
PURCHASING REAL ESTATE IN THE PRE-INCORPORATION STAGE

*By Luis R. Chacin and Adriel N. Clayton**

A. INTRODUCTION

On February 25, 2019, the Court of Appeal for Ontario released its decision in *Benedetto v. 2453912 Ontario Inc.*,¹ dismissing an appeal of the lower court's decision concerning the return of a deposit paid on a commercial real estate purchase involving a pre-incorporation contract. The lower court had previously held that the buyer of the real property (the "Buyer") had forfeited its \$100,000.00 deposit to the vendor when it failed to close the transaction as contemplated by the agreement of purchase and sale. The Buyer entered into the agreement in his personal name "in trust for a company to be incorporated without any personal liabilities."

B. CASE SUMMARY

Generally speaking, when a buyer, as an individual, defaults on an agreement of purchase and sale prior to closing by electing not to close the transaction, that individual is in breach of contract and is liable to the vendor, who may pursue damages or alternate remedies. However, in this case, the contract was a pre-incorporation contract executed by the Buyer as a person acting on behalf of a company to be incorporated after the agreement was signed. In such instances, subsections 21(1) and (4) of Ontario's *Business Corporations Act* ("OBCA")² provide that:

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¹ 2019 ONCA 149.

² RSO 1990, c B.16.

(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.

[...]

(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.

The Buyer argued that subsection 21(4) of the OBCA provides an exception for contracts executed by a promoter on behalf of a company intended to be incorporated later. This subsection provides that pre-incorporation contracts may expressly exclude the promoter who executed the contract on behalf of the yet to be incorporated company from being bound by the contract or entitled to the benefits contained therein. The effect of this would be such that the vendor cannot obtain damages against the promoter and can only obtain damages against the newly created corporation if such corporation adopts the contract executed by the promoter. In this regard, the Buyer argued that he was not personally liable under the agreement of purchase and sale, including for the deposit.

However, the court agreed with the lower court decision that the provisions of the OBCA regarding pre-incorporation contracts do not displace the long-standing common law rule that the deposit in a real estate transaction is not part of the contract of purchase and sale, but is rather a security for the buyer's performance of the contract. In this sense, if the buyer refuses to close the transaction, the deposit is forfeited to the benefit of the vendor. The court further stated that the deposit serves two functions: (1) as an incentive to the buyer to close the transaction; and (2) as compensation to the vendor for the opportunity cost of taking the property off the market and the loss of any bargaining power resulting from the disclosed price.

The court clarified that the parties may contract with respect to the deposit, but unless an express provision refers to the deposit also excluding the personal liability of the promoter, the exclusion referred to in the OBCA will not apply to the deposit.

C. CONCLUSION

As demonstrated in this case, individuals acting as promoters of yet-to-be created corporations may continue to be personally liable for deposits paid under agreements of purchase and sale for real property, notwithstanding any clauses indicating that such agreements are without any personal liabilities. Real property investors acting as promoters should therefore be careful with pre-incorporation contracts, and should seek legal advice early in the negotiation process to make sure appropriate measures are taken to meet their expectations and ensure adequate protection.



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