

# Atlantic Business Counsel

LEGAL DEVELOPMENTS OF INTEREST TO BUSINESS IN ATLANTIC CANADA

**September 2011**

Volume XII, Issue 3

Editor:

Susanna P. Duke

Knowledge Manager

709.570.8844

sduke@stewartmckelvey.com

## In this issue

A New Regime for Venture Issuers

Canada's Anti-Spam Legislation –  
Regulations Released and Impact on  
Electronic Marketing Campaigns

Is Arbitration Right for You and Your  
Transaction?

Case Comment: *Masterpiece Inc. v.  
Alavida Lifestyles Inc.*

Best Efforts – A Recipe for Dispute

### Business Disputes Corner

- Case Comment: *Polycorp Properties  
Inc. v. Halifax (Regional Municipality)*

## A New Regime for Venture Issuers

The Canadian Securities Administrators (the “CSA”) have proposed significant changes to the disclosure rules applicable to venture issuers, which should reduce disclosure burdens for venture issuers including the large number of junior mining companies and early stage technology companies with Atlantic Canada based businesses or projects.

Venture issuers generally have less complex businesses, more limited financial resources and are relatively thinly staffed. This means that investors may not require the same level of disclosure in order to sufficiently assess a venture issuer’s business, while the cost and administrative burden of complying with disclosure requirements is relatively-speaking much larger. Current disclosure rules already recognize this difference by exempting venture issuers from some disclosure obligations, such as the requirement to prepare and file an annual information form, and modifying other obligations, such as providing longer time periods for the filing of annual and quarterly financial disclosures, allowing simpler forms of CEO and CFO certifications for these filings and reducing corporate governance disclosures. The new proposals are intended to further streamline and tailor venture issuer disclosure by eliminating certain disclosure obligations and requiring supplemental disclosure on topics seen to be of greater relevance to venture issuer investors. In addition, as a result of the proposed changes venture issuers would be automatically qualified for short-form prospectus offerings.

Proposed National Instrument 51-103 *Ongoing Governance and Disclosure Requirements for Venture Issuers* (“NI 51-103”) introduces a modified definition of “venture issuer”. Generally, all issuers listed solely on the TSX Venture Exchange, NEX, AIM, PLUS-SX or other designated venture market will continue to be venture issuers. However, debt-only, preferred share-only and asset-back security issuers listed on the above exchanges will be “senior issuers” and will continue to be subject to the current disclosure regime.

### Streamlined Disclosure

The key disclosure changes contained in NI 51-103 include the introduction of annual and mid-year reports, elimination of three- and nine-month interim financial reports,

simplification of information circular disclosure and modified material acquisition, related party transaction and material change reporting.

## Annual Reports

NI 51-103 introduces an annual report requirement that is intended to provide stand-alone, comprehensive disclosure for venture issuers. The annual report would feature a description of the venture issuer's business including corporate structure, business overview, two-year history, and a discussion of performance targets and milestones of the issuer. For mining issuers, the required disclosure about material mineral projects would not automatically trigger a technical report under National Instrument 43-101 *Standards of Disclosure for Mineral Projects* ("NI 43-101"); however, the mineral project disclosure would have to be prepared by or under the supervision of a qualified person. Under NI 43-101, a technical report would be required if the annual report contained first time disclosure of mineral resources, reserves or a preliminary economic assessment, or a material change to such disclosure.

The annual report would also provide an overview of outstanding securities and trading information, including details regarding reporting insiders, biographical and security information for directors and executive officers. Director and executive compensation disclosure would be moved to the annual report from the management information circular. As part of this change, the CSA proposes to revise the compensation disclosure requirements for venture issuers, including amending stock option disclosure, to remove disclosure of the grant date fair value of stock options and add tabular disclosure related to the exercise of convertible securities, enhancing discussion of compensation-related performance goals, and requiring disclosure about how each significant element of compensation is determined.

Governance disclosure, including new substantive disclosure requirements relating to conflict of interest,

ethical conduct, related party transactions, facilitation of independent judgment and insider trading, would also move to the annual report, as would board and committee disclosure, including new requirements to report board and committee meeting attendance records and revised substantive requirements relating to audit committees.

The integrated annual report would also include annual audited financial statements and auditor's report, management's discussion and analysis ("MD&A") of the annual financials and CEO/CFO certificates regarding the annual report disclosure.

## Mid-Year Report

NI 51-103 would introduce a mid-year report that incorporates the required six-month interim financial report, together with associated MD&A and CEO/CFO certificates. The requirement to file three- and nine-month interim financial reports, MD&A and CEO/CFO certificates would be eliminated; however, issuers would have the option to file those financial statements. The six-month reporting standard is consistent with requirements of many reporting regimes outside of North America.

Under the proposals, if venture issuers elect to file three- and nine-month interim financial reports, then they must provide these interim financial reports for at least two years. The voluntary filed interim financial reports would not need to be accompanied by MD&A and would not require CEO/CFO certification.

## Acquisitions and Related Party Transactions

NI 51-103 would eliminate Business Acquisition Reports and modify current reporting requirements to introduce requirements for timely disclosure of material related entity transactions and material acquisitions. These reports would be integrated with current material change reporting requirements. Material acquisitions would still require the filing of financial statements for the acquired business within 75 days, although this would only be required

for acquisitions where the value of the consideration transferred equals 100% or more of the venture issuer's market capitalization, rather than the current balance sheet and income tests. NI 51-103 would maintain the confidential material change report regime; however, venture issuers would not be permitted to file reports of material related entity transactions on a confidential basis.

## Proxy and Information Circulars

Under the proposed changes, information circular disclosure would be greatly reduced as governance, audit committee and executive compensation disclosure would be relocated to the annual report.

## Delivery of Materials to Securityholders

NI 53-101 would provide alternative delivery options for delivering annual reports, mid-year reports and information circulars to securityholders. However, venture issuers would need to review the delivery and/or mailing requirements contained in their governing statutes and constating documents to determine if the proposed alternative delivery options are actually available to them.

## Securities Offerings

The proposed rules also address venture issuer security offerings. Proposed revisions to National Instrument 44-101 *Short Form Prospectus Distributions* would permit the incorporation of annual reports by reference into a short form prospectus. As a result, all venture issuers will be qualified to file short form prospectuses. Under the current regime, only venture issuers that elect to file an annual information form are eligible to file a short form prospectus. Mining issuers should note that proposed amendments to NI 43-101 would make the filing of a preliminary short form prospectus by a venture issuer a trigger for filing a technical report.

The proposal would revise National Instrument 41-101 *General Prospectus Requirements* to introduce a new long

form prospectus form for venture issuers that more closely conforms to the proposed continuous disclosure regime, and which requires only two years of audited financial statements. Other amendments would permit the annual report to be incorporated by reference into the TSXV short form offering documents and the qualifying issuer offering memorandum in National Instrument 45-106 *Prospectus and Registration Exemptions*.

If the proposals are adopted, venture issuers who have not voluntarily opted to provide the additional interim statements, will not require three- and nine-month financial reports and MD&A for the above offering documents. This may be a boon for venture issuers undertaking IPOs or who do not regularly undertake prospectus offerings and are not staffed to quickly turn prospectus disclosure. In particular, as a result of the proposed amendments, financial statements and the financial information contained in yet unfiled draft or preliminary prospectuses would not "go stale" on the issuance of new financial statements every three months, instead venture issuers will have a six-month period in which to complete a prospectus offering without having to incorporate new financial statements.

## Summary

The proposals represent a significant shift for venture issuers. NI 51-103 and the related amendments were published by the CSA with a request for comments on the proposals by October 27, 2011. Please contact the authors with questions related to the current disclosure regime, the proposed venture issuer disclosure regime or if we can assist you with formulating comments on the proposals for submission to the CSA.



Gavin Stuttard  
Halifax Office  
902.444.1709  
gstuttard@stewartmckelvey.com



Tauna Staniland  
St. John's Office  
709.570.8842  
tstaniland@stewartmckelvey.com

---

## Canada's Anti-Spam Legislation – Regulations Released & Impact on Electronic Marketing Campaigns

### Introduction

On December 15, 2010, the Federal government took a significant step in cracking down on spamming by passing Bill C-28, previously known as the “Fighting Internet and Wireless Spam Act”, which bill has since been renamed and is now commonly referred to as “Canada’s Anti-Spam Law” (“CASL”). Once in force, electronic marketers (individuals, businesses and non-profits alike) will have to comply with specific consent, disclosure and unsubscribe requirements when sending out electronic communications.

In short, CASL will prohibit the sending of commercial electronic messages (e.g., emails, voicemails, texts, tweets and instant messages) (“CEMs”) to an electronic address without the prior consent of the recipient. Consent may be implied where the sender has an existing business or non-business relationship with the recipient. Otherwise, express consent is needed unless the message fits into a prescribed exception. In most cases, implied consent will expire two years after the formation of the relationship or last commercial transaction.

### Regulations Introduced

Recently, the Canadian Radio-television and Telecommunications Commission (“CRTC”) and Governor in Council (through, Industry Canada) introduced two separate sets of draft regulations to CASL on June 30, 2011 and July 9, 2011, respectively. The CRTC draft regulations establish that a sender must include an unsubscribe mechanism and at a minimum the sender’s name, physical and mailing address, telephone number, email address and web address in a CEM or request for consent. If the CEM is being sent on behalf of someone else, then the identification and contact information for the person on whose behalf the CEM was sent must also be disclosed. The unsubscribe mechanism and identifying information may be provided in a link to a website. The CRTC regulations also establish a “two-click” rule so that the recipient is able to unsubscribe action in no more than two clicks.

The Industry Canada draft regulations provide definitions for the terms “family relationship” and “personal relationship”, two categories of CEMs that are exempt from the form and consent requirements of CASL. The meaning of “membership” in relation to a “club, association or voluntary organization”, are also defined. These are particularly key definitions for non-profit organizations as this is a category of existing non-business relationship that qualifies for implied consent to send a CEM to a member recipient.

These regulations are each subject to a 60 day period for comment following which they will be finalized and registered. It is at that time that CASL will come into force, which could be as early as the fall of this year. If significant revisions are required to the regulations, however, this timing could be delayed.

## Ensure Compliance Now

While CASL is meant to restrict the most damaging forms of spam, legitimate electronic marketers will be significantly impacted by this new anti-spam regime. Furthermore, the potential liability for violating CASL is high with maximum penalties of \$1,000,000 for individuals and \$10,000,000 for corporations per violation. There is also vicarious liability for the acts of employees.

Therefore, where electronic marketers are using electronic distribution lists to conduct marketing campaigns, but have not been keeping track of when recipients were added to the list or how, it is advisable to start now. Running a renewal or re-opt in campaign, where the recipients on the distribution list are asked to confirm their desire to continue receiving messages, is a good start. This will not only give the electronic marketer express consent to continue sending to those contacts, but it will also create a more targeted distribution list. Once CASL comes into force, express consent cannot be obtained by sending a request by email so electronic marketers should use CEMs with their existing customer list to maximize the number of recipients with whom they have an existing relationship so as to benefit from the three year transition period during which express consent can be obtained to continue sending communications.

Stewart McKelvey will continue to monitor the progress of this legislation and regulations.



Burtley Francis  
Halifax Office  
902.444.1714  
bfrancis@stewartmckelvey.com

---

## Is Arbitration Right for You and Your Transaction?

Arbitration is becoming the preferred method of resolving business disputes under many kinds of domestic and international transactions. Its availability, and more importantly its effective and beneficial use, requires planning and consideration at the time that the contract is negotiated. Although in theory an agreement to arbitrate is possible to make after the dispute has arisen, parties by that time are often too at odds with each other and too entrenched in their positions to give objective and co-operative attention to the most efficient process by which their differences may be adjudicated.

The characteristics of arbitration, and if correctly used its benefits, may be generally summarized:

- The ability to choose (or at least to influence the choice of) the decision-maker, including that person's background, training and familiarity with the parties' industry;
- The ability to choose all elements of the hearing and pre-hearing processes, and to tailor-make the process, its timelines and its probable cost to best suit the circumstances of the parties and their transaction;
- The decision when made is final and binding – win, lose or compromise, the dispute is at an end;
- The process is private and confidential;

- Statistics are said to show that arbitration is better likely than litigation to preserve ongoing business relationships;
- The successful party's recovery of its costs can be greater in degree than in litigation;
- Arbitration awards are generally more easily enforceable worldwide than are court judgments.

To the contrary, however, arbitration can be plagued with certain notorious disadvantages, including:

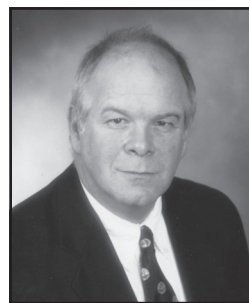
- Cost and delay can greatly exceed those of litigation;
- There is generally no right of appeal – in commercial disputes which involve genuine unsettled points of law the “final and binding” nature of the process is potentially disadvantageous to the loser;
- The loser's exposure in costs can greatly exceed that which it faces in litigation;
- It is more difficult – approaching practical impossibility in some cases – to resolve multi-party commercial disputes in arbitration than in litigation;
- Obtaining and enforcing preliminary protective orders (injunctions, preservation orders, security for costs or for the claim itself), even when theoretically available, may be more complex and less certain than in litigation.

As a process, arbitration is almost infinitely flexible – but only with the parties' prior agreement. Many of the disadvantages mentioned above may be avoided or effectively managed, and obtaining most of the listed benefits may be maximized, by receiving both parties' prudent attention at the time of negotiation of the transaction.

It is said that when commercial parties negotiate and conclude a contract, they focus on the performance of the contract and not (or not sufficiently) on the possibility of its breach. When the breach occurs, then at best the opportunity to influence the efficient resolution of the resulting dispute may be irretrievably lost, and at worst an imprudent arbitration clause if contained in the contract may

mean there are dispute resolution inefficiencies embedded in the contract, often to the relative disadvantage of one or other of the parties.

The “standard” arbitration clause is a dangerous fallacy. Clients are encouraged, at time of contract negotiation, to discuss with their legal advisers the possibility that a carefully-considered arbitration clause, well suited to the parties' situations and to their transaction, might be appropriate to include. Furthermore, clients are invariably well-advised not to execute a contract containing any arbitration clause without prior consultation and advice as to what exactly this arbitration clause commits them to in the event of a dispute. Embedded problems in the clause can be identified and corrected, but only if addressed at time of negotiation.



William Moreira, Q.C.  
Halifax Office  
902.420.3346  
wmoreira@stewartmckelvey.com

---

## Case comment: *MASTERPIECE INC. v. ALAVIDA LIFESTYLES INC.*

On May 26, 2011, the Supreme Court of Canada released its unanimous decision in *Masterpiece Inc. v. Alavida Lifestyles Inc.*<sup>1</sup>, a case dealing with two confusing trade-marks. The Court essentially corrected a few errors made

<sup>1</sup> <http://www.canlii.org/en/ca/scc/doc/2011/2011scc27/2011scc27.html>

by the Federal Court and the Federal Court of Appeal in respect of analyzing the likelihood of confusion between two trade-marks relating to retirement residence facilities. Perhaps the most surprising outcome of this decision is how much has been written about it in the press and other publications, given that most trade-mark practitioners understood that the lower courts in this case had made a couple of significant analytical errors. In light of the rarity of intellectual property decisions from our highest court however, the enthusiastic response to this one is more understandable.

The legal errors made by the lower courts which the Supreme Court of Canada corrected were:

- effectively transforming Canada from a “first-to-use” jurisdiction to a “first-to-file” jurisdiction by refusing to expunge a subsequently used yet confusing trade mark;
- considering location of use and geography as a determining factor in the analysis of likelihood of confusion; and
- considering the nature and cost of products and services as a determining factor in the analysis of likelihood of confusion.

## Facts

The basic facts were relatively simple. Without properly searching availability for use or registration, Alavida, the Ontario company (“Alavida”) applied to register the trade-mark “*Masterpiece Living*” but only on a proposed use basis, which means that it had not in fact started using the mark. Masterpiece, the Alberta company (“Masterpiece”) had started actually using the trade-mark “*Masterpiece the Art of Living*” before Alavida’s application, but only in Alberta. Shortly after Alavida had applied to register its mark (on a proposed use basis), Masterpiece applied to register its (already used) mark, but its application was denied on the basis of a likelihood of confusion with the

prior application by Alavida. Masterpiece then went to the Federal Court to expunge Alavida’s trade-mark, however, that trial court dismissed the application on the basis that there was no likelihood of confusion. The Federal Court of Appeal later upheld the trial court’s decision. The Supreme Court of Canada reversed both decisions and concluded that there was a “strong similarity” between the marks and accordingly a likelihood of confusion, thereby justifying the expungement relief sought by Masterpiece.

## First to Use

Under the Trade-marks Act<sup>2</sup>, Alavida was not entitled to register its mark because a confusingly similar trade-mark had already been used elsewhere in Canada. Thus, the decision affirms that Canadian trade-mark law is (as it always was) founded upon the doctrine that trade-marks can only legally exist if they have been used (as has been the case for centuries at common law) and that being the first to file does not mean that one is entitled to register a mark that is confusing with a previously used unregistered mark.

## Location

The lower courts considered relevant that Alavida had only used its mark in Ontario and that Masterpiece had only used its mark in Alberta, such that confusion would be unlikely. That was clearly incorrect. The likelihood of confusion analysis prescribed by the *Trade-marks Act* requires one to make the hypothetical assumption that both marks are used in the same area at the time of the application. Furthermore, the exclusive rights granted by the *Trade-marks Act* are Pan-Canadian, not restricted provincially or otherwise geographically in the manner common law marks were protected historically using compensatory tort principles.

## Cost

Similarly, the nature and cost of a product or service is irrelevant to the likelihood of confusion test. The lower

<sup>2</sup> R.S.C., 1985, c. T-13

courts reasoned that where there is a higher purchase cost, there is a greater probability that the consumer will do additional research and thereby eliminate any potential “first impression” or “initial interest” confusion. The Supreme Court held that such a consideration is irrelevant and potential confusion must always be assessed as a matter of first impression. Just as copyright law needs to balance the rights of content owners and the rights of users, trade-mark law goes beyond merely protecting owners of registered trade-marks and serves a consumer protection purpose in disallowing confusing trade-marks to co-exist in the marketplace. One might well ask why consumers of “higher-end” brands should deserve less consumer protection than other consumers. To ask the question answers it.

## Ad-words

Potentially, the most significant aspect of the decision of the Supreme Court may be the passing comments by Justice Rothstein about “leading consumers astray” and the impact thereof on goodwill, which can be applied to trade-mark disputes over ad-words (namely, key search words purchased from major on-line search engines) and against cyber-squatters.

*“Indeed, before source confusion is remedied, it may lead a consumer to seek out, consider or purchase the wares or services from a source they previously had no awareness of or interest in. **Such a diversion diminishes the value of the goodwill associated with the trade-mark and business the consumer initially thought he or she was encountering in seeing the trade-mark. Leading consumers astray in this way is one of the evils that trade-mark law seeks to remedy.** Consumers of expensive wares or services and owners of the associated trade-marks are entitled to trade-mark guidance and protection as much as those acquiring and selling inexpensive wares or services.” (my emphasis).*

So far, the case law in Canada concerning the use of ad-words is relatively uncharted but the jurisprudence emerging in the United States suggests that the use of ad-words in search engines may be lawful because it is generally analogous to purchasing ad space in the yellow pages, thereby not giving rise to concerns of potential trade-mark law violations. The foregoing remarks by Justice Rothstein may influence lower Canadian courts to be less accepting of ad-words as American courts. The remarks may also assist in reclaiming domain names from cyber-squatters who misdirect consumers to confusing or unauthorized websites.

## Take-Aways

The main practical take-aways of the Supreme Court’s *Masterpiece* decision are:

1. always conduct trade-mark searches, particularly for unregistered trade-marks and trade names, before filing a trade-mark application or commencing use of a mark;
2. always apply to register your trade-mark as early as possible in its life cycle; and
3. once your trade-mark is registered, regularly monitor the relevant marketplace for any registered or unregistered marks that may be potentially confusing.

If you would like more information concerning the Supreme Court’s decision or to discuss your own particular trade-mark needs, please feel free to contact me (902.420.3343 or [mbelliveau@stewartmckelvey.com](mailto:mbelliveau@stewartmckelvey.com)) or any other member of our Intellectual Property Group. Our Firm has the largest number of trade-mark agents in Atlantic Canada and we would be pleased to assist you in protecting and growing your brand.





Marc Belliveau  
Halifax Office  
902.420.3343  
mbelliveau@stewartmckelvey.com

---

## Best Efforts – A Recipe for Dispute

Contracting parties often need to deal with conditions and obligations that are not fully within their control. Consider the following examples:

- Example 1: A distributor (“DistributorCo”) would like to enter into a distribution agreement to import a new product but needs to obtain a government permit to do so.
- Example 2: A manufacturer (“ManufactureCo”), who currently delivers 20,000 widgets per month to a customer, would like to enter into a new supply contract with that customer agreeing to deliver 30,000 widgets per month by January 2012, knowing that this 10,000 per month increase in widget making capacity will require the overhaul of its existing facility.

Generally, the promising party knows that it should not agree to contractual language that makes it their absolute duty to accomplish an objective that is not within their full control. However, parties faced with obligations outside their control sometimes decide to address the uncertainty by making the obligation subject to the promising party’s “best efforts”. In Example 1, DistributorCo might agree to add the following language to the distribution agreement:

“DistributorCo shall use its best efforts to obtain the import permit by October 1, 2011.”

In many cases, parties use “best efforts” language without being aware of the law of best efforts. What they may think they are doing is adding some straight forward language to show their intention to work hard to complete the promise. In Example 2, the CEO of ManufactureCo thinks, “yes, we will work really hard to complete our facility renovation so that we are able to deliver the 30,000 widgets per month by January 2012” and so agrees to insert the following language in the contract:

“ManufactureCo shall use its best efforts to deliver 30,000 widgets per month commencing in January 2012.”

To the layperson the above “best efforts” language may sound perfectly good and reasonable. However, contracting parties need to step back and consider what they are really promising. To do this they must consider (i) what does “best efforts” really mean, (ii) what are they promising to use “best efforts” to do, and (iii) if the promise cannot be fulfilled what will the other side say that they should have done?

### What Does Best Efforts Mean?

A common view among Canadian corporate lawyers is that best efforts is the most onerous of the “efforts” standards, requiring the promisor to do everything in its power to accomplish the objective (even if it bankrupts itself in the process). Other standards – such as “reasonable efforts” or “commercially reasonable efforts” – are seen to be less onerous.

*Atmospheric Diving Systems Inc. v. International Hard Suits Inc*<sup>1</sup>, a 1994 decision of the British Columbia Supreme Court, remains one of the most cited Canadian cases regarding the “best efforts” standard and it states that:

---

<sup>1</sup> [1994] B.C.J. No. 493

- “best efforts” imposes a higher obligation than “reasonable efforts”
- “best efforts” means taking, in good faith, all reasonable steps to achieve the objective, leaving no stone unturned;
- “best efforts” includes doing everything known to be usual, necessary and proper for ensuring the success of the endeavour;
- “best efforts” are not boundless; the contract provisions, parties and purposes must be considered in setting the relevant boundaries;
- a party using best efforts must act honestly and fairly;
- evidence that a party could have achieved the contractual condition may be evidence that the party did not use its best efforts. However, evidence that a party could not have achieved the contractual condition – i.e., that there was inevitable failure – is not relevant to the issue of liability but is relevant to causation of damages.

There are many who argue that the various efforts standards (including, “best efforts”, “all reasonable efforts”, “commercially reasonable efforts”, “reasonable efforts”, etc.) as they are actually applied in court decisions generally amount to the same thing – and that at the end of the day all of the efforts standards will be bound by reasonableness. This view was recently supported by a decision of the *Ontario Superior Court of Justice in Southcott Estates Inc. v. Toronto Catholic District School Board*<sup>2</sup>, in which the court stated about the best efforts standard:

“The cases have used a variety of words to describe this obligation; “to act in good faith and to take all reasonable steps”; “to use best efforts”; “to act diligently and honestly”; “to do all that is necessary to act reasonably and in good faith and not in a capricious or arbitrary manner”[, “]to proceed in good faith using due diligence” and “take all reasonable steps”. Whatever words are used, in the final analysis the court must determine,

based on the particular facts, whether the party on whom the obligation rested and who seeks to rely on the non-fulfillment of the condition has satisfied the court that it took all reasonable steps to fulfill the condition.”

So, despite the warnings, even under “best efforts” provisions you will likely not be required to bankrupt your company to fulfill the promise. People have attempted to reconcile “reasonable efforts” and “best efforts” by stating that best efforts is taking all reasonable steps (i.e., no “unreasonable” stone unturned) whereas reasonable efforts involves taking only some reasonable steps. However, there is lingering and perhaps legitimate fear that a contracting party which has promised to use “best efforts” to fulfill an obligation will be at greater risk when a court is determining (with the benefit of hindsight) what those “best efforts” should have entailed. Corporate lawyers acting for the promisor will be more comfortable with “reasonable efforts” because contracting parties should be able to justify their actions as long as they have taken a “reasonable” course of action to fulfill the promise – not all reasonable steps, whatever the additional steps required by the all might entail.

### What Am I Promising to Use Best Efforts to Do?

In Example 2, ManufacturCo wishes to enter into a new supply contract with a customer which will require it to increase its capacity by 10,000 widgets per month, an increase which will require the overhaul of its facility. The CEO of ManufacturCo had agreed to use “best efforts to deliver 30,000 widgets per month commencing in January 1, 2012” without much thought as to how broad this promise might be.

*Automaster Automotive Services Ltd. v. Kenco Enterprises Ltd.*<sup>3</sup> is a 2009 BC Supreme Court case which provides an excellent example of the repercussions of being “overbroad” in your best efforts promise.

Automaster operated a transmission repair shop in Nanaimo, British Columbia out of a property which it leased

<sup>2</sup> 2010 CarswellOnt 2602

<sup>3</sup> 2009 BCSC 1594

from Kenco. The parties entered into an agreement pursuant to which Automaster acquired an option to purchase the property from Kenco for a period of 18 months from the start of the lease. The option provided that Automaster would use its “best efforts” to complete the purchase of the property within the first 12 months of the lease.

One week before the expiry of the 18 month option period, Automaster gave notice that it was exercising its option to purchase the property. Kenco indicated that it was not prepared to proceed with the transaction. Automaster then commenced an action for specific performance of the option agreement – to force Kenco to sell Automaster the property.

At trial, witnesses for Kenco indicated that during the first 12 months of the lease the period during which “best efforts” were to be used, Kenco received no indication that the option would be exercised. Automaster stated that the option was not exercised earlier because it was in the process of selling another property in Vancouver the proceeds of which would have been applied to the purchase of the Kenco property. The Vancouver sale did not close as planned and Automaster did not exercise its option to purchase the new property until that sale was completed.

The court was satisfied that during the first 12 months of the lease, Automaster was making all reasonable efforts to sell its property in Vancouver. However, Automaster’s obligations under the option agreement required it to use “best efforts” to acquire the Kenco property, not to sell the Vancouver property. The Court found that, given that the sale proceeds from the Vancouver property were not forthcoming, Automaster’s best efforts promise required it to explore other sources of financing to complete the purchase. The court found that Automaster had lost its rights under the option as a result of its failure to use “best efforts” to complete the sale.

In Example 2, it is clear that ManufactureCo’s promise to use best efforts to deliver 30,000 widgets per month

commencing in January 1, 2012 is overbroad. This promise would likely require it to go above and beyond completing the facility renovation. For example, if it is unable to complete the renovation and produce the extra widgets in its facility, the customer may argue that “best efforts” would require ManufactureCo to buy the widgets from another manufacturer and sell them to the Customer at the contract price or, perhaps, the best efforts promise would require cancelling other customer contracts so that ManufactureCo could free up an additional 10,000 units for delivery to the customer.

### If the promise does not end up being fulfilled what will the other side say that I should have done?

Even if the promisor has picked the proper subject for its “best efforts” promise, best efforts promises are by their nature vague and imprecise. The result of this imprecision is that determining whether a party has made sufficient efforts will depend on the circumstances and will likely be decided by a court with the full benefit of hindsight. A promisor may find that a court interprets its best efforts promise to require it to have taken steps that were unpalatable to it but that are seen by a court to be one of a number of “reasonable steps” that should have been taken. Indeed a court may hold that a party subject to a best efforts clause is obligated to take steps and make efforts that in the view of the promisor are out of proportion to the benefits to it under the contract or not normal steps it would choose to take in the business.

So, in Example 2, assume that the CEO of ManufactureCo had been more focused in its best efforts promise and had agreed to use “best efforts to complete the necessary facility upgrades by December 31, 2011” so that it would be in a position to deliver 30,000 widgets per month to the customer by January 2012. Even in this case ManufactureCo may end up being surprised at what a court viewed “best efforts” to be. The CEO of ManufactureCo should consider if, for example, best efforts may require it to finance the facility upgrade on terms that are not desirable to the

CEO, to incur substantial cost overruns to get the facility upgrade completed on time, or to hire someone other than ManufactureCo's preferred contractor to complete the work, if the preferred contractor has a scheduling conflict.

## What to do when faced with a contractual obligation outside your control

By thoughtlessly inserting best efforts provisions into contracts – perhaps just to signal a desire to work especially hard to meet a condition of the contract – the promising party opens itself up to a substantial risk of opportunism and litigation should they be unable to fulfill best efforts obligation. Instead when faced with a contractual promise that is not within the promisor's control, the promisor should consider what promises it is actually willing to make and craft its promise to reflect those efforts and, where appropriate, put limits on the scope of its promise. In particular, we would encourage commercial parties to:

1. Use the “reasonable efforts” rather than the “best efforts” standard so you are not open to a reassessment of whether all reasonable steps were taken and should be able to argue from a position of strength if you are unable to fulfill the promise but took a reasonable course of action in diligently pursuing the promise.
2. Understand the scope of the promise and ensure the promise is appropriately focused on the proper subject matter of the promise.
3. Where appropriate, define “reasonable efforts” or “best efforts” to set out or provide greater guidance on the parties' actual expectations for fulfilling the obligation. This could include incorporating specific promised actions, references to industry practice or to the promisor's normal or past practice. If you are the recipient of the promise – remember that if an action is not seen by the court to be “reasonable” it will not be required under either the “reasonable efforts” or “best efforts” standard. Therefore, the recipient of the promise should consider specifically listing any actions that it wants taken that may potentially be over and above what is “reasonable”.
4. Where appropriate, provide carve-outs from the “reasonable efforts” or “best efforts” standards specifying what the promisor is not required to do to achieve the promise. Carve-outs can be tailored to the circumstances of the promise and may include, for example (a) stating that the promisor will not incur any liabilities, (b) setting limits on the expenditures that the promisor must incur in attempting to fulfill the promise, (c) stating that the promisor will not take any actions that would cause it to incur costs or suffer any losses that are out of reasonable proportion to the benefits provided by the contract, (d) stating that the promisor will not take any action that in the opinion of the promisor would jeopardize a material customer or supplier relationship, (e) stating that the promisor will not change its business strategy or dispose of significant assets, (f) stating that the promisor will not initiate any litigation, or (g) stating that the promisor will not lobby or provide inducements to foreign officials.

Indeed, what your “best efforts” or “reasonable efforts” promise looks like should depend on the particulars of the promise. For example, it may be perfectly reasonable, in Example 1, for DistributorCo to promise to “use reasonable efforts to obtain the import permit by October 1, 2011” without further definition or carve-out. On the other hand, in Example 2, the fulfillment of ManufacturerCo's promise to complete a facility upgrade is much more complex and it would be appropriate to insert a definition of reasonable efforts, including limits on the actions that ManufacturerCo is required to take to achieve the promise.



Tauna Staniland  
St. John's Office  
709.570.8842  
tstaniland@stewartmckelvey.com

# Business Disputes Corner

## Case Comment: *Polycorp Properties Inc. v. Halifax (Regional Municipality)*

On June 20, 2011, Justice Gregory Warner of the Supreme Court of Nova Scotia rendered his decision in *Polycorp Properties Inc. v. Halifax Regional Municipality*<sup>1</sup>. The decision related to an application by Polycorp Properties Inc. (“Polycorp”) to allow Polycorp to develop a vacant lot next to the Ocean Towers apartment complex on Barrington Street in Halifax. In granting Polycorp’s application, the Court effectively reaffirmed the importance of clarity and certainty in municipal rules governing land use.

Justice Warner’s decision brought to an end an approximately 18-month process which began when the Halifax Regional Municipality (“HRM”) refused Polycorp’s application for a development permit on the stated basis that the vacant lot was designated as open recreational space pursuant to an agreement regarding the development of the Barrington Street Housing Project in the early 1970s. The HRM’s decision to refuse the permit came after Polycorp conducted extensive due diligence in relation to the property, including title searches which revealed no development agreement recorded on title, and receipt of a zoning confirmation letter from the HRM which similarly indicated no restrictions on development. On the strength of its due diligence, Polycorp had proceeded with its purchase of the vacant lot for \$1.275 million and subsequently commenced the development permit process.

The HRM argued that the Barrington Street Housing Project was pursuant to a special authorization under the old *Halifax City Charter*, which authorization served to prevent future development on the vacant lot, much like a development agreement. It was further argued by the HRM that Polycorp’s due diligence should have alerted it to the fact that there was such a restriction on the property.

The HRM also commenced a separate application for a correction to the parcel register, on the basis that certain language had been removed from the title description during the course of the lot being consolidated in 2005, which information HRM suggested would have notified Polycorp of the restriction on development.

Both applications were heard simultaneously on May 16, 17 and 18, 2011. Justice Warner granted Polycorp’s application, declaring that its development rights on the property are not affected by any development agreements or other restrictions alleged by the HRM, and that the development permit application should be solely governed by the terms of the Land Use By law. Justice Warner also dismissed the HRM’s application for a correction to the parcel register.

The decision of Justice Warner reaffirmed the importance of the parcel register as the basis for determining restrictions or encumbrances on the property. The *Municipal Government Act*<sup>2</sup> provides that development permit applications are to be determined in accordance with the applicable zoning under the Land Use By law, and that any exceptions to that zoning created by a development agreement must be recorded on title in order to be affective. Justice Warner found that the Barrington Street Housing Project agreement could not have restricted future development of the property because it was not registered on title, and that even if it was registered, there was nothing in that agreement that specifically restricted development as contended by the HRM.

As an alternative basis for granting Polycorp’s application, Justice Warner also found that the principles of estoppel were applicable to allow Polycorp to rely on the content of the zoning confirmation letter, and thus to now prevent the HRM from reneging on the contents of that letter. In other words, because the HRM represented to Polycorp in the zoning confirmation letter that there were no restrictions on

<sup>1</sup> 2011 NSSC 241

<sup>2</sup> 1998 S.N. c.18

development, and because Polycorp relied on that letter in purchasing the property and seeking a development permit, the HRM is now precluded from attempting to rely on any purported restriction which it did not identify in the letter.

Also of particular significance was Justice Warner's decision on costs. For its success in the applications, Polycorp was awarded \$88,875 plus HST and disbursements. This award of costs was significantly higher than most costs awards in relation to short applications, due to the significant financial consequences that Polycorp stood to suffer if its development rights were not acknowledged. In reaching this award, Justice Warner used the basic costs tariff ordinarily used for a trial based on an "amount involved" of \$1.275 million. This figure was chosen to reflect the purchase price of the property and, accordingly, the loss in value to the property that would result if Polycorp was not permitted to develop it. The HRM was also ordered to pay costs of \$20,000 to each of three other parties which were named in HRM's unsuccessful application to correct the parcel register. These awards demonstrate the flexibility of the Court's discretion with respect to costs, and serve as a caution that applications, while ordinarily shorter and less complex than full trials, may still involve serious costs consequences where significant rights are at stake.

On the whole, this decision is important in its reaffirmation that the ability to enter confidently into business transactions depends on the party's ability to rely on the results of its due diligence, and of the certainty of property rights as protected by law. This importance is perhaps best summed up by the first sentence of Justice Warner's decision: "A requisite of the 'rule of law', whatever definition one adopts, is that the law is at least visible and certain, and not subject to the machinations of Government."

Polycorp was represented by **Robert G. Grant, Q.C.** and **Matthew Pierce** of Stewart McKelvey.



Matthew Pierce  
Halifax Office  
902.444.1738  
mpierce@stewartmckelvey.com

This newsletter is intended to provide brief informational summaries only of legal developments and topics of general interest and does not constitute legal advice or create a solicitor-client relationship. The newsletter should not be relied upon as a substitute for consultation with a lawyer with respect to the reader's specific circumstances. Each legal or regulatory situation is different and requires review of the relevant facts and applicable law. If you have specific questions related to this newsletter or its application to you, you are encouraged to consult a member of our Firm to discuss your needs for specific legal advice relating to the particular circumstances of your situation. Due to the rapidly changing nature of the law, Stewart McKelvey is not responsible for informing you of future legal developments.

# Service First

---

1. We will work to provide you with the highest quality of confidential, ethical legal services.
2. We will work with you to develop a full understanding of your business / organization and expectations.
3. We will pursue your work conscientiously and without delay. We will work together with you to establish time specific goals and objectives that meet your needs.
4. We will delegate work to our lawyers who have the legal expertise and experience appropriate to both the nature and complexity of the matter and our understanding of your expectations. Where deemed appropriate by you, we will designate a qualified lawyer as an alternative service contact to ensure continuity of service when the lawyer responsible for your matter is not available. At your request, we will work with you to develop practical fee estimates. We will always strive to add value.
5. At your request we will provide documentation that outlines the scope of the legal services to be provided; the potential timeline for handling the matter; a list of the client team members and alternate service contact, with their fields of expertise; and our lawyers' contact information.
6. We will meet and strive to exceed your expectations and always welcome your feedback. We will from time to time, seek from you, either formally or informally, an assessment of our performance.
7. We will maintain effective channels of communications including keeping you informed of all significant developments in the legal matter and responding to your contact in a timely fashion.
8. Accounts will be easy to understand. We will always be receptive to client feedback on our billing practices. When issues arise, we will treat them seriously and respond promptly.
9. If you are dissatisfied with our services, or if you feel we have failed to meet any of these commitments, we ask that you call the service lawyer on your matter, the alternate service lawyer, the local practice manager or managing partner to discuss your concern. We will honestly and fairly address your concerns.

# Practice Contacts

## Business

The firm provides comprehensive services in all aspects of company and commercial law including creation of corporate and other vehicles, shareholder agreements, partnerships, joint ventures, distribution, agency and other such agreements; franchising and licensing; all manner of commercial contracts; mergers and acquisitions including structuring, due diligence, bids, and associated financing and tax planning; MBOs, LBOs, amalgamations, and asset and share transactions; cross-border transactions and assisting foreign clients making investments in Atlantic Canada, including the establishment and expansion of operations; all aspects of business disputes, including commercial litigation, arbitration and mediation. Stewart McKelvey has expertise in using corporations and unlimited liability companies, as well as international trust companies formed in the jurisdiction in which we practice, to solve the unique requirements of our domestic and international clients.

## Department Manager, Business

Maureen Ryan - Partner  
709.570.8880  
mryan@stewartmckelvey.com

## Practice Group Leaders

### Business Disputes

Colin Piercey  
(902) 420-3345  
cpiercey@stewartmckelvey.com

### Natural Resources & Environmental

Greg Moores  
709.570.5797  
gmoores@stewartmckelvey.com

### Business Transactions

Deanne MacLeod  
902.420.3313  
dmacleod@stewartmckelvey.com

### Owner Managed Business

Peter Klohn  
506.632.2788  
pklohn@stewartmckelvey.com

### Commercial Real Property & Lending

Brian Tabor, Q.C.  
902.420.3397  
btabor@stewartmckelvey.com

### Tax, Estates & Trusts

Jim Cruickshank  
902.420.3394  
jcruickshank@stewartmckelvey.com

### IP/IT/Entertainment

Rob Aske  
902.420.3310  
raske@stewartmckelvey.com