitation period to commence its secondary proceeding was reset in 2008, when the OSC agreement and order were

COMMERCIAL LITIGATION UPDATE

made. The BCSC, therefore, maintained that its enforcement proceeding was within the six-year window. The OSC supported the BCSC's argument, having also been granted intervener status.

McLean argued that any enforcement proceeding commenced against her must be based on the actual misconduct completed in 2001, and therefore, the BCSC's proceeding was commenced outside the limitation period. McLean had lost at the British Columbia Court of Appeal, but was granted leave to appeal to the Supreme Court of Canada.

The securities acts of the various provinces and territories (with the exception of Quebec) contain very similar provisions and limitation periods to the ones at issue in British Columbia. The outcome of the McLean case will, therefore, have ramifications for how enforcement proceedings to protect the public interest are conducted throughout the country, thereby impacting financial advisors in all provinces.

Advocis is an association of financial advisors with approximately 11,000 members across the country. Advocis' position before the Supreme Court of Canada was that if the BCSC's interpretation of when the limitation period commenced is correct, this will subject its members to multiple proceedings with potentially different outcomes in each province over potentially decades, as each time an order is made in one province, another province can claim the making of the order in that other province restarted the limitation period. Such an interpretation will effectively eliminate the protection of the limitation period, whose purpose is to encourage diligent prosecution by securities regulators and to provide parties with repose from ancient obligations. While Advocis is in favour of a true reciprocal enforcement regime, where the order of one province is adopted in the other Canadian jurisdictions, that is not the regime that currently exists, since each provincial regulator is currently entitled to make its own decision on what sanctions, if any, to impose in the public interest. The Supreme Court reserved its decision.

The Factum filed on behalf of the Intervenor, Advocis, can be viewed here: http://www.blaney.com/sites/default/files/LB_JP_Advocis_Factum_SCC_2013Mar21.pdf.

And the oral argument before the Supreme Court can be viewed here: http://scc-csc-gc.insinc.com/en/clip.php?url=c/486/1938/201303210505wv150en,002Content-Type:%20text/html;%20charset=ISO-8859-1. ■

EXPECT THE BEST

Blaney McMurtry
BARRISTERS & SOLICITORS LLP

2 Queen St. East, Suite 1500
Toronto, Canada M5C 3G5
416.593.1221 TEL
416.593.5437 FAX
www.blaney.com