CITATION: *First National Financial GP Corporation* v. *Golden Dragon HO 10 Inc. et al.*, 2020 ONSC 6994
COURT FILE NO.: 17-73967
DATE: 20201116

ONTARIO

SUPERIOR COURT OF JUSTICE

APPLICATION UNDER Section 47 of the *Bankruptcy and Insolvency Act*
R.S.C. 1985, C. B-3, as amended

BETWEEN:	)	
FIRST NATIONAL FINANCIAL GP CORPORATION Applicants	)	Eric Golden for First National Financial GP Corporation, Applicants
– and –	)	
GOLDEN DRAGON HO 10 INC. and GOLDEN DRAGON HO 11 INC. Respondents	)	Martin Diegel, for Golden Dragon HO 10 Inc. and Golden Dragon HO 11 Inc., Respondents Thomas G. Conway and Kevin Caron, for Liahona Mortgage Investment Corp. David P. Preger, for Deloitte Restructuring Inc., (Court Appointed Receiver)
	)	**HEARD:** July 22, 30, 31, and August 12 and 13, 2020.

REASONS FOR JUDGMENT

C.T. HACKLAND J.

Overview

[1] First National Financial GP Corporation ("FN"), seeks a declaration that it is entitled to be paid an amount of approximately $1.5 million, representing a prepayment of future interest arising from the sale by a court appointed receiver of two properties on which FN holds first mortgages,

345 and 347 Barber St. in the City of Ottawa. This prepayment is resisted by the second mortgagee on 345 Barber, Liahona Mortgage Investment Corp. ("Liahona") and by the respondents, Golden Dragon HO 10 Inc. ("GDH 10 Inc."), mortgagor on 347 Barber, and Golden Dragon HO 11 Inc. ("GDH 11 Inc."), mortgagor on 345 Barber. FN bases its claim for the prepayment amount on the terms of its mortgages on the properties including the relevant commitment letters incorporated by reference into these mortgages, as well as on the common law applicable to closed commercial mortgages which are discharged prior to their full term.

[2] This matter was heard by way of Zoom videoconference on a written record, including an Agreed Statement of Facts and affidavit materials which were not cross-examined on. No viva voce evidence was called. This hearing followed an earlier contested motion in which I approved an agreement of purchase and sale, recommended by the receiver, for the sale of the properties. The court's endorsement is reported at 2019 ONSC 6127, and a subsequent ruling of the Court of Appeal quashing the mortgagor's appeal of the approval order is reported at 2019 ONCA 873 (Fairburn J.A.).

[3] On approval of the sale, I directed that the sum of $1.7 million be held in trust by the receiver from the net proceeds of the receiver's sale, pending the determination of FN's claim for this prepayment penalty, referred to by FN as a "yield maintenance payment".

<u>Background</u> (paras 4-43 below are extracted from the Agreed Statement of Facts, ex. 12)

[4] First National Financial GP Corporation ("FN") is a Toronto-based lender of commercial and residential mortgages.

[5] The Respondents, Golden Dragon Ho 10 Inc. (the "GDH 10") and Golden Dragon Ho 11 Inc. ("GDH 11") (collectively, the "Debtors"), owned two adjoining apartment buildings municipally known as 345 Barber Street, Ottawa ("345 Barber"), and 347 Barber Street, Ottawa ("347 Barber", and together with 345 Barber, collectively, the "Properties").

[6] Liahona Mortgage Investment Corporation ("Liahona") is a mortgage investment fund which held a second ranking mortgage security over 345 Barber in the principal amount of $2.9

million, registered on title to 345 Barber on or about August 19, 2016. The interest rate was 10%, with interest-only monthly payments of approximately $24,166.67. The term was for one year.

[7] No payments were credited to Liahona's second mortgage over 345 Barber after April 3, 2017.

The Properties

[8] The apartment building located at 345 Barber was constructed sometime in the 1960's, and there were 80 rental units when FN took its first mortgage over that property in 2007.

[9] The apartment building located at 347 Barber was only constructed after FN took its first mortgage over 345 Barber in 2007, and it was to consist of 30 affordable housing units.

The FN Mortgages

[10] Pursuant to two commitment letters dated March 2, 2007 and March 5, 2007 (the "FN Commitment Letters"), FN agreed to lend up to a total of $7,546,240.00 (the "Loan") to Quex Property Corporation ("Quex").

[11] As security for the Loan, FN obtained, among other security, a first ranking mortgage over 345 Barber in the principal amount of $4,882,240.00, registered on title to 345 Barber on or about April 2, 2007 (the "FN 345 Barber Mortgage").

[12] A year later, on or about April 9, 2008, FN obtained, and registered on title to 347 Barber, a first mortgage in the amount of $1,584,000.00 (the "FN 347 Barber First Mortgage"), and a second mortgage for $1,080,000.00 (the "FN 347 Barber Second Mortgage"). It was a term of both the FN 347 Barber First Mortgage and the FN 347 Barber Second Mortgage (collectively, the "FN 347 Barber Mortgages") that they would rank *pari passu* with each other.

[13] The term of the FN 345 Barber Mortgage was for 20 years, at an interest rate of 5.11%.

[14] The term of the FN 347 Barber Mortgages was for 20 years, at an interest rate of 5.69%.

[15] The FN 345 Barber Mortgage and the FN 347 Barber Mortgages (collectively, the "FN Mortgages") were guaranteed by Raymond Stern and Natalie Stern, the principals of Quex.

[16] Term 26 of the Schedule to each of the FN Mortgages states: "The Chargor shall not, without the prior written approval of the Chargee and CMHC further charge or otherwise encumber the Property or any part thereof or any interest therein."

Transfer of the Barber Properties

[17] On or about May 24, 2016, Quex transferred 345 Barber to GDH11 for $7,763,927.50, and transferred 347 Barber to GDH10 for $2,911,072.00, for a total purchase price of $10,674,999.50.

Affordable Housing

[18] Pursuant to agreements with the City of Ottawa (the "City") and the Ministry of Municipal Affairs and Housing (the "Ministry") entered into by Quex, 30 of the 110 units at the Properties are to be rented as affordable housing (70% below market rent). Pursuant to a subsequent agreement with the City entered into in 2013, reasonable efforts were to be made to have all 30 affordable housing units located in 347 Barber (the "Affordable Housing Agreements").

[19] The City and Ministry provided Quex with financial assistance to construct the new affordable housing units at the Properties. As security for this financial assistance, Quex granted a mortgage to the City and the Ministry for $1,805,004.00 over 347 Barber (the "Affordable Housing Mortgage"). The Affordable Housing Mortgage was subordinated to the FN 347 Barber Mortgages at the times those two FN mortgages were registered on title, and the Affordable Housing Mortgage was assumed by the purchaser on the Receivership Sale.

The FN Mortgage Assumption Agreements

[20] Pursuant to an assumption agreement dated May 18, 2016, GDH 11 assumed all the past, present and future debts and liabilities and obligations of Quex to FN under the FN 345 Barber Mortgage.

[21] Similarly, pursuant to two assumption agreements dated May 18, 2016, GDH 10 assumed all the past, present and future debts and liabilities of Quex to FN under the FN 347 Barber Mortgages.

[22] Pursuant to these assumption agreements, the principals of Quex, Raymond Stern and Natalie Stern, remained jointly and severally liable to FN for any shortfall under the FN 345 Barber Mortgage up to a maximum amount of $2,440,120.00, and under the FN 347 Barber Mortgages up to a maximum amount of $2,131,200.00

Demand for Payment of Arrears and Failure to Cure Defaults

[23] GDH 11 was in unremedied default of the payments due under Liahona's mortgage over 345 Barber as of December 2016.

[24] Liahona issued a Notice of Sale on or about April 20, 2017 and obtained default judgment against GDH 11 in the amount of $3,033,988, together with judgment for possession of 345 Barber, on June 10, 2017.

[25] Both GDH 11 and GDH 10 were in unremedied default of the payments due under the FN Mortgages beginning in June 2017. Following these monetary and other non-monetary defaults under the FN Mortgages (which, per the Cross-Default Provisions, were defaults under all three of the FN Mortgages), on or about August 17, 2017, FN made demand on GDH 10 and GDH 11, to among other things pay the arrears and cure the non-monetary defaults on or before August 28, 2017, and also delivered Notices of Intention to Enforce Security pursuant to s. 244 of the BIA.

[26] The amounts claimed by FN in these demands to bring its mortgages into good standing totalled $150,632. The amounts constituted the outstanding principal and interest payments owing to that date, as well as administrative charges, forced placed insurance, appraisal costs, building condition assessments and legal fees. The amount can be particularized as follows:

a) $108,985 under the 345 Barber Mortgage;

b) $21,517 under the first 347 Barber First Mortgage;

c) $20,130 under the second 347 Barber Second Mortgage.

[27] On or about August 30, 2017, FN retained CLV Group Inc. to attorn the rents at the Properties.

[28] By Order dated September 22, 2017 (the “Appointment Order”), I granted an application made by FN to appoint Deloitte Restructuring Inc. as the interim receiver (the “receiver”) of the Properties.

[29] The Appointment Order authorized the receiver to, among other things:

a) take possession of and exercise control over the Properties and any and all proceeds, receipts and disbursements arising out of, or from, the Properties;

b) undertake any renovations and make any repairs to the Properties necessary to ensure that the Properties were well maintained and rentable and is in compliance with the applicable laws and building codes; and

c) market available rental units enter into new rental agreements or renew expiring rental agreements where applicable.

[30] Term 31 of the Appointment Order provided as follows:

> **THIS COURT ORDERS** that notwithstanding the commencement of the within Application and the appointment of the Receiver, the Applicant shall be deemed to be protecting its security, shall not be deemed to have resorted to realizing upon its security over the Property, and the equitable right of redemption in respect of the Applicant’s mortgages over the real property of the Respondents identified on the attached Schedule “A” shall not be triggered.

[31] On October 20, 2017, I granted a motion extending the appointment of the receiver until further Order of the Court.

[32] On May 21, 2019, on a motion by Liahona for an Order expanding the receiver’s mandate in its capacity as interim receiver of the Properties to authorize it to conduct a marketing and sale process to realize on the Properties, and on a motion by the receiver for, *inter alia*, advice and direction with respect to expanding the receiver’s mandate to authorize it to conduct a sale process in respect of the Properties as proposed in the receiver’s sixth report, including engaging CBRE Limited as a listing broker, the Court granted an order (the “Expanded Powers Order”) expanding

the receiver's mandate to that of a receiver and manager, authorizing the receiver to conduct a marketing and sale process to realize on the Property, and approving the receiver's proposed marketing and sale process.

[33] Terms 11 and 12 of the Expanded Powers Order state as follows:

> CONTINUING EFFECT OF APPOINTMENT ORDER
>
> 11**. THIS COURT ORDERS** that except as otherwise varied and amended by this Order, all other terms of the Appointment Order shall remain in full force and effect.
>
> 12. **THIS COURT ORDERS** that notwithstanding (i) the variation and amendment of the status and mandate of the interim receiver Deloitte Restructuring Inc. as provided for in this Order, (ii) any other terms(s) of this Order, and (iii) FN not opposing this Order, FN shall still be deemed to be protecting its security over the Property, shall not be deemed to have resorted to realizing upon its security over the Property, and the equitable right of redemption in respect of FN's mortgages over the lands and premises described in Schedule "A" to the Appointment Order shall not be triggered.

[34] Pursuant to an Amended and Restated Approval and Vesting Order dated October 11, 2019 and an Endorsement released on October 23, 2019, I approved the sale by the receiver of the Properties, and a partial distribution from the net proceeds of sale, subject to the receiver holding back "the sum of $1.7 million pending the Court's further ruling on a disputed prepayment penalty claimed by FN." I also directed a trial of an issue (the "Yield Maintenance Issue") with respect to FN's entitlement to the payment of what he referred to as the "yield maintenance penalty".

[35] FN opposed the sale of the Properties on the Sale Approval and Vesting Order motion. FN's position was that its agreement to have the receiver sell the properties was premised on it receiving payment of the Yield Maintenance from the sale proceeds. FN submitted that, if it was precluded from receiving the Yield Maintenance, it wished to maintain its mortgages in place until the end of their terms or until the properties were sold by the Debtors.

[36] The sale of the Properties by the receiver (the "Receivership Sale") was completed on or about November 7, 2019. The titles to the Properties were vested to the new purchaser on that date. Subsequently, the FN Mortgages and the Liahona Mortgage were vested off title.

[37] On November 25, 2019, I granted an Interim Administration and Distribution Order dated as of October 23, 2019.

[38] Pursuant to the Interim Administration and Distribution Order, the receiver distributed the following amounts on November 26, 2019:

a) $8,551,802 to FN in full satisfaction of the outstanding principal, interest, costs and professional fees owing under the FN Mortgages, save and except the claimed Yield Maintenance amounts;

b) $1,684,020 to Liahona in partial satisfaction of the outstanding principal and interest owing under its mortgage over 345 Barber;

c) the real estate commission owed to CBRE Limited; and

d) the receiver's borrowing charge.

[39] Pursuant to the Interim Administration and Distribution Order, the receiver set aside a reserve fund for:

a) the outstanding future fees and disbursements of the receiver and its counsel in administering the receivership, including the trial of the issues;

b) the Yield Maintenance amounts claimed by FN;

c) an amount equivalent to one year of interest at 1.6% per annum on Yield Maintenance; and

d) the future legal fees and disbursements of FN in connection with the receivership, including the trial of the issues.

[40] The payout statements provided by FN as of the closing of the Receivership Sale provided for following payout amounts:

a) $6,931,061.60 under the 345 Barber Mortgage, including Yield Maintenance in the amount of $949,305.70;

b) $2,313,907.32 under the first 347 Barber Mortgage, including Yield Maintenance in the amount of $416,080.76; and

c) $846,551.56 under the second 347 Barber Mortgage, including Yield Maintenance in the amount of 107,755.36.

[41] Liahona and the Debtors have agreed to the calculation of the Yield Maintenance amounts above, as being in accordance with the formulas set out in the FN Mortgages.

PREPAYMENT PRIVILEGES

[42] The FN Mortgages were closed mortgages, with no right of prepayment save and except for the prepayment privileges set out therein.

[43] The Commitment Letter dated March 2, 2007, in respect of the FN 345 Barber Mortgage, provides as follows at Term 34:

> **34. Prepayment Privilege**
>
> Provided that there has been no default under the mortgage and only in the event of a bona fide "arms' length sale of the subject property, the Borrower shall have the privilege to prepay the mortgage, in whole, together with compensation for lost interest, “Yield Maintenance”, as reasonably calculated by the Lender. In the event of such prepayment in whole, the compensation will be the greater of the yield maintenance amount or three (3) months’ interest. (emphasis added).
>
> **"Yield Maintenance”** means the amount in dollars, if any, by which the present value of all remaining payments of principal and interest due under the mortgage, plus the present value of the principal balance secured by the mortgage that would have been due on the maturity date hereof, when discounted at the Lender’s interpretation, based on duration of the mortgage, of “Government of Canada Bond Yields”, as hereinafter defined, exceeds the principal balance of the mortgage which is outstanding on the date of such payment. (emphasis added).
>
> “Government of Canada Bond Yields” means the bid yield to maturity, as determined and interpolated by the Lender, and expressed as an annual rate of interest, calculated semi-annually not in advance, of non-callable Government of Canada Bonds payable in Canadian dollars, having a notional durations closest to the maturity date of the Loan, if purchased at that time.

[44] Term 33 of the Commitment Letter contained a virtually identical provision in respect to the 347 Barber FN mortgages.

[45] The Agreed Statement of facts also included a number of other less relevant pre-payment provisions in the mortgage terms, as well as FN's discharge statements which contain reference to the amounts claimed by FN in this matter, which FN refers to, on the discharge statements, as a "pre-payment penalty".

Issues

[46] The fundamental issue in this hearing is FN's entitlement to receive from the net proceeds of the court appointed receiver's sale of the two properties, the amount of approximately $1.5 million representing compensation for lost future interest, (the "yield maintenance" payment), resulting from the mortgages being vested off title to complete the receiver's sale.

FN's Position

[47] FN claims that its mortgages on the two properties, when vested off title by the court in order to complete the sale carried out by the court appointed receiver, entitle it to receive in addition to payment of all principal owing under the mortgages, plus arrears of interest, an additional amount which FN counsel describes as "yield maintenance" which is, in substance, a portion of the future interest payments accelerated to the end of the term of the mortgages and calculated in accordance with a formula set out in the mortgages. The three FN mortgages were for a term of 20 years, with about 8 years remaining on the term at the time of the receiver's sale. This claimed entitlement is based on the terms of the contractual documentation pertaining to the mortgages (i.e. the mortgage terms, the mortgage schedules and the commitment letters incorporated by reference into the mortgages), when read in the context of the common law pertaining to closed commercial mortgages discharged before the end of their term.

Position of Liahona and the Mortgagors

[48] Liahona, the second mortgagee on 345 Barber, as well as the mortgagors GDH 10 Inc. and GDH 11 Inc., submit that yield maintenance is not payable because the mortgage terms do not specifically authorize or provide for it in the factual circumstances of this case, which they submit is fatal to the claim. The mortgagors also argue that in all the circumstances, FN must be found to have realized on its security so as to trigger the mortgagors' entitlement to exercise their equity of

redemption, in which case they would not be obligated to pay any penalty by way of accelerated future interest.

[49] Liahona submits, in the alternative, that recognizing an entitlement to the claimed yield maintenance payments on a contractual or on a common law basis would offend public policy by creating an unfair preference in FN's favour over other creditors of the insolvent mortgagors, in contravention of the scheme of distribution in the *Bankruptcy and Insolvency Act*, R.S.C., 1985, c.B-3, ("BIA") and the common law anti-deprivation rule and also contravenes sec. 10 of the *Interest Act,* R.S.C., 1985, c.I-15.

Analysis

[50] There has been confusion in this proceeding as to the basis on which FN claims it is entitled to a yield maintenance payment out of the proceeds of the receiver's sale of the properties. Initially the parties had agreed that the court would be asked to decide the following issue: "*Whether the terms of the FN charges over the Properties entitle FN to the Yield Maintenance claimed as a result of the early repayment of its charges*". FN was seeking the answer "yes" to that question. However, so far as the terms of the mortgages are concerned, as can be seen from the plain wording of the prepayment provision (para 43 above) in the commitment letters (which were incorporated into the mortgages), there is no prepayment entitlement available to the debtors (the mortgagors) when they are in default in payment and accordingly FN has no entitlement to charge a yield maintenance penalty, based only on the express terms of the charge.

[51] To be clear, the prepayment provision provides that the borrower only has the privilege of prepayment when not in default under the mortgages and only when there is a bona fide arm's-length sale of the property. Only then would the mortgagor be entitled to redeem upon payment of the yield maintenance charge referenced in the prepayment term. Here, because the mortgagors were in default, the prepayment term does not apply.

[52] The prepayment term is primarily for the benefit of the borrower, in the defined circumstances. Some of the cases cited to the court refer to provisions of this sort as "mortgagor-centric." The lender cannot be permitted to rely on a mortgage term that is for the borrower's benefit, to impose an express or implied obligation on the borrower to pay an accelerated interest

penalty. Authority for this proposition can be found in *58 Cardill Inc. v. Rathcliffe Holdings Limited*, 2017 ONSC 6828, affirmed on appeal, 2018 ONCA 672, see also *Comfort Capital v. Yeretsian*, 2018 ONSC 5040; and *Benson Custodian Corporation v. Situ et al.,* 2019 ONSC 3077.

[53] In any event, counsel for FN clarified that what FN is claiming is a prepayment charge based on accelerated future interest i.e. interest that would have been earned over the remaining eight years on the charges had they not been prematurely vested off title in the receiver's sale. As an accommodation to the borrowers, FN charged the yield maintenance payment calculated on the formula provided for in the prepayment provision in the mortgages, quoted above (para 43). FN claims the yield maintenance amount is roughly $750,000 less than the total of the future interest payments that would have accrued over the balance of the term of these mortgages. This is clarified in paragraphs 17,18 and 19 of FN's Reply Factum, as follows:

> 17. The Stage 1 question in the case at bar is:
>
> > Whether the terms of the FN charges over the Properties entitle FN to the Yield Maintenance claimed as a result of the early repayment of its charges.
>
> 18. FN's position is that the answer to the Stage 1 question is "Yes, because the amount FN is claiming ($1.5M), is actually less that the total future interest owing under its closed mortgages ($2.25M)".
>
> 19. The terms of the FN mortgages include that they are 20-year closed mortgages, and FN is therefore entitled to all lost future interest to maturity (approximately $2.25M), or any discounted amount FN is prepared to accept as a compromise. In this case, the discounted amount of approximately $1.5M represents "Yield Maintenance", or the present value of the differential between the amount for all future interest due under the FN mortgages, and the amount if the principal under the FN mortgages was invested in a Government of Canada bond.

[54] To avoid further confusion, I will consider FN's claim for 'yield maintenance', not as yield maintenance required to be paid by the express terms of the mortgages, since no term of the mortgage documentation entitles FN to yield maintenance in the circumstances, but rather yield maintenance in the sense of an accelerated future interest payment calculated using the yield maintenance calculation formula in the mortgage.

[55] I will now discuss whether the FN mortgages are closed commercial mortgages and, if so, whether FN is entitled to compensation for lost future interest when the mortgages were vested off titled and if such entitlement exists, can it be "any discounted amount FN is prepared to accept as a compromise", as claimed in FN's Reply factum.

[56] Subject to the debtors' claimed entitlement to exercise their equity of redemption, I will accept that FN's mortgages were closed mortgages from the time when the mortgagors went into default and continued as such to the time, the mortgages were vested off title on the closing of the sale of the properties by the court appointed receiver. I find that these mortgages were closed in the sense that there were no prepayment provisions available to the debtors in the circumstances, because the debtors were in default. I will discuss below the debtors' submission that the mortgages were in fact opened up by FN when FN took steps in relation to the properties that should be characterized as a realization on their security, so as to trigger the mortgagors' equity of redemption.

[57] I observe that the FN mortgages were commercial mortgages granted by debtors (mortgagors) who are corporations. If these mortgages had been given by a non-corporate borrower, they would have been subject to section 18 (1) of the *Mortgages Act*, R.S.O., 1990, c.M-40, which allows borrowers with mortgages with terms of five years or greater to redeem such mortgages, after five years, on payment of any arrears plus three months interest:

> 18. (1) Where any principal money or interest secured by a mortgage of freehold or leasehold property is not, under the terms of the mortgage, payable until a time more than five years after the date of the mortgage, then, if at any time after the expiration of such five years any person liable to pay or entitled to redeem tenders or pays to the person entitled to receive the money the amount due for principal money and interest to the time of such tender or payment, together with three months further interest in lieu of notice, no further interest is chargeable, payable or recoverable at any time thereafter on the principal money or interest due under the mortgage.
>
> (2) <u>This section does not apply to any mortgage given by</u> a joint stock company or other <u>corporation</u> nor to any debenture issued by any such company or corporation for the payment of which security has been given on freehold or leasehold property. (underlining added).

[58] I agree with FN that well settled case law recognizes that when a closed mortgage is redeemed prior to the end of its term, the mortgagee must pay not only the outstanding principal and accrued interest, but also the future interest to the end of the term. The exceptions to this arise when the mortgagee takes steps to realize on its security – in such cases an equitable right of redemption without payment of penalty accrues to the borrower. Other exceptions are mortgages with specific terms that provide otherwise or statutory exceptions such as section 18 (1) of the *Mortgages Act* which, as noted, does not apply to corporate borrowers such as the mortgagors in the present case.

[59] As noted by Master MacLeod (as he then was) in *Re Centre d'Apprentissage et de Formation + de Cornwall* 2013 ONSC 2749, "at common law, there was no right to prepay a mortgage as the mortgagee was entitled to repayment of the principal amount of the loan together with the interest originally bargained for unless the mortgage contained a prepayment clause".

[60] The common law rule that future interest is payable on a mortgage with no right of prepayment, where the mortgagee has not resorted to its security and has not triggered the right to redeem, was recently re-affirmed by Justice Kimmel in *NJS Midtown Portfolio Inc. v. CMLS Financial Ltd.*, 2020 ONSC 3973. Justice Kimmel held at para. 73:

> In circumstances where a mortgagor wants to sell a property that is encumbered and there is no contractual right to prepay the mortgage and receive a discharge, the mortgagor must reach an agreement with the mortgagee to amend the terms of the mortgage and pay whatever penalty is negotiated, failing which the mortgagee is entitled to insist upon payment of full compensation for the interest it would lose over the remainder of the mortgage term. *Pedahbun Lodge v. Canada Mortgage and Housing Corporation*, 2007 CanLII 460 (ON SC), at para.42, citing *Saperstein v. Royal Trust Corporation of Canada* (1988), 1988 CanLII 3005 (BC CA), 24 B.C.L.R. (2d) 114.

[61] The *Saperstein* decision referenced by Justice Kimmel concerned the right of a mortgagee to retain a payment, in lieu of future interest. In *Saperstein*, the mortgagor went into monetary default halfway into the five-year term of a closed mortgage. The mortgagee demanded only the arrears, and on the mortgagor's sale of the property demanded principal, arrears and $14,050.00 for lost future interest to maturity instead of the entire $59,000.00 owing for lost future interest.

The $14,050.00 figure represented the difference in the value of the mortgage sought to be discharged and the value of a replacement mortgage at current, lower interest rates, as well as a sum for lack of notice to seek a discharge.

[62] In *Saperstein*, the British Columbia Court of Appeal, confirmed that when a mortgagor proposes to sell a mortgaged property under a closed mortgage, the mortgagee is entitled to demand, as consideration for agreeing to an early discharge of the mortgage, the entire amount owing under its closed mortgage, or it may demand a lesser sum. Justice McLachlin (as she then was) stated:

> 10. The mortgagee under the general terms of its mortgage was entitled to approximately $59,000 in future interest [to maturity]. It was entitled to demand a lesser sum in consideration of early discharge. When the mortgagor complied with that request by paying the sum demanded, the mortgage was discharged. In effect, the original contract

[63] In *1186708 Inc. v. Attara Dev*., 2013 ONSC Morawetz J., (as he then was) held (paras 13 and 33), that a court will not vest a mortgage holder off title without compensating the mortgagee for what it has lost. A closed mortgage vested off title must be taken as it stands, with no prepayment privilege and a requirement to compensate for the loss resulting from the early vesting off title of the mortgage. In *Attara*, a court appointed sales officer, appointed under section 101 of the *Courts of Justice Act*, in the context of a shareholder's dispute, carried out the marketing and sale of the property in dispute. The mortgagors objected to paying a prepayment charge on the fully closed mortgage, alleging that it was unconscionable and excessive compensation. The court ordered payment of the future interest the mortgagees were seeking.

[64] It can be seen from *Attara*, *Saperstein, NJS Midtown Portfolio Inc.* and other cases, that when a mortgage is vested off title, the mortgagee will be entitled to amounts due under the mortgage and in the case of a closed mortgage this will include future interest accrued to the end of the term.

[65] The law is well settled that a mortgagor cannot open up a closed mortgage by his own default. An equity of redemption is not accorded to a mortgagor in such circumstances. As was held by Philip J. in *Household Realty Corp. v Avestal Credit Union Ltd., (1996) 18 O.T.C. 361*

> [15] It is trite law to say that no person is allowed to take advantage of its own conduct at the expense of the other. Howland J.A., in *McCallum v Zivojinovic* (1977), 16 O.R. (2d) 721 (C.A.) at p. 726 put it this way:
>
> > There is a very old principle which was laid down by Lord Coke, that a man shall not be allowed to take advantage of a condition which he himself brought about.
>
> That right to prepay the balance of principal, in my view, will only exist if Avestel has taken steps to enforce its mortgage rights to payment. If Avestel took such a step, it would then trigger Household's equitable right to redeem.

[66] Liahona submits however that there is no particular significance to the fact that the FN mortgages are closed mortgages because the lender's entitlement to future interest is a matter of contract and must be specifically provided for in the mortgage itself. Reliance is placed on the statement of Boswell J., in *Lee v. He*, 2018 ONSC 5932:

> Mortgages are secured loans. Loans are contractual agreements. Pursuant to the loan agreement, the borrower is entitled to the use of the lender's capital for some stipulated period of time. The lender, in return, is entitled to a stream of interest income, in addition to the ultimate repayment of its capital. <u>When a borrower goes into default, the lender is theoretically entitled not only to repayment of its capital, but also to the present value of the lost income it would have received by way of interest had the breach not occurred.</u> The lender's damages are, of course, subject to the requirement that it take steps to reasonably mitigate its losses through the reinvestment of its capital. (underlining added)

[67] I would respectfully agree with Boswell J.'s statement that future interest payments (present valued) are owing on the borrower's default, to the end of the term of the mortgage. I agree with Justice Boswell's observation that this entitlement arises from an implied contractual term. I do not agree that this decision requires that the entitlement to future interest must be specifically provided for in the mortgage terms.

[68] Liahona maintains that in order to claim an entitlement to future interest under a closed mortgage, the mortgagee must prove there is a specific clause in the mortgage capable of supporting the claim. As noted, I do not accept this submission. It is contrary to the many decisions which recognize the lender's entitlement to future interest when a closed mortgage is discharged prior to its term. The contractual basis for this need not be found in a liquidated damages clause. It will suffice that the mortgage terms require that the interest is paid over the term of the mortgage.

When the mortgage is terminated prematurely, such as when it is vested off title in a receiver's sale under court supervision, the future interest is not forfeit, it becomes due (present valued).

Debtors' Insolvency

[69] Liahona goes on to submit that special circumstances exist in this case, namely that the debtors were insolvent and the secured properties were sold by a receiver appointed under the BIA pursuant to court order, when the mortgages were vested off title. The debtors' insolvency is said to distinguish the present case from cases referred to previously. Liahona submits the issue is whether FN has established a contractual entitlement to the yield maintenance penalty in the circumstances, and if it has, whether it can be enforced as a matter of law and public policy.

[70] I agree that some of the cases relied on by FN did not arise in insolvency situations, although others did. I was not provided with any authority to justify this distinction. Common sense would suggest that many mortgagors who default on payments due under their mortgages are indeed insolvent. It seems anomalous that once a mortgagor becomes insolvent, its obligations under a mortgage change. Stated otherwise, it is unclear on what basis a mortgagor's insolvency should derogate from pre-existing contractual or common law rights of a mortgagee to future interest payments when the mortgage is discharged prior to maturity.

[71] Liahona submits that once a mortgage is vested off title in a receiver's sale, the security ceases to exist and any future interest then coming due is in the nature of damages. As such, the future interest becomes an unsecured debt that the mortgagee must pursue as an unsecured creditor. I do not accept that this is a correct statement of the law. Rather, when the mortgage is vested off title by the receiver, the proceeds of the sale stand in the place of the security, for the full amount secured by the mortgage i.e. the principal, as well as accrued and future interest.

[72] Liahona submits that cases such as *Rathcliffe* and *Comfort Capital* stand for the proposition that a mortgagee can not claim an entitlement to an interest amount triggered upon the commencement of enforcement proceedings unless its mortgage specifically provides for it. I am not able to accept that proposition.

[73] In *Rathcliffe*, there was no issue as to a mortgagee's entitlement to prepayment of future interest when a mortgage was terminated prior to the end of its term. In that case a mortgagee on a receivership sale asserted an implied entitlement to three months interest. The mortgage provided no such entitlement; however, the mortgage contained a clause stating:

> 12. The said Chargor covenants with the Chargee that in the event of non-payment of the principal amount at the time or times above provided in the mortgage then he shall not require the Chargee to accept payment of the said principal amount without first giving three months' previous notice in writing, or paying a bonus equal to three months' interest in advance on the said principal amount (the "Three-Months' Interest Provision").

[74] Justice Sanfilipo held that the Three-Months' Interest Provision had no application in the circumstances. He determined that the clause that the mortgagee relied on was "mortgagor-centric", in that it embodied a right belonging to and for the benefit of the mortgagor. Figuratively the clause was a shield, permitting the mortgagor to discharge the defaulted mortgage upon the payment of three months' interest. It did not embody a right in the mortgagee to use the provision as a sword to collect an additional payment in the event of a realization.

[75] I accept that the *Rathcliffe* decision would require this court to reject any submission that an otherwise inapplicable prepayment provision in the FN mortgage could impliedly authorize FN to charge yield maintenance upon the receiver's sale of the properties. The prepayment provision in the FN mortgage was for the benefit of the mortgagor (when not in default), and not for the benefit of the mortgagee, and was intended for situations in which the mortgagor (but not the receiver or the court) seeks to discharge the mortgage. However, as discussed previously, FN does not rely on the Yield Maintenance clause other than as a calculation formula for the amount of future interest claimed. FN relies on the established common law entitlement that a mortgagee may claim future interest on a closed mortgage, calculated over the full term of the mortgage, when the mortgage is discharged prior to its term, as long as the mortgagee has not realized on its security. In my opinion, *Rathcliffe* does not purport to address or overturn this well-established common-law rule of mortgage law.

Anti-Deprivation Rule

[76] Liahona submits that to allow FN to recover yield maintenance (again, in the sense of a prepayment of future interest out of the proceeds of sale of the properties), in debtor insolvency situations such as this, would offend the common law anti-deprivation rule.

[77] Liahona accurately summarizes this Rule at para 71 of its Reply factum:

> 71. The common-law anti-deprivation rule invalidates contractual provisions that remove assets otherwise available to creditors in the event of insolvency or bankruptcy.60 The Ontario Court of Appeal recently cited with approval the following description of the anti-deprivation rule from Professor Roderick J. Wood's textbook *Bankruptcy and Insolvency Law*, 2nd ed (Toronto: Irwin, 2015) at 88 with approval:
>
>> Canadian courts have recognized that a contractual provision that is designed to remove value from the reach of an insolvent person's creditors is void on the basis that it violates the public policy of equitable and fair distribution on bankruptcy. This is referred to as the "fraud on the bankruptcy law principle." The principle can be usefully broken down into two distinct components: the anti-deprivation rule and the *pari passu* rule. The anti-deprivation rule operates by invalidating provisions that withdraw an asset that would otherwise be available to satisfy the claims of creditors upon the insolvency of the party or the commencement of insolvency proceedings.

[78] I also accept that Canadian cases applying the anti-deprivation rule have adopted an "effect based" approach to determining the validity of the contractual provision in issue. Counsel referred to several cases in which insolvency or bankruptcy triggered a contractual provision that had the effect of depriving creditors of an asset that would otherwise have been available to them, see *Capital Steel v. Chandos Construction Ltd*, 2019 ABCA 31; *Hutchingame Growth Capital Corporation v. Independent Electricity Systems Operators*, 2020 ONCA 430.

[79] A recent decision of the Supreme Court of Canada considering the anti-deprivation rule was handed down subsequent to the argument of this matter, see *Chandos Construction LTD. V. Deloitte Restructuring Inc*., 2020 SCC 25. The Court upheld a decision of the Alberta Court of Appeal striking down a contractual provision which purported to allow a general contractor to set off 10% of the contact price against its subcontractor in the event of the sub-contractor's

insolvency or bankruptcy. The clause provided for a fee for inconvenience and for monitoring the work in the event of the subcontractor's bankruptcy. The court held the clause was invalid by virtue of the common law anti-deprivation rule which renders void any provision in an agreement which provides that upon an insolvency or bankruptcy, value is removed from the reach of the insolvent person's creditors which would otherwise have been available to them.

[80] In *Chandos*, Rowe J., for the majority, described the anti-deprivation rule as a common law rule "that operates to prevent contracts from frustrating statutory insolvency schemes" (para 1). Justice Rowe stated at para 31:

> … the anti-deprivation rule renders void contractual provisions that, upon insolvency, remove value that would otherwise have been available to an insolvent person's creditors from their reach. This test has two parts: first, the relevant clause must be triggered by an event of insolvency or bankruptcy; and second, the effect of the clause must be to remove value from the insolvent's estate. This has been rightly called an effects-based test.

[81] I am of the opinion that the anti-deprivation rule has no relevance to FN's entitlement in this case for the following reasons:

1. The rule is premised on a contractual provision having the effect of prejudicing the interests of other unsecured creditors on a bankruptcy or insolvency of the debt or paragraph.

2. The contract must be triggered by or come into effect in the event of bankruptcy or insolvency. This is a matter of contractual interpretation. Normally the offending contractual provision would reference an amount due on a bankruptcy or insolvency.

3. The rule does not apply to common law rules or common law entitlement, but to contractual provisions.

4. The rule is not applied to defeat or postpone valid mortgages or other secured interests.

[82] In the present case FN seeks to rely on a common law entitlement to a prepayment of future interest triggered by the termination of the mortgages prior to their full term. The anti-deprivation rule is not engaged in such circumstances. The rule cannot be used to defeat the pre-existing rights of secured lenders whose rights are not premised on the borrower's potential bankruptcy or insolvency. Furthermore, with regard to the prepayment clauses in the FN mortgages, they provide

for a prepayment right only to borrowers who are not in default and as such could not reasonably be interpreted as applying to insolvency situations or as being triggered by insolvency.

[83] Liahona submits, in the alternative, that recognizing an entitlement to payment of accelerated future interest when a mortgagor is insolvent would be contrary to the scheme of distribution in the BIA. Liahona submits at para 87 of its Reply factum:

> a) Pursuant to section 84.2 of the BIA, no person may claim an accelerated payment under any agreement, including a security agreement, with a bankrupt individual by reason only of the individual's bankruptcy or insolvency.
>
> b) Under section 134 of the BIA, a secured creditor shall in no case receive more than 100 cents on the dollar and interest as provided by the BIA.
>
> c) Under section 128(3) of the BIA, a trustee in bankruptcy may redeem a security on payment to the secured creditor of the debt or value of the security as assessed.

[84] I do not accept the submission that the interest prepayment claimed by FN would contravene any of the three provisions of the BIA referred to in the previous paragraph. This payment is not claimed "by reason only of the (borrowers) bankruptcy or insolvency". Rather, the claim for prepayment of interest is based on a common law entitlement arising on the early termination of a closed mortgage, when the borrower has no equity of redemption. FN does not seek payment of more than the amount owed by reason of an insolvency. Lastly, a receiver in a bankruptcy could only lawfully redeem these mortgages upon payment of the full amount secured by the mortgages.

<u>Section 8 of the Interest Act</u>

[85] Liahona submits that payment of the yield maintenance amount would offend section 8 of the *Interest Act* which provides:

> No fine, etc., allowed on payments in arrears
>
> 8 (1) No fine, penalty or rate of interest shall be stipulated for, taken, reserved or exacted on any arrears of principal or interest secured by mortgage on real property or hypothec on immovables that has the effect of increasing the charge on the arrears beyond the rate of interest payable on principal money not in arrears.

> Interest on arrears
>
> (2) Nothing in this section has the effect of prohibiting a contract for the payment of interest on arrears of interest or principal at any rate not greater than the rate payable on principal money not in arrears

[86] Liahona submits that this provision renders unenforceable contractual provisions that impose a penalty on arrears of principal and interest secured by a mortgage on real property that have the effect of increasing the charge on the arrears beyond the rate of interest payable on principal money not in arrears.

[87] Two Ontario decisions have held that provisions requiring a mortgagor to pay additional interest monies upon default are not enforceable, see *Tomell Investments Ltd v. East Marstock Lands Ltd*., 1975 CarswellOnt 340 and *Benson Custodian Corporation v. Situ et al*., 2019 ONSC 3077.

[88] In *Tomell*, Galligan J. (as he then was) rejected a mortgagee’s claim to a three months interest bonus alleged to be owing due to the mortgagor’s monetary default under the mortgage. The mortgage in that case specifically provided that, upon default of any money owing under the mortgage, or on any proceedings taken by the mortgagor under the mortgage, the mortgagee could require the payment of a three months interest bonus in addition to the principal and interest amounts secured by the mortgage. Galligan J. stated:

> In this case, the interest payments are approximately six months in arrears. For the sake of illustration, I propose to assume that the interest payments are in arrears for six months. The arrears of interest therefore amount to $36,000. A bonus equal to three months' interest on the principal money amounts to $18,000. The bonus therefore amounts to 50% of the arrears. The rate of interest payable upon principal money is 16%. It is my opinion therefore that the bonus clause in this mortgage has the effect of increasing the charge on arrears of interest beyond, and substantially beyond, the rate of interest payable on principal money, and therefore is in violation of s.8 of the Interest Act.

[89] In *Benson*, Schabas J. held that a liquidated damages clause in a mortgage was unenforceable because it contravened section 8 of the *Interest Act*. The clause provided that the mortgagee could recover a sum equal to three months interest on the principal amount outstanding

if the mortgagee issued a notice of sale or a statement of claim to recover any amounts due under the mortgage.

[90] Liahona submits that FN's claimed yield maintenance payment in the present case would have the effect of increasing the charge payable on the arrears beyond the rate payable in the FN mortgages. In the case of FN's mortgage on 345 Barber, the interest payable was 5.11% as of the date of repayment. The interest arrears owing under that mortgage were $579,725. The future interest (yield maintenance) amount was calculated in the sum of $949,305. Accordingly, it is argued, the penalty is approximately 164% of the interest arrears and therefore charging this amount would have the effect of increasing the charge on arrears of interest substantially beyond the interest payable on the principal amount under the mortgage and was therefore in contravention of section 8 of the *Interest Act*.

[91] However, FN is not seeking a penalty to be added to arrears of interest. It seeks payment of capitalized future interest (discounted to the amount produced by the yield maintenance calculation). Liahona's argument suggests that as a general proposition any future interest entitlement, the quantum of which exceeds the arrears of interest, would contravene sec 8(1) of the *Interest Act*, which is a proposition I do not accept.

[92] As noted, section 8(1) prohibits penalties which have the effect of increasing the charge on interest arrears beyond the rate payable on principal not in arrears. The yield maintenance payment in the present case does not purport do so. It is a calculation of future interest at the same rate provided for in the mortgage for amounts not in arrears. This calculation can be seen from the expert report of Bruce Roher (exhibit 9) which has been agreed to in this proceeding. To argue that no future interest can be charged and that the corporate mortgagors in this case could have obtained a discharge without paying such future interest is, in effect, to invoke section 10(1) of the Interest Act, which is a provision not available to corporate borrowers, see *Pedahbun Lodge v. Canada Mortgage and Housing Corporation*, 2007 CanLII 460 (ON SC) and *Saperstein v. Royal Trust Corporation of Canada (1988)*, 1988 CanLII 3005 (BC CA), 24 B.C.L.R. (2d) 114.

[93] I am satisfied that the future interest payments (yield maintenance) sought by FN do not contravene section 8(1) of the *Interest Act.*

Realizing on its Security

[94] The law is settled that when a mortgagee takes steps that amount to a realization on its security, the law of equity will grant to the borrower an equity of redemption, i.e., a right to redeem the mortgage upon payment of principal and interest owing, and without penalties. The right of redemption is an equitable right and therefore is a discretionary entitlement which will not be available to a borrower who acts in bad faith, such as by defaulting on mortgage payments for the purpose of terminating the mortgage in order to refinance at lower interest rates, or other situations involving bad faith or a lack of clean hands.

[95] The mortgagors submit that FN, through the activities of the court appointed receiver, did realize on its security in this case, with the result that the mortgagors are entitled to an equity of redemption that would defeat FN's claimed interest prepayment. Liahona did not support this position in oral submissions but did so in its reply factum.

[96] So far as Liahona is concerned, it sought and received from the court the Expanded Powers Order authorizing the receiver to market and sell the properties. The relevant provision of that order is set out above (paras 30 and 33). This order remains in full force and effect. I will not entertain a submission by counsel for Liahona that directly contradicts a provision in a court order sought by Liahona and provided to the court for signature by Liahona's counsel.

[97] The debtors (the mortgagors) have served a Notice of Motion seeking to set aside the two provisions which deem the receiver's activities to not be a realization on security by FN and deem the mortgagors' equity of redemption to not be triggered. I will discuss this below.

[98] The mortgagors argue that the extensive activities of the court appointed receiver on behalf of FN should be characterized as a realization on its security by FN. This submission is made notwithstanding the provision of the Appointment Order and subsequently the Expanded Powers Order which provide that FN is deemed not to be realizing on its security and notwithstanding that a court appointed receiver is not an agent of the creditor or the debtor, as held recently by Dunphy J. in *Comfort Capital v. Yeretsian*, 2018 ONSC 5040.

[99] The case law clearly establishes that when a mortgagee takes possession of the mortgaged property to collect rental arrears and to put the mortgage in good standing, or to preserve or stabilize the security, the mortgagee is not realizing on or enforcing its security, with the result that the mortgagor is not given an equity of redemption. On the other hand, taking possession of the mortgage property in order to sell it and redeem the mortgage is a realization on security and the borrower has an equitable right of redemption (i.e., the right to pay the principal and accrued interest without further penalty).

[100] In the present case, the Appointment Order defined the receiver's mandate which was to stabilize the two properties and to collect the rent. The court did not allow or authorize the receiver to realize on the security and was not requested to do so. The receiver duly reported its activities to the court in a series of receiver's reports. The court approved these activities. I do not accept the submission made by the mortgagors that the receiver's activities, prior to the Expansion of Powers Order, constituted a realization on the mortgages. The receiver's activities were directed at securing and stabilizing the property and restoring the rental revenues.

[101] As noted previously, the Expanded Powers Order subsequently authorized and directed the receiver to market and sell the properties, which it proceeded to do. Liahona sought this order from the court on the basis that without a sale of 345 Barber, due to cash flow limitations, it would not receive any interest payments on its second mortgage until the termination of the prior FN mortgage, (some eight years in the future) or until the mortgagors sold the property. The receiver advised the court of its support for the sale of the two properties and the rationale for it, as did counsel for FN. The Receiver's Report to the Court stated:

> 35. Liahona has advised the Receiver that it wishes that the Property be sold in order that it can attempt to realize on its loan to GDH 11. The Receiver understands that Liahona has not received any payments since Liahona advanced its loan with the principal balance of $2.9 million to GDH 11 secured by a second mortgage over 345 Barber.
>
> 36. As such, Liahona has advised the Receiver that it will be making a motion to expand the Receiver's mandate to authorize it to conduct a marketing and sale process in order to realize on the Property. In terms of the current economics, Liahona's position is understandable based on the cash flow being generated by the property that indicates that there is no prospect in the

> foreseeable future for Liahona to see any payments from the Receiver against its loan.

[102] FN did not oppose the proposed sale and indeed fully co-operated by agreeing to have the order for sale include in the sale the adjoining property, 347 Barber, thereby enabling the sale as the adjoining apartment building was constructed on both properties, rendering it commercially necessary that both properties be sold together. Because Liahona had no security on 347 Barber, the receiver dealt with this property pursuant to powers derived from section 101 of the *Courts of Justice Act* and as directed by the Expanded Powers Order.

[103] The court subsequently approved the marketing and sale of the two properties. I find that FN, by not opposing and indeed cooperating with Liahona's motion to the court to obtain the Expanded Powers Order authorizing the receiver to market and sell the property and by allowing 347 Barber to be included in the sale, to make the sale commercially feasible, was not engaging in a realization on FN's security so as to trigger an equity of redemption in favour of the mortgagors. Moreover, as noted previously, the Expanded Powers Order specifically stated:

> 12. **THIS COURT ORDERS** that notwithstanding (i) the variation and amendment of the status and mandate of the interim receiver Deloitte Restructuring Inc. as provided for in this Order, (ii) any other terms(s) of this Order, and (iii) FN not opposing this Order, FN shall still be deemed to be protecting its security over the Property, shall not be deemed to have resorted to realizing upon its security over the Property, and the equitable right of redemption in respect of FN's mortgages over the lands and premises described in Schedule "A" to the Appointment Order shall not be triggered

[104] The mortgagors have served a Notice of Motion requesting the court to set aside paragraph 12 of the Expanded Powers Order and the similar provision, term 31 of the earlier Appointment Order. The mortgagors point out they did not attend the hearing at which the original Appointment Order was granted. They submit the deeming provision is unusual and not part of the standard Model Order and assert that the deeming provisions were intended to have the effect of giving FN, "*a carte blanche to take all kinds of steps, any of which individually, or cumulatively, would, but for the deeming provisions, amount to enforcement or be considered to be FN resorting to its security and FN had an obligation to highlight this paragraph to the court in the circumstances and explain its impact and not let it hide in the woods*."

[105] I understand this submission to be essentially that the mortgagors and their counsel did not appreciate that the clauses in the two orders that deemed the receiver's mandate not to be a realization on the securities on the part of FN, would defeat any claim the mortgagors might otherwise have had to claim an equity of redemption in the FM mortgages. I am unwilling to accept assertions about what the mortgagors did or did not understand, or what course of action they may have considered pursuing, in the absence of any affidavit evidence provided by the mortgagors.

[106] The mortgagors submit that the broad scope of the remedial activities assigned to the receiver would normally be accepted as constituting a realization on the mortgage security. Counsel for the mortgagors lists in the factum of GDH 10 and GDH 11, his own clients' extensive defaults and lack of cooperation creating a situation in which the receiver was provided by court order with a very interventionist mandate to correct a deteriorating situation in the apartment buildings. Counsel for the mortgagors candidly stated (in his client's factum) that the situation in the apartment building "amounted to a disaster from the perspective of any reasonable lender".

[107] As stated previously, the receiver's original mandate in the Appointment Order was to stabilize the property, repair certain of the rental units and to rent the units and collect rental revenues. Due to the mortgagors' gross mismanagement of the apartment buildings prior to the receivership, the receiver's duties were necessarily extensive, but the purpose was to restore the security and collect the rental arrears owing under the mortgages on the properties (i.e. the mortgages of FN on both properties and the Liahona mortgage on 345 Barber and the Social Housing mortgage registered on 347 Barber). There is no merit in the suggestion that FN was realizing on its security in the context of the receiver's activities, carried out under court direction and approval, pursuant to the Appointment Order. Moreover, the case law establishes that a court appointed receiver does not act as agent for the secured creditor, see Dunphy J. in *Comfort Capital Inc*.

[108] The mortgagors submit that the receiver's carrying out of the court approved marketing and sale of the properties under the Expanded Powers Order would have constituted a realization of security on FN's part, were it not for section 12 of the Expanded Powers Order that provided that that FN was still deemed to be protecting its security and that the equitable right of redemption

was not triggered. It is that provision of the order (term 12) that the mortgagors seek to have set aside.

[109] Rule 59.06 of the *Rules of Civil Procedure* governs motions to vary court orders:

> 59.06(1) An order that contains an error arising from an accidental slip or omission or requires amendment in any particular on which the court did not adjudicate may be amended on a motion in the proceeding.
>
> Setting Aside or Varying
>
> (2) A party who seeks to,
>
> a) have an order set aside or varied on the ground of fraud or of facts arising or discovered after it was made;
>
> …
>
> d) obtain other relief than that originally awarded, may make a motion in the proceeding for the relief claimed.

[110] In *Mehedi v. 2057161 Ontario Inc.*, 2015 ONCA 670, Lauwers J.A., for the Court of Appeal, referenced two cases governing the application of Rule 59.06(2).

> 13. The test under rule 59.06(2)(a) to re-open a trial that applies after the judgment or other order has been issued and entered was set out by Doherty J.A., speaking for the court, in *Tsaoussis (Litigation Guardian of) v. Baetz* (1998), 41 O.R. (3d) 257, [1998] O.J. No. 3516 (Ont. C.A.), at paras. 41 and 44. As he noted, the onus is on the moving party to show that all the circumstances "justify making an exception to the fundamental rule that final judgments are exactly that, final." In particular, the moving party must show that the new evidence could not have been put forward by the exercise of reasonable diligence at the original proceedings. The court will go on to evaluate "other factors such as the cogency of the new evidence, any delay in moving to set aside the previous judgment, any difficulty in re-litigating the issues and any **prejudice to other parties or persons who may have acted in reliance on the judgment**." [Emphasis added]

> 17. In *671122 Ontario Ltd. v. Sagaz Industries Canada Inc.*, 2001 SCC 59, the Supreme Court accepted, at paras. 20 and 64, the motion judge's application of the two-part test for re-opening a trial described by the High Court in *Scott v. Cook*, [1970] 2 O.R. 769 (Ont. H.C.):

> First, would the evidence, if presented at trial, probably have changed the result? Second, could the evidence have been obtained before trial by the exercise of reasonable diligence?

[111] I decline to allow the mortgagor's motion to vary the two orders to delete the clauses which deem that the receiver's activities and the terms of the order will not constitute a realization on FN's security for the reasons outlined below.

[112] The two provisions of the orders in question were relied on by FN in making its decision to co-operate with Liahona's request to the court to authorize the receiver to market and sell the properties. Absent this clause in the Extended Powers Order, FN's cooperation with the sale may have triggered the mortgagors' equity of redemption and result in the loss of FN's common law entitlement to the interest prepayment charge (the yield maintenance). I accept FN's evidence that they would have opposed the sale and The Expanded Powers Order if they were thereby disentitled to the yield maintenance prepayment, which is consistent with the position FN took at the argument of the motion to approve the agreement of purchase and sale entered into by the receiver.

[113] Even if the mortgagors had specifically opposed the inclusion of the deeming provision in the Expanded Powers Order, with a full appreciation that it protected FN's right to charge an interest pre-payment penalty (yield maintenance) and also if the parties had somehow known that the Affordable Housing mortgage would not need to be paid out on closing of the transaction (but would be assumed by the new purchaser, thereby creating greater than anticipated net proceeds of sale), the court would still have authorized the proposed Expanded Powers order, including the clause deeming the marketing and sale to not constitute a realization by FN on its security.

[114] In other words, even with a more fulsome appreciation of the outcome of the future sale transaction and even with a specific consideration of the current yield maintenance dispute that arose later at the time of the sale approval motion, the court would still have signed the Extended Powers Order in its present form. It was and remains the case that Liahona required a sale of 345 Barber to realize any timely recovery on its second mortgage and the sale projections (the property appraisals) showed that the expected proceeds of sale would be more than sufficient to pay out the FN mortgages, including the yield maintenance claim, so that the present dispute could be dealt

with in due course by holding back a sufficient amount of the sale proceeds to cover a disputed yield maintenance claim.

[115] As noted, the mortgagors filed no affidavit evidence to advise the court what they would have argued had the then unforeseen yield maintenance dispute and the greater than expected net sales proceeds have been anticipated. However, I think the mortgagors would have supported the sale, including the deeming provisions (without which FN would have opposed the sale) with the chance of recovering some equity in the property. I find that matters would have transpired just as they have. Accordingly, the mortgagor's motion to remove the deeming clauses from the Appointment Order and the Expanded Powers Order is dismissed.

The CMHC "Due on Sale" clause

[116] Counsel for the mortgagors also submitted that upon review of the various prepayment clauses in the FN mortgages, there was no "Due on Sale" clause which FN was required to include in the mortgages pursuant to its undertaking to insure (UTI), required by CMHC as a condition of ensuring the mortgages. This clause speaks of accrued interest rather than future interest being due on a mortgagor's sale of the property when the lender is not consenting to the sale. If the Due on Sale clause is deemed to be included in the FN mortgages, counsel contends, it would conflict with the prepayment clauses from the commitment letters which references "yield maintenance" and therefore "arguably", counsel says, no future interest can be due when the properties are sold.

[117] I do not accept this submission for several reasons. It is unsupported by any affidavit evidence. Counsel chose not to cross-examine FN's affiant, Mr. Sebben, to put his conclusions to a party who could be expected to confirm or refute them. The parties have all presented to the court an Agreed Statement of Facts which accepts that the FN mortgages are "closed mortgages" i.e. closed for the balance of their respective terms, in the prevailing circumstances. Lastly, the mortgage provisions in the Agreed Statement of Facts allow FN to choose which provision to apply in the event of a conflict between the mortgage terms from the commitment letters and the terms contained in the mortgage schedules.

Motion to Strike Affidavits

[118] Liahona brought a motion to strike portions of affidavits filed by FN's representative Mr. Sebben that outlined circumstances surrounding FN becoming aware of the Liahona second mortgage on 345 Barber, including the failure by Liahona or the mortgagors to notify FN and obtain its consent to the Liahona mortgage (as required by the FN mortgages) and other indications of Liahona's lack of due diligence in taking what was foreseeably a high risk second mortgage. Contrary to Liahona's submission that this evidence was not relevant, I found it to be relevant for a more fulsome understanding of the commercial circumstances surrounding this transaction and was also of some assistance in evaluating the mortgagors' claim to equitable relief and as to the proper allocation of the receiver's expenses. The motion to strike this evidence is dismissed.

Allocation of Receiver's Expenses

[119] The court was asked to determine the allocation of the receiver's expenses, including the costs of sale, as between the two properties. The receiver has recommended an expense allocation of approximately 73% to 345 Barber and approximately 27% to 347 Barber. This reflects several factors including the relative value of the properties and a series of other valid measures carefully explained in the Receiver's Reports previously approved by the court. FN and the mortgagors support this allocation.

[120] Liahona submits that 100% of the receiver's expenses should be allocated to 347 Barber, the property on which they do not hold a mortgage, for the purpose of allowing a greater net recovery on Liahona's mortgage on 345 Barber. This is said to be warranted because it was the mortgagors who "caused the receivership by defaulting under the Liahona mortgage and the FN mortgages, and by allowing the properties to go into a state of disrepair requiring stabilization." The evidence before the court in this hearing suggests that there are a number of equitable issues in the 'clean hands' category as between Liahona and the debtors and both bear some responsibility for the difficult commercial situation which precipitated and subsequently complicated the administration of this receivership.

[121] In the court's opinion, the receiver's expenses are properly allocated on the objective basis recommended by the receiver.

Disposition

[122] A Declaration will issue that the FN mortgages were fully closed mortgages on the closing date of the receivership sale and FN is entitled to be paid the sum of $1,473,141.82, which represents a prepayment of future interest on the FN mortgages, calculated in accordance with the yield maintenance formula as defined in the FN mortgages. Further, an order will issue authorizing the receiver to pay this sum to FN from funds held in trust from the proceeds of the sale of 345 and 347 Barber.

Mr. Justice Charles T. Hackland

Released: November 16, 2020

CITATION: *First National Financial GP Corporation* v. *Golden Dragon HO 10 Inc. et al.*, 2020 ONSC 6994
COURT FILE NO.: 17-73967
DATE: 20201116

ONTARIO

SUPERIOR COURT OF JUSTICE

BETWEEN:

FIRST NATIONAL FINANCIAL GP CORPORATION

Applicants

– and –

GOLDEN DRAGON HO 10 INC. and GOLDEN DRAGON HO 11 INC.

Respondents

REASONS FOR JUDGMENT

Hackland J.

Released: November 16, 2020