

Innocent Vendors, Mitigating Damages, and Crediting Deposits: Clarifying the Rules

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The Ontario Court of Appeal has recently clarified the rules when a vendor relists a property and sells it at a loss following the original purchaser's default. Questions were answered concerning the innocent vendor's duty to mitigate, and whether the deposit must be credited towards the vendor's damages.

Background

The facts in *Azzarello v. Shawqi*, 2019 ONCA 820, are straightforward. After listing their house for sale, the plaintiff vendors accepted the defendant purchaser's offer and he paid a \$75,000 deposit. However, the purchaser found it difficult to obtain financing, and the closing date was extended. The purchaser then advised that he had received a bank's approval for a mortgage, but he wanted a 10% reduction of the purchase price based on an appraisal of the property. The vendors refused, relisted the property, and sold it for a price lower than the 10% reduction the purchaser had offered. The vendors then sued the purchaser for the difference between the original purchase price and the new sale price, plus their additional carrying costs.

On a motion for summary judgment, the motion judge granted the vendors the damages that they claimed. She also held that they were entitled to keep the purchaser's \$75,000 deposit and did not have to credit it towards their damages.

The Court of Appeal's Decision

In deciding the purchaser's appeal, the Court of Appeal answered two important questions concerning: (1) an innocent vendor's duty to mitigate its damages; and (2) whether a deposit must be credited towards the damages caused by the purchaser's default.

Question 1: Does the duty to mitigate require an innocent vendor to accept a defaulting purchaser's offer to pay a reduced purchase price?

The Court of Appeal answered "no" to this question.

The Court found no fault on the vendors' part in refusing to entertain the purchaser's revised offer and reselling the property to a third party for \$1.28 million even though accepting the purchaser's revised price with its 10% reduction could have garnered more – about \$1.4 million (para. 37).

The Court found that to require an innocent vendor to mitigate their damages by accepting a reduction in price from the purchaser would allow the defaulting purchaser to "secure a significant tactical and procedural advantage over the innocent vendor" (para. 39). Endorsing such an approach would "undermine the sanctity of the bargain" by encouraging purchasers to default, especially in a falling market. This would leave vendors with the "risk and expense of recovering the balance of the original purchase price in an action."

In the Court's view, such an outcome would not be acceptable: "The duty to mitigate does not go that far" (para. 40).

Accordingly, an innocent vendor's duty to mitigate does not require acceptance of a defaulting purchaser's offer to pay a reduced purchase price.

Question 2: Is an innocent vendor required to credit the defaulting purchaser's deposit toward any damages suffered?

The Court of Appeal answered "yes" to this question, and allowed the appeal from the motion judge's decision on this issue.

The general rule is that a defaulting purchaser's deposit is forfeited, even without the vendor proving any damage. A deposit therefore provides an incentive for a purchaser to close the transaction. This general rule is subject to a judge granting relief from forfeiture based on a purchaser meeting both requirements of a two-part test: (1) the forfeited deposit must be out of all proportion to any damages suffered; and (2) it must be unconscionable for the vendor to retain the deposit (para. 47).

While the general rule applies without a vendor proving any damage, in *Azzarello*, the vendors did prove their losses. The motion judge awarded the vendors damages for the losses that they claimed based on the difference between the original purchase price and the new sale price, plus their additional carrying costs. The motion judge, however, also gave the vendors the \$75,000 deposit and held that they did not have to deduct this amount from the damages they had been awarded against the purchaser.

This was too much for the Court of Appeal. In allowing the appeal on this issue, the Court reviewed previous case law, as well as the agreement between the parties.

The Court of Appeal noted that the agreement called for the deposit to be credited to the purchase price in the event that the transaction was completed. Although the agreement did not deal with the situation where the transaction failed to close due to the purchaser's default, the damages in such a case are based on the difference between the original purchase price and the subsequent sale price received by the vendor. In other words, the measure of damages "is based on the vendor receiving the purchase price that was bargained for" (para. 53). The Court drew from this the dispositive conclusion: "One can infer that the intent of the parties was that the deposit be applied to the purchase price whether received on completion or as damages" (para. 53).

In the result, the defaulting purchaser in *Azzarello* was entitled to subtract his \$75,000 deposit from the damages that he was ordered to pay to the vendors.

The Takeaways

Courts wish to see parties act in accordance with their bargains. This appears to underlie the Court of Appeal's decision in *Azzarello*.

On the one hand, a defaulting purchaser cannot rely on the duty to mitigate to compel an innocent vendor to accept a reduced purchase price. This would "undermine the sanctity of the bargain". On the other hand, an innocent vendor cannot prove its losses, receive a damages award, and then pocket the deposit without giving credit to the defaulting purchaser. This would compensate the vendor beyond what the parties' agreement contemplated had it been performed.

In short, the Court will strive for an outcome that best accords with the parties' contract.

situations, the reader should seek professional advice.

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