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Mortgage and Real Property Law Report

A Legal Newsletter for the Mortgage and Real Estate Industries

Vol. 25, No. 2 • May 2019

Court Explains Nature of "True Condition Precedent"

In a case called *THMR Development Inc. v. 1440254 Ontario Ltd.*, the Buyer and Seller had entered into an Agreement of Purchase and Sale respecting a mixed residential/commercial property. The property was subject to a closed mortgage with a lender, and the parties wanted to keep the mortgage in place to avoid a $258,000 pre-payment penalty. The Agreement therefore included a mortgage assumption provision, requiring the lender to approve the sale transaction.

That mortgage assumption provision included what it termed a "true condition precedent" that could not be waived: That the Buyer must be approved by the lender to assume the existing first mortgage, on terms the Buyer found acceptable. If within a stipulated period the Buyer – at its sole and absolute discretion – was not satisfied with the terms of the existing first mortgage, then the Agreement would be null and void.

The lender did consent to the Buyer's assumption of the mortgage, by way of a letter. However, that letter listed some minor terms and conditions that had to be remedied before closing, including a closing date correction. The Buyer dealt with the lender directly to resolve those, but never formally signed and returned the approval letter containing the lender's offer, as the Agreement technically required.

The Seller claimed this meant the true condition precedent was never satisfied, and the Agreement was at an end. In light of the Seller's position, the Buyer applied to the court for specific performance of the Agreement.

The lower court judge ruled that the proper interpretation of the mortgage assumption provision called for the Buyer to have accepted "in a legal way" to be bound by the lender's terms. The judge concluded there was "no evidence" here of legal acceptance on the Buyer's part.

The Court of Appeal reversed the lower court judge's ruling. First, it noted that a true condition precedent exists where the parties' rights and obligations under the contract depend on a future uncertain event, the happening of which is beyond either of their control, and which depends entirely on the will of a third party. Until the event occurs, neither party to the contract has a right to performance.

Here, the only third party was the lender, and the only true condition precedent was its approval of the Buyer's assumption of the mortgage, under the mortgage assumption agreement. That condition precedent was satisfied when the lender sent its approval letter – which was later amended only slightly, and to the Buyer's satisfaction. At that point the Buyer was bound to close the deal with the Seller.

The Court also held that specific performance was an available remedy instead of damages in this case, because there were no suitable, alternative commercial properties in area. If the lender was willing to approve the mortgage assumption again, then the transaction could proceed. If not, the Court would entertain further submissions. See: *THMR Development Inc. v. 1440254 Ontario Ltd.*, 2019 ONCA 954.

Time of the Essence Clarified

The Seller sold certain lots of industrial land to the Buyer. Their Agreement of Purchase and Sale obliged the Buyer to build an industrial building on the property within 30 months of closing, failing which the Seller had an Option to Purchase the land back at essentially the same price at which it was sold. The Agreement did not specify any time period within which the Seller could exercise that Option.

When the Buyer did not build on the property within 30 months as agreed, it obtained a one-year extension, which also lapsed without construction starting.

About three months after that extended deadline, the Seller notified the Buyer it wished to exercise the Option. The Buyer then asked for another year extension, which the Seller refused. After some negotiations around a mortgage that had been placed on the property without the Seller's consent, at the 6-month point the Seller gave a second notice, and started an application for specific performance. The Buyer countered by stating that the Seller's failure to tender prevented it from asking the court for this remedy.

An earlier judge concluded that: (1) the timing of the Seller's notices, being either three or six months later than the first opportunity to exercise the Option, were outside the notice period provided for in the Agreement; and (2) they did not comply with the Agreement's "time is of the essence" clause.

The Appeal Court disagreed with these findings. In fact, it concluded that the Seller had given notice within a reasonable time.

The judge had misunderstood the effect of a "time is of the essence" clause; it simply means that a specified time limit in an agreement is essential, and that a breach of it will automatically allow the innocent party to terminate the contract. The clause does not itself impose a time limit, but rather dictates the *consequences* that flow

from failing to comply with a time limit that is stipulated in an agreement.

Here, there was no specified time-limit that applied to the Option, so the "time is of the essence clause" was not even engaged, much less breached as the judge had incorrectly found.

But even without a time-limit stipulated, it was implicit that the Seller had to exercise the Option within a reasonable period, which assessment depended on the particular circumstances. In this case, the Buyer did not appear interested in timely compliance, since it did not even start building within 30 months as required, and asked for two extensions spanning a year each. At no time did the Buyer complain that the Option had expired. Even at the six-month point, the Seller's notice had still been given within a reasonable time.

As for the Seller's claim for specific performance, it was not defeated by his failure to tender. A party is only entitled to specific performance if he or she is ready, willing and able to close. Tendering is usually the best way to do this, but it is not a prerequisite in all circumstances – especially if it is clear from words or conduct that the other party has repudiated the agreement.

In this case, the Seller was relieved of the obligation to tender when the Buyer clearly communicated a decision not to proceed with the transaction. However, while the Seller was not required to *tender* in these circumstances, it was still required to show he was ready, willing, and able to close before it could request specific performance. This readiness was demonstrated by the Seller's affidavit evidence which showed it had purchased a $500,000 mortgage that the Buyer had improperly put on the property without the Seller's consent. The prior judge was thus wrong to conclude there was "no evidence" of the Seller's readiness and willingness to close.

As for the propriety of a specific performance remedy, the law confirms that it should only be granted if damages are inadequate, and there is evidence that the property is "unique" or that its substitute would not be readily available. Here, there was no substitute property in another location that would meet the goals of the subdivision plan already in place. It is exactly because of that intended plan that the Seller entered into the Option agreement. The Appeal Court therefore ordered that the Seller could exercise the Option, and granted the claim for specific performance. See: *Di Millo v. 2099232 Ontario Inc.*, 2018 ONCA 1051.

Option to Purchase vs Right of First Refusal?

The Town of Pelham and a private corporation each owned adjacent 30-acre blocks of land. Together they entered into a "coordinated servicing and development" agreement, to facilitate the Town's goal of building a community center, and the corporation's goal of building a medical center and retirement residence. Each owner had the right to acquire land from the other in certain circumstances, after giving a Notice of Option to Purchase. In the case of the corporation, its right to buy the Town's land was contingent on the Town not needing it for its own purposes and was exercisable within one year of the Town granting site plan approval.

The Town did build its community center and had surplus land remaining afterwards. As a means of raising $12 million that would help fund the entire development, it decided to sell that surplus to a third party. The corporation objected; even though it had not yet submitted an application for site plan approval in connection with the planned medical center and retirement residence, it claimed its Option to buy the surplus land prevailed. The Town went to court for a declaration otherwise.

The court agreed to grant the declaration sought by the Town. It also deleted a Notice of Option to Purchase that the corporation had registered on title, based on the incorrect premise that its purchase right was an "interest in land" that could be registered on title.

The court began by examining the difference between a true option to purchase on the one hand, and a right of first refusal on the other, as well as the difference between the legal interests in land obtained under each. It noted that an option to purchase constitutes an equitable interest in land (contingent on the option-holder's election to exercise it), but a right of first refusal does not. With an option, once certain specified events occur that are solely within the option-holder's control, and the option is exercised, then the entity holding the option can compel a conveyance of the property to him or her. The option is specifically enforceable at the time the option is granted.

In contrast, a right of first refusal entails a personal, contractual right, but it hinges on obtaining the consent of the person who granted it – it is only at that point that the right of first refusal is converted into an option to purchase. But, unlike a true option, it does not create any rights in property, and is not immediately enforceable by way of an action for specific performance.

Here, the corporation had the opportunity to purchase the Town's surplus land, but it was only exercisable within one year of a future event, namely obtaining site plan approval for the development of its medical center and retirement residence; otherwise the opportunity became null and void. Not only did the Town have some input into that site plan approval process (which admittedly had to be exercised in good faith), but it also had the right to decide whether it needed the surplus land for purposes of its own.

Since these elements gave the Town some measure of control over whether the corporation could exercise its right at all, it rendered the purchase opportunity more in-line with a right of first refusal – which was personal to the corporation – rather than an option to purchase. Given the legal nature of that first refusal right, this also meant that the corporation's purchase right was not tantamount to an equitable interest in land that could be registered.

In the end, the court declared that corporation did not have an option to purchase the Town's surplus land and that the Notice was to be removed from title. See: *Pelham (Town) v. Fonthill Gardens Inc.*, 2019 ONSC 567