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Are Option Agreements Unbalanced? They Should Be.

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At first glance, a commercial agreement that provides for an option to purchase property or a right may seem unfair. The party who has the option, i.e. the optionee, could invest significant money and time in a venture; however, if the optionee does not satisfy every precondition of the option, it may have nothing to show for it in the end. So why do Canadian Courts enforce the preconditions of an option agreement so strictly? A recent decision of the Ontario Court of Appeal, *798839 Ontario Ltd. v. Platt*, 2016 ONCA 488, per Blair J.A. ("*Platt*"), answers this question.

In *Platt*, the Court made it clear that the reason for requiring the optionee to fulfill every precondition of the option is to protect the interests of the party who gave the option, i.e. the optionor. By giving the option, the optionor risks that it will be bound by the price it offered if the optionee fulfills the preconditions of the option. Thus, the Courts require that the optionee strictly adhere to the terms of the option because of the risk assumed by the optionor.

While this reasoning could very well result in the optionee investing time, money and effort in an option that is never realized, this is the chance the optionee takes. In the eyes of the Court, the unfairness to the optionee is irrelevant.

The Facts

Platt involved an agreement to develop mining claims in northern Ontario. The respondent owned the rights to various mining claims with respect to mineral deposits. After exhausting all of his funding, the respondent sought investors to develop his mining rights. The appellant was an investor interested in pursuing the project with the respondent.

The appellant and the respondent entered into various agreements, including an "Option Agreement". Under the Option Agreement, the appellant agreed to engage in exploration development, test and a feasibility study. If these preconditions, amongst others,

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were fulfilled, the appellant would earn a 100% interest in the mining claims.

The appellant and the respondent would then carry forward with the project together and the respondent would thereafter retain a right to a 5% royalty payment from all profits. Moreover, under the Option Agreement, the respondent had the right to buy back a minimum 50% interest in the mining claims if the appellants failed to develop the venture further, to the level of production.

Ultimately, the relationship between the parties deteriorated in 1989. By that time, the appellant had advanced $10.8 million for the development and exploration of the mining claims. However, the appellant had not fulfilled all the requirements of the option in order to acquire a 100% interest in the mining claims.

The parties brought numerous claims and counterclaims against each other. The appellant brought an action against the respondent arguing, amongst other things, that the Option Agreement transferred title to them completely and that they therefore owned the mining claims. The monies transferred to the respondent, the appellant argued, were merely being held in trust by the respondent as trustee.

The trial judge held that the appellant only earned a 100% interest in the mining claims *after* fulfilling the option's preconditions. Because the appellant failed to comply with these conditions, the respondent remained entitled to the mining claims.

On appeal, the Court of Appeal upheld the trial judge's ruling.

Option Agreements Are Inherently Unbalanced

At the appeal, the appellant argued that the trial judge erred in interpreting the Option Agreement. In particular, the appellant argued that the trial judge failed to properly consider important aspects of the factual matrix surrounding the Option Agreement.

First, the appellant claimed that the respondent, at the time he entered into the Option Agreement, was in "dire financial straits". He desperately needed an investor. Thus, the appellant argued that the respondent did not have the "leverage to extract the type of unbalanced protection of his interest that emerged from the Option Agreement".

Second, the appellant argued that that the trial judge's interpretation of the Option Agreement meant that the appellant would invest $20 million in the venture and lose everything, with nothing to show for their investment. At the same time, the respondent optionor would retain his mining claims and all the benefits of the optionee's investment.

The Court of Appeal rejected both these arguments.

The Court held that the "logical end point" of the appellant's argument was that, under the Option Agreement, the appellant would obtain complete title to the mining claims, whether or not they carried out their exploration, development and testing obligations under the agreement and whether or not they advanced all the monies they were required to advance. This was not a sound interpretation of the Option Agreement.

The Court acknowledged that its interpretation of the Option Agreement would result in unfairness to the appellant optionee. However, the Court held that the unfairness in requiring the optionee to fulfill all the conditions of the option before it obtained legal title to the mining claims was part and parcel of an option agreement.

An option agreement carries significant risk for the optionor, who will be held to the terms of the deal, including the price the optionor offered, if the option is exercised:

> The reality is that option agreements are by nature instruments that can be viewed as providing for "unbalanced" outcomes from the perspective of either the optionor or the optionee. The optionor benefits from the "price" if the option is exercised…but runs the risk of being stuck with that the price even if the value of the property or right that is optioned turns out to be considerably more than the optionor bargained for. The optionee buys the ability to obtain the property or the right

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> optioned at the agreed "price" upon performing its obligations, but has the complete discretion or freedom whether to perform the obligations or not; however, if the option[ee] chooses not to do so, it loses the price paid for the option.

Citing Angela Swan and Jakob Admanski in *Canadian Contract Law*, 3rd ed., at page 276, the Court recognized that option agreements are "lopsided in the sense that, apart from the obligation to pay for the option, the optionee has complete freedom to exercise the option or not".

However, the inherent unfairness or lack of balance in an option agreement is not a reason to render the agreement invalid. The optionee will typically lose the option price if it decides not to pursue the option by fulfilling all the conditions of the option.

Based on the reasoning above, the Court in *Platt* held that there was nothing wrong with the appellant advancing $10.2 million towards the mining venture without obtaining an interest in the mining claims. The testing and exploration the appellant agreed to do was "simply the price they agreed to pay for the right to earn their 100% interest" in the mining claims.

The appellant failed to fulfill other conditions under the Option Agreement and therefore failed to earn an interest in the mining claims. In so doing, the appellant forfeited its interest in the claims.

Conclusion

The logic of *Platt* may seem harsh, particularly given the size of the appellant's investment in the mining project up until the fallout between the parties.

However, the Court's reasoning is consistent with the peculiar nature of option agreements. The lesson of *Platt* is clear—an optionee who claims an interest in property or rights bargained for under an option agreement must ensure that all conditions of the option agreement are fulfilled. A failure to thoroughly fulfill the terms of an option may leave the optionee without right or remedy.

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