

**ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST**

B E T W E N:

EMERALD CASTLE DEVELOPMENTS INC.

Applicant

- and -

FAAN MORTGAGE ADMINISTRATORS INC., in its capacity as the Court-Appointed Trustee
of BUILDING & DEVELOPMENT MORTGAGES CANADA INC. formerly known as
CENTRO MORTGAGE INC., and OLYMPIA TRUST COMPANY

Respondents

APPLICATION UNDER SECTION 37 OF THE *MORTGAGE BROKERAGES, LENDERS AND ADMINISTRATORS ACT*, 2006, S.O. 2006, C. 29; SECTION 101 OF THE *COURTS OF JUSTICE ACT*, R.S.O. 1990 c. C. 43, and *Rule 14.05(3)(d) of the RULES OF CIVIL PROCEDURE*, R.S.O. 1990, Reg. 194, as amended

**RESPONDING FACTUM OF FAAN MORTGAGE ADMINISTRATORS INC. IN ITS
CAPACITY AS TRUSTEE OF BDMC**

October 8, 2020

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PART I - INTRODUCTION

1. The Applicant, Emerald Castle, owes almost \$30 million to 453 people through a Fortress syndicated mortgage loan brokered and administered by the Respondent, BDMC. In this application, Emerald Castle suggests that under the End of Term Event clause, it is entitled to pay only \$9.1 million to escape *all* obligations under the loan. In exchange for this partial payment, Emerald Castle states that it is entitled to extinguish the debt, receive a full discharge of the security it granted, receive a full release from BDMC and the Investors, *and develop the property on which the loan is secured for its sole benefit and future profit.*

2. In other words, the Emerald Castle Owners will be out of pocket only \$12.3 million¹ and will own the property worth around 2.5 times that much according to Emerald Castle's own evidence. The Investors will lose more than \$20.7 million² with no chance of future recovery.

3. This application should be dismissed because the End of Term Event clause is not enforceable. Under Emerald Castle's interpretation, the clause is manifestly unfair and was not adequately disclosed to the Investors. Applying well-established jurisprudence recently confirmed by the Court of Appeal, even if Emerald Castle did nothing wrong, the combination of manifest unfairness and lack of disclosure renders the clause unenforceable.

4. In this case, Emerald Castle was willfully blind to the manifest unfairness and poor disclosure to Investors. For example, Emerald Castle paid \$16.6 million for the property. Two years later Emerald Castle permitted Fortress to use a \$32 million "benchmark of value" that

¹ \$12.3 million = \$16.6 million (purchase price) - \$12 million (taken from Investors as "repatriation" of equity) - \$1.38 million (taken as management fees) + \$9.1 million (to be paid to Investors under this application)

² \$20.7 million = \$21.25 million (principal) + \$8.57 million (interest as at March 27, 2020 (17th Report)) - \$9.1 million (proposed payment by Emerald Castle)

Emerald Castle knew was not directly linked to fair market value to raise \$21.25 million from the Investors. Emerald Castle permitted Fortress and others to take \$7.45 million of the loan proceeds. Emerald Castle took \$12 million as a “repatriation” of its equity in the property and then placed a \$22 million mortgage on Castlemore to “secure its equity”. Emerald Castle then took an additional \$1.38 million in project management fees, although no construction occurred. In the circumstances, the End of Term Event clause should not be enforced.

5. In the alternative, if the End of Term Event clause on which Emerald Castle relies is enforceable, it permits Emerald Castle to make a partial payment and, in exchange, receive only a partial release of its security in the amount of the partial payment. On its face, the End of Term Event clause does not permit Emerald Castle to make a partial payment to the Investors, keep the property, and walk away from its remaining debt obligations, as Emerald Castle requests.

PART I - SUMMARY OF FACTS

The Parties

6. FAAN Mortgage Administrators Inc. is the Court-appointed trustee (“**Trustee**”) over BDMC (17th Report, Application Record (“**AR**”) Vol 3, Tab 7A). BDMC acted as lender in trust for the investing public (the “**Investors**”), who made loans to borrowers through syndicated mortgages (1st Report, AR Vol 3, Tab 7C pp. 61-62 ¶13).

7. BDMC was the principal mortgage broker and administrator used by Fortress Real Developments Inc. and affiliates (collectively, “**Fortress**”) (1st Report, AR Vol 3, Tab 7C pp. 61-62 ¶13). At Fortress’ request, BDMC raised initial financing from Investors for early-stage real estate developments (1st Report, AR Vol 3, Tab 7C pp. 61-62 ¶13), including a 48-acre parcel of land in Brampton (“**Castlemore**”) (1st Auciello Aff’t, AR Vol 1, Tab 2 pp. 20-21 ¶2, 9).

8. Emerald Castle Developments Inc. (“**Emerald Castle**”) owns Castlemore. Emerald Castle has five beneficial owners (collectively, the “**Emerald Castle Owners**”) (17th Report, AR Vol 3, Tab 7 pp. 17-18 ¶30).

Castlemore and the Related Loan to Emerald Castle

9. Emerald Castle purchased Castlemore in 2012 for \$16.6 million (1st Auciello Aff’t, AR Vol 1, Tab 2 p. 20 ¶2 and Ex. A, AR Vol 1, Tab 2A). Two years later, Emerald Castle used \$32 million as the “the benchmark of value” for the loan (Cross, AR Vol 3, Tab 12 p. 324 q. 412-415). Emerald Castle selected this benchmark independently from the \$32 million appraisal provided to Investors, an appraisal Emerald Castle asserts it did not know existed (Cross, AR Vol 3, Tab 12 p. 324 q. 404). Emerald Castle stated that its “benchmark” was “not directly” linked to the fair market value of the property but rather was “based on the number [...] acceptable to it” (Cross, AR Vol 3, Tab 12 p. 324 q. 407; 401-411).

10. Relying on this \$32 million “benchmark of value”, Emerald Castle borrowed \$21.25 million from 453 Investors through BDMC using Castlemore as security (17th Report, AR Vol 3, Tab 7 p. 17 ¶29).

11. Four agreements relate to this loan (Cross, AR Vol 3, Tab 12 pp. 308-09 q. 170-178):

(a) ***Investor Participation***: Investors, such as Dr Pizzuto, entered into a Participation and Servicing Agreement with BDMC under which Investors provided cash to BDMC to be loaned to Emerald Castle (Pizzuto Aff’t, AR Vol 2, Tab 6L). About 64% of the money was advanced from Investors’ retirement accounts (17th Report, AR Vol 3, Tab 7 p. 17 ¶29).

- (b) **Loan Agreement:** BDMC loaned \$21.25 million raised from Investors to Emerald Castle under a Loan Agreement dated August 25, 2014 (1st Auciello Aff't, AR Vol 1, Tab 2B).
- (c) **Fortress Participation:** The Loan Agreement refers to a Development Consulting Agreement (the "DCA") between Emerald Castle and Fortress. The DCA was not disclosed to Investors when they signed their Participation and Servicing Agreement (1st Auciello Aff't, AR Vol 1, Tab 2C; Pizzuto Aff't, AR Vol 2, Tab 6 p. 167 ¶37).
- (d) **Fortress Side Letter:** Emerald Castle and Fortress entered a side letter dated August 25, 2014 ("**Fortress Side Letter**") (17th Report, AR Vol 3, Tab 7 p. 17 ¶26). The Fortress Side Letter was not disclosed to Investors (Cross, AR Vol 3, Tab 12 p. 313 q. 256). The Fortress Side Letter contemplates using \$810,000 of the loan to fund a \$200,000 payment to unidentified third parties; a \$225,000 payment to Emerald Castle as a consulting fee; a \$375,000 payment to Fortress as an additional placement fee; and \$10,000 as a donation to a charity selected by BDMC (17th Report, AR Vol 3, Tab 7H).

12. Fortress described the "business deal" behind the DCA as Fortress becoming an "equal partner" in the Emerald Castle project, but not an "owner of the lands" (Pizzuto Aff't, AR Vol 2, Tab 6M p. 332 ¶7). Emerald Castle denies that Fortress is a "partner" or "owner" of the project.

13. It is agreed that BDMC and the Investors are not "partners" or "owners" of the project (2nd Auciello Aff't, AR Vol 2, Tab 3 p. 10 ¶11; Cross, AR Vol 3, Tab 12 p. 307 q. 142-147).

14. The loan by BDMC to Emerald Castle is secured by a general security agreement (the “GSA”) charging the personal property and undertaking of Emerald Castle used in connection with Castlemore (1st Auciello Aff’t, AR Vol 1, Tab 2D). There is no dispute about the validity of this security.

15. The loan by BDMC to Castlemore is also secured by a charge on the real property (13th Report, AR Vol 3, Tab 7E p. 151 ¶57; 1st Auciello Aff’t, AR Vol 1, Tab 2A). There is no dispute about the validity of the charge. There appears to be a dispute about its priority. The Trustee has always described the BDMC charge as being in second position, behind a charge in favour of Cameron Stephens Financial Corporation (“Cameron Stephens”) (12th Report, AR Vol 3, Tab 7D p. 102 ¶15; 1st Auciello Aff’t, AR Vol 1, Tab 2A). Emerald Castle takes the position that the BDMC charge is *pari passu* with “a mortgage obtained by Emerald’s owners *to secure their equity in the project*” (Applicant’s Factum, ¶3 (emph. added)).

How the Proceeds of the Loan Were Used

16. The first tranche of the loan was advanced to Emerald Castle in November 2014 (Pizzuto Aff’t, AR Vol 2, Tab 6 p. 166 ¶33). As of October 28, 2015, the total principal amount owing to the Investors was \$21,246,153 (17th Report, AR Vol 3, Tab 7 p. 17 ¶28; Pizzuto Aff’t, AR Vol 2, Tab 6 p. 166 ¶33).

17. 35% of the \$21.25 million funded by Investors (≈\$7.45 million) was paid to various parties, mostly related to Fortress, as fees (17th Report, AR Vol 3, Tab 7 p. 18 ¶31; Cross, AR Vol 3, Tab 12 p. 315 q. 285):

Amount	Paid To
\$4.1 million	an agent of Fortress as consultant fees

Amount	Paid To
<i>\$2.28 million</i>	as referral fees to the F Brokers (FMP Mortgage Investments Inc., FFM Capital Inc. and FDS Broker Services Inc)
<i>\$640,000</i>	as a broker fee to BDMC in its capacity as mortgage broker. 90% of this amount was then paid to Paza Service Corp., an entity owned by a principal of Fortress, Vince Petrozza
<i>\$362,000</i>	to Olympia Trust as annual and monthly fees
<i>\$95,000</i>	to BDMC as administration fees

18. The remaining 65% (≈\$13.81 million) was paid to or for Emerald Castle (EC Response to Request to Admit, AR Vol 3, Tab 11 p. 245 ¶5; Cross, AR Vol 3, Tab 12, pp. 315-17 q. 286-311):

Amount	Paid To
<i>\$12 million</i>	the Emerald Castle Owners through a complicated series of transfers between Emerald Castle, the Emerald Castle Owners, and 2429730 Ontario Ltd. (242 Ontario). ³
<i>\$585,000</i>	Fortress per the Fortress Side Letter (see ¶11(d), above)
<i>\$65,141.91</i>	Friedman law firm for legal fees and disbursements
<i>Only \$1 million</i>	Emerald Castle to be available to fund the Castlemore Project

19. Of all funds received, Emerald Castle used only a small part of the available \$1 million to fund work on Castlemore. As of July 24, 2020, only \$265,694 was spent on accounting fees and other soft costs related to the development of the Castlemore Project (EC Answer to UT, AR Vol 3, Tab 13 p. 350 q. 3).

20. Almost all of the loan proceeds received by Emerald Castle were paid by Emerald Castle to the Emerald Castle Owners. \$12 million was paid to the Emerald Castle Owners because those

³ Auciello is the president of 242 Ontario and confirmed that its sole business purpose is to provide capital to the Emerald Castle project (Cross, p. 33-34, q. 120-126)

Owners used the loan to “repatriate[] their equity” and create the purported *pari passu* security (Cross, AR Vol 3., Tab 12 p. 316 q. 295). In addition, Emerald Castle paid \$1.38 million as project management fees to one of its Owners, Cachet Developments, although no construction occurred (EC Response to Request to Admit, item 5). This is five times more than Emerald Castle spent on the soft development costs.

21. Emerald Castle’s pattern of borrowing from BDMC to pay its principals continued after all funds were exhausted. Although no development had occurred, Cachet Developments issued three capital call notices asking the Trustee (on behalf of BDMC) to fund 50% of an \$850,000 expected deficit. Emerald Castle’s proposed use for these funds included paying its owner, Cachet Developments, more management fees (17th Report, AR Vol 3, Tab 7 pp. 19-20 ¶37). There is no basis in the Loan Agreement nor in the DCA that would permit Emerald Castle to issue such capital call notices to BDMC or the Trustee. At best, Emerald Castle had the right under the DCA (to which BDMC is not a party) to ask Fortress, not BDMC, to arrange additional funding. Emerald Castle had no conversations with Fortress about the capital calls (Cross, AR Vol 3, Tab 12 p. 318 q. 329). The Trustee did not pay Emerald Castle from the funds that it is holding for the Investors pursuant to Court order (17th Report, AR Vol 3, Tab 7 p. 20 ¶38).

Trustee’s Attempt to Monetize the Castlemore Loan

22. The Trustee was appointed over BDMC in April 2018. Pursuant to its mandate, the Trustee has been evaluating potential monetization or other transactions for the benefit of Investors on all BDMC projects, including Castlemore. On October 21, 2019, the Trustee presented to Castlemore Investors an offer by Emerald Castle to pay \$9.5 million in exchange for a full release and complete extinguishment of all rights and obligations of Emerald Castle, BDMC, and the Investors. The

proposed payment reflected approximately 45% of the loan principal (12th Report, AR Vol 3, Tab 7D pp. 113-20).

23. Emerald Castle justified the discount on the basis of “significant delays to the Castlemore Project”, “a continued lack of certainty on the timing of development”, “significant increases in municipal and regional development charges”, and “a softening of the housing market in the City of Brampton and the Greater Toronto Area”, amongst other factors (12th Report, AR Vol 3, Tab 7D p. 115).

24. The Trustee recommended that Investors accept this settlement offer based on many factors, including the minimum five-year timeline to complete the Castlemore project, the uncertainty surrounding whether Brampton would approve the project, the potential impact of the End of Term Event clause in the Loan Agreement, and the results of an appraisal of Castlemore (12th Report, R Vol 3, Tab 7D pp. 114-17). The Trustee advised Investors that “although the Offer provides only a partial repayment to the Castlemore SMLs, there is value in the certainty provided by accepting the Offer and crystalizing the outcome of the BDMC Loan” (12th Report, R Vol 3, Tab 7D p. 117).

25. Contrary to Emerald Castle’s submission, the Trustee has never confirmed that “Emerald Castle had the right to trigger the End of Term Event clause” (Applicant’s factum, ¶23). Rather, as is described in the 12th Report, Emerald Castle asked the Trustee “to consider its settlement offer [...] as an alternative to a repayment of the Castlemore Loan in accordance with the End of Term Process” (12th Report, AR Vol 3, Tab 7D p. 104 ¶24). The Trustee considered many factors, including those described in paragraph 24, above, and the Trustee’s experience on other projects. Based on those factors, the Trustee concluded that a 45% recovery on the outstanding principal

balance of the loan was reasonable. The Trustee presented to Investors Emerald Castle's interpretation of the End of Term Event clause but, in light of all of the other factors, the Trustee did not need to and did not form a conclusive view on what the End of Term clause meant or whether it was enforceable at the time of the 12th Report (Trustee's Response to Interrogatories, AR Vol 3, Tab 8 p. 224 q. 5).

26. On October 31, 2019, after further negotiation with the Trustee, Emerald Castle increased its offer to \$10.45 million. The Trustee filed a motion asking the Court to approve this larger proposed settlement. Then the Trustee received additional Investor feedback that resulted in materially less support for the proposed settlement than other settlements approved by the Court in the BDMC proceedings (17th Report, AR Vol 3, Tab 7 p. 15 ¶20). The Trustee's motion was adjourned *sine die*, and the Castlemore Settlement Agreement expired in accordance with its terms (17th Report, AR Vol 3, Tab 7 p. 20 ¶20).

Emerald Castle Purports to Invoke the End of Term Clause in the Loan Agreement

27. The loan matured on November 24, 2019 (1st Auciello Aff't, AR Vol 1, Tab 2 p. 22 ¶13). On December 6, 2019, contrary to the stay of proceedings, Emerald Castle advised that it intended to "proceed with the implementation" of the End of Term Event clause in the Loan Agreement (1st Auciello Aff't, AR Vol 1, Tab 2F). Emerald Castle obtained an appraisal of Castlemore and delivered it to the Trustee on January 9, 2020 (1st Auciello Aff't, AR Vol 1, Confidential Tab 2H). The Trustee did the same and delivered its appraisal to Emerald Castle on February 14, 2020 (1st Auciello Aff't, AR Vol 1, Confidential Tab 2N). The Trustee made clear that it was not "in any way attorning or agreeing to the process set out in [the End of Term Event clause]" (1st Auciello Aff't, AR Vol 1, Tab 2M).

Emerald Castle Initiates this Application Contrary to the Stay of Proceedings

28. On March 2, 2020, contrary to the stay of proceedings, Emerald Castle issued the notice of application in this proceeding. To efficiently address this procedural irregularity, the Trustee consented in writing to Emerald Castle commencing this application, subject to a full reservation of rights. The Trustee did not consent to Emerald Castle's purported invocation, contrary to the stay of proceedings, of the End of Term Event clause (17th Report, AR Vol 3, Tab 7F).

29. On March 17, 2020, this Court granted an Order sealing information pertaining to the appraisal or valuation of the Property (17th Report, AR Vol 3, Tab 7G). On September 3, 2020, this Court bifurcated the interpretation of the Loan Agreement from the calculation of the payment the End of Term Event and Waterfall clauses require.

PART II - STATEMENT OF ISSUES, LAW & AUTHORITIES

30. This application raises two issues:

- (a) *Are the End of Term Event and Waterfall clauses enforceable?* No. The End of Term Event and Waterfall clauses are not enforceable because they are manifestly unfair and were not properly disclosed to the Investors.
- (b) *If enforceable, does the End of Term Event clause allow Emerald Castle to pay substantially less than it owes under the Loan Agreement in full satisfaction of all its obligations and nonetheless keep Castlemore?* No. If enforceable, the End of Term Event clause only permits Emerald Castle to make a partial payment of the amount owing and receive, in exchange, a partial release of its security in the amount of the payment.

A. The End of Term Event and Waterfall Clauses Are Not Enforceable

31. Emerald Castle's interpretation of the End of Term Event clause is manifestly unfair. Emerald Castle proposes to pay less than 1/3 of the amount owed to the Investors, completely walk away from its remaining debt obligations under the Loan Agreement and keep Castlemore for its own profit. Emerald Castle did not ensure that Investors were adequately notified of the End of Term Event clause or of Emerald Castle's interpretation of it. This lack of proper disclosure renders the clause unenforceable.

32. The Court of Appeal for Ontario recently reaffirmed that "inadequate notice of a particularly unfair term may render that term unenforceable" (*MacQuarie Equipment Finance Ltd v 2326695 Ontario Ltd. (Durham Drug Store)*, [2020 ONCA 139](#) at ¶33). Like Castlemore, *MacQuarie* involved three parties and two separate contracts. Ms. Abdulaziz, a pharmacy owner, entered into an agreement with a telemedicine provider. Ms. Abdulaziz was then presented with a second agreement that, unbeknownst to her, was with a different party (a medical equipment lessor). The termination provisions in the two contracts were commercially normal but different from each other. Ms. Abdulaziz did not review the second agreement. She was not notified about the difference in the termination provisions.

33. The Court of Appeal held that the lack of adequate notice was so unfair that it rendered the termination clause unenforceable. The clause was rendered unenforceable even though:

- (a) the clause was commonplace and not, on its face, harsh or oppressive; and
- (b) the equipment lessor seeking to enforce the clause had no intention to mislead Ms. Abdulaziz (*MacQuarie* ¶37-38).

34. *MacQuarie* is on all fours with the present case. Even if Emerald Castle did not intend to mislead the Investors, Emerald Castle cannot believe that Investors agreed to loan \$21.25 million on a “benchmark of value” of \$32 million in exchange for security worth less than \$10 million.

35. In fact, Investors were repeatedly told that their investment was fully secured on the Castlemore property. As many examples in the record show, Investors were told:

Your principal amount is fully secured against the subject property (as a mortgage) where you enjoy steady interest on your funds and, where available, a deferred lender fee at the end of your term” (Pizzuto Aff’t, AR Vol 2, Tab 6 p. 159 ¶10 quoting from Tab 6D, emph. added).

and

Face amount of your investment is fully Registered & Secured via a charge against the property ***Unique Feature*** (Pizzuto Aff’t, AR Vol 2, Tab 2A, emph. in original).

36. Investors were not told that the “benchmark of value” of \$32 million was “not directly” linked to the fair market value of the property but rather was “based on the number [...] acceptable to [Emerald Castle]” (Cross, AR Vol 3, Tab 12 p. 324 q. 407; q. 401-411). Investors were not told that the “benchmark of value” was intended to be diluted by a *pari passu* mortgage obtained by Emerald Castle’s owners “to secure their equity” (Applicant’s Factum, ¶3 (emph. added)).

37. Like *MacQuarie*, the promotional materials provided to the Investors did not clearly disclose the nature of the security, but rather assured Investors of the priority of their security. Like *MacQuarie*, Emerald Castle’s interpretation of the End of Term Event clause is onerous and directly conflicts with the assurances the Investors received. Like *MacQuarie*, Investors were not notified of the End of Term Event clause or Emerald Castle’s onerous interpretation of it.

38. Investors never agreed that Emerald Castle “would be entitled to receive any funds from the sale of [Castlemore] or profits before repayment in full of all amounts owing” (which would amount to elevating an equity interest over a secured debt interest) (Pizzuto Aff’t, AR Vol 2, Tab 6 p. 169 ¶45). In fact, Investors were told the opposite in the promotional materials:

WHAT IF THE DEVELOPER OR DEVELOPMENT FAILS? A default would occur if the developer cannot pay back the funds by the maturity date of the contract. [BDMC], in advance, would work with the developer to find a solution that could include:

- A payment to investors in exchange for an extension
- An institutional refinance to buy out the Fortress Investors

If these cannot be achieved, then the process would commence *to sell the property to recover the investor monies. This is a significant advantage to being secured via syndicate mortgage; recovery of your investment will take priority over all unsecured debts, monies owed by the corporation and even construction liens* (Pizzuto Aff’t AR Vol 2, Tab 6 p. 159 ¶10 quoting from Tab 6D, emph. added).

Investors were never notified of Emerald Castle’s interpretation that if the loan was not repaid by the Maturity Date, they would lose most of their investment, the debt would be extinguished, they would lose their security in the land, and be forced by a Court to release Emerald Castle from its remaining obligations under the Loan Agreement, all while Emerald Castle retained the property.

39. Dr. Pizzuto first had a chance to review the Loan Agreement during the final meeting in which Dr. Pizzuto provided the investment and signed the documents. Like Ms. Abdulaziz in *MacQuarie*, (i) the onerous provision was not brought to his attention, (ii) he did not have the opportunity to receive independent legal advice, and (iii) he did not have the opportunity to read carefully the documents provided to him during the meeting (Pizzuto Aff’t, AR Vol 2, Tab 6 pp. 162-63, 169 ¶22-23 and 43).

40. The End of Term Event clause references another provision in the Loan Agreement called the “Waterfall” (s. 7.2). Dr. Pizzuto did not receive independent legal advice about the Waterfall clause (Pizzuto Aff’t, AR Vol 2, Tab 6 p. 165 ¶30). Dr. Pizzuto testifies that “[i]t certainly was never explained that the waterfall provisions might have an effect on the obligation of the Borrower to fully repay the principal and interest owing under the Loan” (Pizzuto Aff’t, AR Vol 2, Tab 6 p. 165 ¶30).

41. Like the Court in *MacQuarie*, this Court need not conclude that Emerald Castle committed a wrong to find that the End of Term Event clause is unenforceable. If Emerald Castle is right in its interpretation of the End of Term Event clause, it would be permitted to pay 1/3 of the amount owed on the loan and, in turn, keep and develop Castlemore, fully discharge the BDMC security, and avoid its remaining obligations under the Loan Agreement. This result is manifestly unfair given the the repeated assurances to the Investors that their investment was fully secured.

42. Emerald Castle’s position is particularly unreasonable given that Emerald Castle’s Development Manager promoted the Castlemore investment at an event that was, to its knowledge, attended by “executives, brokers, and accounting professionals” (EC Answer to UT, AR Vol 3, Tab 13 p. 350-51 q. 5).

43. Emerald Castle’s position is also particularly unreasonable given that Emerald Castle bargained for the right to approve Fortress’ marketing materials and then had no regard for whether the materials used to solicit investment were consistent with Emerald Castle’s interpretation of the Loan Agreement (1st Auciello Aff’t, AR Vol 1, Tab 2C p. 72 s. 8; Cross, AR Vol 3, Tab 12 p. 328-29 q. 446-453). Emerald Castle chose to rely entirely on Fortress, a party it did not vet, to make representations about Castlemore to Investors (Cross, AR Vol 3, Tab 12 p. 321 q. 373-376).

44. This Court has the jurisdiction to determine the enforceability of the End of Term Event clause on an application. For example, in *TMJ Hygiene Service Corporation v. Aces Capital Inc*, [2018 ONSC 1572](#), the Court granted an application rescinding an agreement between two parties and ordered that funds paid under the agreement be returned to the purchaser. Similarly, on this application, this Court should apply the Court of Appeal’s reasoning in *MacQuarie* and find the End of Term Event clause and the referenced Waterfall clause are unenforceable.

B. The End of Term Event Clause Only Allows for a Partial Discharge of the Security

45. In the alternative, if the End of Term Event clause is enforceable, this Court should reject Emerald Castle’s interpretation of the clause as inconsistent with the words used by the parties and the factual matrix in which the Loan Agreement was negotiated. Reading the words used and considering the factual matrix, the End of Term Event clause permits Emerald Castle to make a partial payment and receive: (i) a partial discharge of the security in the amount of the payment; and (ii) forbearance of BDMC’s ability to enforce the remaining security.

46. The Court of Appeal set out the general principles of contractual interpretation for commercial contracts in *Ventas Inc v. Sunrise Senior Living Real Estate Investment Trust*, [2007 ONCA 205](#) at ¶24. A commercial contract is to be interpreted:

(a) as a whole, in a manner that gives meaning to all of its terms and avoids an interpretation that would render one or more of its terms ineffective;

(b) by determining the intention of the parties in accordance with the language they have used in the written document and based upon the “cardinal presumption” that they have intended what they have said;

(c) with regard to objective evidence of the factual matrix underlying the negotiation of the contract, but without reference to the subjective intention of the parties; and (to the extent there is any ambiguity in the contract),

(d) in a fashion that accords with sound commercial principles and good business sense, and that avoid a commercial absurdity.

47. This Court can decide questions of contractual interpretation on an application. In *J.M.B. Cattle v Kaufman*, [2015 ONSC 7372](#), aff'd [2016 ONCA 417](#), the court considered the interpretation of a land purchase agreement on an application. In *Equitable Trust v. Rose Corporation*, [2011 ONSC 4239](#), aff'd [2012 ONCA 44](#), the Court determined the enforceability of a covenant on an application, finding that the parties' different legal positions could be dealt with as the material facts were not in dispute. In the present case, the material facts are undisputed. However, the parties' positions diverge on the interpretation of the End of Term Event clause.

48. The End of Term Event clause is s. 14 of the Loan Agreement. It is set out in its entirety in Schedule C hereto. Below, each relevant portion of the clause is examined. A plain reading of the clause, in the context of the factual matrix in which the Loan Agreement was negotiated, supports the Trustee's interpretation that the End of Term Event clause allows Emerald Castle to make a partial payment in exchange for a partial, not full, release of the security, with any remaining debt still outstanding and due and owing from Emerald Castle.

(a) A Plain Reading of the End of Term Event Clause Provides Only for a Partial Discharge

49. The End of Term Event clause starts by stating that it applies if the loan is not repaid by the Maturity Date. The loan matured in November 2019 and was not repaid (1st Auciello Aff't, AR Vol 1, Tab 2 p. 22 ¶13). But for the Court finding the clause unenforceable, the End of Term Event clause applies.

50. The next phrase explains that the security remains in place but cannot be enforced if Emerald Castle follows the process set out in the End of Term Event clause:

and notwithstanding the provisions of the Security, *the Lender shall only be permitted to exercise its rights under the Security* in the event that the following procedures are not adhered to by the Borrower (1st Auciello Aff't, AR Vol 1, Tab 2B p. 51 emph. added).

The emphasized phrase is telling: on its face, the clause does not fully discharge the security. Rather, it limits the Lender's ability to exercise its rights under the security. If Emerald Castle follows the procedures in the End of Term Event clause, the Trustee cannot start a power of sale or otherwise take steps to enforce the security. However, the security continues to exist to secure the unpaid portions of the loan, preserving the Investors' priority position on title.

51. The clause then sets out different procedures for Vacant Lands as opposed to lands under servicing or house construction. There is no dispute that Castlemore is "Vacant Lands". The End of Term Event clause says that if the loan is not repaid on the Maturity Date, then the Vacant Lands "shall be liquidated in an orderly fashion to maximize revenues" (1st Auciello Aff't, AR Vol 1, Tab 2B p. 51 s. 14(i)). The clause then gives Emerald Castle a choice: it can list the Vacant Lands for sale with a reputable broker (1st Auciello Aff't, AR Vol 1, Tab 2B, p. 51 s. 14(i)(E)) or it can make a payment calculated in accordance with a formula (1st Auciello Aff't, AR Vol 1, Tab 2B p. 51 s. 14(i)(B)).

52. Under the second option (s. 14(i)(B)), in exchange for the payment, Emerald Castle receives two benefits: (i) BDMC must forebear on enforcing its remaining security, as discussed in paragraph 50 above, and (ii) the security is partially discharged in the amount of the payment. Section 14(i)(B) expressly states that Emerald Castle will receive a "partial discharge of [BDMC's] security as against the Vacant Lands". The use of the word "partial" is deliberate and consistent with the business deal struck in the End of Term Event clause: Emerald Castle can make a partial

payment in exchange for a partial discharge and forbearance on the remaining security so that it can complete construction of Castlemore without interference by BDMC.

(b) The Waterfall Clause Reinforces that Partial Payment Equals Partial Discharge

53. The Waterfall clause reinforces that Emerald Castle is not entitled to keep the property and receive a full discharge after a partial payment. The partial payment contemplated by s. 14(i)(B) is calculated in two steps. Pursuant to s. 14(i)(A), the parties determine the Appraised Value of the Vacant Lands. Then, pursuant to s. 14(i)(B), the Borrower pays the Lender a Paydown, as if that Paydown was received as a payment under s. 7.2 (*i.e.*, the Waterfall).

54. The reference to the Waterfall provision in s. 14(i)(B) reinforces the conclusion that Emerald Castle can receive a full discharge after a partial payment ***only if all Project Lands have been sold***. The End of Term Event clause states that the discharge received under the End of Term Event clause is the same as the discharge under the Waterfall. Section 14(i)(B) states:

the Borrower shall have the option of obtaining a partial discharge of the Lender's Security as against the Vacant Lands upon payment ***as if same was a receipt under Section 7.2*** (the "Paydown") of the Appraised Value. (1st Auciello Aff't, AR Vol 1, Tab 2B p. 51 emph. added)

55. The Waterfall in s. 7.2 explains that BDMC is entitled to repayment of all amounts owing unless and until all Project Lands have been sold. Section 7.2 reads:

In the event that there is a shortfall, ***once, all Project Lands have been sold and the Lender's rights under s. 14 have been fully exercised***, and any amount remains owing to the Lender on the Loan, the Lender agrees to waive its rights to repayment of any such shortfall and provide a release of the Borrower and a discharge of all remaining Security. (1st Auciello Aff't, AR Vol 1, Tab 2B p. 40, emph. added)

In other words, if Emerald Castle continues to own Castlemore, the Investors retain their secured interest in and ability to benefit from the proceeds flowing from Castlemore. Emerald Castle may only receive a full release and discharge of security once “all Project Lands have been sold” such that all value has been extracted from the Project Lands for the benefit of the Investors.

56. Emerald Castle’s interpretation of the End of Term Event clause asks this Court, in effect, to add words to the Waterfall. Rather than reading “all Project Lands have been sold”, Emerald Castle asks this Court to read in the phrase “or deemed to have been sold”. Emerald Castle’s proposed interpretation strays beyond the four corners of the document. The Trustee’s interpretation gives effect to words the parties used in the End of Term Event clause and the Waterfall clause. Under these clauses, until Emerald Castle actually sells the property or fully repays the debt, it remains liable for the debt and that debt remains secured.

57. A second clause reinforces the Trustee’s view. Section 17(f), which reads in part: “The terms and conditions contained in this Agreement are inserted for the exclusive benefit of the Lender and may be waived, in whole or in part, by the Lender at any time or times.” The parties expressly agreed that the Agreement was intended to be interpreted for the benefit of the Lender. Emerald Castle’s interpretation – in addition to reading in language to the Waterfall clause – is not an interpretation for the benefit of the Lender. Emerald Castle’s interpretation should be rejected.

(c) Poor Drafting of the Loan Agreement Does Not Override the Parties’ Intention that a Partial Payment Results in a Partial Discharge

58. The Loan Agreement is a poorly drafted document replete with typographical errors, cross-references that reference nothing, and misplaced paragraphs. This poor drafting is compounded by the Loan Agreement’s references to and incorporation of terms from the DCA, a document that BDMC is not party to and that was never disclosed to the Investors (Pizzuto Aff’t, AR Vol 2, Tab

6 p. 167 ¶37). However, this poor drafting does not overwhelm the commercially reasonable interpretation that holds Emerald Castle liable for its debt unless and until it sells Castlemore.

59. Section 14(i)(B)(II) of the Loan Agreement requires BDMC to “provide partial discharges of all of its Security in respect of such Vacant Lands and shall no longer form part of the Security held by the Lender for the Loan” (1st Auciello Aff’t, AR Vol 1, Tab 2B p. 52). A plain reading of this phrase, which focuses on the phrase “partial discharges,” is consistent with the Trustee’s interpretation: once BDMC receives a Paydown from Emerald Castle, it must reduce its security over the Vacant Lands to reflect the payment which will “no longer form part of the Security”.

60. Emerald Castle’s interpretation, however, focuses on the phrase “all of its security in respect of such Vacant Lands” to support its position that BDMC must release its full security package, including a GSA that is not limited to the land. As the Court of Appeal pointed out in *Ventas*, such an ambiguity is to be resolved with sound commercial principles and good business sense. Permitting Emerald Castle to pay Investors a fraction of the amount they are owed while squeezing them out of the benefits of Castlemore makes no commercial sense, particularly in light of the repeated representations to Investors that their investment was “fully Registered & Secured via a charge against the property ***Unique Feature***” (Pizzuto Aff’t, AR Vol 2, Tab 6A).

(d) The Factual Matrix Underlying the Loan Agreement Supports the Interpretation that a Partial Payment Grants a Partial Discharge

61. The Court of Appeal in *Ventas* instructs courts to interpret contracts “with regard to objective evidence of the factual matrix underlying the negotiation of the contract” (¶24). The factual matrix in which the Loan Agreement was negotiated supports the robustness of the Investors’ security and the Investors’ right to participate in the benefits of Castlemore.

62. The factual matrix in which the Loan Agreement was signed is this: Emerald Castle negotiated the Loan Agreement with Fortress and allowed Fortress to raise money for Emerald Castle. Fortress and its related entities took more than \$7 million of the Investors' money pursuant to the agreements with Emerald Castle. Fortress told Investors that their investment was fully secured on Castlemore (see ¶35, above, for specific examples); Investors were not told that their security could be fully discharged in the absence of full payment of the loan without selling Castlemore (Pizzuto Aff't AR Vol 2, Tab 6 p. 169 ¶45). What Emerald Castle and Fortress said to each other before the Loan Agreement was signed, including the subjective memorandum referenced in Emerald Castle's factum, should not be considered as part of the factual matrix.

63. The objective factual matrix does not support an interpretation that would allow Emerald Castle to keep the property and deprive Investors of 2/3 of their investment. Rather, it supports the interpretation that a partial payment of the loan entitles Emerald Castle to a partial release of the security and holds Emerald Castle liable for the remaining portion of the debt.

PART III - ORDER REQUESTED

64. The Trustee asks the Court to dismiss this application, with costs on a full indemnity basis. Such costs are justified because Emerald Castle breached the stay of proceedings in paragraph 11 of the Appointment Order by invoking the End of Term Event clause. Paragraph 11 stays and suspends "all rights and remedies against the Respondent [BDMC], the Trustee, or affecting the Property" (17th Report, AR Vol 3, Tab 7A). In this application, Emerald Castle seeks to extinguish the debt and eliminate BDMC's security, a clear impact on the Property.

ALL OF WHICH IS RESPECTFULLY SUBMITTED this 8th day of October, 2020.



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**SCHEDULE “A”
LIST OF AUTHORITIES**

1. *Equitable Trust v. Rose Corporation*, [2011 ONSC 4239](#), aff'd [2012 ONCA 44](#)
2. *J.M.B. Cattle v Kaufman*, [2015 ONSC 7372](#), aff'd [2016 ONCA 417](#)
3. *MacQuarie Equipment Finance Ltd v 2326695 Ontario Ltd. (Durham Drug Store)*, [2020 ONCA 139](#)
4. *TMJ Hygiene Service Corporation v. Aces Capital Inc*, [2018 ONSC 1572](#)
5. *Ventas Inc v Sunrise Senior Living Real Estate Investment Trust*, [2007 ONCA 205](#)

SCHEDULE “B”
TEXT OF STATUTES, REGULATIONS & BY - LAWS

1. *Rules of Civil Procedure, RRO 1990, Reg 194*

14.05(3) A proceeding may be brought by application where these rules authorize the commencement of a proceeding by application or where the relief claimed is,

(a) the opinion, advice or direction of the court on a question affecting the rights of a person in respect of the administration of the estate of a deceased person or the execution of a trust;

(b) an order directing executors, administrators or trustees to do or abstain from doing any particular act in respect of an estate or trust for which they are responsible;

(c) the removal or replacement of one or more executors, administrators or trustees, or the fixing of their compensation;

(d) the determination of rights that depend on the interpretation of a deed, will, contract or other instrument, or on the interpretation of a statute, order in council, regulation or municipal by-law or resolution;

(e) the declaration of an interest in or charge on land, including the nature and extent of the interest or charge or the boundaries of the land, or the settling of the priority of interests or charges;

(f) the approval of an arrangement or compromise or the approval of a purchase, sale, mortgage, lease or variation of trust;

(g) an injunction, mandatory order or declaration or the appointment of a receiver or other consequential relief when ancillary to relief claimed in a proceeding properly commenced by a notice of application;

(g.1) for a remedy under the *Canadian Charter of Rights and Freedoms*; or

(h) in respect of any matter where it is unlikely that there will be any material facts in dispute requiring a trial.

SCHEDULE "C"
RELEVANT CONTRACTUAL CLAUSES

7.2 Waterfall

A. Distribution of the available cash flow, being cash flow not required for the payment of Project costs and reasonable reserves for future costs to complete and repairs and warranty coverage as provided for in the Project Budget (notwithstanding the inclusion in the Project Budget as Project costs, for purposes of this Section 7.2 accrued and capitalized interest and Development Consultant Fees/Costs shall be excluded) or otherwise approved by the Lender and derived from the Project, shall be made in the manner and priority set forth below (the "Waterfall"):

1. to pay the principal and interest under the VTB (or replacement thereat) and the First Ranking Construction Loan Security;
2. to pay to the Borrower any unpaid Project Management Fees plus applicable HST as per the approved Project Budget;
3. pay to the Borrower or as it may direct an amount equal to 2.5%, as a one-time fee, on the amount of any guarantee provided by an entity arranged by the Borrower, as required by the Senior Lender, or holder of the replacement VTB, if any, without duplication or overlap, to the Senior Lender or replacement VTB Lender, if any, in excess of an amount equal to any corresponding guarantee provided by Fortress (the "Senior Loan Guarantee Fee");
4. (a) to pay to the Borrower any unfunded Equity Repayment (the "Shortfall Amounts");

(b) to pay to the Borrower and/or the Lender, as the case may be, any Excess Advance, on a pro rata basis, based on the Excess Advances made by each of them;

(c) to pay to the Borrower and to the Lender, on a pro rata basis, the Project Preferred Return owing to each of them; and

(d) to pay to each of the Borrower and the Lender the principal amounts of the Additional Loans (excluding Excess Advances already recovered), and Additional Equity Advances (excluding Excess Advances already recovered), on a pro rata basis.

5. to repay to the Lender and Borrower, on a pro rata basis to the Lender, principal advances of the Loan excluding any Additional Loan recoveries under Section 4 and excluding accrued and capitalized interest and excluding the amount of the Development Consultant Fees/Costs (the "Principal Equity Advances") currently estimated to be \$13,000,000.00 for the Lender and to the Borrower or as it may designate the Borrower's Equity (currently estimated that it will be \$13,000,000.00 (excluding any Additional Equity Advances recovered under Section 4) ("Net Borrower's Equity"), representing the Borrower's remaining Borrower's Equity in the Project (after Equity Repayment and Additional Equity Advances from Loan advances and payment under Section 7 A(4));

6. to pay on a pro rata basis: (i) to the Lender accrued interest of 8% per annum as set forth herein on the Principal Equity Advances (excluding Excess Advances made by the Lender); and (ii) to the Borrower an 8% annual return on the Borrower's Equity (excluding Excess Advances made by the Borrower); and

7. then, to pay the remaining cash flow for the Project on a pro rata basis (based on the respective ratio that the Principal Equity Advances bear to the Borrower's Equity) to Fortress on account of the Fortress Profit Share as may be adjusted by the Dilution Provision, if applicable and to the Borrower on account of the Borrower's Distribution Share and from the Fortress Profit Share, there shall be deducted and paid to the Lender, any remaining funds owing on the Loan.

In the event that there is a shortfall, once all Project Lands have been sold and the Lender's rights under s. 14 have been fully exercised, and any amount remains owing to the Lender on the Loan, the Lender agrees to waive its rights to repayment of any such shortfall and provide a release of the Borrower and a discharge of all remaining Security.

B. Notwithstanding anything contained herein, the parties acknowledge that the distribution of funds defined as the "Waterfall" in the DCA, specifically spells out how funds are to be paid to either the Borrower or the Lender and/or Fortress as and when received from the sale of the Project, in whole or in part, or other revenues emanating from the Project, and that the provisions of such Waterfall shall be paramount and govern in the event of a conflict with any of the provisions set out in Sections 7.2 and 14 of this Loan Agreement with regards to the distribution of any funds realized by the Lender under this Loan Agreement and its Security or under the sale of the Property as set forth herein or in any Security. The Waterfall in this Agreement and the Waterfall in the DCA are intended to provide for the same distribution of the available cash flow without duplication.

14. End of Term Event

In the event that the Loan is not repaid in full on or before the Maturity Date or the Term Extension as the case may be or, as further extended from time to time, and notwithstanding the provisions of the Security, the Lender shall only be permitted to exercise its rights under the Security in the event that the following procedures are not adhered to by the Borrower:

(i) with regard to any portions of the Project which are not under construction for either servicing (the "**Servicing Lands**") or for house construction ("House Construction Lands") ("Vacant Lands") same shall be liquidated in an orderly fashion to maximize revenues as follows:

(A) Each party shall obtain its own appraisal of the Vacant Lands using an accredited AACI appraiser. Each party shall be required to obtain such appraisal within sixty (60) days of the Maturity Date, failing which the appraisal obtained by only one party shall serve to govern the value of the Vacant Lands as set forth herein. In the event that both appraisals are obtained as aforesaid, the appraised value for the purposes of this section shall be the average of the 2 appraisals ("Appraised Value"). Each party shall deliver a copy of the appraisal so obtained within the said 60 day period. Each party shall be responsible for the payment of the costs of its appraisal;

(B)

(I) Within thirty (30) days of receipt of the Lender's appraisal, the Borrower shall have the option of obtaining a partial discharge of the Lender's Security as against the Vacant Lands upon payment as if same was a receipt under Section 7.2 (the "**Paydown**") of the Appraised Value less (i) any deemed commissions and closing adjustments as if the Property had been sold to the Borrower in accordance with the Waterfall; and (ii) the amount of any financing which has been specifically raised against and secured in favour of the Senior Lender or any other lender by the Vacant Lands to generate a pay down of the Loan to the Lender and repayment of Borrower's Equity to the

Borrower, (the "Project Mortgage"), all in accordance with the Waterfall. No adjustment shall be made for any other secured financings still registered against the title to the Vacant Lands being used as collateral security for construction financing for the Servicing Lands or the House Construction Lands. The Appraised Value shall be reduced by the amount of such secured financings.

(II) Upon payment of the Paydown as set out in Section 14(i)(B)(I), the Lender shall provide partial discharges of all of its Security in respect of such Vacant Lands and shall no longer form part of the Security held by the Lender for the Loan.

(C) With respect to the House Construction Lands and/or the Servicing Lands, unless there is an Event of Default under the terms of the Security or DCA, the Borrower and the Manager shall be permitted to continue, with respect to the Servicing Lands, to complete all servicing arrangements with existing Senior Lenders, and with respect to the House Construction Lands, to complete the house construction and sale of the remaining lots where house construction has commenced in any particular phase. The Borrower shall be permitted a reasonable period of time to complete such servicing or house construction, not to exceed 12 months for servicing after the Maturity Date and not to exceed 18 months after the Maturity Date for house construction and sale (the "End Date");

(D) With respect to the Servicing Lands and the House Construction Lands remaining at the end of the applicable End Date, the procedure set forth in Sections 14 (i)(A) and (B) shall be *mutatis mutandis*; and

(E) In the event that the Borrower does not exercise its option to obtain a partial discharge of the Vacant Lands, the Servicing Lands or the House Construction Lands as set forth in Section 14 (i)(B) or (D), the applicable lands shall be listed for sale with a reputable commercial real estate agent selected by the Lender and approved by the Borrower, acting reasonably, within five (5) Business Days of written request at a price equal to the Appraised Value and the parties shall agree on any offer. In the event of a dispute of

either the selection of the agent, the terms of such retainer, the terms of any listing and the acceptability of any offers received as a result of such listing, either party may submit such dispute to binding arbitration to an arbitrator selected by the Lender and the Borrower and if they are unable to agree on such an arbitrator, then the arbitrator, on application by either the Lender or the Borrower shall be appointed by a Justice of the Superior Court of Justice sitting in Toronto. The arbitration shall proceed in accordance with the provisions of the *Arbitration Act, 1991* (Ontario) and any amendments or successors thereto, which provisions shall apply mutatis mutandis. The Arbitrator shall have the power to proceed with the arbitration and to deliver his or her award notwithstanding the default by any party in respect of any procedural order made by the Arbitrator. The arbitrator shall render a decision, after receipt of all required information, within five (5) Business Days thereafter and whose decision shall be binding without appeal, and otherwise in accordance with the *Arbitrations Act* (Ontario).

17. General

(f) The terms and conditions contained in this Agreement are inserted for the exclusive benefit of the Lender and may be waived, in whole or in part, by the Lender at any time or times. In the event of inconsistency or conflict between the provisions of this Agreement and the provisions of the Security, this Agreement shall prevail to the extent of such inconsistency or conflict.

**EMERALD CASTLE
DEVELOPMENTS
INC.**

Applicant

and

**FAAN MORTGAGE ADMINISTRATORS INC., IN ITS
CAPACITY AS THE COURT-APPOINTED TRUSTEE OF
BUILDING & DEVELOPMENT MORTGAGES CANADA INC.
FORMERLY KNOWN AS CENTRO MORTGAGE INC. ET AL.
and OLYMPIA TRUST COMPANY**

Respondents

Court File No: CV-20-00637238-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

PROCEEDING COMMENCED AT TORONTO

FACTUM OF THE RESPONDENT (FAAN)

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