

Mortgage lender did not breach duty of honest contractual performance

Commercial Real Estate | Litigation | Litigation & Dispute Resolution | Ontario Mortgages Act | Real Estate

25 October 2021

A mortgage lender enforcing its rights under a mortgage may owe the borrower a duty to do so honestly and in good faith. However, this does not mean that a lender must refrain from taking steps that it is entitled to do to protect its interests even though the consequences to the borrower may be harsh.

In *2343680 Ontario Inc. v. Bazargan*, 2021 ONSC 6752 (CanLII), the defendant borrowers were the owners of a large, single-family residence in an affluent neighbourhood in Whitchurch-Stouffville, Ontario. On December 8, 2017, they entered into a first mortgage with MCC Mortgage Holdings Inc. ("MCC") for \$1,608,750, at 7.29% per annum, with monthly interest-only payments of \$11,557.45.

On the same date, the defendants entered into a second mortgage with the plaintiff numbered corporation in the amount of \$371,250, with an interest rate of 13.99% per annum. The second mortgage required interest-only payments of \$4,328.16 per month, commencing 1 January 2018, with the balance due in full on December 8, 2018.

In total, the defendants mortgaged their property in the combined amount of 1,980,000. Their monthly, interest-only, payments totalled \$15,885.61.

The defendants struggled to make the payments on the second mortgage almost from the outset. By the summer of 2018, they were struggling to keep both mortgages current.

No further interest payments were made on the second mortgage after 17 October 2018, and the principal was not repaid when it came due on December 8, 2018.

MCC initiated power of sale proceedings. On 22 October 2018, the plaintiff paid \$25,726.43 to MCC to bring the first mortgage into good standing. The power of sale was thereby averted. The plaintiff thereafter paid further sums due on 1 November 2018, to keep the first mortgage in good standing.

On December 14, 2018, the plaintiff bought out MCC's first mortgage for \$1,598,782.35. This did not improve the situation with the defendants, however, and the plaintiff commenced an action to enforce the mortgages.

The defendants made no further payments towards the outstanding mortgages, with one exception consisting of an interim payment of \$50,000 in December 2020, required by court order.

On 14 September 2021, the Ontario Superior Court of Justice heard a motion for summary judgment brought by the plaintiff. By that point, the plaintiff was seeking \$2,481,321.84.

In response to the plaintiff's claim, the defendants alleged, amongst other things, that the lender had breached a duty of honest contractual performance.

A trilogy of cases released by the Supreme Court of Canada has affirmed two "good faith" doctrines, namely the duty to act honestly in the performance of contractual obligations and the duty to exercise contractual discretion in good faith: see *Bhasin v. Hrynew*, 2014 SCC 71; *C.M. Callow Inc. v. Zollinger*, 2020 SCC 45; and *Wastech Services Ltd. v. Greater Vancouver Sewerage and Drainage District*, 2021 SCC 7.

Gardiner Roberts

Bay Adelaide Centre — East Tower
22 Adelaide Street West, Suite 3600
Toronto, ON M5H 4E3

Phone: 416.865.6600
Fax: 416.865.6636
contactGR@grllp.com

Mortgage lender did not breach duty of honest contractual performance

The duty to act honestly, however, is not an obligation of honesty “at large.” It is directly linked to performance of the contract and does not turn a contractual party into a fiduciary or impose any broad obligations of loyalty or trust. Rather, the duty requires that parties generally perform their contractual duties honestly and reasonably, and that “they must refrain from lying or knowingly misleading another contracting party” (para.28).

In response to the lender’s summary judgment motion, the borrowers argued that one of the plaintiff’s representatives had misled them into believing that she was working in their best interests to sort out a renewal of the first mortgage when in fact she was really looking to take it over and apply a higher interest rate (13.99%). The defendants claimed that they could have arranged new financing at a better rate but were thwarted because the plaintiff provided them with an inflated discharge statement, based on the application of a 13.99% interest rate to the balance owing on the first mortgage.

The court assessed the allegations raised by the defendants and found them to be without merit. Specifically, while the defendants complained that the plaintiff initially sought to recover 13.99% interest on the balance it paid to buy out the first mortgage, the court found that this was in fact consistent with the terms of the mortgage. Further, since the defendants never actually paid the 13.99% interest on the balance owing there was no consequence to the initial demand.

Next, the defendants argued that they had not been given the opportunity to negotiate a schedule of terms of additional provisions to the mortgage and that it was—like most terms and conditions—a “take it or leave it” schedule. The court noted that this might be a case of hard bargaining, but it was not dishonest performance as the defendants always had the option to “leave it”. Instead, they agreed to it.

The defendants then argued that the plaintiff had induced them to breach the terms of the first mortgage. However, the court found that the defendants had breached the terms all on their own by failing to make timely interest payments. There was no evidence that the plaintiff encouraged, much less induced, the defendants not to make payments to MCC as they fell due. Nor was the plaintiff estopped from paying out the first mortgage merely because it had previously brought it into good standing. In most cases, the court noted, it is not in the interests of a second mortgagee for a first mortgage to go into default, and the steps taken by the plaintiff were those permitted under the terms of the mortgage.

There was some suggestion of illegality raised by the defendants, as the plaintiff was not licensed under the [Mortgage Brokerages, Lenders and Administrators Act, 2006](#) as a mortgage broker, mortgage lender, or mortgage administrator. However, whether a license was required to conduct the plaintiff’s business was not established in the evidence and it was not the court’s responsibility to develop or substantiate allegations loosely made by the defendants.

Lastly, the defendants argued that they had been duped by the plaintiff into allowing the first mortgage to go into default so that the plaintiff could take it over and charge them 13.99% interest on the combined value of the two mortgages. The court rejected this position entirely. One of the defendants was a successful immigration consultant with some legal training and not some naïve borrower who could not understand the plaintiff’s actions as lender.

In sum, the court concluded that the plaintiff lender had not breached any duties of honest contractual performance. The plaintiff did not mislead the defendants with respect to any of the terms of the mortgage contract and acted pursuant to the agreed-upon terms to protect its interests as a second mortgagee.

The defendants’ assertion of bad faith dealing was the legal equivalent of a “Hail Mary” pass and was rejected.

The decision reflects the increasing acceptance of courts to assess the duty of honest contractual performance and shows that the doctrine may apply to the performance of a lender’s obligations under a mortgage. While the consequences to a borrower may seem harsh, a lender’s exercise of rights that are expressly permitted under a mortgage agreement will rarely equate to dishonest performance. A PDF version is available to download [here](#).

For more information please contact: **James Cook** at **416.865.6628** or jcook@grllp.com

(This blog is provided for educational purposes only, and does not necessarily reflect the views of Gardiner Roberts LLP).

Author



James R.G. Cook

Partner

416.865.6628

jcook@grllp.com