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Court Reviews Prompt Payment Incentives Under the *Interest Act*

The central question in *Equitable Trust Co. v. Lougheed Block Inc*. was whether incentives for the prompt payment of mortgages offend the provisions of the federal *Interest Act*, which prohibit a lender charging a higher rate of interest after a mortgage default, than before.

The facts involved two mortgage renewal agreements relating to a $27 million mortgage. In the first one, the interest was fixed at 3.125% per annum, to be increased to 25% a month before the maturity date. When the borrower defaulted, the mortgagee offered a second renewal agreement: interest was now to be 25% per annum, with a certain calculated amount to be added to top-up the principal each month. However, if there was no default before the maturity date, the added amount would be forgiven.

The borrower defaulted by failing to make any payments at all under the second mortgage renewal.

The three-member Alberta Court of Appeal panel was asked to consider whether either of these two renewal agreements offended the provisions of section 8 of the federal *Interest Act*. That provision forbids the levying of a "fine, penalty or rate of interest … that has the effect of increasing the charge on the arrears beyond the rate of interest payable on principal money not in arrears…", and targets not merely interest, but also lump-sum bonuses and increased rates of compounding interest.

All three judges concurred that the first renewal did not breach the Act: the higher rate of interest – which took effect one month before maturity – was triggered merely by the passage of time, not strictly by any act of default by the borrower. In coming to this conclusion, the judges stressed that these kinds of agreements must be reviewed using a contextual approach, and one that considers not just the form of the transaction, but also its substance. The members of the court also agreed that the borrower's sophistication level, the lender's motives, and the existence of any legitimate commercial purpose for the incentive provision, were all irrelevant to determining whether the Act's provisions were offended.

As for the second renewal agreement, the court was split: two of the three judges concluded that its terms essentially provided for 25% interest, with a discount to the principal amount in the event there was no borrower default. This did not fall within the literal and narrow meaning of the s. 8 prohibition, which was aimed not at incentives for performance, but rather at "penalties for non-performance". (In contrast, the lone dissenting Appeal judge concluded that the offered incentive in the second renewal effectively increased the interest rate on arrears, in breach of s. 8).

The Alberta court's conclusion diverges somewhat from prior decisions on the same point in both Ontario and British Columbia (where, in both provinces, s. 8 was interpreted to cover both "penal and non-penal incentives"). The bottom line is that at least in Alberta, a mortgage agreement may include certain prompt-payment incentives without breaching s. 8 of the *Interest Act*, even if those incentives can be lost upon default – and even if the overall effect is that the charge on arrears is increased. In light of this ruling, the situation in other provinces may have to be re-examined. *Equitable Trust Company v Lougheed Block Inc*., 2014 (ABCA).

Subsequent Lender Requests Mortgage Status; E-Mail Statement Binds Prior Mortgagee

The central issue in *Amendola v. Carelli* was whether, because of misrepresentations made in an e-mail, a second mortgagee lost priority over a third mortgagee in connection with certain interest payments owed under the second mortgage.

The facts were these: Frank Carelli ("Frank") loaned his sister-in-law Anna $240,000, and secured the loan with a second mortgage on her home. The term was for six months, with a 10% interest rate calculated half-yearly. Anna's property was already subject to a first mortgage with a bank.

In 2010, Anna wanted to borrow another $65,000 from Tony Amendola ("Tony"), who became a third mortgagee. Prior to advancing the funds, Tony made inquiries as to the status of the first two mortgages: The bank reported back that the first mortgage was current; and Frank responded with an e-mail which simply said "I'm confirming that the second mortgage is in good standing to-date." The e-mail reply went on to invite Tony to call if he had further questions.

Relying on these representations, Tony

advanced the funds, assuming that both first and second mortgages were in good standing in respect of all their terms and that Anna was up-to-date on all payments. Tony received similar assurances from Frank in 2012, when he agreed to lend an additional $100,000 secured by a fifth mortgage.

As it turned out, when Frank had first made inquiries of Tony in 2010, the second mortgage had not been in good standing at all: Anna had failed to make an interest payment on a certain date in late 2009, as required by the agreement.

Anna eventually defaulted on the third mortgage held by Tony in 2012, and he took steps to enforce his rights under it. This included keeping up the insurance coverage, and making payments to the bank to keep the first mortgage in good standing. He obtained judgment on his third mortgage in 2013, and obtained a writ of possession for the property; it was sold for just under $1 million, with the money put into trust pending resolution of the priority dispute between mortgagees.

Frank then stepped forward to claim the entire $240,000 that he had loaned Anna, plus interest at 10% since 2009 – all purportedly in priority to the interests of Tony as third mortgagee and to those of subsequent mortgagees. This was despite Frank's misrepresentations to all of them, to the effect that the second mortgage was in good standing up to the time that those other mortgages were placed. In explanation of his 2010 e-mail to Tony suggesting otherwise, Frank claimed that by way of a private agreement with Anna, he had agreed to waive or defer that interest-payment requirement, and that Tony should have been able to deduce this was the case. In any event, Frank said, the informality of the e-mail reply made it clear that it was not to be relied upon, unlike a formal mortgage statement would be. Finally, Frank pointed to the line in his e-mail inviting Tony to call him with any questions, which Tony did not do.

Tony resisted Frank's claim and the matter went to court for resolution. The court began by pointing out that a second mortgagee is entitled to rely on the statements of a first mortgagee at the time a subsequent mortgage is placed. Although it was true that Frank had not provided a formal mortgage statement in this case, his e-mail still amounted to a misrepresentation in law, and Tony's reliance on it was still reasonable. As the court said:

"Leaving out a crucial piece of information such as the fact that the mortgage is in "good standing" only because interest payments have been waived, and then providing a phone number for "any further questions", is either a very naïve or a very clever form of miscommunication."

Further, any private waiver or deferral agreement between Anna and Frank should have been disclosed to Tony.

Frank's repeated misrepresentations as to the status of the second mortgage were intended to induce Tony to lend Anna the funds. This was a situation of equitable estoppel; Frank was not entitled to claim any waived or deferred interest payments in priority to Tony and other subsequent mortgagees, at least for the period prior to the date in 2012 when his last misrepresentation to Tony was made.

The court therefore awarded Tony the principal and interest that was due under the third mortgage, to be paid out of the proceeds of sale being held in trust. He was also entitled to be repaid for the costs of maintaining and repairing the property, and for the expenses incurred to prepare it for sale. See *Amendola v. Carelli*, 2014 (ONSC).

CPL Not Granted in Case Where Specific Performance Claimed

In *Starwood Acquisitions Inc. v. 267 O'Connor Ltd.*, the court made an important finding: it refused to grant a Certificate of Pending Litigation in connection with a failed commercial property deal, because the only remedy being claimed by the plaintiff was for specific performance. In light of the facts, this was a case where damages should have been claimed instead.

A Toronto property development company agreed to purchase a commercial property from the seller for $11,400,000, with a closing date in May of 2014. The downtown Ottawa property consisted of a six-story medical building with parking.

Shortly after the agreement was signed, the buyer raised several concerns about existing leases and other matters. Disputes arose; the deal did not close as planned, and the buyer started a lawsuit for specific performance and an abatement of the purchase price. The buyer also asked for a Certificate of Pending Litigation (CPL).

In considering whether to grant the CPL, the court applied the relevant legal test, finding that the potential buyer clearly had an "interest in land", and a "triable issue" as to such interest, arising from the potential breach of contract concerns over the leases. However, the tripping point for granting the CPL was the fact that the buyer was claiming not damages, but rather specific performance. The latter is an equitable remedy available for breach of contract, but is granted only where the land has a peculiar and special value, to the point where money would not be a complete remedy for the breach.

In this case, the commercial property was being purchased by a property developer with a long list of similar projects, undertaken over many years in many different cities and provinces. Other comparable downtown Ottawa properties with similar development potential were still available. Simply put, there was nothing special about this property; rather, it was merely an attractive investment opportunity, given its location and prospects for development. On this point the court observed:

"Where land is purchased as an investment, damages are an appropriate remedy."

Since an award of damages rather than specific performance was the appropriate recourse, the court declined to grant a CPL. See *Starwood Acquisitions Inc. v. 267 O'Connor Limited*, 2014 (ONSC).