COURT OF APPEAL FOR BRITISH COLUMBIA

Citation: *Forjay Management Ltd. v. 625536 B.C. Ltd.,* 2020 BCCA 70

Date: 20200227
Docket: CA45958

Between:

Forjay Management Ltd.

Respondent
(Petitioner)

And

625536 B.C. Ltd.

Appellant
(Respondent)

And

0981478 B.C. Ltd., Mark Chandler, Canadian Western Trust Company In Trust, HMF Home Mortgage Fund Corporation, James Mercier, Morris Kadylo, Urszula Piaseczna, U.S. Bank National Association, Baramundi Investments Ltd., Charanjit Kaur, Simrat Virdi, Mukhtiar Singh Nijar, Mohan Vilkhu, Jaspreet Singh Khatra, Amandeep Singh Dhaliwal, Nirmal Singh Chohan, Sajal Jain, Suparna Jain, Babal Rani Bansal, Satpal Bansal, Parminder K. Mann, Leena Jain, Vasant Patel, 1074936 B.C. Ltd., 1084165 B.C. Ltd., 1084164 B.C. Ltd., 1084322 B.C. Ltd., Surjit Kaur Parmar, Harbhajan Singh Parmar, Daljeet Kaur Gill, Bhasham Kaur Gill, 812 Capital Holdings Ltd., Catalyst Assets Corp., 0951019 B.C. Ltd., Wonder Marble & Stone Inc., Intech Pay Ltd., 1086286 B.C. Ltd., 1085537 B.C. Ltd.,1083516 B.C. Ltd. and Reliable Mortgages Investment Corp.

Respondents
(Respondents)

Before: The Honourable Madam Justice Fenlon
The Honourable Madam Justice Dickson
The Honourable Mr. Justice Butler

On appeal from: An order of the Supreme Court of British Columbia, dated February 25, 2019 (*Forjay Management Ltd. v. 0981478 B.C. Ltd.*, 2019 BCSC 238, Vancouver Docket H170498).

Counsel for the Appellant:	C. Harvey, Q.C. J.E. Shragge
Counsel for the Respondents Forjay Management Ltd. and Reliable Mortgages Investment Corp:	K.M. Jackson L.M. Hellrung
Place and Date of Hearing:	Vancouver, British Columbia November 15, 2019
Place and Date of Judgment:	Vancouver, British Columbia February 27, 2020

Written Reasons by:
The Honourable Madam Justice Fenlon

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

Summary:

In the context of receivership proceedings arising out of a failed residential real estate development, the trial judge held that advances made by the first and second mortgagees in excess of the face amount of their mortgages were secured and ranked in priority to the third mortgage. She also found the second mortgage provided for a criminal interest rate and fashioned a remedy that struck one of the $2 million broker fees but increased the interest rate from 12% to 18%. Held: Appeal allowed in part. The judge did not err in concluding that the over advances were secured by the first and second mortgages. The registration system is intended to convey certainty of title, not certainty of value. The prior charges permitted advances beyond the original advance of principal, putting a subsequent encumbrancer on notice to make further enquiries. The judge did not make a palpable and overriding error in finding that the first mortgagee did not receive notice of the third mortgage for the purposes of s. 28 of the Property Law Act. The provision requires notice in writing of the subsequent registration. Actual notice does not suffice. Thus, the over advances may tack in priority onto the first mortgage. The judge erred in principle in assuming she had wide-ranging discretion to alter the contractual rate of interest on the second mortgage. Having determined that the rate exceeded the criminal interest rate, the options were to either sever particular terms of the contract or read-down the interest to an effective annual rate of 60%.

Reasons for Judgment of the Honourable Madam Justice Fenlon:

[1] The appellant 625536 B.C. Ltd. (“625”) appeals orders made in ongoing receivership proceedings arising out of a failed residential real estate development in Langley. 625 says the judge erred in finding that advances made by prior mortgage holders in excess of the face amount of their mortgages were secured and ranked in priority to 625’s mortgage. It says the judge also erred in her application of the notice requirement in s. 28(2) of the *Property Law Act*, R.S.B.C. 1996, c. 377 and in the manner in which she remedied a criminal interest rate payable on one of the prior mortgages.

Background

[2] There is a long and complex history to the underlying receivership proceedings which began in 2017. For the purposes of this appeal, the following facts are relevant.

[3] In 2014 the respondent Mark Chandler and 098147 B.C. Ltd. (“098”, and together, “the Borrower”), purchased land on which a 92-unit residential tower was to be built. At the time, the lands were in foreclosure, and the appellant 625 had loaned money to the original developer. The Borrower assumed 625’s loan of about $1.8 million as part of the purchase and secured it by way of a new mortgage, registered against title as a second mortgage on May 28, 2014. On that same day, the respondent Reliable Mortgages Investment Corp. (“RMIC”) and a co-lender, the respondent Canadian Western Trust Company (“CWT”) registered a first mortgage to secure a $4.2 million loan to the Borrower.

[4] RMIC and CWT intended their lending commitment to be short-term and limited to the funds needed by the Borrower to purchase the lands. However, the Borrower could not obtain financing to further the construction. In order to protect its investment, CWT, now joined by the respondents Forjay Management Ltd. (“Forjay”) and HMF Home Mortgage Fund Corporation (“HMF”) committed to loan a further $10 million to the Borrower. This second loan was secured by a mortgage registered on January 23, 2015. It was a term of the lending agreement that 625 would subordinate its loan to advances under the new mortgage. A priority agreement to that effect was registered the same day. 625 received a $300,000 fee for this concession.

[5] To summarize, then, as of January 23, 2015, the respondents RMIC and CWT held the first mortgage; the respondents CWT, Forjay and HMF held the second mortgage; and the appellant 625 held the third mortgage. I will adopt the terminology of the summary trial judge and refer to the First Mortgage, the Second Mortgage and the 625 Mortgage.

[6] The First and Second Mortgage lenders had often done business together in the past. The principal of Forjay and RMIC was James Mercier. The principal of CWT and HMF was Ajay Soni. Mr. Soni and Mr. Mercier considered themselves to be business partners. It was Mr. Soni who introduced Mr. Mercier to the Borrower and suggested the initial investment.

[7] By August 2015 the advances made under the Second Mortgage had exceeded the $10 million face value of the mortgage, and by June 2018 those advances had grown to $21.8 million. 625 says that advances beyond the $10 million principal declared on Form B of the Second Mortgage are not secured by that mortgage and cannot take priority over 625's loan. 625 takes the same position with respect to advances made under the First Mortgage which exceeded the Form B amount of $4.2 million. By October 2017, just before the receivership, approximately $14.6 million had been advanced under the First Mortgage. Although the precise amounts claimed under each mortgage have fluctuated as interest accrues and payments are made by the receiver, those details are not of concern on this appeal.

[8] The Borrower took no part in the appeal which is a contest between 625 and the First and Second Mortgagees as represented by Forjay and RMIC who shared counsel on appeal. With that context, I turn now to the first ground of appeal.

1. Are the advances made beyond the Form B amounts of the First and Second Mortgages secured?

[9] Under s. 225 of the *Land Title Act*, R.S.B.C. 1996, c. 250, a mortgage must be in two parts. Part 1 consists of a form approved by the Director and containing the information specified by the Director ("the Director's Requirements"). Part 1 of the form is generally referred to as Form B. In clause 5(a) of Form B, the principal amount of the loan is to be set out. The Director's Requirements instruct applicants to:

> Enter the principal amount expressed in figures only. If the principal amount is not a sum certain, enter SEE SCHEDULE and set out the obligation in a schedule.

[10] Part 2 consists of the terms governing the mortgage. Those terms are referred to in Form B at clause 9 as follows:

> 9. MORTGAGE TERMS
>
> Part 2 of this mortgage consists of (select one only):
>
> (a) Prescribed Standard Mortgage Terms ☐
>
> (b) Filed Standard Mortgage Terms ☐ D.F. Number:

> (c) Express Mortgage Terms ☐ (annexed to this mortgage as Part 2)
>
> A selection of (a) or (b) includes any additional or modified terms referred to in item 10 or in a schedule annexed to this mortgage.

[11] 625 submits that the First and Second Mortgages secured only the Form B principal amounts of $4.2 million and $10 million respectively, and that the judge erred in finding they secured substantial advances beyond those limits. They say that, having designated sums certain of $4.2 and $10 million in the Form Bs, the mortgagees have made their choice and are limited to claiming that amount under their security. To hold otherwise, 625 says, is contrary to the object of the British Columbia's Torrens system of land registration which is intended to provide certainty of title and certainty of interests against title. In short, 625 contends that if the lender can advance significant sums beyond the principal amount declared on the face of the mortgage, someone interested in advancing money subsequently would not be able to rely on the registration of the prior mortgage registered on title — they would instead be misled by it.

[12] In addressing this argument, the judge noted that few authorities have discussed the interpretation of clause 5(a) of Form B. She considered the view of Mr. Justice Edwards in *Vancouver City Savings v. Automotive Finance Corp*, 2000 BCSC 411 (*sub nom Vancouver City Savings Credit Union v. Alda Wholesale Ltd.*), that the description of a sum certain in clause 5(a) does not constitute a guarantee of the amount secured by a mortgage, but rather provides the public with information about the maximum principal initially secured by the mortgage. She concluded:

> [82] The cautionary tale from *Vancouver City Savings* is, therefore, that any party seeking to know the amount outstanding under the mortgage at any given time will typically be required to make enquiries of the mortgagee. While that case refers only to principal and interest, 625 readily concedes that an amount outstanding under a mortgage may also include other items that have been, in accordance with the mortgage terms, added to it. This will typically include such things as costs and protective disbursements. Indeed, such provisions are found in the Mortgages.
>
> [Emphasis added.]

[13] The judge's reference above to the provisions found in the mortgages takes us to a consideration of Part 2 of those documents. Both the First and Second Mortgages incorporated terms filed by the mortgagees which were not the prescribed standard terms, but were, rather, terms the respondents had developed and routinely used in their lending arrangements. The judge quoted a number of those terms in her reasons for judgment at para. 24. For the purposes of this appeal it suffices to note the following:

> **Interpretation**
>
> 1.(1) In these mortgage terms
>
> > …
> >
> > (u) "principal amount" means the amount of money shown as the principal amount on the mortgage form as reduced by payments made by the borrower from time to time, or increased by the advance or readvances of money to the borrower by the lender from time to time, and includes all money that is later added to the principal amount under these mortgage terms;
> >
> > …
> >
> > (x) "this mortgage" means the combination of the mortgage form and these mortgage terms.
>
> …
>
> **Construction of buildings or improvements**
>
> > 9. …
> >
> > > (3) The borrower covenants with the lender that the lender may, without any order or direction of the borrower in that behalf, pay to contractors, sub-contractors, material men, labourers and other persons supplying or having a claim for work, services and/or material supplied in and about the construction, repairing, altering or replacing of any buildings or other structures or any part thereof on the said lands and premises, any monies due to them for such work, services and materials of the monies being advanced by the lender under the mortgage, or, if the mortgage monies have been fully advanced, may pay the same and add all monies so paid to its said mortgage, but nothing herein contained will bind the lender to pay or advance any such monies or to continue to pay or advance any such monies after it has paid or advanced any such monies under this mortgage.

[14] It cannot be disputed that, as the judge found, these terms permit significant additions to the initial principal amount to be secured by the mortgages. The issue

raised by 625 is whether the principal amount stated in clause 5(a) on Form B nonetheless acts as a cap on security for advances of principal beyond that sum. Relying on *Sattva Capital Corp. v. Creston Moly Corp.,* 2014 SCC 53 at paras. 55 and 58, 625 says that the words "sum certain" must be given their ordinary meaning of a fixed sum of money, and that the judge's interpretation of this phrase as equivalent to "variable and indeterminate" is the exact opposite of the plain meaning of the words used by the borrower and lender. Further, 625 says that if there is a conflict between the stated sum certain in Part 1 of the mortgages and the standard mortgage terms in Part 2, the stated sum prevails because it states the specific whereas the mortgage terms are general provisions: *Hastings Park Conservancy v. Vancouver (City*), 2008 BCCA 117 at para. 91.

[15] 625 submits that its position is buttressed by s. 206 of the *Land Title Act* which requires parties to enter into and register a modification agreement if they want to change their mortgage. It says the judge's conclusion that the stated principal in Form B is not a cap on the principal secured by the mortgage would conflict with the statutory objectives of simplicity and public accessibility which prompted the implementation of the statutory form of mortgage nearly 30 years ago.

[16] I would not accede to these submissions. With respect, the interpretation contended for by 625 is premised on two flawed assumptions: first, that the registration system is intended to convey certainty of value of land and encumbrances; and second, that there is an inconsistency between the face amount stated in 5(a) and the terms of the mortgage.

[17] In my respectful view, the first assumption is unsound because, as Mr. Justice Edwards noted in *Vancouver City Savings,* the amount secured can never be known without further inquiry. The Torrens System is concerned with certainty of title and existing encumbrances. Anyone searching the title of the land in issue here would be made aware of the existence of the mortgages and their terms. The searcher could readily ascertain that the mortgages allow advances beyond the principal amount of the loan stated on Form B, and would thereby be put on notice that further inquiries

must be made. In this regard it is noteworthy that the very definition of "principal" in the Standard Mortgage Terms is inconsistent with a fixed sum:

> **"principal amount"** means the amount of money shown as the principal amount on the *mortgage form* as reduced by payments made by the *borrower* from time to time, or increased by the advance or readvance of money to the *borrower* by the *lender* from time to time, and includes all money that is later added to the principal amount under these mortgage terms;
>
> [Emphasis added.]

[18] The notion that the principal stated on the face of the mortgage constitutes a cap is inconsistent with findings in cases beyond *Vancouver City Savings.* For example, in *Richmond Savings Credit Union v. Nijjer et al.*, 2000 BCSC 1150, aff'd 2002 BCCA 87, advances under a mortgage governed by terms in external documents which provided for different interest rates and repayment terms were found to be duly registered and secured in priority because together, Part 1 and Part 2 of the mortgage set out how the mortgage was meant to operate and "[a]lthough one could not determine the amount owing by reference to the documents filed alone, there was sufficient information such that anyone could acquire whatever information he or she wanted or needed prior to filing a subsequent mortgage": para. 40. In *Kolia v. Marchese*, 2017 ONSC 332, the principal of the mortgage was found to have increased from the original amount of $22,650 to over $450,000: at para. 23.

[19] The second assumption 625 relies on is not in my view borne out by a reading of the mortgages as a whole. There is no inconsistency in stating an amount of principal on the face of the mortgage and providing that it may be increased in certain circumstances. Seen in this light, the two parts of the mortgages are not competing or contradictory — the provisions can be read together harmoniously in order to determine the intentions of the parties.

[20] I agree with 625 that "a subsequent encumbrancer who takes with notice of a prior charge registered in the land titles office cannot have his security prejudiced by any subsequent modification of the prior charge to which he is not a party": *Vancouver City Savings Credit Union v. Harrington* (1984), 51 B.C.L.R. 253 at 257.

But that begs the question of what constitutes a modification. If the prior charge permits advances beyond the original advance of principal, making those advances is consistent with the prior charge — not a modification of its terms.

[21] In summary on this ground of appeal, I am of the view that the judge did not err in concluding that the mortgages secured advances beyond the amounts set out on Form B insofar as the advances were made in accordance with the terms of the mortgages.

2. Do the advances take priority over the 625 Mortgage?

[22] The second ground of appeal raises the common law principle of tacking — a concept that has proved fertile ground for disagreement between and among mortgage holders. The question is whether money advanced under a first mortgage, after a subsequent mortgage has been registered, takes in priority over the second mortgage.

[23] The leading common-law decision on the principle of tacking is *Hopkinson v. Rolt* (1861), 9 H.L. Cas. 514. In *I.W.A. Credit Union v. Johnson* (1978), 6 B.C.L.R. 271, Hinds J., then sitting as a local judge of the Supreme Court, helpfully summarized that decision at 276:

> The majority decisions recognized that if unrestricted tacking were permitted no unfair hardship would be visited upon the second mortgagee who obtained his security with notice of the first mortgage but that unfair prejudice could result to the mortgagor. If the first mortgage was made to secure advances which could be made or withheld, at the option of the first mortgagee, it would place a serious constraint upon the mortgagor in raising money on his equity of redemption. Accordingly, the majority speeches in the House of Lords restricted the doctrine of tacking and held that a first mortgagee could not tack when he had specific notice of the second mortgage. However, by inference the House of Lords held that a first mortgagee could tack when he had no notice of the existence of a second mortgage.
>
> [Emphasis added.]

[24] The focus of the common law was thus on whether the prior mortgagee had actual notice of the subsequent mortgage before making further advances. If they did, those advances ranked in priority after the subsequent mortgagee's advances.

Conversely, if the prior mortgagee did not have actual notice of the subsequent charge, they could continue to "tack" in priority to the second mortgage.

[25] With the introduction of the *Land Title Act* in British Columbia, a question arose as to whether registration of a second or subsequent mortgage constituted constructive notice to the prior mortgagee, in light of s. 27(1) which provides:

> 27 (1) The registration of a charge gives notice, from the date and time the application for the registration was received by the registrar, to every person dealing with the title to the land affected, of
>
> (a) the estate or interest in respect of which the charge has been registered, and
>
> (b) the contents of the instrument creating the charge so far as it relates to that estate or interest,
>
> but not otherwise.
>
> [Emphasis added.]

The Ontario Court of Appeal (Chancery Division) addressed the question in *Pierce v. Canada Permanent Loan & Savings Co.* (1894), 25 O.R. 671 at 676, aff'd (1896), 23 O.A.R. 516, concluding that constructive notice did not suffice:

> In the absence of notice, (i.e., notice which gives him real and actual knowledge, and so affects his conscience), the mortgagee is entitled to assume and act on the assumption that the state of the title has not changed. That protection is given to him by virtue of the Registry Act, as well as by the doctrine enunciated in *Hopkinson v. Rolt*, until he is made aware of a change, not by the hypothetical operation of an instrument registered subsequent to his, but by a reasonable communication of the fact by the one who comes in under the subsequent instrument.
>
> Otherwise, consider the consequences. Before making any subsequent advance the first mortgagee would need to have telegraphic or other electrical advice as to the state of registration on the land each time he paid, for if, before the payment, some transfer from the mortgagor intervened his advance would be postponed to the claim of the newcomer.
>
> [Emphasis added.]

[26] Hinds, L.J.S.C. in *Johnson*, came to the same conclusion at 280 after reviewing a long line of common law authorities:

> … the position in British Columbia with respect to the priorities between moneys advanced under a registered first mortgage subsequent to moneys advanced under a registered second mortgage is as follows:

> A first or prior mortgagee may claim priority, up to the face amount of the mortgage, for moneys advanced under the first or prior mortgage subsequent to the registration and advancement of funds under a second or subsequent mortgage provided that such first or prior mortgagee did not have "notice" of the second or subsequent mortgage at the time such subsequent advances were made. The "notice" previously referred to is actual notice, not constructive notice. The notice referred to in s. 42 of the Land Registry Act [now s. 27 of the *Land Title Act*] is not actual notice.
>
> [Emphasis added.]

[27] *Johnson* was decided not long before the *Property Law Act* replaced the common-law principle of tacking. Section 28(2) of that *Act* provides for four situations in which a prior mortgagee's advances will rank in priority to subsequent mortgages. That will be so where:

> (a) the subsequent registered mortgagees or judgment holders agree in writing to the priority of the further advances,
>
> (b) at the time the further advances are made, the prior mortgagee has not received notice in writing of the registration of the subsequent mortgage or judgment, from its owner or holder,
>
> (c) at the time the further advances are made, the subsequent mortgage or judgment has not been registered, or
>
> (d) the mortgage requires the prior mortgagee to make the further advances.

[28] It is common ground on appeal that s. 28(2)(a) — the existence of a priority agreement — governs the priority of advances made under the Second Mortgage, and that subsection (b) — notice of the subsequent mortgage — governs the priority of advances made under the First Mortgage.

[29] The judge held that the priority agreement between 625 and the Second Mortgagees subordinated the 625 Mortgage to all amounts secured under the Second Mortgage whenever advanced (at paras. 317 and 321). 625 did not contest this finding on appeal, focusing instead on the previous ground of appeal to argue

that advances made under the Second Mortgage that exceeded the "sum certain" were not secured.

[30] The issue to be determined is whether the First Mortgagees received notice of the 625 Mortgage before they advanced funds. Central to the resolution of this issue is the distinction between "actual notice" and the "written notice" required by s. 28(2)(b) of the *Property Law Act*. The present case differs from many tacking cases in that the First Mortgagees readily acknowledge that they had actual notice of the 625 Mortgage — that is, they knew it was registered on title from the outset. The judge found that actual notice did not suffice because the *Property Law Act* allows a prior mortgagee to tack until it receives written notice of registration of the subsequent mortgage. She found that 625 had not provided notice in accordance with s. 28(2)(b), and that the First Mortgagees were therefore entitled to continue to tack in priority to 625's Mortgage.

[31] 625 says the judge erred in so finding because she read into s. 28(2)(b) a requirement to give written notice not only of registration of the subsequent mortgage, but also of the consequences of the notice — i.e., that from that point on any advances will be subordinated to the subsequent mortgage. 625 concedes that the judge correctly stated the law at para. 284 when she said:

> … I agree with 625 that the "actual notice" need not do any more than refer to the fact of the registration of the subsequent mortgage. No case cited by RMIC or which this Court has otherwise been referred to has required "actual notice" of mortgage registration to include notice of the *consequences* of this registration. In my view, this accords with standard business practices and common sense. A person is presumed to know the law and in this context, having been given actual notice of the registration, that prior mortgagee either would (or should) know of its consequences in accordance with s. 28(2)(b).
>
> [Italics in original; underlining added.]

But 625 says the judge later contradicted herself, misstating the law in the following paragraphs:

> [288] The issue then turns to the requirements of s. 28(2)(b) as to whether RMIC ever received from 625 written "actual notice" of the registration of the 625 Mortgage in an express and direct manner so as to alert RMIC to the consequences arising under s. 28(2).
>
> [Emphasis added.]

And further:

> [298] Having considered Ms. Zheng's email in the context of the policy considerations behind s. 28(2)(b), I do not consider that it can be construed as sufficient express and direct notice as to the registration of the 625 Mortgage in accordance with that provision. Again, that provision anticipates a formal written notice being given that would clearly import to the prior mortgagees, i.e., RMIC and CWT, that the 625 Mortgage has been registered such that particularly RMIC was put on notice that further advances under the First Mortgage would no longer be allowed to tack so as to continue to rank in priority under the First Mortgage.
>
> [Emphasis added.]

625 contends the judge must have applied this more onerous notice requirement in finding inadequate the written notice relied on by 625.

[32] I would not accede to this argument which is, in my respectful view, based on a misreading of paras. 288 and 298. The judge had already made a clear ruling that the consequences need not be spelled out in the notice. As I see it, the impugned phrases merely describe the effect of the notice, not its terms.

[33] The judge, then, correctly identified the requirements of s. 28(2)(b). The next question is whether she correctly applied the section to the facts before her.

[34] I begin by noting that the standard of review relating to the application of a statutory provision to particular facts is a question of mixed fact and law. In my view, the question of whether notice had been provided in this case tends heavily towards the factual end of the spectrum and therefore attracts a deferential standard of review: *Housen v. Nikolaisen*, 2002 SCC 33 at para. 36.

[35] At trial, 625 relied on three written communications to establish that it had provided the requisite notice to the First Mortgagees. The judge found only one of the three was a communication from 625 to each of the First Mortgagees: an email

sent by Ms. Zheng, counsel for 625, on December 29, 2014 to the lawyer who acted for both the First and Second Mortgagees: paras. 289–295. I set out the body of that email in full below:

> **Subject:** Priority Agreement between 625536 BC Ltd. and Forjay/Canadian Western/HMF Home Mortgage
>
> **Attachments**: Mortgage for $10,000,000.00 (00737161xC0FD3).pdf; Priority Agreement Sent by Mark Ferbers (00737156xC0FD3).pdf
>
> Good afternoon Ms. Larson,
>
> We are counsel for 625536 BC Ltd., in respect of the above referenced matter.
> We have been forwarded a priority agreement from Mark Ferbers (counsel for the registered owner/0981478 BC Ltd.), requesting our client to give priority to your clients, Forjay/Canadian Western/HMF Home Mortgage, in respect of a $10M mortgage. I believe you are acting for these 3 lenders, but please correct me if I am wrong. I tried calling just a few minutes ago, but it appears you are not currently available.
>
> Your file no. is 91055.
> PID: 027-068-129
> I've attached the mortgage and the priority agreement that were sent to our office.
>
> Our client is agreeable to providing your clients priority over our client's mortgage (second mortgage on the subject property), on certain terms and conditions.
> The terms and conditions that would be included in the priority agreement would added to ensure that any monies advanced under your client's mortgage will be used for improvement the subject property (and nowhere else).
> Our client anticipates being able to provide you with the revised terms of the priority agreement shortly.
>
> In anticipation of the above, can you advise our client the following information:
> a) Do you know what the current balance is under the first mortgage held by Reliable Mortgages and Canadian Western?
> b) Will the funds advanced under this new anticipated mortgage (the $10M mortgage) be used to pay out the first mortgage?

[36] No party took issue with the email coming from 625's lawyer rather than from 625 directly. It is clear that notice can be given by or on behalf of a charge holder: *Stoimenov v. Stoimenov*, (1985), 50 O.R. (2d) 1 at 7 (C.A.); *Shinder v. Shinder,* 2018 ONCA 717 at para. 50. The judge found, however, that the email from 625's lawyer did not amount to notice to the First Mortgagees under s. 282(2)(b), saying:

> [299] At best, Ms. Zheng's email is simply a discussion about a priority agreement between 625 and an entirely different party, namely the Second Mortgagees. She does not even refer to the "registration" of the 625 Mortgage, which is, at a minimum, what s. 28(2)(b) requires. In addition, RMIC was not by any stretch a participant in those discussions and certainly not in any way such that Mr. Mercier would then reasonably understand, in his capacity as a principal of RMIC, that this formal notice was being given.
>
> [Emphasis added.]

[37] 625 contends that this approach is a triumph of form over substance, since the purpose of the written notices is to ensure a prior mortgagee does not unwittingly advance funds in ignorance of the existence of the subsequent charge holder which would result in the loss of its priority. When the prior mortgagee knows the second mortgagee is there, 625 submits no purpose is served by requiring a particular form of notice — any written reference to the mortgage should suffice. At the hearing before us, 625 went so far as to submit that where a prior mortgagee has actual knowledge of a subsequent mortgage, written notice should be presumed.

[38] I acknowledge that proof of actual knowledge is one logical way to draw the line on tacking, but it is not in my view the solution adopted by the Legislature, and the words of the statute cannot be ignored. Unlike the analogous provision in Ontario, (*Registry Act*, R.S.O. 1990, c. R. 20 s. 73) for example, the legislation in British Columbia does not require "actual notice". If it did, I would agree with 625 that the First Mortgagees' priority had been lost. Instead, the statute specifies that the prior mortgagee must have "received notice in writing of the registration of the subsequent mortgage … from its owner…" The Law Reform Commission of British Columbia in its 1986 Report on Mortgages of Land: Priority of Further Advances, commented on the formality of this requirement, saying:

> Paragraph (b) of section 24(1) [now 28(2)] gives the earlier mortgagee priority for advances made without notice of the intervening interest. It may be observed that the notice must be in writing and must be "received" by the prior mortgagee. This imposes on the subsequent encumbrancer a standard of conduct in relation to the notification which is virtually the same as that required for service of a writ of summons. He may not rely on the more relaxed standards attached to the word "deliver" in section 29 of the *Interpretation Act*.
>
> [Emphasis added.]

[39] The respondents say the judge's interpretation of s. 28(2)(b) cannot be characterized as unduly formalistic. To the contrary, they say it is "duly formalistic" given the significant consequences of notice and the realities of commercial construction lending. In this regard, the judge considered 625's knowledge that the First and Second Mortgagees were making significant advances directly to trades or to the Borrower in order to fund the ongoing construction of the development. The Borrower provided 625 with binders each month showing the construction invoices that were being funded by the Second Mortgagees and later by the First Mortgagees: at para. 143. In this regard, the judge said:

> [285] The fact that this "actual notice" must be in writing and received by the mortgagee is the *formal* step by which the prior mortgagee is afforded the means by which it can make an informed decision as to its actions going forward. As stated in *Stoimenov*, the "actual notice" of the registration must be "express and direct". This comports with Satanove J's comments in *AOTK* at para. 12, where she stated that the requirement of actual notice protects a "first mortgagee from losing its priority unwittingly". This prevents the mischief of subsequent charge holders "lying in the weeds" and later seeking to take advantage of the prior mortgagee who continued to make advances in good faith.
>
> …
>
> [300] The concern arising from the circumstances by which [625] did not give any formal notice to RMIC of the registration is that identified by Satanove J. in *AOTK*. 625 was happy to "lie in the weeds" and allow RMIC to continue to advance funds to 098 that Mr. Gosal saw as being to 625's benefit. It can be safely assumed that 625 would have not viewed its third position on a failed and incomplete real estate development project as a beneficial outcome toward repaying its loan. Having only recently seen the potential jeopardy now faced by 625 in respect of its priority, 625 now seeks to claim the benefit of that funding by subordinating these advances to 625's position.
>
> [Emphasis added.]

[40] I agree with the judge that the Legislature chose to address priority issues associated with tacking by imposing on the subsequent mortgage holder the obligation to give a prior mortgagee express written notice of registration. It is a simple step for a subsequent mortgagee or encumbrancer to take. It is intended to clearly import to the earlier mortgagee that a line has been drawn, and that future advances under the prior mortgage will no longer rank in priority. That direct and express notice alerts the prior mortgagee so that it can, if it wishes, take steps to

protect itself — steps that may include the cessation of further advances or the insistence on a priority agreement before further advances are made.

[41] To succeed on this ground of appeal, 625 must establish that the judge made a palpable and overriding error in finding that the December 29 email did not amount to notice under s. 28(2)(b) of the *Property Law Act*. With respect, I see no such error. The judge concluded that a passing reference to 625's Mortgage in an email among legal counsel discussing the terms of a priority agreement between 625 and the Second Mortgagees did not constitute notice to the First Mortgagees. That is, in essence, a finding of fact made on the evidence before her, in the context of a complex series of interrelated lending agreements with respect to which she was highly familiar as the case management judge. In my view, the judge's findings in this regard are supported by the evidence and entitled to deference. I see no basis upon which this Court could properly interfere with those findings and accordingly would not accede to this ground of appeal.

3. Did the judge err in the remedy applied to address the criminal interest rate in the Second Mortgage?

[42] The judge found the Second Mortgage provided for a rate of interest in excess of 60%, contrary to s. 347(1) of the *Criminal Code*, R.S.C. 1985, c. C-46, based on the following terms (at para. 233):

> 1) A total secured amount of $10 million, of which $6 million would be advanced to [the Borrower] in the form of draws, and the remaining $4 million would be paid to the lenders as fees;
>
> 2) A balance due date of February 1, 2016 (i.e. a one-year term); and
>
> 3) An interest rate of 12%, payable monthly in amounts of $100,000.

That finding is not challenged on appeal. The actuarial evidence accepted by the judge established an effective rate of interest of 91.28%, primarily due to the two $2 million lender/broker fees which are defined as interest under s. 347(2).

[43] 625's complaint is with the remedy fashioned by the judge, which it says actually increased the amount of interest due under the Second Mortgage over the long run, to the prejudice of 625's recovery in the foreclosure proceedings.

[44] In order to assess this ground of appeal, it is necessary to review in some detail the judge's reasons for judgment on this issue. She began by noting that the court has considerable discretion to fashion a remedy when a contract calls for a criminal interest rate which is a statutory illegality (at para. 238), quoting from *Transport North American Express Inc. v. New Solutions Financial Corp.*, 2004 SCC 7, in which the majority said:

> 6. A spectrum of remedies is available to judges in dealing with contracts that violate s. 347 of the *Code*. The remedial discretion this spectrum affords is necessary to cope with the various contexts in which s. 347 illegality can arise. At one end of the spectrum are contracts so objectionable that their illegality will taint the entire contract. For example, exploitive loan-sharking arrangements and contracts that have a criminal object should be declared void *ab initio*. At the other end of the spectrum are contracts that, although they do contravene a statutory enactment, are otherwise unobjectionable. Contracts of this nature will often attract the application of the doctrine of severance. The agreement in this case is an example of such a contract. In each case, the determination of where along the spectrum a given case lies, and the remedial consequences flowing therefrom, will hinge on a careful consideration of the specific contractual context and the illegality involved.
>
> [Emphasis added.]

[45] The judge noted there was no suggestion that the Second Mortgage should be declared void *ab initio*. The question was, rather, whether the agreement should be severed or read down so as to be legally enforceable: para. 240. She set out the four factors to be considered in accordance with *Transport* at para. 241:

> 1. whether the purpose or policy of s. 347 would be subverted by severance;
>
> 2. whether the parties entered into the agreement for an illegal purpose or with evil intention;
>
> 3. the relative bargaining position of the parties and their conduct in reaching the agreement; and
>
> 4. the potential for the debtor to enjoy an unjustified windfall.

[46] The judge concluded that the Second Mortgage was not a loansharking transaction, but a commercial lending transaction and that the policy underlying s. 347 would not be subverted by severance or a reading down of the interest rate to the legal limit of 60%: paras. 245–246. The judge found, however, that the Second Mortgagees had been reckless as to the legality of the interest rate: paras. 251–253.

As to the relative bargaining power of the parties, she noted that all parties had legal counsel and were experienced developers and lenders. She recognized that the Borrower had few options but that "this was … a real estate play and [the Borrower] knew how to play that game": para. 258. She found the third factor strongly favoured "a remedy that respects the parties' intentions as to the cost of credit": para. 259. In relation to the fourth factor she said:

> [261] … each party had independent advice and knew the obligations they were taking on. In my view, it is significant that this was a very risky transaction from the lenders perspective. The First Mortgage was already in default. 098 had exhausted all other means of refinancing the Development. The Second Mortgagees were being asked to lend into a construction scenario that they had not initially anticipated. As Mr. Mercier noted in his evidence, he concluded that Forjay had no choice but to continue funding to avoid the disastrous consequences of a shutdown of the project.
>
> [Emphasis added.]

[47] Having considered all of the factors and circumstances, the judge severed one of the $2 million lender/broker fees, increased the interest for $10 million of the advances from 12% to 18% per annum, and ordered that the overall effective annual interest rate was not to exceed 40%.

[48] 625 says that the remedy fashioned by the judge constitutes an error in principle for two reasons. First, the remedy chosen was not open to her on the governing jurisprudence. Second, the remedy actually rewarded the Second Mortgagees who had contracted for an illegal interest rate by increasing the amount they would be paid, all to the prejudice of 625 who had no part in that illegal contract. Although the interest rate provided for in the Second Mortgage exceeded 60% based on a one-year term, the Borrower defaulted and has never paid interest. As a result, at the time of trial, interest had accumulated not just for the one-year term of the contract, but for three years and counting — at 18% rather than 12%.

[49] As the judge acknowledged, she did not have the benefit of a calculation showing the effect of the order she made. She therefore worked in a "safeguard" of a 40% cap on the effective annual rate of interest in any given year. While that cap and the severance of one of the $2 million fees may have worked to 625's

advantage in the initial period of the mortgage loan, 625 says that in the long run, the change in the contractual rate of interest from 12% to 18% does exactly the opposite.

[50] I note that the precise remedy chosen by the judge was not proposed by any party. At trial the Borrower said the $4 million in lender/broker fees should be severed and the Second Mortgagees should recover interest at 12% per annum. Forjay agreed that the $4 million in lender/broker fees should be severed but proposed an interest rate of 18%. CWT and HMF submitted that the Second Mortgage should be read down to the legal rate of interest at 60%. In the alternative, they suggested the Court should strike the obligation to pay interest annually; or strike one of the $2 million lender/broker fees.

[51] The remedy imposed was an amalgam of the various proposals. For the reasons that follow, and with great respect to the judge, I am of the view that she erred in principle in the exercise of her remedial discretion.

[52] First, the judge understood *Transport*'s "spectrum of remedies" to include a reading down to any legal rate of interest in combination with severance and/or modification of terms. In my view, the spectrum of remedies identified at para. 40 in *Transport* is much narrower. It consists of three options:

1) voiding the contract *ab initio*;

2) striking out a term or terms of the contract; or

3) reading down the interest rate to 60%.

[53] The issue in *Transport* was whether the remedy of "notional severance" — i.e., reading down the criminal interest rate to 60% — was available in addition to the traditional options of either declaring the contract to be void *ab initio* or applying "blue-pencil severance" i.e., striking out particular terms of a contract. Originally, courts took the view that a contract with an illegal rate of interest was void *ab initio* and could not be enforced. This was a harsh remedy which resulted in the borrower

receiving a windfall because the lender could not even recover its principal. In order to avoid this, courts began applying the notion of “blue-pencil severance”, striking the illegal portions of a contract but leaving the remaining parts intact. This nonetheless did violence to the intentions of the parties because, although the lender could then recover its principal, a negotiated interest rate which inadvertently contravened s. 347 could result in no interest being payable on a high risk loan. It also led to arbitrary rates of recovery determined by the particular wording of the contract, as described in *Transport* at paras. 34–38.

[54] The credit agreement in *Transport* provided for an interest rate of 60.1% per annum and other fees and charges which added a further 30.8% per annum, for an effective rate of 90.9%. The application judge decided to employ “notional severance” to cap the effective annual interest rate at 60%. A majority of the Ontario Court of Appeal (Sharpe J.A. dissenting) ruled notional severance was not available as a remedy; the only alternative to finding the contract void *ab initio* was blue pencil severance, the removal of specific terms. The majority therefore varied the judge’s order by severing the provision for 60.1% interest, resulting in an effective interest rate of 30.8%.

[55] An appeal to the Supreme Court of Canada was allowed. The majority agreed with Sharpe J.A. that it was open to a court to impose notional severance by “reading down” the illegal interest rate to 60%. The court observed that this remedy has the advantage of respecting the parties’ contractual intentions by giving the greatest possible legal effect to the interest rate expressed in the agreement: *Transport* at para. 37.

[56] This Court addressed notional severance in *Wei v. Li*, 2019 BCCA 114. In that case, the respondent had successfully claimed for the enforcement in British Columbia of two judgments obtained in China. The Chinese judgments provided for an interest rate of 73%. The trial judge found that, although a domestic court generally cannot rewrite a foreign judgment, the interest provision could not be left as it was given that it ran afoul of the criminal interest rate prohibition in Canada. He

therefore changed the interest rate to 60%. Newbury J.A. writing for the majority on appeal stated that "*Transport North American Express Inc. v. New Solutions Financial Corp.* calls for the severance of a criminal rate of interest and its replacement by the rate of 60% where the four criteria … are met" (para. 42) and concluded that the trial judge did not err in replacing the interest rate with a rate of 60%. To similar effect is *Chong v. Abrahams*, 2017 ONSC 3663, a case in which the interest rate was read down from 120% to 60% per annum.

[57] To the contrary is *Eha v. Genge*, 2007 BCCA 258. In that case a pawnbroker who experienced financial difficulties borrowed funds from a friend at an interest rate of 120% per annum. The respondent, who appeared in person, had not defended the claim on the basis of the illegal interest rate, instead making a counterclaim which would have offset the debt. The appellant had at trial acknowledged the criminal interest rate and sought repayment of the $32,000 loan plus interest of 60% or, in the alternative, court order interest (at para. 7). The trial judge refused to enforce the illegal agreement entirely, finding it void *ab initio*. In an oral decision, this Court found the trial judge had failed to adequately engage in the required contextual analysis set out in *Transport* and concluded it would not be appropriate to permit the borrower to evade responsibility for repayment of the principal amount — the main issue on appeal. The borrower was ordered to repay the principal plus court order interest. The Court did not give reasons for selecting the alternative form of interest sought by the appellant rather than the statutory maximum of 60%.

[58] *Transport's* use of the terms, "flexibility", "a spectrum of remedies" and "remedial discretion" was the subject of comment by Professor Waddams in an article entitled "Illegal Contracts, Severance and Public Policy" (2005) 42 Can. Bus. L.J. 278 at 281:

> … I would hope that the references to a flexible remedy and a spectrum do not imply that a judge might select any interest rate between zero and 60% according to his or her view of the culpability of the lender and the appropriate punishment. This would be, in my opinion, to make the rights of the parties to a civil dispute depend too much on considerations more appropriate to the criminal law. I would suggest also that "order" or "disposition" might be a better word in this context than "remedy". The court is

> not here granting a remedy to the borrower for the lender's wrong; still less is it granting a remedy to the lender for any wrong of the borrower's. It is enforcing a contract, but, for reasons of public policy, not to its full extent, and the question in issue is, "To what extent does public policy prevent enforcement of this contract?" The answer will vary with the circumstances of the case, but this is not the same as saying that it is discretionary.
>
> [Emphasis added.]

In my view there is merit to this perspective.

[59] In summary, I am respectfully of the view that the judge erred in principle in assuming she had wide-ranging discretion to alter the contractual rate of interest, sever terms and impose an effective rate of interest falling somewhere below 60% based on what she considered to be commercially and contextually reasonable. Having determined that the contract should not be declared void *ab initio* in these circumstances, it was open to the judge to either sever particular terms (which could have resulted in an effective annual rate of less than 60%) or leave the terms intact and notionally sever the interest rate to an effective annual rate of 60%. I would accordingly accede to this ground of appeal, leave the original terms of the Second Mortgage intact, including the 12% interest rate, and cap the effective annual interest rate at 60%.

4. Applications on appeal

[60] I turn finally to two preliminary applications made by the respondents which the division determined should be addressed in these reasons.

[61] The first is an application to admit new evidence in the form of an affidavit sworn by Mr. Gosal, the principal of 625. That affidavit was filed after the release of the judgment below, in support of a motion 625 filed to determine the amounts secured under its mortgage. The affidavit is said by the respondents to demonstrate that 625 took the position that monies advanced as protective disbursements to address builders liens constituted secured advances under its mortgage — a position the respondents say is inconsistent with 625's first ground of appeal asserting that advances beyond the face amount of principal are not secured.

[62] Having concluded that the respondents should succeed on the first ground of appeal based on the record below, it is not necessary to address the application to adduce new evidence. I note in any event that Mr. Gosal's personal view of what constitutes a secure advance under 625's Mortgage is not of particular assistance to the Court in interpreting the terms of the First and Second Mortgages.

[63] The second application is of greater import. The respondents say 625 should be precluded from challenging the criminal interest remedy imposed by the judge because 625 did not engage on that issue at trial, and to permit them to do so now would significantly prejudice the respondents.

[64] By way of background, in March 2019, 625 along with CWT and HMF sought leave to appeal the judge's orders. No party raised the criminal interest rate issue, or its remedy, in their notices of application for leave to appeal or memorandum of argument on the leave applications.

[65] In mid-April 2019, Forjay, RMIC, HMF and CWT and their principals entered into negotiations which resulted in the settlement of the claims among them, including CWT and HMF's abandonment of its outstanding leave application. It was understood by those parties during their negotiations that the criminal interest rate issue and its remedy were no longer live issues as no party had sought to appeal that part of the receivership judge's order.

[66] On May 2, 2019, 625's leave application was heard. Consistent with its memorandum of argument, 625 argued only two issues: first, the priority of advances under the mortgages beyond the principal amount stated in Form B; and second, whether 625 had provided notice in accordance with s. 28(2)(b) of the *Property Law Act*. 625 was granted leave to appeal that day. The next day, May 3, 2019, the respondents and the other settling parties executed a written agreement formalizing their settlement. They say they relied on the fact that the broker's fees and interest rate payable under the Second Mortgage were no longer at issue and that the amount secured under the mortgages was known. The respondents contend

they will be prejudiced if 625 is allowed on appeal to resile from its "strategic decision" at trial not to engage in the criminal interest rate issue.

[67] In my view it would not be appropriate to grant the order sought to preclude 625 from raising this ground of appeal for three main reasons. First, 625 was granted leave to appeal the summary trial judge's order at large and therefore had leave to appeal all terms of the order, including the criminal interest rate remedy. That fact was known to the respondents before they entered into the settlement. Further, the respondents have known since June 7, 2019, before any funds were distributed under the settlement agreement, that 625 intended to challenge the criminal interest rate remedy on appeal.

[68] Second, this is not a situation in which a party has made a strategic decision and then changed its position on appeal. 625 was content to let the other parties carry the issues relating to the criminal interest rate and its remedy — issues fully aired and argued below. 625 did not concern itself with the remedy because no one proposed or anticipated the remedy ultimately granted by the judge — a combination of the removal of one fee, an increase in the contractual interest rate due on the first $10 million advanced, and an overall cap of 40%. In other words, 625 had no reason to believe that any remedy aimed at reducing the interest rate payable to the Second Mortgagees would actually increase the overall interest they would be entitled to be paid under their mortgage ahead of 625.

[69] Third, the respondents candidly conceded at the hearing of the appeal that they do not know whether the notional severance to 60% would actually result in prejudice to them by making the settlement they entered into improvident. The calculations are still a moving target.

[70] In summary, I would dismiss the respondents' applications to adduce new evidence and to preclude 625 from raising the third ground of appeal.

Disposition

[71] I would allow the appeal only to the extent of setting aside para. 8 of the order and substituting the following:

> The rate of interest agreed to be paid under the Second Mortgage constitutes a violation of section 347(1) of the *Criminal Code*; the effective annual interest rate of the Second Mortgage cannot exceed 60% per annum.

"The Honourable Madam Justice Fenlon"

I AGREE:

"The Honourable Madam Justice Dickson"

I AGREE:

"The Honourable Mr. Justice Butler"