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Mortgagee's Right to Withhold Funds Clarified

In *Pacifica Mortgage Investment Corp. v. Laus Holdings Ltd*., the legal question was whether a mortgagee was arbitrarily and unreasonably withholding funds it had agreed to loan on a multi-year development project that was only about six weeks from completion.

The borrower, a family-owned company run by a husband and wife, owned a 38-unit apartment building slated for conversion into condominiums. Toward this end, the borrower secured $2.6 million in financing from the lender in 2007, with $2 million to be advanced up-front. The mortgage agreement was embodied in a commitment letter and included certain terms and conditions, amongst them that the lender had the right to advance funds at its "sole discretion" after a "satisfactory review of [the] construction/renovation budget by the Lender."

About a year later, the lender advanced a further $300,000 after making a site visit. However, it later refused to advance the final $300,000 on the basis that it had not received sufficient budget information from the borrower. The mortgage's term expired a few days after that refusal, and the parties negotiated a renewal featuring a new commitment letter, a higher interest rate, and an increase in the total borrowed amount to $2.9 million.

Then, in April 2009 – with only about six weeks to go on the project – the borrower required a $600,000 construction draw, and provided the lender with construction budgets to support that estimate. However, since the parties could not come to terms on a further renewal, the existing mortgage went into default. The lender started foreclosure proceedings, and a receiver was appointed by the court.

The borrower objected, claiming that it was unconscionable for the lender to refuse to advance additional funds at such a late date, especially since it effectively prevented the conversion project from being completed. The trial judge disagreed as the mortgage agreement clearly stated that the lender had sole discretion on whether to advance funds. Moreover, any advance was predicated on the borrower providing satisfactory construction budgets, which it had never done during the mortgage's term.

The borrower's appeal of the foreclosure order was likewise unsuccessful. From the lender's standpoint, its security was predicated on the borrower's timely and efficient completion of the conversion project, and upon its own ability to monitor its financial risk on an ongoing basis. As such, it was not unreasonable for the lender to insist that the borrower comply with its contractual obligations to provide updated construction budgets as the conversion progressed, nor to make the advance of further funds contingent upon the receipt of satisfactory information. *Pacifica Mortgage Investment Corp. v. Laus Holdings Ltd.*, 2013 (BCCA), leave to appeal to the Supreme Court of Canada filed May 6, 2013.

Buyer Loses $100,000 Deposit by Failure to Rely on Title Insurance

In this case the buyer, who had agreed to purchase a $1.5 million residential property from the seller, discovered just prior to closing that there was an open building permit on the property. She advised the seller that she wanted to terminate the contract, and requested the return of her $100,000 deposit.

However, the seller pointed out that the agreement of purchase and sale expressly allowed for such permit-related issues to be addressed through title insurance, and insisted that the deal could proceed. At 3:55 p.m. on the afternoon of closing, the seller's lawyer accordingly faxed the buyer's lawyer a letter confirming that the title insurance company was prepared to provide title insurance for the buyer in the circumstances, and that it was prepared to close the transaction as scheduled.

Unfortunately, the buyer's lawyer did not see that fax when it arrived, and wrongly concluded that the deal was dead because of the open permit issue. She confirmed this in a fax to the seller's lawyer just after 4 p.m. In fact, had she seen the fax promptly (rather finding it, as she did, after 6 p.m. that same day) the necessary title insurance could have been arranged within a few minutes, by phone.

The deal did not close, and the buyer purchased a different property shortly afterwards. She applied to the court for the return of her deposit, claiming that the seller had been in breach.

The court found it was actually the buyer, not the seller, who had breached the agreement of purchase and sale. The seller's contractual obligation to "obtain" title insurance had been fulfilled once it secured the commitment from the title insurer to insure over the open building permit. It was not necessary for the seller to actually *purchase* the insurance policy; this would have necessitated the involvement of the buyer as policy-holder in any event.

With that commitment as to title insurance in place, the seller's contractual duty was fulfilled; the buyer had no right to unilaterally terminate the agreement at that point. Instead, the agreement remained in force until the 6 p.m. closing, and pending that deadline both buyer and seller had a duty to act in good faith and do whatever was necessary to fulfill their respective obligations. But rather than do so, the buyer and her lawyer had made premature assumptions instead: they had wrongly concluded that the deal would not close, and had let the clock run out. This was all in breach of the buyer's contractual duties; her $100,000 was accordingly forfeited to the seller. *Thomas v. Carreno*, 2013 (ONSC).

No Default by Borrower, Yet Bank Entitled to Make Demand for Entire Loan

In a recent Ontario decision, the court held that a creditor Bank was entitled to demand the entire loan amount, even though the borrower was not in default on its monthly payments.

The borrower was Ocean Sands, to whom the lender Bank had advanced $3,120,000 under a demand loan which was guaranteed by a third-party developer. Although Ocean Sands was current on its loan payments, the Bank nonetheless made a demand before the loan's 5-year term had expired. Both Ocean Sands and its guarantor failed to pay, so the Bank launched an action for summary judgment against both of them.

In court, the Bank justified its actions by pointing out that its right to enforce the loan and make a demand was not predicated on an *actual* breach of the loan commitment; rather, the Bank had broad discretion since the repayment terms stipulated that "payments in full" must be made "on demand". The borrower, while conceding this point, countered that the Bank should not be allowed to exercise that discretion unreasonably.

The court found in the Bank's favour. After reviewing the agreement's specific terms, it concluded that there was nothing to prevent the Bank from making a demand prior to the end of the term. But even if a triggering event was required, in this case Oceans Sands and its guarantor had breached various covenants in the loan commitment, relating to statutory declarations, the debt service ratio, and diverting the income stream, among other things. These non-financial defaults by the borrower were enough to trigger the Bank's right to make the demand. As the court explained:

I also disagree ... that there must be something more than simply a demand made by the Bank where the borrower was otherwise in complete compliance without any financial breaches of the facility letter or security given. While I agree that this is somewhat an unusual debtor/creditor case because the debtor is in good standing with its ongoing financial commitments, I also find that it is reasonable not to constrain commercial lenders to lend to borrowers whom they no longer trust or with whom they no longer wish to do business.

Bank of China (Canada) v. Ocean Sands Developments Ltd., 2013 (ONSC).

Can a Single Act Interrupt 20 Years of Land Use?

In a recent Ontario Court of Appeal decision, a dispute between two adjacent landowners raised the question of whether a single incident can stop the clock on the 20-year period of uninterrupted use that is needed to establish an easement in law.

One of two neighbouring commercial properties was owned by a real estate broker; the other was owned by an elderly doctor. The building on the broker's land had been built right up to the lot-line between them. In contrast, the building owned by the doctor had been built to allow for a laneway between the building and lot line. This laneway – which was entirely on the doctor's land – had been used by both the neighbours and their predecessors for more than 20 years, in order to access a parking lot in the rear.

The broker had plans to renovate his building. Since he could not obtain a building permit without proof that he had legal access to the rear parking lot, he asked the court for a declaration that he had a "prescriptive easement" over the doctor's laneway – meaning a legal interest that had accrued over time. While conceding that he never asked the doctor for permission to use the laneway, the broker claimed his legal right to an easement stemmed from more than 20 years' uninterrupted use.

But there was a legal glitch in the broker's plan: In February of 1987, he had approached the doctor to ask for his signature on a document, prepared by his lawyer, purporting to attest to the broker's legal right to use the doctor's lane. However the doctor – who was indignant at the request – flatly refused to sign.

After this 1987 incident, the broker and his tenants continued to use the laneway for years. (The doctor resisted periodically, but in a non-confrontational way: For example at one point he installed two "private parking" signs, but they were ripped down shortly after. He also installed a chain across the lane, which the broker admitted to cutting.) The narrow question for the court, therefore, was whether this 1987 incident served to interrupt the 20-year period needed to establish the broker's purported easement.

The Court of Appeal, in confirming the trial decision, held it did. In law, for the broker to obtain a prescriptive easement, he or his predecessors must have used the lane for at least 20 years *as if they themselves owned it, or else had a right to use it without permission*. The simple fact that the broker approached the doctor in 1987 for written permission was itself evidence that, in his mind, he knew he still needed the doctor's permission; his use of the lane could not be "as of right" (*i.e.* as a matter of entitlement). Such an acknowledgment precluded the broker from establishing the requisite 20-year period of prescriptive use that could create an easement in law. His application for the declaration was accordingly denied. *1043 Bloor Inc. v. 1714104 Ontario Inc.*, 2013 (ONCA).