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Pay to Play: Court of Appeal Enforces Full Payment of Lender Fee

Barring a very narrow set of circumstances, sophisticated parties with equal bargaining power are generally held to the terms of their agreement. *660 Sunningdale GP Inc v First Source Mortgage Corporation* is a recent example where a commercial developer, 660 Sunningdale GP, was ordered to pay the entirety of the lender fee to the lender, First Source Mortgage Corporation, even though the loan did not proceed.

In this case, as is standard in many lending agreements, the agreement required the developer who sought financing to pay a lender fee to the lender. Critically, the lender fee was deemed to be earned upon the acceptance and execution of the agreement. The fee was to be partially paid at the time the agreement was accepted and executed, with the balance to follow.

The developer made partial payment upon executing the commitment letter, but then decided not to proceed with the loan or to pay the balance of the lender fee. After certain negotiations, the balance of the lender fee was placed in trust pending the outcome of the litigation.

The Motion Judge found that the unpaid portion of the lender fee was an unenforceable penalty clause and that relief against forfeiture was appropriate in the circumstances. The Court of Appeal for Ontario (Justices Paciocco, MacPherson, and Miller) reversed the decision and found that:

- the obligation to pay the lender fee did not arise from a breach of any sort and, as such, the payment clause was not an unenforceable penalty clause; and
- relief against forfeiture did not apply because the obligation to pay did not arise from any non-compliance with the contract by the developer.

The Court of Appeal took this opportunity to provide a straightforward analysis on what constitutes a penalty clause and when relief against forfeiture may be available. We provide the highlights below.

Lender Fee is Not a Penalty

The Panel found that the Motion Judge erred by applying the law of unenforceable penalty clauses to relieve the developer/borrower from its agreement to pay the balance of the lender fee. Citing *Peachtree II Associates – Dallas LP v 857486 Ontario Ltd,* Justice Paciocco stated that "common law unenforceability of extravagant penalty clauses and equitable relief against unconscionable forfeiture clauses have the effect of relieving the breaching party of the penal consequences of stipulated remedy clauses." Here, the law on penalty clauses was irrelevant because the lender fee was payable regardless of whether the contract was breached:

> [5] …under the terms of the Loan Agreement, the balance of the Lender Fee was not a 'stipulated remedy' for a breach of the contract. Rather, the balance was payable whether or not the contract was breached. In effect, the motion judge excused 660 Sunningdale [the Developer] from its obligations under a term of the Loan Agreement…"

The Panel simply could not defer to the interpretation below. The Motion Judge did not address whether the lender fee was payable as a remedy for a breach but rather whether the lender fee was extravagant or unconscionable.

Relief Against Forfeiture is Not Appropriate

Relief against forfeiture is only appropriate to relieve a party of the consequences of its non-observance or breach of the terms of a contract. Here, the Motion Judge granted relief against forfeiture from a contractual payment obligation without any finding that there was any non-observance of the loan agreement.

In effect, the Motion Judge erroneously applied the doctrine of unconscionability, which is limited to unfair agreements that have resulted from inequality of bargaining power. The parties to this loan agreement were clearly sophisticated:

> [54] … There was no suggestion in the motion judge's decision that she considered whether there was an inequality of bargaining power between the parties to the Loan Agreement. Moreover, it bears notice that 660 Sunningdale appears to be a commercial developer capable of handling a largescale development, not a disadvantaged consumer. I am satisfied that the motion judge invalidated the terms of the contract relating to the balance of the Lender Fee, without complying with the limits of the doctrine of unconscionability that she was

> effectively applying.

Justice Paciocco further noted that the Motion Judge appeared to conclude, as an alternative, that the developer should receive the return of the balance of the lender fee because it was not earned, as the loan had not been advanced. However, the plain wording of the loan agreement was that the lender fee was deemed to be earned at the time of the acceptance and execution of the agreement, and included a provision that provided an alternative mode of payment if the loan was not advanced through no fault of the lender:

> [57] … Quite simply, in the face of these provisions, the motion judge could not have arrived at a conclusion that the balance of the Lender Fee would not be due without an advance unless she failed to consider the entire Loan Agreement…

In this case, the Court of Appeal demonstrates its willingness to hold sophisticated commercial parties without an inequality of bargaining power to the terms of their agreements. A lender fee is standard in loan agreements, and, as we have seen in this case, borrowers relying on the financing from lenders will have to pay in full regardless of if the loan eventually falls apart. It is important, however, that the terms of the agreement are drafted such that they can be comfortably relied upon in a dispute and protected from the types of arguments made in this case.