CITATION: 660 Sunningdale GP Inc. et al v. First Source Mortgage Corporation et al, 2023 ONSC 2129
COURT FILE NO.: CV-21-828 (London)
DATE: 20230404

ONTARIO

SUPERIOR COURT OF JUSTICE

BETWEEN:	
660 Sunningdale GP Inc. and Michael C. Clawson a.k.a. Mike Clawson Plaintiffs	Michael A. Polvere and James R. Leslie, Counsel for the Plaintiffs/Defendants by Counterclaim
v.	
First Source Mortgage Corporation and First Source Financial Management Inc. Defendants	David Taub and Anisha Samat, Counsel for the Defendants/Plaintiffs by Counterclaim
-and-	
First Source Mortgage Corporation and First Source Financial Management Inc. Plaintiffs by Counterclaim	
v.	
660 Sunningdale GP Inc., Michael C. Clawson a.k.a. Mike Clawson and Clawson 550 Sunningdale Inc. Defendants by Counterclaim	
	HEARD: September 14, 2022

RULING ON MOTION

HEBNER J.

[1] The defendants brought a motion for summary judgment and the plaintiffs responded with their own motion for summary judgment. Both motions were heard together. The plaintiffs and the defendants all agreed that the claim and counterclaim could be dealt with by way of a motion for summary judgment. This is my ruling on the motions.

Overview

[2] The plaintiff, 660 Sunningdale GP Inc. (the developer), is the owner of property located at 660 Sunningdale Road East in London, Ontario ("the property"). The developer was in the process of developing a new subdivision project at the corner of Sunningdale Road and Adelaide Street in London, Ontario, referred to as the "Applewood Project". The Applewood Project was proceeding in phases with new lands being purchased and developed sequentially.

[3] By way of a commitment letter dated March 29, 2021 ("the commitment letter"), the defendants First Source Mortgage Corporation, on behalf of its syndicate partner, First Source Financial Management Inc., agreed to refinance the first mortgage over the property. The defendants are collectively referred to as "the lender".

[4] The commitment letter included the following terms:

- The loan amount was the lesser of $15,500,000 or 62% of the appraised value of the property, with the appraiser to be approved by the lender;
- The term was nine months plus seven days from the "interest adjustment date" being the first day of the month following the first advance under the commitment letter;
- The interest rate was the higher of 9.5% or the CIBC prime rate plus 7.05%, during the first nine months. The interest rate jumped to the higher of 18% or the CIBC prime rate plus 15.55% for the final seven days of the term;
- The guarantors (Michael C. Clawson and Clawson 600 Sunningdale Inc.) guaranteed 100% of the debt.

[5] Article 2 of the commitment letter set out a lender fee as follows:

- The borrower was required to pay the lender a lender fee in the amount of 2.75% of the loan amount with $45,000 (the "initial lender fee") to be paid upon sign back of the non-binding letter of interest and $55,000 (the "first deposit") payable upon acceptance of the commitment letter;
- The balance of the lender fee was payable from the closing proceeds;
- The lender fee was "deemed earned upon acceptance and execution of the commitment letter";
- The lender "shall have an interest in the property for the lender fee and if not paid, and if litigation proceedings are commenced, the lender shall be entitled to a certificate of pending litigation against the property"; and

- The borrower acknowledged that "the lender fee is a reasonable estimate of the lender's costs incurred in sourcing, investigating and underwriting and preparing the loan".

[6] Article 4.17 of the commitment letter, under the heading "Cancellation", included the following term:

> "In the event the loan is not advanced and the commitment is terminated, through no fault of the lender, the deposit shall not be refundable to the borrower and may be retained by the lender as liquidated damages. Notwithstanding the foregoing, the borrower shall be responsible for and pay the deficiency between the lender fee and the deposit forthwith on demand, unless if caused by the default of the lender."

[7] The developer accepted the commitment letter on March 31, 2021 and advanced a $100,000 deposit to the lender.

[8] On April 22, 2021, the developer terminated the commitment letter by way of an e-mail from their lawyer, Mr. Cassino. The e-mail read "Good afternoon. I am told this loan is not proceeding." Shortly thereafter, the developer contracted for financing from different lenders.

[9] No funds were ever advanced from the lender to the developer.

Positions of the Parties

[10] The lender asserts that the total lender fee payable is $426,500. The developer has paid $100,000, leaving $326,500 outstanding. The lender seeks judgment in the unpaid amount of $326,500 along with interest, damages for legal fees, and costs.

[11] The developer asserts that the lender made unreasonable demands after the commitment letter was signed. The developer asserts that the demands amounted to a change in the fundamental and essential terms of the commitment letter. The developer further asserts that the lender registered wrongful encumbrances that hindered the developer's ability to fund the project. The developer asserts that the lender's actions impeded the deal and claims that, therefore, the lender is in breach of the commitment letter and acted in bad faith in its implementation. Accordingly, the fee is not payable. The developer seeks judgment in the total amount of $426,500 plus interest and costs.

[12] In any event, the developer asserts that Article 4.17 is a penalty clause and ought not to be enforced.

The Issues

1. Was the commitment terminated "through no fault of the lender"?
2. Did the lender act in bad faith by making unreasonable demands?
3. Is the lender fee an unenforceable penalty clause?
4. Is either side entitled to summary judgment?

The Facts

[13] The evidence filed on behalf of the developer was an affidavit of Kevin Stephens, a shareholder of 660 Sunningdale GP Inc. at the time of the events in issue.

[14] Mr. Stephens' evidence is that after the commitment letter was signed, the lender began to make unreasonable demands. He asserts that the demands amounted to a change in the fundamental and essential terms of the commitment letter. The demands alleged were:

- Insisting on an out-of-date residual valuation method;
- Insisting on a valuation method that would only be available after the closing date of April 21, 2021;
- Insisting that one of 660 Sunningdale's directors resign;
- Insisting that Peter Griffis sign as guarantor;
- Unreasonably rejecting the project costing projections; and
- Generally, not exercising the duty of good faith.

The Valuation Method

[15] The commitment letter included, in Article 3.01, a list of lender conditions, which included an appraisal requirement as follows:

> Review and approval by the Lender of an appraisal, by the Lender's approved appraiser, addressed to the Lender and its lender clients, or if acceptable to the Lender, a Reliance Letter provided by the appraiser confirming the "As-Is" value for the subject Property not less than $25,000,000. The Appraisal is for the account of the Borrower."

[16] The developer provided an appraisal report on March 17, 2021. The lender was not satisfied with the report and requested a "residual value appraisal". Mr. Stephens asserts that he made enquiries of the author of the original appraisal and was told that the "residual value appraisal had not been utilized in over a decade and is no longer recognized as an industry standard or an accepted appraisal method." Moreover, Mr. Stephens asserts that such an appraisal would require at least 60 days to obtain and as such would not be viable given the lender's deadline of April 21, 2021, and the timeline for funding.

[17] Mr. Zaidener gave evidence on behalf of the lender. He asserts that the residual value appraisal was required by Article 3.01 of the commitment letter under "Lender Conditions":

> k) Land Residual Value: Project economics to confirm a satisfactory net residual land value as determined by the Lender, corresponding to not less than the Appraised "As-Is" Value for the subject Property. At the Lender's sole and absolute discretion, in the event the net aforementioned residual land value is less than the Appraised Value, the Lender may be prepared to

> accept said value with the proviso the value is not less than and corresponds to a reasonable underwriting value as established independently by the Lender.

The Guarantor Issue

[18] The developer asserts that Mr. Zaidener, on behalf of the lender, wanted a net-worth statement from Peter Griffis, an officer and director of the developer, and required that he sign as a guarantor. Mr. Zaidener deposes that he does not recall making such a request, but in any event the lender had the right to do so under paragraph 1.11 of the commitment letter, the paragraph setting out the required security:

> 12) Such other reasonable legal security as requested by the Lender and/or its legal counsel.

The Director Issue

[19] The developer asserts that Mr. Zaidener required that Pierce Ji of Landeal step down as a director of 660 Sunningdale GP Inc. Mr. Zaidener said in his affidavit "I do not recall asking that Pierce Ji of Landeal step down as a director of 660 Sunningdale GP Inc."

Breach of the Duty of Good Faith

[20] Mr. Stephens asserts that:

- The lender attempted to change the amount it was willing to advance by deducting approximately $3,000,000 from the agreement. There is no response to this assertion.
- The lender advised that it could not fund the project. The lender disputes this allegation and asserts that it was able, willing, and ready to advance the funds.

The Encumbrances

[21] The lender registered a PPSA on Block 1 of the registered plan of the subdivision, being phase 1 of the Project. Phase 1 had nothing to do with the proposed financing. The PPSA caused difficulty with a construction draw and raised questions with lenders. The PPSA was removed after Mr. Stephens called the lender's lawyer.

[22] On April 28, 2021, the lender caused a caution to be registered on properties that had nothing to do with the financing, specifically the exact same parcel of land encumbered by the improper PPSA. This took place after the developer terminated the commitment letter and does not factor into the analysis of the bad faith allegations. The registration was dealt with by the developer paying $326,500 into its lawyers' trust account.

Analysis

[23] I start by re-stating the issues to be addressed:

1. Was the commitment terminated "through no fault of the lender"?
2. Did the lender act in bad faith by making unreasonable demands?
3. Is the lender fee an unenforceable penalty clause?
4. Is either party entitled to summary judgment?

Summary Judgment Motions

[24] Rule 20.04(2) of the *Rules of Civil Procedure*, R.R.O. 1990, Reg. 194 states:

> (2) The court shall grant summary judgment if,
>
> (a) the court is satisfied that there is no genuine issue requiring a trial with respect to a claim or defence; or
>
> (b) the parties agree to have all or part of the claim determined by a summary judgment and the court is satisfied that it is appropriate to grant summary judgment.

[25] In *Hryniak v. Mauldin*, 2014 SCC 7, the Supreme Court provided guidance on circumstances in which summary judgment is appropriate. At paragraphs 49-50, Karakatsanis J., writing for the Court, stated:

> There will be no genuine issue requiring a trial when the judge is able to reach a fair and just determination on the merits on a motion for summary judgment. This will be the case when the process (1) allows the judge to make the necessary findings of fact, (2) allows the judge to apply the law to the facts, and (3) is a proportionate, more expeditious and less expensive means to achieve a just result.
>
> These principles are interconnected, and all speak to whether summary judgment will provide a fair and just adjudication. When a summary judgment motion allows the judge to find the necessary facts and resolve the dispute, proceeding to trial would generally not be proportionate, timely or cost effective. Similarly, a process that does not give a judge confidence in her conclusions can never be the proportionate way to resolve a dispute. It bears reiterating that the standard for fairness is not whether the procedure is as exhaustive as a trial, but whether it gives the judge confidence that she can find the necessary facts and apply the relevant legal principles so as to resolve the dispute.

[26] A party on a summary judgment must put its "best foot forward". A court is entitled to assume that the record contains all of the evidence that a party would present at trial. See *Sweda Farms v. Egg Farmers of Ontario*, 2014 ONSC 1200,

[27] Here, the parties have agreed that the entire claim and counterclaim ought to be determined by way of summary judgment. Each side requests summary judgment in its favour. The

question is whether I am satisfied that summary judgment is appropriate. I consider each of the issues identified above.

Was the Commitment Terminated Through No Fault of the Lender? Did the lender act in bad faith by making unreasonable demands?

[28] I am unable to determine this issue on the evidence filed.

[29] The developer asserts that the lender breached the terms of the commitment letter, or acted in bad faith, by unreasonably insisting on a residual value appraisal. However, Article 3.01(k) of the commitment letter required a residual value appraisal.

[30] The developer asserts that the lender unreasonably required Peter Griffis to sign as an additional guarantor. Mr. Zaidener asserts that he does not recall making such a request. He neither confirms nor denies it. However, paragraph 1.11 of the commitment letter provides that the lender may request additional reasonable security and there is no evidence that the guarantee was unreasonable.

[31] The developer asserts that the lender insisted that one of its directors, Mr. Pierce Ji, resign. Mr. Zaidener asserts that he "does not recall" making that demand. He neither confirms nor denies the allegation.

[32] I am entitled to assume that I have all of the evidence before me that would be before the trial judge. Mr. Stephens for the plaintiff deposes that the lender made the demands discussed above and Mr Zaidener cannot recall. Mr. Stephens provides explanations as to why both demands could not be met.

[33] Rule 20.04(2.1) gives the court the power to weigh the evidence, evaluate the credibility of a deponent, and draw any reasonable inference from the evidence. I apply those powers here and accept the evidence of Mr. Stephens that the demands described were made by Mr. Zaidener. The demands were significant to the developer – the demanded exposure of an individual to a corporate debt and the demand by a lender to change the internal structure of a corporation are demands that one would expect a borrower to remember well. I take the answer by Mr. Zaidener that he "doesn't recall" to mean that he could very well have made those demands.

[34] The question then is whether the demands were reasonable. I have insufficient evidence to make that determination.

[35] The developer asserts that as a result of its failure to comply with the lender's demands, the lender tried to change the amount it was willing to advance by deducting approximately $3 million from the agreement. If the demands were reasonable for a debt in the amount of the proposed mortgage, then I would see this as the lender attempting to salvage the deal. As I make no finding on whether the demands were reasonable, I cannot conclude that the reduction is a breach on the part of the lender.

[36] As for the registrations, the PPSA registration was removed after a call to the lender's lawyer. There is insufficient evidence to explain whether and to what extent the registration had any effect on the developer's ability to continue with the project. As for the caution, it was registered on title after the termination of the commitment letter and cannot be considered in the analysis of whether the lender breached the commitment letter.

[37] In short, despite the agreement of the parties, I am unable to determine whether the termination of the commitment letter was the fault of the lender. However, I am able to conclude that the requirements complained of, and the PPSA registration, at the very least made the developer's life difficult. To insist on a particular type of appraisal that, on the evidence filed was impossible to obtain within the time available; to demand an additional guarantor; to require a director to resign; and to register an improper PPSA would have individually been difficult for the developer to deal with. Collectively, these issues caused the developer to unilaterally terminate the commitment letter and look elsewhere for financing.

Is the Lender Fee an Unenforceable Penalty Clause?

[38] Section 98 of the *Courts* of *Justice Act*, R.S.O. 1990, c. C.43 states "A court may grant relief against penalties and forfeiture, on such terms as to compensation or otherwise as are considered just".

[39] In *City Star Roofers Inc. v. 2169462 Ontario Limited*, 2022 ONSC 1407, Lococo J. summarized the law at paras. 20-21:

> In Peachtree II Associates – Dallas L.P. v 857486 Ontario Ltd. (2005), 76 O.R. (3d) 362 (C.A.), leave to appeal denied, [2005] S.C.C.A. No. 420, Sharpe J.A. provided a useful summary of the law relating to the enforceability of penalties and forfeitures, both at common law and in equity. He referred to such provisions as "stipulated remedy clauses", under which the parties agree in advance on the monetary or other consequences of a breach, should one occur: see *Peachtree*, at para. 1.
>
> By way of brief summary, a stipulated remedy clause may be characterized as a penalty (the payment of a sum of money) or a forfeiture (the loss of a right, property or money, often being held as security or part payment): *Peachtree*, at paras. 22 and 31. At common law, a stipulated remedy will be treated as an unenforceable penalty if, determined at the time of contract formation, it is "extravagant and unconscionable in amount" compared to the greatest conceivable loss upon breach; however, the remedy will be enforced if it is a genuine attempt to pre-estimate damages upon breach: at para. 24. If the stipulated remedy is a forfeiture, it will be enforced in equity when it is not unconscionable to do so, determined at the time of breach: at paras. 25-26. Sharpe J.A. went on to note the strong judicial preference for classifying a stipulated remedy clause as a forfeiture rather than a penalty, when faced with a choice: at para. 31. He also noted that courts should, whenever

> possible, favour analysis based on equitable principles and unconscionability over the strict common law rules relating to penalty clauses: at para. 32.

[40] The Court of Appeal for Ontario has set out the test for determining whether relief from forfeiture should be granted in *Redstone Enterprises Ltd v. Simple Technology Inc*., 2017 ONCA 282. Lauwers J.A., at para. 10 stated that a party seeking relief from forfeiture is required to establish that:

> 1. The forfeited sum was out of proportion to the damages suffered by the other party upon breach, and
>
> 2. It would be unconscionable for the other party to retain the money.

[41] In *Infinite Maintenance Systems Ltd. v. ORC Management Limited* (2001), 139 O.A.C. 331 (C.A.), the issue arose from the wording of compensation in a cleaning contract. The defendant agreed to pay compensation to the plaintiff if the defendant hired the plaintiff's workers during a prohibited period after the termination of the contract.

[42] Writing for the court, Weiler J.A. stated at paras. 13-15:

> The trial judge recognized that the compensation clause which was intended to discourage solicitation of its personnel was *prima facie* enforceable. The onus of establishing that the clause is a penalty is on the respondent as the person seeking to set it aside: *Canadian General Electric Co. v. Canadian Rubber Co.* (1915), 52 S.C.R. 349 (S.C.C.). Although the clause contains no definition of compensation, the trial judge held that the clause was not so vague as to render it void for uncertainty. He held that it must be given a commercially reasonable interpretation. I agree. To allow the appellant's claim for its gross contract price would not be a commercially reasonable interpretation. Nor would it be commercially reasonable to construe the clause as a genuine pre-estimate of damages. In claiming the gross amount of the contract as damages in its statement of claim, the appellant was overreaching. Before us, the appellant acknowledged that its profit was $2,100 a month on the contract. This amount would be the highest potential pre-estimate of loss.
>
> In determining whether a clause is a pre-estimate of damages or a penalty, the most important factor a court will consider is quantum. As stated by Lord Justice Dunedin in *Dunlop Pneumatic Tyre Co. v. New Garage & Motor Co.* (1914), [1915] A.C. 79 (U.K. H.L.), at 87:
>
> > It [a "liquidated damage" clause] will be held to be a penalty if the sum stipulated for is extravagant and unconscionable in amount in comparison with the greatest loss that could conceivably be proved to have followed from the breach.

> When a court characterizes a provision as a penalty clause, it will nevertheless award the damages that have been proved. For example, in *H.F.Clarke Ltd. v. Thermidair Corp* (1974), [1976] 1 S.C.R. 319 (S.C.C.), the Court found the clause which provided for payment of $200,000 was a penalty but awarded the plaintiff its provable damages of $90,000. On the view I take of the case, had the respondent not hired Deborah and Martin, the appellant would have had the benefit of their services and would not have had to incur the expense and effort to find, hire, and retrain two other team members. The loss of Deborah and Martin as members of the appellant's team meant that the appellant lost the future profit it would have made from the value it added to their skills that took place over a period of approximately six months. It had to expend time, effort and expense to train two new team members. I would quantify this loss by taking the time required to train two persons and multiplying it by the profit the appellant earned during the training period ($2,100 a month). The result is that the appellant is entitled to $12,600 as its loss.

[43] Is Article 4.17 a pre-estimate of damages or a penalty clause? The test is whether the sum stipulated is "extravagant and unconscionable in amount in comparison with the maximum loss that could have been sustained by the party seeking to enforce the clause". See *Save Max Real Estate Inc v. Dutta*, 2019 ONSC 6116, at para. 32.

[44] The facts in *Marshallzehr Group Inc. v. Ideal (BC) Developments Inc.*, 2021 ONCA 229, are similar to the facts in this case. The plaintiff lender signed a commitment letter agreeing to provide financing to the defendant developer for a real estate project. Marshallzehr advanced funds to its counsel to be held in trust pending Ideal's satisfaction of the funding conditions. The loan never closed – the lender terminated as the developer did not satisfy the conditions. The lender sought payment of its "Lender Fee" in the sum of $396,000. The motions judge agreed with the lender and the Court of Appeal did not. The Court of Appeal considered the language in the commitment letter, and particularly the term that the fee was to be payable from the advance of funds.

[45] In the case at hand, the lender asserts that the fee was compensation for both the work involved in arranging the loan and the risk to the lender in entering into the commitment letter. The difficulty with this assertion is that there was little evidence as to the costs incurred by the lender. The only evidence is that the lender incurred legal fees, disbursements, and HST of $5,200.

[46] I turn to the wording of Article 4.17 of the commitment letter. The deposit ($100,000) and the balance of the lender fee ($326,500) are treated differently. The deposit must be paid before any funds are advanced. If the loan is never advanced, and it is not the lender's fault, the deposit is to be retained by the lender "as liquidated damages".

[47] The balance of the lender fee was not payable until the mortgage funds were advanced. The entire fee was specified to be a "reasonable estimate of the lender's costs incurred in sourcing, investigating and underwriting and preparing the loan". Clearly, the lender did

not source, underwrite and prepare the loan as no loan was made, and so the lender did not incur those costs. The lender did not provide any evidence that the loan was investigated. Indeed, the lender did not provide any evidence whatsoever as to the damages it suffered as a result of the cancellation of the loan.

[48] In my view, the liquidated damages amount of $100,000 is a pre-estimate of damages whereas the balance of the lender fee, $326,500, is a penalty. I make this finding for several reasons: the parties agreed that if the loan did not proceed the lender had liquidated damages of $100,000; it is apparent that much of the work for which the lender fee was payable (namely underwriting, sourcing, and preparing the loan) was not done; and the balance of the lender fee was to be paid out of the loan advance, which never happened. I cannot conclude that the commitment letter was terminated at the fault of the lender, and therefore I find that the lender is entitled to retain the deposit of $100,000.

[49] As to the balance of the lender fee, I consider whether relief ought to be granted to the developer.

Should the Court Grant Relief?

[50] With no evidence from the lender as to its damages, I can only conclude that the balance of the lender fee was out of proportion to the damages the lender actually suffered.

[51] I am unable to conclude that the actions of the lender constituted a default on the evidence provided. I can, and do, conclude that the demands and actions of the lender made it difficult for the developer to comply and lead the developer to look for financing elsewhere. Given that, in my view, it would be unconscionable to require the developer to pay the balance of the lender's fee to the lender.

Disposition

[52] The result is mixed success between the parties. The defendant's motion for summary judgment is dismissed. The plaintiff is entitled to summary judgment on its motion in the sum of $326,500.

[53] The defendants shall not be required to return the deposit of $100,000 to the plaintiffs.

[54] The balance of the lender fee, being the $326,500 held in trust, plus interest, shall be released to the plaintiffs.

Costs

[55] In the event the parties cannot agree on costs, they may file brief written submissions, along with a costs outline and any relevant offers to settle, within 20 days. If either side wishes to respond to the other's submissions, they may do so within 10 days thereafter.

Original Signed by "Justice P.L. Hebner"
Pamela L Hebner
Justice

Released: April 4, 2023

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RULING ON MOTION

Hebner J.

Released: April 4, 2023