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Court refuses to enforce mortgage prepayment penalty

By James R.G. Cook

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Many Canadian mortgages have a prepayment term that imposes a penalty if the mortgage advance is repaid by the borrower before the maturity date. The general purpose of such a term is to provide compensation to the lender for the unanticipated time required to find another borrower of the funds, in contrast to the maturity date where the lender expects to take steps to prepare to reinvest the funds. The specific penalty imposed by a prepayment term, if any, depends on the wording of the mortgage contract between the parties.

A recent Ontario Superior Court of Justice decision, *2598508 Ontario Inc. v. 2394049 Ontario Inc. o/a Goodman Green Solutions*, [2021 ONSC 5293 \(CanLII\)](#) involved a dispute over the interpretation of a prepayment clause in a mortgage, which stated:

provided that upon giving at least one month's written notice, the Borrower, when not in default hereunder and having never been in default,

shall have the right to prepay the whole or any part of the principal outstanding plus interest accrued, all applicable fee(s), costs, and other sum which may be due as herein set out (the "Mortgage Due") on any monthly payment date.

The mortgage had a maturity date of December 6, 2018, and the mortgagor had not been in default at any time. On November 8, 2018, the mortgagee's lawyer sent a letter to the mortgagor confirming that the maturity date was approaching and advising as to the consequences under the terms of the mortgage if it was not paid on the due date.

On November 15, 2018, the mortgagor's lawyer requested a payout statement for discharge purposes. He advised that the mortgagor had arranged for new financing with a closing date scheduled for November 22, 2018, and requested that the payout amount be calculated as of that date.

On November 20, 2018, the mortgagee's lawyer forwarded a discharge statement that included a prepayment charge based on one month's interest calculated from the maturity date of December 6, 2018, to January 6, 2018.

A barrage of correspondence ensued between the parties and their lawyers. The mortgagor took the position that since it was going to pay back all the principal and interest that would be due under the mortgage as of December 6, 2018, no prepayment penalties could be charged even though it was doing so two weeks before the maturity date. The mortgagee disagreed, arguing that proper notice had not been provided under the terms of the mortgage.

As the dispute could not be resolved prior to the refinancing date, the mortgagor paid one month's interest penalty under protest and commenced a court application to have the issue determined.

In response to the application, the mortgagee took the position that the parties had reached a settlement at the time the prepayment was made, and if not then it was actually entitled to charge three months' interest (not just one month) pursuant to the terms of the mortgage.

In a July 2021 [decision](#), the court rejected the mortgagee's argument that a settlement had been reached. There was no written communication (e-mail, letter, release, minutes of settlement, etc.) between counsel or the parties confirming the alleged agreement. There was conflicting evidence as to telephone communications between the lawyers for the parties and the court was not persuaded that a binding settlement had been reached.

As to the prepayment issue, the court focused on the words of the mortgage as a matter of contractual interpretation.

The court noted that very few Canadian cases and legal authorities discuss the meaning of the word "prepayment" in the context of a mortgage. Prior disputes have mainly addressed whether the definition of "prepayment" includes involuntary prepayments made when a lender calls the loan. The court noted that such authorities were of limited utility to the current dispute given that there was no question that the prepayment of the mortgage was voluntary.

The court agreed with the mortgagor that the prepayment clause was a term for its benefit pursuant to which it could save interest due over the remaining term of the mortgage. The prepayment clause provided that the mortgagor "shall have the right to prepay the whole or any part of the principal outstanding plus interest accrued". However, the defined term "Mortgage Due" only encompassed interest accrued as of the prepayment date. As the mortgagor did not pay interest accrued as of November 22, 2018, but rather interest up to the maturity date (December 6, 2018), it did not exercise its right under the prepayment clause to pay the principal outstanding and only the interest accrued as of the payment date. The court found that the prepayment clause was therefore not triggered.

Since the mortgagor did not properly invoke the prepayment clause, and the mortgagor did not seek to pay a reduced amount of interest under the mortgage, the court concluded that the mortgagee could not impose a prepayment charge. The court based its conclusion on the wording of the prepayment clause and reasoned that this was consistent with the fact that a prepayment privilege is normally associated with the waiver of interest not yet due.

As a result, the court found that the mortgagee improperly imposed a one month's interest



prepayment charge pursuant to the prepayment clause in order to discharge the mortgage on November 22, 2018, and the mortgagor was entitled to the return of that fee, which was paid under protest.

This was not the end of the matter, however. The court determined that while the prepayment clause was not triggered, the mortgagor's payment on November 22, 2018, was nevertheless a breach of the mortgage. Even though the mortgagor paid the full amount of interest payable under the mortgage, repayment was not allowed before December 6, 2018.

This conclusion was supported by the other agreements signed by the parties. The mortgage commitment provide that early payment was allowed upon one month's notice on payment date, which was not provided by the mortgagor. Further, a Mortgage Loan Agreement and Disclosure also stated that, after the first six months, the mortgage was "fully open on with one month's notice on payment date."

The court concluded that the fact that the payment was made only two weeks before the maturity date, and that it may have been reasonable to expect that the mortgagee would be accommodating and accept payment a few days early, this did not change the express terms of the mortgage regarding when payments can be made.

Nevertheless, the mortgagee did not adduce any evidence that it suffered any damages as a result of receiving payment of the mortgage two weeks early. In the absence of evidence regarding any damages as a result of the mortgagor's breach of contract, the mortgagee was not entitled to an order for damages.

In the result, the court found that the

prepayment charge imposed by the mortgagee was improper as the prepayment clause was not triggered. While the mortgagee might have been entitled to damages resulting from the mortgagor's early repayment, it failed to establish any damages as a result of the mortgagor's breach. The mortgagor was awarded costs of \$60,000 as a result of its success in the proceedings: [2021 ONSC 6050 \(CanLII\)](#).

As noted by the court, there have been few cases addressing voluntary early prepayment disputes. The decision demonstrates that such disputes turn on the wording of the written mortgage agreements between the parties, and such terms ought to be carefully reviewed before making any decisions to prepay a mortgage—or to impose any penalties relating to such prepayment—before maturity.

Contact us

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