

CANCELLATION AND RESCISSION RIGHTS WITHIN CONSTRUCTION CONTRACTS

Although developers continue to submit project proposals to strengthen local economies and increase affordable housing, there is a growing trend in which development projects are being cancelled. Readers will likely be familiar with a contract coming to a premature end because a party terminates the contract. Sometimes, however, equity or the terms of a contract permit a party to exercise a right that causes the project to be rescinded or cancelled such that the contract is completely undone.

Rescission is, in the legal sense, *“the unmaking of a contract, or an undoing of it from the beginning”*.¹ Rescission is an equitable remedy at law and not a term that is negotiated as part of a contract. When an equitable right to rescission is available and duly exercised, the parties to the contract are placed back into substantially the same position they were in before entering the contract.

A party may be entitled to rescind a contract in response to discovery of a material misrepresentation by the other party. An example would be a purchaser asserting that they are rescinding the contract after discovering that a builder has materially misrepresented their previous experience or their ability to perform the complex work required. If the right to rescind is disputed by the builder, the purchaser will be

obliged to prove that they relied on the misrepresentation when entering into the contract.

The exercise of a right of rescission, where available, must be done within a reasonable time period. What is a “reasonable time” will be based on the particular facts of each case, but rescission will likely only be available when, at most, a nominal amount of work has not been completed so that it remains possible to place the parties back into the positions they were in prior to entering the contract. Otherwise, the dissatisfied party may need to pursue other remedies to respond to the misrepresentation.

Parties to a contract can also negotiate a cancellation clause that will similarly allow the contract to be undone post-execution. This type of clause should specify the period in which a right to cancel can be exercised and the reasons why. A party might seek to include a cancellation clause to respond to factors that are beyond that party’s reasonable control.

In the recent case of *Firestar Custom Home Builders Inc. v 1099000 B.C. Ltd.*, the BC Court of Appeal considered a cancellation clause that related to a purchaser’s ability to obtain financing for a construction project.²

(Continued on page 2)

The case involved a contract that included the following clause:

The Builder and Purchaser agree that if the Builder is not able to commence construction within a period of sixty (60) days from the date of this Agreement due to causes beyond his reasonable control, such as an inability to obtain a building permit, failure of the Purchasers [sic] to qualify for a mortgage (if a condition of this agreement), or failure to comply with provincial or municipal statutes, the Builder or the Purchasers may cancel this Agreement on written notice mailed to the address of the other party shown on this agreement. The Builder's liability to the Purchasers shall be limited to the refund of any monies paid by the Purchasers to the Builder less any costs reasonably incurred by the Builder on account of this Agreement.

The start of construction was initially postponed for almost two years because of delays in obtaining a building permit. By the time the building permit was in place, the purchaser's lender required a reappraisal of the project after which the lender advised the purchaser that it would not fund construction. The purchaser then advised the builder that it was cancelling the contract.

The builder contested the purchaser's ability to rely on the cancellation clause and also claimed that the purchaser was required to pay the builder's lost profits. At summary trial the BC Supreme Court held that because the builder had not started construction within 60 days and because the purchaser was refused financing, the purchaser was entitled to cancel the contract, and could do so years after the contract had been executed.

The builder appealed the court's decision and argued that the contract could not be cancelled because the contract did not include an express

condition regarding the purchaser obtaining financing. The BC Court of Appeal noted that such a condition was not expressed in the contract, but it was not clear whether financing was a condition imposed by an implied term, a collateral agreement, trade usage or otherwise. The Court of Appeal concluded that this evidentiary issue was not raised at trial and that it was too late to raise it on appeal. The Court of Appeal consequently affirmed the finding that the parties mutually agreed to the terms of the cancellation clause which allowed for rescission if the purchaser failed to obtain financing.

The BC Court of Appeal also rejected an argument by the builder that the purchaser was liable to pay compensation on the basis that the purchaser repudiated the contract. Repudiation occurs when one party says that they will not perform their obligations under a contract despite being obliged to do so. The innocent counter party then has a choice: terminate the contract immediately and seek damages or reject the repudiation and insist the contract be performed. The Court of Appeal held that repudiation was not engaged in this case because the contract was cancelled. Cancellation freed the purchaser from its contractual obligations so there was nothing to repudiate.

Although contractors may believe that they have entered into a binding contract, they should remain mindful of the possibility that such a contract is later undone because of a cancellation clause or the exercise of a right of rescission.

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¹ Black's Law Dictionary, 5th ed. (1979), "rescission of contract".

² *Firestar Custom Home Builders Inc. v 1099000 B.C. Ltd.*, 2022 BCCA 324.



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Our lawyers combine legal experience in local government, commercial real estate development, and construction law to provide legal services to local governments, owners, builders and developers on a range of projects, from concept to completion, and beyond.

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