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**BARRISTERS**

*The Duty of Good Faith in Real Estate Matters*  
*or*  
*Betrayal begins with Trust [Phish 2000]*

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## **THE DUTY OF GOOD FAITH**

Contract law generally has long accepted the concept of good faith as an implied obligation in the performance of contracts. In *Dynamic Transport v OK Detailing*<sup>1</sup> the Supreme Court of Canada said:

**"The court will also imply that each party is under an obligation to do all that is necessary on his part to secure performance of the contract."**

Since *Dynamic*, Courts have repeatedly found a duty to act reasonably, in good faith in the performance of contracts. A party who has failed in this contractual duty to use its best efforts to fulfill a condition will not be permitted to rely on its failure to use its best efforts as a ground of avoiding the contract.

The real estate jurisprudence is replete with circumstances where, for reasons such the possibility of achieving a higher price for a property, or a better opportunity, a party has sought to avoid a contractual obligation. In the real estate context, it is not rare to find parties for whom an agreement of purchase and sale may be nothing more than the starting point for negotiations. The law imposes on these and others a duty to perform contracts in good faith.

This paper will explore good faith in the real estate context. As a starting point, we will address the pre-contractual stage. Then we will address conditions in contracts, and finally the closing process. At each stage, good faith plays a role.

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<sup>1</sup> [1978]2 S.C.R. 1072

What exactly “good faith” entails; the breadth of its parameters, and the extent of its application is the focus of this paper. “Good faith” is contextual: its scope is defined in relation to the terms of the contract in question and the particular factual matrix.

At the conceptual level, litigation often focuses on establishing the existence of “bad faith” as evidence of a lack of “good faith”. The Ontario Court of Appeal affirmed in *Shelanu Inc. v. Print Three Franchising Corp* that the standard of good faith is breached when a party “acts in a bad faith manner”.<sup>2</sup>

In *Shelanu*, Justice Weiler found that the duty of good faith allows a party to act in its own self-interest, while having regard to the legitimate interests of the other party. Justice Weiler stated:

"Unconscionability" accepts that one party is entitled as of course to act self-interestedly in his actions towards the other. Yet in deference to that other's interests, it then proscribes excessively self-interested or exploitative conduct. "Good faith," while permitting a party to act self-interestedly, nonetheless qualifies this by positively requiring that party, in his decision and action, to have regard to the legitimate interests therein of the other. The "fiduciary" standard for its part enjoins one party to act in the interests of the other — to act selflessly and with undivided loyalty. There is, in other words, a progression from the first to the third: from selfish behaviour to selfless behaviour. Much the most contentious of the trio is the second, "good faith." It often goes unacknowledged. It does embody characteristics to be found in the other two [emphasis added].<sup>3</sup>

Justice Weiler continued that the duty of good faith “requires that parties to a contract exercise their rights under that agreement honestly, fairly and in good faith.” “Good faith” conduct is the

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<sup>2</sup> *Shelanu Inc. v. Print Three Franchising Corp.* (2003), 64 O.R. (3d) 533

<sup>3</sup> *Ibid* at para. 68

*“guide to the manner in which the parties should pursue their mutual contractual objectives. Such conduct is breached when a party acts in “bad faith” — a conduct that is contrary to community standards of honesty, reasonableness or fairness.”*

As “good faith” is somewhat of an amorphous term, its application attracts evaluation on a case-by-case basis. From the litigation perspective this is helpful as there is a healthy body of jurisprudence addressing the various aspects of real estate transactions where the duty to act in good faith appears. Below are various situations where the real estate solicitor will benefit from a keen awareness.

### **GOOD FAITH IN PRE-CONTRACTUAL NEGOTIATIONS**

Traditionally, Ontario courts have not recognized a duty to negotiate a contract in good faith. As noted by the Justice Weiler, speaking for the Court of Appeal in *978011 Ontario Ltd. v. Cornell Engineering Co.* 2001 CarswellOnt 1290 at paragraph 32<sup>4</sup>:

we have a judicial system that emphasizes individual responsibility and self-reliance. Generally, parties negotiating a contract expect that each will act entirely in the party's own interests. Absent a special relationship, the common law in Canada has yet to recognize that in the negotiation of a contract, there is a duty to have regard to the other person's interests, namely, to act in good faith

Agreements to negotiate in good faith would be problematic to enforce as a party who has not committed to arriving at a finalized agreement would not at that stage bear obligations respecting the ultimate conclusion of the negotiations. There is no contractual remedy when

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<sup>4</sup> Application for leave to appeal to the Supreme Court of Canada dismissed November 1, 2001 (Gonthier, Major and Binnie JJ.).

the contract in question is not completed.<sup>5</sup> As confirmed by Justice Belobaba in *1001411 Ontario Ltd. v. City of Toronto Economic Development Corp.*, “there is no stand-alone duty of good faith that is independent of the terms of the contract”<sup>6</sup>. Accordingly, the courts have been wary to extend a good-faith duty to the pre-contractual stage.

Despite this, nuanced exceptions to or circumventions of this rule have crept into the case law. From the perspective of a client on the receiving end of bad faith pre-contractual negotiations, depending on the particular circumstances, there may be caselaw to support a claim for damages. On the other hand, there remains a solid body of caselaw to support the general proposition that there exists no duty in Canada to negotiate pre-contractually in good faith.

In the 1989 Supreme Court of Canada decision *International Corona Resources Ltd. v. Lac Minerals Ltd.*, the possibility of such a pre-contractual duty seemed to be emerging. Justice LaForest stated:

[T]he institution of bargaining in good faith is one that is worthy of legal protection in those circumstances where that protection accords with the expectation of the parties.<sup>7</sup>

Subsequent decisions, however, did not pick up on Justice LaForest’s comment and have avoided the application of good faith principles in a pre-contractual setting. In *Martel Building*

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<sup>5</sup> See *Canada Trustco Mortgage Co. v. Homburg* (1998), 1998 CarswellNS 519 (N.S. C.A.)

<sup>6</sup> 2009 CarswellOnt 9128,

<sup>7</sup> [1989] 2 S.C.R. 574

*Ltd. v. Canada*<sup>8</sup>, the Supreme Court of Canada considered whether the tort of negligence included a duty of care on parties during contractual negotiations for a leased premise.

The Supreme Court recognized that the bilateral nature of most negotiations means that gains of one party are sometimes obtained at the expense of the other party. The court noted that the prospect of causing deprivation by economic loss is implicit in the negotiating environment and found a *prima facie* duty of care. Despite this, the court held that there were policy reasons to negate that duty or as they put it: “*compelling policy reasons to conclude that one commercial party should not have to be mindful of another commercial party's legitimate interests in an arm's length negotiation.*”<sup>9</sup> These policy reasons include:

- the primary goal of commercial negotiations is to achieve the most advantageous financial bargain. In the context of bilateral negotiation, such gains are realized at the expense of the other negotiating party;
- Second, there is a risk of deterring socially and economically useful conduct. It would defeat the essence of negotiation and hobble the market place to extend a duty of care to the conduct of negotiations and to label as negligent a party's failure to disclose its bottom line, its motives or its final position. This would force the disclosure of privately acquired information and the dissipation of any competitive advantage derived from it. This would be incompatible with the activity of negotiating and bargaining;
- Third, to impose a duty could interject tort law as after-the-fact insurance against failures to act with due diligence or to hedge the risk of failed negotiations through the pursuit of alternative strategies or opportunities;

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<sup>8</sup> [2000] 2 S. C.R. 860

<sup>9</sup> *Ibid* at para. 55

- Fourth, the courts would assume a significant regulatory function, scrutinizing the minutiae of pre-contractual conduct, when other causes of action already provide remedies; and,
- Fifth, needless litigation should be discouraged – extending a duty of care to negotiations would encourage a multiplicity of proceedings.<sup>10</sup>

In *Martel*, the court had left open the particular question of “good faith” as separate from the question of a duty of care during pre-contractual negotiations:

As a final note, we recognize that Martel's claim resembles the assertion of a duty to bargain in good faith. The breach of such a duty was alleged in the Federal Court, but not before this Court. As noted by the courts below, a duty to bargain in good faith has not been recognized to date in Canadian law. These reasons are restricted to whether or not the tort of negligence should be extended to include negotiation. Whether or not negotiations are to be governed by a duty of good faith is a question for another time.<sup>11</sup>

In *Peel Condominium Corporation No. 505 v. Cam-Valley Homes Ltd.*<sup>12</sup> The Ontario Court of Appeal used *Martel* for the authority that there is no duty to bargain or negotiate in good faith in Canadian contract law. At the trial level, Justice Epstein (as she then was) relied on the principle that contracting parties owe one another a duty to act reasonably and in good faith.

At the Court of Appeal, the ruling was overturned by a split decision. Speaking for the majority, Justice Finlayson was careful to separate contract formation from contract performance, and citing *Martel*, he confirmed that it is only after the contract is negotiated and signed that the purchaser is entitled to rely on the developer to carry out the agreement honestly and in good faith. With regard to Justice Epstein’s reasons he stated:

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<sup>10</sup> *Ibid* at paras. 63-71

<sup>11</sup> *Supra* Note 3 at para 73

<sup>12</sup> 2001 CarswellOnt 579

I think that the weakness of the trial judge's analysis is that she fails to draw a bright line between the status of the respective developer and purchaser prior to executing a binding agreement of purchase and sale and the obligation of the contracting parties to complete the closing of the sale in good faith.

...However, the concern in [LeMesurier](#) was with the parties' conduct in performing an executory contract: one already made. The trial judge appears to have taken this authority a step further by applying the principles in [LeMesurier](#) to the pre-contractual phase of the parties' relationship and, in particular, to the time that the agreements were being prepared by the developer. This notion that the developer has an obligation to incorporate all the purchasers' "reasonable expectations" into the disclosure documents is unrealistic and unsupported by authority. [LeMesurier](#) does not decide that arm's length parties owe each other a duty of good faith during the bargaining phase of their relationship. In fact, there is supporting case law that there is no duty to bargain or negotiate in good faith: *Mannpar Enterprises Ltd. v. Canada* (1999), 173 D.L.R. (4th) 243 (B.C. C.A.), at 265-267 and *Weiss v. Schad* (November 17, 1999), Doc. 92-CQ-15488 (Ont. S.C.J.) at para. 123. As Iacobucci and Major JJ. Stated for the court in [Martel Building](#)...<sup>13</sup>

Having in mind that Canadian law has not yet recognized a duty to bargain in good faith, Justice Newbould in *Carterra Management v. Palm Holdings Canada Inc.*<sup>14</sup> was recently faced with a motion for a certificate of pending litigation where no Agreement of Purchase and Sale had been signed. Justice Newbould found that a Letter of Intent was sufficient to create "an interest in land" as contemplated by the relevant legal test for a CPL. Although not framed in the context of good faith/bad faith, the case does provide the argument that a vendor may not be permitted to walk away from a transaction under negotiation in bad faith.

In *Carterra*, the parties had signed a Letter of Intent towards the purchase by Carterra of the Four Points Sheraton Hotel along the lakeshore in Toronto, operated by the defendant Palm Holdings. Before the parties formally entered into an APS, Palm Holdings received an expert

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<sup>13</sup> *Ibid* at para 38-40

<sup>14</sup> 2011 ONSC 4573

opinion that the property was worth more than they had originally thought and thus they sought to walk away from the deal with Carterra and put the property back on the market to try and get a better price.

The Letter of Intent was in the standard form and provided that Carterra had an interest in negotiating an agreement with Palm Holdings. The Letter of Intent set out the purchase price, the deposits, the closing date, the mortgage terms and other matters. The Letter also expressly provided that it only represented an expression of interest and did not create a binding agreement. The following terms were included in the Letter of Intent:

#### **4. Agreement of Purchase and Sale**

**Immediately after acceptance of this letter, the Vendor and Carterra will proceed in good faith to negotiate and finalize the terms of the Agreement in an expeditious manner and in any event within one month from the date of this letter's acceptance by all parties (the "Negotiation Period")...**

#### **14. Non-Binding**

**Except for Paragraphs 12 (Confidentiality) and 13 (No Solicitation) hereof, this letter shall only constitute a letter of understanding and is not contractual in nature and shall not bind any party hereto or create any legal or other obligations relating to the Property or otherwise. No binding agreement of purchase and sale of the Property shall exist between the parties unless and until the parties are satisfied, in the respective sole and absolute discretion, with all of the terms and conditions of the Agreement and such Agreement has been executed.**

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It was clear from the evidence that the parties were close to a final agreement. Carterra took the position that everything was complete and agreed to, but for the formality of signing the APS. In particular, Carterra relied on s.13 of the Letter of Intent which provided:

### **13. No Solicitation**

The Vendor agrees that after delivery of the draft Agreement of Purchase and Sale and until negotiations between the Vendor and Purchaser are terminated, (it being understood that the Vendor will not unilaterally terminate negotiations without one weeks prior notice to the Purchaser), the Vendor will not solicit a possible sale of all or any part of the Property with any other party.

Carttera argued that the parties had reached an agreement and that Palm Holdings could not terminate negotiations because they had already ended. According to Carttera, the negative covenant in s.13 should therefore have been enforced and Palm Holdings should not be entitled to market the property.

Palm Holdings acknowledged they were close to a deal but that absent a signed APS, Carttera's claim was doomed to failure based on s.14 of the Letter of Intent and s.4 of the *Statute of Frauds*.

Justice Newbould found that despite the arguments of Palm Holdings, it could not be said that there was no triable issue with respect to specific performance and whether there was a binding agreement. Further, with respect to Carttera's s.13 argument, Justice Newbould found that *"if a certificate of pending litigation were not granted and Palm holdings signed an agreement with a new purchaser, Carttera would lose the benefit of that No Solicitation Clause."*

In this case, a significant factor was that the CPL would not be overly harmful to Palm Holdings as it wanted a 30 month closing period so it could continue to operate the hotel on the property. It is also worth cautioning that in the case of CPLs, the threshold for finding a triable issue is low<sup>15</sup> and the onus is on the respondents to demonstrate that there is no triable issue.<sup>16</sup>

Master Birnbaum faced a similar question with a different factual underpinning in *Cohen v. Moore*, 2008 CarswellOnt 310, [2008] and found that “*bad faith conduct does not create an interest in land.*”

### **CONTRACTUAL CONDITIONS – HOW HARD DO YOU HAVE TO TRY?**

The doctrine of good faith in the performance of a contract is embedded in the terms of that contract. It may be an implied term of the contract or can be based on a non-explicit common law root in the contract. It is also not uncommon in contracts for the sale of land for a duty of good faith to be explicitly set out with regard to certain terms of the contract.

In the decision of *Southcott Estates Inc. v. Toronto Catholic District School Board*<sup>17</sup> the impugned agreement of purchase and sale contained an explicit provision whereby the defendant school board was under an obligation to act in good faith and use its best efforts to obtain a severance from the city.

It was conceded by the defendant that the good faith duty existed. At trial, the evidence showed that the school board did not act with reasonable diligence in seeking the severance.

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<sup>15</sup> *Obsidian Group v. Kingswhite Properties*, 2007 CanLII 41895 (ON SC), para 7

<sup>16</sup> *G.P.I. Greenfield Pioneer Inc. v. Moore*, 2002 CarswellOnt 219 (C.A.) at para 20

<sup>17</sup> 2009 CarswellOnt 494; overturned on other grounds by Court of Appeal: 2010 ONCA 310; leave to appeal to S.C.C. granted: 2010 CarswellOnt 8726

The defendant school board, however, made arguments based on causation. It took the position that the plaintiff did not satisfy the burden of proving that even if the defendant breached its obligation to use its best efforts, the severance would have been granted in time for the transaction to be completed by the contractual closing date of January 31, 2005.

The specific issue in that case was whether the city planning department would have opposed the severance as premature to the committee of adjustments. The defendant argued, and presented evidence, that regardless of its good faith obligation, the deal could not have closed because of the planning department issue. However, the school board had been told by the Committee of Adjustment to file a development plan, the essence of which had been approved by the city planner. The board chose not to.

At trial, there was evidence that by the time the Committee of Adjustment hearing was to be held, the school board was looking for a higher price or a joint venture. At the hearing, the Committee postponed its decision, citing the failure to file the development plan. When the closing date came without the severance, the school board declared the agreement at an end. With the underlying evidence that the defendant had breached its duty of good faith, the court favoured the plaintiff. Justice Spiegel found on a balance of probabilities that:

There was a reasonable probability that [the planning department] would have achieved the required level of comfort with the plaintiff's development application within ten weeks of the date of filing the application. Based on my finding that the application could have been filed by September 13, 2004, this means that by November 22, 2004 the Planning Department would not have considered the severance premature. I also find that there was a reasonable probability that had this occurred, [the city counselor] would have taken the same position.

I find that had the defendant not breached the obligation to use its best efforts, it could have obtained a hearing before the COA much earlier than it did. However, even if the hearing was held as late as December 16, 2004, I find that in the absence of an objection from the Planning Department and [the city counselor], the severance would likely have been granted and the transaction would have been completed by January 31, 2005.<sup>18</sup>

The Court of Appeal went even further in recognizing the weight of the good faith provision. The board argued that even if it had not breached its obligation in relation to the severance, there would have been insufficient time to complete the contract which stipulated that time was to be of the essence. Southcott took the position that regardless of the time of the essence clause, and in light of the good faith clause, the board was not entitled to speculate on the likelihood of the severance's success and was required to make good faith attempts to obtain it. If the board thought that there was not enough time for such, it was obliged to extend the time for completing the contract. Southcott argued that a party in breach of its contractual obligation (including the duty to perform in good faith) cannot rely on a time of the essence clause.

The Court of Appeal agreed and held that given the unchallenged finding that the board was in breach of its obligation to use its best efforts to obtain the severance, it could not rely on the time of the essence clause as a ground for escaping its contractual requirements:

12 In my view, given the trial judge's unchallenged finding that the Board was in breach, the Board was not entitled to rely on the time of the essence clause and terminate the agreement.

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<sup>18</sup> *Ibid* para 22

13 It is a well-established principle of contract law that a party cannot use its own breach or default in satisfying a condition precedent as a basis for being relieved of its contractual obligations, while a party in breach of its obligation to do what is required to complete a transaction cannot terminate the agreement by relying on a time of the essence clause...

In *North America Construction (1993) Ltd. v. Deem Management Services Ltd*<sup>19</sup> where there was no bad faith on the part of the vendor, the opposite result was achieved. Here the plaintiff purchaser occasioned some minor difficulties which would have pushed the closing of the sale of a commercial property back a few days. Without any bad faith, and after having already agreed to two closing extensions, the vendor gave notice that it was relying on the time of the essence clause and treating the agreement as at an end.

The plaintiff argued that the vendor owed a good faith obligation to honestly perform a contract honestly entered into and therefore extend the closing by three days. The plaintiff maintained that the vendor had an obligation to take reasonable steps to overcome minor and previously unforeseen defects which arose on the day of closing. The Court found on the evidence that the vendor had not acted in bad faith and that it was in fact the dilatory pace at which the purchaser proceeded with its contractual performance that brought about the “minor” problems. Accordingly, the vendor was entitled to rely on the time of the essence clause and treat the agreement as at an end. Justice Kane noted:

There is a tension reflected in jurisprudence between the need of parties to know that the courts will enforce contractual terms negotiated by competent independent parties and the ability of the courts on specific facts to look beyond the written term of a contract and provide equitable relief. Most often, piercing

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<sup>19</sup> 73 R.P.R. (4th) 253

the contractual term is justified in jurisprudence by acts of wrong doing, default or capriciousness by the party seeking to enforce the contractual term.

In *1473587 Ontario Inc. et al. v. Jackson et al.*<sup>20</sup> by inadvertence, the purchaser was seven days late in delivering the deposit. During the seven day period, the vendor found a new purchaser and entered into second agreement, treating the first as repudiated because time was of the essence.

The issue went to court to determine whether the parties would be held strictly to their bargain or whether there was room to accommodate the plaintiffs' inadvertent error. The plaintiff was of the mind that the purchaser was acting in bad faith by not accepting the late deposit.

In reaching his decision which was affirmed on appeal, Rutherford J. looked at the seminal Privy Council decision in *Union Eagle Ltd. v. Golden Achievement Ltd.*<sup>21</sup> where, he stated, "*the holding of parties to their bargain in this respect perhaps met its zenith.*" In *Union Eagle*, the purchase of a Hong Kong flat was to close at 5:00 p.m. on the closing date. In the period intervening the signing and closing of the agreement, real estate prices in Hong Kong had skyrocketed and the property in question was worth much more than the contract price. Due to rush hour traffic, the cheque for tender arrived at 5:10 p.m. and the vendor treated the agreement as terminated under the time is of the essence clause. There was no intentional delay by the purchaser, there was no specific deadline for registration and the vendor did not suffer any damages as a result of the 10 minute delay. Regardless, the Privy Council held that the parties should be bound to the agreement they had made.

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<sup>20</sup> 74 O.R. (3d) 539 (Sup. Ct. Jus.)

<sup>21</sup> [1997] A.C. 514

Following the Privy Council’s reasoning, Rutherford J. held that the plaintiff was late to tender which entitled the vendor to treat the agreement as repudiated. The fact that the vendor was not sympathetic to the inadvertence did not operate to diminish any good faith on the part of the vendor:

Mr. Horst suggested that perhaps the Vendors were not acting in good faith in not immediately asserting their right to treat the contract as discharged and then discussing the possibility of a sale of the entire property with Forecast. While it may seem unfair, or perhaps more accurately, unfortunate to Loblaw that another purchaser with an inclination to do business came along precisely at the time Loblaw fell into breach of the deposit provision, it was through no fault, guile, deception or subterfuge on the part of the Vendors. The Vendors' solicitor returned the six-day overdue cheque the same day he received it, telling Loblaw that the Vendors did not agree to accept the late deposit. That the Vendors discussed and subsequently came to an agreement with Forecast based on the early advice received that the first agreement was no longer binding does not, in my view, come anywhere near using their position unfairly or playing fast and loose with Loblaw. Loblaw was told that its cheque would not be accepted the same day two of the defendant Vendors first met with Forecast and the cheque was actually sent back to Loblaw several days before Forecast and the Vendors executed the second agreement.<sup>22</sup>

In a 2009 Superior Court decision, *Mutual Apartments Inc. v. Lam*,<sup>23</sup> Justice Kelly endorsed the decision of Rutherford stating that “*any waiver of the time is of the essence provision would have to be explicitly and fully proven*”. In this case, the purchaser gave the deposit cheque to its solicitor but the solicitor by inadvertence neglected to deposit the cheque into the trust account. The vendor did not realize this at the time and continued to work towards closing the transaction. The vendor later wished to avoid the transaction for other reasons. Upon discovering that the deposit had not been made, the vendor used this as an excuse. As time

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<sup>22</sup> 74 O.R. (3d) 539 (Sup. Ct. Jus.) at para. 22

<sup>23</sup> 2009 CarswellOnt 3768

was of the essence, the vendor was able to avoid the transaction but was not seen as straying from its duty to act in good faith:

When Mutual, through inadvertence, failed to deposit the cheque within the time specified, it breached a fundamental term of the contract. Mutual cannot rely upon the fact that the defendants continued to attempt to close the transaction after the default of the payment on April 18, 2001 thereby waiving such right. As I have stated above, they did not know that Mutual had breached such a term of the APS so that they could not have waived such a right. They presumed that such a condition was complied with and therefore continued to work towards the closing of the transaction.

I am of the view that even though Mutual provided the second deposit cheque to its lawyer, it had the money to cover the cheque and it was not deposited through inadvertence, it is a breach of a fundamental term of the APS and as such, the APS is null and void for that reason.<sup>24</sup>

Accordingly, there exists good authority in Canada for the proposition that time is of the essence clauses will be strictly enforced. The *Union Eagle* case has been cited approving several times since it was decided in 1997. However, as is seen in *2054476 Ontario Inc.*, where the circumstances that give rise to application of the time is of the essence clause may have been brought about by the bad faith of the party seeking to rely on the provision, the court will not hesitate to intervene.

Southcott demonstrates that a party under an obligation to bring about an event on which a contract is conditional, which tries to repudiate the contract relying on the condition, must prove it used reasonable efforts to fulfill the obligation. Failing this, the party cannot rely on the condition to repudiate the contract. The caselaw shows that the same principle will apply where no such contractual good faith provision exists.

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<sup>24</sup> *Ibid* at para 35

As of the date of this paper, an appeal to the Supreme Court of Canada is pending on an issue of mitigation. A cross appeal on causation is also pending. It will be interesting to see what the Supreme Court says on the causation issue.

As noted above, there is no stand-alone duty of good faith in contract law. Justice Cronk commented on such in *IT/NET Inc. v. Cameron*, an employment law case:

The respondent raises another argument to sustain the judgment. It says that the appellant owed it a duty of good faith that he breached on the facts of this case.

I cannot agree that such a duty arises here. In *Transamerica Life Canada Inc. v. ING Canada Inc.* [\(2003\), 68 O.R. \(3d\) 457](#) (Ont. C.A.) this court made clear that Canadian courts have not recognized a stand alone duty of good faith that is independent from the terms expressed in a contract or from the objectives that emerge from those provisions. Unlike *TSP-Intl Ltd. v. Mills*, [\[2005\] O.J. No. 616](#) (Ont. S.C.J.), in this case the appellant was bound by the two clauses of his written contract considered above. There is no room to import a separate duty of good faith where both express clauses have been complied with.<sup>25</sup>

The case of *Leung v. Leung*,<sup>26</sup> reveals that at common law “a vendor is under a duty to act in good faith and to take all reasonable steps to complete the contract.” Further, the case provides some useful rules by which parties to a real estate transaction must play:

- Where a vendor acted contrary to good faith in his performance of the contract, the law precludes him from relying on the "time of the essence" provision to terminate the contract...
- The duty to act in good faith to complete the contract extends to cases involving minor omissions or defects...

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<sup>25</sup> *IT/NET Inc. v. Cameron* 2006 CarswellOnt 201 at paras. 29-30

<sup>26</sup> [1990] O.J. No. 2276 (Ont. Gen. Div.)

- No requirements of precision should be imposed on a party whose tendered performance includes minor but easily corrected errors.<sup>27</sup>

It is a worthwhile exercise to compare these principles to the decision in *North America Construction (1993) Ltd* where, by acting reasonably and in good faith, the vendor was able to satisfy the criteria in *Leung* and still terminate the contract despite the fact that a closing extension of a few days would have permitted the completion of the contract.

In *John E. Dodge Holdings Ltd v. 805062 Ontario Ltd.*<sup>28</sup> the duty to complete a contract in good faith is stretched far. The defendant agreed to sell four acres of serviced undeveloped land in Vaughan to the Plaintiff, a hotel builder. The standard form agreement of purchase and sale contained the following clause:

**Planning Act:** This Agreement shall be effective to create an interest in the property only if Vendor complies with the subdivision control provisions of the Planning Act by completion and Vendor covenants to proceed diligently at his expense to obtain any necessary consent by completion.

The defendant applied for and obtained the severance however it was subject to the condition that the defendant build an extensive (and expensive) road extension through the property. The defendant applied to the committee of adjustments to remove the condition but was unsuccessful. Based on the significant expense it would have to incur to complete the severance, the defendant took the position that it was able to terminate the agreement. The Plaintiff sued for specific performance.

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<sup>27</sup> Barry J. Reiter, R.C.B. Risk and Bradley N. McLellan, *Real Estate Law*, 3rd ed., p. 790, cited in *Leung v. Leung*:

<sup>28</sup> 2001 CarswellOnt 3984

At the trial level, Justice Lax looked at the extent of the obligation that the defendant had assumed and what was required of the defendant to fulfill this obligation. The covenant in question imposed all of the risk, burden and uncertainty of obtaining the severance on the defendant vendor. The defendant thus argued that the severance issue created a commercial absurdity as the severance was to the benefit of neither party and that that it would impose an additional significant financial obligation on the defendant.

Justice Lax found, and the Court of Appeal agreed, that the provisions were clear, the parties were sophisticated and thus had a good faith obligation to do what was required to satisfy the condition:

It seems to me that the commercial absurdity here is not the purchaser's interpretation of the vendor's obligation under the *Planning Act* provision. It is one thing to imply a good faith obligation on a vendor to use best efforts when the agreement is silent. The vendor's covenant here is express and unqualified. 805 assumed the risks of obtaining compliance with the *Planning Act*. These risks included the cost of dedicating and constructing the road. There is nothing commercially absurd about requiring the vendor to pay for this, as this is the agreement that the parties made. This is particularly so where the vendor has not only contemplated for some time that it will be required to do this, but was prepared to do this at the time the Agreement of Purchase and Sale was signed. That the vendor later changed its mind can in no way affect its covenant.

The Court of Appeal looked at the Supreme Court of Canada decision of *Dynamic Transport Ltd. v. O.K. Detailing Ltd.*<sup>29</sup>, and noted that in a purchase and sale transaction, “*the party proposing to carry out a subdivision of land is the vendor. The Supreme Court therefore implied a promise on the part of the vendor “to act in good faith and to take all reasonable steps to complete the*

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<sup>29</sup> [1978] 2 S.C.R. 1072 at 1084

*sale*". The Court of Appeal then addressed the question of what is encompassed by "all reasonable steps" and looked to the wording of the provision in question:

What is or is not required of a vendor will depend on the wording of the agreement and the circumstances under which it was entered into. In this case paragraph 14 specifically imposes an obligation on the vendor to "proceed *diligently* at his expense to obtain any necessary consent" [emphasis added]. The dictionary definition of diligence as contained in *Webster's Encyclopedic Unabridged Dictionary of the English Language* is "constant and earnest effort to accomplish what is undertaken." One of the synonyms given for diligence is perseverance.

The Court of Appeal thus agreed with Justice Lax that the only way for the defendant to obtain "any necessary consent" as agreed to, was to bear the cost of building the road extension or seek to have the committee of adjustments decision overturned.

If the defendant thought the condition was unreasonable, it could have appealed the committee of adjustments decision but it did not. Given the duty of good faith, The Court of Appeal made clear that it was not up to the defendant to determine the reasonableness of the severance condition:

The statutory scheme provided by the *Planning Act* does not end with the decision by the Committee. If the vendor is of the opinion that the imposition of a condition by the Committee is unreasonable, or otherwise not well-founded, it has the right to appeal to the Ontario Municipal Board and a further right to have this decision reviewed by the Divisional Court. There is no need to read a requirement into paragraph 14 that any condition imposed by the Committee must be "reasonable" because reasonableness is provided for through the existing process under the *Planning Act* and related legislation that functions as a complete code. Hence, it is appropriate that the process under the *Planning Act* be the arbiter of the reasonable conditions for a severance, not the vendor.

## LAYING IN THE WEEDS AT CLOSING

In the 2009 decision of *2054476 Ontario Inc. v. 514052 Ontario Ltd.*<sup>30</sup> the judge imposed a common law duty of good faith on the vendor who sought to avoid a closing by frustrating its efficient completion.

The plaintiff purchaser claimed specific performance of certain property transactions. Throughout the course of the transaction, the vendor had encountered several problems which had affected numerous delays in its ability to close. The vendor made “valiant efforts” to be ready for closing but problems always impeded such and time extensions were necessary. Because of the delayed closing, the purchaser asked for abatements of the purchase prices (which was contemplated in the contracts).

Closing was eventually set for December 10, 2004 and the frustrated vendor sought to finally complete the transaction on this date or abort the sale. The performance of the vendor's obligations under the contracts in question was costly and time consuming and the closing dates had been delayed time and time again. Moreover, evidence at trial indicated that the value of the property had greatly increased, thus making it in the vendor's interest to abort.

Three days before closing, the vendor's lawyer sent draft closing documents, and statements of adjustments to the purchaser's lawyer. The vendor's lawyer heard nothing back until the day of closing. At trial, it was admitted that the purchaser's lawyer was not in funds. This more than likely was a material reason why there had been no response to the vendor's lawyer.

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<sup>30</sup> 2009 CarswellOnt 296

On the morning of the closing, at 9:30 a.m. the vendor's lawyer delivered executed closing documents in escrow. Thirty minutes later, the vendor's lawyer received a letter from the purchaser's lawyer seeking large abatements, the entitlement to which was questionable.

At 2:30 in the afternoon, the purchaser's lawyer advised a mortgagee that the transaction would not be closing. To this point the lawyers for the purchaser and vendor had not spoken. At 3:45 that afternoon, the purchaser's lawyer sent hand written comments to the vendor's lawyer, commenting on changes required to the statements of adjustments. (Similar statements of adjustments had been delivered months earlier.) This was the first time any comment had been made.

At 5:02 p.m., the purchaser's lawyer wrote that she was now in funds, and was ready to close. At the same time she said that she was not satisfied with the closing documents. However, by this time the vendor's lawyer had considered the deal dead. He had left the office, without ever returning a call from the purchaser's lawyer.

In the result, the court decided that the vendor had not been acting in good faith and its actions amounted to an anticipatory breach. Two properties were involved and in one case specific performance was ordered and in the other a postponed closing date was set.

Interestingly, this case can be compared to *Carterra*, discussed above. They both involve the situation where a vendor has engaged a purchaser for the sale of a piece of land at a certain price. One case was at the pre-contractual stage and the other at closing. Though through different legal analysis, the effect was the same: whether supported by a letter of intent or an

agreement of purchase and sale, a vendor who finds a higher price for his land after coming (or nearly coming) to terms with a purchaser, will not be able to avoid that transaction through bad faith. In *Union Eagle*, the opposite is seen. Where there is no evidence of bad faith, contractual terms can be strictly enforced.