Remedies Update: Ontario Courts Provide Guidance on the Penalties of Breaching Contracts for Real Property Transactions

Agreements related to real property don't always work out. Commercial tenants default on their leases, homeowners fail to pay their mortgages, agreements of purchase and sale fail to close, etc…. These scenarios are common. But despite their frequency, it is not always clear what legal recourse exists when these contracts go sideways. Thankfully, a recent string of decisions from the Ontario courts provide some guidance.

First off, in *Calloway REIT (Westgate) Inc. v. Elita's Perfect Touch Hair Studio Inc.*, the Ontario Superior Court set out a tenant's liability under a commercial lease, even when the lease agreement doesn't even get off the ground. That decision also sets out the liability that indemnifiers face when there is a default under the lease.

In *Calloway*, Elita's Perfect Touch Hair Studio (the "Tenant"), leased a unit in Mississauga for a ten-year term from Calloway REIT (the "Landlord"). Two individuals (the "Indemnifiers"), signed indemnity agreements in which made them responsible for the obligations of the Tenant under the lease. The lease and indemnity agreements were signed in January 2015.

Under the lease, the Landlord was obligated to provide the Tenant with drawings of the leased premises within 15 days of execution. The Landlord delivered the drawings many months after the deadline. On July 3, 2015, the Tenant indicated that it would be taking possession of the premises in two weeks, which did not occur.

On October 28, 2015, the Landlord sent a letter to the Tenant and reminded it of its obligation to take possession of the Premises under the lease. The Tenant never took possession, nor did it provide the security deposit or make any of the rent payments stipulated in the lease. On December 4, 2015 the Landlord delivered a notice of default to the Tenant and terminated the Lease two months later. To mitigate its losses, the Landlord re-let the premises for lower rent and a shorter term.

The Landlord sued the Tenant for the shortfall resulting from its breach of the Lease in the amount of $236,158.55 and commenced a summary judgment motion to collect payment. In defending the motion, the Tenant alleged that the landlord fundamentally breached the lease by refusing to provide possession of the unit. The Tenant also alleged that it never received the drawings that were required under the lease.

The court rejected these arguments on the basis that a fundamental breach is one that denies a party of substantially all of the benefit of the contract. The delay in providing the drawings did not constitute such a breach and the Tenant was therefore not entitled to treat the lease at an end. On top of this, the Court held that, in writing to the Landlord and stating that it wanted to take possession of the premises, the Tenant waived the Landlord's failure to adhere to the timeline for delivering the drawings.

The Landlord was granted judgment for the amount of rental arrears up until the lease termination and for future losses for the period that the lease should have ended according to its terms.

The *Calloway* decision shows the importance of following through when it comes to a commercial lease. If a tenant signs a deal and does not live up to its end, the consequences are clear.

Speaking of consequences, it is generally accepted that, when a buyer fails to close on a property purchase, they will forfeit their deposit. However, a recent decision from the Ontario Court of Appeal confirms that a vendor is not entitled to reap a complete windfall in this regard.

In *Azzarello v. Shawqi*, a vendor and purchaser agreed to the sale of a home for the price of $1,555,000 with a deposit of $75,000. The closing date was pushed several times because the purchaser did not have the available funds. The vendor eventually exercised its right to terminate the agreement and the home then sold for $275,000 less than the original purchase price.

The vendor sued the purchaser for the difference in the purchase price of the home and other associated costs. On a motion for summary judgment, the judge held that the purchaser breached the agreement by failing to close. She awarded the vendors the difference in purchase price of $275,000 as well as associated costs, totalling $308,688.31. On top of these damages, the deposit was also ordered to be forfeited to the vendor.

On appeal, it was held that the vendor was not entitled to the deposit on top of the damages award. The court upheld the established principle that when a purchaser repudiates an agreement, the deposit

is forfeited to the vendor without determining if damages were suffered. However, forfeiture of a deposit is also subject to the equitable doctrine of relief from forfeiture.

In determining relief from forfeiture, the measure of the vendor's damages must be assessed. In cases such as this, when the vendor suffered damages by accepting a lesser purchase price, the vendor should not be entitled to retain the deposit on top of its damages. Rather, the deposit should be treated as part payment for the damages. As such, the court held that the vendor was entitled to its damages, less the amount of the deposit.

This takes us to the third remedy that the courts have dealt with recently – namely, the recovery that a mortgagee is entitled to when a homeowner defaults under its mortgage. In *Benson Custodian Corp. v. Situ et al.*, a mortgagee sought to realize upon a mortgage in default. In addition to the regular remedies, the mortgagee claimed additional monies in the form of three months' interest on the principal amount outstanding, totalling $21,750.

The mortgage specifically provided for this penalty, but the mortgagor claimed that these funds should not be payable. In addressing this issue, the Court turned to section 8 of the *Interest Act*, which prevents fines, penalties or rate of interests being exacted on any arrears of the principal or interest secured by a mortgage.

The mortgagee claimed that it should be entitled to the interest penalty because the amount being claimed was not "so egregious as to be a fine or penalty." The court did not accept this argument because the provision in question does not turn on the size of the fine, penalty or rate of interest.

The mortgagee also claimed that the interest did not qualify as a fine or penalty, but rather a payment for the privilege of retiring the mortgage. The Court distinguished this argument on the basis that the mortgagor was not retiring the mortgage, but rather had defaulted under it.

Conversely, it was held that the type of interest being claimed by the mortgagee would indeed constitute a penalty for default and section 8 of the *Interest Act* was therefore applicable. Accordingly, the three months of interest were not payable by the mortgagor.

The *Situ* decision is an important reminder of an often overlooked principle which holds especially true for mortgages. Namely, just because the contract states that certain penalties are payable, this does not necessarily mean that the Court will award them.

These decisions demonstrate that, when it comes to real property agreements, the remedies are not as obvious as they may seem. That is why it is important to keep apprised of the latest decisions before making (or defending) these claims.

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