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Mortgage and Real Property Law Report

Vol. 19, No. 2 • April 2013

A Legal Newsletter for the Mortgage and Real Estate Industries

Must Seller Suffer Damages in Order to Retain Deposit?

The B.C. Court of Appeal recently scrutinized the law on whether real estate deposits are refundable, and confirmed important points about their general nature and legal purpose.

The facts involved a residential real estate transaction governed by a standard form agreement of purchase and sale. Despite having paid a $100,000 deposit, the buyer was unable to close on the specified date. The sellers then terminated the contract, and were able to sell the property to another party for a higher price. Relying on the buyer's breach, the sellers claimed the right to keep the $100,000 deposit; not surprisingly, the buyer wanted it returned.

The parties disagreed on the proper interpretation of the standard form's "deposit clause", which stated that in the event of the buyer's breach, any deposit would be forfeited to the sellers "on account of damages". Since the sellers had not suffered any actual damages in this case, the question for the court was whether, in light of this wording, they were entitled to keep the deposit nonetheless. A lower court had ruled that they were not.

That ruling was overturned on subsequent appeal. The B.C. Appeal Court confirmed that under established Canadian law, a "true" deposit is traditionally viewed as non-refundable "earnest money for the performance of the contract", rather than as an up-front part payment. If the buyer breaches the contract, the deposit is usually forfeited. (The exception is where the deposit essentially constitutes a penalty imposed on the buyer, or where the deposit amount is unreasonable in light of the overall transaction. In such cases a court may order relief against forfeiture). Historically, the Court said, deposits were designed to motivate the parties to carry out their bargains.

With that said, the law does recognize that there can be refundable as well as non-refundable deposits; the contract's particular wording determines which type is in play. Several basic principles govern the interpretation exercise:

- Whether a deposit is forfeited upon the buyer's default depends on contractual intention.
- Absent wording to the contrary, "deposit" should be given its normal meaning in law.
- A term that the deposit is forfeited "on account of damages" does not alter the non-refundable nature of a deposit.
- A deposit is subject to being forfeited even if no damages are shown.

Applying these concepts, the standard form contract in this case provided for the buyer's deposit to be "absolutely forfeited" to the seller; the phrase "on account of damages" was not intended to limit forfeiture to situations where the seller had actually suffered damages. The sellers were accordingly entitled to keep the $100,000 deposit the buyer had paid. See *Tang v. Zhang*, 2013 (BCCA).

Overholding Tenants: Misconceptions Put to Rest

The Ontario Court of Appeal has clarified the rights and obligations of overholding commercial tenants, namely whether they have a unilateral right to continue occupying leased premises after the initial lease term expires.

The tenant in question operated a chronic pain management clinic under a 5-year lease of commercial premises which was slated to end on December 31, 2011. As that date neared, the tenant advised the landlord it was relocating the clinic and was not planning to renew the lease. However, since the new premises were not quite ready the landlord granted the tenant several short extensions, but refused to allow it to remain beyond January 1, 2012. The landlord had found a new commercial tenant that was moving in on that date.

Nonetheless, the tenant did not move out on December 31, 2011 as required; the landlord changed the locks the next day. Claiming that the tenant's failure to surrender the premises left it with no option, the landlord retook possession and removed the tenant's goods to make room for the incoming new occupant. The tenant objected, asserting that it was an overholding tenant as defined in the lease, that it was now subject to a month-to-month tenancy, and that the landlord's conduct was itself in breach of the lease's provisions. The tenant applied to the court for an emergency ruling.

The legal outcome hinged on two competing lease provisions: the "overholding clause" (which provided that if the tenant continued to occupy the premises at the expiry of the initial term, then there will be a deemed month-to-month tenancy terminable upon one month's notice), and the "surrender clause" (which required the tenant to "peaceably surrender and give up to the Landlord vacant possession" when the lease term ended). The court's challenge was to determine which of these conflicting terms should prevail. The lower court had found in the tenant's favour.

The landlord was successful in a subsequent appeal.

The Court of Appeal ruled that on proper interpretation of this lease, the overholding clause gave rise to a month-to-month tenancy in favour of the tenant *only* if the landlord consented – such consent was usually evidenced by the landlord accepting rent from the tenant after the initial lease term ended. It was also implicit that in such circumstances, the landlord would waive the tenant's usual obligation to vacate.

This interpretation of the terms of the lease made good commercial sense: otherwise, the landlord would be subject to uncertainty as to whether the tenant would be delivering up vacant possession at the lease's end, and could not safely re-let the premises to another tenant.

As such – and unless there was evidence here that the landlord had given such consent and waiver – the tenant's obligation to comply with the surrender clause remained. Further, the Court observed that while such surrender clauses are often found in leases, they are technically superfluous since the tenant has an implicit obligation to deliver vacant possession when the lease ends.

Here, the evidence was abundant: not only did the landlord not consent to the tenant's overholding after December 2011, it made it clear that it needed the premises, and in fact signed a new lease with another party. Further, at no time did it accept rent from the tenant after that date.

Nonetheless, the tenant had unilaterally decided to stay beyond the initial term in breach of its duty to deliver vacant possession, effectively becoming a trespasser. The landlord had therefore been justified in changing the locks and removing the tenant's goods. See *AIM Health Group Inc. v. 40 Finchgate Limited Partnership*, 2012 (ONCA).

Court Confirms Power to Rectify Land Registry

Recently the Ontario Court of Appeal confirmed the courts' power to correct errors in the land registry, in a decision which overturned a controversial lower court ruling that seemed to undermine the basic premise behind the land titles system as a whole.

The dispute in *MacIsaac v. Salo* arose between the owners of three adjoining pieces of waterfront land. As part of the legal subdivision by the prior owner, a surveyor had been hired to prepare a reference plan to show the location of an access road, which was intended to form a registered right-of-way. The goal in preparing the reference plan was to reflect the location of an existing gravel pathway that ran from the main highway, traversed two of the parcels, and led into the third. Unfortunately, the surveyor incorrectly showed the right-of-way as running in a straight line; in reality the gravel road on which it was based curved at one point to avoid a large rock outcrop. The erroneous reference plan was nonetheless deposited in the local land titles office.

When the discrepancy as to the registered right-of-way came to light, it prompted discord and even altercations amongst the three owners, one of whom eventually barricaded a section of the road. The task of removing the outcrop to make the right-of-way conform to reference plan would require substantial blasting and road work.

Two of the owners sued the third for damages, and the surveyor was sued as well. The court was asked to rectify the registered reference plan as part of the lawsuit's resolution. The lower court – quite surprisingly – declined to correct the error on the registry, concluding that neither it nor the Director of Titles had the authority to do so. This conclusion tended to undermine the integrity of the land titles recording system in Ontario.

Fortunately, the Ontario Court of Appeal reversed that decision to allow the title register to be rectified, pointing out that no injustice would arise in this particular case as a result.

The Court reasoned that under established Ontario land titles law the title register – and the integrity of the information on it – had to prevail over the desire to balance the interests of various innocent parties, even if the outcome to individual landowners appeared to be unfair.

It also considered the nature of the interests that may be affected in the course of such a correction. While the *Land Titles Act* did allow a court to order rectification of the register in prescribed circumstances, the issue here was not an erroneous *registered instrument* (such as a transfer or charge), but rather an incorrect *reference plan* that had been deposited in the land registry office. A reference plan's purpose is to provide a "convenient graphic description of the property being transferred or subject to a charge"; it does not create an "interest in land" itself, and (unlike a survey) is not definitive of the boundaries or extent of the land. These registered documents could therefore be corrected in those cases where they contain a misdescription as to those features.

The Court of Appeal accordingly granted the appeal and ordered the register to be rectified in keeping with a proposed sketch which re-aligned the right-of-way to fit the existing centerline, while avoiding the rock outcrop. See *MacIsaac v. Salo*, 2013 (ONCA).

LEGAL ALERTS

Legislative Update

Bill 20, the *Respect for Municipalities Act (City of Toronto), 2013*, received its second reading on March 7, 2013. By amending various legislation, the Bill proposes to free Toronto from the oversight of the Ontario Municipal Board ("OMB"). Among the noteworthy amendments are changes to the *Development Charges Act, 1997* which eliminates rights of appeal to the OMB relating to development charge by-laws, development charges and front-ending agreements with respect to the City of Toronto, as well as amendments to the *Planning Act* to repeal the right to appeal to the OMB with respect to the City of Toronto relating to (among other things) official plans amendments, zoning by-law matters, committee of adjustment matters and plan of sub-division matters. The Bill proposes to create a local appeals board for Toronto with the intention of resolving all planning disputes.