

REAL ESTATE DEALS: MAKING AND BREAKING THEM IN CHALLENGING TIMES

PAPER 2.1

Seller Remedies in a Collapsing Deal

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SELLER REMEDIES IN A COLLAPSING DEAL¹

I.	Introduction	1
II.	Retaining the Deposit	1
	A. What is a Deposit?	1
	B. When Does a Breaching Buyer Keep Their Deposit?	3
	C. Deposits Under R.E.D.M.A.	5
III.	Claiming Damages	6
	A. When Can a Seller Enforce Contractually Stipulated Damages?	6
	B. When Can the Seller Claim Damages in Addition to the Deposit?	7
	C. Assessment of Damages	8
	1. What Date?	8
	2. What Losses?	9
	3. What Mitigation?	9
IV.	Conclusion	9

I. Introduction

1. The serious downturn in our real estate market has brought legal issues to the forefront which for the past 15 years or so emerged in only a small minority of cases: can the buyer rescind, is the deposit forfeit, and can the seller claim additional damages.

2. This paper endeavours to identify the key legal issues for a seller facing a buyer who has collapsed the deal.

II. Retaining the Deposit

A. What is a Deposit?

3. At law, a deposit is earnest money intended to signify the buyer's genuine intention to complete the real estate purchase. It is to be forfeit to the seller in case of the buyer's default and regardless of whether the seller has suffered actual damages in the amount of the deposit or at all. It generally also plays the role of partial payment of the purchase price if the transaction completes.

Howe v. Smith (1884), 27 C.H. d. 89, at 95

Liu v. Coal Harbour Properties Partnership, 2006 BCCA 385, 56 B.C.L.R. (4th) 230 at paras. 9, 15-16

1 Thank you to Stephanie Sanger who contributed research and analysis for the preparation of this paper.

2.1.2

4. Where the buyer defaults, the seller will usually seek an order terminating the contract due to the buyer's repudiation or failure to close, but at the same time retaining the earnest money already paid. This is a well-established practice supported by authority.

B.C. Dev. Corp. v. NAB Hldg. Ltd. (1986), 6 B.C.L.R. (2d) 145 (C.A.) at 154

5. The deposit is therefore an important exception to the general rule against enforcement of contractually stipulated damages which are not a genuine pre-estimate of loss. Our courts have often quoted the following statement from the Privy Council:

One exception to this general rule is the provision for the payment of a deposit by the purchaser on a contract for the sale of land. Ancient law has established that the forfeiture of such a deposit (customarily 10% of the contract price) does not fall within the general rule and can be validly forfeited even though the amount of the deposit bears no reference to the anticipated loss to the vendor flowing from the breach of contract.

... Ever since the decision in *Howe v. Smith* [(1884) 27 Ch.D. 89] the nature of such a deposit has been settled in English law. Even in the absence of express contractual provision, it is an earnest for the performance of the contract: in the event of completion of the contract the deposit is applicable towards payment of the purchase price; in the event of the purchaser's failure to complete in accordance with the terms of the contract, the deposit is forfeit, equity having no power to relieve against such forfeiture.

Workers Trust & Merchants Bank Ltd. v. Dojap Investments Ltd., [1993] A.C. 573, [1993] 2 All E.R. 370 (P.C.) quoted for example in *Liu, supra*, at para. 16

6. The question of whether a pre-closing payment is a deposit, as opposed to solely a partial, pre-closing payment towards the purchase price, is a matter of interpretation of the contract as a whole.

Claymore Homes Inc. v. Gilot Developments Inc., et al., 2006 BCSC 1616

Tecson v. Bang Tian Complete Auto Services Ltd. et al., 2002 BCSC 1183

Ngo v. Loke, 2003 BCPC 4

375186 B.C. Ltd. v. Coquitlam Enterprises Ltd. (1997), 38 B.C.L.R. (3d) 247 (S.C.), var'd (1998), 61 B.C.L.R. (3d) 160 (C.A.)

Morell et al. v. Nedoma, 2007 BCSC 431

7. Where the contract is silent as to the role of the pre-closing payment, the most natural term to be implied is that it is a deposit so that, the contract being performed, the payment shall be brought into account, but the contract not being performed by the buyer, it shall remain the property of the seller.

Liu, supra

Morell, supra

8. To put the question beyond doubt, sellers are well advised to use phrases to describe the pre-closing payment in the purchase and sale agreement such as "non-refundable deposit" or "deposit to be absolutely forfeited."

9. The seller may keep a deposit despite suffering no actual damages.

Hughes v. Lukuvka (1970), 14 D.L.R. (3d) 110, 75 W.W.R. 464 (B.C.C.A.)

Lee v. Skalbania (1987), 47 R.P.R. 162, [1987] B.C.J. No. 2502 (QL) (S.C.)

10. A deposit clause that says the deposit is non-refundable "on account of damages" does not mean that, if the seller incurred no damages, the deposit must be returned. The deposit is non-refundable regardless of whether there were damages.

Williamson Pacific Developments Inc. v. Johns, Southward, Glazier, Walton and Margetts (1997), 35 B.C.L.R. (3d) 180 (C.A.)

11. If the pre-closing payment is not a true deposit but only a partial pre-payment on the purchase price, then a defaulting buyer is entitled to its recovery subject to a cross-claim by the seller for damages.

Stockloser v. Johnson, [1954] 1 All ER 630 (C.A.)
375186 B.C. Ltd., *supra*

Scott v. Butterfield, [1951] 2 D.L.R. 339, [1951] B.C.J. No. 112 (QL) (S.C.) at 343-44

12. For suitability of awarding a forfeiture of a deposit by summary trial under Rule 18A, though damages were not yet quantified and remained an outstanding issue in the litigation, see *Cassidy v. Smith*, 2008 BCSC 1153.

13. Where the agreement for sale states that the deposit is forfeit to the seller upon termination of the contract due to the buyer's breach, the seller's acceptance of the buyer's repudiation and termination of the agreement will be inferred from reselling of the property. Unless the contract states to the contrary, no notice of any kind to the buyer is required for such an election to be valid.

Siekham v. Hiebert, 2008 BCSC 207

B. When Does a Breaching Buyer Keep Their Deposit?

14. Under s. 24 of the *Law and Equity Act*, R.S.B.C. 1996, c. 253, deposits will be lost to a seller when found by a court to be a penalty or otherwise unconscionable.

15. Section 24 states:

The court may relieve against all penalties and forfeitures, and in granting the relief may impose any terms as to costs, expenses, damages, compensations and all other matters that the court thinks fit.

16. A deposit will be penal when it is considered both beyond the bounds of reasonable earnest money and not a genuine pre-estimate of damages.

17. By longstanding practice, 10% of the purchase price is considered reasonable earnest money. Deposits greater than 20% of the purchase price, however, will "invite particular scrutiny by a court."

Liu, supra

Cassidy, supra

Tecson, supra

Williamson Pacific, supra

18. The relevant time for assessment of whether an amount is reasonable earnest money or a penalty is the time of making the contract. As our Court of Appeal has stated:

The question whether a sum stipulated is penalty or liquidated damages is a question of construction to be decided upon the terms and inherent circumstances of each particular contract, judged of as at the time of the making of the contract, not as at the time of the breach. ...

Hughes, supra at 113 citing Lord Dunedin in *Dunlop Pneumatic Tyre Co. Ltd. v. New Garage & Motor Co.*, [1915] A.C. 79 at 86-87

19. Deposits of more than 10% of the purchase price will be generally upheld, though beyond typically reasonable earnest money, where they reflect a genuine pre-estimate of damages (in which case they are not penalties), especially in volatile real estate markets or if they are in proportion to the actual loss suffered (in which case they are not unconscionable).

2.1.4

Hinkson Holdings Ltd. v. Silver Sea Developments Limited Partnership, 2007 BCCA 408
B.C. Dev. Corp., *supra*
Lam v. Ernest & Twins Ventures, 2001 BCSC 710

20. Where the agreement for sale stipulates that a deposit is liquidated damages, this is some evidence that it is a genuine pre-estimate, especially where it cannot be said that the deposit is out of all proportion to the actual damages. Such a term of the agreement is not conclusive, but should not be disregarded without good reason.

Hinkson Holdings, *supra*
Hughes, *supra*
Liu, *supra*

21. The well-settled considerations for when contractually stipulated damages are penalties as opposed to liquidated damages is summarized, for example, in *MTK Auto West Ltd. v. Allen*, 2003 BCSC 1613 at paras. 15-16, as set out further in para. 40 of this paper.

22. In *Liu*, a deposit of 20% of the purchase price was held to be a pre-estimate of damages and not unreasonable given the uncertainty of the condominium development market. The Court stated:

[25] While in the instant case the deposit was higher than in many of the cases such as *Hughes*, it appears from the *Blackcomb* case that a 20% deposit is not considered beyond the bounds of reasonable in this sort of transaction concerning condominium property. I venture to suggest that this may be because quite typically in these situations the property is being sold before building has commenced. These transactions have, of necessity, a much longer time horizon than an ordinary house sale as was the situation for instance in *Hughes*. The vagaries and vicissitudes of land value fluctuations and future building costs are unknown at the date when the parties enter into the agreement of purchase and sale. Given these uncertainties, coupled with the relatively long time interval to the prospective completion date, it seems a particularly apt situation for the parties to enter into an agreement fixing an estimate of damages if the transaction fails to complete.

Liu, *supra*
See also *Blackcomb Skiing v. Schneider*, 2000 BCSC 720

23. In *Hinkson Holdings*, a deposit of 25% was upheld, because it was agreed to be a genuine pre-estimate of minimum damages and the buyer was given repeated opportunities and accommodations by the seller to complete the sale, all to no avail.

24. A 30% deposit was upheld in *Lam* because it was agreed to be a genuine pre-estimate of damages and in proportion to the damages actually sustained.

25. If a deposit is found to be a penalty, the court has a broad discretion to grant relief from forfeiture if it is unconscionable for the vendor to retain the deposit.

Stockloser v. Johnson, *supra*
B.C. Dev. Corp., *supra*
375186 B.C. Ltd., *supra*
Hughes, *supra*

26. A court should not strike down a penalty clause as being unconscionable lightly, because it is a significant intrusion on freedom of contract. There must be clear evidence of oppression for the court to intrude.

MTK Auto West, *supra*, at para 22

27. The time to assess unconscionability is the time when the forfeiture clause is invoked. As recently stated in *Axton Industries Limited v. Bobbiduncan Holdings Limited, Pawelek et al.*, 2006 BCSC 1204, var'd 2007 BCCA 312, 69 B.C.L.R. (4th) 306, at para. 187:

2.1.5

...at this stage of the analysis the Court is no longer concerned with the circumstances in effect at the time the clause was negotiated. Rather the focus shifts to the circumstances at the time the clause itself is invoked. As Ritchie J. noted in *Dimensional Investments Ltd. v. Canada* (1968) S.C.R. 93, this is “the difference between the characterization of the clause as being a penalty in the first place versus its being oppressive.”

28. Relevant factors in assessing unconscionability include: the sophistication of the parties, their conduct in the transaction, whether the buyer was represented by a realtor or a lawyer, the gravity of the breach, and the disparity between the value of the property forfeited and the damage caused by the breach. The unclean hands of the buyer will not be an automatic bar to its equitable relief.

Liu, supra
MTK Auto West, supra
Blackcomb Skiing, supra

29. One important issue on which there appears to be disparity in the case law is whether the court will grant relief from forfeiture to a buyer who does not intend to complete the purchase but only to recover the deposit. For cases suggesting the court will not do so, see, for example, *Blackcomb Skiing, supra* and *Cama Trade Inc. v. Michie*, 2003 BCSC 1477. For cases the other way, see, for example, *Tanus Developments Ltd. v. Vanguard Properties Ltd.*, [1990] B.C.J. No. 336 (QL) (S.C.) and *375186 B.C. Ltd.*. For more on this issue, see *B.C. Dev. Corp.*

30. Where the court finds it unconscionable to forfeit the deposit to the seller, it may instead award the seller reasonable damages.

MTK Auto West, supra

31. Another situation in which a defaulting buyer will be entitled to the return of its deposit is where the seller is claiming for specific performance and the contract states that the seller is entitled to forfeiture of the deposit only upon the sellers' termination of the contract.

Winley Investments Inc. v. Milore Sales Ltd. (1991), 16 R.P.R. (2d) 200, [1991] B.C.J. No. 857 (QL) (S.C. Master)

C. Deposits Under R.E.D.M.A.

32. The *Real Estate Development Marketing Act*, S.B.C. 2004, c. 41 [*REDMA*], applies to developers who market in BC subdivision lots, strata lots, or other such shared interests in land.²

33. Under *REDMA*, the buyer's deposit must be promptly paid into trust with a brokerage, lawyer, notary, or prescribed trustee, who then holds the deposit as trustee and not as agent.

34. The trustee must not release the deposit except in stipulated circumstances, which include:

- (a) to the buyer (but not the developer) with the written consent of both parties;
- (b) in accordance with a buyer's right of rescission under *REDMA*; or
- (c) in accordance with a court order.

35. The trustee must release the deposit to the developer if the developer certifies in writing that:

- (a) the buyer has no right to rescission;

2 For recent buyer successes under *REDMA* which fall outside the scope of this paper, See *Sharbern Holding Inc. v. Vancouver Airport Centre Ltd.*, 2009 BCCA 224 and *Shumaker v. Cardel Resorts Ltd.*, [2007] B.C.J. No. 502.

- (b) if required, the subdivision plan, strata plan, or other plan has been deposited in the appropriate Land Title Office;
- (c) approvals required for lawful occupation of the unit have been obtained; or
- (d) the buyer's interest in the development unit has been registered and the evidencing instrument delivered to the purchaser.

36. A trustee must also release the deposit if the developer certifies that the purchaser has no right to rescission, has failed to pay a subsequent deposit when required, and the contract stipulates that such failure forfeits the original deposit to the developer.

37. Under s. 19 of *REDMA*, a developer may use the deposit for construction and marketing of the development property upon obtaining a deposit protection contract from an insurer (as defined in s. 189.2(1) of the *Insurance Act*).

III. Claiming Damages

A. When Can a Seller Enforce Contractually Stipulated Damages?

38. The law of when a seller of real estate is entitled to contractually-stipulated liquidated damages follows the well-settled law of contract in this area.

39. Liquidated damages are enforceable if they are a genuine pre-estimate of damages rather than a penalty payment.

40. The question of whether a stipulated sum is one or the other is a question of construction to be decided upon the terms and factual matrix of the particular contract, judged at the time of its making (not the time of breach).

MTK Auto West, supra
Axton Industries, supra

41. In *MTK Auto West*, the Court quoted the principles applicable to this question of construction from *Dunlop Pneumatic Tyre Co. Ltd. v. New Garage and Motor Co. Ltd.*, [1915] A.C. 79, (H.L.), as follows at para. 15:

(a) It will be held to be penalty if the sum stipulated for is extravagant and unconscionable in amount in comparison with the greatest loss that could conceivably be proved to have followed from the breach. (Illustration given by Lord Halsbury in *Clydebank Case*, [1905] A.C. 6).

(b) It will be held to be a penalty if the breach consists only in not paying a sum of money, and the sum stipulated is a sum greater than the sum which ought to have been paid (*Kemble v. Farren* 6 Bing. 141). This though one of the most ancient instances is truly a corollary to the last test. Whether it had its historical origin in the doctrine of the common law that when A. promised to pay B. a sum of money on a certain day and did not do so, B. could only recover the sum with, in certain cases, interest, but could never recover further damages for non-timeous payment, or whether it was a survival of the time when equity reformed unconscionable bargains merely because they were unconscionable—a subject which much exercised Jessel M.R. in *Wallis v. Smith*, 21 Ch. D. 243—is probably more interesting than material.

(c) There is a presumption (but no more) that it is penalty when “a single lump sum is made payable by way of compensation, on the occurrence of one or more or all of several events, some of which may occasion serious and others but trifling damage” (Lord Watson in *Lord Elphinstone v. Monkland Iron and Coal Co.*, 11 App. Cas. 332).

On the other hand:

(d) It is no obstacle to the sum stipulated being a genuine pre-estimate of damage, that the consequences of the breach are such as to make precise pre-estimation almost an impossibility. On the contrary, that is just the situation when it is probable that pre-estimated damage was the true bargain between the parties (*Clydebank Case*, Lord Halsbury, [1905] A.C. at p. 11; *Webster v. Bosanquet*, Lord Mersey, [1912] A.C. at p. 398).

B. When Can the Seller Claim Damages in Addition to the Deposit?

42. Whether a deposit operates as a limit upon the damages recoverable is, in each case, a question of construction of the contract.

43. As a general rule, in the absence of an indication to the contrary, the parties will be taken to have intended that the stipulated sum operates as a limit. A clause which says that the deposit “shall be absolutely forfeited by way of liquidated damages” will generally be interpreted as limiting the seller’s damages to the amount of the deposit.

Fraser v. Van Nus (1987), 14 B.C.L.R. (2d) 111 (C.A.)

44. Where a deposit is kept as liquidated damages, the seller is not entitled to go beyond and seek damages at common law.

Bains & Sarai Holdings Ltd. v. Sabota (1985), 63 B.C.L.R. 206 (C.A.)

45. As a result of our Court of Appeal’s decision in *Fraser*, it is advisable for vendors to include an express right in the purchase and sale agreement both to retain the deposit as absolutely forfeited and claim any additional damages.

46. Agreements which say that a deposit will be absolutely forfeited to the seller as liquidated damages, and do not expressly include any right to seek additional losses, will generally be interpreted to entitle the seller only to the amount of the deposit.

Gisvold v. Hill (1963), 37 D.L.R. (2d) 606, [1963] B.C.J. No. 121 (QL) (S.C.)
E. & B. Mortgages Ltd. v. Skrivanos (1980), 118 D.L.R. (3d) 139, 18 R.P.R. 215 (B.C.S.C.)

47. Where there is no reference to the deposit being paid as liquidated damages, this may be interpreted to entitle the seller to pursue additional damages.

Le Soleil Hospitality Inc. et al. v. Louie et al., 2007 BCSC 595, aff’d 2008 BCCA 206

48. Where the buyer refuses to complete, the seller has three courses of action available:

- (i) sue for specific performance (which also includes the right to damages);
- (ii) accept the repudiation and sue for damages at common law; or
- (iii) exercise the option given by the contract to cancel the contract and keep the deposit as liquidated damages.

49. A vendor who wishes to seek its actual damages, but faces a contractual limit to the forfeiture of the deposit, might elect not to accept the buyer’s repudiation and claim the deposit, but instead to keep the contract alive and sue for damages. The seller will be subject to the obligation to reasonably mitigate.

Clendening v. Cedarhurst Properties Ltd. (1977), 31 B.C.L.R. 153 (C.A.)
Siekman, *supra*
E. & B. Mortgages, *supra*
Elliott v. Simms (1982), 34 B.C.L.R. 152 (S.C.)

50. Where the seller, upon the anticipatory breach by the buyer, resells the property before the time of completion, this can only be interpreted as acceptance of the wrongful repudiation and termination of the contract.

C. Assessment of Damages

I. What Date?

51. The standard date for assessment of damages is the date of the breach of contract, though the court may consider alternative dates.

642947 Ontario Ltd. v. Fleisher (2001), 56 O.R. (3d) 417, 209 D.L.R. (4th) 182 (C.A.) [*642947 Ontario Ltd.*]

Davidson v. Miller, 2003 BCSC 44 [*Davidson*] (1993), 76 B.C.L.R. (2d) 61 (C.A.) (where the Court found the appropriate date to be the date of resale)

52. In *Mavretic v. Bowman* (1993), 76 B.C.L.R. (2d) 61 (C.A.), our Court of Appeal addressed a situation where the defaulting buyer resisted damages on the basis that the seller did not suffer any actual loss because, as at the date of trial, the home in question was worth more than at the closing date of the contract. The majority of our Court of Appeal upheld the trial judge in assessing damages as at the date of breach, however, when the home had been worth more than the purchase price, stating at para. 13:

In my view, the fact that the value is higher at the trial date than at the completion date does not constitute circumstances that should encourage deviation from the normal or usual approach that damages be assessed at the date of the breach of contract. The vendors were entitled to their money either to buy another piece of property or to invest the proceeds as they saw fit. Had the purchasers completed, they could have been in the position to reap the benefit of the rising market.

53. The Court also stated at para. 10:

Fixing the date for assessing damages at the date of the trial, as in the case at bar, creates, in my view, additional difficulties. The real estate market may be volatile, reaching high points and depressed conditions very quickly from time to time. Several months elapsed from the breach ... until the date of trial ... During any period the market could have reached high and low points several times—such a luck of the draw approach could only be appropriate in special cases.

54. In a falling market, damages at the date of closing may not fairly compensate an innocent vendor, and the court may therefore award damages equal to the difference between the contract price and the resale price, instead of between the contract price and the fair market value on the date of closing. As “a general rule, in a falling market the court should award the vendor damages equal to the difference between the contract price and the ‘highest price obtainable within a reasonable time after the contractual date for completion following the making of reasonable efforts to sell the property commencing on that date’ ... Where, however, the vendor retains the property in order to speculate on the market, damages will be assessed at the date of closing.”

642947 Ontario Ltd., *supra* at para. 41, referring to *100 Main Street Ltd. v. W.B. Sullivan Construction Ltd.* (1978), 20 O.R. (2d) 401 (C.A.)

55. In a recent decision, our Supreme Court held that the date to assess damages in a falling real estate market was three months after the breach, that being a reasonable amount of time for re-sale after the completion date.

Cassidy v. Smith, 2008 BCSC 1778

2. What Losses?

56. As with all contractual damages assessments, the court will endeavour to put the vendor in the same position it would have been in had the contract been performed by awarding damages which have arisen fairly and naturally from the defendant's breach of contract, provided they are not too remote. In *Cassidy*, these damages were held to include, not only the difference between the contract price and the market value of the property, but also the costs of maintaining the property for a reasonable time (such as interest charges, taxes, hydro, fuel). Damages did not include costs associated with a second, replacement property where, in the circumstances of the case, it would not have been in the reasonable contemplation of the purchaser that the vendor had purchased such a property without it being "subject to" closure of the purchaser's sale.

Cassidy, supra

See also *Davidson v. Miller, supra* (where the seller received damages for extra commissions paid, interest on its mortgage, property taxes, and home insurance)

3. What Mitigation?

57. In a falling market, a seller is obliged to respond quickly by reducing its price if the re-listed purchase price is not attracting serious offers. Acting on the advice of realtors will not necessarily be an acceptable approach.

Hargreaves v. Spence (1983), 45 B.C.L.R. 367 (S.C.)

Cassidy, supra

IV. Conclusion

58. This area of law reveals many ways in which a seller's solicitor and litigator can make a difference when the buyer collapses the real estate purchase. Carefully drafted terms and the right strategies regarding deposits, liquidated damages, additional damages and termination will give the seller straightforward remedies to counteract the prejudice of a collapsing deal.

59. It is hoped that this paper will assist buyers and their lawyers on these issues.