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Deal Fails to Close: Seller Need Not Accept Buyer's Lower Price in Mitigation

In a recent decision, the Ontario court confirmed that once an agreement of purchase and sale fails to close, the seller's legal duty to mitigate his or her losses does not encompass an obligation to accept a lower bid from the same buyer.

The facts involved a seller who had agreed to sell her home to the buyer for $850,000. A closing date was set, and the seller duly delivered the keys and closing documents in anticipation. However, the buyer was repeatedly unable to arrange the financing needed, and twice asked for and received a closing-date extension.

The parties finally settled on October 17, 2017 as the new closing date. In the course of doing so, the buyer's lawyer wrote to the seller, referencing an additional term to the effect that the transaction "can be closed at any time prior to the amended closing date", and adding that the property had to be vacant upon closing.

Still prior to the fixed closing date, the buyer assigned the agreement to a third party, who wrote to the seller on October 5, 2017, advising that he now wanted to complete the transaction the very next day – on October 6, 2017.

With only one day's notice, the seller would be able to move out most of her things, but not all of them. She advised that she would be unable to offer vacant possession on closing, especially since October 6, 2017 fell on the Friday of the Thanksgiving long weekend. She offered instead to proceed with a Friday closing, but deliver vacant possession by the middle of the following week.

The assignee rejected this compromise. Instead, he refused to close at all, citing a breach of the newly-added contract terms that required vacant possession to be delivered on October 6, 2017 as requested.

Still willing to cooperate, the seller then suggested they close on October 17, 2017 as originally agreed. Again, the assignee refused, and once again the deal did not close. Had it done so on that date and at the agreed price, the seller would have netted $804,040.

With the contract at an apparent end, the seller took prompt steps to sell the property to someone else, by re-listing it on MLS for $850,000. Importantly, less than a month later the buyer again offered to purchase the property from the seller, but this time for the lower price of $799,00.

The seller refused; instead, she continued to try to market and sell the property. Despite her diligent efforts, she eventually had to drop the price to $759,900, and ultimately sold it for $657,000, with her net proceeds being about $623,270.

She then sued the original buyer for the difference between the two net sale proceeds amounts, *i.e.* $180,775.50 plus additional moving and storage costs, expenses and interest. The buyer counterclaimed for the return of his $50,000 deposit, together with added damages for alleged breach of contract.

The seller was successful on her motion for summary judgment. One of the key issues for the court was whether the seller had fulfilled her duty to mitigate damages after the original deal failed to close on October 17, 2017. The buyer claimed she had not, since she refused his November offer of $799,000. The court disagreed.

In law, the burden always remained with the buyer to show that: (1) mitigation was possible and (2) the buyer had failed to take reasonable efforts to reduce her damages. In this regard, Canadian courts require only that the seller act reasonably, rather than perfectly.

The court stated it was not considered a failure to mitigate where an innocent seller refuses the defaulting buyer's revised terms as part of an offer to purchase the property at a lower price. The seller may choose to accept such an offer, but in law cannot be *obliged* to do so.

Here, the seller acted reasonably to try to re-sell her home, at what turned out to be a lower price. The court noted this price differential was sufficiently explained by a steady drop in the housing market around the material time.

Moving on to the tests for summary judgment, the court concluded that the seller had not breached the agreement to close. Neither the buyer nor its assignee had a unilateral right to fix the closing date; as the court put it, this was "a wish not a promise". Moreover, the court held that the seller

> *"… did not breach the agreement when she declined the fantasy of closing on half-a-business days' notice before a holiday long weekend."*

The reality was that neither the buyer nor the assignee had financing ready on closing; this was in contrast to the seller who was ready, willing and able to perform her side of the agreement at all times.

Having succeeded in obtaining summary judgment, the seller was awarded damages of almost $145,000, representing the difference between the buyer's offer and the ultimate sale price, plus interest and carrying costs. See *Malatinszky v. Miri*, 2020 ONSC 16.

Can Landlord Avail Itself of Bankrupt Tenant's Letter of Credit?

A company was the tenant of a commercial landlord that owned an industrial building. The 2014 lease between them had required the tenant to supply an unconditional letter of credit in the landlord's favour. It had a principal amount of $2.5 million, a declining balance governed by a stipulated formula, and an initial one-year term to be renewed annually. The letter of credit was intended to secure the tenant's obligations to the landlord under the lease. These included any damages or losses arising from the tenant's failure to pay rent or perform other obligations under the lease, including for bankruptcy-related causes.

The tenant went bankrupt in 2018 and a trustee in bankruptcy was appointed. At that point, the tenant was up-to-date on its rent obligations and had never defaulted on them previously.

The trustee chose this juncture to disclaim the lease between the tenant and the landlord. The landlord nonetheless drew down the full $2.5 million under the letter of credit, with about $625,000 of it being intended to cover three months' accelerated rent for the unexpired term of the lease, pursuant to s. 136 of the *Bankruptcy and Insolvency Act*.

The trustee objected to the landlord taking anything over $625,000. Although it did not dispute the landlord's entitlement to three months' accelerated rent, the rest of the draw-down related to alleged damages for the tenant's breach of the lease. In the trustee's view, the proper recourse for redressing the latter was through a court action, not under the letter of credit.

Relying on its disclaimer of the lease, the trustee asked the court's permission to access the letter of credit funds currently in the landlord's hands, by way of an order forcing the landlord to repay the trustee any excess amounts received.

The court granted the trustee's request. First, it confirmed the landlord was indeed entitled to draw down about $625,000 for accelerated rent. However, once the tenant made an assignment in bankruptcy, it ceased to have the right to deal with its property; those rights passed to the trustee instead.

Here, the trustee had validly exercised its option to disclaim the lease. In law, this operated as a voluntary surrender of the lease with the consent of the landlord, which in turn extinguished all further obligations by the tenant, under its terms.

This also meant the landlord was not entitled to draw on the letter of credit, even though it had been provided by the tenant as security. That document had merely afforded the landlord protection for any rent amounts owed up to the date of the disclaimer – but not thereafter.

The court ordered the landlord to pay the trustee about $1.875 million, which was $2.5 million less the three months' accelerated rent of about $625,000. See *7636156 Canada Inc. v. OMERS Realty Corporation*, 2019 ONSC 6106.

Commercial Landlord's Eviction of Tenant Restrained

A commercial tenant leased premises from the landlord for $8 per square foot. The lease stated that under some conditions, the tenant was entitled to renew for another five years, with renewal rent to be agreed "by reference to prevailing rental rates for similar space in similar area in which the premises is situated."

Near the end of the original term, the tenant notified the landlord that it wanted to exercise the option to extend the term for five years. The landlord replied that it "might not renew the leases", but that if it did, the rent would be $28 per square foot, taking into account the going rate for similar commercial units in the area. As compared to the original rate, this would increase the rent by more than threefold.

Not surprisingly, this sparked a dispute between the parties. The landlord offered to compromise with $18 per square foot, failing which the tenant had 40 days to vacate. The tenant countered with $15 per square foot. After some further back-and-forth, the landlord delivered a notice of termination. It agreed to continue some discussion with the tenant, while letting the notice of eviction stand. But shortly before the 40 days expired, the landlord signed a six-year lease with another business for $24 per square foot, to commence in early 2020. It took steps to proceed with the existing tenant's eviction process.

In response, the existing tenant brought an urgent court application for an interlocutory injunction, to prevent the eviction from taking place.

In all the circumstances, the court sided with the tenant and granted the injunction.

When assessing these facts against the established test for an injunction, the court noted that all criteria were met. Here, there was at least one serious issue to be tried: it was whether the parties had agreed to a net rental rate for the renewal period. There would also be irreparable harm if the existing tenant was evicted, since it would suffer severe business losses, go out of business, and endure the destruction of its competitive position and reputation.

Neither of these could be adequately compensated for in damages. With that said – and while evidence showing that a party will be put out of business if the injunction is not granted is typically sufficient to establish "irreparable harm" – the fact that the tenant waited until the very last minute to seek the injunction meant that it had met the test by only the "slimmest of margins", as the court put it.

Finally, the court ruled that the balance of convenience favoured the tenant: if the injunction was not granted, the tenant would be evicted without having secured new premises – even though it had no explanation as to why it could not have done so much earlier.

In the end, the court granted the interlocutory injunction and pending a further court hearing to resolve the core dispute, ordered the tenant to pay $24.75 per square foot in rent, until otherwise ordered by the court. See *Narwhal International Limited v. Teda International Realty Inc.*, 2019 ONSC 7494.