

**PRECEDENT**

Court file no.

**SUPERIOR COURT OF JUSTICE**

**BETWEEN:**

FINANCIAL INSTITUTION

Plaintiff

- and -

JOHN SMITH, JOHN DOE,  
JANE BROWN and LISA GREEN

Defendants

**AND BETWEEN:**

JOHN SMITH, JOHN DOE,  
JANE BROWN and LISA GREEN

Plaintiffs by Counterclaim

- and -

FINANCIAL INSTITUTION  
and COMPANY A

Defendants to the Counterclaim

**STATEMENT OF DEFENCE and  
COUNTERCLAIM**

TO THE DEFENDANTS TO THE COUNTERCLAIM

A LEGAL PROCEEDING has been commenced against you by way of a counterclaim in an action

in this court. The claim made against you is set out in the following pages.

IF YOU WISH TO DEFEND THIS COUNTERCLAIM, you or an Ontario lawyer acting for you must prepare a defence to counterclaim in Form 27C prescribed by the Rules of Civil Procedure, serve it on the plaintiff by counterclaim's lawyer or, where the plaintiff by counterclaim does not have a lawyer, serve it on the plaintiff by counterclaim, and file it, with proof of service, in this court, WITHIN TWENTY DAYS after this statement of defence and counterclaim is served on you.

If you are not already a party to the main action and you are served in another province or territory of Canada or in the United States of America, the period for serving and filing your defence is forty days. If you are served outside Canada and the United States of America, the period is sixty days.

If you are not already a party to the main action, instead of serving and filing a defence to counterclaim, you may serve and file a notice of intent to defend in Form 18B prescribed by the Rules of Civil Procedure. This will entitle you to ten more days within which to serve and file your defence to counterclaim.

IF YOU FAIL TO DEFEND THIS COUNTERCLAIM, JUDGMENT MAY BE GIVEN AGAINST YOU IN YOUR ABSENCE AND WITHOUT FURTHER NOTICE TO YOU.

If you wish to defend this proceeding but are unable to pay legal fees, legal aid may be available to you by contacting a local legal aid office.

Date:

Issued by:

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Local Registrar

Address of court office:

145 Queen Street West  
Toronto, Ontario  
M5H 2N5

TO: FINANCIAL INSTITUTION

AND

TO: COMPANY A

## STATEMENT OF DEFENCE

1. The defendants admit the allegations contained in paragraphs --- of the Statement of Claim.
2. The defendants deny the allegations contained in paragraphs --- of the Statement of Claim.
3. The defendants have no knowledge of the allegations contained in paragraph --- of the Statement of Claim.

### Background

4. In 1995, Company A (the "Borrower") acquired a package of land located in the City of Toronto (the "Property"). At that time, it was the Borrower's intention to develop the Property as a residential subdivision.
5. In November, 1995, the Financial Institution (the "Bank") agreed to provide a credit facility in the amount of \$10,000,000.00 to the Borrower for, *inter alia*, the purpose of servicing the Property.
6. As part of the security provided to the Bank for the credit facility, the defendants, the "Guarantors" guaranteed the liabilities of the Borrower, on a joint and several basis, up to a maximum amount of \$10,000,000.00.
7. The agreements and documents relating to the credit facility and the security were part of an overall loan agreement. The parties to the overall loan agreement were the Borrower, the Bank and the Guarantors.
8. The terms of the overall loan agreement were, *inter alia*, the following:
  - a. the Bank would provide a credit facility in the amount of \$10,000,000.00 to the Borrower;
  - b. the Borrower would pay the Bank interest at a rate of prime plus 1.0%;

- c. the Borrower would pay the Bank a non-refundable fee of \$10,000.00;
  - d. the Borrower would provide the Bank with a Fixed and Floating Charge Debenture (the "Debenture") in the amount of \$10,000,000.00, second only to an existing first mortgage (the "First Mortgage") on the Property in the amount of \$5,000,000.00;
  - e. the Borrower would provide the Bank with a general security agreement;
  - f. the Guarantors would provide their joint and several guarantees in the amount of \$10,000,000.00; and,
  - g. it was an implied term of the overall loan agreement that the parties would act reasonably and in good faith towards each other.
9. The Borrower proceeded to service part of the Property (the "Serviced Property").
10. In November, 1997, the overall loan agreement was amended to provide, *inter alia*, as follows:
- a. the total amount of the credit facility available to the Borrower would be reduced from \$10,000,000.00 to \$9,000,000.00;
  - b. the interest rate payable by the Borrower would be increased from prime plus 1.0% to prime plus 3.0%;
  - c. the Borrower would pay the Bank a non-refundable fee of \$10,000.00;
  - d. the Debenture, the general security agreement and the guarantees would remain in place; and,
  - e. it was an implied term of the amending agreement that the parties would act reasonably and in good faith towards each other.
11. At the time the overall loan agreement was amended, the Bank's Debenture

remained second in priority to the First Mortgage.

### **The Playdium**

12. In the period between January, 1995, and mid 1997, the demand for property of the same type as the Property was adversely affected by a depressed market. This was known to the Bank. As a result, the Borrower began to consider developing a part of the Property, the south portion of the Serviced Property, as a Playdium centre (the "Playdium"). The Bank encouraged this approach.

13. In furtherance of the Playdium, the Borrower took the following steps, all of which were known to the Bank:

- a. the Borrower re-zoned the south portion of the Serviced Property for the Playdium;
- b. the Borrower prepared a detailed written description of the Playdium and provided the Bank with a copy; and,
- c. the Borrower had a professional appraisal done which indicated that if the Playdium was completed, then, as a going concern, the south portion of the Serviced Property would have a value of \$15,000,000.00, and a copy of this appraisal was provided to the Bank.

14. On about three occasions between January and the end of April, 1993, the Borrower and the Guarantors met with the Bank.

15. During those meetings, the Borrower and the Guarantors set out information related to the financing requirements of the Playdium.

16. During those meetings, the fact that the postponement of the Bank's Debenture was crucial to the viability of the Playdium was specifically discussed.

17. During those meetings, the Bank, represented the following:

- a. that the Bank would postpone their charge on the south portion of the

serviced Property in favour of the Construction Financing to a maximum of \$10,000,000.00, if the Borrower discharged the First Mortgage on the Serviced Property; and,

- b. that there would be no difficulties in postponing the Bank's charge in favour of the Construction Financing.

18. In January, 1998, the Borrower obtained a discharge of the First Mortgage on the Serviced Property and, as a result, the Bank's Debenture now had first priority.

19. The Bank's continuing intention and agreement to postpone were re-affirmed during further meetings that took place between the Borrower, the Guarantors and the Bank on March 3, 1998, as well as during numerous telephone conversations throughout the relevant period.

20. Based upon and in reliance on the representations, promises and assurances from the Bank, the Borrower had a financing proposal prepared which was submitted to the Bank for approval and for the postponement.

21. Contrary to its earlier position the Bank, in or about April, 1998, demanded a payment of \$2,000,000.00 in reduction of the Borrower's indebtedness as a condition of granting the postponement. Thereafter, the Borrower, in an attempt to mitigate and salvage the development, continued its discussions with the Bank.

### **The Bank's Breach of its Contractual Obligation to Postpone**

22. The meetings between the Borrower, the Guarantor and the Bank which took place between January and the end of April, 1998, resulted in an agreement to further amend the overall loan agreement as follows:

- a. the First Mortgage, as it related to the serviced Property, would be discharged, to the benefit of the Bank;
- b. the Bank would postpone the Bank's Debenture as it related to the south portion of the Serviced Property to the Construction Financing;

- c. the \$10,000,000.00 secured by the new first mortgage would be used to construct the Playdium; and,
- d. the Borrower would continue to incur the costs of pursuing the Playdium.

23. In reliance on the agreement by the Bank to postpone, the Borrower discharged the First Mortgage and incurred substantial costs in pursuing the Playdium. Subsequently, the Bank refused to grant the postponement without the imposition of onerous and impossible terms which had never before been agreed to or discussed.

24. The Bank's failure to provide the postponement was in breach of the agreement by the Bank to postpone and was, consequently, in breach of the overall loan agreement, as amended. The Bank's breach has materially altered the risk of the Guarantors to the Guarantor's prejudice and, therefore, the guarantees should be discharged.

25. The Bank, as a consequence of being in breach of the agreement and the overall loan agreement, as amended, is not entitled to demand payment of the Borrower's indebtedness from the Guarantors.

### **The Bank's Misrepresentations to the Borrower**

26. The Bank represented to the Borrower the fact that it was the Bank's intention to postpone the Construction Financing.

27. The Bank owed a duty of care to the Borrower in that the Bank knew that the Borrower was likely to rely on its representation of the fact that it was the present intention of the Bank to postpone.

28. The Bank breached its duty of care by making its representation in that the Bank made the representation negligently and carelessly or, in the alternative, recklessly.

29. The Borrower relied on this representation and incurred substantial costs in pursuing the Playdium.

30. The representation was material to the Borrower in that the Borrower would not have proceeded with the Playdium without the Bank's representation of the fact that it was

the present intention of the Bank to postpone.

31. The Bank's negligent representation and breach of its duty of care owed to the Borrower has materially altered the risk of the Guarantors to the Guarantors' prejudice and, therefore, the guarantees should be discharged.

### **The Bank's Breach of its Duty to Act in Good Faith**

32. Further, and in the alternative, it was a term of the overall loan agreement, as amended, that the Bank would act in good faith towards the Borrower.

33. The Bank had represented to the Borrower that there would be no difficulties in arranging for the postponement of the Bank's security as it applied to the south portion of the Property. In reliance on the Bank's representation, the Borrower discharged the First Mortgage and incurred substantial costs in pursuing the Playdium. Subsequently, the Bank refused to grant the postponement without the imposition of onerous and impossible terms. The Bank retained the benefit of the discharge of the First Mortgage without postponing its own Debenture so as to allow the Playdium to proceed.

34. The Bank's reversal and its failure to provide the postponement constituted a breach of the Bank's duty to act in good faith towards the Borrower. The Bank, by its failure to act in good faith, has materially altered the risk of the Guarantors to the Guarantors' prejudice and, therefore, the guarantees should be discharged.

35. The Bank, as a consequence of it being in breach of the overall loan agreement, as amended, is not entitled to demand payment of the Borrower's indebtedness from the Guarantors.

### **The Standstill Agreement**

36. In or about January, 1999, the Bank, the Borrower and the Guarantors entered into a "standstill" arrangement whereby, among other things, the Bank agreed to take no action with respect to enforcement of its security and to take no action against the Borrower and the Guarantors, so as to permit the Borrower to finalize construction financing of the Property. Under the standstill arrangement the liability of the Guarantors was to be restricted to the deficiency, if any, remaining after completion of the development or sale of

the property.

37. The Borrower and the Guarantors were ready, willing and able to complete the standstill arrangement with the Bank.

38. The Bank subsequently requested that the Borrower and the Guarantors agree to provide the Bank with a Full and Final Release of any claims that the Borrower and the Guarantors may have had against the Bank as a result of the Bank's conduct. As this was not part of the standstill arrangement, the Borrower and the Guarantors did not provide the Full and Final Release to the Bank.

39. The Bank refused to proceed with the standstill arrangement.

40. The Bank, in refusing to proceed with the standstill arrangement and in taking this action, is in breach of the standstill arrangement.

#### **Damages Suffered as a Result of the Bank's Misconduct**

41. As a result, the Bank has prevented the Borrower and the Guarantors from obtaining optimal realization from the Property and has caused them to suffer damages by way of wasted expenditures, lost income and lost profit which, if not for the improper conduct of the Bank, would eventually have been realized from the Property.

42. Full particulars of those damages will be provided before trial, but are currently estimated to be approximately \$10,000,000.00.

43. With respect to the alleged guarantees of the Guarantors, there was no consideration received by the Guarantors. Further, the Bank knew or ought to have known that the Guarantors received no benefit in connection with the alleged guarantees and, notwithstanding, the Bank failed to advise or ensure the Guarantors seek and receive independent legal advice concerning the alleged guarantees.

44. If it is found that the Guarantors have any obligations under the guarantees (which is not admitted but expressly denied), the Guarantors plead that they have been released from any such obligations or that such obligations are unenforceable for reasons which include:

- a. there is nothing owing by the Borrower to the Bank;
- b. the Bank has failed, upon default by the Borrower, to receive and secure the lands given as security for the indebtedness of the Borrower to the Bank;
- c. the Bank has been negligent in the realization of the security it held with respect to the obligations of the Borrower to the Bank;
- d. the Bank has failed to obtain a fair and proper amount for the security;
- e. the Bank has failed to realize on the security in a commercially reasonable manner and has otherwise breached its duties to the Guarantors; and,
- f. the Bank has failed to mitigate its losses by exercising its rights to realize on the security.

45. The defendants plead and rely on the *Negligence Act*, R.S.O. 1990, c.N1.

46. If the Bank had satisfied its duties to deal fully and properly with the security and to mitigate its damages by realizing on the security in a commercially reasonable fashion, the amounts which the Bank seeks to recover from the Guarantors would have been fully repaid out of the proceeds from disposition of the security.

47. As a result of the aforesaid breaches by the Bank, the Guarantors have suffered serious prejudice and substantial damages which they are entitled to set off against any amount which may be found owing by them to the Bank.

48. The full particulars of these damages can only be known once the Bank provides the defendants with a full accounting of the amounts alleged to be owing by the Borrower and the amounts received, if any, on eventual disposition of the security.

49. The defendants therefore require and demand a full accounting of the accounts alleged to be owing by the Borrower and of the amounts to be received on the disposition of the security.

50. The defendants therefore state that the subject guarantees are unenforceable or, in the alternative, discharged, or, in the further alternative, null and void.

51. The defendants therefore submit that this action be dismissed with costs payable to the defendants.

### **COUNTERCLAIM**

52. The defendants claim against the Bank and the Borrower:

- a. a declaration that their guarantees of the indebtedness of the Borrower to the Bank are invalid, unenforceable and are discharged;
- b. a declaration that no money is owed by the Borrower to the Bank;
- c. a full accounting of the accounts alleged to be owing by the Borrower and the amounts received by the Bank on the disposition of any security; and,
- d. such further relief as this Honourable Court may deem just.

53. The defendants claim against the Bank:

damages for breach of contract and for negligent misrepresentation in the amount of \$10,000,000.00;

- a. the costs of the action and the counterclaim on a solicitor and client scale;
- b. prejudgment and postjudgment interest in accordance with the *Courts of Justice Act*, R.S.O. 1990, c.C.43; and,
- c. such further relief as this Honourable Court may deem just.

54. The defendants repeat and rely on the allegations contained in the Statement of Defence and incorporate them herein.