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Mortgage and Real Property Law Report

Vol. 24, No. 4 • August 2018

A Legal Newsletter for the Mortgage and Real Estate Industries

Appeal Court Clarifies Meaning of "*To the Best of the Seller's Knowledge and Belief*"

In the appeal of a significant case we reported on previously in our last Newsletter (see Vol. 24, No. 3 (June 2018)), the Ontario Court of Appeal examined the meaning of "to the best of the Seller's knowledge and belief", in the context of a real estate deal where the sellers unwittingly sold property formerly used as an illegal marijuana grow-op.

The phrase appears in the "Illegal Substances Clause" found in the Ontario Real Estate Association (OREA) standard-form Agreement of Purchase and Sale. That Clause states that the seller "represents and warrants" that "to the best of the Seller's knowledge and belief, the use of the buildings and structures thereon has never been for the growth or manufacture of illegal substances."

The interpretation of that wording was the focus of the dispute between the buyer and sellers, who had used the standard form Agreement in their now-aborted real estate deal. About a month after they signed it – but before closing – the buyer discovered from internet searches that the property had been used as a marijuana grow-op before the sellers had even acquired it.

The buyer claimed this terminated his obligations under the Agreement entirely. The sellers disagreed; they asserted the buyer had unjustly reneged on the deal, and felt justified in keeping his $30,000 deposit. Shortly after, they sold the property to another party for $86,000 less than the buyer had agreed to pay, and sued him for this amount as well. The lower court judge sided with the buyer, declaring him entitled to have his deposit on the now-void deal returned.

On later appeal, the Court of Appeal reversed, concluding that the lower court judge had erred in several respects.

First, the judge incorrectly divided the Illegal Substances Clause into two parts – a "representation" and a "warranty" – and then mis-casted each by applying different slants to how the phrase "to the best of the Seller's knowledge and belief" operated in both.

When that phrase was applied to the "representation" part of the Clause, it did not stand alone; it had no lasting resonance beyond the date on which the Agreement was signed, and could not be relied on by the buyer as being true until closing. The lower court judge's misinterpretation also overlooked the interrelated nature of the "representation" and the "warranty" portions of this Clause, which worked together and were to be given meaning in accord with standard rules of contractual interpretation.

The Appeal Court concluded that the Clause's proper interpretation was this: Since the sellers' representation and warranty statement referred only to information "to the best of [their] knowledge and belief", they were not giving *absolute* information about the property. The representation about the grow-op use was limited to their knowledge and belief *as it existed when they executed the Agreement.* As the Appeal Court explained:

… [G]enerally speaking, a contractual representation is a statement of present or past fact, while a warranty is a contractual undertaking or guarantee that the fact is true…

This is reinforced by the plain-language of the Clause – which the Court noted had no reference to the closing date, as some of the Agreement's other clauses did.

Here, the sellers were completely unaware of the property's history when they signed, so they did not breach the Clause. The Agreement remained valid and enforceable against the buyer, and they were entitled to keep his $30,000 deposit when he later failed to close. The Court ordered certain issues to be remitted back for trial, including a determination on whether the sellers had suffered additional damages. See *Beatty v. Wei*, 2018 ONCA 479.

Lender's Enforcement of "Additional Fees" Upheld

In *Attalla v. Moody*, the court drew an important distinction between a lender's right to sue on a borrower's covenant to pay "additional fees", *versus* the lender's rights to added charges arising under the mortgage security taken on a property.

The homeowner-borrowers had given a third mortgage to the lender for one year, for $1.1 million at 11.75 percent. It included a provision allowing for "Additional Fees" of three months' interest in the event that: (1) the borrowers did not renew or discharge the mortgage by the maturity date; or (2) the lender issued either a Notice of Sale or a Statement of Claim.

At the one-year maturity date – and not having availed themselves of the renewal option – the borrowers owed the full amount of the principal and interest and remained in default afterwards. The lender did issue a Statement of Claim against the borrowers for $1,330,000, and also issued a Notice of Sale. Both documents referred

to the "Additional Fees" of $33,000, representing three months' interest.

Eventually the lender obtained possession, and took steps to list the property for sale. The borrowers responded by registering a caution on title, claiming (among other things) that the Notice of Sale was invalid since it contained reference to the "Additional Fees" which they said were in violation of s. 8 of the federal *Interest Act* as being an illegal "fine or penalty". The lender applied to the court to resolve the dispute, so it could sell the property.

The court examined the nature of the Additional Fees, concluding that they did not contravene the *Interest Act*. The aim of that Act was to prohibit fees that increase the charge specifically on *arrears*, which these Fees did not do. They were simply independent fees, triggered because the lender was required or compelled to bring enforcement proceedings in light of the borrowers' default. They essentially represented the costs incurred by the lender to issue its Notice of Sale and Statement of Claim. The fact that the amount happened to be determined by reference to a fixed number of months' worth of interest did not transform it into a prohibited "interest charge".

Also, the court observed that the Fees were not secured by the mortgage itself, since they were not added to the principal amount outstanding if left unpaid. They did not serve to increase the amount required to pay off the arrears, discharge the mortgage, and redeem the property. The enforcement of the lender's claim was based on the buyers' covenant, and not against either the equity or the security on the property.

Their only rational purpose, in this case, was simply to offset the costs of the lender's enforcement steps, the court said.

Having decided the Additional Fees were not illegal, the court went on to conclude that Notice of Sale was not void for including them. But even if the Notice was technically defective in a minor way, it was not invalidated entirely to the point that the lender's attempt to sell the property was impugned. See *Attalla v Moody*, 2017 ONSC 1971.

Seller's Duty to Mitigate After Failed Deal: Examined

In *Gamoff v. Hu*, the court considered facts that it said "tragically demonstrates" how a family overextended themselves in a "hot" real estate market while trying to finance the purchase of their dream home. The case is also interesting legally, because it highlights the nature of a seller's duty to mitigate damages in the face of a buyer's breach.

The sellers had listed the property for $2 million, prompting 18 showings and three offers to purchase, one of which was from the buyers for $2,050,000. Despite insisting they did not want to engage in a bidding war, the buyers upped their offer to $2,250,000, which the sellers accepted. They promptly tendered a $30,000 deposit, and began negotiating about the timing for another $90,000 still to be submitted.

Soon after, the buyers reconsidered. They told the agent they had paid too much, but in truth they had learned they could not obtain the necessary financing. But since their offer was not conditional on financing, they were not entitled to simply back out. So, they simply failed to pay the additional $90,000 deposit, and advised the sellers that they could not proceed. They asked them to either re-list the property, or to reach out to one of the two other parties who had put in offers earlier.

The sellers did re-list a few months later, at the price of $2,250,000. But by this time the market had begun to cool, and they received no offers. They dropped the price to $1,998,000, and later to $1,798,000. Ultimately, they accepted an offer of $1,770,000, and sued the buyers for the difference between that figure and $2,250,000, which the buyers had originally agreed to pay.

Among the issues for the court was the scope of the sellers' duty to mitigate, and the precise point in time when that duty arose. From the buyers' standpoint, the timing of that duty was especially important, since the real estate market had begun its decline around the time they advised the sellers that their financing had fallen through. The buyers claimed the sellers could have immediately re-listed, or reached out to those who had tendered earlier, higher offers, thus minimizing their damages. The buyers also complained that if they had re-listed at $2 million (rather than the original $2,250,000) they could have attracted other offers immediately.

The sellers, in contrast, sought summary judgment for what they said was the buyer's straightforward breach and resulting liability in damages, for the difference between what they offered and what the property eventually sold for.

The court considered these facts, pointing out that it was the buyers' onus to show the sellers had been unreasonable. Absent evidence to the contrary, it was wholly appropriate for the sellers to re-list the property at $2,250,000 in what was still a "hot" market. The court noted they had re-listed shortly after learning the buyers could not obtain financing, and dropped the price periodically to try to generate offers. Expert evidence also showed that a comparable property was listed and sold within six days for a similar price.

Although it could certainly speculate, the court said it was "in no different position than a trial court would be in terms of crystal ball gazing" as to whether or not the sellers' conduct was reasonable. It had to assess what was fair in this scenario. Here, the court was more than satisfied that the sellers had acted reasonably in re-listing the property in the manner they did.

In the end – and while the court expressed "every sympathy" for the buyers – there was no genuine issue requiring a trial. The sellers were entitled to their damages based on the difference between the contracted-for sale price, and the ultimate sale price of $1,780,000. The court also cautioned that with its changing nature, the real estate market might see more buyers overextending themselves in the face of a decline, and recommended that offers be made conditional on financing, and on the sale of any existing home they may have. See: *Gamoff v. Hu*, 2018 OSCJ 59,281