February 16, 2017

Residential Tenancy Agreements, Options to Purchase, *In Terrorem* Clauses, and Relief from Forfeiture

By: Jonnette Watson Hamilton

Case Commented On: *Dreamworks Ventures Ltd v Dye*, 2017 ABPC 20 (CanLII)

This residential tenancy case, arising in the context of a rent-to-own arrangement, is light on the law. The dispute was primarily about the tenants' responsibility for cleaning and painting after they left the house and this decision assesses the damages. Nevertheless, the case raised one interesting legal point. Judge Allan H. Lefever mentioned an *in terrorem* clause in connection with the Option to Purchase that had been granted to the tenants in return for a non-refundable $5,000 deposit that was part of the rent-to-own arrangements. While he mentions the clause, he did not discuss it because it was not relevant to the dispute. The *in terrorem* clause tried to scare the tenants to stop them from filing a caveat to protect their interest under the Option to Purchase. Can this *in terrorem* clause possibly be valid? This, it seems, is a difficult question to answer.

The lawsuit was started by Dreamworks Ventures Ltd. According to their website, Dreamworks Ventures Ltd is in the "Residential Property Matchmakers" business; it is an online third-party service that links home buyers with home sellers through a rent-to-own program: "Our home buyers consist of people who cannot purchase a home through conventional methods, for various reasons. Our home sellers are people who are having a hard time selling their house, or people who want to make money in selling their house" (at Who We Are). In this case, Mandy and Kevin Dye were home buyers (although Kevin Dye was not named in the law suit, presumably because he filed for bankruptcy in 2015). We are not told who the home sellers were.
Five documents, all dated July 19, 2013 and all made between Mandy and Kevin Dye and Dreamworks, set out the legal relationships between the two parties. The details of these documents that are set out in the judgment are sketchy because of the focus of the decision.

The first document was a Lease for a house in Medicine Hat, showing Dreamworks as the landlord and Mandy and Kevin Dye as the tenants. The monthly rent was $1650. This Lease would have been a residential tenancy agreement regulated by the *Residential Tenancies Act*, SA 2004, c R-17.1.

The second document was an Option to Purchase the house between August 1, 2013 and July 31, 2015 for the sum of $285,000. This Option to Purchase, granted to the Dyes, stated that it amended the lease by providing that, if the option was exercised, $400 of each monthly "lease" payment would be credited toward the purchase price of the house.

The third document acknowledged that Mandy and Kevin Dye had paid a deposit of $5,000 on July 19, 2013. It also stated that the $5,000 deposit and the $400 per month credit from the lease payment were "non-refundable".

The fourth document was entitled "The Purchase Process" and the fifth document was a "Move In/Move Out Inspection Checklist", which was incorporated by reference into the Lease.

What we see in the Lease and the Option to Purchase appears to be, for the most part, a rather standard residential rent-to-own arrangement in terms of its structure, payment amounts, etc. See, for example, "Rent-To-Own Homes: How the Process Works", *Investopedia* (16 September, 2016); Mark Weisleder, "Rent-to-own works, but beware the pitfalls", *The Star* (30 July 2013); Gordon Powers, "Is Rent to Own Housing Ever a Good Idea?" *Money Wise* (8 December 2014).

However, this rent-to-own arrangement had at least one non-standard feature: the *in terrorem* clause. It was a provision in one of the documents that stated that, if a caveat was filed at the Land Titles Office to protect the interest of Mandy and Kevin Dye under the Option to Purchase, then both the Lease and the Option to Purchase were automatically terminated and any monies paid towards the Option to Purchase — the $5,000 deposit and the $400 per month credit — would be forfeited to Dreamworks (at para 7).

We do not know whether the *in terrorem* clause had any impact on the Dyes. They do not appear to have filed a caveat. But neither did they exercise their option to buy the house. They paid their monthly rent of $1,650 from August 1, 2013 until June 30, 2015. Then they served a Notice of Termination on Dreamworks, effective July 31, 2015, and vacated the property.

"*In terrorem*" is Latin for "into/about fear". It is a legal threat, usually given to force someone to act or refrain from acting without the need to resort to a lawsuit or criminal prosecution to compel them to act or not act. This type of clause is used, for example, in wills when a provision is inserted that forfeits the gifts made to any beneficiaries who contest the will and lose. They are often upheld by the courts in that context: see Gerry W Beyer, Rob G Dickinson, and Kenneth L Wake, "The Fine Art of Intimidating Disgruntled Beneficiaries with *In Terrorem* Clauses" (1998) 51 SMU Law Review 225 (including a brief review of the history of these clauses over the past 2,000 years).

It is true that it appears to be common in residential rent-to-own arrangements to provide in the Option to Purchase that the tenant will forfeit the right to buy the property and forfeit any deposit if they fail to make a rent or option payment: see Jemima Codrington, "Caveat emptor, warn rent-to-own landlords", *Canada Real Estate Wealth* (12 February 2013). And if a tenant fails to pay rent, they can also be evicted under the *Residential Tenancies Act*. But the *in terrorem* clause in the Dyes' arrangement is very different. It purports to automatically terminate both their Lease and their Option to Purchase the house, and to forfeit their option money to Dreamworks, if they file a caveat in the Land Titles Office.

Under section 130 of the *Land Titles Act*, RSA 2000, c L-4, a person claiming an interest in land may file a caveat with the Land Title Office. Having done so, anyone coming along later who claims to have an interest in the same land is subject to the caveator's claim (section 135, *Land Titles Act*. The purpose of and reason for filing a caveat is to give notice to the world of what is claimed by the caveator: *Ruptash and Lumsden v Zawick*, 1956 CanLII 67 (SCC), [1956] SCR 347 at 355. Had the Dyes seen a lawyer about their rent-to-own arrangement, one of that lawyer's first pieces of advice probably would have been to file a caveat to protect themselves from Dreamworks or the owners selling the house to someone else before the Option to Purchase expired on July 31, 2015.

It was settled law in Canada from 1959 to 1996 that an option to purchase land for a named consideration is an equitable interest in land: see *Frobisher Ltd v Canadian Pipelines and Petroleums Ltd*, 1959 CanLII 47, [1960] SCR 126 at 171-72. As the Supreme Court of Canada put it in *Canadian Long Island Petroleums Ltd et al v Irving Industries Ltd*, 1974 CanLII 190, [1975] 2 SCR 715 at 731: "An option to purchase land is specifically enforceable. This gives the option-holder an equitable interest in the land; this interest is contingent upon his election to exercise the option." And further, in the same case at 731: "[T]he essence of an option to purchase is that forthwith upon the granting of the option, the optionee, upon the occurrence of certain events, solely within his control can compel a conveyance of the property to him." If the Dyes' Option to Purchase was an interest in land, it could have supported a caveat: section 130 of the *Land Titles Act*.

However, in 1996 the Supreme Court of Canada precipitously changed the law of specific performance in the context of an agreement for the sale and purchase of real property by saying specific performance would no longer "be granted as a matter of course absent evidence that the property is unique to the extent that its substitute would not be readily available": *Semelhago v Paramadevan*, 1996 CanLII 209 (SCC), [1996] 2 SCR 415 at paras 20-22. As a result, the question arises whether an option to purchase is still specifically enforceable and therefore an equitable interest in land capable of supporting a caveat in Alberta?

It has been more than twenty years since *Semelhago* changed the law, and ten years since *1244034 Alberta Ltd v Walton International Group Inc*, 2007 ABCA 372 (CanLII) made it clear what kind of impact this change had on the ability to caveat agreements for the sale and purchase of lands. However, as far as I can tell, there is no Alberta case specifically considering the application of *Semelhago* and *Walton* to options to purchase, but one case has come close.

That case — *Mylonas Enterprises Ltd v Foundation Place Inc*, 2013 ABQB 385 (CanLII) — involved an option to purchase as well as a vendor's right to repurchase. Rights of repurchase are not options to purchase because they depend on the occurrence of a future event — usually performance or non-performance by the purchaser — that is not solely within the control of the vendor, which means they are properly characterized as rights of first refusal: *Wetaskiwin Stock Car Club v Draeger*, 2016 ABQB 144 (CanLII), at para 10. And a right of first refusal is deemed to be an equitable interest in land by section 63(1)(a) of the *Law of Property Act*, RSA 2000, c L-7. Justice Keith Yamauchi in *Mylonas* (at para 22) asserted that no one could challenge the proposition that options to purchase real property create interests in land given the *Canadian Long Island* description of their nature. But because *Canadian Long Island* pre-dated *Semelhago*, Justice Yamauchi went on to consider the changes in the law made by the latter decision. He distinguished *Semelhago* because it dealt with an agreement for purchase and sale and he was dealing with "a right of repurchase which, once the vendor complies with its obligations, will be an option to purchase" and that allowed him to conclude the right to repurchase "created an interest in the Lands …" (at para 47).

It therefore appears that the question of whether the Dyes' Option to Purchase would support a caveat is unsettled. There is at least a suggestion in *Mylonas* that an option to purchase is still an interest in land, as it was prior to *Semelhago*. This seemingly illogical conclusion is perhaps driven by what the dissenting judgment of Justice Slatter in *Walton* (at paras 37-28) called the "inconsistency" of the statutory deeming of the "lesser" right of first refusal to be an interest in land. See also the reservations expressed in *Draeger* at paras 16-18.

If the Dyes had registered a caveat to protect their option to purchase (assuming for the moment that it is an interest in land), it would have protected them, for example, against Dreamworks or the owners selling the house to a third party after agreeing to sell it to the Dyes for $285,000 if the Dyes wanted to buy it during their two-year window of opportunity. Without a caveat registered against the title, Dreamworks or the owners could have sold the house out from under the Dyes. Dreamworks did not sell the property out from under the Dyes and neither did the owners. But, because the Dyes did not file a caveat, Dreamworks could have.

Is there any remedy against such a heavy-handed *in terrorem* clause? If a person breaches a clause in a contract, they can ask a court to provide them with relief from forfeiture. In this case, if the Dyes had filed a caveat to protect their interest under the Option to Purchase, they would have breached their contract and that contract provided that the Dyes' would then forfeit their tenancy, their Option to Purchase, and their $5,000 deposit and $400 per month credits.

Section 10 of the *Judicature Act*, RSA 2000, c J-2, provides for relief from forfeiture in the following terms:

> 10. Subject to appeal as in other cases, the Court has *power to relieve against all penalties and forfeitures* and, in granting relief, to impose any terms as to costs, expenses, damages, compensation and all other matters that the Court sees fit. (emphasis added)

In equity, the term "forfeiture" has a limited definition. *Snell's Equity,* 30th ed at 599, speaks of "forfeiture for breach of covenant or condition where the primary object of the bargain is to secure a stated result and the provision for forfeiture is added as security for the production of that result." In the Dyes' case, what result does the provision for forfeiture secure? The primary object of all of the documents appears to be the sale of the house to the Dyes for $285,000 within two years. How does providing for forfeiture if a caveat is filed to protect their right to buy the house secure that object? Arguably, it does the opposite. There is no argument to be made that the forfeiture was anything other than a penalty.

Note that the court "has the power" and may impose any terms "it sees fit." A court's power to grant relief from forfeiture is discretionary: *Saskatchewan River Bungalows Ltd v Maritime Life Assurance Co*, 1994 CanLII 100 (SCC), [1994] 2 SCR 490 at 504. Following *Saskatchewan River Bungalows*, courts consider, first, whether there is a forfeiture and then three factors in deciding whether or not to exercise their discretion to provide relief from forfeiture: *Bowlen v Digger Excavating (1983) Ltd*., 2001 ABCA 214 (CanLII) at para 31; *Saskatchewan River Bungalows* at Part IV.B.

In the Dyes' case, there would be no question that the *in terrorem* clause provided for a forfeiture, because more than money was to be forfeited. Then a court would consider:

> 1) Was the conduct of the plaintiff reasonable in the circumstances?
> The Dyes have the legal right under section 130 of the *Land Titles Act* to file a caveat to protect their interest in land (assuming that an option to purchase is still an interest in land post-*Semelhago*). Exercising a legal right to protect the interest in land granted by the contract with Dreamworks is reasonable conduct. It prevents fraud.
>
> 2) Was the object of the right of forfeiture essentially to secure the payment of money?
> In the Dyes' situation, the purpose of Dreamworks' right of forfeiture is to terminate the Option to Purchase, leaving them free to sell the house again, and to terminate the

tenancy, leaving them free to rent or sell the house, as well as to secure the payment of money.

3) Was there a substantial disparity between the value of the property forfeited and the damage caused the seller by the breach?
The Dyes would have been forfeiting their right to buy the house for $285,000, their right to live in the house as tenants, and their $5,000 deposit and $400 per month credits. What possible damage would they have caused by filing a caveat (assuming for the moment that an option to purchase is an interest in land)?

Although not relevant to the Dyes' case because they did not file a caveat, there is also an interesting question about whether the courts' general power to relieve from forfeiture under section 10 of the *Judicature Act* applies to residential tenancy agreements under the *Residential Tenancies Act*. The question arises because the power to relieve from forfeiture does not apply to penalties or forfeitures that are imposed by statute: *R v Canadian Northern Railway*, 1923 CanLII 444 (UK JCPC), [1923] 3 DLR 719 (PC); *Tamglass American Inc. v Richter, Allen & Taylor, Inc.*, 2005 ABCA 341 (CanLII) at para 22.

The British Columbia Court of Appeal has determined that relief from forfeiture is not available to residential tenants in that province. See *Ganitano v Metro Vancouver Housing Corporation*, 2014 BCCA 10 (CanLII) and see the comment on this decision by Scott Symthe: "What a Relief! BC Court of Appeal decides that equitable relief from forfeiture not available to residential tenants." See also *Sereda v Ni*, 2014 BCCA 248 (CanLII) at para 64.

In *Ganitano*, the BC Court of Appeal held that "the [BC Residential Tenancy Act] provides a comprehensive scheme for dealing with matters relating to the non-payment or late-payment of rent in residential tenancy situations" (at para 40) and "[i]n a residential tenancy, the tenant's obligation to pay rent is not merely a matter of contract, but an obligation imposed by statute" (at para 41). The BC Court of Appeal specifically notes that "s. 26(3) precludes a landlord from resorting to the common-law remedy of distress to assist in obtaining arrears of rent" (at para 41). The BC Act has also abolished the common-law right of a landlord to treat a tenancy as forfeited when a tenant fails to pay rent; instead the landlord must follow procedures set out in the statute in order to have the tenancy terminated. Thus, the BC Court of Appeal concluded: "Such a termination is a statutory forfeiture (i.e., a taking back of the remainder of the term of the tenancy) and is beyond the reach of [relief from forfeiture]" (at para 44).

The question of whether section 10 of the *Judicature Act* applies to residential tenants appears to be an open one in Alberta. The result in BC would not necessarily apply here. Alberta's *Residential Tenancies Act* is not "a comprehensive scheme". In Alberta, unlike BC, it is taken for granted (and procedurally provided for in section 104 of the *Civil Enforcement Act*, RSA 2000, c C-15) that landlords still have the common-law remedy of distress for rent available to them for non-payment of rent. The BC Court of Appeal's reasons for finding relief from forfeiture was unavailable to residential tenants therefore does not apply in Alberta.

On the other hand, the only way to terminate a residential tenancy in Albert is provided for in the *Residential Tenancies Act*. A residential tenancy cannot be terminated because a tenant files a caveat to protect an Option to Purchase. That is not one of the reasons prescribed in the statute and its regulations for terminating a tenancy: see sections 6, 26, 27, 29-36.

So … to return to the question and answer at the beginning of this post: Can this *in terrorem* clause that requires the forfeiture of the remaining term under the residential tenancy agreement, the opportunity to buy the rented property for $285,000, and the deposit and the monthly credits if a caveat to protect the option to purchase is filed, possibly be valid? It seems that is a very difficult question to answer. Is an option to purchase an interest in land that will support a caveat? That would affect whether filing a caveat would be seen as reasonable conduct and whether it might cause damage to the seller, both points to consider in an application for relief from forfeiture. Is relief from forfeiture available to residential tenants in Alberta? Can a residential tenancy be forfeited "automatically", as demanded by the *in terrorem* clause, instead of through the prescribed procedures in the *Residential Tenancies Act*, in light of section 3 of that statute?

Are there any more of these "no caveating" *in terrorem* clauses out there in other rent-to-own arrangements? If so, perhaps we might one day have some answers to these questions.

(With thanks to my colleague, Nigel Bankes, for his comments on earlier drafts of this post. All errors are, of course, my sole responsibility.)

This post may be cited as: Jonnette Watson Hamilton "Residential Tenancy Agreements, Options to Purchase, *In Terrorem* Clauses, and Relief from Forfeiture" (16 February, 2017), online: ABlawg, http://ablawg.ca/wp-content/uploads/2017/02/Blog_JWH_Dreamworks_Dye.pdf