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Ontario Court of Appeal orders borrower to pay $326,500 balance of lender fee despite failed loan

By **Karunjit Singh**

Law360 Canada (April 10, 2024, 3:47 PM EDT) -- The Ontario Court of Appeal has ruled that a commercial developer must pay $326,500 in lender fees for a failed loan transaction, overturning a lower court decision that the lender was not entitled to the amount since it was payable under an unenforceable penalty clause.

In *660 Sunningdale GP Inc. v. First Source Mortgage Corporation*, 2024 ONCA 252, Justice David Paciocco held that the motion judge erred in applying the law of unenforceable penalty clauses as the obligation to pay the lender fee did not arise as a remedy for any conduct by the developer.

"[U]nder the terms of the Loan Agreement, the balance of the Lender Fee was not a 'stipulated remedy' for a breach of the contract. Rather, the balance was payable whether or not the contract was breached," the judge wrote.

The respondent developer, 660 Sunningdale GP Inc., had agreed in a commitment letter to pay a lender fee to the appellant, First Source Mortgage Corp., on behalf of its syndicate partner, First Source Financial Management Inc. as part of the consideration for a multimillion-dollar loan.

The loan agreement stipulated that the lender fee was to be partially paid through a $100,000 payment made at the time that the loan agreement was accepted and executed, with a remaining payment of $326,500 to follow. Under the agreement, the lender fee was deemed to be earned upon the acceptance and execution of the commitment letter.

The respondent paid $100,000 upon executing the commitment letter but, shortly thereafter, decided not to proceed with the loan or to pay the balance of the lender fee.

The parties agreed to deposit the balance in trust and commenced litigation to resolve any payment obligations. The parties, including the respondent Michael Clawson, who guaranteed 660 Sunningdale's debt under the loan agreement, agreed to proceed by way of summary judgment.

In *660 Sunningdale GP Inc v. First Source Mortgage Corp*, 2023 ONSC 2129, a motion judge held that the appellant was entitled to keep the $100,000 that had been paid, but the respondent was entitled to the release of the balance, plus interest.

The motion judge held that the balance was payable under an unenforceable penalty clause, and that relief against forfeiture should be granted for the balance under s. 98 of the *Courts of Justice Act*.

First Source appealed the decision.

Justice Paciocco cited *Peachtree II Associates - Dallas L.P. v. 857486 Ontario Ltd.* (2005), 76 O.R. (3d) 362, in which the Ontario Court of Appeal held that both the common law unenforceability of extravagant penalty clauses and the equitable relief against unconscionable forfeiture clauses have the effect of relieving the breaching party of the penal consequences of stipulated remedy clauses.

The judge noted that under the loan agreement, the lender fee was not payable as a stipulated remedy for a breach of the contract, but rather as consideration for First Source obtaining the loan commitment.

"By its terms, the Lender Fee is payable as a consideration whether or not the contract is ultimately breached by 660 Sunningdale. Put otherwise, the obligation to pay the Lender Fee does not arise because of conduct by 660 Sunningdale, as a remedy for that conduct," the judge wrote.

The court concluded that the lender fee provision was not a stipulated remedy clause and could not be an unenforceable penalty clause.

The judge noted that it is settled law that it is an error to apply the law relating to penalty clauses to funds that are payable under a contract, in the absence of a breach.

The respondents argued that the motion judge did not err because she interpreted the lender fee as a stipulated remedy and that the court should defer to her interpretation.

The respondents highlighted that article 2.01(b) of the agreement included an acknowledgement by the borrower that the lender fee was a reasonable estimate of the lender's costs incurred in sourcing, investigating, underwriting and preparing the loan.

Justice Paciocco rejected this argument, noting that the motion judge had not addressed whether the lender fee was payable as a remedy for a breach, which was a necessary condition to it being characterized as a stipulated remedies clause.

The court held that the motion judge committed a legal error in using the law of unenforceable penalty clauses to relieve 660 Sunningdale from its agreement to pay the balance of the lender fee as consideration for the loan agreement.

Justice Paciocco also found that the motion judge erred in excusing 660 Sunningdale from paying the balance of the lender fee based on the law of relief against forfeiture.

He found that by granting 660 Sunningdale relief against forfeiture from a contractual payment obligation that did not arise from its non-observance of the loan agreement, the motion judge, in effect, applied the independent doctrine of unconscionability incorrectly in circumstances where there was no finding of inequality of bargaining power.

Justice Paciocco noted that the independent doctrine of unconscionability is limited to unfair agreements that have resulted from inequality of bargaining power and that it was not applicable in the case at bar.

The judge observed that there was no suggestion in the motion judge's decision that she considered whether there was an inequality of bargaining power between the parties to the loan agreement.

Justice Paciocco also noted that there were indications in the impugned decision that the motion judge may have found, in the alternative, that 660 Sunningdale should receive the return of the balance of the lender fee because it was not earned.

The court noted that the motion judge had cited *Marshallzehr Group Inc. v. Ideal (BC) Developments Inc.*, 2021 ONCA 229, in which the Ontario Court of Appeal found that a lender fee was not payable because it was not earned.

Justice Paciocco held that the decision in *Marshallzehr Group Inc.* turned on the particular terms of the commitment letter in that case and that the relevant contract, in that case, provided that the lender fee would be deducted from the initial advance.

"Since the commitment letter did 'not contain any other language of entitlement to the lender fee,' as a matter of construction, the lender fee was not earned until the Initial Advance was paid. It was therefore found not to be payable," the judge wrote.

The judge noted that the loan agreement before the motion judge was materially different from the loan agreement at issue in *Marshallzehr Group Inc.*

He further noted that the agreement provided that the lender fee was deemed to be earned at the time of the acceptance and execution of the commitment letter and included a provision that

provided an alternative mode of payment if the loan was not advanced through no fault of the lender.

"Quite simply, in the face of these provisions, the motion judge could not have arrived at a conclusion that the balance of the Lender Fee would not be due without an advance unless she failed to consider the entire Loan Agreement," the judge wrote.

Justice Paciocco allowed the appeal and ordered that the balance of the lender fee be paid to First Source and not 660 Sunningdale.

Justices Bradley Miller and James MacPherson concurred in the decision.

The decision makes it clear that parties who have equal bargaining power are free to make whatever contractual bargains they might choose and that it's not open to the court to revisit those agreements and make changes after the fact, said David Taub of Robins Appleby LLP, counsel for the appellants.

Taub noted that the decision would be helpful for the type of contracts in which it is quite common for a lender to have an initial fee upfront but only take part of the fee immediately on signing, with the second part usually being withheld from the mortgage financing.

"I think it is clearer now that if a contract fee is payable in two stages and the second stage is to be paid once the mortgage is advanced … when the contract says that that second part is payable and due and owing immediately, it will be due and owing even if the mortgage is never advanced because the borrower walks away from the deal," he told Law360 Canada.

Samuel Mosonyi of Robins Appleby LLP also acted as counsel for the appellants.

Counsel for the respondents were Michael Polvere and Natalie Kuehn of Siskinds Law Firm. They were not immediately available for comment.

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