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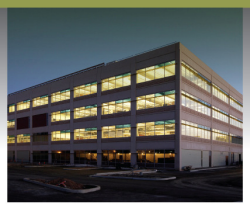
Mortgage and Real Property Law Report



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A Legal Newsletter for the Mortgage and Real Estate Industries

Court Rewrites Bank Loan and Guarantee to Correct "Mutual Mistake"

The Ontario Court of Appeal recently considered whether it was appropriate to "rectify" an agreement between sophisticated parties to a loan/guarantee arrangement, in the face of what amounted to a mistake.

A corporation, E Ltd., had persuaded the Bank to extend its line of credit to $700,000. E, as president and sole shareholder of E Ltd, personally guaranteed the loan and also pledged a $700,000 collateral mortgage on his own property. Eventually E Ltd. owed the Bank over $3 million, and it soon became insolvent. The Bank called the loan and sought to enforce the security provided by E. Ultimately, E paid $700,000 to the Bank, which discharged the collateral mortgage; however it demanded an additional $700,000 under E's personal guarantee as well. E refused to pay, and the Bank sued both E and E Ltd. The Bank succeeded against E Ltd at trial, but the action against E personally was dismissed. The trial court conceded that, in normal cases, the terms on the face of the collateral mortgage and guarantee would have bound E to personally pay the entire debt of E Ltd. In this case, however, there was evidence that the parties' common intention was otherwise: the collateral mortgage was intended to be security for E's guarantee obligation, which was extinguished when he paid the first $700,000. It said:

"The case before us is not a case of unilateral mistake. On the trial judge's reasonable view of the record, it is a case of common mistake: when entering into the written agreement, neither party intended to create two independent $700,000 obligations. Both thought the obligations were connected."

That being the situation, rectification by the court was the remedy. Moreover, the Court of Appeal dismissed the notion that this would "open the floodgates", by making it too easy for a court to correct mistakes in signed contracts, even those entered into by sophisticated parties. Rather, it found that to allow the Bank to collect $1,400,000 on its security for a $700,000 loan would amount to unfair dealing and would unjustly enrich the Bank at E's expense. See *Royal Bank of Canada v. El-Bris Ltd.*, 2009 (ON C.A.)

Limitation Periods on Mortgage Enforcement

Whenever a mortgage goes into default, various issues arise immediately, including the choice of which remedy to pursue. But one of the most important preliminary tasks is to determine the appropriate limitation period within which to take steps to exercise that chosen remedy.

As you may know, routine mortgages are generally governed by the *Real Property Limitation Periods Act*. However legislative changes in the form of the *Limitations Act, 2002* have added other limitation periods, and address specific issues such as debt acknowledgments, and the effect of partial payments. Also, the Ontario Court of Appeal has recently clarified limitations law in connection with specific scenarios, namely: 1) for demand promissory notes (in the 2006 decision of *Hare v. Hare*); and 2) for demand mortgages (in the September 2009 decision of *Mortgage Insurance Co. of Canada v. Grant*.)

As a result, the law relating to limitation periods has become very complex, but the following is a quick, shorthand summary:

- To recover, out of land or rent, any sum secured by mortgage: — within 10 years from the date the right accrues.
- To effect foreclosure and power of sale: — within 10 years from the date the right to do so first accrues.
- To recover possession of the land where the mortgage is in arrears: — within 10 years from the last payment of principal or interest.

Note that the limitation period may be affected in some circumstances, for example where there has been fraud, or where there has been a written acknowledgment of the debt.

Guarantee Survives Expiry of Commitment Letter

The need for careful drafting is the lesson to be learned from a recent decision. A corporation had obtained a $3 million commercial mortgage from the lender in connection with the purchase of a waterfront property, marina and hotel. The full loan was repayable once the 10-month term expired, and it was supported by several unconditional guarantees provided with independent legal advice. The guarantors and the borrowing corporation each executed a mortgage commitment letter, which contained a clause that it was the "entire agreement" between them. However, issues arose as to the fitness of certain buildings for development, so the commitment letter expired before the lender advanced the borrowed funds. Still, the parties proceeded on the assumption that the transaction would proceed if certain conditions were met, and when it did close the mortgage specifically referred to the commitment letter as being the basis for the corporation's indebtedness. The lender later sued on both the payment covenant in the commitment letter, and on the guarantees.

The court found that the terms of the guarantees were clear and unambiguous: their wording rendered them unaffected by the expiry of the commitment letter. Instead, they were effective regardless of any loss suffered in respect of the underlying security. As the court observed, there was no evidence to the contrary:

"…the record is bereft of any document that suggests that the guarantors advised anyone, after the closing of the transaction, that they considered their guarantees at an end following the expiry of the commitment letter."

Moreover, the corporation was aware of the "entire agreement" clause, and both parties were sophisticated and had entered into the transaction "with their eyes open". The guarantors had agreed to guarantee the corporation's indebtedness to the lender no matter how it arose, and regardless of any alterations in the terms of the arrangement between them (including the expiry of the commitment letter, and issues as to the property's fitness for development). The lender was accordingly entitled to summary judgment for repayment of the loan and for payment under the guarantee. See *Carevest Capital Inc. v. Belle Harbour Developments Inc.*, 2009 (ON S.C.)

Tarion Not Blamed for Failed Development Agreement

A builder has unsuccessfully sought to blame Tarion for not accepting its late registration renewal, which in turn helped scuttle a development agreement.

In connection with 106 lots that it owned, a developer entered into an agreement with the builder: the developer would complete all services and make the lots ready, while the builder would construct the homes in exchange for a portion of the selling price. Eventually, both builder and developer claimed breaches of the agreement by the other, including the developer's allegation that the builder's registration with Tarion had lapsed. The relationship between the parties unravelled; the developer barred the builder from the site, claimed the right to retain improvements made by the builder so far, and sued for damages.

Among other defences, the builder in turn looked to Tarion for refusing to accept its registration renewal application. The builder had presented it without the required financial statements, and had submitted it five days beyond the Tarion's deadline (which had already been extended once). Still Tarion, in a gesture designed to protect one of the home buyers, had gratuitously allowed a "one-off" registration for that particular lot. On this point, the court concluded,

"[t]he fact remained that Tarion's registration had expired. The Registrar's actions, taken to protect the consumer, could not retroactively revive the registration."

The trial judge found the builder's failure to file the financial statements was deliberate, because it was subject to a GST audit and faced a hefty fine. Without those documents, the renewal application simply did not comply with the Regulations, and Tarion could not be held liable for the fact that the development agreement subsequently fell apart. See *King's Bay Development Corp. v. Cornerstone Custom Homes Ltd.*, 2009 (ON C.A.).

No Injunction to Prevent Stray Golf Balls on Development Property

A developer/builder of a residential subdivision next to a Collingwood golf course was unsuccessful in preventing any golf from being played on part of the course until his dispute with the course owner was resolved. Stray golf balls were spraying onto the developer's property, and an attempt to settle the matter with the golf course owner – which included a "land swap" and re-alignment of nine of the holes on the golf course – had proven unsuccessful. The developer accordingly sued to have the agreement enforced, and brought the injunction pending trial.

The court dismissed the injunction, finding there would be no irreparable harm as a result. Although stray golf balls were a nuisance, the developer could be compensated for delay, or lost sales by way of monetary damages. There was nothing to suggest that, for example, an application for site plan approval could not proceed, or that development could not continue on lands unaffected by the golf ball spray. The developer could mitigate its damages pending trial, whereas the golf course owner would suffer serious negative consequences from closing even a single hole. Indeed, to prevent the owner from offering less than 18 holes would be a serious interference with its business and would likely cause both damage to its reputation and loss of clientele. See *Tanglewood (Sierra Homes) Inc. v. Munro Golf Ltd.*, 2009 (ON S.C.)

Mortgage Replacement Scheme Held Valid

An interesting mortgage transaction has been declared valid, despite an appeal to Supreme Court of Canada. Taylor Ventures (TV) owned a development property. Just before it went bankrupt, it fraudulently conveyed the property to another company owned by one of the property's beneficial owners. That person discharged a commercial mortgage but replaced it with a similar mortgage, which in turn was assigned to another company also related to the new owner. Although the initial fraudulent conveyance by TV was declared void, the Receiver asked the Court to also declare the mortgage void or unenforceable. The B.C. Court of Appeal declined; it held that, by buying-back a mortgage that it had granted to a third party acting in good faith, the recipient of the fraudulently conveyed property – despite guilty intent and wrongful control – could nonetheless enforce its own interest in it. The Supreme Court of Canada dismissed the application for leave to appeal that decision. See *Taylor Ventures Ltd. (Trustee of) v. High Meadow Holdings Ltd.*, 2008 (S.C.C.)

LEGAL ALERTS

Christine Jonathan joins the firm

Christine is the newest member of our team of litigation lawyers, and brings with her a wide range of experience in commercial matters including insolvency, shareholder disputes, mortgage and guarantee enforcement, fraud, general breach of contract, and debt collection. She also represents employers and employees in all aspects of employment law. Christine obtained an Honours B.A from Queen's University in 1982, an LLB from Osgoode Hall in 1986, and was called to the Bar in 1988.

Update on Bill C-10

As we reported in our Spring 2009 newsletter, the Federal Government had recently introduced Bill C-10, "An Act to implement certain provisions of the budget tabled in Parliament on January 27, 2009 and related fiscal measures." Among other things that Bill amends the *Bank Act*, providing Cabinet authority to override the existing prohibition on financial institutions issuing shares to the Federal Government if necessary to "promote the stability of the financial system in Canada." The Bill received third reading on March 4, 2009, and certain parts are now in force as of March 12, 2009; others have retroactive in-force dates. See S.C. 2009, c. 2

WSIB Premium Rates Frozen for Most in 2010

The Ontario Workplace Safety and Insurance Board (WSIB) has recently announced that premium rates for employers in rate groups with good health and safety records will be frozen for 2010. (Rate increases for other rate groups will be calculated in the usual manner). The vast majority of Ontario employers will therefore have their premium rates maintained at 2009 levels.