



FEBRUARY 2004

COMMERCIAL REAL ESTATE GROUP

All the while our lawyers have continued to demonstrate their leadership in commercial real estate law by speaking to industry colleagues and fellow lawyers at conferences throughout the year. The irrepressible Mary Flynn-Guglietti has been particularly prolific this year, chairing the 2003 and the 2004 Six Minute Municipal Lawyer and presenting a “2003 Case Law Update” for the OBA’s 2004 Institute of Continuing Legal Education. I also participated at the Six Minute Municipal Lawyer conference and spoke on “Municipal Approvals for Common Element Condominiums”, a relatively new creature provided for in the *Condominium Act, 1998*. John Fox and Lou Macchione addressed the GTA Infrastructure Summit, presenting a comprehensive paper on public-private partnerships in real estate. John is also involved with our Brownfield Development Group and delivered a presentation in Montreal last year entirely in French! David Slan presented a summary of “Construction Liens in a Commercial Context” at the Six Minute Real Estate Lawyer, presented on the topic of “Commercial Condominium Leasing” at the ICSC Law Conference, and will also be speaking to the OBA about “Negotiating Agreements of Purchase and Sale” at their conference titled “Nuts and Bolts of Real Estate”. Our new partner Andrea Onn will be chairing this OBA event.

WELCOME MESSAGE FROM GEORGE PAYNE

McMillan Binch celebrated its 100th anniversary in 2003 and, true to form, the members of our Commercial Real Estate Group have been working hard to remain on top of developments in commercial real estate law. And there have been some very interesting developments! This newsletter includes our report on four cases we feel everyone in our industry should be aware of. This year the courts reminded us of the importance of paying attention to our contracts, when they forced a Magna subsidiary to complete a road extension in order to complete a severance. They also shed light on the dark side of being able to rely on the register under the Land Titles registration system, finding that a bank taking a mortgage based on a fraudulent transfer has the right to enforce the mortgage against an innocent owner. We have also noted important cases relating to co-ownerships and the GST, which I think you will find interesting.

Of course reading case law is not all we have been up to and 2003 has been an exciting, successful and memorable year for McMillan Binch and the Commercial Real Estate Group. The year started off with our partner David Ross being a participant on a team which won a NAIOP REX Award for Office Lease of the Year, and ended with the firm moving to our new facilities at BCE Place (Our own Office Deal of the Year!). In fact, we were the largest move within the Toronto Downtown Core last year, with the entire firm moving over one weekend. Our new location is a reflection of our commitment to client service with a progressive layout featuring new offices, and new technologies intended to make us that much more efficient. We would love to show off our new premises to you and hope that we will have an opportunity to do so soon!

We have bound our Group’s papers in our first ever annual review of our work. If you are interested in receiving a copy of this material, I would be happy and proud to send it to you. Just give me a call or drop me an e-mail.

On behalf of our Commercial Real Estate Group, I wish you a happy and prosperous 2004. If we can be of assistance to you this year in any of your commercial real estate dealings, please do not hesitate to call on us.

Regards,

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**GREENBANKTREE POWER CORP. v.
COINMATIC CANADA INC.**

**PURCHASE AND SALE OF COMMERCIAL
REAL ESTATE AND THE PARTITION ACT**

Most real estate professionals who enter into co-ownership arrangements set out those arrangements in writing. But when one buys a co-ownership interest, there is not always agreement with one's new co-owners. The majority owner who doesn't insist on a written agreement runs a risk of having his or her interests thwarted by a minority owner. The Court's decision in *Greenbanktree Power Corp. v. Coinmatic Canada Inc.*¹, which considers the *Partition Act*², provides a cautionary tale.

In *Greenbanktree*, a portfolio of properties located in the Toronto area had been assembled by a group of families and various others without a written co-ownership agreement. When providence called with a good deal, most of the co-owners wanted to sell. But one of the co-owner families, owning a relatively small, undivided interest in some of the portfolio properties, held out for a premium. The remaining co-owners sold their interests in the property anyway, leaving the holdout family suddenly in co-ownership with a new, unfamiliar co-owner. The holdout family was unwilling to continue in this new co-ownership, yet also unwilling to be bought out at the price offered by the new co-owner. They applied to have the matter resolved under the *Partition Act*.

The *Partition Act*, among other things, governs co-ownership arrangements where there are no formal contractual agreements. Greatly paraphrased, the *Partition Act* provides that, where co-owners of real estate cannot agree on how to govern the real estate, then, at the demand of any one or more co-owners, the co-ownership relationship will be ended by Court Order. The Court can either "partition" the property (that is, divide it up, with discrete portions of the property granted exclusively to each co-owner in accordance with their proportionate interests); or, where the property does not lend itself to partitioning (a single building, for example), the Court can order the co-owned property sold, with net proceeds from the sale

distributed amongst the co-owners in accordance with their interests. This partition or sale can be imposed on any co-owner (and their mortgagee), regardless of the comparative size of the co-ownership interest of the parties. Taken to the extreme, a 1% owner can use the *Partition Act* to compel the sale of land over the objection of a 99% owner.

To make matters worse for majority owners, the costs of a forced sale may fall more heavily on them. Aside from the shared loss arising from the natural price discounting inherent in any distressed sale, a court-ordered sale can trigger a host of additional costs. In *Greenbanktree*, for instance, the forced sale by the minority co-owner was expected to result in \$3,000,000 dollars in costs due to capital gains taxes for the majority co-owner, Land Transfer Taxes and other closing costs, plus a sizeable penalty for mortgage breakage costs.

In making its decision, the Court in *Greenbanktree* had to determine if the relative size of the minority co-owner's interest limited its ability to seek a sale under the *Partition Act*, whether any weight should be given to the large costs that would be incurred due to the premature sale of the property, and whether the minority co-owner's conduct could be considered "malicious, oppressive or vexatious".

The Court sided with the minority co-owner and ordered the sale of the property. It found that the size of the minority co-owner's interest in the property was not relevant, that the additional costs due to the sale were not a reason in and of themselves to take away the minority co-owner's right to force a sale and that the minority co-owner's conduct was not "malicious, oppressive or vexatious".

The Court was of the view that the new majority co-owner bought the property with full knowledge that the minority co-owner was not co-operative and could invoke the *Partition Act*, that the minority co-owner was entitled to hold-out and ask for a "last man standing" premium, and that the majority co-owner's hardship was their own fault for failing to analyze the risks before completing the deal.

¹ (2002) 59 O.R. (3d) 449, (Ont. S.C.J.), [hereinafter "Greenbanktree"]

² R.S.O. 1990 c. P4.2

In conclusion, purchasers entering a co-ownership arrangement need to be aware of the outcome of *Greenbanktree*. The law does allow parties to contract out of the *Partition Act* and, in our view, potential co-owners should make it a priority to enter into a written co-ownership agreement to, among other things, contractually exclude the statutory partition and sale remedies found under the *Partition Act* before completing the purchase of a property together with other parties.

JOHN E. DODGE HOLDINGS LTD. v. 805062 ONTARIO LTD.

PLANNING ACT PROVISIONS IN COMMERCIAL REAL ESTATE AGREEMENTS OF PURCHASE AND SALE

It is a common refrain amongst lawyers that standard form contracts should not be accepted sight-unseen, just because they are on pre-printed forms. The wording of every standard form agreement should be considered carefully prior to its use, having regard to the particulars of the deal involved.

In *John E. Dodge Holdings Ltd. v. 805062 Ontario Ltd.*³ the Ontario Court of Appeal was required to interpret a *Planning Act*⁴ provision commonly found in real estate board standard form agreements of purchase and sale. The provision reads as follows:

PLANNING ACT:

This Agreement shall be effective to create an interest in the property only if Vendor complies with the subdivision control provisions of the Planning Act by completion *and Vendor covenants to proceed diligently at his expense to obtain any necessary consent by completion* (our emphasis).

This provision would ultimately cause the vendor under the agreement in question to have to build a road, at its expense, which it didn't want to build.

In July 1999, John E. Dodge Holdings Ltd. ("Dodge") agreed to purchase approximately four acres of land near Canada's Wonderland, north of Toronto, from Magna subsidiary 805062 Ontario Ltd ("Magna"). The

standard-form agreement of purchase and sale used in the transaction contained the *Planning Act* provision reproduced above.

For the transaction to proceed, severance approval was required from the City of Vaughan. Magna obtained the severance, subject to the condition that it extend a roadway to the northern boundary of the property "if required". The cost of the roadway extension was estimated to be at between \$350,000 and \$500,000 and, since relations between Dodge and Magna were cordial, Dodge offered to pay half of the cost.

About two weeks after receiving the approval, Magna modified its plan to build a new plant on the land that it would retain after the severance and sale to Dodge, which eliminated its need for a roadway extension. However, the City of Vaughan still required the extension. Unwilling to pay half the cost for a roadway it no longer needed, Magna tried to persuade the Committee of Adjustment to remove the condition. When the Committee refused, Magna considered appealing to the Ontario Municipal Board, but ultimately decided against it.

Determining on its own that the required roadway was an unreasonable condition, Magna felt it was entitled to terminate the contract. Magna purported to unilaterally terminate the contract by writing to Dodge and stating that "it is not now possible to complete the transaction contemplated by the Agreement of Purchase and Sale". However, Dodge still wanted the land, sued for specific performance of the contract and won.

In the lower Court decision⁵, the Court found that the land's proximity to Canada's Wonderland and to Highway 400 made it "especially suitable for the plaintiff's proposed use, and there is no persuasive evidence that these features can be reasonably duplicated elsewhere". Specific performance was ordered. Magna appealed. It contended that it was never the parties' intention to build a road and dedicate its use to the municipality. It also argued it had used all reasonable efforts to have the "extra requirements" imposed by the Committee of Adjustment removed.

At the Court of Appeal, Madam Justice Karen Weiler found that "what is or is not required of a vendor will depend on the wording of the agreement and the

³ (2003), 10 R.P.R. (4th) 98 (Ont. C.A.),

⁴ R.S.O. 1990, c. P.13.

⁵ John E. Dodge Holdings Ltd. v. 805062 Ontario Ltd. (2001), 46 R.P.R. (3d) 239 (Ont. S.C.J.).

circumstance under which it was entered into”. Here, the contract “specifically imposes an obligation on the vendor to ‘proceed diligently at his expense to obtain any necessary consent.’[...] Hence, it is appropriate that the process under the *Planning Act* be the arbiter of the reasonable conditions for a severance, not the vendor. The vendor cannot take advantage of its failure to invoke the remedies available to it to terminate the agreement.”

Fundamentally, the Court simply looked to the plain words of the contract for resolution. The contract provided that Magna had to obtain a severance at its expense. Further, the Court found that the imposition of a road extension was a foreseeable event. Therefore, the Committee’s decision did not create a radical change in Magna’s obligation and Magna was obliged to fulfill the condition.

TORONTO DOMINION BANK V. JIANG

FRAUD IN REAL ESTATE TRANSACTIONS

The case of *Toronto Dominion Bank v. Jiang*⁶ is a bewildering case to read, and the result is startling. Imagine being a homeowner who is told one day that a bank is enforcing a mortgage against your home that secures a loan you didn’t arrange!

In *Jiang*, innocent home owners were the victims of a fraud committed by a rogue named Jiang. Unbeknownst to them, Jiang registered a transfer of their property to himself and then mortgaged the property to the Toronto Dominion Bank as security for a \$200,000 line of credit, which he drew in full. The mortgage was registered against title to the property. Jiang then defaulted on the mortgage. Not surprisingly, he was nowhere to be found. The Bank sought to enforce the mortgage and sell the house. The homeowners were understandably distressed and objected.

The Court sided with the Bank, relying upon the doctrine of “deferred defeasibility”, confirming that the Bank was entitled, by the *Land Titles Act*⁷, to rely on the parcel register which showed Jiang as the registered owner and its mortgage being validly registered. The doctrine is “deferred” indefeasibility because while the Bank had rights against the home owners, the evil grifter Jiang did not. He could not have relied on his

⁶ (2003), 9 R.P.R. (4th) 114 (Ont. S.C.J.), [hereinafter, “Jiang”].

⁷ R.S.O. 1990, c. L. 5, in particular, Sections 78(4) and 155

fraudulent transfer to get possession of the home. The Bank, however, committed no fraud, had no notice of Jiang’s misbehaviour and was entitled to rely on the parcel register. It therefore had a valid mortgage and was in a position to enforce its security registered against title to the property.

By way of recompense, the Court pointed the victim to the Land Titles Assurance Fund. Under the *Land Titles Act*, the person wrongly deprived of an interest in land by reason of an entry on the register must attempt to recover from the rogue responsible for the wrong. Where the individual wrongfully deprived of land is unable to recover, he or she is entitled to have the compensation from the Fund. However, this can be a lengthy and costly process.

In *Jiang*, although the victim must take action against Jiang, the Court and the Bank did provide some assistance. The Court declared the transfer to Jiang to be void and of no effect, while the Bank deferred any action against the property until the claim with the Land Titles Assurance Fund was resolved. The case is naturally upsetting to home-owning readers and the Court directs concerned citizens to the legislature, noting, “the course of action to resolve the issues leaves the victim bearing the ultimate risk, but that is where the provisions of the *Land Titles Act* places the risk.” Small comfort indeed. It should be noted that an event of this nature is not restricted to residential properties. This could have even more serious consequences for the victim in a commercial property context, as the delay in resolving the matter could, for example, result in the loss of a sale or create difficulties in completing a financing. The unfortunate event demonstrates the need to check your property’s registration from time to time and certainly before undertaking any major event which will involve dealing with your title.

KO ET AL. V. THE QUEEN.

GST AND THE SALE OF SUBDIVIDED REAL PROPERTY

*Ko et al. v. The Queen*⁸ provides an interesting review of rules that can have an impact on the determination of whether the sale of subdivided land is exempt from goods and services tax (GST) under GST legislation⁹.

⁸ (2003), G.T.C. 532 (Tax Court of Canada [Informal Procedure]).

⁹ Excise Tax Act, RSC 1985, c. E-15, as amended, [hereinafter “the GST legislation”].

It should be remembered that since April 1996, the general rule is that any subdivided land is subject to GST.

Mr. and Mrs. Ko and two siblings (the “Kos”) each owned a one-half undivided interest in a parcel of land in Surrey, British Columbia. When the Kos acquired the land, a detached house was situated on it. On January 20, 1998, the Kos subdivided the property into five separate lots, and on April 5, 1998, they registered as a partnership (“the partnership”) under the GST legislation.

When the partnership sold lot 2, which contained the original residence, the sale qualified for the basic “used residential complex” GST exemption.

When the partnership sold lots 1 and 4 to unrelated third parties, they charged and collected GST on the sales, and reported and remitted the tax with the partnership’s GST returns.

The partnership entered into an agreement to sell lot 5 to Mr. and Mrs. Ko for no consideration in October 1998 and to sell lot 3 to the siblings for no consideration in December 1998. No GST was charged, collected, or paid on the transfer of these lots.

On March 6, 2001, the Minister of National Revenue issued a notice of reassessment against the Kos for \$17,920.00 of unpaid GST, calculated as 7 percent of the fair market value (FMV) of \$256,000 for the lots in 3 and 5, plus interest of \$2,138.02 and penalties of \$2,563.42. The Kos appealed the reassessment to the Tax Court of Canada.

In dismissing the appeal, the Court first addressed whether the sale was taxable as being in the course of a business or commercial activity. To determine this the Court had to establish who exactly sold the lots, the Kos in their capacity as individuals, or as members of the partnership. Despite certain evidence to the contrary, the Kos argued that they did not conduct their activities as part of a partnership. Examining Section 2 of the British Columbia *Partnership Act*,¹⁰ the Court found that the Kos did subdivide and sell the lots through the partnership. Section 2 provides, “Partnership is the relation which subsists between persons carrying on business in

common with a view of profit.” According to the Court, the following facts supported its finding:

- The four taxpayers registered for GST purposes as a partnership.
- The partnership reported and remitted the GST collected on the sales of lots 1 and 4 to third parties on the partnership’s GST returns.
- All four taxpayers co-owned the five lots created by the subdivision of the original parcel.
- The taxpayers transferred lots 1, 2 and 4 to third parties for profit.

The Court’s finding that the transfers of lots 3 and 5 were part of the partnership’s business activities can be disputed. The lots were transferred for no consideration to non-arm’s-length parties, *clearly without a view to making a profit*, so that those transfers could have been determined to be part of the individuals’ (the Kos’) activities in their own right, quite separate and apart from the partnership’s activities.

The Court then went on to consider whether the taxable supply was subject to an exemption. Since Mr. and Mrs. Ko were building a house on lot 5, they argued that Section 3, Part I of Schedule V to the GST legislation (“the owner-built home exemption”) applied. This exemption applies to an individual’s sale of an owner-built home where the individual has used the home primarily as a place of residence after the construction has been substantially completed. The Court rejected this argument on the basis that when the “supply” was made in October 1998, no “residential complex”¹¹ existed on lot 5. The house located on the lot was not finished or approved for occupancy until December 1998 and the Court found that the “supply” by way of sale of a less than substantially completed house is not a sale of a “residential complex”. Under Section 133, a supply of land (or a service) made pursuant to an agreement is deemed to have been made at the time the agreement is entered into, and the provision of the land (or service) under the agreement is deemed to be part of that supply.

Had the owner-built home exemption applied, Mr. and Mrs. Ko would have paid unrecoverable GST on their

¹⁰ RSBC 1996, c. 348, as amended.

¹¹ As defined in subsection 123(1) of the GST legislation.

construction costs, instead of on the full FMV of the land. The result of the Court's decision is harsh because clearly this transfer fits within the intended scope of the owner-built home exemption. Understandably, the Court did not wish to apply too liberal a definition of "residential complex" and thereby create unintended mischief in the application of the many complex rules in the GST legislation that depend on this definition.

The moral of the story, on the basis of 20/20 hindsight, is that eight years later GST issues are still biting unsuspecting and uninformed individuals in land transactions and it pays to get professional structuring advice prior to taking an irreversible step even, in what may appear to be the simplest of transactions!

The foregoing provides only an overview. Readers are cautioned against making any decisions based on this material alone. Rather, a qualified lawyer should be consulted.

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