

A Deposit in a Pre-Incorporation Transaction is Still a Deposit: A Comment on *Benedetto v 2453912 Ontario Inc*

D A R C Y L . M A C P H E R S O N *

I. INTRODUCTION

In *Benedetto*,¹ the promoter of a pre-incorporation transaction argued that a deposit had to be returned to him when the transaction did not close. His reason was that there was language in the agreement to indicate that he was invoking the protection of subsection 21(4) of the *Business Corporations Act* (Ontario).² The Court refused.³

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¹ *Benedetto v 2453912 Ontario Inc*, 2019 ONCA 149, BW Miller JA, for the Court [*Benedetto*].

² RSO 1990, c B.16 [OBCA].

³ While this is technically an Ontario case, decided under an Ontario statute, a number of other jurisdictions have substantively similar provisions in their corporate statutes. See e.g. *Canada Business Corporations Act*, RSC 1985, c C-44, s 14(4) [CBCA]; *Business Corporations Act*, RSA 2000, c B-9, s 15(6) [ABCA]; *The Corporations Act*, CCSM, c C225, s 14(4) [Manitoba CA]; *Business Corporations Act*, SNB 1981, c B-9.1, s 12(4) [New Brunswick BCA]; *Corporations Act*, RSNL 1990, c C-36, s 26(5) [Newfoundland and Labrador CA]; *Business Corporations Act*, SNWT 1996, c 19, s 14(4) [Northwest Territories BCA]; *Business Corporations Act*, SNWT (Nu) 1996, c 19, s 14(4) [Nunavut BCA]; *The Business Corporations Act*, RSS 1978, c B-10, s 14(4) [Saskatchewan BCA]; and *Business Corporations Act*, RSY 2002, c 20, s 17(6) [Yukon BCA]. British Columbia has

While I agree with the ultimate result in the case, there are three basic issues that will be considered in this Comment. After laying out the reasoning of the Court of Appeal (in Part II), I turn to a fundamental concern that lies at the heart of my discomfort with this ruling, namely, my view that any deposit is inextricably intertwined with the contract that provides for it. This runs directly counter to the reasoning provided by the Court of Appeal (the focus of Part III). In Part IV, I suggest that there is a more direct route to deal with the issue of deposits in pre-incorporation transactions that use language that is reasonably considered a subsection 21(4) inclusion. Essentially my argument is three-fold. The first argument is one of contractual interpretation. Drawing upon both recent case law from the Supreme Court of Canada, as well as older case law from other courts, I suggest that a proper interpretation of the contract at issue (and others like it) would have led to a narrow interpretation of the language of the subsection 21(4) inclusion. Narrowly construed, the inclusion does not force the payment of the deposit, but also does not mandate its return. Second, the tort of deceit may also have a role to play here. I then suggest that there was in fact a third route that would have allowed the Court to refuse to return the deposit, namely, the law of restitution. Finally (in Part V), I will review the academic commentary that immediately followed the release of this judgment, suggesting that the Court of Appeal's conclusion was problematic. I will suggest that the commentary, which criticizes the Court of Appeal, is itself flawed.

II. THE FACTS AND REASONING OF THE COURT OF APPEAL

The appellant was a buyer in a real estate transaction.⁴ As is typical in real estate transactions, a significant deposit was required. That deposit was paid by the individual appellant. But, there was a catch. The contract was a pre-incorporation transaction⁵ that included the following language: “in

a very different set of statutory provisions, somewhat unlike its Ontario counterpart. See the *Business Corporations Act*, SBC 2002, c 57, s 20, as amended.

⁴ *Benedetto*, *supra* note 1 at para 2.

⁵ There are a number of ways to refer to these types of transactions, including “pre-incorporation contract” and “pre-incorporation transaction,” among others. In some cases, including *Westcom Radio Group Ltd v Mclsaac* (1989), 70 OR (2d) 591, 63 FLR (4th) 433, the statutory wording choices became central to the judgment. It is beyond

trust for a company to be incorporated without any personal liabilities.”⁶ Very similar language had previously been held to be a subsection 21(4) inclusion.⁷ For clarity, s. 21 provides as follows:

21(1) Except as provided in this section, a person who enters into an oral or written contract in the name of or on behalf of a corporation before it comes into existence is personally bound by the contract and is entitled to the benefits thereof.

(2) A corporation may, within a reasonable time after it comes into existence, by any action or conduct signifying its intention to be bound thereby, adopt an oral or written contract made before it came into existence in its name or on its behalf, and upon such adoption,

(a) the corporation is bound by the contract and is entitled to the benefits thereof as if the corporation had been in existence at the date of the contract and had been a party thereto; and

(b) a person who purported to act in the name of or on behalf of the corporation ceases, except as provided in subsection (3), to be bound by or entitled to the benefits of the contract.

(2.1) Until a corporation adopts an oral or written contract made before it came into existence, the person who entered into the contract in the name of or on behalf of the corporation may assign, amend or terminate the contract subject to the terms of the contract.

(3) Except as provided in subsection (4), whether or not an oral or written contract made before the coming into existence of a corporation is adopted by the corporation, a party to the contract may apply to a court for an order fixing obligations under the contract as joint or joint and several or apportioning liability between the corporation and the person who purported to act in the name of or

the scope of this comment to address issues, and this will have to wait for another day.

⁶ *Benedetto*, *supra* note 1 at para 2.

⁷ *1394918 Ontario Ltd v 1310210 Ontario Inc* (2002), 57 OR (3d) 607 at para 2, 154 OAC 137 (CA), Carthy JA, for the Court [*1394918 Ontario Ltd*]. The language in that case was as follows: “Raymond Stern in trust for a company to be incorporated and not in his personal capacity.” The Court in *Benedetto* did not make specific reference to the language of the subsection 21(4) inclusion, though it did refer to the judgment in *1394918 Ontario Ltd* for the purpose of explaining that, in general, the promoter who provides a subsection 21(4) inclusion is typically not liable on the underlying contract (see *Benedetto*, *supra* note 1 at para 12). Nonetheless, the similarity between the two sets of language makes it very difficult to argue that the two should be treated differently from each other.

A word about language is necessary here. I use the term “a subsection 21(4) inclusion” or “a subsection 14(4) inclusion” (depending on the statute) to refer to language designed to invoke the subsection. Some people may argue that the wording is in fact an exclusion of liability, which I agree is its effect. However, the wording is included to invoke the limitation of liability. Therefore, I will refer to such a contractual term as an “inclusion.”

on behalf of the corporation, and, upon such application, the court may make any order it thinks fit.

(4) If expressly so provided in the oral or written contract referred to in subsection (1), a person who purported to act in the name of or on behalf of the corporation before it came into existence is not in any event bound by the contract or entitled to the benefits thereof.

Thus, there are really three parties to a transaction agreed to where both:

- i. a corporation is anticipated to later replace one of the parties and become a party to the transaction, and
- ii. the corporation is not in existence at the time that the transaction was entered into.

The first party is the party that enters into a contract⁸ in the name of or on behalf of a corporation that does not yet exist. Typically, this person is referred to as the “promoter.”⁹ The second potential party is the corporation that is later brought into existence. The final party (or parties) is the descriptively named “third party.” The third party, while a party to the contract, is not expected to bring a corporation into existence to carry out all or part of the underlying transaction.

Subsection 21(1) places liability on the promoter until a corporation is formed to take over the liabilities and benefits of the contract pursuant to subsection 21(2).¹⁰ Subsection 21(3) allows the Court the discretion to

⁸ Certain of the equivalent sections to s 21 of the OBCA, *supra* note 2, extend this protection to individuals who purport to enter into a pre-incorporation contract as well. See CBCA, *supra* note 3, s 14(1); ABCA, *supra* note 3, s 15(2); Manitoba CA, *supra* note 3, s 14(1); New Brunswick BCA, *supra* note 3, s 12(1); Northwest Territories BCA, *supra* note 3, s 14(1); Nunavut BCA *supra* note 3, s 14(1); Saskatchewan BCA, *supra* note 3, s 14(1); and Yukon BCA *supra* note 3, s 17(2), as all of them include language referring to a “purported” contract, “purporting to contract” or “enters or purports to enter into a written contract.” Interestingly, while s 26(1) of the Newfoundland and Labrador CA, *supra* note 3 does not use the term “purported,” the subsection equivalent to s 14(4) of the CBCA (s 26(5) of the Newfoundland and Labrador CA) does use the word “purported.”

⁹ J Anthony VanDuzer, *The Essentials of Canadian Law – The Law of Partnerships & Corporations*, 4th ed (Toronto: Irwin Law, 2018) at 200–01.

¹⁰ See the judgment of Justice Abella of the Court of Appeal for Ontario (as she then was) in *Sherwood Design Services Inc v 872935 Ontario Limited* (1998), 39 OR (3d) 576, 158 DLR (4th) 440 (CA) [*Sherwood*]. In my view, this case contains one of the most detailed and persuasive analyses of the section.

apportion on the liability under the contract between the corporation and the promoter.¹¹

Subsection 21(4) has two major effects. First, it removes the potential liability from the promoter that would otherwise apply pursuant to subsection 21(1). Second, subsection 21(3) is expressly subject to subsection 21(4), meaning that the apportionment remedy provided for pursuant to subsection 21(3) is not available where there is a subsection 21(4) inclusion.

The Court of Appeal cites two Canadian cases for the principle that a deposit is separate from the underlying agreement of purchase and sale.¹² The Court then points out the contract is silent as to the effect of the deposit, namely whether it should have to be returned in the circumstances of the case.¹³

In the end, therefore, the Court of Appeal relies on the argument that the deposit is a contract separate from the pre-incorporation transaction. If this is so, it then follows that the wording of the pre-incorporation transaction, including the wording that purports to disclaim liability for the promoter pursuant to subsection 21(4) of the *OBCA*¹⁴ cannot affect the interpretation of the deposit.

III. THE PROBLEMS WITH THE REASONING OF THE COURT OF APPEAL

There are a number of problems with this approach to deposits. First, the Court seems to suggest that deposits are separate from contracts, at least for some purposes.¹⁵ While the Court points out that there is a case where the contract was written and the deposit was not,¹⁶ there are plenty of cases

¹¹ See the judgment of Justice Van Camp in *Bank of Nova Scotia v Williams* (1976), 12 OR (2d) 709, 70 DLR (3d) 108 (HCJ). This case provides one of the few analyses of the subsection.

¹² *Tang v Zhang*, 2013 BCCA 52 [Tang]; *Comonents Inc v Hetherington Welch Design Ltd*, 2006 CanLII 33779 (Ont SC) [Comonents]. The Court also cites the British case of *Howe v Smith* (1884), 27 Ch D 89 (CA).

¹³ *Benedetto*, *supra* note 1 at para 16.

¹⁴ *OBCA*, *supra* note 2.

¹⁵ *Benedetto*, *supra* note 1 at para 7.

¹⁶ *Ibid* at para 5.

that suggest that a deposit is part of the contract the performance of which the deposit is designed to secure.¹⁷

In fact, the law of contracts is said to be concerned with “legally enforceable promises.”¹⁸ Taking this as our definition of a contract, it is very difficult for me to accept that the deposit is not a contract, either independent of the contract of purchase and sale or as an integrated part of that contract. In fact, the entire purpose and effect of the judgment of the Court was to give legal effect to the agreement voluntarily agreed to as between the appellant and the respondent. Therefore, at first blush at least, a deposit would seem intimately connected with a contract. The Court of Appeal seems to say that they are not enforcing the contract of purchase and sale, but rather enforcing the security. If the Court of Appeal is correct, then there is no need to consider the application of subsection 21(4) because the exclusion of liability applies only to the agreement of purchase and sale, and not to the security.

But a deposit by definition depends on the underlying contract. In other words, if the underlying contract of purchase and sale were not present, there would be nothing to secure. Thus, to suggest that the deposit is entirely divorced from the contract is, to me at least, clearly untenable.

The cases on which the Court of Appeal relies for this purpose actually serve a much more limited role than the Court of Appeal ascribes to them. The question that those cases are trying to answer is whether or not the recipient of the deposit must prove actual damage to it in order to maintain the deposit.¹⁹ Put another way, does the recipient of the deposit have to go through a damage analysis (as it would if it were seeking contractually-based damages) in order to be able to keep the deposit? The answer to this question in these cases was, unsurprisingly to me, in the negative.²⁰ A

¹⁷ See *Stevenson v Colonial Homes Ltd* (1961), 27 DLR (2d) 698, [1961] OR 407 (CA); *Sanitary Refuse Collectors v City of Ottawa* (1972), 23 DLR (3d) 27, [1972] 1 OR 296 (HCJ); *Trilwood Investments Ltd v Bruce Agra Foods Inc* (1998), 37 OR (3d) 182, 38 BLR (2d) 116 (Gen Div); *Vanvic Enterprises Ltd v Mack* (1985), 17 DLR (4th) 177, [1985] 3 WWR 644 (BCCA).

¹⁸ See John D McCamus, *The Essentials of Canadian Law – The Law of Contracts*, 2nd ed (Toronto: Irwin Law, 2012) at 1.

¹⁹ *Tang*, *supra* note 12 at para 1; *Comonents*, *supra* note 12 at para 17.

²⁰ See SM Waddams, *The Law of Contracts: Student Edition*, 7th ed (Toronto: Thomson Reuters Canada Limited, 2017) at para 470.

deposit is designed to show seriousness of intent. One shows seriousness of intent by putting money at risk if one decides to walk away from the transaction. The potential purchaser in a real-estate transaction knows that if he or she refuses to close the transaction, there is the loss of the deposit. This creates a prudential incentive for the buyer to complete the transaction. This prudential incentive would be lost, or the very least substantially diminished in its effectiveness, if the seller needed to prove how they had expended money or otherwise suffered financial loss on the basis of the provision of the deposit (damages directly related to the deposit) in order to keep the deposit amount. So, in my view, while the cases cited by the Court of Appeal are correct as far as they go, they are answering a completely different question than that which confronts the Court of Appeal in *Benedetto*.²¹

The distinction seemingly drawn by the Court of Appeal also depends on differentiating the contract itself, on the one hand, from the security that enforces the performance of the contract, on the other. With all due respect to the Court of Appeal, this is very close to what was referred to in another pre-incorporation transactions case as “more sophistry than analysis.”²² While *Benedetto*²³ is a real-estate case, there can be little doubt that deposits are also used in sales of personal property.²⁴

In the common-law provinces of Canada, while there are other security regimes,²⁵ security interests in personal property are generally dealt with through the *Personal Property Security Acts*.²⁶ By definition, a security interest

²¹ *Benedetto*, *supra* note 1.

²² *Sherwood*, *supra* note 10 at para 10.

²³ *Benedetto*, *supra* note 1.

²⁴ *994814 Ontario Inc v RSL Canada Inc* (2006), 9 PPSAC (3d) 240 (Ont CA), Rouleau JA, for the Court.

²⁵ See e.g. *Bank Act*, SC 1991, c 46, ss 425–436.1.

²⁶ *Personal Property Security Act*, RSA 2000, c P-7 [PPSA (Alberta)]; *Personal Property Security Act*, RSBC 1996, c 359 [PPSA (British Columbia)]; *Personal Property Security Act*, CCSM, c P35 [PPSA (Manitoba)]; *Personal Property Security Act*, SNB 1993, c P-7.1 [PPSA (New Brunswick)]; *Personal Property Security Act*, SNL 1998, c P-7.1 [PPSA (Newfoundland and Labrador)]; *Personal Property Security Act*, SNWT 1994, c 8 [PPSA (Northwest Territories)]; *Personal Property Security Act*, SNS 1995-1996, c 13 [PPSA (Nova Scotia)]; *Personal Property Security Act*, SNWT (Nu) 1994, c 8 [PPSA (Nunavut)]; *Personal Property Security Act*, RSO 1990, c P-10 [PPSA (Ontario)]; *Personal Property Security Act*, RSPEI 1988, c P-3.1 [PPSA (Prince Edward Island)]; *Personal Property Security Act*, 1993, SS

in property is created through a security agreement.²⁷ Moreover, a security agreement is statutorily effective in accordance with its terms.²⁸ Furthermore, by definition, a security agreement under the PPSA can only be created voluntarily, subject to certain noted exceptions.²⁹ It then follows that the security element of the transaction is nonetheless contractual in nature. It also follows that the separation that the Court of Appeal attempts to rely upon, between the contract of purchase and sale, on the one hand, and the security for the completion of the transaction (the deposit), on the other, simply is not made out in many areas of law. Security depends on a contractual undertaking. As such, in most cases, the contractual promise of security is found in the same document that contemplates the purchase and sale.³⁰ I fail to see that there is a meaningful separation between the law of contract, on the one hand, and the law of security, on the other.

IV. ALTERNATE ROUTES TO THE SAME RESULT

A. Introduction

The analysis offered in the previous section would seem to suggest that I disagree with the result of the Court of Appeal. To be clear, nothing could be further from the truth. While I do not agree with all of the elements that

1993, c P-6.2 [PPSA (Saskatchewan)]; *Personal Property Security Act*, RSY 2002, c 169 [PPSA (Yukon)].

²⁷ Under the PPSA (Ontario), *ibid*, s 1, *sv* “security agreement,” a security agreement is defined as follows:

“security interest” means an interest in personal property that secures payment or performance of an obligation, and includes, whether or not the interest secures payment or performance of an obligation, (a) the interest of a transferee of an account or chattel paper, and (b) the interest of a lessor of goods under a lease for a term of more than one year.

²⁸ *Ibid*, s 9.

²⁹ *Ibid*.

³⁰ For a simple example of this, see *Guntel v Kocian*, [1985] 6 WWR 458 (Man QB), Dureault J. In this case, the following simple document was sufficient for both purposes:

“Sept. 1, 1982

I Fay Kocian, sell my 1979 GMC, Crew cab, serial number TCS249B517842 to Bryan Ward for \$ 2100.00.

Fay Kocian (signed) 90 Strand Circle, Winnipeg, Man. R2N 1N1 Ph: 257-0779”

the Court of Appeal used to arrive at its result, I am 100 percent in favour of the result reached by Justice Miller and his colleagues. In this section, therefore, I offer three alternative approaches that will arrive at the result reached by the Court of Appeal, while avoiding this controversial analysis.

B. Contractual Interpretation

Although the Court of Appeal does deal with certain elements of contractual interpretation³¹ in my view, it leaves aside certain key developments in the interpretation of contracts that might have been addressed so as to buttress the conclusion that the Court of Appeal reached. The first of these is the Supreme Court of Canada's 2014 decision in *Bhasin v Hrynew*. Even without this recent development, there are other cases from provincial Courts of Appeal that suggest that the result in *Benedetto* is defensible as a matter of contractual interpretation.

1. Bhasin v. Hrynew

In 2014, the Supreme Court of Canada released its decision in *Bhasin v Hrynew*.³² This case represents an acknowledgement by the country's highest court that in fact there is an obligation on all contractual parties to behave honestly, and to not mislead each other in carrying out their contractual obligations. The Court of Appeal in *Benedetto* makes no reference to this case or its holdings.

First, how could this duty of honest performance of contracts be engaged here? Clearly, if the promoter does not believe that he or she is actually obligated to pay anything or, as in *Benedetto*, is actually entitled to the return of the deposit if it is ever so paid, then the deposit is illusory protection. Leading one party into a false sense of security would seem to be the very essence of violating the rule in *Bhasin v Hrynew*.

If a party, in this case the promoter, knew that the "deposit" in the case was illusory (because the promoter knew that he or she intended to avoid liability under it), in my view, the promoter is violating his duty of honest performance. Honesty requires that you actually tell the other party that you do not intend to perform the obligations that are set out in the contract. Writing a contract that at least one party (the promoter) believes to be

³¹ *Benedetto*, *supra* note 1 at para 16.

³² *Bhasin v Hrynew*, 2014 SCC 71 [*Bhasin*].

unenforceable by the other party to it cannot be considered to be honest contractual performance. In my view, therefore, the way to hold the promoter liable is not through the direct enforcement of the contract (or, at the very least, not the enforcement of the express provisions thereof) but rather, to hold the promoter liable on the implied obligation of honest contractual performance.

A careful reader may point out though that there is in fact a different question at play here. This question would be characterized as follows: how can the rules of honest contractual performance provided for in *Bhasin v Hrynew* be upheld against a specific exclusion of liability provided for under a statutory provision (in this case, subsection 21(4) of the *Ontario Business Corporation Act*)?³³ The answer, in my view, lies in the fact that the statutory provision is permissive and not mandatory. The question that must be answered therefore is whether we will give effect to the subsection 21(4) inclusion in the contract. It is not about whether we are giving effect to subsection 21(4) in and of itself. Put another way, this is simply a matter of contractual interpretation. There is an implied duty of contractual fairness in terms of contractual execution which binds both parties. Do we give effect to that implied term, or do we give effect to the express term that indicates that the promoter is taking no liability on him- or herself?

To answer this question, we must determine what type of implied term is at play here. The decision of Justice McLachlin (as she then was) in *Machtinger v HOJ Industries Ltd*³⁴ is instructive in this regard. Though Justice McLachlin spoke only for herself in *Machtinger*, her judgment in this case has been cited with approval on numerous occasions.³⁵ Justice McLachlin distinguishes between terms implied in fact, terms implied by custom and usage, and terms implied in law. The first two categories of implied terms may be overwhelmed by express terms to the contrary within the contract where the implied term is said to apply. The third category, however, cannot be contracted out of by specific contractual language by the parties thereto. The result in *Machtinger* would indicate this. In that case, an employer sought to enforce a specific provision of the employment contract of two

³³ OBCA, *supra* note 2.

³⁴ *Machtinger v HOJ Industries Ltd*, [1992] 1 SCR 986 [*Machtinger*].

³⁵ *Fasullo v Investments Hardware Ltd*, 2012 ONSC 2809 at para 41; *MJB Enterprises Ltd v Defence Construction (1951) Ltd*, [1999] 1 SCR 619 at para 27.

employees who had been fired that they were not entitled to any severance pay or payment in lieu of notice upon the termination of their employment.³⁶ Notwithstanding the clear contractual terms, Justice McLachlin (along with her colleagues in the majority) found routes by which they could enforce the specific statutory obligation to make a payment of severance in lieu of notice.³⁷ The implied term referred to *Bhasin v Hrynew*, that is, the duty of honest performance of contractual obligations, would seem to fall into this category as well. The reason for this is simple. Justice Cromwell, writing for the Court in *Bhasin v Hrynew*, found that if there were not a general expectation on all contractual parties that the contract would be performed honestly, this would undermine the very institution of contracts and require that people write in their expectation of honest performance rather than simply being able to expect it.³⁸ Based on *Bhasin v Hrynew*, therefore, it seems to be clear that the duty of honest performance of a contract cannot be contracted out of by the parties thereto.³⁹ To allow a contracting out of such an obligation would undermine the very organizing principle which is said to animate the need for a duty of honest performance in the first place.⁴⁰

Can this obligation of honest performance be placed on the promoter? In my view, it can. There are two reasons for this. The first reason is that the duty of honest contractual performance is, in my view, placed on those performing its provisions, not merely the technical parties to the contract. On the one hand, prior to the incorporation of the corporation, and its adoption of the underlying transaction, the promoter is a party to the contract. Otherwise, there is no contract to begin with. The liability of the promoter may be limited, but that does not render him or her not a party to the contract at all. Therefore, even in the event that the court were to find that only parties to the contract could be helped to execute its provisions honestly, the promoter, until its ability to affect the transaction is concluded under subsection 21(2)(b), remains a party to the contract,

³⁶ *Machtiger*, *supra* note 34 at 990.

³⁷ *Ibid.*

³⁸ *Bhasin*, *supra* note 32.

³⁹ *Ibid* at para 74.

⁴⁰ *Ibid* at para 73.

notwithstanding a contractual inclusion that avoids liability under subsection 21(4).

However, the better view of the law is that in fact the duty of honest contractual performance is to be placed on any person whose obligation it is to perform the contract. This is particularly the case where there is a corporation which is a party to the contract. Notwithstanding the contractual liability that can inure to a corporation pursuant to a contract entered into on its behalf by an agent, this does not change the fact that in reality the performance of the contract will generally be left to the agents of the corporation (officers and other employees) in order to be carried out.⁴¹ As such, it is a natural outgrowth of the *London Drugs*⁴² case that the person performing the underlying obligations of the contract is under an obligation to behave honestly in so doing. The status of this person as an employee/agent of the corporation does not avoid the liability of that agent for not fulfilling his or her obligations.⁴³ Similarly, the avoidance of liability for the underlying contractual obligation cannot be said to specifically permit dishonest dealing. It seems to me that one cannot write a contract that specifically permits a party to engage in objectively dishonest behaviour vis-à-vis the other.

Thus, the promoter cannot be said to have intended to be dishonest with the other contracting party. Put another way, the argument of the promoter here would have to be that he or she fully intended to not engage in honest behaviour with the other contracting party when entering into this contract. But, as an organizing principle of contracts,⁴⁴ it would be inconsistent to allow any party to argue that the other parties to the contract knew or ought to have known that the first party intended to take advantage of the other party's clear misunderstanding.

Justice Miller writes as follows:

It was reasonable for the motion judge to interpret the phrase “without any personal liabilities” in the context of the contract as a whole, as not applying to the deposit. As he noted, the contract had no express provisions concerning the deposit. In particular, “(t)he terms of the Deposit do not include a provision that

⁴¹ *London Drugs Ltd v Kuehne & Nagel International Ltd*, [1992] 3 SCR 299 at 441, Iacobucci J, for the majority.

⁴² *Ibid.*

⁴³ *Ibid* at 407–08, Iacobucci J, for the majority.

⁴⁴ *Bhasin*, *supra* note 32 at para 33.

if the contract is not performed, the Deposit is to be returned to [the appellant]. Under settled law, such a ‘contrary intention’ must be expressly stated if the deposit is not to be forfeited upon the failure of the purchaser to perform his or her obligations under the agreement of purchase and sale.” As the motion judge found, the interpretation offered by the appellant would render a deposit meaningless, providing no incentive to close the transaction, and no compensation to the vendor for failure to close.⁴⁵

If a “contrary intention” were displayed, I cannot see a situation where one would use the term “deposit” to describe the payment. Where it was not intended to be kept by the person to whom it was given, the word “deposit” is inaccurate. As S.M. Waddams explains:

Not every advance payment of money is categorized as a “deposit” and consequently liable to forfeiture on breach. A mere part payment must be accounted for subject to proof of actual loss. A “deposit” may, by contrast, it is said, be retained even though the holder suffers no loss at all, though it must be brought into account if the holder claims a larger loss. The only distinction between deposits and penalty clauses is that a deposit is payable in advance to secure a later performance whereas a penalty is payable after breach.⁴⁶

A “deposit” that is to be returned regardless of the non-completion of the underlying transaction is not a deposit at all. It is a part payment of the purchase price for the underlying transaction. The non-completion of the transaction (regardless of the reason for non-completion, unless the contract provides otherwise) mandates the part payment be returned, because there is nothing to pay for, other than damages proven by the innocent party. Put another way, the default position with a part payment is that it is to be returned to the party providing it in the event of non-completion, and the default position with a deposit is that the innocent party gets the value of the deposit if the transaction does not close. But, if the promoter’s argument were accepted, the use of the word deposit would be turned on its head. The default position of a part payment would apply despite the use of the word “deposit” in a contract.

Here, the parties chose specific language (“deposit”) that implies a result. The promoter claims that this result is impossible because of another provision (the subsection 21(4) inclusion), and that, therefore, the ordinary implication of the term “deposit” cannot be effective. For me, as a matter of contractual interpretation, we should view this claim with suspicion.

⁴⁵ *Benedetto*, *supra* note 1 at para 16.

⁴⁶ *Waddams*, *supra* note 20.

2. *Other Case Law*

Related to the previous sentence, the second element here is one of conflict between contractual terms. The *OBCA*⁴⁷ simply says that if there is an inclusion pursuant to subsection 21(4), it then follows that the liability so excluded is not enforceable as against the promoter. However, the statute does not define either (i) what words are supposed to be used to gain that exemption nor, and perhaps more importantly, (ii) how those words used are to be interpreted. This is a matter of contract, not a matter of statute. Here, the question then becomes similar to any exclusion clause provided for under any other contract.⁴⁸ It is to be interpreted in accordance with the rules provided for the interpretation of any other contract. This, for example, would include the general rule that exclusion clauses that invalidate other parts of the contract are likely to be narrowly interpreted so as to give effect to as many parts of the contract as possible.

One sees this quite clearly in the decision in *Tilden Rent-A-Car Co v Clendenning*, written by Justice Dubin (as he then was) for the majority.⁴⁹ In this case, the court considered an exclusion clause that would essentially invalidate other parts of the contract. Here, Mr. Clendenning was alleged to have consumed alcohol prior to a single-car accident. He sought to rely upon additional insurance coverage he had purchased from Tilden, so as to avoid the liability that would otherwise have accrued to him. In response, Tilden attempted to rely upon an exclusion clause contained within the additional coverage indicating that the insured would not drive the vehicle if they had consumed any alcohol whatsoever. Given that Mr. Clendenning had pled guilty to driving under the influence of alcohol, Tilden argued that this disqualified him from relying on the additional coverage. The majority found that Tilden could not rely upon the exclusion clause because it was essentially overbroad and was destructive of the entire purpose of the

⁴⁷ *OBCA*, *supra* note 2.

⁴⁸ A careful reader might suggest that I am being inconsistent here. I have previously referred to “a subsection 21(4) inclusion” (see the text accompanying note 7). Here the comparison is to an exclusion clause. A subsection 21(4) inclusion refers to the effect of the language which makes subsection 21(4) relevant to the discussion. However, once the wording of the transaction invokes the subsection, the subsection functions as a limitation or exclusion of liability. Therefore, it is appropriate to refer to this wording as an “inclusion,” while still considering the law applicable to exclusion clauses.

⁴⁹ *Tilden Rent-A-Car Co v Clendenning* (1978), 83 DLR (3d) 400, 18 OR (2d) 601 (Ont CA).

insurance contract into which the parties had entered (that is, the contract for the additional insurance coverage). The exclusion clause not only prohibited alcohol, but it also prohibited speeding at any amount over the posted speed limit, and other exclusions which the court found were essentially unreasonable.⁵⁰

On the facts of *Benedetto*,⁵¹ even independent of *Bhasin v Hrynew*, it would be unreasonable to allow the promoter to rely upon the exclusion provided for subsection 21(4) of the *OBCA* to force the return of the deposit. This is because to do so would be entirely destructive of the purpose of the provision of a deposit in the first place. A deposit is intended to show the seriousness of intent of the party providing the deposit by delineating the circumstances under which the other party may be allowed to keep the deposit in the event that the transaction is not completed. The point of the deposit is to place a prudential disincentive against non-completion by the party providing the deposit. The deposit is that party's "skin in the game." The party providing the deposit will now have something to lose if they choose not to complete the underlying transaction without good cause. Because this is the purpose of a deposit, it makes sense that the party in whose favour the deposit is given (in this case, the seller) need not prove specific damages in order to be allowed to keep the deposit. Allowing the seller to keep the deposit even in the absence of specific damages which need to be remedied furthers the specific purpose of the deposit itself, that is, to force the depositor to recognize a loss in the event that the transaction does not close through the fault of the depositor. However, on the facts of *Benedetto*, to give full effect to the subsection 21(4) inclusion would be to deny the deposit of any meaningful role in the transaction at all. It would not show seriousness of intent to complete the transaction because, in the event of non-performance of the transaction (if the promoter's argument were accepted), the deposit needs to be returned to the promoter. Put another way, though he calls the money paid over to the seller "a deposit," the promoter in fact does not have "any skin in the game." He does not need to identify good cause as to why the deposit should be returned. He is simply leading the third party (in this case, the seller) to believe that there is a prudential disincentive against non-performance of the transaction when,

⁵⁰ *Ibid* at 403.

⁵¹ *Benedetto*, *supra* note 1.

in fact, the promoter maintains control of the entire situation such that he or she knows that he or she can always get the deposit back. In other words, this is not a deposit at all. Just as in *Tilden*, where giving full effect to the exclusion clause would have rendered the additional insurance essentially nugatory, giving full effect to the subsection 21(4) inclusion would have meant that the “deposit” was meaningless or close to meaningless. It is meaningless until a corporation adopts the contract. This means that the person who gives the deposit entirely controls whether it means anything. As such, even if the rule in *Bhasin v Hrynew* has no application here,⁵² the case of *Tilden* could, in my view, nonetheless be used to prevent recovery of the deposit by the promoter.

Also, the *Tilden* case does not stand alone in this regard. To continue further on this matter, one could also rely upon the case of *Gallen v Allstate Grain Co*,⁵³ in particular the majority judgement of Justice Lambert. In this case, the Court was asked to give effect to a very broad exclusion clause (where the seller of seed took on no liability for the productivity of the seed).⁵⁴ However, the court found that there was a specific representation made that the buckwheat produced by the seed would be of sufficient strength so as to overwhelm any weeds that might arise.⁵⁵ The Court first “read down” the very broad exclusion clause,⁵⁶ finding that there was no contradiction between it and the oral representation given.⁵⁷ In the next paragraph, Justice Lambert gave effect to the oral representation, as follows:

But even if I am wrong and cl. 23, if it stood alone, would bear the meaning that Allstate was not to be liable for anything that prevented the production and harvesting of a buckwheat crop grown from the seed, I think it is proper to interpret cl. 23 in its relationship with the oral representation that was made in this case, because it is in the light of that representation that the parties would

⁵² Of course, based on the argument provided in Part IV.2.A., *above*, I do not believe this to be the case.

⁵³ *Gallen et al v Allstate Grain Co Ltd et al* (1984), 9 DLR (4th) 496, 53 BCLR 38 (BCCA), Lambert JA [*Gallen*].

⁵⁴ Clause 23 of the contract provided as follows “23. Allstate gives no warranty as to the productiveness or any other matter pertaining to the seed sold to the producer and will not in any way be responsible for the crop.” *Ibid* at 505.

⁵⁵ *Ibid* at 514.

⁵⁶ *Ibid* at 512–13.

⁵⁷ *Ibid* at 513.

have interpreted cl. 23 when they read it over before signing the document. If that approach to interpretation is the correct one, then the oral representation and cl. 23 must be interpreted harmoniously, if that can be done without depriving cl. 23 of a natural and sensible meaning.⁵⁸

Therefore, the Court of Appeal in *Gallen* refused to read a very broad exclusion clause so as to not give effect to another provision of the contract. Similarly, I would suggest that you read the subsection 21(4) inclusion in the way suggested by the promoter would be to deprive the deposit of a “natural and sensible meaning.”

Furthermore, in *Gallen*, it was also stated that the law of contracts should not be “a tool for the unscrupulous to dupe the unwary.”⁵⁹ There is certainly an argument here that the plaintiff⁶⁰ would be fully aware of the consequences of what he was attempting to do in saying that there was a deposit when in fact he knew or ought to have known that in fact there were no circumstances under which the deposit would ever be paid by him, unless and until the corporation decided to go forward with the transaction. Therefore, it seems clear to me that even as a matter of contractual interpretation, there is no reason to interpret the exclusion of liability in the broad-brush terms that the defendant in the *Benedetto* case sought to impress upon the court, and that the court was right in rejecting that interpretation.

C. The Tort of Deceit

The elements of deceit are as follows:

First, in order to sustain an action of deceit, there must be proof of fraud, and nothing short of that will suffice. Secondly, fraud is proved when it is shewn that a false representation has been made (1) knowingly, or (2) without belief in its

⁵⁸ *Ibid.*

⁵⁹ *Ibid* at 510.

⁶⁰ It is notable that subsection 21(4) has certain requirements that would not necessarily apply to other contractual provisions, such as the need to be in writing. However, the reality is that subsection 21(4) is not something that the average contracting party would intuit as being part of the law of corporations without professional advice. In other words, relatively few non-lawyers would be so fully in the corporate law as to know of both the existence and effect of subsection 21(4) so as to use without professional advice. Therefore, to suggest that the wording invoking subsection 21(4) should negate the “deposit” would itself require generally professional advice prior to contract formation, at least in most cases.

truth, or (3) recklessly, careless whether it be true or false. . . . Thirdly, if fraud be proved, the motive of the person guilty of it is immaterial. It matters not that there was no intention to cheat or injure the person to whom the statement was made.⁶¹

Thus, if a person knowingly misstates a material fact, that is, they lie about something material, they are guilty of civil fraud.⁶² Clearly, this is not dependent upon the contract itself, being a tort at common law. It would be doubtful that a person should be allowed to commit fraud and then say “but you should have been on notice by virtue of the subsection 21(4) inclusion that I would be attempting to defraud you because I was showing my intent to not be bound by the implied obligation to treat you honestly in my dealings with you pursuant to the contract.” This simply to me seems a very unlikely course for any contractual party to be able to take, and an even odder argument for a court to accept.

Furthermore, it is an equitable principle that “fraud unravels all.”⁶³ As Justice Cameron, in dissent (on the basis of a factual disagreement with the majority) explained in *Bolianatz Estate v. Simon*:

Fraud and its effects are far reaching, and they have long commanded the special attention of both common law and equity, especially equity because of its roots in conscience. For centuries the rule has been that fraud unravels all. As Lord Justice Denning put it in *Lazarus Estates Ltd. v. Beasley*, [1956] 1 Q.B. 702 at p. 712: “No court in this land will allow a person to keep an advantage which he has obtained by fraud...Fraud unravels everything.”⁶⁴

This principle has a long history. In *Spence v. Crawford*,⁶⁵ the following was written:

How that goal may be reached must depend on the circumstances of the case, but the court will be more drastic in exercising its discretionary powers in a case of fraud than in a case of innocent misrepresentation. This is clearly recognised by Lindley, M.R., in the *Lagunas* case [*Lagunas Nitrate Co. v. Lagunas Syndicate*]⁶⁶....

⁶¹ *Derry v Peek* (1889), 14 App Cas 337 (HL) at 374, Lord Herschell, cited with approval by Justice Karakatsanis, writing on behalf of the Supreme Court of Canada in *Bruno Appliance and Furniture, Inc v Hryniak*, 2014 SCC 8 at para 19.

⁶² *Derry v Peek*, *ibid.*

⁶³ John McGhee, *Snell's Equity*, 33rd ed (London, UK: Sweet & Maxwell, 2015) at 8-006. See *Master v Miller*, (1791) 4 TR 320 at 337; *May v Platt*, [1900] 1 Ch 616 at 623; *London General Omnibus Co Ltd v Holloway*, [1912] 2 KB 72 at 81.

⁶⁴ 2006 SKCA 16 at para 132.

⁶⁵ [1939] 3 All ER 271 (HL) at 288, Lord Wright.

⁶⁶ [1899] 2 Ch 392 (CA) at 434, Lord Lindley, MR.

There is no doubt good reason for the distinction. A case of innocent misrepresentation may be regarded rather as one of misfortune than as one of moral obliquity. There is no deceit or intention to defraud. The court will be less ready to pull a transaction to pieces where the defendant is innocent, whereas in the case of fraud the court will exercise its jurisdiction to the full in order, if possible, to prevent the defendant from enjoying the benefit of his fraud at the expense of the innocent plaintiff...

These are merely instances. Certainly in a case of fraud the court will do its best to unravel the complexities of any particular case, which may in some cases involve adjustments on both sides.

Both of these quotations are reproduced with approval in *Kupchak v. Dayson Holdings*,⁶⁷ a 1965 decision of the British Columbia Court of Appeal.

Is there a misrepresentation here? The promoter (presumably with legal advice considering that a s. 21(4) inclusion was provided in writing in the contract)⁶⁸ chose the wording of a “deposit.” Given that the parties agreed to put the amount of the deposit into the hands of a third party familiar with real-estate practice (it was a real-estate brokerage),⁶⁹ it seems what this is intended to convey to all parties of the transaction, that is, if the promoter walks away without good cause, the amount will remain in the hands of the seller. The argument of the promoter here indicates that the promoter did not intend to follow that reasonable expectation of the seller.

To my way of thinking, even if this is not an intentional falsehood by the promoter, it is nonetheless a reckless statement that proves to be untrue due to the actions of the very person who made the statement (that is, the promoter). Furthermore, it is not as if the promoter would be unaware of their own expectations with respect to the deposit (that is, the promoter wanted it back). As a result, the promoter was at least reckless with respect to the use of the word “deposit” in these circumstances. As a result, this is a fraudulent misrepresentation. Furthermore, given that the misrepresentation preceded the contract, this is sufficient to show reliance on the misrepresentation, as there is no indication either that the other party knew the true affairs, or that “full and accurate information” had been

⁶⁷ (1965), 53 DLR (2d) 482 at 485, 53 WWR (NS) 65 (BCCA), Davey JA, for the majority [*Kupchak*].

⁶⁸ See *Gallen*, *supra* note 53.

⁶⁹ *Benedetto v 2453912 Ontario Inc*, 2018 ONSC 4524 at para 1.

provided by the misrepresenting party to “counteract” an earlier misrepresentation.⁷⁰

Even if in fact the adage were not entirely accurate (in that fraud does not in and of itself unravel a contract), it still follows that the fraudulent party should not be allowed to benefit from fraudulent behaviour.⁷¹ The party that sought to be fraudulent would no longer have the benefit of a subsection 21(4) inclusion upon which to rely to show that the promoter was not liable for fraud in the first place.

D. Unjust Enrichment?

The law of unjust enrichment may also be applicable here. This is not a case where the plaintiff was seeking to enforce payment of the deposit. The deposit had already been paid. The payor of that deposit was seeking its return. So, even assuming that despite the wording of the contract, the promoter was not under an obligation to pay that deposit, the real question here was: “On what basis would a person be entitled to the return of the deposit?” The most obvious answer to this question would be unjust enrichment. In *Pro-Sys Consultants Ltd v Microsoft Corporation*, the Supreme Court reaffirmed the test for unjust enrichment as follows:

The well-known elements required to establish an unjust enrichment are (1) an enrichment of the defendant; (2) a corresponding deprivation of the plaintiff; and (3) an absence of juristic reason (such as a contract) for the enrichment (see *Alberta Elders*, at para. 82; *Garland v Consumers’ Gas Co.*, [2004] 1 SCR 629, at para. 30; *Rathwell v Rathwell*, [1978] 2 SCR 436, at p. 455; *Pettkus v Becker*, [1980] 2 SCR 834).⁷²

⁷⁰ *Ennis v Klassen*, [1990] 4 WWR 609 at 5, 70 DLR (4th) 321 (Man CA), Huband JA, for the majority.

⁷¹ See, for example, *Kupchak*, *supra* note 67 at 485. For another example of a doctrine that is driven to removing the advantages of fraudulent behaviour, consider the doctrine of rectification. On this point, see *Performance Industries Ltd v Sylvan Lake Golf & Tennis Club Ltd*, 2002 SCC 19, Binnie J, for the Court (finding that the object of rectification is “to prevent a written document from being used as an engine of fraud or misconduct ‘equivalent to fraud’” at para 31). This is “corrective,” I take this to mean that the goal is not to fashion a new agreement between the parties, but to enforce the prior oral agreement that presumably preceded the fraud or misconduct. This is not to suggest that the elements of rectification are fully made out here. I fully acknowledge that they are not. Rather, the point is that the courts tend to seek to remove the economic advantages that a fraudster seeks through his or her fraudulent behaviour.

⁷² *Pro-Sys Consultants Ltd v Microsoft Corporation*, 2013 SCC 57 at para 85, Rothstein J, for

Is this a case where these elements can be made out? In my view, the purchaser in *Benedetto* can clearly make out the first two elements. By allowing the seller to keep the deposit, there is clearly a substantial enrichment of the seller, and a corresponding deprivation to the purchaser. The remaining element, however, is much less clear. Is there a “juristic reason” why the money should remain where it is? In my view, there is. In order to explain why this is so, we must review the analysis of “juristic reason” offered in *Garland v Consumers’ Gas Co.*⁷³ In that case, Justice Iacobucci, speaking for the Court, wrote in part as follows:

First, the plaintiff must show that no juristic reason from an established category exists to deny recovery. By closing the list of categories that the plaintiff must canvass in order to show an absence of juristic reason, Smith’s objection to the Canadian formulation of the test that it required proof of a negative is answered. The established categories that can constitute juristic reasons include a contract (*Pettkus, supra*), a disposition of law (*Pettkus, supra*), a donative intent (*Peter, supra*), and other valid common law, equitable or statutory obligations (*Peter, supra*). If there is no juristic reason from an established category, then the plaintiff has made out a prima facie case under the juristic reason component of the analysis.

The *prima facie* case is rebuttable, however, where the defendant can show that there is another reason to deny recovery. As a result, there is a de facto burden of proof placed on the defendant to show the reason why the enrichment should be retained. This stage of the analysis thus provides for a category of residual defence in which courts can look to all of the circumstances of the transaction in order to determine whether there is another reason to deny recovery.

As part of the defendant’s attempt to rebut, courts should have regard to two factors: the reasonable expectations of the parties, and public policy considerations.⁷⁴

We begin with the basic idea that there is in fact a contract at play here. This is identified by name as one of the juristic reasons that fits an established category, according to Justice Iacobucci. Now, the plaintiff may suggest that the contract referred to specifically says that he is not liable on the underlying contract. However, unjust enrichment is not concerned with liability for damage. Rather, it is concerned with whether there is a reason to force the return of money that has been paid. In my view, the question is not whether this particular person should have made this payment. Instead,

the Court.

⁷³ *Garland v Consumers’ Gas Co.*, 2004 SCC 25, Iacobucci J, for the Court [*Garland*].

⁷⁴ *Ibid* at paras 44-46, citing *Pettkus v Becker*, [1980] 2 SCR 834; *Peter v Beblow*, [1993] 1 SCR 980.

the question is whether there is a reason to allow the recipient of the payment to hold onto that payment, once it is received. We will return below to the idea that there is in fact a reason why the promoter in this particular case may have made the payment. The contract, as written, provided for a deposit.⁷⁵ The Court of Appeal was correct in pointing out that the purpose of the deposit is to show seriousness of intent.⁷⁶ If this is the purpose of a deposit, the provision of it, by anyone, is generally in furtherance of that contract.

In my view, it matters not that the promoter himself is not a party to the contract. It matters only that there is a contract under which the deposit was paid. Perhaps a simple analogy would help here. Imagine that a young adult wished to purchase a home. That young adult had a sufficient cash flow to be able to make the periodic payments on the mortgage, but not to make those payments and to make the payment of the deposit required at the time of signing the contract of purchase and sale. The young adult's parent agrees to make the deposit payment. If a non-party to the contract (the parent) offered to pay the deposit on behalf of the party (the young adult), and then the party defaulted such that the deposit money would be payable to the third-party (the seller of the home), would the non-party have the right to reclaim from the seller the deposit paid to the seller by the non-party?

Of course not. The source of funds for the deposit matters not in the least, in my view. The dispute, if there is to be one, is the means by which the non-party recovers from the defaulting party the deposit given to the defaulting party. In other words, this becomes a dispute between the parent and the child. The seller need not concern him- or herself with the source of the funds for the deposit. As long as it is a "deposit," and there is a default according to the wording of the contract, the deposit remains where it is, that is, with the seller. The parent would not be permitted to argue that he or she was not a party to the contract and that, therefore, the money paid by him or her to the seller cannot be kept by the seller. The parent operated to assist the child; that assistance operated in the way that it was supposed to, in the sense that without the deposit money being paid to the seller, the seller would not have been prepared to complete the transaction. Nothing about the actions of the seller is in any way suspect.

⁷⁵ *Benedetto*, *supra* note 1 at para 14.

⁷⁶ *Ibid* at para 55.

What is the role of the promoter? If nothing else, he or she is a functionary.⁷⁷ As the Court of Appeal for Ontario put it in *1394918 Ontario Ltd v 1310210 Ontario Inc*:

Prior to incorporation and adoption, the promoter is not personally bound or entitled to benefits of the contract. He might be described as a functionary, performing such duties as assuring that any necessary inspections of property or title are pursued, that deadlines are met, and defaults avoided which might excuse the third party from the obligations. At the same time, the corporation does not exist or has not adopted the contract and thus is not bound by it or entitled to its benefits. There is an entity called a “contract” under the statute, but no one is entitled to sue for its breach. That is not to say that ongoing obligations can be ignored. I would term this a nascent contract, its enforceability being suspended.⁷⁸

The promoter allows the transaction to function in the interim, from the time that the transaction is entered into, until either: (a) responsibility for the transaction is adopted by the corporation pursuant to subsection 21(2), or (b) the transaction is terminated. On the facts of *Benedetto*,⁷⁹ it is clear that it was the latter result that occurred.⁸⁰

If the third party were to sue the promoter to enforce the deposit, this would be solely dependent on the enforceability of the contract as against the promoter. In other words, if the contract were signed and the deposit were not paid, would the third party have an action against the promoter for the enforcement of the deposit? In my view, any such proposed action would be doomed to failure. The impact of a subsection 21(4) inclusion would mean that the court could not compel the performance of the contract. However, once the money was paid over, the issue is quite different. The promoter does so, not on his own behalf, but as a functionary of the contract itself, who is given the right (I will assume, for the purposes of the current argument, the right, but not the obligation) to make the contract function until the actual contractual party (that is, the corporation) comes into existence, and takes over all obligations under the contract.

Clearly, when the promoter operates as a functionary, in order to keep the contract on foot and potentially allow it to be completed, he does so as

⁷⁷ *1394918 Ontario Ltd v 1310210 Ontario Inc* (2002), 57 OR (3d) 607 at para 9, 154 OAC 137, Carthy JA, for the Court [*1394918 Ontario Ltd*].

⁷⁸ *Ibid* at para 9.

⁷⁹ *Benedetto*, *supra* note 1.

⁸⁰ *Ibid* at para 17.

a representative or potential representative of the corporation that will later come into existence. Perhaps more importantly, he does not represent the third party's interests. Thus, in economic terms, he remains at arm's-length from the third party.⁸¹ Generally, when a party operates at arm's-length from another party, those parties may have divergent economic interests. The promoter cannot expect that the seller will protect the interests of the promoter in the circumstances. In demanding the deposit, there is a recognition that the seller is protecting his or her interests against the possibility of the potential buyer walking away from the transaction. In delivering the deposit, the promoter is acknowledging the legitimacy of those concerns, and permitting the contract to go forward on the terms agreed to.

Yet, if the promoter were permitted, by a subsection 21(4) inclusion, to demand the return of the deposit, it would be as if the potential seller was there to guarantee the obligations between the promoter and those who hired him or her. If the people who hired the promoter were unwilling to make him or her whole, after the promoter paid the deposit, the promoter would have a claim under agency law.⁸² The basis of this claim would be that an agent is generally entitled to reimbursement for his or her expenses in the course of undertaking his or her duties as an agent.⁸³ In other words, allowing the promoter to demand the return of the deposit from the third party essentially places the third party in the position of hoping that the transaction closes, rather than giving an incentive to the promoter (or his or her principals, if any)⁸⁴ to ensure that it closes so as not to lose the deposit.

⁸¹ Arms-length refers to a standard situation where orthodox economic principles would apply. In other words, the seller wants the highest possible price for his or her goods or services, and the buyer wants to pay the lowest possible price. For example, family members are generally considered not to be at arms-length from each other, because their bonds of love and affection may cause them to accept a transaction that an economist would consider to be "irrational" in economic terms.

⁸² See e.g. Cameron Harvey & Darcy MacPherson, *Agency and Partnership Law Primer*, 5th ed (Toronto: Thomson Reuters Canada Limited, 2016) at 178. See also Gerald Fridman, *Canadian Agency Law*, 3rd ed (Markham, ON: LexisNexis Canada Inc, 2017), s 4.13.

⁸³ Harvey & MacPherson, *ibid*; Fridman, *ibid*.

⁸⁴ Lest I be misunderstood, when I refer to "principals," I am not referring to the non-existent corporation. At common law, it was simply not possible to hold a non-existent corporation liable on a contract that was entered into prior to the incorporation of the corporation. On this point, see *Kelner v Baxter* (1866), LR 2 CP 174 (Common Pleas);

If, on the other hand, there are no other principals, and the promoter is engaging in the transaction for him or herself, but wants the underlying property to be held by a corporation when the transaction closes, there is even less reason to protect the promoter in such a scenario. He or she can simply bring the corporation into existence without the approval of any other individuals, and the transaction can be completed. This of course assumes that the shareholders (or others) in the nascent corporation put in sufficient debt or equity to allow the corporation to complete the pre-incorporation transaction.⁸⁵

Regardless of whether the promoter is serving an already existing principal or not, it should be reasonably clear that the law places no obligation on the recipient of deposit funds to question the source of those funds to ensure that those funds can be returned. Even if the transaction is not completed, and the deposit needs to be returned by the third party, it is

Black v Smallwood (1966), 117 CLR 52 (HCA); *Newborne v Sensolid (Great Britain) Ltd*, [1954] 1 QB 45 (CA).

At common law, all that was left was the novation of a contract following the incorporation of the corporation. However, novation is really the creation of a contract on the same terms as the original contract, and the replacement of the original contract by the novated contract following the incorporation. But this is not the enforcement of the original contract as against the corporation. Rather, this is the enforcement of a contract entered into subsequent to the incorporation of the corporation against which it is sought to be enforced. This explains, in part, why statutory reform was necessary, so as to allow the corporation to be “brought into” the original contract.

When I refer to “principals” in this paragraph, I am referring to individuals (or already existing corporations) who hire the promoter to enter into the underlying contractual terms. In most common agency relationships, there are actually three parties involved. The first is the principal (the person who engages the agent to enter into transactions on behalf of him or her); the agent (the person whose actions pursuant to instructions generally bind the principal), and the third party (the party with whom the agent interacts so as to create a change to the principal’s position). On these points, see e.g. *Harvey & MacPherson*, *ibid* at 1; *Fridman*, *ibid*, s 1.2. See also *Freeman & Lockyer v Buckhurst Park Properties (Mangal) Ltd*, [1964] 1 All ER 630 at 630–31, Lord Justice Diplock, as he then was.

⁸⁵ Interestingly, under Ontario law, there is no requirement for a promoter to ensure that the corporation that is brought into existence to complete a pre-incorporation transaction entered into prior to the incorporation of the corporation. Nothing in s. 21 requires that any money be put into the corporation by anyone. Moreover, unless the promoter has actively misled a third party with respect to this, s-s. 21(3) has no application. On this point, see *Bank of Nova Scotia v Williams*, *supra* note 11.

quite clear that it should be returned to the other contracting party, in this case, the putative buyer.

This, of course, leads to the question of to whom the third-party seller would return this particular deposit, had the return of such deposit been hypothetically necessary? The corporation does not yet exist or has not yet adopted the contract pursuant to subsection 21(2). As such, it has no rights under the contract. If the seller had walked away, it seems to me, that the promoter would have been the correct person to whom to return the deposit money, in his role as functionary. After all, to whom else would the deposit money have been returned? If the answer is “no one,” then not only with the seller be able to walk away from the transaction with impunity, the seller would in fact be better off than when they began the transaction. The law cannot be seen to countenance this degree of economic perversity.

If I am correct that the law would not permit such a perverse result, in my view, it then follows that in the reverse situation (where the promoter is trying to both not complete the contract and force the return of the deposit), the equally perverse result of allowing both things to occur should be avoided. One way to avoid that perverse result is to acknowledge the contract. Once one need not be a party to the contract for that contract to form the basis of a “juristic reason” for the purposes of unjust enrichment, then the promoter cannot reasonably expect the return of the deposit if he or she backs away from the transaction prior to closing.

Another way to resolve the same issue is to say that Party A (in this case, the promoter) paid the money to Party B (in this case, the seller) in order to keep the contract between Party B and Party C (the non-existent corporation) on foot. If Party B does not make the payment, there will clearly be a right to repudiate the contract.⁸⁶ For whatever reason, Party A

⁸⁶ For the sake of this argument, I am assuming that if the deposit had not been paid, this would be a demonstration of a lack of seriousness of intent because (as shown by the argument above) seriousness of intent is the very purpose of a deposit. If a party demonstrates a lack of seriousness of intent to complete the underlying transaction, a court would not force the non-breaching party to complete the non-breaching party's performance under the contract. Thus, in my view, the failure to provide the deposit would have been a breach of condition. For cases discussing the difference between breach of warranty (damages, but repudiation of the contract is not allowed), on the one hand, and breach of condition (damages and repudiation of the contract are both allowed), see e.g. *Hongkong Fir Shipping Co Ltd v Kawasaki Kisen Kaisha Ltd*, [1962] 2 QB 26, [1962] 2 WLR 474 (CA); and *Spirent Communications of Ottawa Ltd v Quake Technologies (Canada) Inc*, 2008 ONCA 92, Gillese JA, for the Court. As long as there is

wants the contract to remain on foot and, therefore, pays the amount. There is now an offer by conduct (the offer to pay the money by Party A).⁸⁷ The conduct of Party B (accepting the deposit amount) is consistent only with acceptance.⁸⁸ The consideration received by Party A is that the contract between Party B and Party C remains on foot (which it did). Party A therefore, paid consideration to ensure that that Party B will complete the contract between Party B and Party C. This is valid consideration at law.⁸⁹ Therefore, there is a contract between Party A and Party B. Neither Party A nor Party B is a non-existent corporation in this scenario. In this scenario, s. 21 of the OBCA⁹⁰ has no application.⁹¹

a possibility of a breach of condition, repudiation is a possible remedy. If repudiation is a possible remedy, then additional consideration to avoid this potential outcome may be valid at law. See *Williams v Roffey Bros*, [1990] 1 All ER 449 (CA), Lord Justice Glidewell.

⁸⁷ See *J Evans & Sons (Portsmouth) Ltd v Andrea Merzario Ltd*, [1976] 2 All ER 930 at 935 (CA), Lord Justice Roskill (as he then was).

⁸⁸ *St John Tug Boat Co Ltd v Irving Refining Ltd*, [1964] SCR 614, Ritchie J, for the Court.

⁸⁹ *Shadwell v Shadwell* (1860), 142 ER 62, 30 LJCP 145.

⁹⁰ OBCA, *supra* note 2.

⁹¹ To be clear, I am not suggesting that the Court of Appeal needed to find a separate contract to arrive at the result that it did. In my view, however, if, as the plaintiff here alleged, there was no obligation on him to perform the contract between the non-existent corporation, on the one hand, and the third party, on the other, this does not preclude the Court from enforcing a separate contract based on the activities undertaken by the promoter to achieve the goals of the first contract. As long as the basic elements of a contract are present (offer, acceptance, and consideration), why should this contract not be found to be a contract? Even the *aminus contrahendi* (intention to contract, see the judgment of Lord Moulton in *Heilbut Symonds and Co v Buckleton*, [1913] AC 30 (HL)) is present, as the promoter clearly intends to keep the contract from Party B and Party C from collapsing.

V. MEMBERS OF THE BAR THINK THAT THE COURT OF APPEAL IS WRONG

Angela Swan thinks the Court of Appeal is wrong,⁹² and another member of the profession agrees.⁹³ Her argument is three-fold. First, she thinks that the argument of the Court of Appeal that separates the deposit from the contract of purchase and sale is wrongheaded. In the excerpt below, she refers to this as the “second ground.” She writes:

The premise of the second ground, *viz.*, that the deposit and the contract of purchase and sale reflect different obligations—see para 7 of Miller J.A.’s reasons—is simply flatly wrong: there is one contract, under the terms of which a deposit was paid.⁹⁴

As can be seen in the analysis offered in Part III of this article, I agree with this point. Unfortunately, while I have great respect for the knowledge of contracts possessed by Ms. Swan,⁹⁵ after this point, we part company on the issues addressed here.

She argues that there would be no juristic reason why the deposit should not be returned. I begin by asserting that above, I made an argument that in fact the law of restitution favours the result reached by the Court of Appeal.⁹⁶ My goal here is not to repeat this argument; rather, here, my goal is to deal head-on with Ms. Swan’s commentary.

She writes:

A deposit paid by a purchaser when the vendor breaches the contract or the contract is otherwise unenforceable – whether or not the agreement deals with the return of the deposit – cannot be retained by the vendor because, the contract being unenforceable by the vendor, it cannot resist a claim in restitution by the purchaser: there is no juridical basis for the vendor’s claim to keep the deposit.

⁹² See Angela Swan, “Pre-Incorporation Contracts and the Court of Appeal” (13 March 2019), online: *Aird Berlis* <www.airdberlis.com/insights/publications/publication/pre-incorporation-contracts-and-the-court-of-appeal> [perma.cc/2HV5-D6VZ].

⁹³ See David Sanders, “The Court of Appeal wrongly upends a routine practice” (15 March 2019), online: *Camberwell House* <personallaw.ca/2019/03/15/the-court-of-appeal-wrongly-upends-a-routine-practice> [perma.cc/HK3A-D3RG], which supports the views of Ms. Swan.

⁹⁴ Swan, *supra* note 92.

⁹⁵ See Angela Swan, Jakub Adamski & Annie Y Na, *Canadian Contract Law*, 4th ed (Markham, ON: LexisNexis Canada Inc, 2018).

⁹⁶ See Part IV.4, *above*.

This situation existed in *Benedetto*; the nominal party, the corporation-to-be-incorporated, could not be sued when the contract had not been adopted, just as the promoter, who had disclaimed personal liability, could not be sued, and, the contract being then unenforceable by the vendor against anyone, the vendor has no defence to the promoter's claim in restitution for money had and received or money paid.⁹⁷

In my view, this misses the mark. It is not that the defendant seller is attempting to enforce the contract against anyone. The plaintiff promoter is seeking the return of the deposit. If every time there was a claim in restitution involving a contract, this necessarily involves enforcing the contract, Ms. Swan falls into a trap similar to that which confounded the analysis of the Court of Appeal. The Court of Appeal was artificially separating the deposit from the contract. Ms. Swan is artificially combining the enforceability of the contract with the element of a contractual underpinning to an unjust enrichment claim. In fact, if the contract always had to be enforceable before the contract could form the basis of a juristic reason to resist an unjust enrichment claim, there would be no need for unjust enrichment in a contract case. The value would move in accordance with the contract. But, where the value moves for other reasons, the contract may justify not returning the value. Ms. Swan is clearly looking at this through the lens of the promoter. I am looking at the contract. The contract is valid.⁹⁸ If so, it remains a juristic reason that the value transferred to keep it operating can remain in the hands of the defendant.⁹⁹

The third point made by Ms. Swan is found in the contribution's only footnote. She writes:

The decision [in *Sherwood*] was in fact reversed—yes, reversed!—six months later in *Szecket v. Huang* (1998), 42 O.R. (3d) 400, 168 D.L.R. (4th) 402, 42 B.L.R. (2d) 1

⁹⁷ Swan, *supra* note 92.

⁹⁸ See *1394918 Ontario Ltd*, *supra* note 77 at para 10.

⁹⁹ It appears that Ms. Swan is trying to protect the ability of lawyers to use the law to the advantage of their clients because she views the use of subsection 21(4) as a standard tool in the law to be used. While I cannot disagree, in my view, the law of deposits is equally a tool that is also important in the law. Allowing one important tool to overwhelm the other is a bad idea. Deposits are more common (and are more easily understood by the layperson) than is subsection 21(4). If there is conflict between the two tools, I choose to advantage the layperson over the lawyer. In addition, the answer is that parties that expect the “deposit” to be returned not agree to a deposit, or at least be honest that the deposit is not to be kept in the event of non-completion, that is, it is a partial payment, and not a deposit at all.

(C.A., McMurtry C.J.O., Laskin & Borins J.J.A.). The lesson of *Szecket* has not, however, been accepted; the Court of Appeal still refers to *Sherwood Design* and ignores *Szecket*.¹⁰⁰

There are three answers to this statement. First, even if one panel (in *Szecket*¹⁰¹) could overrule the holding of another (in *Sherwood Design Services Inc. v. 872935 Ontario Ltd.*¹⁰²), it would also follow that the panel in *Benedetto*¹⁰³ could overrule the holding of the panel in *Szecket*. Surely, our jurisprudence is not that easily overwhelmed by subsequent developments.

Second, the excerpt is internally contradictory. According to CanLII,¹⁰⁴ *Szecket* has been cited by 10 cases; *Sherwood* has been cited by 16 cases. Therefore, as Swan herself appears to recognize, the weight of authority does seem to favour *Sherwood* over *Szecket*.¹⁰⁵ While Swan and others¹⁰⁶ seem to prefer the reasoning in *Szecket*, that in itself does not support Swan's "overruling" hypothesis.

Finally, the panel in *Szecket* specifically disavows the statement made by Ms. Swan. In *Szecket*,¹⁰⁷ the panel (which included Justice Borins, previously the *ad hoc* justice who authored the dissenting opinion in *Sherwood*),¹⁰⁸ wrote as follows:

Although it is a salutary principle that it is inappropriate for one panel of this court to disagree with the decision of another panel on a question of law, we are satisfied that it would not offend this principle for us to adopt Borins J.A.'s analysis of the law of pre-incorporation contracts. If neither the reasons, nor the result of the majority, are in any way inconsistent with the legal analysis of the minority, it is open to a subsequent panel of the court to adopt the legal analysis of the minority. We have reached this conclusion because the issue in the *Sherwood* case was different from the issue we have to decide in this appeal. Further, because the majority in *Sherwood* did not comment on the legal analysis of pre-incorporation

¹⁰⁰ Swan, *supra* note 92, n 1.

¹⁰¹ *Szecket v Huang* (1998), 42 OR (3d) 400, 168 DLR (4th) 402 (CA) [*Szecket*].

¹⁰² *Sherwood*, *supra* note 10.

¹⁰³ *Benedetto*, *supra* note 1.

¹⁰⁴ As of August 5, 2019.

¹⁰⁵ Swan, *supra* note 92, n 1.

¹⁰⁶ *Ibid.* See also Poonam Puri "The Promise of Certainty in the Law of Pre-Incorporation Contracts" (2001) 80 Can Bar Rev 1051.

¹⁰⁷ *Szecket*, *supra* note 101.

¹⁰⁸ *Sherwood*, *supra* note 10.

contracts, there was no essential difference of opinion between the majority and the minority of the court on this subject. Finally, the result of this appeal does not impugn the result reached by the majority in the Sherwood case. The main issue in the *Sherwood* case centred on the interpretation of s. 21(2) of the OBCA and its application of the facts to that case, whereas in this appeal the focus is on the interpretation of s. 21(4).¹⁰⁹

While I disagree vehemently with the panel's characterization of the reasons of the majority in *Sherwood*,¹¹⁰ I think one has to take the panel in *Szecket* at their word, in that they were not trying to impugn the result in *Sherwood*. If the panel in *Szecket* is not "impugning" the result in *Sherwood*, in my view, it is very difficult to accept that they are "overruling" the case.¹¹¹

VI. CONCLUSION

In the end, I believe that the result in *Benedetto*¹¹² is correct, though the commentary that criticizes the case is partly correct as well. However, there are other routes to the result of the Court of Appeal, and, to me, those routes, particularly when taken collectively, are quite persuasive. The critical commentary is, for my taste, too harsh and misstates earlier decisions.

There is undoubtedly a conversation that needs to be had in both judicial and legal circles about the appropriate use of pre-incorporation transactions. Maybe the debate detailed here can be a catalyst for this

¹⁰⁹ *Szecket*, *supra* note 101 at para 28 [emphasis added].

¹¹⁰ *Sherwood*, *supra* note 10. In my view, the majority disagreed with the legal approach offered by Justice Borins with respect to pre-incorporation transactions, and the driving forces behind the legislative changes to the common-law scheme in this regard.

¹¹¹ I leave aside, for the moment, the argument that corporate lawyers routinely advise their clients to utilize subsection 21(4) (and its equivalents in other jurisdictions) for tactical reasons in contract negotiations. Most major law firms have shelf corporations already incorporated to assist clients on short notice, if necessary. See Swan, *supra* note 92, and Sanders, *supra* note 93. This is really a policy question, raised by the commentary, but not directly by the case itself.

This policy question leads us into broader questions of the appropriateness of subsection 21(4) (and its equivalents in other jurisdictions) in the modern legal world, and questions of ethical issues such as "sharp" practice by lawyers. In an effort to keep this case comment within reasonable bounds, these broader questions will need to be left to another day.

¹¹² *Benedetto*, *supra* note 1.

conversation because the use of pre-incorporation transactions seems unlikely to disappear in the near future.