

Court File No. 31-2303814
Estate No. 31-2303814

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

IN BANKRUPTCY AND INSOLVENCY

**IN THE MATTER OF THE PROPOSAL OF 1482241 ONTARIO LIMITED,
OF THE CITY OF TORONTO, IN THE PROVINCE OF ONTARIO**

BRIEF OF LAW OF THE PROPOSAL TRUSTEE
(motion returnable March 28, 2018)

Date: March 22, 2018

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SUPERIOR COURT OF JUSTICE
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IN BANKRUPTCY AND INSOLVENCY

**IN THE MATTER OF THE PROPOSAL OF 1482241 ONTARIO LIMITED,
OF THE CITY OF TORONTO, IN THE PROVINCE OF ONTARIO**

BRIEF OF LAW OF THE PROPOSAL TRUSTEE

OVERVIEW

1. Crowe Soberman Inc. is the proposal trustee (in such capacity, the “**Proposal Trustee**”) of 1482241 Ontario Limited (the “**Debtor**”).
2. On March 16, 2018, the Proposal Trustee brought a motion seeking, among other things,
 - (a) an order approving the agreement of purchase and sale (the “**Sale Agreement**”) relating to the property located at 240 Duncan Mill Road, Toronto, Ontario (the “**Duncan Mill Property**”), and vesting in the purchaser all of the Debtor’s right, title and interest in and to the Purchased Assets (as defined in the Sale Agreement), free and clear of any claims and encumbrances (the “**Approval and Vesting Order**”); and
 - (b) an order permitting the Proposal Trustee to make certain distributions from the proceeds of the sale, including, without limitation, distributions to:

- (i) Dan Realty Corporation, E. Manson Investments Limited and Copperstone Investments Limited (collectively, the “**First Mortgagees**”), on account of the amounts owing to the First Mortgagees by the Debtor in accordance with the charge registered on title to the Duncan Mill Property as Instrument Nos. AT935525 and AT4236037 (the “**First Charge**”); and
- (ii) Janodee Investments Ltd. and Meadowshire Investments Ltd. (together, the “**Second Mortgagees**”), on account of the amounts owing to the Second Mortgagees by the Debtor in accordance with the charge registered on title to the Duncan Mill Property as Instrument No. AT4349221 (the “**Second Charge**”).

3. By order dated March 16, 2018, the Honourable Justice Hainey granted the Approval and Vesting Order, as well as some of the related relief. By agreement of the parties, four discrete issues (the “**Outstanding Issues**”) were adjourned to a further hearing, to be addressed on March 28, 2018, or as may the court may direct.

4. The Outstanding Issues are as follows:

- (a) the claim by the First Mortgagees for \$206,250 for three months’ interest;
- (b) the issue of whether the Order of Justice Whitaker dated October 27, 2014 affects the validity and/or enforceability of the Second Charge;
- (c) the issue of the interest rate under the Second Charge as raised by the Debtor; and

- (d) the impact of the DSF Writ (as defined in the Supplement to the Fourth Report), if any, on the amount secured by the Second Charge.

5. The Proposal Trustee is filing the within Brief of Law to assist the Court and the parties with the determination of the Outstanding Issues.

(a) The Interest Penalty

6. The First Mortgagees' discharge statement contains a fee in the amount of \$206,250.00, which is described as a "Three (3) Months Interest Penalty (\$68,750 x 3)".¹ This fee arises from the applicable commitment letter, which contains the following provision:

In the event that the Loan is not repaid on the maturity date, then the Lender may at its option charge an additional fee equivalent to three months interest on the then outstanding principal balance of the Loan.²

7. This contractual provision must be considered in light of s. 17 of the *Mortgages Act*, R.S.O. 1990, c. M.40, together with s. 8 of the *Interest Act*, R.S.C., 1985, c. I-15.

8. Pursuant to s. 8 of the *Interest Act*, a mortgagee may not impose a "fine, penalty or rate of interest" on arrears of amounts owing for principal and interest, at a higher rate than was charged on amounts not in arrears. However, an interest penalty will not be contrary to s. 8 of the *Interest Act* if it may be imposed pursuant to s. 17 of the *Mortgages Act*. That section permits a mortgagor in default to repay the amounts owing pursuant to the mortgage upon either (a) paying three months' interest on the principal money in arrears, or (b) giving the mortgagee three months' notice of its intention to make such a payment: *Mastercraft Properties Ltd. v. EL EF Investments Inc.*, 1993 CarswellOnt 614 (Ont. C.A.) (at paras. 19-22).

¹ Appendix D to the Supplement to the Fourth Report.

² Appendix C to the Supplement to the Fourth Report at p. 5.

9. The case law identifies a number of factors which may be relevant to determining whether fees such as the Interest Penalty are enforceable, having regard for these statutory provisions. These factors may include:

- (a) whether the fee is properly characterized as a “fine, penalty or rate of interest” within the meaning of s. 8 of the *Interest Act*;
- (b) whether the fee is payable at the option of the mortgagee or the mortgagor;
- (c) whether the mortgagee has taken steps to enforce its charge;
- (d) whether the contractual provision that establishes the fee provides the mortgagor with the option of providing notice in lieu of payment of the fee; and
- (e) whether the mortgagor has given notice of its intention to repay the amounts owing pursuant to the mortgage.

10. See *Mastercraft Properties Ltd. v. EL EF Investments Inc.*, *supra*, *Ialongo v. Serm Investments Ltd.*, 2007 CarswellOnt 1246 (Ont. S.C.J.), *Mintz (In Trust) v. Mademont Young Inc.*, 2010 ONSC 116 (Ont. S.C.J.) (at paras. 7-20), and *2468390 Ontario Inc. v. 5F Investment Group Inc.*, 2017 ONSC 4641 (Ont. S.C.J.) (at paras. 20-36), together with the cases cited therein.

11. On the basis of the current record, and in the limited time available, the Proposal Trustee is unable to complete the fulsome analysis necessary to make a recommendation as to whether the Interest Penalty is payable. The Proposal Trustee invites the parties to submit additional evidence and argument on this issue to permit the Court to make this determination.

(b) **The Validity and/or Enforceability of the Second Charge in Light of the Whitaker Order**

12. The Second Charge was registered on title to the Duncan Mill Property on September 21, 2016, and an amendment thereto was registered on September 22, 2016.³ As at the date of registration of the Second Charge, the Debtor was enjoined from selling, mortgaging, encumbering or otherwise dealing with the Duncan Mill Property without the consent of the Neelofar Ahmadi or Jamshid Hussaini (together, the “**Property Claimants**”) or court order, pursuant to the Whitaker Order dated October 27, 2014 (the “**Whitaker Order**”). However, the Whitaker Order had never been registered on title to the Duncan Mill Property; only a CPL dated June 13, 2014 was registered.⁴

13. The Second Mortgagee and its counsel assert, by way of correspondence sent to counsel for the Proposal Trustee, that they did not have notice of the Whitaker Order or the CPL as at the date the Second Charge was registered.⁵

14. The issue for determination on this hearing is whether the Whitaker Order affects the validity and/or enforceability of the Second Charge. Any issue relating to the impact of the Second Charge on any claim asserted by the Property Claimants will be addressed at a later date.

15. Section 93(3) of the *Land Titles Act, 1990*, R.S.O. 1990, c. L.5 applies to this question. The section provides as follows:

93(3) The charge, when registered, confers upon the chargee a charge upon the interest of the chargor as appearing in the register subject to the encumbrances and qualifications to which the chargor’s interest is subject, ***but free from any unregistered interest in the land. (emphasis added)***

³ Supplement to Fourth Report at Appendix F.

⁴ Supplement to Fourth Report at paras. 11-13, Appendices H, I.

⁵ Second Supplement to Fourth Report at para 16, Appendix F; Supplement to Fourth Report at paras 12-13.

16. On the face of this statutory provision, the Second Charge is unaffected by unregistered interests, including the Whitaker Order. However, if the Second Mortgagee did in fact have actual knowledge of the existence of the Whitaker Order, then the case law suggests that the Whitaker Order *may* have an impact on the enforceability of the Second Charge.

17. In making this assessment, the Court must consider, among other things:

- (a) s. 78(5) of the *Land Titles Act*, which provides that instruments affecting an interest in land rank in the order in which they are entered in the register, despite any express, implied, or constructive notice;
- (b) the Court of Appeal's decision in *Romspen Investment Corp. v. 2126921 Ontario Inc.*, 2010 ONCA 854, which granted an equitable mortgage priority over a registered mortgage on the basis of the doctrine of actual notice, despite s. 93(3) of the *Land Titles Act*; and
- (c) the subsequent decisions of this Court in *Romspen Investment Corp v. Woods Property Development Inc.*, 2011 ONSC 3648 (Ont. S.C.J.) (at paras. 124-136) (reversed on other grounds) and *Trez Capital Limited Partnership v. Wynford Professional Centre Ltd.*, 2015 ONSC 2794 (Ont. S.C.J.) (at para. 36), which held that there is nothing in the language of s. 93(3) of the *Land Titles Act* that could permit an unregistered interest to take priority over a registered interest.

18. In addition, *R. v. Sankar* 2012 ONSC 1498 (Ont. S.C.J.) (at para. 129) speaks to the question of whether the registration of the CPL ought to have alerted the Second Mortgagee to

the existence of the Whitaker Order, and the requirement that a subsequent encumbrancer have actual notice of the unregistered interest.

19. The Proposal Trustee is unable to reach a recommendation on this issue on the basis of the existing evidentiary record, and in light of the current case law. The Proposal Trustee invites the parties to make submissions on this issue.

(c) The Interest Rate Payable Under the Second Charge

20. This is a purely factual question which ought to be determined on the basis of evidence presented by the Debtor and the Second Mortgagee.

(d) The Impact of the DSF Writ on the Second Charge

21. On December 11, 2015, Devry Smith Frank LLP (“**DSF**”) registered a writ of seizure and sale as against the Debtor, Alain Checroune, and A. Checroune Realty Corporation (the “**DSF Writ**”). The Second Charge was thereafter registered, without the DSF Writ being discharged. Having failed to secure the discharge of the DSF Writ, the Second Mortgagee’s interest is encumbered by the DSF Writ.

22. However, as a result of the Debtor’s initiation of these insolvency proceedings, the Debtor’s obligation to DSF pursuant to the DSF Writ (the “**DSF Claim**”) is unsecured, and the DSF Claim must be treated rateably with the Debtor’s other unsecured debts. Further, the execution of the DSF Writ is stayed pursuant to s. 69.1(1) of the BIA: *Toronto-Dominion Bank v. Phillips*, 2014 ONCA 613 (at paras. 27, 30, 33).

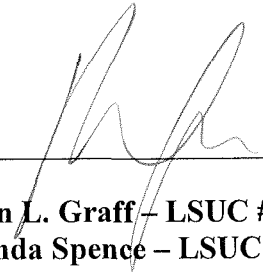
23. This circumstance results in a form of circular priority, whereby the Second Charge is subject to the DSF Writ, but the DSF Writ ranks equally with the claims of the other unsecured creditors, who rank subsequent to the Second Charge.

24. Circular priorities are typically dealt with by means of the partial subordination formula described in *Re C.I.F. Furniture Ltd.*, 2011 ONCA 34 (Ont. C.A.) (at paras. 21-22). However, it is unclear how an unsecured claim ought to be incorporated into such an analysis, particularly when the Proposal Trustee has not yet initiated a claims process, and is therefore unaware of the extent of unsecured claims that may be made, and who those claimants may be.

25. The issue is further complicated by the Second Mortgagee's assertion that it advanced funds to secure the discharge of the DSF Writ, but that the DSF Writ was not discharged due to an error committed by counsel for the Debtor acting on that transaction. Subject to receiving additional evidence relating to the flow of these funds, it may be the case that counsel for the Debtor ought to be found liable to either DSF for the amount of the DSF Claim, or to the Second Mortgagee in respect of any reduction to be applied to the distribution to the Second Mortgagee from the sale proceeds, on account of the DSF Writ.

26. In light of the foregoing, the Proposal Trustee is unable to provide a recommendation with regard to the impact of the DSF Writ on the Second Charge. The Proposal Trustee invites the parties to submit additional evidence and argument on these issues.

ALL OF WHICH IS RESPECTFULLY SUBMITTED this 22nd day of March, 2018.



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SCHEDULE "A"

LIST OF AUTHORITIES

1. *Mastercraft Properties Ltd. v. EL EF Investments Inc.*, 1993 CarswellOnt 614 (Ont. C.A.)
2. *Ialongo v. Serm Investments Ltd.*, 2007 CarswellOnt 1246 (Ont. S.C.J.)
3. *Mintz (In Trust) v. Mademont Young Inc.*, 2010 ONSC 116 (Ont. S.C.J.)
4. *2468390 Ontario Inc. v. 5F Investment Group Inc.*, 2017 ONSC 4641 (Ont. S.C.J.)
5. *Romspen Investment Corp. v. 2126921 Ontario Inc.*, 2010 ONCA 854
6. *Romspen Investment Corp v. Woods Property Development Inc.*, 2011 ONSC 3648 (Ont. S.C.J.)
7. *Trez Capital Limited Partnership v. Wynford Professional Centre Ltd.*, 2015 ONSC 2794 (Ont. S.C.J.)
8. *R. v. Sankar* 2012 ONSC 1498 (Ont. S.C.J.)
9. *Toronto-Dominion Bank v. Phillips*, 2014 ONCA 613
10. *C.I.F. Furniture Ltd.*, 2011 ONCA 34 (Ont. C.A.)

SCHEDULE "B"

TEXT OF STATUTES, REGULATIONS & BY-LAWS

Mortgages Act, R.S.O. 1990, c. M.40

Payment of principal upon default

17 (1) Despite any agreement to the contrary, where default has been made in the payment of any principal money secured by a mortgage of freehold or leasehold property, the mortgagor or person entitled to make such payment may at any time, upon payment of three months interest on the principal money so in arrear, pay the same, or the mortgagor or person entitled to make such payment may give the mortgagee at least three months notice, in writing, of the intention to make such payment at a time named in the notice, and in the event of making such payment on the day so named is entitled to make the same without any further payment of interest except to the date of payment.

Exception

(2) If the mortgagor or person entitled to make such payment fails to make the same at the time mentioned in the notice, the mortgagor or person is thereafter entitled to make such payment only on paying the principal money so in arrear and interest thereon to the date of payment together with three months interest in advance.

Saving

(3) Nothing in this section affects or limits the right of the mortgagee to recover by action or otherwise the principal money so in arrear after default has been made. R.S.O. 1990, c. M.40, s. 17.

Interest Act, R.S.C., 1985, c. I-15

- **8 (1)** No fine, penalty or rate of interest shall be stipulated for, taken, reserved or exacted on any arrears of principal or interest secured by mortgage on real property or hypothec on immovables that has the effect of increasing the charge on the arrears beyond the rate of interest payable on principal money not in arrears.

- **Marginal note: Interest on arrears**

(2) Nothing in this section has the effect of prohibiting a contract for the payment of interest on arrears of interest or principal at any rate not greater than the rate payable on principal money not in arrears.

Land Titles Act, 1990, R.S.O. 1990, c. L.5**Protection of unregistered estates**

71 (1) Any person entitled to or interested in any unregistered estates, rights, interests or equities in registered land may protect the same from being impaired by any act of the registered owner by entering on the register such notices, cautions, inhibitions or other restrictions as are authorized by this Act or by the Director of Titles. R.S.O. 1990, c. L.5, s. 71 (1).

...

Effect of registration

(2) Where a notice, caution, inhibition or restriction is registered, every registered owner of the land and every person deriving title through the registered owner, excepting owners of encumbrances registered prior to the registration of such notice, caution, inhibition or restriction, shall be deemed to be affected with notice of any unregistered estate, right, interest or equity referred to therein. R.S.O. 1990, c. L.5, s. 71 (2).

Effect of unregistered instruments

72 (1) No person, other than the parties thereto, shall be deemed to have any notice of the contents of any instruments, other than those mentioned in the existing register of title of the parcel of land or that have been duly entered in the records of the office kept for the entry of instruments received or are in course of entry. R.S.O. 1990, c. L.5, s. 72 (1).

Charges

93 (1) A registered owner may in the prescribed manner charge the land with the payment at an appointed time of any principal sum of money either with or without interest or as security for any other purpose and with or without a power of sale. R.S.O. 1990, c. L.5, s. 93 (1).

Statement of principal

(2) A charge that secures the payment of money shall state the amount of the principal sum that it secures. 1998, c. 18, Sched. E, s. 135 (1).

Effect of charge when registered

(3) The charge, when registered, confers upon the chargee a charge upon the interest of the chargor as appearing in the register subject to the encumbrances and qualifications to which the chargor's interest is subject, but free from any unregistered interest in the land. R.S.O. 1990, c. L.5, s. 93 (3).

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OF THE CITY OF TORONTO, IN THE PROVINCE OF ONTARIO**

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**ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST
(IN BANKRUPTCY AND INSOLVENCY)**

Proceedings commenced at Toronto

**BRIEF OF LAW OF THE PROPOSAL TRUSTEE
(motion returnable March 28, 2018)**

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