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Reneging Home Sellers Liable For Buyer's Price Difference for New Home

After a 2-year search in a competitive market, involving 50 home viewings and at least 10 unsuccessful bids, a buyer finally succeeded on placing the winning offer on a sellers' north Toronto home. To do so, she agreed to pay $685,000, which was $35,000 over the asking price.

However, soon after the sellers changed their minds and advised they would not be completing the transaction. Adamant to proceed nonetheless, the buyer launched a lawsuit for specific performance about two weeks before the intended closing, but the sellers did not yield. The sellers acknowledged fault for breaching the contract, returned the $35,000 deposit, and continued to live in the home.

Faced with the collapsed deal and an ever-rising market, the buyer continued to look for another suitable home in the area. After yet another bidding war, she bought a less-suitable home for $760,000, which was over her budget.

The buyer claimed $315,000 in damages from the sellers based on the difference between the original sale price, ($685,000) and the home's current appraised market value ($1,000,000). Alternatively, she asked for $75,000, which was the extra she spent to buy the less-appealing $760,000 home in mitigation of the sellers' breach.

The matter eventually came before the Ontario Court of Appeal, which first considered the buyer's initial specific performance claim. It pointed out that such a remedy is not automatic: there must be evidence that the property is unique and that a substitute is not readily available. Here, the buyer had indeed shown "fair, real and substantial justification" for her position; her prolonged and intensive home search was a testament to the uniqueness of the sellers' home. However, since the buyer had accepted the return of the $35,000 deposit, this was tantamount to acknowledging the end of the contract, so the specific performance remedy was found to be foreclosed to her in law.

However, she could still claim damages for the sellers' admitted breach. In assessing those, the court dismissed the sellers' objection that the buyer had been unreasonable in buying the $760,000 home in mitigation. That purchase resulted from a frantic and intense search by the buyer's agent, and had to be viewed in the context of the other failed deal, the stiff competition for homes in the area, and the limited availability. Her decision to pay more than originally budgeted for was also reasonable in the circumstances, particularly in light of her living situation and her family's needs. Despite the higher price, the home was not necessarily "better" (as the sellers claimed); the buyer was essentially forced to pay $760,000 to be placed in the same position she would have been, had the sellers not breached the contract. The $75,000 price difference between homes was therefore granted as an appropriate measure of her damages, plus $2,000 for other expenses. See *Chai v Dabir*, 2015 (ONSC).

Interest Act Prohibitions Extend to Promissory Note

The provisions of s. 8 of the federal *Interest Act*, R.S.C. 1985, c. I-15, which place strict prohibitions on the interest penalties that can be charged on mortgage arrears after default were the subject of the Ontario Appeal Court's scrutiny in an important recent decision. The issue was whether the restrictions applied not only to interest penalties arising under a mortgage, but also to those arising under a related promissory note for the same debt.

As part of the parties' consulting arrangement, the lender had advanced a one-time loan of almost $500,000 to the borrower, secured by both a promissory note (the "Note"), as well as a mortgage on certain properly located in Markham (the "Mortgage"). However – and this is an important point – the Note was itself secured by the Mortgage and arose out of the same loan. Both the forms of security (which would be paid down equally with every payment) called for the principal amount and interest to be paid in 80 equal monthly instalments of $6,000, with interest at 0.75%, until August 15, 2017. But there were some key differences as well: the Mortgage provided for a Late Payment Charge (of $10 per day), a Missed Payment Fee (of $300 per late installment) and an N.S.F. Fee (of $300 per cheque). The Note, on the other hand, contained none of these late payment charges but did contain a clause that bumped the interest rate from 0.75% to 10% per annum "after demand, default and pre and post judgment" (the "Interest Escalation Provision").

When the borrower stopped making monthly payments after only a year, the validity of the Note's Interest Escalation Provision and of the Mortgage's various late payment charges became the focus of the subsequent litigation, in light of section 8 of the *Interest Act*. That section states that in connection with mortgage default "[n]o fine, penalty or rate of interest" can be taken on arrears of principal or interests if it has the effect of increasing the charge on arrears to a

higher rate of interest than what is being charged on the money **not** in arrears. The borrowers claimed that this section operated to invalidate the lender's ostensible late payment charges (totaling over $30,000), and the 10% per annum it was claiming under the Note's Interest Escalation Provision (amounting to almost $60,000). An earlier ruling by a motion judge had granted the lender's claim, which for a one-year period post-default had totalled amost $100,000 more than the amount of the original loan.

On later appeal, the court began by declaring the Note's Interest Escalation Provision to be invalid. It agreed with the borrower that although it was contained in the Note rather than in the Mortgage itself (which had no equivalent clause), it had the practical post-default effect of increasing the initial 0.75% interest rate to a 10% rate on arrears for a loan that was secured by a mortgage, and was therefore in the Act's purview. The Note itself was secured by the Mortgage, which in turn related to security on land and both stemmed from a single loan. The Act's own wording focused on whether arrangements to increase the interest on arrears had a prohibited "**effect**"; nothing suggested it had to arise from interest charged under a mortgage *per se*. Rather, section 8 could apply even where the prohibited charges were contained in another debt instrument that secured a loan which was itself secured by a mortgage on real property. As the court put it:

Where, as here, the debt instrument and the mortgage that secures it are for the same principal amount and provide for the same payment terms, and where payment of one is payment of the other ….the two instruments secure repayment of the original or principal liability – here, the single loan – and s. 8 applies to both.

The Appeal Court determined that the appropriate post-default interest rate was the agreed 0.75%, and re-calculated the lender's entitlement accordingly. It also held that the various late payment charges and default fees totaling more than $30,000 were also in breach of section 8, since they fell within the category of "fines" or "penalties" and noted that the lender had not proven that it incurred any actual losses due to the borrower's late payment, in any case. See *P.A.R.C.E.L. Inc. v. Acquaviva*, 2015 (ONCA).

"Buyer Beware" Has Limits

In a recent case called *Kelly v. Pires*, the Ontario court confirmed the limits on the legal principle of "buyer beware", in a case where the seller had fraudulently misrepresented the existence of a defect causing water damage on the property.

The buyer agreed to buy the seller's home, subject to a satisfactory building inspection. Being a qualified building inspector himself, the seller did his own inspection and was satisfied with what he saw. The deal closed 10 days later, and the buyer moved in immediately with his wife and young family.

However, while stripping wallpaper in a basement room slated for repainting, the buyer's wife noticed black marks on parts of the underlying drywall. This led to the discovery of significant moisture issues, including the widespread presence of mold. The removal of some wood paneling revealed newer drywall extending for an entire wall and newly-added foam insulation suggested deliberate concealment attempts. Experts later confirmed widespread damage, including moldy drywall, blackened lower-level studding and wet insulation.

When confronted, the seller (who now happened to live next door) denied any knowledge of moisture problems, but when pressed admitted that some repairs had been done periodically by family members. He refused to contribute to the repair costs, claiming the moisture could have been detected during the pre-closing inspection. He considered the mold to be the buyer's problem, effectively raising a "buyer beware" defense to the new owner's complaints.

The buyer sued, claiming that the seller had fraudulently misrepresented the lack of moisture damage to the home. He claimed about $60,000 in damages for the cost of repair, as well as various amounts to redress the six months of inconvenience to his 5-member family, all of whom had to live in the cramped 1,000-square-foot upper level, with one shared bathroom, during remediation. The buyer also described fear for his children's physical safety and marital stress during that time.

In assessing the buyer's claim, the court heard of the home's complex and checkered history, with repairs and renovations conducted piecemeal over the years by various self-taught members of the seller's family. Their collective evidence denying knowledge of a moisture problem was simply not credible. For example, renovations had been made at one point to allow a family member to move in with her elderly and disabled mother, but the move never took place. The court surmised this was because the "chronic and extensive" mold problem had already come to light at that point.

Indeed, the water damage was not only extensive, but it was known to and actively obscured by the seller, the court found. The very nature of the repairs and concealment efforts – made by relatives under the seller's direction – suggested it. In contrast, the buyer's pre-closing inspection met the required standard, so it could not be said that he contributed to his own losses.

The court noted that while the longstanding principle of "buyer beware" still governs, it is trumped in cases of active concealment by a seller, who is obliged by law to disclose known latent defects in quality that make a property unfit for habitation. Here, the seller's deliberate cover-up of the latent defect causing mold and extensive water damage amounted to fraudulent misrepresentation.

The court awarded the buyer $30,000 for the needed repairs. As for his more esoteric claims for stress-related damages, the court acknowledged the strain on the family but could not quantify those damages in the absence of a professional opinion. See *Kelly v. Pires*, 2015 (ONSC).