Court of Appeal File No.:
Court File No.: CV-24-00722148-00CL

COURT OF APPEAL FOR ONTARIO

B E T W E E N:

KINGSETT MORTGAGE CORPORATION AND FIRST SOURCE FINANCIAL MANAGEMENT INC.

Applicants (Respondents)

- and -

MAPLEQUEST VENTURES INC. AND DIGRAM DEVELOPMENTS CALEDON INC.

Respondents (Appellants)

IN THE MATTER OF AN APPLICATION UNDER SUBSECTION 243(1) OF THE *BANKRUPTCY AND INSOLVENCY ACT*, R.S.C. 1985, c. B-3, AS AMENDED, AND SECTION 101 OF THE *COURTS OF JUSTICE ACT*, R.S.O. 1990 c. C.43, AS AMENDED

APPELLANTS' BOOK OF AUTHORITIES

November 12, 2025

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AND TO: **SERVICE LIST**

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INDEX

TAB 1

1991 CarswellOnt 617
Ontario Court of Justice (General Division)

Canada Trustco Mortgage Co. v. Windsor Painting Contractors Ltd.

1991 CarswellOnt 617, 22 R.P.R. (2d) 222, 30 A.C.W.S. (3d) 907

CANADA TRUSTCO MORTGAGE COMPANY v. WINDSOR PAINTING CONTRACTORS LIMITED and GEORGE PAPP

Cusinato J.

Judgment: November 22, 1991
Docket: Docs. London 84-SC-09471 and Windsor 91-OC-00159

Counsel: *Thomas J. Corbett* , for plaintiff.
Hugh Geddes and *Pamela Krause* , for defendants.
Pat Iannetta , on counterclaim.

Subject: Property; Corporate and Commercial; Civil Practice and Procedure
Related Abridgment Classifications
Civil practice and procedure
XXIV Costs
XXIV.8 Scale and quantum of costs
XXIV.8.a General principles
Real property
VIII Mortgages
VIII.12 Possession and ejectment
VIII.12.d Rights and duties of mortgagee in possession
VIII.12.d.i Duty to account
Headnote
Mortgages --- Possession and ejectment — Rights and duties of mortgagee in possession — Duty to account — Mismanagement
Practice --- Costs — Scale and quantum of costs
Mortgages — Possession — Rights and liabilities of mortgagee-in-possession — Mortgagee having possession for over five years — Mortgagee operating property at deficit from outset of possession — Mortgagee's conduct constituting improvident realization and failure to mitigate loss.
In February 1979, the mortgagor obtained a $1 million building loan from the mortgagee for an apartment building with commercial space. The mortgagee failed to perform an independent title examination, and did not learn of restrictions innocently undisclosed by the mortgagor, which reserved exclusive use to senior citizens. After default on the mortgage, the mortgagee exercised its exclusive right to possession in July 1980, and effected legal possession one month later. No comparative analysis of the property's value was performed. The mortgagee managed the property at a deficit exceeding $60,000 per year. A sale arranged for September 1982 did not close, in part because the mortgagee was until then unaware of the restrictions on the property. As well, the mortgagee acquired additional property as part of its management of the mortgaged property. Possession continued until December 31, 1985, when the premises were sold. The mortgagee sued the mortgagor and guarantor for the amount payable under the mortgage, approximately $1.2 million as of October 1988. The amount included occupation charges, maintenance, commissions, capital purchases, improvements, realty fees and accumulated interest. The mortgagee attributed its failure to sell the building earlier to its initial lack of knowledge of the building's restrictions, its unsuccessful attempts to rezone the building to eliminate the restrictions, and the depressed real estate market. The issues at trial were whether the mortgagee

had improvidently realized the security, the legal and equitable rights of the mortgagee vis-à-vis the mortgagor and guarantor, and the mortgagee's obligation to mitigate its loss.

Held:

The action was allowed in part.

A mortgagee-in-possession must protect the value of the security and weigh the potential benefits of continued management expenditures against immediate sale of the property at a possible loss. In this case, operation of the property at a deficit required that the mortgagee immediately examine how expenses could be recovered and consider an immediate sale. Belief in poor market conditions did not justify failing to even test the market. Failure to consider an immediate disposition of the building, and the attempt to rezone the property rather than comply with the existing restrictions, resulted in needless expense and rapid accumulation of the debt. The length of possession by the mortgagee and its failure to properly assess the property were not reasonable, and constituted failure of the mortgagee to mitigate its loss.

The plaintiff was awarded damages of $100,000, its estimated maximum loss as of October 15, 1982, the date by which sale of the building could have been completed had the plaintiff ascertained all facts concerning the property.

Table of Authorities

Cases considered:

Burt, Boulton & Hayward v. Bull, [1895] 1 Q.B. 276 (C.A.) — *considered*

Canada Trustco Mortgage Co. v. Bartlet & Richardes (1991), 17 R.P.R. (2d) 190, 3 O.R. (3d) 642 (Gen. Div.) — *referred to*

Continental Trust Co. v. Yorkario Investments Ltd. (1989), 5 R.P.R. (2d) 164, 67 O.R. (2d) 737 (H.C.) — *referred to*

Cuckmere Brick Co. v. Mutual Finance Ltd., [1971] Ch. 949, [1971] 2 All E.R. 633 (C.A.) — *referred to*

Elman v. Conto (1978), 18 O.R. (2d) 449, 82 D.L.R. (3d) 742 (C.A.) [leave to appeal to S.C.C. dismissed (1978), 18 O.R. (2d) 449n, 82 D.L.R. (3d) 742n] — *followed*

Hausman v. O'Grady (1986), 61 O.R. (2d) 96, 42 D.L.R. (4th) 119 (H.C.) , additional reasons at (1986), 14 C.P.C. (2d) 188 (Ont. H.C.) [affirmed (1989), 67 O.R. (2d) 735, 57 D.L.R. (4th) 480 (C.A.)] — *considered*

Hoskin v. Price Waterhouse Ltd. (1982), 35 O.R. (2d) 350 (H.C.) — *considered*

Laws v. Toronto General Trusts Corp. (1904), 8 O.L.R. 522, 4 O.W.R. 164, 1904 CarswellOnt 583 (Ont. Div. Ct.) — applied

Miller v. Davis Lumber Co. (1969), 69 W.W.R. 161 (B.C. S.C.) — *applied*

Siskind v. Bank of Nova Scotia (1984), 46 O.R. (2d) 575, 10 D.L.R. (4th) 101 (H.C.) — *referred to*

Standard Chartered Bank v. Walker, [1982] 1 W.L.R. 1410, [1982] 3 All E.R. 938 (C.A.) — *considered*

Vorvis v. Insurance Corp. of British Columbia, [1989] 1 S.C.R. 1085, 25 C.C.E.L. 81, [1989] 4 W.W.R. 218, 36 B.C.L.R. (2d) 273, 94 N.R. 321, 58 D.L.R. (4th) 193, 90 C.L.L.C. 14,035 — *referred to*

Statutes considered:

Construction Lien Act, 1983, S.O. 1983, c. 6 [now R.S.O. 1990, c. C.30].

Action for amount due under covenant for payment contained in mortgage.

***Cusinato J.*:**

Type of Action

1 This action involves a claim by Canada Trustco Mortgage Company ("C.T."), the mortgagee, for an amount due under a covenant for payment contained in a mortgage.

2 Joined in this action as a defendant for payment under the mortgage covenant is George Papp ("G.P.") as guarantor, the major shareholder of Windsor Painting Contractors Limited ("W.P."), the mortgagor.

Issues

3

(1) Is C.T. guilty of an improvident realization resulting from the sale of its security, having regard not only to the sum realized at time of sale, but the actions or inactions of C.T. during a lengthy possession?

(2) What are the legal and equitable implications and rights of a mortgagee as it relates to itself, the mortgagor, and the guarantor within the terms of the mortgage contract, at common law, and in equity?

(3) Has the mortgagee an obligation to the defendants to *mitigate against loss* , or may it deal with its own self interest after default, without restriction?

Mortgage Particulars

4 The mortgage, the subject of this action, dated April 24, 1979, and registered May 1, 1979, covers the lands described as Lot No. 6, Block 10, on the west side of Ouellette Avenue, city of Windsor, Registered Plan 358. It secures the principal sum of $1,150,000 with interest therein at 11 per cent per annum, calculated half yearly, for a term of five years.

5 The mortgage provides for payments of principal and interest as stipulated, with monthly instalments of $10,557, payable on the 30th of each month commencing September 30, 1979, to and including August 30, 1984.

6 Provisions within the mortgage state that in the event of default in payment of any sum due for principal or interest at any time, then compound interest shall be payable on the sums in default as prescribed within the terms of the mortgage.

7 Upon the evidence, the principal sum advanced in three instalments to October 1, 1979, totalled $975,190. With the final advance, the interest adjustment of $24,810 was credited to the mortgage account, showing a total advance of $1 million as of that date.

8 The balance of the principal sum, as shown in the mortgage amounting to $150,000, was subject to compliance of the terms within the letter of commitment. This sum, in fact, was never advanced for failure to meet those terms. As identified by Tab 8, Exhibit 1, "the commitment," the mortgagor was required to establish an annual revenue of $200,000, which in fact, prior to default, was not achieved.

Plaintiff's Claim

9 The plaintiff's claim fixed as of October 7, 1988, is stated to be in the total sum of $1,195,364.62 (Exhibit 5, Tab 188), less an adjustment for interest of $638 (Exhibit 8), together with per diem interest thereafter of $360.24. This sum includes occupation charges, maintenance, commissions, capital purchases, improvements, realty fees, and accumulated interest. Included in this sum is the compound interest as applicable within the terms of the mortgage from the date of default to October 7, 1988, and a claim for such compound interest thereafter to the date of judgment.

10 In support of the proposition for payment of compound interest for the sum in arrears from time to time, counsel for the plaintiff refers to *Elman v. Conto* (1978), 18 O.R. (2d) 449, 82 D.L.R. (3d) 742 (C.A.) , at p. 453 [O.R.], Arnup J.A.:

> This mortgage contains an express provision that in case of default in payment of interest, 'compound interest shall be payable'. This is certainly the kind of 'express' or 'clearly stated' provision that the authorities speak of as being essential. [These same words are contained within the subject mortgage before the court]. Effect must be given to the agreement so made unless it is impossible to carry it out because the parties have neglected to provide a further essential term.
>
> It is inherent in the term 'compound interest' that at periodic intervals unpaid interest is added to the unpaid principal, and interest then begins to accrue on the aggregate sum.

[And further on, His Lordship states:]

> 'To compound', *the first overdue instalment is added to the principal, and the new amount* (Lord Jowitt's Dictionary of English Law calls it 'a sort of secondary principal') *commences to bear interest.*

[Emphasis added.] Upon these principals, compound interest is appropriate and payable to C.T. for any amount found due, from a date to be fixed and upon the sums determined to be due and payable.

Facts

11 Within the evidence, the application by W.P. for a building loan dated February 28, 1979, identifies a 31-suite apartment building together with commercial space and facilities for parking equal to the number of apartments to be constructed (Tab 3, Exhibit 1).

12 Through the assistance of Richard Sutton, a mortgage broker for Murray & Company acting as the defendant's agent, the mortgage was committed March 22, 1979.

13 Although, in my examination of the application for commitment, there appears no disclosure as to the site restrictions of the property, I do not find on the evidence any intent to deceive or withhold information by the applicant.

14 As to the lands and premises, within the provisions of Zoning By-law 728 for the city of Windsor prior to commitment, this property was originally zoned under a C2A category. While there were area and height restrictions that related to density, the major setback was parking, which provided that each apartment unit required 1.25 parking spaces for each unit constructed. Sometime prior to W.P.'s application, W.P. had applied successfully to the committee of adjustment for a variation to zoning. As a result of his success, the applicant was given a specific site exemption, increasing the density as to the lands and premises and the number of apartment units which could be constructed to 31, with equal parking requirements, thereby granting a reduction to parking by .25 spaces for each unit. The commercial construction as required by the original by-law was not affected, nor was there a parking requirement for such space.

15 This variance was granted to the residential zoning, and it provided, however, that the property be given a specific designation "for the exclusive use of senior citizens," as defined within By-law 728, "persons 55 years of age or older."

16 In dealing with the actions of the mortgagee, post-commitment, it is without dispute on the evidence the mortgagee intended to carry out its own independent examination of title, and in fact retained a solicitor for such purpose. I conclude for this reason, and others presented in the evidence, that while the mortgagor may have innocently failed to disclose the site restrictions, this was not a matter which could not have been easily ascertainable.

17 During construction, C.T. relied on the independent engineering firm of McGuire and Associates, retained by the mortgagor to comply with the plans and specifications submitted to the city.

18 C.T. accepted their certificates as to partial completion to allow release of the mortgage advances pursuant to the provisions of the *Construction Lien Act, 1983* , S.O. 1983, c.6, and information, if sought, as to zoning was readily available from them.

19 With all of these means available to C.T. to determine the zoning of the lands and premises, I nevertheless accept that both before and after their mortgage commitment, and even after the advances made to W.P., C.T. still was unaware of the restrictive use of this property for seniors.

20 That this information of site restrictions came to their attention at a much later date and after default is accepted. This is true, even though on the evidence there was deposited against title, prior to their commitment and advances, the terms of the variance granted by the committee of adjustment, Tab 2, Exhibit 7. This information, further, was in the possession of their solicitor immediately after his search of title for the mortgage security, Tab 10, Exhibit 1, and his failure to report such information, I understand, was because the mortgagee had not requested same.

21 Therefore, while the lack of this information may have directed the mortgagee's conduct at a later date, it is not demonstrated on the evidence that it affected the mortgagee's security, or that it would have affected their commitment to mortgage.

Conduct of Mortgagor and Mortgagee After Default

22 After commitment of this mortgage almost at the outset, due to a declining market, the mortgagor experienced difficulties. It became apparent even as early as January of 1980, after substantial completion, that the mortgagor showed inability to lease the premises.

23 These market conditions triggered the mortgagor's inability to meet the mortgage commitment, and thus his inability to draw down the final principal advance.

24 From these consequences, the result was not only non-completion of a number of cosmetic items as it related to the residential portion of the building, but as well the completion of the commercial space.

25 The complexities of the situation on February 27, 1980, directed C.T. to enter into a property management agreement with W.P., which executed agreement by G.P. appears at Tab 29, Exhibit 1.

26 The agreement identified by Tab 53, Exhibit 1, illustrates that while C.T. effectively operated and controlled the premises under the terms of this agreement, securing rentals, deducting its charges and managing the apartment from on or about March 1, 1980, C.T. did not, upon the evidence, execute the agreement.

27 Within the terms of this authorization, the premises fell under the control of C.T. as rental agents, and this situation continued until approximately July 25, 1980, when C.T. exercised its exclusive right to possession pursuant to the provisions of the mortgage.

28 To give understanding to C.T.'s actions, on April 9, 1980, C.T. closed out the loan of W.P. upon the mortgage without the final principal advance for failure to achieve the rental income required pursuant to the letter of commitment (Tab 32, Exhibit 1). C.T.'s actions accord with their correspondence directed to the defendant W.P. on April 30, 1980 (Tab 33, Exhibit 1).

29 Following this action, C.T.'s solicitor was instructed to commence notice of sale proceedings pursuant to the terms of the mortgage. On July 22, 1980, the principal of the defendant corporation, together with the guarantor, received writs of summons, claiming among other things possession of the mortgage premises (Tab 42 and 43, Exhibit 1). It is after these events that on or about July 25, 1980, C.T. exercised its right to sole possession of the premises under the mortgage and effected legal possession August 27, 1981.

30 Their legal possession thereafter continued from this date until December 31, 1985, when the premises were sold, a period of approximately five and a half years. During this time, C.T. collected the rents, paid the expenses, conducted the operations incidental to the premises and exercised all of their rights without interference of the owner.

31 It is this period of time that must be reviewed to see whether C.T. not only managed the property as a person of ordinary prudence would manage as if it were his own, but whether they took appropriate steps to mitigate the loss not only to itself, but that of W.P. and G.P. Inherent within this concept of mitigation is the exercise of reasonable precaution for the disposition of the property asset at an appropriate time to protect not only market value of the property, but disposition when it is proper and reasonable to do so.

Rights and Duties of Mortgagee — Mortgagor and Guarantor

32 Generally, a mortgagee taking possession places upon itself a heavy burden to act as a prudent owner, and thus the legal principle "to manage the property as a person of ordinary prudence would manage it if it were his own."

33 With possession arises the obligation to act bonafidely, and while a mortgagee may act to secure its own position, it is to balance such interest with that of the debtor to mitigate loss.

34 As long as the equitable right to redeem subsists, the mortgagee is liable to be called to account in respect of his management. There is thus an implied obligation upon the mortgagee in possession to protect the diminishment of the security. It must weigh the continuation of essential expenditures to protect their interest during retention, and balance this with the immediate sale of the property, even at a loss. An additional consideration is to weigh further capital expenditures to increase its capital value for either immediate sale, or sale at a later date in a proper market.

35 Derek Rostant, specializing in insolvency from the accounting firm of Peat Marwick Thorne, qualified himself as an expert in the duties of a receiver and in matters of insolvency. In his view, possession of an asset and the course of action by a receiver, and by analogy that of a mortgagee, requires constant analysis and adjustment. It is based upon the principles of "cost versus reward" [expended costs versus benefits received for those costs, "the reward"], together with an analysis of the "time value of money." This latter concept relates to the cumulative interest charges to carry the asset ["the increasing debt accumulation"], with the retention of the property.

36 Upon the evidence, C.T. was operating under a negative receivership; that is to say, the property possession and its retention was operating at a deficit exceeding $60,000 per annum [interest costs exceeded the revenue produced, diminishing the value of the security]. Under such conditions, the expert indicates that the immediate examination related to how these expenses could be recovered. The sale of the property with minimum improvement, and compliance with existing zoning, must be measured against its retention for increased capital recovery based on future marketability.

37 This major issue, of course, as always, revolves around the question of judgment, whether it is best to sell immediately and perhaps at a loss because of unfavourable market conditions or to retain the asset for better times.

The Law — "Generally as to Possession"

38

> A mortgagee takes possession when he deprives the mortgagor of the control and management of the mortgaged property.

(W.B. Rayner and R.H. McLaren, ed., *Falconbridge on Mortgages* , 4th ed. (Aurora, Ont.: Canada Law Book, 1977), p. 643.)

> If the property covered by the mortgage includes a business carried on upon the mortgaged premises, *the mortgagee is entitled to carry on the business for a reasonable time* and to use the name of the mortgagor for that purpose so that the property may be sold as a going concern, but the mortgagee will be liable for gross negligence in management and will be personally liable upon new contracts made by him.

[Emphasis added.] (*Burt, Boulton and Hayward v. Bull*, [1895] 1 Q.B. 276 (C.A.) ; *Falconbridge* , supra, p. 647.)

> A mortgagee in possession is entitled to credit in his account of rents and profits for payments properly made for purposes incident to his possession. *In the case of substantial repairs and improvements, the mortgagee, in order to entitle himself to reimbursement for money expended by him, must establish ei ther that the mortgagor concurred in the expenditure of the money* (whether expressly or after notice, by acts denoting acquiescence), *or that the outlay was a reasonable one increasing the selling value of the property* or necessary for the purpose of keeping the property in a proper state of repair.

[Emphasis added.] (*Laws v. Toronto General Trusts Corp.* (1904), 8 O.L.R. 522 (Ont. Div. Ct.); *Falconbridge* , supra, p. 648.)

Legal Obligations of the Mortgagee-in-Possession

39

> The mortgagee having asserted his common law right to possession and having taken the management of the property out of the mortgagor's hands, must himself assume the responsibilities of management. He must manage the property as

> a person of ordinary prudence would manage it if it were his own, and so long as the equitable right to redeem subsists, is liable to be called to account in respect of his management.

(*Miller v. Davis Lumber Co.* (1969), 69 W.W.R. 161 (B.C. S.C.) ; *Falconbridge* , supra, p. 651.)

40 In addressing these legal obligations that rest upon a mortgagee, there are different considerations while in possession and upon sale pursuant to the power of sale. While the mortgagee has a legal right both to possession and sale, it must balance these rights with those of the mortgagor, it must act in good faith, and secondly, the mortgagee must use the same care and skill as a prudent owner would in selling his own property to produce the best possible price. These obligations also extend to the surety — and/or the guarantor.

> The creditor, while entitled to enforce the securities if he is not paid, is obliged in equity to realize upon them in the manner most likely to produce the best possible sale. If the creditor enforces his remedies with due regard to the interests of the sureties in this respect, the sureties cannot have any well grounded complaint. If on the other hand, the creditor fails so to do, I take it to be inequitable on his part to sue for the amount of the deficiency which is the result of his own conduct.

(*Hoskin v. Price Waterhouse Ltd.* (1982), 35 O.R. (2d) 350 (H.C.) , at p. 354.)

41 The rights of a mortgagee in the exercise of the power of sale and the price obtained are well stated in *Hausman v. O'Grady* (1986), 61 O.R. (2d) 96, 42 D.L.R. (4th) 119 (H.C.) , additional reasons at (1986), 14 C.P.C. (2d) 188 (Ont. H.C.) , particularly at p. 106 [O.R.]. (See also *Continental Trust Co. v. Yorkario Investments Ltd.* , Carruthers J. (1989), 5 R.P.R. (2d) 164, 67 O.R. (2d) 737 (H.C.) , and *Siskind v. Bank of Nova Scotia* , Carruthers J. (1984), 46 O.R. (2d) 575, 10 D.L.R. (4th) 101 (H.C.) .)

42 In the language of Salmon L.J., adopted at p. 107 [61 O.R. (2d)] by Anderson J., of the report re Hausman, and found in *Cuckmere Brick Co. v. Mutual Finance Ltd.*, [1971] Ch. 949, [1971] 2 All E.R. 633 (C.A.) , at p. 965 [Ch.], this language follows:

> Once the power has accrued, [referring, of course, to the power of sale] the mortgagee is entitled to exercise it for his own purposes whenever he chooses to do so. It matters not that the moment may be unpropitious and that by waiting a higher price could be obtained. He has the right to realise his security by turning it into money when he likes. Nor, in my view, is there anything to prevent a mortgagee from accepting the best bid he can get at an auction, even though the auction is badly attended and the bidding exceptionally low. Providing none of those adverse factors is due to any fault of the mortgagee, he can do as he likes.

Legal Consequences of a Mortgagee-in-Possession

43 The question, then, is whether the plaintiff has demonstrated negligent conduct under the fact situation before the court if its agents do not complete the analysis as suggested by the expert Rostant. Did C.T., as suggested by Rostant, consider with reasonable prudence an *immediate sale* to prevent the further erosion of the security to the mortgagor from the accelerating debt, thereby fixing the loss, or was the accumulation of interest debt not a concern to them?

44 As stated by Lord Denning in *Standard Chartered Bank v. Walker*, [1982] 1 W.L.R. 1410, [1982] 3 All E.R. 938 (C.A.) , at pp. 941-942 [All E.R.]:

> His Lordship expressed the duties of a mortgagee who enters into possession and realizes a mortgage property as a duty "*to use reasonable care to obtain the best possible price which the circumstances of the case permit. He owes this duty not only to himself (to clear off as much of the debt as he can) but also to the mortgagor so as to reduce the balance owing as much as possible, and also to the guarantor so that he is made liable for as little as possible on the guarantee* . This duty is only a particular application of the general duty of care to your neighbour which was stated by Lord Atkin in *Donoghue v. Stevenson*, [1932] A.C. 562 , ... and applied in *Anns v. Merton London Borough*, [1977] 2 All E.R. 492 ... *There are several dicta to the effect that the mortgagee can choose his own time for the sale, but I do not think this means that he can sell at the worst possible time. It is at least arguable that, in choosing the time, he must exercise a reasonable degree of care* .

> ... The receiver is the agent of the company, not of the debenture holder, the bank" (by analogy, the mortgagee is the agent of the mortgagor). "He owes a duty to use reasonable care to obtain the best possible price which the circumstances of the case permit. He owes a duty not only to the company (of which he is the agent) to clear off as much of its indebtedness to the bank as possible, but he also owes a duty to the guarantor, because the guarantor is liable only to the same extent as the company. The more the overdraft is reduced, the better for the guarantor. *It may be that the receiver can choose the time of sale within a considerable margin, but he should, I think, exercise a reasonable degree of care about it* . The debenture holder, the bank, is not responsible for what the receiver does except in so far that it gives him directions or interferes with his conduct of the realisation. If it does so, then it too is under a duty to use reasonable care towards the company and the guarantor.
>
> *If it should appear that the mortgagee or the receiver have not used reasonable care to realise the assets to the best advantage, then the mortgagor, the company, and the guarantor are entitled in equity to an allowance* . They should be given credit for the amount which the sale should have realised if reasonable care had been used. Their indebtedness is to be reduced accordingly.

[Emphasis added.]

Mortgagee-in-Possession — Choosing Time of Sale

45 Possession, of course, involves judgment, and while it is always a question of timing as to when it is best to sell, it does not require a standard of perfection (*Hausman v. O'Grady* , supra, p. 105 [61 O.R. (2d)]), but it does involve a mortgagee, as stated by Lord Denning, to act reasonably, which inherently requires analysis of all the facts to be considered. That mistakes are made is not the test, but rather whether C.T. failed to consider the alternatives and thus failed to act prudently.

46 Hindsight is not the test, even if it is now clearly shown that there was error in judgment. It is rather whether the retention of the property, particularly in the early years of possession without advertising or testing the marketplace, go far beyond mere error in judgment and the precautions taken of possession versus sale were those of a reasonable man bespoken by the authorities.

47 In accordance with legal principle, a mortgagee's fundamental obligation is to act reasonably and in good faith. In doing so, it is entitled to consider its own interest to make a complete recovery, but fairness must be embodied in such a consideration. It is here where the consequence of retaining the property, the risk of continued possession versus the consequence of immediate sale, and the effect upon the mortgagor and guarantor must be weighed.

48 In taking possession, there are imposed obligations to direct a proper course of action. This is only possible with the gathering of all relevant information as it relates to the property asset. It is only with this review of the positives and negatives that the appropriate concerns to retain or sell the asset may be reviewed.

49 A sale under even poor market conditions to stop the bleeding may prove to be the most prudent conduct, but these decisions are not made in a vacuum.

50 In so functioning, the mortgagee-in-possession is carrying out the requirements as stated in the dicta by Lord Denning, "to act as a prudent ordinary owner would do in directing a proper course of action."

51 Here, then, the issue is whether the mortgagee acted in such a manner as to minimize loss and to maximize recovery. There is a maxim, "Your first loss is your best."

52 From July 1980, when sole possession was exercised under the mortgage covenant until December 1982 and beyond, there is no real evidence of formal advertising, or attesting of the market conditions for the sale of this property, other than the one agreement with Crich Holdings Ltd. ("Crich"), which did not materialize.

53 Although the expert for the defence agrees it was not appropriate to advertise a final sale before legal possession was complete, this situation existed as of August 27, 1981.

54 The reason for these failures, as stated by the representatives of the mortgagee, was due to their belief of the depressed market, and that at the time they felt a sale was untenable because of the number of apartment buildings listed for sale. To this I say that every building has its own separate considerations in the eyes of the purchaser, and even if it was thought that there was no viable market under the situation existing, this alone was not a justification to do nothing. Some steps to test the marketplace should have been carried out, where you are holding a negative receipt.

55 In fact, we are aware that as of September 1982, the plaintiff was able to arrange a private sale to Crich. While this sale was arranged some 21 months after possession and 15 months after legal possession, it illustrates my contention that there are buyers even in a depressed market. The failure of this transaction to close had much, in my view, to do with the mortgagee's failure to know all of the facts as it related to the asset they had in possession. This is true even though they had the asset for some 21 months, and while the defence suggests this is wilful blindness, equivalent to negligence, that determination must be considered only after review of all of the evidence.

56 It would appear, nonetheless, if the mortgagee had been aware of the exemptions to the property, compliance could have taken place prior to the proposed closing date for the property sale to Crich set for September of 1982. Their failure in this regard, and this lack of knowledge, cannot now be visited upon the defendants and used as a justification for their actions or the length of their possession.

57 It is unmistakable that after the plaintiff became aware of the restricted zoning, that the representatives of C.T. in control, many of them transferred personnel from other areas of the province, had but one thought in mind, and that was to return to the zoning they believed they had originally secured.

58 In dealing with this specific area of the evidence, I am puzzled concerning their position. I do not believe that this restricted zoning category is unique to the city of Windsor, but in listening to the evidence of the mortgagee's representatives as well as many of the other witnesses called on behalf of the plaintiff, they appeared unfamiliar with this designation. The exclusive use by seniors as it related to the apartment dwellings, particularly where there was no subsidy or rent control applicable, was not something to which they showed any familiarity.

59 This may well be the reason for their rezoning efforts, but this was a major cause for considerable delay, and this failure to direct their mind as to an immediate disposition of the building resulted in needless expense and the rapid accumulation of the debt.

60 If the mortgagee had directed its efforts to conformity of the existing zoning as it related to the site plan, this might well have been accomplished quickly and the building would have been available for sale almost immediately. This is true even though W.P. had not obtained an occupancy permit for the residential apartments prior to default.

61 In dealing with the seniors category, and conformity of the tenancies, there is some evidence that not all of the apartments conformed, but it is unclear as to the number of tenants which constituted non-compliance. It is nonetheless to be noted that any such tenancy not complying with the site zoning operated contrary to the zoning by-law for which the property was exempted.

62 While termination of such tenancies may have raised issues of damages against the owner and/or mortgagee, that is another area which remains unexplained as to why it was not pursued by the mortgagee.

63 On the issue of conformity, Edward Link, the now building commissioner for the city of Windsor, and at the time of the mortgagee's possession an assistant in the building commissioner's office, testified to the following. He confirmed that the reduction in the number of apartment units to 31 as permitted, with equal parking, would have allowed for the issuance of an immediate partial occupancy permit as to the residential portion of the building. In my consideration of the parking and the Gloss report, this did not appear to be a major problem.

64 Mr. Link also conceded in cross-examination that the major concern at the meetings with the mortgagee's representative related to steps necessary to have the property restored to the original zoning compliance without restriction, rather than the requirements for compliance.

65 While I have stated repeatedly that this was a major if not fundamental error in judgment by the mortgagee, this thinking existed from the earliest as a resolution to their problem. It was, as I understand the mortgagee's view at the time, that the marketability of the building as an apartment exclusively for use by seniors reduced its value. This is not borne out by the evidence, nor has the plaintiff satisfied me of this fact on a balance of probabilities.

66 It was the mortgagee's economic consideration that the public available to lease the premises within the restrictions, in their view, attributed to the building having a depreciated value. There was, on this point, no real evidence to this effect, although there were overtures made from a number of corporate in-house witnesses, but without substantial verification. The only real evidence on this issue was given by William Docherty, a Windsor developer, and his evidence was to the contrary. In his testimony, he identified a number of apartment buildings in the Windsor area which were developed as seniors' buildings exclusively, and the history of what occurred upon their sales.

67 In my analysis of listening to the plaintiff's witnesses, they harboured some confusion relating to the effective rental rates that an owner was able to charge to senior occupants. These witnesses, it was clear, appeared confused, and translated this restriction to the building's operation as one of government subsidy, which it was not.

68 I found this confusion to rest not only in the mind of C.T.'s representatives, but also Richard Sutton, the mortgage broker, called for the plaintiff. I found him to be unfamiliar with seniors' buildings which were not subsidized.

69 While these beliefs existed, and even if they were true in that these matters were of concern to the plaintiffs, nothing was done to compare the value of a seniors' building to a building without restriction. In fact, there is no evidence before me that a comparative analysis was ever made, and the only evidence on value is that of William Docherty, the developer. It is this position as adopted by the mortgagee which constituted error in judgment and resulted in unreasonable delay for the final disposition of the property.

70 Their approach added to not only further capital expenditures, but was a major factor to the large accumulation of debt as claimed.

71 While no doubt there may have been some obstacles that would confront the mortgagee to ready the building for sale, even under the restricted zoning then existing, these were not insurmountable on the evidence of Edward Link and the report of Gerry Gloss, architect, as filed, Exhibit 2, Tab 110.

72 These deficiencies to rectify any existing problems could have been accomplished without great expense or difficulty, and the building's availability for sale would certainly have been greatly accelerated.

73 On the building's value as a seniors' building, we have the evidence of William Docherty. He testifies that, at the time, there was a need for seniors' buildings in the Windsor locale, and in fact he was the promoter and innovator of this concept. The seniors' buildings described by Mr. Docherty, of which he was the owner of many, were constructed without subsidy and under a conventional mortgage.

74 Such buildings were to satisfy a particular demand for the growing number of seniors who wanted to dispose of their own properties, but continue to have many of the amenities not found elsewhere, or in other subsidized buildings. In his experience, many seniors demanded larger and more luxurious accommodations, with provisions for a library, laundry room, rec rooms, and in some instances a pool within its location.

75 The reduced parking requirements, it was suggested, was a positive. Why incur the additional costs when many seniors did not wish to pay for a parking area that was not being used by them?

76 It should also not go unnoticed that with this apartment building, parking was provided above the usual minimum requirements for a seniors' building. Any surplus parking not required could then be used by the commercial tenants. Under both the previous C2A zoning as it then existed, and the special site zone for this property, in either case provision for parking was not a requirement which was imposed for the commercial space.

77 Based upon Docherty's evidence, since most seniors had no use for parking, this would have worked as a benefit to the commercial space, and this could be accomplished without the purchase of any additional lands. This could be an important asset, since this property was located on a main street, and street parking was limited. Other benefits to the owner with a senior's designation were also described. While these benefits may not directly add to the building's income, it gives to the owner of the building some stability. With occupancy by seniors, there is a lower vacancy rate, a reduction in wear and tear to the premises causing less repairs, and a reduction in the cleaning and general upkeep of the premises. Since many seniors wanted to reside with groups of similar maturity, it could increase the demand for occupancy. Therefore, while the mortgagee viewed the zoning with a negative, the developer looked upon it as a positive. In trying to determine the value of a seniors' building, it is as in the sale of any building dependent on the economic climate, but a seniors' building is not in itself a drawback to sale.

78 In fact, on the evidence, the sale of a number of such seniors' buildings with these restrictions, including not only several of Docherty's own, but others of which he was aware, including one such apartment building purchased by Crich, the proposed purchaser of this property, in December of 1982, sold for prices far better than a conventional building. In some of these sales of his own buildings, rather than a reduction in value, a premium was paid by the purchaser.

79 The point as made by the developer is that as in all sales, particularly of apartment buildings, location is important. On the evidence of not only Docherty called for the defence, but as well all of the plaintiff's witnesses, this building, the subject of the lawsuit, was excellently located on the main arterial corridor of Ouellette Ave. It was close to the city's core area, and was not only a luxury-type accommodation with many amenities, but situate among one of the best locations within the municipality.

Conclusion

80 I now conclude with the obligation of a mortgagee-in-possession summarily taken from the authorities.

81 While perfection is not required, a mortgagee taking possession must act prudently. It is hoped, if not obligatory, that the mortgagee will during possession take reasonable care to maximize income and obtain, in the event of sale, the best possible price. The mortgagee should, on a regular if not continuous basis, where the asset value is depleting, make reasonable efforts for a quick sale to minimize the loss.

82 In so doing, the mortgagee protects not only his own investment, but the interest of the principle debtor and the guarantor.

83 While the plaintiffs paid lip service to these principles, the realities do not support this proposition. Even though the plaintiffs sought and received advice from a credit committee, internal to their corporation, this committee was not given all of the information to make or direct a proper course of action. In their review of a proper course of action, there is nothing in the evidence which directs their minds to the rectification of the immediate problems, which includes site compliance with the existing zoning.

84 As late as 1983, no full examination was taken by the mortgagee and/or the advisory committee as it related to the cost of carrying the debt compared to an early sale of the property for something less.

85 If this analysis had been undertaken by the credit committee, this claim in its existing form may never have been before the court. It is in this course of action taken by the mortgagee that they failed, and in a large part this results in the claim they now present. The committee's recommendation, I conclude, was based on a course of action with limited information.

86 It is with these circumstances in mind that I determine the meaning of the term improvident, as it relates to the sale of the lands and premises. This concept must relate not only to the final price received, but the mortgagee's actions during possession, and bears directly on the deficit and the net receipt to be enjoyed by all. For the reasons I have stated, I do not consider the

purchase of additional property, thus incurring a large capital expenditure with the further time delay it involved, was the action of a prudent mortgagee, where it failed to consider the alternatives.

87 The mortgagee considered only half of the equation. By adding to the existing debt load, it is my belief C.T. added little to the retail value of the building for sale. For this reason, the capital expenditure as submitted by the mortgagee was not justified, and a quick sale without delay may have avoided what became, after 1981, a declining property asset.

88 Under the circumstances presented, there is nothing to suggest that C.T.'s loss could not have been successfully crystallized by September of 1982, if all the facts had been known by them.

89 While C.T. showed it was able to obtain an offer, it failed in its obligation during their period of possession to learn all the facts about the property, and this was the direct result of the offer not closing. To now deal with the issues raised at the commencement of judgment, I answer the first issue in the affirmative.

90 C.T. had an obligation not only to receive the best possible price at the time of sale, but to act upon a sale as soon as prudently possible.

91 The mortgagee's failure to consider all of the consequences to possession, and their inaction to promote a sale, resulted in their failure to do what was expected, and was a direct consequence to the rapid increase in the debt. It is here where C.T. was guilty of improvident conduct in not following a proper course of conduct. To this end, they should not be entitled to recover on their full claim.

92 On the legal duty of the mortgagee, it is to take reasonable precaution. The mortgagee must, in the exercise of such obligation, proceed with a reasonable degree of care, not only from the commencement of possession, but to the final disposition of the property asset. In so doing, it protects the interest not only of itself, but more importantly, it meets its obligation to the mortgagor and guarantor. This position is confirmed in the dicta of Lord Denning, *Standard Chartered Bank v. Walker* , Denning J.A., p.940, supra:

> If he (mortgagee) fails to use reasonable care to realize upon the assets to the best advantage of all, then the mortgagor and guarantor are entitled *in equity* to an allowance from any claim. This duty is in addition to the *common law duty* to your neighbour.

93 I do not, on the evidence, conclude that C.T. under all the circumstances so acted.

94 On the issue of mitigation, this principle is well settled in the law, where you have a right to claim whether in tort or contract, you owe a duty to your neighbour to minimize your loss. Where, through its failure to act quickly and providently, the mortgagee depletes the mortgagor's security and the guarantor is exposed to a claim, then it cannot be said that the mortgagee mitigated against its total loss.

95 The length of possession by the mortgagee in this instance, and its failure to identify its property asset before September of 1982, was not reasonable. This failure is demonstrated by its non-consummation of the agreement of purchase and sale, which was originally set for closing on September 3, 1982, Tab 87, Exhibit 2.

96 It is upon these considerations that this court must have regard to the plaintiff's claim.

Damages

97 I do not conclude that the subject matter of the security, the apartment building, was in September of 1982 of any less value than a conventional building without restriction. The plaintiff has failed in this regard to show otherwise on a balance of probabilities. Based on the offer submitted and dated July 16, 1982, for which closing was to take place in early September 1982, and extended to October 15, 1982, the difference between the accumulated debt shown as of that date, of $1,394,243.62 (Tab 188, Exhibit 5), and the value fixed in the offer to purchase (Tab 85, Exhibit 1), of $1,332,616, is approximately $61,627.62. In

adding thereto the realty commission of 2 per cent, provided in the agreement of purchase applied to the sale price, this would add an additional expense to the mortgage debt of approximately $27,652.32.

98 In addition to these amounts, I shall allow the additional sum of $10,000 plus, to cover legal fees and other allowances that may have been overlooked, to arrive at my aggregate award.

99 In my consideration of the Crich agreement of purchase and sale, and the value placed thereon, while one might expect that there should be a reduction in value for the sale of a building with 31 apartment units as opposed to 32, for the reasons already given, there is nothing to establish this fact. This is true, even though I recognize that the total income may well be reduced from a decreased number of units. While this fact may be difficult to dispute, there is nothing to suggest that the rent loss could not be made up from the balance of the units contributing to their beneficial use of a common area converted from the 32nd unit.

100 It is for these reasons that I refrain from granting any price adjustment, and none is warranted, particularly when on the experience of Docherty a number of these buildings, including his own, were sold at a premium.

101 I have noted from Tab 188, Exhibit 5, that the taxes if a sale had been completed on October 15, 1982, would have been prepaid as of October 13, 1982, which should give the vendor a credit of approximately $8,600 based on a total tax for the year of $41,741.83.

102 I have considered that this adjustment on tax would probably be consumed by other adjustments and incidental costs, and for this reason it plays no part in my final determination of damages.

103 Based on the foregoing, and without any precise means to calculate an award for damages, I have determined that an award fixed in the amount of $100,000 as of October 15, 1982, would be adequate compensation. This, in my view, should have been the plaintiff's maximum loss as of that date.

104 If the plaintiff had acted as a prudent owner, and had ascertained all of the facts concerning the property, then the sale of the said building could have been completed with dispatch at least by October 15, 1982, the day to which the offer to close was extended.

105 It is for these reasons given, I conclude that the loss at that date to the mortgagee should not have exceeded $100,000. Together with this loss as of October 15, 1982, the plaintiff is entitled to interest at the rate of 11 per cent per annum as per the terms of the mortgage, together with compound interest where applicable, calculated from October 15, 1982, to the date of judgment.

106 As to this final sum and the calculations thereon, while I assume it to be in the area of $265,000, I will leave the precise calculation to the parties. If the parties are unable to agree as to the appropriate sum for judgment after calculation, then they may speak to me for direction and confirmation of the final figure.

107 In arriving at my conclusions, particularly the area of damages, while I am aware of the reported decision of Flinn J., *Canada Trustco Mortgage Co. v. Bartlet & Richardes* (1991), 17 R.P.R. (2d) 190, 3 O.R. (3d) 642 (Gen. Div.) , much of the comparative evidence on damages reported before that court was not brought before me, other than the report of Gerald E. Waters, C.A., of Richard Wise & Associates.

108 It is possible, for these reasons, that we have arrived at a different conclusion in the direction taken as to damages. In my own appraisal, it is based on my views of the evidence before me, and my best estimate of the plaintiff's loss. I am cognizant that the plaintiffs, during their course of managing the building, recovered their management costs and expenses from the rents charged. It was only the net income which was applied to reduce the mortgage debt after reduction of expenses.

109 On the evidence of Richard Gates, solicitor, I am satisfied that the guarantor was aware and advised of the risks and his obligations under the mortgage, and therefore the judgment applies to both defendants. As to the guarantor, I also point out that his obligation for payment has been fixed to a date when the mortgagee should have divested itself of the property, and therefore the guarantor suffers no prejudice.

Counterclaim

110 The defendant corporation, by counterclaim, sues for loss of profits and punitive damages. As to loss of profits, while I am satisfied that the plaintiff by counterclaim was left without the ability to obtain either a bid or performance bond, this does not necessarily flow from the conduct of C.T. At best, it could only establish upon the evidence that such inability was prolonged by C.T.'s failure to crystallize the debt. I am also not satisfied on the evidence that the failure of W.P. to generate bid and performance bonds did not result from its own inability to keep the mortgage current, which in itself was the direct result of the mortgagee taking possession of the said property.

111 On the evidence of Jerry Sovran, accountant for the corporate plaintiff by counterclaim, W.P. suffered some loss of gross profits, but I do not attribute this directly to the actions of C.T.

112 In my examination, there is no causal connection for W.P.'s loss of profit which would justify a claim for damages. As to the claim for punitive damages, it arises where a court finds the conduct of a party worthy of punishment and then remits compensation to the party victimized (*Vorvis v. Insurance Corp. of British Columbia*, [1989] 1 S.C.R. 1085, 25 C.C.E.L. 81, [1989] 4 W.W.R. 218, 36 B.C.L.R. (2d) 273, 94 N.R. 321, 58 D.L.R. (4th) 193, 90 C.L.L.C. 14,035 , p. 193 [D.L.R.] and following, particularly at p. 202).

113 The facts before me do not establish that this is an appropriate claim for punitive damages, nor do I find any conduct which would justify such a claim. Under the circumstances, both aspects of this counterclaim are dismissed.

Costs

114 As to the issue of costs, I will leave it to the parties to submit their positions in writing within 30 days.

115 As an alternative, if all counsel agree, they may arrange, at their convenience, a court date, in the city of Windsor, to address me on the issue of costs.

Action allowed in part.

KINGSETT MORTGAGE CORPORATION et al
Applicants

-and-

MAPLEQUEST VENTURES INC. et al
Respondents

Court of Appeal File:
Court File No. CV-24-00722148-00CL

COURT OF APPEAL FOR ONTARIO

PROCEEDING COMMENCED AT
TORONTO

APPELLANTS' BOOK OF AUTHORITIES

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RCP-E 4C (May 1, 2016)