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WHAT TO DO WHEN A PARTY CAN'T CLOSE

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INTRODUCTION

I have been asked to review what to do when a party to a transaction cannot close. The law in this area is not new, but there seems to be an influx of decisions lately relating to failed real estate transactions and it was thought that a refresher would be helpful.

Whether a party is unable to close because they are not able to obtain the necessary financing, they cannot provide vacant possession as required, or market fluctuations have caused buyers or sellers remorse – we, the lawyers, are left dealing with the fledging transaction.

I have received many anxious calls from lawyers on the day of closing asking for advice on how to handle a transaction that isn't going to be completed. Many times, they knew or suspected there was going to trouble, but didn't deal with it until the day of closing because it wasn't an actual crisis until then.

We are all busy and staff are hard to find (or keep) so many of us are stretched thin, but our professional obligations remain the same regardless of how busy, stressed or understaffed we may be.

As lawyers, it is our job to advise our clients as to their rights and obligations under the agreement of purchase and sale, and part of that is explaining the options and consequences if a party to a transaction is unable or unwilling to close.

The first step is to determine if there is truly no way to complete the transaction at all. Can title insurance be obtained to insure over a requisition that the vendor would otherwise be unable to satisfy? Section 10 of the standard OREA agreement provides title insurance as a possible

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response to a requisition.[2]

Does your client have any other resources that will enable them to complete the transaction? For a purchaser client who has a monetary shortfall, can they borrow funds from friends or family? Can they get a guarantor or co-borrower to improve their creditworthiness? Do they have any other properties that can be re-financed?

If the issue relates to a title requisition, could a *Vendors and Purchasers Act* application resolve it?[3]

Purchasing a property is generally the largest financial transaction people make. It can be stressful. It can be emotional. In hot markets, it can be rushed. Ensuring that clients understand the consequences of failing to complete a transaction is imperative.

If there is absolutely no way for one of the parties to complete the transaction, then you will be left to stick-handle the aborted transaction.

OPTIONS

There are basically three options when a party is not able to close:

1. Amend the existing agreement terms
2. Terminate the agreement
3. Sue for specific performance

This paper will explore each of these options and provide summary commentary gleaned from case law.[4]

1. Amend the existing agreement terms

This can include an extension of the closing date, a reduction in the purchase price, a change in

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2 See *Thomas v. Carrano*, 2013 ONSC 1495 (CanLII)
3 See *Phinny v. Macauly*, 2008 CanLII 47015 (CanLII)
4 There is a plethora of caselaw on aborted real estate transaction and this paper is meant to provide a general overview of the key issues to consider. It is beyond the scope of this paper to provide a comprehensive review of all the relevant caselaw.

the payment provisions (e.g. arranging a vendor take back mortgage), or other terms of the agreement such a vacant possession requirements.

No obligation to amend

There is no obligation on the innocent or non-defaulting party to amend the agreement (to extend the closing date, to accept a lower price, to agree to a VTB, etc.).[5]

Any aspect of the agreement can be amended by the parties

If an innocent party does agree to amend the terms of the agreement, they can insist on terms and conditions, such as an additional non-refundable deposit, payment of their legal fees for negotiating and/or preparing an amendment, occupancy for a non-defaulting purchaser, etc.

Amending may be the most practical solution in certain situations

Amending existing terms may be a favourable option for innocent parties who have another transaction relying on the closing. For example, if a vendor has also signed an agreement to purchase another property and needs the funds from the sale of her existing house to complete the purchase of the new property, the practicalities of agreeing to a short extension or even to reducing the purchase price may outweigh the benefits of noting the purchase of the existing house in default. Sure, the vendor may have valid legal grounds to insist on strict compliance with the agreement, but if the purchaser is unable to obtain a mortgage for the required amount, then the purchase is simply unable to close. What good will a judgement 2 or 3 years from now do if the vendor is then forced to default on his purchase transaction because he requires the funds from the sale of his existing house to complete the purchase? As unpalatable as the idea may be, in some circumstances it may make the most practical sense.

Time of the Essence

Most agreements contain a provision that time is to be of the essence. Paragraph 20 of the OREA form 100 standard re-sale agreement states:

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5 *Azzerello v. Shawqi*, 2019 ONCA 820 (CanLII)

> **20. TIME LIMITS:** Time shall in all respects be of the essence hereof provided that the time for doing or completing of any matter provided for herein may be extended or abridged by an agreement in writing signed by the Seller and Buyer or by their respective lawyers who may be specifically authorized in that regard.

If neither party is ready, willing and able to complete the transaction on the scheduled closing date, the agreement continues, and time is no longer of the essence. Either party can reinstate time as being of the essence by setting a new closing date on reasonable notice.[6] In this case, there is no innocent or non-defaulting party, so neither party can take steps to enforce their rights under the contract, as neither is in a position to complete the agreement on the scheduled closing date.

Where there have been mutual breaches of the agreement of purchase and sale and neither party is in a position to complete the transaction on the closing date and neither party restores time as being of the essence, the agreement can be treated abandoned and the purchaser is entitled to a return of the deposit.[7]

2. Terminate the agreement

The non-defaulting party can accept a repudiation of the agreement by the defaulting party and, if desired, pursue damages against the defaulting party.

Repudiation

A breach or repudiation of an agreement of purchase and sale before the scheduled completion date does not, in itself, terminate the contract. The non-defaulting party must accept the repudiation for the breach to result in a termination of the contract.[8]

If the non-defaulting party accepts the repudiation, then the contract is terminated or "disaffirmed". If the innocent party treats the contract as subsisting or “affirmed”, then the contract is affirmed.[9]

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6 *Domicile Developments Inc. v. MacTavish* 1999 CanLII 3738 (ONCA); *King v. Urban & Country Ltd.* (1974) 1 OR (2d) 449 ONCA); *Zender v. Ball* (1974) , 5 OR (2d) 747 (ONSC)

7 *Malka v. Racz*, 2022 ONSC 1362 (CanLII)

8 *Brown v. Belleville (City)* 114 OR (3d) 561

9 *Guarantee Co. of North America v. Gordon Capital Corp.* [1999] 3 SCR 423

Disaffirmation must be clearly and unequivocally communicated within a reasonable time. This communication can be inferred from conduct or can be express communication accepting the repudiation. If the non-defaulting party accepts the repudiation the contract is terminated.

A failure by the non-defaulting party to accept the repudiation does not mean the contract has been affirmed - the non-defaulting party's conduct must be consistent with the contract still being in force. The non-defaulting party may be given a reasonable period of time to decide whether to affirm or disaffirm the contract; however, depending on the circumstances, inaction for too long may be considered as either a failure to elect to disaffirm or as affirmation of the contract.[10]

Tender

Tendering is a process by which the non-defaulting party shows that they are ready, willing and able to complete the transaction on the scheduled closing date, that they are not the cause of the delay or default, and that there has been no waiver. By tendering, the innocent party puts themselves in the position of relying on time being of the essence.[11]

Being able to become ready does not make a party "ready, willing, and able" to close.[12]

The non-defaulting party is not required to tender in the event of an anticipatory breach - when the other party has clearly repudiated the agreement or confirmed that they will be unable to complete the transaction.[13]

Where there has been an anticipatory breach, the non-defaulting party does not need to wait for the closing date to commence an action for damages or specific performance[14]

Mitigation

When a purchaser fails to complete a real estate transaction and the vendor brings an action for damages, a common defence is that the vendor failed to mitigate their damages.

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10 *Ching v. Pier 27 Toronto Inc.* 2021 ONCA 551
11 *Time Development Group Inc. (In trust) v. Bitton*, 2018 ONSC 4384 (CanLII)
12 *Zender v. Ball et. Al.* 1974 CanLII 730 (ON SC)
13 *Di Millo v. 2099232 Ontario Inc.* 2018 ONCA 1051
14 *Roy v. Kloepfer Wholesale Hardware and Automotive Co Ltd.*, 1951 CanLII 334 (ONCA)

> *There is, in fact, no positive duty or obligation to mitigate, apart from the duty of self-interest; rather, it is a principle of the calculation of damages that the innocent party is denied recovery for avoidable loss. A person mitigates for the sensible reason that he or she would not otherwise recover for the growing losses because, for the purposes of calculating compensatory damages, the innocent party is treated as if he or she mitigated.*[15]

Where it is alleged that the non-defaulting party has failed to mitigate, the burden of proof is on the defaulting party, who needs to prove both that the non-defaulting party has failed to make reasonable efforts to mitigate and that mitigation was possible.[16]

An innocent party's mitigation efforts need to be reasonable, not perfect, "using what it knows then, without hindsight, and it need not do anything risky".[17]

It is not a failure to mitigate when an innocent vendor refuses the defaulting purchaser's revised terms to purchase the property at a lower price.[18]

Forfeiture of Deposits

A forfeited deposit does not constitute damages for breach of contract but stands for the performance of the contract.[19]

The Court of Appeal has confirmed that:

> *A true deposit is an ancient invention of the law designed to motivate contracting parties to carry through with their bargains. Consistent with its purpose, a deposit is generally forfeited by a buyer who repudiates the contract, and is not dependant on proof of damages by the other party. If the contract is performed, the deposit is applied to the purchase price.*[20]

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15 *DHMK Properties Inc. v. 2296608 Ontario Inc.* 2017 ONSC 2432 (CanLII)
16 *Southcott Estates Inc. v. Toronto Catholic District School Board*, 2012 SCC 51*; Asamera; Evans v. Teamsters Local Union No. 31*, 2008 SCC 20; *Red Deer College v. Michaels*, 1975 CanLII 15 (SCC); *Miller v. Wang*, 2018 ONSC 7668
17 *Malatinskzy v. Miri*, 2020 ONSC 16 (CanLII)
18 *Azzarello v. Shawqi* 2019 ONCA 820, *Malatinskzy v. Miri*, 2020 ONSC 16 (CanLII)
19 *Ching v. Pier 27 Toronto Inc*. 2021 ONCA 551
20 *Tang* v. *Zhang* 2013 BCCA 52; *Redstone Enterprises Ltd.* v. *Simple Technologies Inc.* 2017 ONCA 282

The test for relief from forfeiture of deposits poses two questions:

i) is the forfeited deposit out of all proportion to the damages suffered; and
ii) would it be unconscionable for the vendor to retain the deposit.[21]

Damages

For innocent vendors, the normal measure of damages at common law for the failure to complete a purchase of land is the difference between the contract price and the market value of the land, plus the out of pocket expenses incurred as a result of the purchaser's breach, including carrying costs, real estate commissions, legal fees, etc.

For innocent purchasers, damages are typically the difference between the cost of obtaining an equivalent property and the property they would have purchased, but for vendor's default, plus the out of pocket expenses incurred as a result of the vendor's breach.

In *Akelius Canada Inc.*,[22] damages for "speculative profit" were denied. The agreement related to the purchase of several apartment buildings. The Court of Appeal noted that the purchaser was not in the business of flipping apartment buildings, but rather investment and rental. The fact that the vendor re-sold the apartment buildings 2 years later for almost 25% more was not relevant.

Conversely, in *The Rousseau Group v. 2528061 Ontario Inc.*,[23] damages for lost profits was awarded to a purchaser following the failure by the vendor to close. The court considered the sophistication of the parties and the fact that the agreement of purchase and sale and the purchaser's actions showed that the purchaser was buying the land to develop and that the vendor knew this. In proving its damages, the purchaser provided expert evidence of the costs and profits of comparable developments. The purchaser was awarded its estimated profits of $11.1 million.

3. Pursue specific performance

In some circumstances, the innocent party can bring an action for specific performance of the

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21 *Varajao* v. *Azish*, 2015 ONCA 218; *Redstone Enterprises Ltd.* v. *Simple Technologies Inc.*, 2017 ONCA 282; *Azzarello* v. *Shawqi*, 2019 ONCA 820
22 2022 ONCA 259 (CanLII)
23 2022 ONSC 486 (CanLII)

contract. If they do so, the agreement should not be terminated, as the non-defaulting party seeks to hold the defaulting party strictly to the terms of the agreement.[24]

It is advisable to carry out the tender process in order to confirm to the court that you were ready, willing, and able to complete the transaction on the scheduled closing date.

Whether specific performance for property will be granted will turn on the particular facts. The Court of Appeal in *Lucas v. 1858793 Ontario Inc. (Howard Park)*[25] has recently confirmed that the specific performance analysis is not merely a search for uniqueness. Other factors such as the inadequacy of damages as a remedy and the behaviour of the parties also play a role.[26]

A FEW RECENT DECISIONS

Ching v. *Pier 27 Toronto Inc.*[27]

This decision relates to a new-build condo where the vendor unilaterally extended the closing date multiple times beyond what was permitted in the Tarion Addendum. The court confirmed that each time the vendor extended the closing date without authority, it breached the agreement, and the purchasers were entitled to affirm the agreement or accept the repudiation. The purchasers did not acknowledge or accept multiple breaches of the agreement by the vendor and did not request a return of their deposits within a reasonable period following the breaches. Instead, the purchasers requested permission from the vendor to assign the agreement and to allow prospective purchasers to inspect the unit, thereby treating the agreement as if it was subsisting.

The purchasers ultimately failed to complete the transaction on the final scheduled closing date and their deposits of $214,238.85 were forfeited, even though the vendor was able to re-sell the unit at a higher price.

Ultimately, the Court of Appeal upheld the forfeiture of the deposits affirming that a forfeited deposit does not constitute damages for breach of contract but stands for the performance of the

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24 *Chai v. Dabir*, 2015 ONCS 1327 (CanLII)
25 2021ONCA 52 (CanLII)
26 See *Landmark of Thornhill Ltd. v. Jacobson*, 1995 CanLII 1004 (ON CA); *John E. Dodge Holdings Ltd. v. 805062 Ontario Ltd., 2001 CanLII 28012* (ONSC); *UBS Securities Inc. v. Sands Brothers Canada Ltd.*, 2009 ONCA 328

27 2021 ONCA 551

contract.

2174372 Ontario Ltd. v. *Dharmashi*[28]

This is a decision on a motion for summary judgement relating to a new home purchase where both parties allege that the other party was responsible for the failure to close. Several weeks prior to closing, the purchaser notified the vendor's sales representative that he was "unable to move forward with the completion of the agreement" without concessions from the vendor, including a price reduction and extension of the closing date. As a result of a downturn in the market, the purchaser's current property was worth less than anticipated and accordingly the purchaser was not able to provide a sufficient deposit to obtain the mortgage financing for which he had been pre-approved. The vendor declined to amend the agreement and offered to allow the purchaser to retract the repudiation of the agreement. The purchaser did not retract his repudiation of the agreement, but again requested a reduction in the price.

Shortly thereafter, the vendor's lawyer wrote to the purchaser and confirmed that the purchaser was legally obligated to complete the transaction on the scheduled closing date, failing which the deposits would be forfeited and the vendor would re-sell the property and look to the purchaser for any damages resulting from the purchaser's breach of the agreement. The purchaser replied the same day confirming that he was unable to close due to mortgage approval restrictions and noting that he was happy to meet if there was any ability to renegotiate the agreement.

A week before the scheduled closing date, the vendor's lawyer confirmed that the vendor was ready, willing, and able to complete the transaction on the scheduled closing date.

Unbeknownst to the vendor, the purchaser attended at the building site on his own and discovered that the home was not ready for occupancy – the purchaser noted that there was no electricity, no heating, no lighting, the flooring was not completed, no carpeting, there were no sinks, toilets or bathtubs, no faucets, no appliances, no countertops, no locks or garage doors. The purchaser also confirmed that no occupancy permit had been issued by the municipality and that no inspection had been requested.

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[28] 2021 ONSC 6139

The court subsequently confirmed that the property was not substantially complete and was not ready for occupancy on the scheduled closing date.

The vendor's lawyer tendered the vendor's closing documents on the purchaser's lawyer on the morning of day of closing. Later that day, the purchaser's lawyer delivered the requisite closing documents signed by the purchaser and a copy of a certified cheque for the balance due on closing, and noted that while the purchaser was ready, able and willing to close the transaction, but he would not be taking possession as the property was not substantially complete and not ready for occupancy. He noted that the vendor was in breach of the agreement as the property was not substantially complete and not ready for occupancy.

It turns out that the purchaser had arranged for a short-term high interest mortgage, knowing that the vendor would not be in a position to provide occupancy on the closing date.

The vendor's lawyer wrote to the purchaser's lawyer the next day confirming that the purchaser's lawyer had neither asked for the purchaser's deposit to be returned nor elected to terminate the agreement. Accordingly, the agreement remained valid and the vendor's lawyer set a new closing date approximately one month later. The purchaser's lawyer replied the same day confirming that as far as the purchaser was concerned, the agreement was terminated and the purchaser was entitled to have his deposit returned.

The court confirmed that the purchaser's email to the vendor confirming that he was "unable to move forward with the completion of the agreement" was a clear repudiation of the agreement. The court also confirmed that the vendor clearly affirmed the agreement and declined to accept the repudiation when the vendor's lawyer wrote to the purchaser confirming that he was legally obliged to complete the transaction on the scheduled closing date.

It was clear and unequivocal that the vendor elected not to terminate the agreement but insisted on its continued performance right up until the scheduled closing date. Consequently, the agreement continued and both parties were obliged to close in accordance with the terms of the agreement. The vendor was unable to do so and was found to be in breach. As a result, the purchaser was entitled to a return of his deposits. In addition, the purchaser was entitled to damages in the amount of $25,000, representing the lender fee that was payable even though the mortgage was not registered and the funds were returned to the lender shortly after the

scheduled closing date.

Park Avenue Homes Corp. v. Malik[29]

This is another decision relating to the failed closing of a newly constructed home. The vendor and purchaser signed an agreement for a new build, semi-detached home with a purchase price of $788,900. Deposits totalling $60,000 were paid. Between signing the agreement and the closing date, the real estate market had dropped and the appraised value of the subject property was lower than the purchase price. The purchaser was unable to obtain adequate financing and did not close.

The court noted that the decrease in the value of the subject property was a result of a general decline in the real estate market and that purchasers assume the risk of fluctuations in the market value of the property.[30] "A drop in the market for real estate is not unforeseeable and not a valid basis for being let out of an Agreement of Purchase and Sale."[31]

LESSONS AND BEST PRACTICES

Clients can be quick to blame their lawyer if a deal goes sour, so we need to ensure that we protect ourselves as much as possible.

- Be alert to signs of a potential default. If the other party has not obtained counsel, or is not responding, this may be a sign that they are not prepared to close. If you receive overly technical or strange requisitions, this could be a sign that the purchaser is looking for an excuse to get out of the deal.[32]

- Be familiar with the Tarion requirements for delayed occupancy/closing dates and advise

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29 2022 ONSC 973 (CanLII)

30 See *Redstone Enterprises Ltd. v. Simple Technology Inc.*, 2017 ONCA 282 (CanLII)

31 See *Perkins v. Sheikhtavi*, 2019 ONCA 925 (CanLII); *Burkshire Holdings v. Ngadi*, 2021 ONSC 2550 (CanLII); *Forest Hill Homes v. Ou*, 2019 ONSC 4332 (CanLII)

32 See *Karami v. Kovari*, 2019 ONSC 637 (CanLII), where the purchaser changed counsel the day before closing and the newly retained lawyer sent a letter claiming the agreement was null and void because the purchase price was not clear because negotiations caused unclear hand written changes to the agreement (even though the purchase price had been referenced in prior amending agreements) and claimed that title was not clear because the parcel register noted that there was an exception to the Land Titles guarantees under s. 44(1) for rights by way of adverse possession, prescription, misdescription or boundaries settled by convention.

clients purchasing new construction homes to send you copies of delay notices received from the builder so that you can review to confirm the validity of same.

- Discuss the options and consequences with your client and take notes for your file.

- Obtain written instructions as early as possible. It may take some time to resolve – so waiting until 4pm on the day of closing to try to reach your client for instructions is not only stressful, but may jeopardize your client's position. You also need to give the other lawyer sufficient time to seek instructions.

- If your client has no intention of closing, get clear instructions in writing before sending notice of anticipatory breach. Document your advice to your clients.

- If you receive notice of anticipatory breach, seek instructions and respond accordingly. Doing nothing may affect your client's options.

- Carefully consider the wording of requests to extend a closing date. I have seen many that would constitute anticipatory breach.

- In order to tender, you have to be in a position to close if the other party has their act together and is able to provide everything needed to close.

Justice Paul Perrell reviewed the decision in *Phinny v. Macauly*[33] at the 2009 Law Society Real Estate Summit.[34] The *Phinny* case is a cautionary tale for real estate lawyers and if you haven't read it, you should.

The transaction in *Phinny* related to the purchase of approximately 450 acres on Lake Huron consisting of 12 islands, a water lot, and the mainland property. Phinny, the purchaser, and Macualy, the vendor, were both eager to complete the transaction.

However, Phinny's lawyer was not satisfied with answers that he had received to his letter of

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33 2008 CanLII 47015 (ONSC)

34 Perrell, Paul M., "How to Protect Yourself When the Client's Deal is in Trouble", 6th Annual Law Society Real Estate Summit, April 22, 2009

requisitions regarding a potential mining reservation and an easement and advised Phinny not to close. Phinny refused to close and sued for the return of his deposit of $30,000. The vendor counterclaimed for damages in the amount of $343,645, being the difference in the purchase price he was able to get following the re-listing and eventual sale of the property to a different purchaser.

Phinny defended the counterclaim and brought in his lawyer as a third-party claim.

The court confirmed that Phinny had defaulted on the agreement, as the requisitions were either not valid or were suitably answered prior to closing, but dismissed the vendor's counterclaim because the vendor had failed to mitigate its damages. The court confirmed that Phinny's lawyer was negligent in advising Phinny that he had reason to refuse to close the transaction and held the lawyer responsible to indemnify Phinny for his lost deposit and any other losses he suffered.

Justice Perrell summarized several lessons for real estate lawyers from the Phinny case:

1. A purchaser's lawyer is ill-advised to rush to take the position on behalf of his or her client that a real estate transaction has aborted because of the vendor's apparent inability to convey title as promised under the agreement of purchase and sale unless absolutely certain this is the case.

2. The *Vendors and Purchasers Act* may provide a real estate lawyer and his/her client with an escape route out of a troubled transaction.

3. In aborting real estate transactions, lawyers must have a very clear understanding about when their clients have the right to treat the contract at an end.

4. It is a fundamental principle that not all defects are sufficient to justify refusing to close a transaction.

5. A lawyer best protects him/herself and better serves the client by emphasizing that the modern attitude of the courts is to favour the enforcement of agreements of purchase and sale and to recognize that vendors and purchasers owe a duty of honesty to each other to perform a contract honestly made.

CONCLUSION

Real estate lawyers need to provide timely advice as to the options available and the consequences when a party is unable to complete a transaction. Being able to provide timely and accurate advice is critical. This requires an understanding of when a party can be declared in default, consideration of the practicalities of the client's situation and the consequences of the proposed actions before proceeding.

Having a litigator or two in your network experienced in real estate matters is also helpful so that timely referrals can be made for clients who find themselves involved in a troubled transaction.