IN THE COURT OF APPEAL
OF NEWFOUNDLAND AND LABRADOR

Citation: *Patrick Street Holdings Ltd. v. Cook*,
2019 NLCA 69
Date: October 24, 2019
Docket Number: 201701H0093

BETWEEN:

PATRICK STREET HOLDINGS LTD. APPELLANT

AND:

JOHN COOK FIRST RESPONDENT

AND:

J-3 CONSULTING & EXCAVATION LTD. SECOND RESPONDENT

AND:

11368 NL INC. THIRD RESPONDENT

Coram: White, Hoegg and O'Brien JJ.A.

Court Appealed From: Supreme Court of Newfoundland and Labrador
General Division 201601G6652
(2017 NLTD(G) 167)

Appeal Heard: November 14 & 29, 2018
Judgment Rendered: October 24, 2019

Reasons for Judgment by: White J.A.
Concurred in by: Hoegg and O'Brien JJ.A.

Counsel for the Appellant: Thomas W. Fraize Q.C. and Lara Fraize-Burry
Counsel for the First and Second Respondent: David P. Goodland Q.C.
Counsel for the Third Respondent: Sarah J. Clarke

White J.A.:

[1] This appeal flows from an unsuccessful real estate development, and a dispute on how the limited funds available following a power of sale should be distributed. This requires a determination on whether certain charges can be considered valid security interests, and what the priority of the interests should be.

Parties to the Appeal

[2] The appellant, Patrick Street Holdings Ltd. ("Patrick Street Holdings"), was the mortgagee over an area of land in the Kenmount Terrace subdivision in St. John's (the "Subject Property"). Following a default in mortgage payments, Patrick Street Holdings commenced power of sale proceedings.

[3] The first respondent, John Cook ("Cook"), was a mortgagee with respect to two additional mortgages on parcels of land within the Subject Property.

[4] The second respondent, J-3 Consulting & Excavation Ltd. ("J-3 Consulting"), was a mechanics' lien claimant against the owner of the Subject Property.

[5] The third respondent, 11368 NL Inc. ("11368 NL"), was the beneficial owner of the Subject Property prior to the power of sale proceedings.

The Facts

[6] Madden's Ltd. registered a mortgage against the Subject Property on December 20, 2011. The Madden's Ltd. mortgage provided collateral security on three promissory notes for amounts of $813,141.50, $800,000.00 and $468,000.00.

[7] In April 2015, 11368 NL entered a mortgage agreement as mortgagor with PMC Holdings as mortgagee. Through this mortgage, 11368 NL obtained funds to develop property in the Kenmount Terrace subdivision. PMC Holdings subsequently assigned this mortgage to Patrick Street Holdings in March 2016.

[8] J-3 Consulting supplied work, equipment and materials to the development of over 50 lots within the Subject Property. Following a payment dispute, J-3 Consulting registered a mechanics' lien against 11368 NL and lots within the Subject Property in December 2015. The initial lien claim was for $690,535.05.

[9] The amount of the lien claim was amended four times in the subsequent months to reflect additional work done, and receipt of partial payments. The lien was last amended on August 12, 2016 bringing the final amount claimed to $705,428.72. A consent judgment was entered for this amount on September 30, 2016 in a Supreme Court proceeding between J-3 Consulting and 11368 NL.

[10] In April 2016, Patrick Street Holdings (and other companies) registered a mortgage against certain parcels of the Subject Property "to the limit of" $4,000,000. No money was advanced to 11368 NL under this mortgage, with the mortgage acting as collateral security on a loan guaranteed by 11368 NL. Affidavit evidence filed at the hearing indicated that the amount outstanding under the principal debt at the time of the power of sale was $8,523,007.86.

[11] Cook registered two mortgages against two lots within the Subject Property in July 2016. Under these mortgages, 11368 NL was advanced a total of $225,000. These funds were sought and utilized for a purpose unrelated to the development of the Subject Property. 11368 NL paid Cook $168,237.82 pursuant to the mortgages, leaving an outstanding secured obligation of $56,762.18.

[12] In addition to the liens and mortgages, numerous "directions to pay" were also registered against the Subject Property. These documents directed legal counsel for 11368 NL to direct proceeds of sale from lots within the Subject Property to legal counsel for creditors of 11368 NL.

[13] In July 2016, Patrick Street Holdings commenced power of sale proceedings against the Subject Property. At a public auction, the Subject Property was sold to Patrick Street Holdings for $11,400,000. As this amount was more than 75% of the appraised value of $15,100,000, court approval was not necessary.

[14] In October 2016, Patrick Street Holdings provided an accounting of the sale proceeds to J-3 Consulting and Cook as required by section 10 of the *Conveyancing Act*, R.S.N.L. 1990, c. C-34. Under the distribution outlined in the accounting, there were insufficient funds to pay the remaining amounts on the J-3 Consulting lien or the Cook mortgages.

[15] J-3 Consulting and Cook objected to the accounting as provided, and commenced applications in the Supreme Court, seeking payment of their claims and a more detailed accounting.

[16] After reviewing the various registrations and agreements, the Applications Judge made a determination on which registrations were valid security interests against the real property, the value of the registered claims, and a determination on the priority of payment. Under the final accounting as determined by the Applications Judge, there were sufficient proceeds from the sale to make payment of J-3 Consulting and Cook's claims, and payment was ordered accordingly.

Issues on Appeal

[17] The appellant, Patrick Street Holdings, has taken the position that the Applications Judge's determination on the validity of claims, the value of claims, and the priority of claims was flawed.

[18] The following issues are raised:

1. Did the Applications Judge err in finding that the directions to pay do not rank in priority to the J-3 Consulting lien or the Cook mortgages?

2. Did the Applications Judge err in removing an amount of $800,000 from an otherwise valid mortgage registered by Madden's Ltd.?

3. Did the Applications Judge err in disallowing a $4,000,000 mortgage held by Patrick Street Holdings on the basis that the amount owing under the mortgage was not established?

Issue 1 – Priority of the Directions to Pay

[19] The Applications Judge classified five of the documents registered with respect to the Subject Property as "directions to pay." These documents directed legal counsel for 11368 NL to pay certain amounts from the sale of lots within the Subject Property to legal counsel for creditors of 11368 NL.

[20] The amounts payable under these directions constitute additional amounts owed by 11368 NL arising from the development and sale of condo units on Water Street in St. John's. This obligation related to a guarantee given by 11368 NL to a group of companies (including Patrick Street Holdings) on the debts of another group of companies.

[21] The amount on one of these directions was not specified. The four specified directions amounted to $437,805.44, $488,273.76, $126,308.92, and $132,211.46, for a total of $1,184,599.58.

[22] These directions to pay were all registered at the Registry of Deeds prior to the registration of the J-3 Consulting lien or the Cook mortgages. Despite this, the Applications Judge concluded that the directions to pay did not rank in priority over the lien or Cook mortgages.

The Lien

[23] The Applications Judge concluded that a direction to pay which was issued with respect to a collateral cause unrelated to the ongoing construction cannot displace the priority given to lien claimants under the legislation. He noted that mechanics' liens operate as a "vital security instrument for builders, contractors, labourers and material and equipment suppliers."

[24] There are various provisions of the *Mechanics' Lien Act*, R.S.N.L. 1990, c. M-3, which speak to the priorities between liens and other instruments.

> 8(3) Where the land and premises upon or in respect of which work is done or materials are placed or provided are encumbered by a mortgage or other charge that was registered in the registry before a lien under this Act arose, the mortgage or other charge has priority over all liens under this Act to the extent of the actual value of the land and premises at the time the 1st lien arose, which value is to be ascertained by the judge.
>
> 8(4) The time at which the 1st lien arose shall be considered to be the time at which the 1st work was done or the 1st materials placed or provided, irrespective of whether a claim for lien in respect of those materials or that work is registered or enforced and whether or not that lien is before the court.
>
> 8(5) A mortgage existing as a valid security, notwithstanding that it is a prior mortgage within the meaning of subsection (3), may also secure future advances.
>
> […]

> 15(1) Notwithstanding subsection 8(5), the lien has priority over all judgments, executions, assignments, attachments, garnishments and receiving orders recovered, issued or made after the lien arises, and over all payments or advances made on account of a conveyance or mortgage after written notice of the lien has been given to the person making those payments or after registration of a claim for the lien as provided here, and, in the absence of that written notice or the registration of a claim for lien, all payments or advances have priority over that lien.

[25] Under this framework, a previously registered "mortgage or other charge" has priority over a subsequent lien, but only to the extent of the actual value of the land at the time the lien arose. Section 15(1) then establishes that a lien has priority over all subsequent "judgments, executions, assignments, attachments, garnishments and receiving orders recovered," as well as payments or advances pursuant to a conveyance or mortgage, so long as the lien was registered or notice was provided.

[26] There are then two questions to consider with regard to the priority as between the lien and the directions to pay.

[27] The first is whether the directions to pay can be considered an "other charge" that "encumbers" the property. If so, they would rank in priority pursuant to section 8(3), as they were registered before the lien arose.

[28] I would conclude that they are not.

[29] As noted by the Applications Judge, "encumbrance" is a defined term in the *Conveyancing Act*. While this definition is not directly incorporated into the *Mechanics' Lien Act*, it is a relevant consideration.

> 2(d) "encumbrance" includes a mortgage and a trust for securing money and a lien and a charge of a portion, annuity or other capital or annual sum;

[30] The directions do not fall under any of these specifically listed categories.

[31] *Black's Law Dictionary*, 9th ed. (St. Paul, MN: Thomson Reuters, 2009) defines "encumbrance" as follows:

> A claim or liability that is attached to property or some other right and that may lessen its value, such as a lien or mortgage; any property right that is not an ownership interest.

[32] The directions do not convey an interest in the real property. The documents are simply a binding direction for the solicitor of 11368 NL to

transfer proceeds of sale to the solicitor for certain creditors. It is only funds that would otherwise be going to the owner that are re-directed. The directions contain no assignment of an interest in land, which could constitute an encumbrance.

[33] If the directions to pay are not an "other charge" under the *Mechanics' Lien Act*, then the question of priority is not explicitly addressed by that Act, and falls to be determined under the *Conveyancing Act*.

[34] The distribution of funds following a power of sale is outlined in section 14(3) of the *Conveyancing Act*:

> 14(3) The money that is received by the mortgagee arising from the sale, after the discharge of prior encumbrances to which the sale is not made subject, shall be held by him or her in trust to be applied
>
> (a) 1st, in payment of all costs, charges and expenses properly incurred as incident to the sale or an attempted sale, or otherwise;
>
> (b) secondly, in discharge of the mortgage money, interest and costs, and other money due under the mortgage; and
>
> (c) the residue of the money received shall be paid to the person entitled to the mortgaged property, or authorized to give receipts for the proceeds of the sale of the mortgaged property.

[35] This section contemplates four stages of payment:

1. Payment to discharge any encumbrances ranking in priority to the mortgage under which the power of sale is being exercised. This would include any prior attachments on the property, as well as any subsequent attachments which have a super priority;

2. Payment of costs associated with the sale;

3. Payment of money due under the mortgage under which the power of sale is being exercised, including interest and costs;

4. Payment to "the person entitled to the mortgaged property."

[36] The fourth step in distribution of funds established by section 14(3)(c) was interpreted by Goodridge J. (as he then was) in *Re Brenton Brothers Ltd.* (1979), 24 Nfld. & P.E.I.R. 25, 65 A.P.R. 25 (Nfld. S.C. (T.D.)). In considering

the directly comparable term under the predecessor legislation, Justice Goodridge remarked:

> 21 One might query who are the persons entitled to the mortgaged property. It is my further opinion that they are those same persons who would be entitled to redeem the mortgage or who would be entitled to be joined as defendants in a foreclosure action.
>
> 22 These two classes of persons are basically the same and both clearly include judgment creditors who have levied upon the mortgaged property and subsequent or puisne encumbrances and, of course, the mortgagor itself.

[37] On the same basis that I would conclude that the directions to pay are not encumbrances under the *Mechanics' Lien Act*, I would also conclude that they are not an encumbrance that would make the beneficiary of the directions a "person entitled to the mortgaged property." As such, there is no error in the Applications Judge's finding that the J-3 Consulting lien ranks in priority to the directions to pay.

[38] This analysis is not changed by the fact that the directions were registered with the Registry of Deeds. Under section 7(2) of the *Registration of Deeds Act, 2009*, S.N.L. 2009, c. R-10.01, the registrar has authority to register "other instruments that the registrar has reasonable grounds to believe meet the requirements of this Act." This section provides the registry with broad authority in accepting documents. This acceptance is of itself meaningless. It is the statutory rules and common law rules surrounding priority which govern.

The Cook Mortgages

[39] In finding that the Cook mortgages had priority over the directions to pay, the Applications Judge relied on the accounting obligations imposed on a mortgagee exercising a power of sale under the *Conveyancing Act*. Under the *Conveyancing Act*, mortgagees are required to account to "mortgagors" and "encumbrancers." The Applications Judge noted that while the definition of "encumbrance" includes "mortgages" and "liens," it does not include directions to pay.

[40] As such, the Applications Judge concluded that the beneficiaries of the directions to pay did not have priority in the context of an accounting following a power of sale.

[41] While the Applications Judge grounded his conclusion on who the mortgagee is required to provide the accounting document to—which does not speak to actual priority of payment—the same conclusion is reached by relying on section 14(3) of the *Conveyancing Act*.

[42] In considering section 14(3), the reasons outlined above for the priority of the lien are equally applicable to the Cook mortgages.

[43] As such, I agree with the conclusion of the Applications Judge that the Cook mortgages rank in priority to the directions to pay.

Issue 2 – The $800,000 Bonus

[44] The Applications Judge removed $800,000 from the amount attributed to a mortgage given by Madden's Ltd. This mortgage was collateral security for three promissory notes.

[45] The $800,000 promissory note was not a conventional debt obligation. While the promissory note itself stated that the debtors were obligated to pay $800,000, this was subject to clause 21 of a Letter of Offer dated December 19, 2011. This clause reads as follows:

> There will be an $2,000.00 per lot bonus on lots sold from the lands above the 190 metre contour line, the total bonus shall be the greater of $800,000.00 or $2,000.00 x the number of lots, the bonus shall be secured by a second mortgage on the lands above the 190 metre contour line, subject to the First Mortgage given to support the financing hereunder. The bonus has to be paid within 10 years of the date hereof, [no interest shall apply to the outstanding balance of the bonus during the 10 years].

[46] The Applications Judge did not allow the $800,000 mortgage on the basis that it was contingent on events that did not occur. The reasons for this were briefly stated:

> [57] Patrick Street Holdings allowed $3,521,564.61 for mortgages #1, 2 and 3. The face amount of mortgage #3 is simply a consolidation of the two amounts that show in mortgages #1 and 2 and adds no new money to 11368 NL Inc.'s indebtedness to Madden's Limited. I will allow $2,237,180.95 for all three charges. From Jason Weston's cross-examination, it is apparent that Patrick Street Holdings incorrectly added interest to an $800,000.00 bonus that should not have been included in the calculations. **In addition, the bonus was contingent on events that never occurred: the sale of lots in Kenmount Terrace above the 190m contour line, so I do not allow it either.**

(Emphasis added.)

[47] Patrick Street Holdings argues that, despite the $800,000 being a "bonus," it is still a valid debt obligation secured by a mortgage. Under the agreement, if no properties above the 190 metre contour line were sold after 10 years, the amount owing under the promissory note is still $800,000.

[48] The mortgage document also states that the 10-year-term is subject to acceleration if the mortgagor sells the mortgaged property during the term:

> If the Mortgagor should sell or assign the Mortgaged Premises, the Indebtedness and all other amounts which may become due by the Mortgagor to the Mortgagee under this Mortgage shall immediately become due.

[49] Patrick Street Holdings argues that the effect of this acceleration clause is that the $800,000 became due and payable when the power of sale was exercised, and should have been included in the accounting.

[50] While the Applications Judge did not directly address the acceleration clause in the mortgage, I accept that it has no application in the present circumstances. The acceleration clause is not triggered by *any sale* or assignment of the property; the trigger is a sale or assignment *by the mortgagor*.

[51] In the present case, the property was not sold by 11368 NL, the mortgagor. Rather, it was sold by Patrick Street Holdings, the mortgagee, pursuant to the power of sale provisions in the mortgage and under the *Conveyancing Act*. Section 14(1) of the *Conveyancing Act* states that in a power of sale proceeding, the mortgagee is the party authorized to convey the property:

> A mortgagee exercising the power of sale conferred by this Act shall have power by deed to convey the property sold for the estate and interest in the estate that is the subject of the mortgage, freed from all estates, interests and rights to which the mortgage has priority, but subject to all estates interests, and rights that have priority to the mortgage.

[52] A power of sale proceeding does not involve the mortgagee forcing the mortgagor to sell the property. Rather, it involves the mortgagee exercising its authority to sell the property, subject to statutory procedural requirements and a requirement to act in good faith (*Frost Ltd. v. Ralph* (1980), 40 Nfld. & P.E.I.R. 207 (Nfld. S.C. (T.D.)), aff'd (1982), 40 Nfld. & P.E.I.R. 204 (Nfld. S.C. (C.A.)).

[53] Accordingly, I would not interfere with the Applications Judge's conclusion that the $800,000 was not payable at the time the power of sale took place.

Issue 3 – The Disallowed Mortgage

[54] Patrick Street Holdings was the mortgagee with respect to a mortgage on the Subject Property which was registered for an amount of $4,000,000. This mortgage acted as collateral security for a guarantee given by 11368 NL on behalf of a group of companies. The principal debt guaranteed totalled $10,072,816.52, and was owed by a group of companies to another group of companies, including Patrick Street Holdings.

[55] The Applications Judge disallowed this mortgage entirely from the accounting. He found that the actual amount owing under the mortgage was not properly established on the evidence.

[56] The affidavit evidence of Jason Weston filed by Patrick Street Holdings for the hearing of the application stated that at the time the power of sale was exercised, the amount owing under the principal debt guaranteed by the mortgage was $8,523,007.86. This statement was not challenged in cross-examination.

[57] The guarantee document is incorporated as a component of the mortgage. Under the terms of the guarantee, the creditor is entitled to demand payment from the guarantor, regardless of whether attempted remedies against the principal debtor have been exhausted:

> 7. PAYMENT AND REMEDYING DEFAULTS
>
> The Guarantor shall pay the amount guaranteed or rectify any default immediately upon receiving a demand from the Lender and shall do so whether or not the Lender has exhausted its recourses against the Borrower, other parties, the Loan Security or anything mortgaged under the Loan Security. A demand is effectually made when a letter is posted to the address of the Guarantor last known to the Lender.

[58] Similar to the $800,000 bonus, the mortgage contained an acceleration clause in the event of a sale by the mortgagor.

> AND the Mortgagor hereby covenants with the Mortgagee that, while an amount of principal and/or interest is outstanding on the indebtedness;
>
> […]

> (g) to not, without the consent, in writing, of the Mortgagee first obtained, sell or assign the said land and premises and in the event of doing so, the said principal sum and all other monies then owing under the documents evidencing the indebtedness and hereunder shall immediately become due and payable;

[59] For the reasons previously stated with respect to the $800,000 bonus, I would conclude that the power of sale proceedings do not constitute a sale by the mortgagor which would trigger acceleration under the mortgage. As such, I would not conclude that this clause causes the amount guaranteed to have been payable at the time of the power of sale.

[60] On appeal, Patrick Street Holdings did not argue that the specific language of the mortgage caused the $4,000,000 to become payable at the time of the power of sale. Rather, they submitted that this Court should follow the approach taken in *Glasswall Ltd. v. 2009861 Nova Scotia Ltd.*, (1994), 130 N.S.R. (2d) 241, [1994] N.S.J. No. 133, (N.S.S.C.), aff'd (1994), 134 N.S.R. (2d) 356, 119 D.L.R. (4th) 713 (N.S.C.A.) where it was concluded that a mortgage given to support a guarantee can be a valid claim entitled to priority in accordance with its registration timing. The Nova Scotia Court reached this conclusion despite recognizing the "apparent unfairness" it created:

> A collateral mortgage, even if provided as collateral security for the debts or obligations of a different corporate entity, may be prior to a later registered lien claim. The priority in favour of a collateral mortgage security given to secure the debts of another is not excluded, notwithstanding the apparent unfairness created by mortgage monies being advanced to another entity, on another project and not for the purpose of increasing the selling value of the lands on which the lien holders have expended labour or furnished supplies.

[61] However, even if this Court were to find that the legal conclusion in *Glasswall* should be followed, there is a significant factual distinction. *Glasswall* proceeded based upon an agreed statement of facts which established that the amount of the mortgage securing the guarantee was due and payable in full by the guarantor.

[62] In the present case, the Applications Judge did not find that there was sufficient evidence to conclude that 11368 NL as guarantor was liable to make payment at the time of the sale. The mere fact that the registration cost of the mortgage reflected a value of $4,000,000 is not determinative of the amount actually owing under the mortgage.

[63] The Applications Judge's conclusion that the amount owing was not established, and that therefore the mortgage should be disallowed from the accounting, is entitled to deference on appeal. As there is no basis before the Court to warrant appellate intervention, I would uphold the decision of the Applications Judge in finding that there should be no payment under the $4,000,000 mortgage in priority to the J-3 Consulting lien or the Cook mortgages.

Conclusion

[64] Accordingly, I would conclude that:

1. In assessing the registrations against title to the Subject Property, the Applications Judge correctly removed the five directions to pay from the accounting.

2. There was no reviewable error in the Applications Judge's decision to deduct the $800,000 from what was otherwise accepted as a valid mortgage.

3. The Applications Judge did not commit an error in disallowing the $4,000,000 mortgage registered to secure a guarantee.

[65] I would dismiss the appeal.

Costs

[66] In his decision, the Applications Judge awarded costs only to J-3 Consulting and Cook. While this Court appreciates the submissions made on behalf of 11368 NL, I would exercise my discretion to similarly award costs only to J-3 Consulting and Cook. As they were jointly represented, I would make a single award for costs on column 3 under the *Court of Appeal Rules*, payable by Patrick Street Holdings.

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C. W. White J.A.

I Concur: _____

L.R. Hoegg J.A.

I Concur: _____

F. P. O'Brien J.A.