FMC LAW

Focus on
Real Estate

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Case Comment: *Southcott Estates Inc. v. Toronto Catholic District School Board*

By Janet MacNeil and Harkiran Bains

On October 17, 2012, the Supreme Court of Canada released its decision in *Southcott Estates Inc. v. Toronto Catholic District School Board* (2012 SCC 51). This decision has significant implications on a purchaser's duty to mitigate its losses when a transaction fails due to the vendor's breach, particularly when the purchaser is a single purpose corporation.

Southcott Estates Inc. ("Southcott") is a single purpose corporation, without assets, created solely to purchase and develop the specific property at issue in the action. Southcott entered into an agreement of purchase and sale with the Toronto Catholic District School Board (the "Vendor"). The Vendor subsequently breached this agreement and failed to complete the sale. Southcott consequently sought specific performance of the agreement and argued that it was not required to mitigate its losses by seeking to purchase a reasonable alternative property.

Under the doctrine of mitigation, a plaintiff has a duty to take all reasonable steps to mitigate losses caused by the defendant's breach. A plaintiff will not be able to recover those losses that could have been avoided by taking reasonable steps to mitigate after the breach. In cases where it is alleged that the plaintiff failed to mitigate, the onus is on the defendant to prove first, that mitigation was possible and second, that the plaintiff failed to make reasonable efforts to mitigate.

The trial judge and the Court of Appeal both found that while the Vendor had breached the agreement, Southcott's claim for specific performance was not justified as the property

was not unique and damages were an adequate remedy. Unlike the trial judge however, the Court of Appeal found that Southcott had unreasonably failed to take steps to mitigate its losses, and therefore reduced the damages award to a nominal sum.

On appeal to the Supreme Court, the following three issues were raised:

1. Should a single purpose company mitigate its losses?
2. To what extent must a plaintiff mitigate where the plaintiff has made a claim for specific performance?
3. Did the trial judge err in concluding that there was no evidence of comparable profitable properties available for mitigation?

Southcott argued that as a single purpose corporation, created solely to purchase a specific property, it was impecunious and unable to mitigate its losses by seeking an alternative property without any capital investment from its parent company, and without the corporate mandate to do so. The Court rejected Southcott's reasoning, and concluded that a single purpose corporation cannot avoid the duty to mitigate by simply asserting that it lacks the funds to pursue alternative opportunities or that it is prevented from doing so due to its limited corporate mandate. The Court found that to hold otherwise would give an unfair advantage to those conducting business through single purpose corporations. To not require single purpose corporations to mitigate their losses would expose defendants contracting with such corporations to higher damage awards than those reasonably claimed by other plaintiffs, based solely on the single purpose corporation's limited assets.

Southcott also argued that it acted reasonably by not attempting to mitigate its losses as it was pursuing a claim for specific performance. The Court held that while a claim for specific performance can be difficult to reconcile with the doctrine of mitigation, a plaintiff's inaction in seeking a substitute property is only justified where the circumstances reveal "some fair, real, and substantial justification" for the claim or "a substantial and legitimate interest" in seeking specific performance. The Court found that Southcott could not justify its inaction and could not reasonably refuse to mitigate. The property's unique qualities related only to the profitability of the land for development, and for this, damages were seen as an adequate remedy.

Although Southcott admitted that it did not make any efforts to mitigate, the Vendor still had the burden of proving that mitigation was possible. The Court found that there were other comparable, profitable development properties available to Southcott. This finding was based on expert evidence regarding land suitable for development sold during the relevant time period in the same area, the other investment properties purchased by Southcott's parent company and the absence of any evidence to the contrary.

Ultimately, in a 6-1 decision (with McLachlin C.J. dissenting), the Court dismissed Southcott's appeal, finding that it failed to satisfy its duty to mitigate by pursuing opportunities to purchase a comparable property after the Vendor's breach.

The decision in *Southcott* is significant as it requires a purchaser acquiring land for development purposes (and hence, for profit) to attempt to mitigate its losses in the event the transaction is not completed due to a vendor's breach. The duty to mitigate will apply regardless of whether specific performance is pursued (except in limited circumstances), and will continue to apply even if the purchaser is a single purpose corporation with no assets. The Court's reasoning suggests that plaintiffs seeking specific performance on a contract for the sale of an investment property may have more difficulty establishing that the property is unique, and therefore that specific performance is warranted. This decision is also significant because in

determining whether a single purpose corporation could have mitigated its losses by pursuing comparable properties, courts are not restricted to looking at the actions of the corporation alone, but may also look to the actions of the corporation's parent company.

It is interesting to note that in McLachlin C.J.'s dissenting opinion, she agreed with the trial judge's finding that the Vendor failed to prove that Southcott had the opportunity to mitigate, and concluded that this was sufficient to dispose of the appeal. Contrary to the views of the majority, McLachlin C.J. found that Southcott did not act unreasonably in failing to take advantage of any mitigation opportunities. She expressed the view that a plaintiff cannot pursue specific performance and mitigate its losses at the same time. If the plaintiff does so, the plaintiff could potentially end up with two properties – the one that it initially wanted and the one that it bought in order to mitigate its damages. As a result, McLachlin C.J. concluded that "demanding that losses be mitigated unless success in obtaining specific performance is assured would deter valid claims for specific performance and hold plaintiffs to an impossible standard".

Why Landlords Should Think Twice Before Terminating

By Andrew Prior and Jennifer Wong

A recent decision of the British Columbia Court of Appeal is a useful caution for commercial landlords when they are considering whether there is a right to terminate a lease and what the risk might be if the termination is wrongful.

In *Shanahan v. Turning Point Restaurant Ltd.* [*Shanahan*], the tenant paid the landlord two months' base rent at the commencement of the term as a deposit (the "Deposit"). The tenant's business was not profitable and the tenant subsequently defaulted on its monthly rental payment. In response, the landlord delivered notice of default to the tenant advising that the landlord had the right to terminate the lease when the arrears reached 30 days, and advising the tenant to bring the rent up to date immediately. The tenant responded by asking the landlord to apply the Deposit it held to the rent in arrears. The landlord did not do so and purported to terminate the lease for non-payment of rent.

At trial, the landlord argued that the Deposit was implicitly for first and last month's rent while the tenant claimed it was a general deposit which it was entitled to have applied mid-term to any rent that might be in arrears. While the landlord could have expressly asked that the first and last month's rent be paid in advance in the course of lease negotiations, the trial judge found that the executed lease agreement made no mention of such a requirement. The tenant was therefore well within its rights to request that the Deposit be applied to the mid-term rental arrears. The trial judge then assessed damages against the landlord as a remedy for wrongful termination of the lease. On appeal, the BC Court of Appeal upheld the trial judge's findings but reduced the trial judge's assessment of damages for wrongful termination.

Shanahan underlines the importance of clear drafting and carefully reviewing the terms of the lease to ensure it accurately reflects the intent of the parties. When a problem arises, it is equally important to carefully review the terms of the lease to determine whether there is a precise right to terminate. If the landlord wrongfully terminates the lease, as did the landlord in *Shanahan*, the landlord could be found in breach of the lease thereby entitling the tenant to terminate the lease, avoid future obligations and potentially claim damages.

In assessing the potential risks of wrongful lease termination, *Shanahan* also serves as a caution against assuming that the tenant has no claim for damages for wrongful termination simply because its business is not profitable at the time of termination. When assessing the quantum of damages, the court will look at a number of

factors, including the potential loss of opportunity and assess the strength and weaknesses of various possibilities. Consequently, the opportunity, however remote, that but for the landlord's wrongful termination the tenant's business could have recovered from difficult financial circumstances and become profitable, may be considered by the court in assessing damages.

Landlords should therefore exercise caution and consider all potential factors before terminating a lease as the analysis of whether damages may be assessed against the landlord for wrongful lease termination does not end at whether the tenant's business is profitable at the time.

That's Unreasonable! Where's My Consent?

By Sonja Homenuck and Ryan Maynard

Commercial leases often include clauses that require a tenant or landlord to consent to a particular action, such as requiring the landlord's consent to a tenant's proposed assignment of the lease, or requiring the tenant to consent to a location to which the landlord proposes to relocate the tenant. At times, this requirement is contractually qualified, requiring the consent not to be unreasonably withheld. But what constitutes unreasonable withholding of consent and what, if anything, can the party requesting the consent do about it?

How do you know when they are being unreasonable?

Whether consent has been unreasonably withheld has received the most judicial consideration in the context of a landlord refusing to consent to a proposed assignment of a lease or sublease by a tenant. Most leases are negotiated to include wording that consent may not be unreasonably withheld, but in the absence of that qualification, section 23 of the *Commercial Tenancies Act*[1] deems that the consent cannot be unreasonably withheld. Note that parties are free to negotiate a different standard, but this is rare.

In determining whether consent is being unreasonably withheld, the courts have laid out several principles to be considered.

The first principle is that of onus of proof. The party claiming the other is acting unreasonably has the burden of proving it.[2] In deciding whether the burden has been discharged, the question that the court asks is not whether the court would have reached the same conclusion as the party whose consent is required, or whether a reasonable person might have given consent under the circumstances; rather, the question is whether a reasonable person would have considered the same reasoning/reason (whether the reason for refusing consent was a reasonable consideration).[3] For example, if a tenant is required to consent to a relocation of its premises to another location, and refuses consent on the basis that it is of the opinion that the proposed new location has less customer traffic and sales will fall, it is likely a court would uphold the refusal to give consent as being reasonable even potentially if the tenant was incorrect in its judgment (the location may actually have resulted in increased sales), as the reason considered was a "reasonable reason" i.e. that it would be normal and reasonable for a tenant to consider if sales would be affected by a move.

In determining whether the withholding of consent is unreasonable, the court also looks at the applicable covenant in the context of the lease, and ascertains the purpose of the covenant in that context.[4] The question of reasonableness

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[1] *Commercial Tenancies Act*, RSO 1990, c L.7, s. 23.

[2] *1455202 Ontario Inc. v. Welbow Holdings Ltd.*, 2003 CanLII 10572 (ON SC) at para. 9.

[3] Ibid.

[4] Ibid.

is essentially one of fact to be determined on the circumstances at hand, including "the commercial realities of the market place and the economic impact on the party being asked for their consent".[5]

The Court further holds that a refusal of consent will be unreasonable if it was designed to achieve a collateral purpose, or benefit the party, that was wholly unconnected with the bargain between the parties as reflected in their contract giving rise to the consent requirement.[6]

In *Tradedge Inc. v. Tri-Novo Group Inc.*, the landlord refused to consent to an assignment by the tenant. The Court found that the landlord had been unreasonable because its purpose was to increase the rent and was not based on considerations surrounding the proposed assignment. The Court held that the landlord would not have been worse off after the assignment and, in fact, may have actually been better off by the assignment. As such, the Court held that the landlord's refusal to consent to the assignment was unreasonable because the refusal was designed to achieve a collateral purpose.

Courts have held that reasonableness should not be confused with what may seem fair or just or to matters which touch both parties, but that the party refusing consent is entitled to take matters of convenience and interest to them alone into account.[7] Further, it is not necessary for the party whose consent is required, to prove that the conclusions that led it to refuse to consent were justified, if they were conclusions that might have been reached by a reasonable person in the circumstances.[8]

The court also looks at the circumstances surrounding the consent or withholding thereof. In the end, no rigid rule governs what type of circumstances may be taken into account.[9]

What can be done if consent is being unreasonably withheld?

If the party requesting consent believes that the other party is being unreasonable in refusing to consent, one potential remedy is to bring an application to Court for a declaration that the other party is unreasonably withholding consent and to request the Court to grant the consent. Another alternative is to treat the failure to grant consent by the other party as a breach of the contract by such party, but this can be risky, especially if the Court later determines that the consent was not unreasonably withheld. Alternatively, the party requiring the consent may choose not to proceed with the action requiring consent and sue the other party for damages (subject to any limitations and releases in the lease or contract).

Preventing the issue

During the negotiation stage of a lease, the parties should turn their minds to what would be reasonable (e.g. it is deemed reasonable to withhold consent if…) or explicitly limit the grounds that can be used to refuse consent. In the context of an assignment of a lease, grounds might include, but are not limited to, the financial health of the proposed assignee, the effect on other tenants of the landlord, or the nature of the use of the premises. With these limiting grounds in place both parties will have a better idea of what is reasonable in the circumstances and perhaps avoid the argument altogether as to whether a party acted unreasonably.

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[5] Ibid.

[6] *Tradedge Inc. (Shoeless Joe's) v. Tri-Novo Group Inc.,* 2009 CanLII 22578 (ON SC) at para. 31.

[7] *Loblaws Inc.v. The General Store*, 2007 NLTD 160 (CanLII) at para. 18.

[8] *Supra*, note 2.

[9] *1405593 Ontario Inc. v. Westridge Shopping Centres Limited*, 2008 CanLII 44719 (ON SC) at para. 11.

Emphytheusis and Transfer Duties: How Long Until We See Reform?

By Frédérique Geoffrion-Brossard and Mylany David

Introduction

An Act respecting duties on transfers of immovables[10] (the "Act") requires that municipalities collect duties on the transfer of any immovable property situated within their territory. The basis of imposition for transfer duties shall be the greatest of the following:

> 1. the amount of the consideration furnished for the transfer of the immovable;
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> 2. the amount of the consideration stipulated for the transfer of the immovable;
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> 3. the amount of the market value of the immovable at the time of its transfer.[11]

The Act defines a transfer as being "the transfer of the right of ownership on a property, the establishment of emphyteusis and the transfer of the rights of the emphyteutic lessee (…)."[12] The market value is based on the value on the property assessment roll.

In the case of emphyteusis, there are a number of legal transactions that will make the transferee subject to the payment of transfer duties: (i) the establishment of the emphyteusis; (ii) the assignment of the emphyteutic lessee's rights; (iii) the assignment of the bare owner's rights to the immovable property; and (iv) the emphyteutic lessee's purchase of the bare owner's rights.[13]

The said legal transactions constitute a dismemberment of the right of ownership or a transfer thereof, not a transfer of the full right of ownership. Accordingly, can one apply as a basis of imposition the amount of the immovable property's market value regardless of the fact that the transfer dealt with only a portion rather than the entire right of ownership and is it reasonable to do so? Conversely, should the basis be strictly the amount of the consideration furnished or stipulated, which would then constitute a fairer market value for the right that was transferred?

Relevant Jurisprudence

Not many decisions have dealt with the applicable basis of imposition in the case of emphyteusis, either when it is established, when the emphyteutic lessee's rights are assigned, or when the bare owner's rights to the immovable property are assigned.

The Superior Court decision, *4053532 Canada Inc. c Longueuil (Ville de)*[14], which is not available in the various databases, deals directly with this question.

On June 23, 2008, the plaintiff, 4053532 Canada Inc., purchased the rights as "emphyteutic lessor" to three immovable properties located in the City of Longueuil for an amount of $4,200,000. According to the municipal assessment, the total value of those properties amounted to $32,593,029. In April 2009, the plaintiff received a statement of account from the City of Longueuil, the defendant, charging it transfer duties calculated on the market value of the properties.

In its motion to institute proceedings, the plaintiff asked the court to cancel the tax accounts issued by the City of Longueuil, contending that the assignment of the rights of the bare owner did not constitute a transfer as defined in the Act. Subsidiarily, the City of Longueuil should not have

[10] *An Act* respecting duties on transfers of immovables, RSQ, c D-15.1.

[11] *Supra* note 1, s. 2.

[12] *Supra* note 1, s. 1.

[13] *Carrefour Repentigny Inc. c Ville de Repentigny,* 2004 CanLII 48444 (QC SC).

[14] *4053532 Canada Inc. c Longueuil (Ville de*), (SC 505-17-004482-099), 10 June 2011.

charged transfer duties based on the market value of the properties, but rather based on the consideration paid.

The court ruled that it was not necessary for the Act to explicitly state that the assignment of the owner's residual rights is a transfer under the Act. Given that the essence of the right of ownership remains with the bare owner, the wording "transfer of the right of ownership" in the definition of transfer covers such a transaction.

As for the basis of imposition for the transfer duties, the court was of the opinion that the Act leaves little leeway to the City of Longueuil, which must choose the higher of the consideration furnished, the stipulated consideration, or the market value according to the property assessment roll. The court was of the opinion that the legislature had expressed itself clearly in wanting the transfer duties on the transfer of the bare owner's residual rights to be determinable on the basis of the calculation stipulated in the Act, namely the market value of the immovable property:

> "[41] [TRANSLATION] The immovable which must constitute, at the time of its transfer, a unit of assessment entered on the roll, is the one that is the subject of one of the transactions described in the definition of transfer found in section 1, namely the transfer of the right of ownership, the establishment of emphyteusis, the assignment of the rights of the emphyteutic lessee or the lease of a property for longer than 40 years. The real value of the rights transferred pursuant to those transactions becomes irrelevant where that value is lower than the market value as understood in section 1.1 of the Act.
>
> (…)
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> [45] However, as Madam Justice Mailhot indicated in *Racine c Québec (Ville de)*, the fact that transfer duties can be borne both upon the assignment of the rights of the emphyteutic lessee and upon the sale of the owner's residual rights is not aberrant since the Act does not limit the number of transactions to which an immovable property may be subject.
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> [46] In addition, as mentioned by Mr. Justice Baudoin in *Orford (Corp. municipale du canton d'*) *c 2850-1799 Québec Inc.*, with respect to the current section 1.1 of the Act '*an unequivocal legislative will is sufficient to transform a potential inequity into a rule of law*'."[15]

Thus, the court dismissed the plaintiff's argument that the amount selected as the basis of the transfer duties should be the amount of the stipulated consideration rather than the market value.

According to the court, the immovable property that constitutes a unit of assessment entered on the roll when it is transferred is the one that is the subject of one of the transactions described in the Act's definition of transfer. The real value of the rights transferred pursuant to those transactions becomes irrelevant where it is lower than the market value of the immovable property.

The fact that transfer duties can be charged on both the assignment of the rights of the emphyteutic lessee and on the sale of the bare owner's rights is not aberrant, since the Act does not limit the number of transactions on an immovable property.

According to the court, an unequivocal legislative intent is enough to transform a potential inequity into a rule of law. In that regard, the court noted that other provisions of that nature have been enacted by the legislature, such as Article 1205 of the *Civil Code of Québec* and *An Act respecting municipal taxation*[16], which require that the

[15] *Ibid.*, at para. 41, 45 and 46.

[16] *An Act respecting municipal taxation*, RSQ, c F-2.1.

emphyteutic lessee be responsible for the real property charges during the term of the emphyteusis.

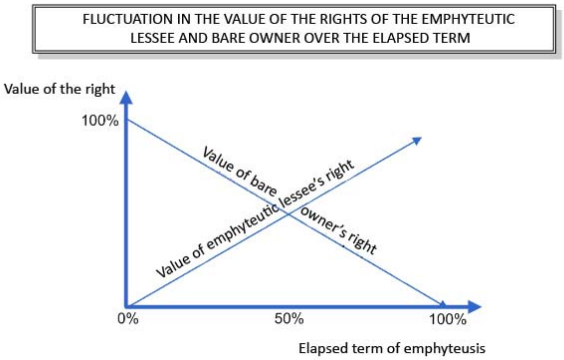
All in all, the court does not have the latitude to enable it to refuse to apply the legislature's clearly expressed intent. Moreover, the court also refused to cancel the assessments as a result of changes made to the property assessment roll.

Comments

The case of *4053532 Canada Inc. c Longueuil (Ville de)* was appealed, but a decision is still pending.

Even if the decision rules on the value to be considered for the calculation of transfer duties, the legislature's decision to allow the double, or even triple, imposition of transfer duties on the full market value of the immovable property is still questionable.

The following graph illustrates the fluctuation in the value of the rights of the emphyteutic lessee and the bare owner over the elapsed term of the emphyteusis:



The case of *4053532 Canada Inc. c Longueuil (Ville de)* has established that regardless of the elapsed term or remaining term of the emphyteusis, any assignment will require the payment of transfer duties on the total value of the property. On that point, as set out above, the court noted that other such provisions have also been enacted by the legislature with respect to the real property charges encumbering an immovable property, for which the emphyteutic lessee must be fully responsible during the term of the emphyteusis. However, it seems that court would have failed to take into account in its analysis that those provisions clearly establish that only the emphyteutic lessee is responsible for the real property charges.

Under the current state of the law, in the event of a simultaneous assignment of the rights of the bare owner and the emphyteutic lessee, with 50% of the term of the emphyteusis having elapsed, the emphyteutic lessee and bare owner will each pay transfer duties on the **total** market value of the immovable property. While it is true that the Act does not limit the number of transactions on an immovable property, it seems reasonable to us to think that it should nevertheless provide for fair transfer duties that do not constitute double taxation. Thus, we are of the opinion that the elapsed term or remaining term of the emphyteusis should be taken into account in the calculation of the property's market value.

Another example of how the Act shows little consideration for the situation of emphyteusis is the fact that if the emphyteutic lessee decides to perfect his right and purchase the rights of the bare owner, he must then pay transfer duties to the municipality, although he already paid duties when the emphyteusis was established. On this point, the jurisprudence implies that the market value that would apply to the transaction would be that of the land and the building built by the emphyteutic lessee, not just that of the land.[17]

In *H.L.P. société en commandites c Beauport (ville de)*[18], the Court of Appeal determined that during the term of the emphyteusis, the emphyteutic lessee is not the superficial owner of the works it has built and that it enjoys the erected building not under a right of accession, but because the

[17] *Carrefour Repentigny c Repentigny (ville de),* [2005] RDI 128.

[18] *H.L.P. société en commandites c Beauport (ville de),* [2000] RJQ 1095.

emphyteutic contract entails that legal consequence.

Accordingly, if the emphyteutic lessee were to acquire the rights of the bare owner, there would be a transfer of not only the right of ownership to the land, but also to the structures that were built. However, the doctrine seems to disagree with this position. Indeed, according to several authors, the emphyteutic lessee has a temporary right of ownership to the new capital assets that were built, similar to a superficial ownership.[19] Therefore there would be no transfer of ownership to those capital assets and the emphyteutic lessee should not have to pay transfer duties on the capital assets.

In conclusion, a legislative amendment that would put an end to the inequity caused by the imposition of transfer duties on emphyteutic transactions would be welcome. Indeed, the current state of the law could even discourage potential investors, who would not be interested in investing in the establishment of an emphyteusis since the sums to be paid to the municipalities in transfer duties are higher than the real market value, as that term is commonly understood, and can constitute double taxation.

Recent Highlights for the National Real Estate Group at FMC

The second half of 2012 has been another successful period for FMC's National Real Estate Group in serving our clients. Some highlights are noted below:

- Represented Mirvish Enterprises Limited with respect to a spectacular mixed-use project designed by pre-eminent architect Frank Gehry, containing 218,260 square metres (2,349,408 square feet), consisting of a six-storey retail commercial podium and three towers: one measuring 82 storeys in height and 55,967 square metres (602,443 square feet), the second tower measuring 86 storeys consisting of 90,616 square metres (975,414 square feet) and the third tower of 84 storeys in height, consisting of 71,677 square metres (771,550 square feet).
- Represented a prominent developer with respect to a significant parkland valuation appeal to the Ontario Municipal Board for a development in Toronto's Entertainment District.
- Acted for Bay Yorkville Developments Limited in connection with its sale of the new flagship Four Seasons Hotel to Kingdom Hotels (Toronto) Ltd. at Bay and Yorkville, Toronto, for a sale price of approximately $165,000,000 which was completed on October 5, 2012.
- On September 27, 2012, the Toronto office held another successful Fall Real Estate Breakfast Seminar attended by over 100 of our clients who heard presentations from a number of our lawyers on a wide variety of topics including Section 37 benefits, relocation rights in leases, a condominium update, the new TARION rules and liability for condominium developers with respect to falling glass.

Contact Us

For further information, please contact a member of our National Real Estate Group.

[19] Denys-Claude Lamontagne, *Les droits sur les mutations immobilières*, Yvon Blais, Cowansville, 2001, p. 40; François Frenette, *Biens,* (2005) 107, R. du N. 99 at p. 117; Marie-Pier Cajolet and Caroline Marion, *Les droits sur les mutations immobilières*, 2nd Ed., Chambre des notaires du Québec, 2011.