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Can Borrower Block Power of Sale if Sale Price is Too Low?

In a recent Court of Appeal decision, the dispute centered on whether the borrower could stop the lender's power of sale proceedings because they felt the price obtained for the property was too low.

The borrower had a vision to develop his property into a residential complex. He borrowed $1 million from the lender, secured by a first mortgage. After his default, he was unable to secure refinancing, so the lender commenced power of sale proceedings and agreed to sell to an arm's-length third party. The purchase price was $1,150,000, which was down considerably from the initial list price of $1,420,000.

The borrower's first attempt to ask the court to stop the sale was unsuccessful. Then, on the scheduled sale closing date, the parties attended court to have an appeal heard. The lender asked the court to validate the imminent sale to the third party, and the borrower asked for injunction to have it blocked, so that he could redeem the mortgage instead.

The borrower's complaint was that the lender was selling the property "in bad faith", after only three weeks on the market, and well below the appraised value. The borrower felt that the lender's only concern was to recoup the $1 million that had been advanced under the mortgage (rather than focus on getting market value for the property) and that it had heedlessly accepted the second offer that came along, with no regard to the harm that it would cause the borrower.

The Court of Appeal rejected the borrower's appeal and added that the Court could not make the declaration that the lender wanted, either.

It was premature for the Court to rule on whether the lender's sale transaction was valid. The lender had a duty to make reasonable efforts to sell for market value; this involved taking steps in good faith after considering the borrower's interests, and after a reasonable time on the market with proper marketing efforts and appraisals. Whether the lender in this case had met those obligations, or conversely whether the sale was improvident, would come to light only after-the-fact. It was not the Appeal Court's proper role to pre-judge any issue related to a future improvident sale action, which was also the most appropriate venue for assessing any damages that may have arisen from the sale.

Further, subject to the borrower's right to redeem or bring the mortgage into good standing (neither of which had been exercised here) – a lender acting in good faith and without fraud could not be restrained from the proper exercise of its power of sale remedy. Once the lender had accepted the new buyer's offer, the borrower's right to put the mortgage in good standing came to an end, in keeping with the provisions of the *Mortgages Act*. The borrower and any subsequent mortgagees were out of time, and a mere allegation that the lender's sale was in bad faith, or that it had breached its duty of care, did not provide the court with the jurisdiction to make an improvident sale declaration.

The lender was therefore allowed to proceed with its remedy, but the court could not go so far as to give its "blessing" to the sale to the new buyer. Those two parties were not at odds, and absent an actual *dispute*, the court could not declare the contract valid. See *Linderwood Holdings Inc. v. Armanasco*, 2017 ONCA 156; affirming 2016 ONSC 1605.

Is Notice of Sale Void for Inclusion of 3 Months' Interest on Default?

In *Attalla v. Moody*, the simple question was whether a Notice of Sale, given by a mortgage lender to trigger power of sale proceedings, was invalid merely because it referred to an agreed additional fee for three months' interest.

The borrowers owned a property that was the subject of several mortgages. The third mortgage was in favour of a group of lenders for $1.1 million, with a one-year term. The mortgage contained a provision that stated that upon default or if not renewed prior to maturity, the lenders at their option were entitled to charge an additional fee of three months' interest.

When the borrowers failed to renew and did not pay the outstanding balance at maturity, the lenders issued their Notice of Sale, claiming almost $1,133,000, including about $33,000 as the "additional fee," equivalent to three months' interest.

The borrowers – who also owed significant sums of money under first and second mortgages – failed to redeem or refinance, and were evicted after a default judgment was obtained. The lenders then listed the property for sale.

The borrowers went to court to try to block the sale. They complained that the Notice of Sale was defective because it referred to the three months' interest fee, which was tantamount to a "fine or penalty"

prohibited by section 8 of the *Interest Act*. As such, they claimed that the lenders' enforcement attempts were also void.

The court disagreed. Merely because the lenders had imposed some sort of charge of fee did not automatically mean that the provisions of the *Interest Act* had been offended. The key was to look at the effect of the fee, rather than its label. It was not in the nature of a "fine," "penalty" or "interest," nor did it increase the charge on arrears. Based on the principles set out by the Court of Appeal in *P.A.R.C.E.L. Inc. v. Acquaviva* (discussed in SR Law's prior *Mortgage and Real Property Report* newsletter, Vol. 21, No. 3 (August 2015)), the fee was merely an independent charge arising from the borrower's default, to reflect the fact that lenders had been forced to initiate enforcement proceedings. The court stated that "[t]he fee charged in this case does not increase the charge on the arrears in the sense that it does not increase the amount required to pay off the arrears and discharge the mortgage and redeem the property. In the covenant at issue, the fee applied by the mortgagee is not enforceable against the equity. The right of enforcement of this aspect of the mortgagee's claim is against the mortgagors on the covenant, not against the security in the property." The mere fact that the fee happened to be calculated using a fixed number of months of interest did not alone convert it into an interest charge prohibited by law.

After concluding that section 8 of the *Interest Act* had not been offended, the court added that a minor irregularity of this type did not render the Notice of Sale wholly invalid in any case, since it was something that could be cured by a simple subsequent accounting.

The lenders were entitled to proceed unfettered with their power of sale remedy. See *Attalla v. Moody*, 2017 ONSC 1971.

Limited Purpose of Easement Challenged

The Mihaylovs owned lakefront land on Sturgeon Lake, adjacent to a property without lake access, which was owned by the proprietor of a General Store. In the late 1960s, and with the consent of the then-owners, a galvanized steel pipeline had been buried along the entire length of the Mihaylovs' property to allow lake water to be run to the Store owner's lot. The Mihaylovs were fully aware of the pipeline's existence when they bought the property in 2012.

That pipeline served to provide lake water to the Store for almost 50 years, before it sprung a leak in 2014.

The Store owner, claiming he was unable to contact the Mihaylovs (who only visited on weekends), trespassed onto their property and without their permission ran an above-ground PVC pipe to the lake. He later excavated part of the Mihaylovs' land, again without their permission, to try to upgrade or repair the existing pipeline. When the Mihaylovs objected, the matter went before the court to resolve the resulting dispute.

The key issue was the extent to which the Store owner had a right to repair or replace the pipeline, even though it was on the Mihaylovs' property. This led the court to examine the wording and effect of an easement granted by the Mihaylovs' predecessors in 1979, and which was registered on title to both properties.

Unfortunately, that 1979 agreement adverted only to a "Water Pipe Easement," but did not specify its scope or extent. It stated that whoever owned the Store property "shall be able to leave the said water line in its present position, and to draw water from Sturgeon Lake."

On these facts, and contrary to what a lower court judge had ruled, the Appeal Court found that the easement only permitted the previously-installed pipeline to be left in its present position; the Store owner was limited to making repairs, and only with the Mihaylovs' consent.

The court considered the established legal test for granting an easement, and found all but one of the required elements were obviously present. The Four required elements essential to the grant of an easement being: (1) there must be a dominant and a servient tenement; (2) the easement must accommodate the dominant tenement; (3) the owners of the dominant and servient tenements must be different persons; and (4) a right over land cannot amount to an easement unless it is capable of forming the subject-matter of a grant.

It was the last element considered, which was of critical importance here and the Appeal Court confirmed that this last element was met as well. The 1979 agreement entitled the owner of the dominant tenement to leave the pipeline in its present position in order to draw water from the lake. This, the Appeal Court found, was sufficient to constitute an easement in law.

But, from a practical legal standpoint, the lower court judge misinterpreted the scope and effect of that valid easement. It only granted the Store owner the right to leave the pipeline in its present position and to draw water; it did not give him the right to *install* a new pipeline or *replace* the existing one.

Finally, the court pointed out that a so-called "right to repair" which was also embodied in the 1979 agreement and which the Store owner had relied on in trespassing on the land, was actually not a "right" given by the Mihaylovs. Instead, its wording suggested that it amounted to a *promise* by the adjacent landowner to repair the pipeline while respecting the rights granted under the easement. It did not give the Store owner independent rights to make repairs and possibly inflict damage to the property.

The Appeal Court overturned the prior ruling, confirmed the validity of the easement and declared that its effect was only to allow the pipeline to be left in its current position. The Store owner was allowed to enter on the Mihaylovs' land for the limited purpose of repairing the pipeline, but only if they expressly agreed in advance and acquiesced to the nature of the repairs. The court also ordered that the PVC line was to be removed, and forbade the Store owner from trespassing onto the Mihaylovs' land in the future. See *Mihaylov v. 1165996 Ontario Inc.* 2017 ONCA 116.