

Purchasing Property for Development or Investment? What to do if there is a Breach of Contract.

November 8, 2012

By Jonathan D. Born

How a recent court decision impacts single-purpose companies incorporated to purchase real estate assets

The recent decision of the Supreme Court of Canada ("SCC") in *Southcott Estates Inc. v Toronto Catholic District School Board* clarified the remedies available to purchasers upon the breach of an agreement of purchase and sale for land.

Facts

Southcott Estates Inc. ("Southcott") was incorporated by a well-known and active land developer as a single purpose corporation without assets for the purchase of a specific property in the Greater Toronto Area. Southcott entered into an agreement with the Toronto Catholic District School Board ("TCDSB") to purchase land for development into single-family homes. TCDSB failed to satisfy a condition in the purchase agreement and refused to extend the closing date. Southcott sued TCDSB demanding specific performance of the purchase agreement, which included a petition to the court to direct TCDSB to complete the transaction.

At trial, TCDSB was found to have breached the purchase agreement and Southcott was awarded damages for loss of chance of profit. Specific performance of the purchase agreement was not granted by the court as the property was not unique, which is a prerequisite to making such a claim.

On appeal, the Ontario Court of Appeal agreed that TCDSB breached the agreement but reduced the damages award to a nominal sum because Southcott acted unreasonably in not mitigating its loss by taking reasonable steps to minimize the loss suffered. Southcott admitted that it had no intention of taking steps to mitigate its loss, and failed to prove that it could not have mitigated even if it tried because comparable properties were unavailable.

When is specific performance available for real estate transactions?

The remedy of specific performance developed for circumstances where damages were not adequate compensation for the injured party's losses. A damages award would be inadequate if the injured party could not use the money awarded to purchase a substitute property. Although parcels of land were historically viewed as unique, recent cases have held that damages are adequate for transactions where land is viewed as fungible. A party seeking specific performance must demonstrate that money cannot compensate fully for the loss because the land is unique, meaning it has some "peculiar and special value".

Specific performance and a full award of damages are not available at the same time. However, a plaintiff can initially claim both remedies. There are potential conflicts between the right to specific performance and the requirement to mitigate damages. How can a party purchase a substitute property for a property that it claims is unique and irreplaceable? As well, if a party only has funds to purchase one property, how can it be expected to mitigate by purchasing a substitute property and complete the initial transaction if

its claim is successful? Notwithstanding these conflicts, claiming for specific performance does not prevent courts from assessing a plaintiff's mitigation of its losses.

How can a purchaser mitigate its losses?

Generally, a plaintiff cannot recover losses that could reasonably have been avoided. A plaintiff that does take reasonable steps to mitigate losses may recover the costs and expenses of those steps. In the context of real estate transactions, mitigation is done through the purchase of reasonably comparable property.

What issues did the SCC consider?

In a 6 to 1 decision, the SCC dismissed the appeal. The main legal issues considered by the SCC were: 1) whether a single-purpose company should mitigate its losses; and 2) to what extent should a plaintiff mitigate when they are claiming specific performance.

1) Single-purpose companies are required to mitigate

Southcott claimed that, as a single-purpose company, it did not have access to funds to mitigate, and its mandate was limited to the purchase of a specific property. Following the breach of the agreement with TCDSB, sister companies of Southcott wholly owned by Southcott's parent purchased a number of parcels of developable land. The court described these purchases as 'collateral', as they would have occurred irrespective of the breach of the agreement with TCDSB.

A single-purpose company incorporated to take advantage of the benefits of limited liability cannot claim that its parent company mitigated on its behalf through related companies. Southcott itself was required to mitigate by "making diligent efforts to find a substitute property." The SCC commented that single-purpose corporations cannot avoid mitigating damages because they have no assets, as it would be an unfair business advantage.

2) Plaintiffs should mitigate losses despite claims for specific performance

The SCC acknowledged the inherent conflict between specific performance and mitigation, and confirmed that failure to mitigate is justifiable where circumstances reveal some fair, real and substantial justification or a substantial and legitimate interest for seeking specific performance. With a substantial justification or substantial and legitimate interest in specific performance, the refusal of a plaintiff to mitigate by purchasing other properties may be reasonable under the particular circumstances.

Southcott claimed the TCDSB property was unique as justification for specific performance and its failure to mitigate. The SCC determined that Southcott could not reasonably refuse to mitigate as the property was nothing more than a "singularly good investment" and the unique qualities related only to the profitability of the development. Southcott was engaged in a commercial transaction for the purpose of making a profit. The qualities of the property were only of value because of their profitability, and therefore damages were adequate.

In the context of real estate investment and development, purchasers of land for the purpose of profit are obligated to mitigate their losses as property is only of value for its profitability.

Southcott was wholly owned by a well-capitalized parent company with access to financing, and would have been able to mitigate by purchasing other properties. The SCC did not consider whether a company with limited assets or access to funds and lacking the marginal capacity to both mitigate and complete the initial transaction if its claim was successful would be excused from mitigating.

Practical advice after Southcott

- In the event of termination of a contract for the purchase of land, a purchaser should carefully consider its capacity to both mitigate and complete the initial transaction before proceeding with a claim for specific performance.
- A single purpose company will not be treated differently than any other company or purchaser with respect to the availability of specific performance as a remedy and the obligation to mitigate.
- A plaintiff may apply for an order to register a Certificate of Pending Litigation ("CPL") on title to the subject property, which provides notice that a claim has been commenced regarding title to the property. In exercising its discretion to grant a CPL, a court must consider all relevant matters between the parties, including considering whether the property is unique. This early stage examination of the uniqueness of a property will inform the decision to claim specific performance or damages. It is important to note that a plaintiff who registers a CPL may be liable for damages sustained by the vendor while the property was frozen if the court ultimately finds that the plaintiff had no reasonable claim to an interest in land.
- In the context of the purchase of property by a retailer to serve a specific market area, there are often limited alternative sites available to serve that particular market. Following a default by the vendor, the purchaser should pursue available alternatives through listings and brokers. These actions could provide evidence that the initial property is in fact unique and improve the chances of success of a specific performance claim. If no suitable alternative properties can be located or purchased, the search for such a site could indicate that the purchaser tried to mitigate its damages.

WeirFoulds^{LLP}

www.weirfoulds.com

Toronto Office
 4100 – 66 Wellington Street West
 PO Box 35, TD Bank Tower
 Toronto, ON M5K 1B7

Tel: 416.365.1110
 Fax: 416.365.1876

Oakville Office
 1320 Cornwall Rd., Suite 201
 Oakville, ON L6J 7W5

Tel: 416.365.1110
 Fax: 905.829.2035