CHAPTER 6

THE LAW OF CONTRACT

Learning Objectives

After studying this chapter, a student should be able to:

- ☑ Explain the essentials for a binding contract
- ☑ Explain the difference between "void", "voidable", and "unenforceable" contracts
- ☑ Describe the ways in which a contract can be terminated
- ☑ Explain the doctrine of privity of contract and how it interrelates with the right of a party to assign their rights under a contract
- ☑ Describe and apply the remedies available to an innocent party where a breach of contract has occurred

PREFACE

There are general legal principles that apply to the formation and enforcement of all contracts. The purpose of this chapter is to demonstrate how these concepts apply to the contracts that might be encountered by mortgage brokers.

INTRODUCTION

The term *contract* means a promise or promises, made by one person to another, which the courts will enforce. A contract can contain any number of promises, or "terms," to be performed by either party. However, it can also be a very simple promise. For example: "I, Brown, promise to pay Jones the sum of $100.00 for his 1963 automobile," signed "John Brown" and "Jim Jones".

contract
an agreement between two or more persons which creates an obligation to do or not to do a particular thing

The person who makes the promise is called the "promissor" and the person who can enforce that promise is called the "promissee". If the contract contains several mutual promises, each party will be both a "promissor" and a "promissee".

A contract has seven essentials. They are:

- offer;

- acceptance;
- consideration;
- legal intention;
- capacity;
- legal object; and
- genuine consent.

If any one of these requisites is lacking, a contract will not result. The form of contract may be oral, an exchange of letters or telegrams, a formal, lengthy written document, or any other exchange of communication. In each case, however, in order for the agreement to be enforceable, the essential elements of a binding contract must be present. As long as they are, the parties have enforceable rights and obligations under that contract.

Before we discuss the seven essentials necessary for the creation of a valid, enforceable contract, we should look at the different types of ineffectual contracts.

VOID, ILLEGAL, VOIDABLE AND UNENFORCEABLE CONTRACTS

Depending upon which essential element is missing, the effect on the contract will vary. Contracts can be ineffective in four different ways: they can be void, illegal, voidable or unenforceable. It is important to understand what these different forms of deficiency mean in practical terms.

Void. A *void contract* is one which has never existed at all. Even if the parties want it to exist and to have effect, it cannot. The parties are in the same position as if they had never attempted to contract. Money paid by one party to the other will be repayable and no rights can be acquired under it. For example, where parties seek to make a contract in circumstances where there is a mutual or common mistake (discussed later in this chapter) the resulting contract will be void.

void contract
a contract which never had any legal existence or effect and which is not capable of being enforced

Illegal. An illegal contract is one which offends against public policy or against a particular statute (e.g., a contract for murder or a betting contract). Illegal contracts are also void, but the results of a finding of illegality might vary. In some cases, a person who has paid money under an illegal contract will not be able to recover the money, even though the contract is void. In other cases the effect of the finding of illegality will not be so severe. Legality of purpose is one of the essentials for creating a contract discussed below.

Voidable. A *voidable contract* is one which one (or both) of the parties has the option to rescind (cancel). Until the contract is rescinded, it is valid and binding on the parties. An example of a voidable contract would be a contract for the purchase of a car by an infant. Such a contract is voidable by the infant, but it is binding upon the other party. If it is rescinded by the infant, neither party will have any further obligations under the contract.

voidable contract
a contract which exists until repudiated by a party entitled to do so, at which time it becomes void

The right to rescind may be limited where the other party has acted in such a way that it becomes inequitable to allow the contract to be cancelled.

Unenforceable. An unenforceable contract is one which has the essentials of a valid contract but it cannot be sued upon for some procedural reason; for example, section 59 of the *Law and Equity Act* requires most contracts affecting land to be in writing in order to be enforceable in court, therefore oral contracts respecting land will not be enforceable in many instances.

OFFER

Description

An *offer* is a promise made by one party to another. The person who makes the offer is called the offeror, and the person to whom it is made is the offeree. At common law, if the offer contains a promise, it can be expressed in any form: in writing, orally, or even by conduct.

offer
a proposal to do or refrain from doing some specified thing usually followed by an expected acceptance, counter offer, return promise or act. The person who makes the offer is called the offeror. The recipient of the offer is called the offeree

It is important that an offer be made in clear and unambiguous terms. If a dispute arises, the court must find that a reasonable person would feel there is only one reasonable interpretation which can be given to the "offer". If more than one meaning can be given to an offer, then neither interpretation will be followed by the courts.

Example

Dawn Driver orally offers to sell her 1975 Buick automobile to Bob Buyer for $4,000 cash. Buyer replies, "I accept." Although the promises are oral, the contract is binding. If such an agreement ends up in court, there may be problems of proving the agreement, since it will depend upon Driver and Buyer's testimony.

Normally, an offer is made to one specific person or group of persons and only that person or group can accept it. In other words, if A makes an offer to sell a car to B, and C overhears the offer, C cannot try to accept it. Only B can accept or reject A's offer.

Standing Offers

There is an exception to the above principle. Certain offers known as "standing" offers can be made to the public at large. These can be accepted by anyone. An example of this type of offer would be the offering of a reward to the public for providing information. Here the first person to meet the requirements of the offer and to communicate this to the offeror will be the one entitled to enforce the contract. Once a standing offer has been accepted by one person no one else can accept it unless more than one acceptance was contemplated in the offer.

Invitation to Treat

It is important to distinguish an offer from an *invitation to treat* which is something less than a legal offer. An offer, once accepted, creates a contract and can be enforced in the courts. The courts draw a line between promises which

are meant to be binding if accepted and statements which are intended only as a form of invitation to the public to submit their own offers. In most cases, newspaper advertisements and store window displays are invitations to treat. For example, an advertisement in a newspaper to sell a house for $70,000 would usually be an invitation for prospective buyers to make offers. The owner may or may not accept them.

invitation to treat
a type of advertisement used by one to induce the public or some individual to submit their own offers. An invitation to treat is not an offer capable of acceptance to form a contract

Advertisers must be careful, however, because not all advertisements are considered invitations to treat. Each case will be decided on its own facts. If no reasonable person would think there was a serious intent on the part of the offeror to be bound by the terms of the advertisement, an offer has not been made.

Release or Expiry of an Offer

An offer is released or expires when any one of the following occurs:

- a time limit is specified in the offer and the offer is not accepted within the limit;
- no time limit is specified in the offer but a reasonable time has passed (example follows);
- the person who made the offer communicates revocation before acceptance;
- either party becomes insane or dies before the offer is accepted;
- a counter-offer is made; or
- the offer is rejected.

The reasonable time allowed for acceptance of an offer depends upon the circumstances in each case. It will be determined by the nature of the offer or of what is being sold. For example, an offer to sell perishable goods would require prompt acceptance but an offer to sell real property may be deemed to be open

for a longer period. Having a time limit in the offer avoids later disagreement about what is a reasonable time for acceptance.

Assuming that a definite time is set out in the offer, must the offer be kept open for the specified period? The answer is that the offer can be revoked without waiting for the time limit to run out, as long as the offer has not yet been accepted. However, *revocation* must be communicated to the offeree (*Byrne & Co. v. Leon Van Tienhoven & Co.*, [1880] 5 CPD 344).

revocation
the term for the cancellation of an offer communicated by the offeror to the offeree prior to acceptance

It should be noted that the revocation of a written offer does not need to be in writing. However, because the revocation might need to be proven in court, it is a wise practice to put the revocation in writing and to retain a copy for the offeror's records.

As mortgage brokers, you must remember that offers can be revoked, even where they state that they will be open for acceptance during a set time period.

Example

Mike Manager makes an offer to purchase certain equipment on November 21. The offer states that it is open for acceptance until 11:00 p.m. November 22. Sam Supplier decides to think about it overnight because the offer is open until the next night. At noon on November 22, Mike advises Sam that he has found a supplier he likes better, and revokes his offer. Because Sam had not yet accepted the offer, he lost his chance to sell to Mike.

Option Agreement. It is possible to ensure that an offer will be kept open for the stipulated time period by using a type of contract known as an option agreement. Separate consideration is given to keep the offer open. In effect, a separate contract must be formed. "Consideration" is discussed later in the chapter; however, to understand the principle, think of consideration as a payment of money.

Example

Val Vendor gives Pete Purchaser an option to buy a piece of equipment for $75,000. The option is for 30 days. In return for the promise to keep the offer open, Purchaser agrees in writing to pay $1,000 consideration. If the option is exercised (i.e., the offer accepted), the $1,000 will form part of the

purchase price. If the option is not exercised, Val Vendor keeps the $1,000 as payment for keeping the offer open.

Here, Val must keep her offer open for the 30 day time period. She cannot revoke the offer, nor can she contract to sell to anybody else during the time.

Counter-offer. A *counter-offer* is simply an offer from the offeree back to the offeror. When a change is made to the offer by the offeree, it forms a counter-offer. For example, where a purchaser offered $80,000 and the vendor insists on $85,000, this insistence is a counter-offer from the vendor to the purchaser. Legally, the counter-offer terminates the original offer. In effect, the counter-offer becomes the offer. If the counter-offer is not accepted, the offeree cannot accept the first offer because it has already terminated.

counter-offer
a statement by the recipient of the offer which has the legal effect of rejecting the offer and of proposing a new offer to the offeror (who then becomes the recipient of the "new" offer)

Example

Paula Purchaser offers Von Vendor $60,000 for his property. Von Vendor counter-offers at $70,000. If Paula Purchaser refuses this counter-offer, Von cannot attempt to accept the offer for $60,000 since it has been terminated.

A counter-offer is different from an inquiry or a request for information. Such an inquiry or request does not terminate the offer. However, it is sometimes difficult to distinguish these concepts. A good example of the fine line drawn between these two situations is set out in *Livingstone v. Evans et al.*

Livingstone v. Evans, [1925] 4 D.L.R. 769 (Supreme Court of Alberta)

Mr. Evans, through his agent, wrote to Mr. Livingstone, offering him a property for $1800. Upon receipt of this offer Livingstone, through his agent, wrote back to Evans saying "Send lowest cash price. Will give $1600 cash." Evans' agent wrote back, "Cannot reduce price." Livingstone immediately wrote back, accepting the $1800 offer. Evans then sold the land to someone else and Livingstone sued Evans for specific performance, claiming that they had a binding contract. Livingstone won his suit.

The court's reasoning can be summarized as follows:

- a counter-offer terminates the original offer, an inquiry for more information does not. Therefore, if Livingstone's first reply ("...will give $1600") was a counter-offer, Evans' original offer was

terminated and Livingstone could not accept it later. The court found that although Livingstone's first reply did contain a minor request for information, it was, in fact, a counter-offer and therefore Evans' first offer terminated;

- since a counter-offer terminates the original offer, the original offeror can:
- accept the counter-offer. Evans' reply "Cannot reduce price" showed that he did not accept the counter offer;
- reject the counter-offer and effectively end the dealings at that position; or
- reject the counter-offer and renew the original offer; the court found that Evans' reply "Cannot reduce price" was a renewal of the original offer. The court reasoned that Evans' reply implied that he was still standing by his original offer. Since the original offer was renewed, Livingstone was entitled to accept it, which he did.

In addition to illustrating the law of offer and counter-offer, this case shows the importance of clarity in contractual negotiations. If Evans intended to end negotiations with Livingstone he should have stated those intentions clearly. Since Livingstone had the right to accept Evans' renewed offer and did, his rights had priority against any subsequent "acceptances" by third parties.

As a Mortgage Broker...

When dealing with an offer, whether it be an offer of financing, or to provide or purchase mortgage brokerage services, you must be very careful about altering any of the terms of the offer. Such alterations can constitute a counter-offer which terminates the original offer, making it incapable of acceptance. Make certain that the party you are advising is aware that by altering a term in the offer they might lose the deal entirely.

ACCEPTANCE

Description

The acceptance, like the offer, must be given in clear terms. It must be a positive act. For example, an offer cannot state "If I don't hear from you, I'll assume you've accepted." Doing nothing will not be considered legal acceptance.

Proper Means of Acceptance

What form is required for acceptance: oral, written, by conduct? In each case the court must consider the intention of the parties at the time the offer was made. In making this determination, the nature of the offer is important, although not conclusive. If an offer is sent by mail, the court will probably decide that acceptance by mail is what the parties intended. Similarly, if an offer is made by telephone, proper acceptance is by telephone. An offer can state how the

acceptance must be made. For example, A can telephone B and offer to buy B's stereo for $500, but A can tell B to mail the acceptance. A written, formal offer will often have express rules about how and where an acceptance should be made.

As a general principle, the offeree must accept in one of two ways to ensure "proper" acceptance:

- if the offer specifies how the acceptance should be made, the offeree should accept by that method; or
- if the offer says nothing about acceptance, the offeree should accept by the same method as the offer was itself made.

When Acceptance is Communicated

An acceptance has no effect until it is communicated to the offeror. Sometimes it is difficult to determine when this communication actually happens. Contracts are categorized in two types: those which can be accepted by instantaneous means, and those where the parties expect the offer to be accepted by non-instantaneous means. Instantaneous means include telephone and, probably, teletype services and fax. Non-instantaneous means include postal and telegraph services.

When an acceptance is communicated depends on the intended method of acceptance. Where acceptance of an offer is intended to be by instantaneous means, the acceptance will not be complete until it has been actually received by the offeror. For example, if A telephones B with an offer and B accepts, the acceptance is not effective unless A actually hears it. If the telephone line goes dead before A receives this communication, there is no binding contract. If, on the other hand, acceptance of an offer is intended to be by non-instantaneous means, such as by mail, then the acceptance is effective when it is put in the mailbox, not when actually received. If the letter of acceptance is lost in the mail, there is still a binding contract. Of course, the offeree must be able to prove that the acceptance was actually mailed.

There is a reason for this "postal acceptance rule". The law gives the responsibility to the offeror to specify how the offer is to be accepted. If the offeror chooses a method like the mail, they must assume the risks involved in

that type of service. If the offeror wants to avoid this problem, they can specify another form of acceptance or state that mail acceptance will only be effective once it is received by the offeror.

Improper Communication of Acceptance

What happens if acceptance is not properly communicated? It was stated previously that there are two "proper" methods of communicating acceptance. The consequences of failing to follow these are similar.

The first situation occurs where the intention of the parties is that acceptance should be by instantaneous means and the offeree chooses to accept by a non-instantaneous method. In this instance, it is the offeree who assumes the risk. Acceptance must be actually communicated to be effective. If the acceptance is lost, or if the offer lapses before the acceptance reaches the offeror, no contract will result. An offer lapses if the stipulated time period expires or a reasonable time passes before communication of the acceptance.

The second situation occurs where the offeror specifies non-instantaneous acceptance, and the offeree chooses an instantaneous method. For example, the offer states that acceptance should be communicated by registered mail and the offeree chooses telephone. In this case, the offeror can probably refuse the acceptance because it was not what the offer asked for. In some cases, the difference may not be crucial -- registered mail and certified mail are equivalent, for example. However, by ignoring instructions in the offer, the offeree is risking loss of the contract.

Example

Sally Seller telephones an offer to sell certain belongings to Paul Purchaser. The next day, Purchaser decides to accept and mails his acceptance to Seller. As Purchaser has used a slower method of acceptance than contemplated by the nature of the offer, it will only be effective if Seller actually receives it and if the offer has not lapsed. If the acceptance is lost in the mail, there will be no contract.

It must be noted that the rules regarding communication of an acceptance are not the same as the rule regarding revocation of an offer. There is no equivalent "postal acceptance rule" for revocation. Revocation must always be actually communicated to be effective.

CONSIDERATION

Nature

One of the seven essential elements of a contract is the presence of consideration. *Consideration* means "some right, benefit or profit accruing to the promissor or some forbearance, detriment, loss or responsibility suffered by the promissee". In other words, the party trying to enforce the contract must have "paid" something in return for the promise. This consideration must be of some value in the eyes of the court, but it does not have to be money. For example, in a mortgage contract, the lender promises to advance loan proceeds to the borrower and the borrower promises, among other things, to repay the loan, plus interest, usually according to a certain repayment schedule. On the other hand, in a real estate contract, the vendor promises to deliver title to the property and the purchaser promises to pay for it. The "payment" does not need to change hands to make a binding contract. The exchange of mutual promises will provide consideration for the formation of a contract.

consideration
the legal term for something of value that is bargained for, and received by, each party to a contract. Consideration may be in the form of a right, interest, profit or benefit accruing to one party. It may also be in the form of an agreement not to do something, or loss suffered by the other

The courts will not review the adequacy of the consideration (i.e., whether the price was too high or too low) unless fraud, undue influence, duress, or misrepresentation exists. A phrase frequently used is "for $1 and other good and valuable consideration." A one dollar consideration is just as effective as a one hundred thousand dollar consideration.

What is known as "past consideration" is not legally effective. In past consideration, the "payment" given by the promisee has already been made when the promissor offers to pay for it.

Example

Tom asks Jane to do him a favour and help him paint his fence. After the job has been completed, Tom states that he will pay Jane $50.00 for her work. Tom never pays Jane. Jane sues Tom for breach of contract for $50.00.

In this example, Jane cannot enforce Tom's promise to pay the $50.00 because the consideration (i.e., the act of painting the fence) had already been done when Tom made his promise to pay. It was prior to and independent of Tom's offer to pay, so no binding contract could be formed. Jane can only hope that Tom will feel morally obligated to live up to his promise.

This situation is different from the case where the promise to pay is made before the painting is done. Here, there is an exchange of promises in advance and a contract is formed.

Seal

A contract made without consideration can still be binding if it is made under seal. Historically, the use of a seal was very important. The family name was once held in such high esteem that serious intention to be bound by an agreement could be shown by impressing the family seal onto warm wax applied to the contract document. The sealing of the contract made it binding on the parties, even though no consideration existed. Family seals are no longer used in this way. However, red "legal seals" can be purchased at almost any stationery store. If they are affixed to the contract document at the time of the signing, the contract will be binding even though no consideration has been given. Two points should be remembered. First, the parties must be aware of the legal effects of a seal to be bound by the contract. Second, a corporate seal, which is used by a company when signing a document to confirm that it has been approved by the corporation, will not fulfil the requirement for consideration.

Consideration and Amendments of a Contract

There may be times when the parties to an enforceable contract want to change or alter the terms of that contract. This process is known as amending the contract. An amendment is only possible if all of the parties to the contract agree. At law, an amendment is a contract to change an existing contract. Therefore, generally speaking, the amendment must contain all of the essential elements of a contract, including consideration.

This raises the potential problem of past consideration, mentioned earlier. In earlier court decisions, judges have stated that in order for an amendment to a

contract to be enforceable, the party seeking to enforce the amendment must have given some fresh consideration in exchange for the amendment. This fresh consideration could not include anything that the party had previously done, or promised to do, under the original contract. For this reason, parties who wanted to amend a contract often exchanged nominal consideration (such as $1.00) to support the amendment. Alternatively, parties would sign the amending agreement under seal.

However, the absence of fresh consideration may no longer interfere with mutually agreed-upon changes to contracts. The British Columbia Court of Appeal, in *Rosas v. Toca,* stated: "When parties to a contract agree to vary its terms, the variation should be enforceable without fresh consideration, absent duress, unconscionability, or other public policy concerns, which would render an otherwise valid term unenforceable."[1] Despite this case, if amending a contract, it is always safest to put any amendments into writing and to ensure that both parties provide fresh consideration (even just $1.00) or sign the amendments under seal.

As a Mortgage Broker...

You should strive to put all agreements into writing, including broker's fee agreements, and have the agreement signed by all parties. If a court finds that there was no contractual basis to ascertain a broker's fee, *quantum meruit* may be awarded. This amount may be significantly less than the initially negotiated fee. An example is *Azta Management Corp. v. Croft Agencies Ltd.*, 2014 BCSC 1462, where the Supreme Court of British Columbia determined that an oral agreement as to a broker's fee of 10% ending in a hand shake, as well as a string of ambiguous emails regarding the fee, were not enough to demonstrate consensus in the absence of a written and signed agreement. Consequently, the court awarded the broker *quantum meruit* amounting to 1.5% of the loan. This resulted in a loss of fees of approximately $510,000 by the broker.

Quantum Meruit

Quantum meruit is a Latin phrase which means "as much as is deserved". At law, where one person requests the contractual services of another, even though there is no mention of a specific amount, the law will imply a promise to pay a reasonable amount. Obviously it is a good idea to state specifically in each contract what the amount of the consideration is to be, rather than relying on this rule.

quantum meruit
literally, "as much as is deserved". A legal doctrine that no one who benefits by the labour and materials of another should be unjustly enriched thereby; under those circumstances, the law implies a promise to pay a reasonable amount for the labour and materials furnished, even though a specific contract price may not have been agreed to

The principle of *quantum meruit* will be applied by the courts in each of the following circumstances:

- where there was no amount specified in the contract for performance of contractual services;
- a breach of the contract has occurred and the "innocent" party has performed part, but not all of its obligations under the contract and wants to be paid for the partial performance;
- where the contract is void and there has been work performed or services rendered on the assumption that the contract was valid; and/or
- where the original contract has been replaced by a new and different contract. Such a situation may arise when one party is in breach of a contract and the party not in default accepts partial or substituted performance in place of the original contractual obligations.

In each of these instances, the injured party can receive a reasonable sum for the work or services rendered under the *quantum meruit* principle.

LEGAL INTENTION

A person must have intended to create legal intentions in order to be bound by a contract. For instance, inviting a guest over for dinner would not normally be considered an act intended to create legal obligations. However, offering one's car for sale at a certain price to someone would usually contain the necessary intention. The law presumes that there is a serious intention to be bound in the case of an agreement between strangers or in a commercial contract. On the other hand, if the contract is between family members or very close friends, the law presumes that there is no intention to be bound. These presumptions can be reversed if evidence exists to show otherwise. It is important to remember that whether such an intention exists or not is a decision that the courts will make

objectively. In other words, they will ask, “Would a reasonable person think that the parties had a serious intention to be bound?”

CAPACITY

Incapacity to make a contract can arise in a number of ways. The most common types of incapacity are infancy, insanity, drunkenness, and the lack of capacity of a corporation.

Infancy

In each province there is legislation which governs the age at which a person is considered to be an adult in society, capable of looking after their own interests. In British Columbia this age is 19 years. At law, a person younger than age nineteen is considered a minor or *infant*. Note that the legal definition of infant is unlike the common usage that denotes a young child.

infant
in British Columbia, a person under 19 years of age which, generally speaking, is the age of legal competence

Most contracts to which an infant is a party are voidable by the infant. Only a very limited number of contracts are binding. Where a contract is voidable by an infant, the infant may honour it, or ignore it. However, the adult involved does not have a similar choice. In other words, voidable contracts cannot be enforced against the infant but can always be enforced by the infant. Even where the adult does not know the other party is an infant, the contract is voidable.

Section 19(1) of the *Infants Act* provides that a contract entered into by an infant will be unenforceable against the infant (but enforceable by the infant against the adult contracting party) unless one of four exceptions applies. These exceptions in which the contract will be enforceable against an infant are:

- where another statute provides that the contract is enforceable;
- where the infant affirms the contract after turning 19;
- where the infant performs or partially performs the contract after turning 19; or

- where the infant does not repudiate the contract within one year of turning 19.

The court has great discretion in terms of remedies where an infant has made a voidable contract. Among other remedies, the court can order restitution of money paid, compensation, and release from further obligation, and is required to consider any and all relevant circumstances in seeking to do equity between the parties. The set of circumstances in which the contract is enforceable against the infant is quite limited.

Mental Incapacity

Mental illness or disability does not, in itself, prevent an individual from entering into binding contracts. However, the law recognizes that, at some point, cognitive impairments may render a person unable to understand the nature and effects of their actions. At this point, a person is said to be mentally incapable. Common sources of mental incapacity include dementia, Alzheimer's, mental illnesses that cause delusions or hallucinations, and substance abuse (including drugs and alcohol).

There are three parts to the common law test for mental capacity to contract:

1. a contracting party must be able to understand the terms of a contract;
2. this contracting party must be able to understand how the contract will affect their interests; and
3. the other contracting party must not have knowledge of the first party's mental incapacity.

Until proven otherwise, all adult persons are presumed capable of making decisions about their personal and financial affairs.

Contracts involving mentally incapable persons will generally be unenforceable against those persons and any benefits conferred under the contract will almost certainly be lost. Mortgage brokers should be aware of this risk and proceed cautiously when confronted with a contractual arrangement that may involve an incapacitated party.

Powers of Attorney, Adult Guardianship and Representation Agreements

In many cases, issues of mental incapacity will be raised concurrently with issues relating to powers of attorney and adult guardianship. Mortgage brokers should have a general understanding of the differences between these kinds of legal arrangements.

Powers of Attorney and Enduring Powers of Attorney

A power of attorney is a legal document that allows for the appointment of a trusted person or "attorney" to make financial or legal decisions for another person (known as the "donor"). A power of attorney document may be very specific (e.g., allowing the attorney to cash cheques) or very general (e.g., allowing the attorney to make any financial and legal decisions that the donor otherwise would have made). The *Land Title Act* has special requirements for the creation of powers of attorney that authorize the attorney to deal with real estate. Any time a power of attorney is utilized in a real estate or mortgage contract, the licensee should advise all the parties involved to seek legal advice. According to section 29 of the *Power of Attorney Act*, powers of attorney are only valid while the donor is alive and they automatically expire if the donor becomes incapable or bankrupt. According to section 56 of the *Land Title Act*, powers of attorney dealing with real estate are only valid for three years after the date of signing.

Enduring powers of attorney have many of the same characteristics as regular powers of attorney. However, they do not expire after three years and will remain valid if the donor becomes incapable.

An example of a power of attorney agreement is when an elderly couple grants their son or daughter the authority to sign financial documents, such as a mortgage application, on their behalf.

While the power of attorney agreement will bind the donor to any agreement entered into by the attorney (if made within the scope of the attorney's authority), no third party is obligated to engage in a dealing based on a power of attorney. Some lenders may choose not to engage in a dealing based on a power of attorney, while other lenders may only deal with a power of attorney if the authority is directly confirmed by the donor.

The caution of some lenders stems from the fact that the lender may be unable to recover the debt if a court finds an issue with the power of attorney agreement. Issues may arise if an attorney has acted outside the scope of their

authority, or if a donor did not possess the required mental capacity to grant a power of attorney.

As a Mortgage Broker...

In real estate transactions, the consequences of an invalid power of attorney can be significant. The British Columbia Land Title Office ("LTO") may reject a power of attorney if it fails to comply with applicable legislative or LTO practice requirements. Some common reasons why the LTO may reject a power of attorney include:

- The donor's name in the power of attorney does not exactly match the name of the registered owner;
- The power of attorney contains substantively different alternative names for the attorney, e.g., "Jane Smith aka Jane Jones";
- The power of attorney does not grant the appropriate power to deal with the land (e.g., the power of attorney deals with the wrong property, or does not authorize the attorney to mortgage or sell the property);
- A power of attorney was prepared outside of BC and lacks the required extra-jurisdictional solicitor's certificate;
- The power of attorney has expired according to its terms or section 56 of the *Land Title Act*;
- The general power of attorney is invalid due to the donor's incapacity or death; and
- The enduring power of attorney does not come into effect until a particular event occurs (e.g., the enduring power of attorney states that it only comes into effect when the donor loses their capacity to manage their own financial affairs), and that event has not yet taken place.

Apart from LTO requirements, lenders often have separate requirements regarding powers of attorney. For example, some lenders will permit use of a power attorney, but only if a lender title insurance policy is also obtained. Some lenders may have more restrictive conditions for use of powers of attorney. Mortgage brokers should carefully consider any such restrictions to avoid unanticipated issues later in the transaction.

Mortgage brokers working with clients who may be relying upon a power of attorney should take the following steps:

- Obtain a true copy of the power of attorney and read the entire document to ensure that the client has the legal authority to deal with the property;
- Consider obtaining the client's consent to contact their family members to determine whether anyone else holds a power of attorney;
- Consider contacting lenders to confirm their policies and procedures relating to powers of attorney;
- Consult with your designated individual as to any brokerage policies or other appropriate due diligence relating to powers of attorney; and
- Advise clients to seek legal advice as soon as possible as to the validity of the power of attorney for the contemplated transaction.

Failure to exercise care when dealing with powers of attorney can result in professional discipline or other legal consequences for mortgage brokers or their clients.

Adult Guardianship and Committees

If a person becomes mentally incapable because of disease, accident, or age, and there is no enduring power of attorney agreement in place, the Supreme Court of British Columbia can appoint an adult guardian (also known as a "committee") to make important decisions on the incapable person's behalf. In most cases, family members or friends will act as committee; in other cases, the Public Guardian and Trustee (a government body) will be appointed to make decisions on behalf of the incapacitated person. If a committee is appointed for an adult, then that adult no longer has the capacity to enter into contracts on their own behalf, even if they appear lucid or otherwise meet the common law test for capacity.

Representation Agreements and Advanced Directives

Representation agreements are planning documents that allow individuals to transfer their legal decision-making power to another person. Representation agreements created on or after September 1, 2011 cannot authorize representatives to purchase or sell real estate.

Advanced directives are written instructions pertaining to the delivery of healthcare services. These directives cannot authorize representatives to deal with real estate.

Practical Steps for Mortgage Brokers

The law of mental capacity and its relation to real estate transactions and mortgage agreements is complex. Mortgage brokers are not expected to provide legal advice pertaining to these issues, but they are expected to identify potentially problematic situations and to respond appropriately. When faced with a client who appears to have a cognitive impairment (e.g., incoherent speech, signs of memory loss, confusion or contradictory instructions), mortgage brokers should proceed cautiously.

As a Mortgage Broker...

It is not the role of the mortgage broker to assess whether their client has sufficient capacity to enter a mortgage contract. The role of the mortgage broker is to recognize when issues relating to cognitive impairment may exist and then to act appropriately. When mortgage broker encounter clients or potential clients who appear to be experiencing cognitive impairment, the mortgage broker should take the following steps.

Step 1: Consult with your Designated Individual and your Brokerage's Policies

Cognitive impairment is not an infrequent occurrence in our society, and it is important to seek guidance early when these issues may be present.

Step 2: Ask the client whether they have any personal planning arrangements in place

Has the client created any powers of attorney or representation agreements? Are there any committeeships in place or anything of that nature? If the person is unable to answer, can they provide the names of any trusted family, friends, or other persons (e.g., lawyers) whom you may contact for more information?

Step 3: Contact the client's family or friends, with the client's consent

BC Financial Services Authority (BCFSA) recommends that real estate professionals "should contact family members to determine whether they or anybody else hold a power of attorney or have been appointed as a legal representative or substitute decision-maker for this person under any of these statutes to ensure that this person is making the right decisions."[2] While the guidance was provided to real estate agents, the advice is also applicable to mortgage brokers.

Step 4: Obtain and review any personal planning documents

Where personal planning documents exist, BCFSA recommends that real estate professionals obtain a true copy of the document for their file and read the document to ensure that they are dealing with the person who has the legal authority to deal with the property.[3] This advice is also applicable to mortgage brokers.

A title search may also provide capacity-related information. For example, committees (including the Public Guardian and Trustee) and attorneys acting under enduring powers of attorney are both permitted to register caveats against title to the property of an incapable individual.

Step 5: Recommend legal advice

Once the mortgage broker has obtained and reviewed copies of any personal planning documents, the mortgage broker should recommend the client or their representative obtain legal advice about whether their personal planning documents are useable for the client's intended purpose. Where a person may be experiencing cognitive impairment but no personal planning arrangements appear to exist, the mortgage broker must ensure the client obtains legal advice prior to entering any contracts. Mortgage brokers should consult with their designated individual prior to entering into any service agreements with such a person. It may be prudent for the brokerage to obtain legal advice as to enforceability of such service agreements.

Failure to handle issues of cognitive impairment and personal planning documents appropriately can lead to civil liability or professional discipline for mortgage brokers.

Foreigners and Illiterates

A foreigner or illiterate refers to persons who cannot read or speak English. In this context it includes a blind person. The rule is that if the foreigner or illiterate person knew the general nature of the contract, they are bound. However, if the person who read the document to the foreigner or illiterate fraudulently misrepresented what was written, there is no contract.

Foreigners or illiterates will be bound by a contract if they neglect to find out the contents of the document before signing. Therefore the illiterate or blind

person must ask for the document to be read and explained. Where the contract was misrepresented, foreigners or illiterates may be able to plead *non est factum*, which means "that is not my deed" (*Dorsch v. Freeholders Oil Co. Ltd.,* 1964 CanLII 401 (SK CA)). This concept is discussed more fully under "Mistake", later in the chapter.

Incorporated Companies

When a corporation is involved as a party to a contract, a mortgage broker must ensure that the corporation exists. A company cannot make a contract until it is actually formed and legally recognized under the laws of the province. This is very easy to check. All companies must have an official records office. In that office, any person can look over the incorporation documents. At common law, a contract purportedly entered into by a company before the company exists cannot be ratified by the company after it has come into being. In other words, even if the company approves the contract, it is not made binding. The law has been altered by statute in British Columbia so that it is possible for companies incorporated under the *Business Corporations Act* to ratify a pre-incorporation contract by act or conduct. The situation is complicated by the fact that some companies operating in British Columbia are incorporated under federal or another province's legislation; therefore, different ratification rules will apply. It is prudent for a mortgage broker to be cognizant of this issue, and to seek legal advice if it arises. A mortgage broker is still well advised to always ensure the "company" they are dealing with actually exists.

LEGAL OBJECT

Contracts for certain purposes may be considered illegal: for example, a contract relating to operating a bawdy house; a contract seeking to subvert justice; a contract to commit a crime or a tort; and contracts resulting in breaches of statutes, including the *Criminal Code, Income Tax Act, Customs Act*, and the *Competition Act*. In each of these examples, the "contract" may be completely void and a court would not help a party to recover money or property transferred under the illegal contract if the party knew of the illegality.

***Shafazand v. Whitestone Management Ltd.,* 2014 BCSC 21**

A major issue in the *Shafazand* case was whether the parties to a residential construction contract could obtain relief from the courts in circumstances where the contract was illegal.

In *Shafazand,* the defendant, Whitestone, hired the plaintiff, Shafazand, to construct a single family residence. Under their agreement, it was the common intention of both parties that Shafazand would construct an illegal basement suite (prohibited by the applicable Vancouver bylaws), which would be concealed until after the City of Vancouver had completed its final inspection and issued an occupancy permit. Over the course of construction, problems occurred that ultimately resulted in litigation. Shafazand sued to recover the costs of the extra work performed, claiming that Whitestone had made significant amendments to the scope of work under the contract and had continually promised to compensate him for these additional tasks. Whitestone counterclaimed on the basis that Shafazand had failed to construct the residence by the contractual deadline, forcing it to incur labour and supply costs in order to complete the work. The court found both parties' claims to be valid. Offsetting the awards against each other resulted in a balance of $42,000 in favour of Whitestone.

However, given the illegal content of the contract (i.e., a contract to build a structure that was prohibited by Vancouver's bylaws), the court had to decide on public policy grounds whether to permit Whitestone to actually recover the balance of its counterclaim against Shafazand. Recognizing that determining the impact of an illegal contract requires a discretionary approach, the court decided that it would be appropriate in these circumstances to deprive Whitestone of the balance of $42,000, mainly because the company had already sold the residence and thus benefitted financially from the illegal suite. Consequently, the claims of both plaintiff and defendant were dismissed.

Shafazand demonstrates the danger of proceeding under a contract one knows is illegal, as the courts may ultimately deny relief that a party would otherwise be entitled to under contract law.

GENUINE CONSENT

Genuine consent means that the parties had a clear understanding of the substance of the contract, and lack of genuine consent can negate the contract. Genuine consent is considered under the categories of misrepresentation, mistake, duress, undue influence and unconscionable transaction.

Misrepresentation

A *misrepresentation* is a false statement of fact, usually made in the negotiations before the contract is made. The misrepresentation is sometimes included as a term of the contract itself, but does not need to be.

misrepresentation
a false assertion of fact which, if accepted, leads one to an incorrect belief about a given situation

There are three criteria to determine misrepresentation: (1) the statement must be false; (2) it must have induced the other party to enter into the contract; and (3) it must also be one which would have induced a reasonable person to

enter into the contract. If any one of these three points is not proven, the misrepresentation will not be sufficient to render the contract voidable.

Example

Petra Prospect asks Von Vendor if the house for sale has a new furnace. Von states that it is only six months old when, in fact, it is six years old and in poor condition. Relying on Von's statement, Petra purchases the house. Here, Von has made an actionable misrepresentation because:

- the statement that the furnace was six months old is a statement of fact;
- the statement is false;
- the statement induced Petra to buy the house; and
- such a statement would induce a reasonable person to buy the house in these circumstances, (i.e., Petra was not acting unreasonably in relying on the statement in deciding to enter the contract).

It was explained previously that a statement can only form the basis for an actionable misrepresentation if it is a statement of fact. For example, if a vendor said, "We replaced the roof last year," that is a statement of fact. If it were not true, it would be actionable. In contrast, if the vendor said "I don't think the roof will need replacing for two or three years," it is a statement of opinion, and cannot be an actionable misrepresentation, even if it turns out not to be correct. There is an exception to this rule: an expert's opinion is treated by the courts as a statement of fact. Therefore, if a mortgage broker gave an inaccurate opinion about the security value of a subject property, the mortgage broker would be considered an expert in the circumstances and it might be considered a misrepresentation.

The remedy available to an innocent party depends on whether the misrepresentation was made innocently or fraudulently. An innocent misrepresentation occurs when the false statement is made without knowing it is false.

In the case of innocent misrepresentation:

- the innocent party (plaintiff) can sue for rescission (the court will cancel the contract) prior to execution of the contract. With respect to a transfer of land, this means that rescission of the contract will not be available after the completion of the sale. For other contracts, execution includes performance of all acts necessary to render it complete; and

- the plaintiff cannot sue for damages.

A fraudulent misrepresentation occurs when the person making the false statement knows it is false, or says it recklessly and does not care whether it is true or false.

In the case of fraudulent misrepresentation:

- the plaintiff can sue for rescission at any time; and
- the plaintiff can sue for damages (based on tort law).

Mistake

Mistake means a mistake as to an actual term of the contract itself. For a mistake to have legal significance, it must be one of fact and go to the root of the contract. Where a mistake occurs, the contract may be void or voidable.

mistake
a legal term which describes the situation where a person, under some erroneous conviction of law or fact, does, or omits to do, some act which but for the erroneous conviction, he would not have done or omitted doing

Although there is much dispute as to the different categories of mistake recognized in law, it is helpful to draw distinctions amongst the following:

- common mistake;
- mutual mistake; and
- unilateral mistake.

Common Mistake

For our purposes, a common mistake is one where both parties to a contract have made the same mistake about a fundamental term of the contract. For example: both a buyer and a seller make a contract believing that what is being sold exists, but in fact, it has been destroyed. This fact is unknown to both parties. The existence of a common mistake means the contract is void and neither party will have any legal obligations under it.

Example

Dawn Riser offers to sell her cabin in the woods to Hal Hunter for $63,000 and Hal accepts. Although neither realized it, a huge tree had fallen on the cabin and completely destroyed it before the contract was made. Riser and Hunter are contracting under a common mistake. They are both mistaken about the same thing, namely the existence of the cabin.

Mutual Mistake

A mutual mistake occurs when both parties make a fundamental mistake about the contract but each makes a different mistake. A good example is the *Raffles v. Wichelhaus*, [1894] EWHC Exch J19 case where the parties made a contract for the sale of cotton sold at Bombay, India, to be shipped to England aboard a vessel named "Peerless". By coincidence, that year there were two ships with this same name sailing from Bombay. The seller thought he had contracted to sell cotton on the ship leaving in December and the buyer thought he had contracted to buy cotton on the ship leaving in October. The buyer refused the December shipment. The seller sued for breach of contract. The buyer pleaded mistake as a defence. The court held that a reasonable person could not tell which ship was intended. The parties had never reached a consensus. Each party had a different intention and the lack of agreement made the contract void. It should be noted that in the case of a mutual mistake, if one interpretation is more reasonable than the other, the court will accept it and will interpret the contract in this way. This was not the case here.

Unilateral Mistake

A unilateral mistake occurs when one party is mistaken about a fundamental term of the contract and the other party is aware of this mistake but does nothing to correct it.

Example

Ken agrees to purchase a single lot offered for sale by Bob. Bob also owns an adjacent lot, which both Bob and Ken know is not included in the sale. By mistake, the transfer documentation includes both lots. Ken notices the error prior to signing the documents but says nothing. Bob does not notice the error. This was the situation in *Beverly Motel (1972) Ltd. v. Klyne Properties Ltd*, 1981 CanLII 576 (BC SC). The BC Supreme Court held that the purchaser had "snapped at the mistake, and now tries to hold the legal advantage he has gained." The court ordered Ken to reconvey the adjacent lot back to Bob.

A specific type of unilateral mistake is also referred to as "*non est factum*" which means "it is not my deed". This occurs when a person executes one form of document thinking that the document is something else.

Example

A, the owner of Property P, is an old, illiterate woman. She trusts only her next door neighbour, B. One day she has B write up a will for her so that she might leave her property to her niece. B pretends to write the will and brings it to her for her signature. A places her "X" on the document. Later she discovers that B has had her sign a document conveying Property P to B. If B brings an action to enforce the agreement, A can plead unilateral mistake as a defence. She would be successful, as the very nature of the document was misrepresented to her.

It should be stressed that not every mistake will result in a court setting aside a contract. Particularly in the case of written documents, the parties are presumed to have read over and accepted the terms of any document they sign.

Duress, Undue Influence and Unconscionable Transactions

Duress and *undue influence* both affect the genuine consent of one of the parties to a contract. Common law duress occurs where a person is forced to enter into a contract against their will as a result of a threat of actual physical force or by a threat of imprisonment of the person or their family or very close associates. Here the party to the contract has really been robbed of the free will to contract. As a result, the courts will find the contract voidable at the person's option. In equity, the restrictions on what amounts to duress are less, and the acts which would not entitle a person to have a contract set aside at common law will be sufficient to have a contract voided for duress in equity.

duress
a situation where a person is forced to enter into a contractual relationship against his will by the threat of imprisonment either to himself or his family, or the threat of actual physical force

undue influence
any improper or wrongful constraint, manipulation, or persuasion whereby the will of a person is overpowered and he is induced to do or refrains from doing an act which he would not do or would do if left to act freely

While duress is a well-defined principle in law, undue influence does not yet have established boundaries. Like duress, it results in one party to the agreement losing their free will to contract. It occurs most frequently when one person is in a superior or dominant position in relation to another and uses this position to induce the other to enter a contract which they would not have otherwise made (*Morley v. Loughnan*, [1893] 1 Ch 736). This superior position may be the result of a special relationship between the two parties, such as doctor-patient, lawyer-client, or priest-parishioner. If undue influence is found, the contract is voidable at the option of the innocent party.

Unconscionable transactions are another area in which equitable relief is available to rescind a contract at the instance of the weaker party. For a court to characterize a contract as unconscionable, the "material ingredients are proof of inequality in the position of the parties arising out of ignorance, need, or distress of the weaker, which left him in the power of the stronger, and proof of substantial unfairness of the bargain obtained by the stronger" (*Morrison v. Coast Finance Ltd.* 1965 CanLII 493 (BC CA)). When the issue of unconscionability arises, the party seeking to uphold the bargain must establish that the contract is fair and reasonable.

TERMINATION OF A CONTRACT

Once a contract has been made, it can be terminated or discharged in many ways. These are:

- performance;
- agreement to waive performance or substitute another agreement;
- non-fulfillment of a condition precedent;
- frustration; or
- breach of a condition of the contract which is accepted by the injured party.

Before discussing each of these items, note that some contracts for the purchase and sale of real estate in British Columbia can be rescinded/cancelled under the *Real Estate Development Marketing Act* ("REDMA") and the *Property Law Act*.

- For contracts of purchase and sale of "development units", REDMA gives buyers two types of rescission rights: a seven day rescission right, and a rescission right for a failure by the developer to deliver a disclosure statement or an amendment to a disclosure statement.
- Under the *Property Law Act*, buyers of "residential real property" can rescind their contract of purchase and sale within the Home Buyer Rescission Period, which is three business days (excluding Saturdays and "holidays", which include Sundays) after entering into the contract. The three business day period begins to run on the first business day after an offer is accepted and signed (e.g., if an offer is accepted and signed on a Saturday, the three business day period will begin on the following Monday, and will end at the end of the following Wednesday). If a buyer chooses to exercise this rescission right, they must promptly pay the seller a fee of 0.25% of the purchase price. Real estate agents have disclosure obligations that are designed to ensure that their clients are aware of the Home Buyer Rescission Period rules.

Mortgage brokers should be aware of these rescission rights, and, in particular, the time limits under them. It is possible that mortgage brokers may be contacted by buyers who want their help to secure financing within these rescission periods, particularly in active real estate markets where contracts are less likely to contain conditions relating to the buyer obtaining satisfactory financing before being obligated to complete the purchase.

Example

Rajveen, a mortgage broker, is contacted by Hafiz, a homebuyer. Hafiz's offer to buy a residential property was just accepted by the seller. Because of the hypercompetitive market, Hafiz chose not to include a subject to financing condition precedent (discussed later in this chapter) in the contract. Hafiz was concerned that including any subject clauses would make his offer appear less attractive in a multiple offer scenario. However, Hafiz tells Rajveen that he requires financing to complete the purchase. Hafiz's real estate agent told him that he can rescind the contract within three business days, which is the Home Buyer Rescission Period under the *Property Law Act.* Hafiz wishes to secure financing within that period. Hafiz tells Rajveen that if he cannot secure financing within three business days, then he will rescind the contract and pay the 0.25% fee to the seller, because he has no ability to complete the purchase without financing. In these circumstances, Rajveen may recommend to Hafiz that they prioritize mortgage applications to lenders with a quick turnaround time, so as to secure financing within the Home Buyer Rescission Period.

In this example, Rajveen was contacted by Hafiz after his offer was accepted. However, mortgage brokers are often contacted by homebuyers early in the homebuying process, before any offers are actually made. If a mortgage broker expects a buyer to make a subject free offer in the future, the mortgage broker should consider doing as much as possible to collect the buyer's documents and prepare for the buyer's eventual mortgage application. Preparing in advance will allow the mortgage broker and buyer to move quickly after an offer is accepted and submit the mortgage application within the applicable rescission period.

While it is important for mortgage brokers to be aware of these rescission rights, it is beyond the scope of this chapter to explain them in significant detail. If a mortgage broker encounters individuals who have questions about these rescission rights, the mortgage broker should direct those individuals to seek legal advice as soon as possible.

Performance

This is the manner intended by the parties at the outset to be the proper way to terminate their contract. When the final act of performance occurs, the contract is at an end. If substantial performance is made, but one of the parties will not accept it, the party performing it will have met their obligations under the contract, and the party refusing such performance will be in breach of the contract.

Agreement

Often the parties will agree to waive full compliance with the terms of the contract. If both parties still have obligations left to perform, the mutual waiver of their obligations will be sufficient consideration to bind them. Otherwise, either new consideration will have to be given to support the variation, or the agreement to waive the balance of the contract will have to be made under seal. The same rules apply if the parties decide to substitute a new agreement for the first one.

Non-Fulfilment of a Condition Precedent

A *condition precedent* is the formal term for what is usually called a "subject" clause in real estate sales. A condition precedent is a condition in a contract which must be satisfied before the contract is to be performed. For example, a residential home may be sold under a contract of purchase and sale which contains a clause allowing for a mortgage to be arranged by the purchaser. If the other issue cannot be resolved, the contract will be terminated.

condition precedent
legal term for a "subject to" clause. In contract law, a condition precedent calls for the happening of some event or the performance of some act before the contract shall be binding upon the parties

Example

Von Vendor has accepted an offer from Petra Purchaser to purchase his home. The contract of purchase and sale contains a subject to financing condition precedent which will lapse on March 31. Prior to March 31, Von Vendor would only be entitled to accept "back-up" offers. This means his acceptance would be conditional upon the agreement between himself and Petra falling through.

In this example, what if Petra found a way to pay for Von's house without arranging a mortgage? Given that the condition precedent is a term of the contract, could she say "Forget the mortgage. I'll buy it without one"? Where a condition is inserted in a contract solely for the benefit of one of the parties, that party can choose to proceed with the contract without performing the act required in the condition precedent. However, only the party who was intended to benefit from the term can waive it. Once the term has been waived, the balance of the contract must be performed.

Waiver of conditions precedent is covered by section 54 of the *Law and Equity Act*. That section permits a party to a contract to waive a condition precedent if:

- the condition precedent benefits only that party to the contract;

  AND

- the contract can be performed without the condition precedent being fulfilled;

  AND

- the waiver is made before any time stipulated for fulfilment of the condition precedent, or within a reasonable time if no time is stipulated.

Note that any waiver by a party to the contract is only possible if all of the above are satisfied. For example, if a condition precedent could be interpreted to benefit both parties, then both parties must consent to its waiver.

Some buyers believe that a subject-to clause is like a "get out of jail free" card for a buyer who changes their mind about a property, and that the buyer does not need to try to satisfy the condition before the subject removal deadline. This is incorrect. For example, a subject-to financing clause may state, "Subject to the buyer being able to arrange satisfactory financing on or before [date]". If a contract contains a subject-to clause like this one, the buyer cannot escape the contract by simply sitting back and doing nothing until the subject removal date and then saying, "I was unable to remove the condition." Courts have indicated that clauses like this could require the buyer to use best efforts to find financing (or some other standard, like "honest efforts", depending on the circumstances) for the purchase, and if reasonable financing is offered, to take the financing. Buyers should be told to seek legal advice if they have any questions about their obligations with respect to subject-to clauses in the contract of purchase and sale.

Frustration

After a contract has been made, but before it has been performed, it will be *frustrated* if events outside of the control of the parties destroy the subject matter or change it in such a way that it becomes fundamentally different from the original contract and the parties did not, by express or implied terms, make provision as to the consequences flowing from the happening of the event. For example, frustration would occur where a house was destroyed by fire or lightning after a contract of purchase and sale was entered into (but before completion). Unless the contract says otherwise, such events will relieve the parties of their future obligations under the contract. It is not possible for a party to frustrate a contract through their own acts. For example, a contractor cannot sell their own equipment as a way to avoid carrying out a construction contract. Such an act would be a breach of contract.

frustration
a legal doctrine that provides that where the existence of a specific thing is necessary for performance of the contract, the duty to perform is discharged if the thing, for reasons beyond anyone's control, is no longer in existence at the time for performance

Frustration is similar to common mistake in that both deal with the destruction (or substantial alteration) of the subject matter of a contract. In common mistake, the subject matter of a contract is destroyed before the contract is made, and neither party knows about it. In frustration, the subject matter of a contract is destroyed after the contract has been made. It is essentially a difference in timing.

Termination by Breach

When a contractual promise is not performed, it is called breach of contract. The promissee has the right to recover any damage suffered because of that breach, but a breach does not necessarily mean that the contract is ended. The party not in breach usually must perform their contractual obligations despite the other party's breach. It is where the breach is of a fundamental term that the injured party can claim both damages and the right of treating the contract as terminated. The injured party can also refuse to perform their own obligations or to accept any further performance by the other party.

A breach can arise in three ways:

- by one party announcing that they will not perform although the time for performance has not yet arrived (anticipatory breach);
- by one of the parties making the performance of the contract impossible; or
- by failure of a party to perform at the time stipulated for performance.

Examples

On the first of the month, Mike Manager agrees to purchase Landscaping Services from Sam Supplier, the services to begin on the 1st of the next month.

1. If Manager announces to Supplier on the 15th of the month that he is not going to complete the deal on the 1st, Supplier has two choices. First, Supplier can accept Manager's refusal and sue Manager immediately for damages. Second, Supplier can refuse to accept the refusal, wait until the time for performance arrives, and then sue for specific performance or damages.

2. If, prior to the 1st of the month, Supplier sells his business to another party so that he cannot perform his contract with Manager, Supplier is in breach of his contract. (Manager has the same two choices). However, because the business has already been sold to someone else, he will sue at once.
3. If Manager fails to honour the contract on the 1st of the month, and Supplier is ready, willing and able to perform, Manager's failure to perform at the date of performance is a breach entitling Supplier to sue for specific performance or damages.

It was mentioned previously that only a breach of a fundamental term of the contract will allow the innocent party to sue for damages and to treat the contract as being at an end. A promise in a contract which is fundamental is called a condition. A condition is a term which goes to the very heart or root of the contract. For example, many contracts contain the clause "time is of the essence". This phrase creates a condition. The contract must be completed by this date.

A warranty is a promise which is not fundamental to the contract. For example, if A contracts to buy B's home and one term is that the master bedroom be painted before possession, a breach of this obligation is probably a breach of warranty.

Some promises are obvious conditions and some are obvious warranties. However, many are difficult to interpret and must be decided by the courts. In a typical transaction, a refusal to complete is clearly a breach of condition. As a result, in the three preceding examples, the innocent party had the right to treat the contract as being at an end and to sue for damages.

The main reason for distinguishing between conditions and warranties is that different remedies are available for each type of breach. For example, where a breach of warranty occurs, the injured party can sue for damages. However, a breach of warranty does not relieve the injured party from the obligation to perform the contract. The contract continues in full force and effect subject to the claim for damages. However, where a breach of condition occurs, the injured party has three choices:

- he or she can choose to terminate the contract and sue for damages, and their obligations under the contract also end;
- he or she can choose to continue the contract and sue for damages, just as in the case of a breach of a warranty; or

- he or she can choose to continue the contract and sue for specific performance.

Bhasin v. Hrynew, 2014 SCC 71

In *Bhasin*, the Supreme Court of Canada recognized a general principle of good faith performance in contract law. This means that parties to a contract "generally must perform their contractual duties honestly and reasonably and not capriciously or arbitrarily". Although this principle of good faith performance does not impose a duty to put the other party's interests above one's own, it does require parties to be honest with each other and not knowingly mislead each other in relation to the performance of their contractual obligations. Real estate professionals should be aware of this duty of honest performance as it applies to all contracts, including contracts for agency, real estate and mortgage transactions.

Assignment

Generally, a person can *assign* away benefits under a contract to a third party, and the third party can sue to enforce those benefits. Generally, a person cannot assign liabilities under a contract. For example, if a person owes money, they cannot assign that obligation to pay to another party.

assign
to transfer over to another (e.g., "I assign all right, title and interest in Blackacre to my wife, Elaine")

Example

Apple and Brown make a contract under which Apple owes Brown $1,000. Brown happens to owe Carter $1,000. To repay Carter, Brown can assign to Carter his right to receive the $1,000 from Apple. Brown is called the assignor. Carter is called the assignee. Carter must consent to the assignment, but Apple's consent is not needed. Carter can now enforce the original agreement with Apple. Apple cannot assign the debt of $1,000 to anyone because it is a liability.

In a previous chapter, the doctrine of privity of contract was discussed in relation to interests in land. The doctrine of privity of contract simply says that only the parties to a contract have a right to sue or be sued under it. There are some exceptions to the doctrine. One is the exception for contracts which create an interest in land. Another exception is assignment.

There are two types of assignment – statutory and equitable. A statutory assignment is one which complies with the legal requirements set out in

sections 36(1) and (2) of the *Law and Equity Act*. A statutory assignment has three essentials:

- the assignment is in writing;
- the assignment is absolute (for the whole amount) and is unconditional; and
- notice of the assignment has been given in writing to the original promissor.

If any of these essentials are missing, the assignment might still be an equitable assignment. An equitable assignment and a statutory assignment are enforced differently. In an equitable assignment, all three parties must be named as parties in a court action to recover the amount outstanding. In a statutory assignment only the original promissor and the assignee are named as parties to the action. The assignor is not a party to the action.

Example

On February 1, Ernie entered into a contract of purchase and sale to buy Marcia's house for $500,000. The closing date (the date Ernie will become the owner of the house) is April 1. On February 15, Ernie is told by his employer that he needs to permanently relocate to Saskatchewan. At this point, Ernie would prefer not to close on the sale with Marcia because he would prefer to use his money to buy a house in Saskatchewan. Luckily, one of Ernie's co-workers, Bert, was also initially interested in buying Marcia's house. On March 1, Ernie agrees to assign the contract of purchase and sale to Bert. The two enter into an assignment agreement, whereby Bert will pay Ernie an assignment fee of $35,000. Bert is happy about this arrangement because, on March 1, Marcia's house is worth $550,000; however, Bert will only pay $535,000 for it ($500,000 to Marcia on the closing date and $35,000 to Bert as the assignment fee). Ernie is happy because he no longer needs to complete the purchase with Marcia; he can use his money to buy a house in Saskatchewan, and he made a profit of $35,000 through the assignment. Once the assignment agreement is signed, Ernie and Bert notify Marcia of the assignment. Marcia refuses to complete the sale on April 1. Result? If this assignment complies with the three requirements of section 36 of the Law and Equity Act (mentioned above), Bert can sue Marcia for breach of contract for her refusal to complete. Bert may obtain a court order for specific performance, which orders Marcia to transfer her land to Bert in exchange for $500,000. Please note that this example does not involve real estate licensee and does not take into consideration section 8.2 of the Real Estate Services Regulation (see below for more information).

Assignments in residential and commercial real estate contracts (except those sales under the *Real Estate Development Marketing Act*) are limited by sections 8.2 of the *Real Estate Services Regulation*. Essentially, all offers prepared by real

estate licensees must contain the following terms relating to assignments (the "Standard Assignment Terms"), unless instructed otherwise by the buyer:

If the offer does not contain the Standard Assignment Terms, the buyer's licensee must deliver a standard form notice to the seller's licensee (or seller, if the seller is unrepresented) notifying them of the exclusion of the Standard Assignment Terms and advising the seller to obtain independent professional advice.

Vicarious performance. It was stated previously that no one can assign away liabilities under a contract. However, it is legal to have obligations performed by someone else. For example, a builder can require an employee or a sub-contractor to perform its obligations under a building construction agreement. This is called vicarious performance. Vicarious performance is not assignment. It does not result in the substitution of one of the original contracting parties for another. In the example of the construction agreement, the original building contractor is still liable to the other contracting party. The sub-contractor who performs vicariously cannot be sued by the other contracting party for non-performance. The other contracting party can only sue the contractor. If the contractor is found liable, the contractor could sue the sub-contractor if the sub-contractor has breached its own contract with the contractor.

Vicarious performance is not permitted in the case of personal contracts. If A has contracted with B in reliance on B's personal skill, competency, judgment, taste, or other personal qualification, the law presumes that the contract is one of a personal nature. Vicarious performance is considered "no performance" in the eyes of the law for a personal contract. A good example of a personal contract is one where a party makes a contract with an artist to paint a portrait. Obviously, the party does not expect someone else to perform the work.

REMEDIES

The main remedies awarded by the courts in contract law are damages, specific performance, injunction, and *quantum meruit*.

Damages

Damages is the only common law remedy available for breach of contract. The other three remedies are equitable remedies. Anyone who can prove that they have suffered loss as a result of a breach of contract is entitled to be awarded damages. However, an innocent party is not automatically entitled to an equitable remedy for breach of contract. Those remedies are only granted in the court's discretion. Therefore, delay in bringing the court action or the conduct of the party not in breach can result in the court refusing equitable relief.

Damage awards are intended to put the parties in the position they would have been in if the contract had been performed. The leading case on this subject is *Hadley v. Baxendale*, [1854] EWHC J70, which established that damages which flow naturally from the breach or which must have been foreseeable by the parties at the time they entered into the contract are properly recoverable. In both cases, the damages must be the probable result of the breach.

Example

Val Vendor and Bob Buyer have entered into a binding agreement for the sale of Val Vendor's house. Buyer informs Vendor that he does not intend to complete the transaction. What damages, if any, can Vendor claim?

If she succeeds in court, Vendor could recover:

- out-of-pocket expenses incurred in reselling the house; and
- if she can prove reasonable efforts to resell, Vendor can recover the difference in the price where the second sale was for a lower price.

Such damages are said to flow naturally from the breach of contract committed by Buyer and are intended to put Val Vendor in the position she would have been in had the contract been performed. However, an injured party does have a duty to mitigate damages, i.e., they must do what any reasonable person would do to keep losses at a minimum.

Damages are not always established by the courts. Sometimes the parties agree in the contract itself on what the damages will be. When the breach occurs, this agreed amount might be higher or lower than the actual damages suffered. The courts have held that such a clause is enforceable if it amounts to a

genuine pre-estimate of the foreseeable damages if a breach should occur. Otherwise it will be regarded as a penalty and will be unenforceable.

Specific Performance

Specific performance means that the court will order the terms of the contract to be carried out instead of awarding damages. Specific performance is an equitable remedy granted at the discretion of the court. It will not be exercised when damages are considered to be an adequate remedy. As a result, specific performance is only granted in a contract for the sale of property where the property is unique to the extent that its substitute would not be readily available. With regard to personal property, this might involve goods which are rare or of unique value, such as antiques. With regard to real property, the historical common law view was that every piece of real estate was generally considered to be unique and accordingly, an innocent buyer was generally entitled to specific performance. The Supreme Court of Canada has recently observed, however, that because residential, business and industrial properties are now mass produced in much the same way as other consumer products, specific performance should not be granted as a matter of course. Therefore, unless there is evidence that the subject property is unique – in other words, that a reasonable substitute is not readily available – an innocent purchaser may now be limited to the common law remedy of damages in situations of a seller's breach of contract.

specific performance
the court, rather than granting damages in lieu of performance, orders that the terms of the contract be carried out by the party in default

Sihota v. Soo, 2010 BCSC 886

In *Sihota*, two parties, Law and Soo (the defendants), purchased a property together; however, for tax reasons, only Law's name appeared on title. Law entered into a contract of purchase and sale for the property with the plaintiff buyers and when Soo found out, he filed a certificate of pending litigation against the property, which resulted in the sale not completing. In turn, the buyers sued for specific performance. The Court granted specific performance because it was convinced that the property was unique to the buyers for the following reasons:

- the buyers had searched for two years before making an offer on the current property and they did not have any offers on other properties;
- the buyers needed a corner lot large enough to build a house that they had already planned;

- the neighbourhood was a close-knit community, close to many amenities;
- an elementary school was located behind the property and the buyers were expecting their first child; and
- the property was within walking distance to the home of one of the buyers' parents, both of whom were ill and could not drive.

Injunction

An *injunction* can do two things:

- it can stop a party from doing something (e.g., selling property to someone else when the vendor has contracted to sell it to the plaintiff); or
- it can require a party to do something. In this case it is called a mandatory injunction.

injunction
a court order which either restrains a party from doing something or requires a party to do something

Disobedience of an injunction could result in liability for contempt of court. Like specific performance, an injunction is a supplementary, equitable remedy and will only be granted where damages will not provide an adequate remedy.

Quantum Meruit

The principle of *quantum meruit* was introduced earlier in the chapter. When a person requests the services of another in circumstances in which it is reasonable to conclude that the services would be paid for, but no price has been fixed, the law implies a promise to pay a reasonable sum. This principle also applies to goods supplied on request where no contract price is fixed. In such cases the market value of the goods would be the starting point for deciding their reasonable worth.

CONCLUSION

This chapter introduced the general legal principles that apply to the formation and enforcement of all contracts. The seven essential elements of contract (offer, acceptance, consideration, legal intention, capacity, legal object, and genuine

consent) were demonstrated and explained. Although these concepts may seem far removed from the practice of facilitating loan agreements between borrowers and lenders, as a mortgage broker, you will deal with contracts on a daily basis. It is important that you understand how the fundamental principles of contract law apply to these agreements and the consequences when those principles are not followed. In Chapter 7: “Introduction to Mortgage Law”, you will be introduced to contractual provisions commonly found in loan agreements. A firm grasp of the fundamental principles of contract law will help you understand why some of those provisions are required.

1 *Rosas v. Toca*, 2018 BCCA 191

2 *www.bcfsa.ca/industry-resources/real-estate-professional-resources/knowledge-base/report-council/april-2014-report-council-newsletter?hits=cognitive#assisting-clients-with-cognitive-impairments*

3 Ibid.