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COURT OF APPEAL FOR ONTARIO

RE: **NATIONAL TRUST COMPANY (Appellant/Respondent in Cross-Appeal) and URI SAKS, ORLE DEVELOPMENTS INC. (Respondents and Cross-Appellants) and DHARAM P. MALIK (Respondent)**

BEFORE: **FINLAYSON, ABELLA and MOLDAVER JJ.A.**

COUNSEL: **Chris G. Paliare and Susan J. Stamm**
for the appellant

Irving Marks and David Taub
for the respondents and cross-appellants Saks and Orle

Barbara Murchie
for the respondent Malik

HEARD: **May 25 and 26, 1998**

E N D O R S E M E N T

[1] The pivotal issue in this appeal is whether the appellant National was entitled under the loan agreement to write the letter of August 20, 1991 making a demand for the balance of the credit advanced amounting to $8,852,422.65. This letter is premised on the validity of the earlier letter of August 7, 1991 demanding an injection of equity under the loan agreement based on National's estimate that there would be cost overruns totalling $2,000,000 to complete the project.

[2] In rejecting National's submission that it was entitled to make such a demand, the trial judge made the following findings of mixed fact and law:

> I come now to National's principle submission that an event of default had occurred when Orle failed to make a cash equity injection of $2,000,000 by August 16, 1991 as requested on August 7, 1991 and that this event of default entitled National to demand repayment of the loan on seven days' notice. The basis for this submission is Article 5.01(1) (p) which requires the borrower to inject cash equity into "the Development" in an amount equal to any deficiency existing in the unadvanced loan facility required to complete construction of the Development or "to pay for all other Development Costs". National also relies on Article 4.05(b)(c). Article 4.05(b) requires the borrower to pay the full amount

of any cost overrun. Article 4.05(c) states that National is under no obligation to make any advances until the borrower pays any cost overrun and goes on to provide that, while any cost overrun remains unpaid, “the Borrower shall be conclusively deemed to be in default under this agreement”. As indicated earlier, the cost overrun alleged by National was in respect to interest of $2,750,000, which was one of the categories in the soft cost portion of the construction budget and which, on the evidence, would not have occurred until after the 3-year term of the loan on the assumption that Orle would have been unable to repay on the loan at its maturity. It is the position of National, in reliance on Article 4.05(b),t hat it did not have to wait until the cost overrun in fact had occurred before it could demand payment of the cost overrun; it could demand payment on the basis of an anticipated cost overrun occurring at some future time.

I cannot agree with the position advanced by National for a number of reasons. As I will explain, National appears to have equated the requirement to make equity injections with the requirement to pay cost overruns and appears to have overlooked the application and conditions of Article 7. In regard to National’s position, it is important to recognize that both Mr. Eppler’s letter of August 7, 1991 and Mr. Davis’ letter of August 20, 1991 requiring Orle to make cash equity injection of $2,000,000 are based squarely on the language of Article 5.01(p) and indeed use the language of that article. In this regard it is also significant that Mr. Eppler’s letter to Orle of July 19, 1991, which indicated the process that resulted in the calling of the loan, did not request an equity injection of $2,000,000 but requested the payment of a cost overrun in that amount “primarily relating to carrying costs and Tenant Improvements during the lease up of the buildings”. Thus, it is clear that National moved from the position of a cost overrun created by an alleged deficiency in the interest budget to an equity injection due to an in sufficiency in the unadvanced portion of the credit facility to enable Orle to complete the construction of the project. Quite apart from anything else, it is my opinion that the evidence does not establish that on July 19, 1991, Orle was obliged under the loan agreement to pay the cost overrun demanded, nor does it establish that, on August 7, 1991, or, on August 20, 1991, Orle was under any obligation to make a cash equity injection in any amount. As of the respective dates the amount allocated for interest had not been exceeded as only $1,100,000 of the $2,750,000 interest budget had been utilized and the unadvanced portion of the credit facility was sufficient to enable Orle to complete the construction of the project.

To be more specific, on the assumption that National’s demand for repayment of the loan was based on Orle’s failure to pay $2,000,000 in respect to cost overruns its right to claim cost overruns is to be found in Article 4.05, reproduced on page 53, which contains the borrower’s covenant to pay all cost overruns. The definition of cost overruns, reproduced on page 46, applies only to the hard costs of the construction

of the project. Orle's construction budget, which is Schedule "D" to the loan agreement, contains two divisions – the hard costs of construction and the soft costs involved in completing the project. The hard costs were allocated among 53 construction categories and totalled $12,700,000. The soft costs, which included interest and tenant improvements, amount to about $4,700,000. Apart from the fact that no actual cost overrun had occurred with respect to interest or tenant improvements, since these items do not constitute cost overruns within the definition of that term in the loan agreement, Orle had no obligation to make any payments under Article 4.05(a). It follows that, as National was not entitled to demand a $2,000,000 payment by Orle in respect to cost overruns on July 19, 1991, Orle was not in default on August 7, 1991 when National next demanded a payment of $2,000,000 – albeit in the nature of an equity injection.

It is also my opinion that, on the basis of the evidence, National did not have the right under Article 5.01(p) to demand an equity injection in any amount. It is to be emphasized that, between July 19, 1991 and August 7, 1991, National changed its position from demanding payment for a cost overrun to demanding in equity injection. This conversion from a cost overrun to an equity injection occurs without explanation in National's letter to Orle of August 7, 1991. Article 5.01(p), which is reproduced on pages 55-56, contains the lender's right to require the borrower to "inject cash equity into the Development". The right arises upon it appearing to the borrower "that the aggregate of the unadvanced portion of the Credit Facility allocated to pay Development Costs shall be insufficient to complete construction of the Development in accordance with the Plans and Specifications or to pay for all other Development Costs". Although "Development" is defined in the loan agreement, the term "Development Costs" is not. "Development" is defined, in part, as "the proposed building or buildings to be constructed … to be financed in whole or in part by the proceeds of the Credit Facility … ". "Project Costs" is a term defined in the loan agreement and is reproduced on pages 46-47. By definition it is a much broader term than "Development Costs". It is my view that properly interpreted "Development Costs" are only one aspect of "Project Costs" and constitute only the hard costs of construction budgeted in the amount of $12,700,000. On the other hand, "Project Costs" include both the hard costs and the soft costs.

If in his letter of August 7, 1991, Mr. Eppler's purpose in equating a cost overrun with an equity injection was because he believed that a projected overrun in respect to interest constituted a "Development Cost" within the meaning of Article 5.10(p) he was incorrect. We do not know what Mr. Eppler's understanding was because he did not testify. He was incorrect because interest was not a hard cost and, therefore, not a "Development Cost". If Article 5.01(p) was intended to include interest and other soft costs, then the term "Project Costs" – and not "Development Costs" – would have been used. I would also point out

> that there was no evidence to support Mr. Davis' statement in his demand letter of August 20, 1991 that "National Trust had determined that the unadvanced portion of the credit facility was not sufficient to complete the development". As my review of the evidence establishes, this was never the concern of National in its ongoing attempts to protect its investment. It follows that National was never entitled to required an equity injection pursuant to Article 5.01(p). It also follows that National did not have the right on August 20, 1991 under the provisions of the loan agreement to demand that Orle repay the loan. Given this finding, it is not necessary to determine whether the seven days given to Orle by National to repay the loan was reasonable in the circumstances.

[3] We see no basis for interfering with this interpretation the relevant provisions of the loan agreement and its application to the facts of this case by the trial judge.

[4] On appeal, National sought to justify the loan demand on another basis, namely, that the unadvanced portion of the credit facility allocated for development costs was insufficient to cover the hard costs needed to complete the buildings to base. According to National, even though this deficiency did not form the basis of the August 20, 1991 demand, it nonetheless constituted an event of default and provided after-the-fact justification for the demand.

[5] Because this issue was not raised at trial, the trial judge did not squarely address it in his reasons. Nonetheless, in the course of assessing Orle's damages on its counterclaim, the trial judge accepted Orle's calculations and found as a fact that Orle could have completed the buildings for $1,618,007, a figure well below the $2,972,500 remaining in the hard cost budget. The trial judge's finding is supported by the evidence and it is fatal to National's position.

[6] National also submitted that the trial judge erred in concluding that the loan agreement did not permit National to demand repayment of the loan at any time. We reject this submission and agree with the trial judge's interpretation that the word "demand" contained in the agreement means a demand following an event of default as specified in the agreement. It is not an unfettered right standing in isolation.

[7] As to the finding of lack of good faith in making the demand referred to above, there was evidence that National was concerned with a declining economy and considered internally the suggestion that the pace of the respondent Orle Development's project should be slowed down, the project be brought to market later than originally planned and the term of the loan be extended. There is evidence to support the trial judge's conclusion that:

> In my view, based on the facts and a proper interpretation of the loan agreement National's attempt to cap the loan and its demands for the

> payment of $2,000,000 – in the guise of a cost overrun or an equity injection – culminating in the calling of the loan were spurious and were motivated by National's desire to protect its investment at any price. In my view, the only reasonable conclusion to draw is that National was acting in bad faith.

[8] With respect to National's appeal from the trial judge's decision discharging Saks on his personal guarantee, the trial judge found, correctly in our view, that in breaching the loan agreement with Orle, National materially increased Saks' risk. Accordingly, the trial judge did not err in discharging Saks on his guarantee.

[9] Turning next to National's appeal from the dismissal of its claim against Malik for negligence, the trial judge concluded that Malik's retainer was limited and that National accepted the limited scope of his retainer. In view of these findings, the trial judge did not err in determining that Malik had done all that was required of him according to the terms of his retainer.

[10] As for the allegation that Malik was negligent in failing to realize that the budget covered the costs of construction only to shell, Malik can hardly be faulted for this oversight given that the budget appeared to cover the costs of construction only to shell and National itself, through its agent Coates, believed this to be the case. Accordingly, even though the trial judge did not address this issue, we are not persuaded that he would have reached a different conclusion had he done so.

[11] National also took issue with the trial judge's award of damages to Orle on its counterclaim. In this respect, National submitted that the trial judge erred in awarding damages on the basis that National had wrongfully converted Orle's property to its own use. According to National, the trial judge should not have awarded damages on this basis because (a) Orle had not pleaded wrongful conversion and (b) in any event, the tort of wrongful conversion only applied to chattels, not real property.

[12] In our view, it is unnecessary to resolve these issues. Orle pleaded breach of contract in its counterclaim and, in the particular circumstances of this case, had the trial judge approached the issue of damages on the basis of breach of contract instead of wrongful conversion, he would have applied the same principles and arrived at the same result. Accordingly, this ground of appeal fails.

[13] In the result, National's appeal is dismissed with costs.

[14] Turning to the cross-appeal, Orle submits that the trial judge committed two calculation errors in arriving at his award of $6,900,000 on Orle's counterclaim.

[15] First, Orle contends that the trial judge erred in subtracting National's completion costs of $3,500,000 before making the upward adjustment of $1,500,000 to fair market value. According to Orle, the adjustment should have been made as a percentage of the $10,500,000 completed value prior to deducting the completion costs.

[16] We see no merit in this argument. In arriving at the $1,500,000 upward adjustment, we are not persuaded that the trial judge tied that figure to a percentage of the value of the completed buildings. Rather, we think it more likely that he selected a figure which, in his view, accorded with the market conditions and the circumstances surrounding the project as a whole. Accordingly, we would not interfere with the $1,500,000 adjustment figure.

[17] Secondly, Orle submitted that the trial judge erred in substituting the cost of completion twice in arriving at Orle's damages. The trial judge's calculations reveal that he subtracted National's costs of $3,500,000 to arrive at fair market value, subject to an upward adjustment, and then he subtracted Orle's projected costs of $1,600,000 to arrive at the final calculation of damages.

[18] National concedes that the trial judge should not have subtracted the completion costs twice. According to National, Orle's projected costs of $1,600,000 should be removed from the equation. Orle, on the other hand, submits that National's costs of $3,500,000 should be removed.

[19] In our view, Orle's position is the correct one. The trial judge found as a fact that Orle could have completed the buildings for $1,600,000 had National not breached the loan agreement and deprived Orle of its property. After taking possession of the property, National completed the project for its benefit at a cost far in excess of Orle's projected costs. In our view, National should not be given credit for the increased completion costs brought about by its breach of the loan agreement.

[20] Accordingly, Orle's cross-appeal is allowed and Orle is entitled to damages on its counterclaim in the amount of $10,400,000. That amount is to be set off against the $8,800,000 debt owing to National as of October 21, 1991, with the result that Orle is entitled to recover the net amount of $1,600,000 from National as of the date of judgment.

[21] Orle is entitled to pre-judgment interest on the net amount from October 21, 1991 to the date of judgment at a rate of 7.7% per annum pursuant to the *Courts of Justice Act*, R.S.O. 1990, c. C.43. Orle is also entitled to post-judgment interest.

[22] National is entitled to set off the $856,000 paid to lien claimants against Orle's judgment commencing August 17, 1995, the date of the payment. An order will also go directing the accountant of the Ontario Court (General Division) to make payment on account of the respondents' (Orle and Saks) costs at trial, plus accrued interest, to their

solicitors, in trust, from the letter of credit posted by National pursuant to the order of this court dated June 21, 1996.

[23] National's request for a vesting order is not within the purview of this court. If the parties cannot agree, they should apply to the trial judge, now Borins J.A., for the relief sought.

[24] Finally, Orle is entitled to its costs on the cross-appeal.

[25] In the result, Orle's cross-appeal is allowed in part and the judgment below is varied to give effect to these reasons.