COURT OF APPEAL FOR BRITISH COLUMBIA

Citation: *Bankers Mortgage Corporation v. Plaza 500 Hotels Ltd.,*
2017 BCCA 66

Date: 20170209
Docket: CA43655

Between:

Bankers Mortgage Corporation dba InstaFund Financial (Commercial)

Respondent
(Plaintiff)

And

Plaza 500 Hotels Ltd., 406326 B.C. Ltd., KBK No. 85 Ventures Ltd., Firefly Fine Wines and Ales Ltd., and Azim Popat

Appellants
(Defendants)

Corrected Judgment: The text of the judgment was corrected at paragraph 41 on February 15, 2017.

Before: The Honourable Mr. Justice Lowry
The Honourable Mr. Justice Harris
The Honourable Madam Justice Dickson

On appeal from: An order of the Supreme Court of British Columbia, dated April 22, 2016 (*Bankers Mortgage Corporation v. Plaza 500 Hotels Ltd.*, 2016 BCSC 722, Vancouver Registry S149026).

Counsel for the Appellants:	J.M.S. Woolley & T. Chan, Articled Student
Counsel for the Respondent:	P.J. Roberts & J.R. Pollard
Place and Date of Hearing:	Vancouver, British Columbia January 20, 2017
Place and Date of Judgment:	Vancouver, British Columbia February 9, 2017

Written Reasons by:
The Honourable Mr. Justice Harris

Concurred in by:
The Honourable Mr. Justice Lowry
The Honourable Madam Justice Dickson

Summary:

The appellant borrowers and covenantors defaulted on a mortgage and were held liable for an "Exit Fee" payable to the mortgage broker under the terms of a Loan Retainer Agreement. The appellants argue the Exit Fee is a penalty on arrears prohibited by s. 8 of the Interest Act. HELD: appeal dismissed. The trial judge's finding that the Exit Fee was not a penalty, but a genuine pre-estimate of damages, is sound. In any event, the Exit Fee is an unsecured obligation that does not prevent the mortgagor from redeeming the property. It is not "stipulated for, taken, reserved or exacted on any arrears of principal or interest secured by mortgage on real property", nor does it have "the effect of increasing the charge on the arrears beyond the rate … payable on principal money not in arrears." In light of s. 8's purpose, it does not operate to prohibit the Exit Fee.

Reasons for Judgment of the Honourable Mr. Justice Harris:

Introduction

[1] This is an appeal of an order granting judgment to a mortgage broker against certain borrowers and covenantors for a contractual exit fee. The obligation to pay the fee was triggered by the borrowers failing to repay a loan, secured by mortgage, by the specified maturity date. The loan was subsequently repaid and the mortgages securing the loan were discharged. While repayment of the mortgage loan was owed to the lender, the exit fee was owed to a third party, the broker.

[2] The only issue on appeal is whether the judge erred in her conclusion that the exit fee was not a penalty prohibited by s. 8 of the *Interest Act,* R.S.C. 1985, c. I-15. Section 8, which must be read in conjunction with s. 2, provides:

> 2 Except as otherwise provided by this Act or any other Act of Parliament, any person may stipulate for, allow and exact, on any contract or agreement whatever, any rate of interest or discount that is agreed on.
>
> 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.
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> (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.

[3] The material facts may be shortly stated. The appellant borrowers are involved in developing and managing hotel and retail properties in Vancouver and Maple Ridge.

[4] In July 2013, the borrowers needed financing to pay off, *inter alia*, an existing loan they had with IMOR Capital Corp. ("IMOR"). IMOR, together with another lender, had begun foreclosure proceedings against the secured property. The borrowers engaged in discussions with other lenders, but could not obtain loans from them to pay out the loans in default.

[5] Bankers Mortgage Corporation (doing business as InstaFund), the broker and respondent, is the exclusive mortgage broker for IMOR. InstaFund and IMOR have a common officer and director. It is important to emphasize that the borrowers acknowledge that in this case nothing turns on the fact that the lender and broker are related. For the purposes of this appeal, the broker and lender are to be treated as independent, arms-length, separate legal entities.

[6] The borrowers ultimately agreed to a new loan with IMOR to replace the loans in default. The borrowers signed a loan retainer agreement with the broker on July 5, 2013. It included the following terms: (1) the borrowers would receive a loan of $14,400,000 from the lender; (2) the borrowers would pay all fees outlined in Schedule A to the agreement; and (3) the fees set out in Schedule A included an exit fee of $96,000 that was payable by the borrowers to the broker unless: (a) they repaid the loan on or before the maturity date, or (b) the loan maturity date was extended by a loan renewal letter, or (c) the loan was repaid from a separate loan arranged by the broker. Failure to pay the exit fee would be an event of default under the terms of the loan. The exit fee is payable to InstaFund, the broker.

[7] The loan maturity date was February 1, 2014.

[8] A commitment letter for the new loan was provided by the broker on July 30, 2013. It identified IMOR as the lender in trust for private mortgage investors.

Included in the commitment letter is an obligation to pay a broker's fee. The letter does not refer to the exit fee.

[9] It is common ground that the exit fee is not an obligation owing to the lender, IMOR. It is not part of the loan itself. It is not referred to in the mortgage loan documents. The connection to the mortgage loan is through the stipulation in the loan retainer agreement that failure to pay the exit fee is an event of default under the loan and the events which trigger the obligation to pay the fee set out above.

[10] IMOR advanced the loan which was secured, *inter alia*, by mortgages over certain real estate.

[11] The IMOR loan was renewed on January 28, 2014 by extending the loan maturity date to May 1, 2014. It was extended again on May 1, 2014 to August 1, 2014. Each renewal involved fees payable to the broker and retained materially the same exit fee obligation to the broker.

[12] The loan was not repaid by the extended maturity date and went into default.

[13] The borrowers later succeeded in arranging alternative financing that allowed repayment of the IMOR loan. That loan was funded in October 2014 after the August 1, 2014 loan maturity date.

[14] In the meantime, IMOR started foreclosure proceedings under the loan and the broker issued an invoice for the exit fee. IMOR provided the borrowers with a payout statement in respect of the security securing the loan. The statement included the exit fee. In response to the borrower's objection, IMOR removed the exit fee from the payout statement. The loan has been repaid out of the proceeds of the loan that was funded in October 2014 and the security discharged. The exit fee has not been repaid.

[15] The broker then started this action to recover the exit fee. Its judgment has since been registered against real property that previously secured the mortgage.

Summary Trial Judgment

[16] At a summary trial, the judge considered three issues:

(1) Whether the exit fee term contravened s. 8 of the *Interest Act* which prohibits fines, penalties or interest terms which have the effect of increasing the charge on arrears beyond the rate of interest payable on principal not in arrears;

(2) Whether the exit fee is an unenforceable penalty at common law; and

(3) Whether there was consideration to support the exit fee.

[17] The judge relied on *Reliant Capital Ltd. v. Silverdale Development Corp.*, 2006 BCCA 226 [*Reliant*], and *Equitable Trust Company v. Lougheed Block Inc.,* 2014 ABCA 234, to apply a strict or narrow interpretation of s. 8 rather than a legitimate commercial-purpose test. She examined the effect of the exit fee and concluded it was in the nature of an incentive for timely performance. Later in her judgment she concluded the fee was not a penalty but was a genuine pre-estimate of damages. The judge found that the fee did not contravene s. 8. The judge did not need to consider the broker's alternative argument that s. 8 does not apply to unsecured obligations.

[18] The judge found that the exit fee was not an unenforceable penalty at common law because it was a genuine pre-estimate of contractual damages at the time the loan retainer agreement was made. She found that even if the exit fee was not a pre-estimate of damages, it could not be characterized as an unenforceable penalty at common law because the exit fee was not extravagant or unconscionable. The exit fee represented 0.67% of the principal amount of the loan and the loan retainer agreement was entered into by knowledgeable parties assisted by professional consultants.

[19] Lastly, the judge found no merit in the borrowers' argument that the exit fee was not supported by consideration. She found that the entirety of the services provided by the broker were consideration for the entirety of the fees contracted by the borrowers.

[20] Accordingly, the judge granted judgment in favour of the broker.

On Appeal

[21] The borrowers only appeal on the basis that the judge erred in concluding that the exit fee did not offend s. 8 of the *Interest Act*. It remains part of their argument, in support of that proposition, that the judge erred in concluding that the exit fee was not a penalty but was a genuine pre-estimate of damages.

[22] As I apprehend the matter, the appeal reduces to two questions.

[23] First, did the judge err in her conclusion that the exit fee was not a penalty? The judge found that the fee was a genuine pre-estimate of damages. The parties agree that as a threshold matter, s. 8(1) only applies to a "fine, penalty or rate of interest".

[24] Second, in any event, if the exit fee is a penalty, is it one "stipulated for, taken, reserved or exacted on any arrears of principal or interest secured by mortgage or real property … that has the effect of increasing the charge on arrears…"?

[25] I propose to address the second question first. Doing so involves an exercise in statutory interpretation in accordance with the well-known principle that "the words of an Act are to be read in their entire context and in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament": *Bell ExpressVu Limited Partnership v. Rex*, 2002 SCC 42, [2002] 2 S.C.R. 559 at para. 26; and *Rizzo & Rizzo Shoes Ltd. (Re)*, [1998] 1 S.C.R. 27 at para. 21.

[26] The issue on the second question is whether the exit fee, which the parties agree is an unsecured obligation owed to a third party and not the lender, amounts to a charge exacted on the arrears secured by the mortgage which has the effect of increasing the charge on those arrears. The exit fee does not form part of the mortgage debt or the arrears owing under the mortgage which is secured against the

borrowers' real property. It is not enforceable, in other words, as part of the mortgage debt. It is not part of the arrears. The parties agree it was not an impediment to the repayment of the arrears owing under the loan or to the discharge of the mortgage. Nonetheless, the appellants argue the obligation to pay the exit fee was triggered by the borrowers' defaulting on the loan. In that sense, it increased the effective cost of default under the loan since the broker was able ultimately to secure its judgment for the exit fee by registering it against the real property.

[27] I do not think that the exit fee falls within the plain language of s. 8. It is not a charge exacted <u>on</u> the arrears. It is an independent obligation, albeit arising on default under the loan. It does not form part of the arrears nor is it stipulated for, taken, reserved or exacted on the arrears secured by mortgage. It is not enforceable as part of the arrears. It does not have the effect of increasing the charge on those arrears in the sense that it increases the amount of money required to pay off the arrears of the secured loan or to discharge the mortgage and redeem the property. To put the same point slightly differently, the exit fee is not secured as part of the arrears recoverable under the mortgage and part of the secured debt that must be paid to discharge the mortgage and redeem the property.

[28] The most that can be said is the exit fee is related to the arrears secured by the mortgage in the sense that it became payable to a third party, not the lender, when the borrowers failed to pay off the loan by the maturity date, and by the terms of the contractual arrangements a failure to pay the exit fee is an event of default under the loan. But being related to the arrears in this way does not fall within the plain language of the section.

[29] In my opinion, this interpretation of the section is consistent with the purpose of the legislation as that purpose has been articulated in the cases binding on this Court. The intention of Parliament is twofold. First, s. 8 is a limitation on the freedom of contract recognized in s. 2 and must be read in that context. It is for that reason that this Court in *Reliant* opined that s. 8 should be narrowly construed (as opposed to being interpreted through the lens of a legitimate commercial-purpose test)

provided such an interpretation did not frustrate or impair the overall purpose of the legislation: see, para. 37. The purpose was identified as protecting owners of real estate from charges that have the effect (regardless of their form) which would obstruct or make it more costly or impossible for owners to redeem or protect their equity. In my view, the effect of the exit fee in this case does not fall within the legislative purpose reflected in the section. The fee did not inhibit discharge of the mortgage or redemption of the property in a way that risked the equity in the property.

[30] The authority of *Reliant* has been confirmed by the Supreme Court of Canada in *Krayzel Corp. v. Equitable Trust Co.,* 2016 SCC 18 [*Krayzel*]. In *Krayzel,* Mr. Justice Brown cited, with approval, the comments of Finch C.J.B.C. in *Reliant* on the purpose of s. 8:

> [19] … In *Reliant Capital* (at para. 48), Finch C.J.B.C. examined the parliamentary debates leading to s. 8's enactment in 1880, and observed that its origins arose from a concern that farmers were at that time becoming "trapped" by loans carrying fines for arrears that were unknown or unclear.
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> [20] This led Finch C.J.B.C. to state the purpose of s. 8 in these terms:
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>> Parliament has singled out mortgages on real estate for special treatment, or at least treatment that differs from loans that are not secured on real property. <u>I infer that at least one legislative purpose was to protect the owners of real estate from interest or other charges that would make it impossible for owners to redeem, or to protect their equity</u>. If an owner were already in default of payment under the interest rate charged on monies not in arrears, a still higher rate, or greater charge on the arrears would render foreclosure all but inevitable. [Emphasis added by Brown J.]
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>> (*Reliant Capital*, at para. 53)
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> [21] I agree with Finch C.J.B.C. that the purpose of s. 8 is to protect landowners from charges "that would make it impossible for [them] to redeem, or to protect their equity". This understanding of s. 8's purpose also conforms to the recent jurisprudence: *P.A.R.C.E.L. Inc. v. Acquaviva*, 2015 ONCA 331 (CanLII), 126 O.R. (3d) 108, at para. 51.

[31] The focus on the terms of the mortgage and the effect of an alleged penalty on the mortgage obligation by increasing what is owed on the arrears above that owed on money not in arrears is reflected in the language of the Supreme Court, for example, at para. 25:

> … Further, by directing the inquiry to the *effect* of the impugned mortgage term, Parliament clearly intended that mortgage terms guised as a "bonus", "discount" or "benefit" would not as such comply with s. 8. Substance, not form, is to prevail. What counts is how the impugned term operates, and the consequences it produces, irrespective of the label used. If its effect is to impose a higher rate on arrears than on money not in arrears, then s. 8 is offended ...

[32] It is clear from *Krayzel* and *Reliant* that the purpose of s. 8 is to protect the borrower's right to redeem by preventing arrangements that increase the cost of redemption and threaten equity. At para. 22, Brown J. for the majority, explained the point in refusing to distinguish between higher rates on default and discounted rates of interest if there is no default, at para. 26:

> In both cases, the effect is to impose a higher rate of interest on arrears of interest or principal than that payable on principal money not in arrears, thereby making it more difficult for borrowers who are already in default to redeem or protect their equity.

[33] The equitable right to redeem is important to a borrower in default, and lenders cannot use fines, penalties or higher interest rates to practically "balloon", post-default, the amount required to redeem the property and discharge the mortgage. In this way the right to redeem and the protection of equity are related concepts both of which may be threatened by increasing the amount on arrears required to pay off a secured loan.

[34] Finally, the importance of interpreting s. 8 in the context of freedom of contract is underscored by Brown J.:

> Section 8 must also be read in light of, and harmoniously with, s. 2. As the chambers judge pointed out (at para. 35), s. 2 preserves a general right of freedom to contract for "any rate of interest or discount", with the *caveat* that such freedom is subject to what is "otherwise provided by this Act or any other Act of Parliament". Section 2 is therefore subject to the restriction imposed by s. 8 upon the rate of interest on a loan secured by a mortgage: *Tomell Investments*, at p. 983; *Reliant Capital*, at paras. 34 and 37; *P.A.R.C.E.L.*, at para. 51.

[35] In my view, the comments of Finch C.J.B.C. in *Reliant* are entirely consistent with what is said in *Krayzel*. See for example, paras. 52-3 and 56:

> The prohibition against extra charges on arrears remains in place for loans secured by a mortgage. Moreover, the additional charge on arrears is prohibited in mortgage loans whether that charge is expressed as such, or whether the interest provision simply has "the effect" of increasing the charge in respect of arrears.
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> Parliament has singled out mortgages on real estate for special treatment, or at least treatment that differs from loans that are not secured on real property. I infer that at least one legislative purpose was to protect the owners of real estate from interest or other charges that would make it impossible for owners to redeem, or to protect their equity. If an owner were already in default of payment under the interest rate charged on monies not in arrears, a still higher rate, or greater charge on the arrears would render foreclosure all but inevitable.
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> …
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> I therefore conclude that the purpose of the section is to protect property owners against abusive lending practises, while recognizing that generally speaking parties are entitled to freedom of contract.

[36] In the case at bar, any suggestion that the exit fee reflected abusive lending practises cannot survive the findings of fact of the judge on that issue, which have not been challenged on this appeal.

[37] The appellants accept s. 8's purpose as articulated in *Krayzel*, but their contention rests on the proposition that an obligation triggered by default, albeit not forming part of the arrears required to be paid to redeem, is captured by s. 8 because it nonetheless increases the borrower's overall obligations arising out of the transaction. The appellants argue that it is sufficient that there is a relationship between the obligation and the mortgage (e.g., triggered by default, arising out of the same transactional context), and that it is not necessary that the impugned obligation form part of the amount secured by the mortgage that must be paid to redeem or that it be owed to the lender. As occurred here, the third-party unsecured creditor (the broker) may obtain judgment for the exit fee and register the judgment against title to the property, effectively increasing the encumbrances on the borrower's equity. They rely on the clause "or to protect their equity" in para. 53 of *Reliant*.

[38] I cannot accede to this proposition. In my view, the wording of s. 8 is plain and clear that the impugned charge must be *on* the arrears, and have the effect of

increasing the charge *on* the arrears. The clause “or to protect their equity”, in my view, refers to the borrower’s equity of redemption and equity “at stake” due to the foreclosure proceeding; that is, s. 8 protects the right to redeem and thereby prevents the equity in the property from being foreclosed. It is not to protect their equity in the property *generally* from any outstanding unsecured obligations the borrower may have, any of which may be reduced to judgment and enforced by ordinary execution methods, such as registration against property. In my opinion, the appellants’ contention goes well beyond the purpose of the legislation and is incompatible with the plain language of the section read in light of the legislative purpose. To give effect to the argument advanced on appeal would inject legal and commercial uncertainty into lending practices rendering it virtually impossible for parties to lending transactions to predict what kind of relationship would be sufficient to trigger the application of s. 8.

[39] In sum, the legal relationships engaged here do not trigger s. 8. The obligation to pay the exit fee is owed to the broker, not to IMOR (the lender). The lender cannot enforce payment of the exit fee. The exit fee is not secured and is not part of the mortgage debt. Failure to pay the exit fee impeded neither payment of the balance owing to IMOR to redeem nor the discharge of the mortgage by redemption. The exit fee was not part of the arrears. Although triggered by default on the mortgage loan, it is not “exacted on” the arrears.

[40] I now turn to address the trial judge’s finding that the exit fee was not a penalty, but a genuine pre-estimate of damages.

[41] The judge considered the nature of the exit fee in two places. First, she analogized the fee to an incentive (referring to the Alberta Court of Appeal decision that was reversed by the Supreme Court of Canada in *Krayzel*). Second, she analyzed the fee under the common law of penalties. Insofar as the reasons may be taken to suggest that the exit fee could not be a penalty within the meaning of s. 8 because it was an incentive, that reasoning has been overtaken by the Supreme Court of Canada in *Krayzel*. It is clear that *Krayzel* has rejected the distinction

between incentives for performance and penalties for non-performance as a distinction of form and not substance. The critical question is the effect of the charge not its form.

[42] The rejection of a distinction between penalties and incentives is not dispositive of this appeal. It remains necessary to examine the other reasons why the judge concluded that the fee was not a penalty. First, the judge examined the realities of the transaction:

> [61] In the present commercial transaction, this was a loan with risks. The substance of the Loan Retainer Agreement must be viewed in the context of the risks then apparent. The property owned by Plaza 500 had previously been the subject of foreclosure as had properties of the other Borrowers. The risk had manifested as at the time of the Second Renewal Letter as two maturity dates had passed.
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> [62] Mr. Popat in his capacity for all defendants, was, after the Second IMOR Loan had been advanced, actively pursuing replacement financing with Realtech. I find that his intention in signing the Loan Retainer Agreement, with the Exit Fee term which he had opposed, was to repay the Second IMOR Loan prior to the maturity date. Similarly, at the time of the first two renewal agreements, he intended to re-pay IMOR before the extended maturity dates. Mr. Popat was aware from July 2013 that if he did not, the Exit Fee payable to the mortgage broker would apply. In exercising their right to freedom of contract, this course of events does not indicate an abusive or unscrupulous lender or agent or an unaware borrower. In this high-risk transaction both parties intended success. The plaintiff's term was an incentive to achieve that success.
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> …
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> [64] The defendants also submit that in this case where the Exit Fee is payable to the plaintiff, IMOR as the mortgagee could not have levied the Exit Fee directly, and the plaintiff and IMOR cannot arrange their affairs to avoid application of the Act. However, the parties are entitled to fashion their agreements to avoid application of the Act (Langley Lo-Cost Builders at paras. 99 to 101). The corporate or working relationship between the plaintiff and IMOR does not affect my conclusion in this regard. Here, as in Langley Lo-Cost Builders, "the agreement was entirely fair and carried none of the stench of coercion, intimidation or penalty."

[43] The judge analyzed the facts in accordance with the principles articulated in *Dunlop Pneumatic Tyre Co. Ltd. v. New Garage and Motor Co. Ltd.,* [1915] A.C. 79 (H.L.) [*Dunlop*], which explain the distinction between a penalty and a genuine

pre-estimate of damages. After reviewing the relevant legal propositions and cases at paras. 73-79, the trial judge said:

> [80] For the Exit Fee to be enforceable, it is not necessary for the plaintiff to prove loss. As stated in *Dunlop*, the question of whether the Exit Fee is a penalty or liquidated damages is determined at the time of making the contract, not at the time of the breach.
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> [81] In the result, in determining whether the Exit Fee was a genuine pre-estimate of damages, the circumstances of the loan and the market forces are relevant. I accept the evidence of Mr. Hayne which explains that the plaintiff is exposed to certain market forces and foregoes other possible loans when committing funds to borrowers such as the defendants. The plaintiff has only a limited inventory of funds to lend and knew that it would suffer losses when a borrower fails to comply with the payment schedule in the agreement.
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> [82] It would also reasonably have been apparent to the defendants, as sophisticated commercial parties involved in a transaction involving significant risk, that the plaintiff would suffer damages if they failed to repay the loan on time. Whether the defendants understood how these damages would arise is not relevant.
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> [83] I conclude that, applying the principles in *Dunlop*, the Exit Fee is properly characterised as a genuine pre-estimate of damages.

[44] Where a single lump sum is made payable by way of compensation on the occurrence of one or more or all of several events, some serious and others less so, there is a presumption (but no more) that it is a penalty: *Dunlop* at 87. There, that presumption may be displaced by the multiple considerations discussed in *Dunlop* and subsequent cases.

[45] In my opinion, it was open to the trial judge to find such a presumption was displaced on the totality of the evidence. The trial judge correctly stated that the determination must be made at the time of the contract, not its breach. In my view, her analysis, albeit brief, focuses on the correct time. I do not think, contrary to the submission of the appellants that the judge relied on self-serving evidence of Mr. Hayne about post-contract events. In my view, Mr. Hayne’s evidence was relevant to the objectively known circumstances at the time of entering the contract. That reality is captured in the judge’s comments that it would have been apparent to the defendants that the plaintiff would suffer loss if they failed to repay the loan on time.

[46] I do not agree that the judge committed a reviewable error in determining that the exit fee was not a penalty, but was a genuine pre-estimate of damages. In essence, she found that the pre-estimate of damages was the true bargain between the parties: *Dunlop* at 88. Accordingly, the exit fee did not amount to a penalty or fine that triggered the application of s. 8 of the *Interest Act*.

Conclusion

[47] I am unable to accede to arguments advanced on appeal. In my view, the order below must be sustained since s. 8 does not apply to the exit fee. I would dismiss the appeal.

"The Honourable Mr. Justice Harris"

I agree:

"The Honourable Mr. Justice Lowry"

I agree:

"The Honourable Madam Justice Dickson"