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Canadian Mortgage Law and Prepayment Penalties

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Abstract

This article illustrates the imbalance of power between the mortgagor and mortgagee, which is particularly apparent for individual mortgagors. Prepayment and due on sale provisions are standard mortgage terms that contribute to this imbalance. Although these clauses purport to operate separately, in reality, both are frequently triggered by the sale of a property; the law of contract suggests that these provisions should not be enforceable. Relevant legislation is lacking in this area and should be reformed to provide more effective consumer protection while acknowledging that banks operate with the goal of maximizing business. A reasonable compromise would involve basing the transferability of mortgages on objective criteria such as the size of the down payment provided by the buyer, rather than leaving it purely to the discretion of the lender.

This article is helpful for readers seeking to learn more about:

- mortgages, mortgage penalties, prepayment clause, due on sale clause, penalty clauses, financial services, class actions, borrowing rates, enforceability of clauses, consumer protection, unconscionability

Topics in this article include:

- real estate, consumer protection, imbalance in power, legislative protection, economics, contract law, equity, common law

Authorities cited in this article include:

- Interest Act RSC 1985, c I-15
- Land Registration Reform Act RSO 1990, c L4
- Mortgages Act RSO 1990, c M40

Keywords

mortgages, mortgage penalties, prepayment clause, due on sale clause, penalty clauses, financial services, class actions, borrowing rates, enforceability of clauses, consumer protection, unconscionability real estate, consumer protection, imbalance in power, legislative protection, economics, contract law, equity, common law

CANADIAN MORTGAGE LAW AND PREPAYMENT PENALTIES

PETER SPIRO*

INTRODUCTION

Throughout their lives, people sell and purchase homes a number of times for a variety of reasons. In Canada, approximately 500,000 homes are sold per year, most of which have mortgages registered on their titles.[1] Many Canadians buy and sell rental properties in the hope of realizing both rental income and capital gains. In these transactions, either the purchaser of the property assumes the existing mortgage, or the mortgage is discharged on closing and a prepayment charge of at least three months' interest must be paid to the lender, as is almost universally provided for in the mortgage contract. These prepayment charges are colloquially referred to as "penalties." Lenders, however, do not use this terminology, because penalties have a specific meaning in contract law and are generally unenforceable. In residential mortgages, litigation often costs more than the penalty payment.[2] Despite this, litigation has increased in recent years, although it is still rare. For example, prepayment charges on residential mortgages were the subject of a recently failed class action,[3] as discussed below.

In 2010, the federal government's budget included a promise to bring clarity to the subject of mortgage penalties. Here, the federal government specifically used the term "penalty" and recommended "[s]tandardizing the calculation and disclosure of mortgage pre-payment penalties":

> It is important that consumers have the information they need when making financial decisions, including when to prepay a mortgage. As such, the

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[1] The Canadian Real Estate Association "Canadian Home Sales Slip further in January" (17 February 2015), online: <http://creastats.crea.ca/natl/>.

[2] In spite of that, in *Pfeiffer v Pacific Coast Savings Credit Union*, 2000 BCSC 1472, a mortgagor was asked to pay a prepayment charge, but there was disagreement about the calculation of the charge. No doubt the litigation costs were much higher than the amount in dispute, but some people will go to great lengths to get justice.

[3] *Arabi v Toronto Dominion Bank*, (2006), 30 CPC (6th) 164 (Ont Sup Ct) [*Arabi*].

> Government will bring forward regulations to bring greater clarity to the calculation of mortgage pre-payment penalties.[4]

Despite the promise, no regulations were made, resulting in a lack of meaningful legislative control of the terms of prepayment charges in mortgages. While current low interest rates have made the issue less prominent, prepayment charges will become more significant if interest rates rise. Prepayment charges are not the only problematic clauses found in mortgage contracts in Canada. Due-on-sale clauses permit the bank to require payment of the full balance of the mortgage loan upon sale of the property. Thus, due-on-sale clauses, if enforceable, may restrict purchase and sale of mortgaged properties.

This paper is divided into two parts. Part I discusses the relevant legislation governing mortgages in Ontario and what protections, if any, exist for consumers. Part II explores what the common law and the common practices of lenders have provided with respect to consumer protection. In particular, penalty provisions and the due-on-sale clause are examined. There is a lack of consumer protection for borrowers with respect to mortgage interest penalties. This is especially true for individual borrowers, where the inequality of bargaining power leads to potentially unconscionable outcomes. This situation is not insurmountable. This paper concludes by suggesting some possible reforms that could provide a reasonable balance between the interests of borrowers and lenders.

I. THE STATUTORY APPROACH TO MORTGAGES IN ONTARIO

Under the *Constitution Act*, *1867*,[5] the federal government has jurisdiction over banking and finance, while the provincial government has jurisdiction over property. Both levels of government therefore have the power to legislate in the field of mortgages. Under Canadian constitutional law, the principle of federal paramountcy governs where jurisdiction overlaps, so that the federal legislation prevails in the regulation of mortgages. Three relevant pieces of legislation will be discussed: (1) the federal *Interest Act*,[6] (2) the provincial *Land Registration Reform Act*[7] (*LRRA*) and (3) the provincial *Mortgages Act*.[8]

Interest Act

The statute governing interest rates on mortgages in Canada is the federal *Interest Act*. Section 8 of the Act provides that, where mortgage payments fall into arrears, the interest rate charged on the arrears cannot exceed the rate of interest that was payable on

[4] House of Commons, Minister of Finance, *Leading the Way on Jobs and Growth* (March 2010) at 116 (Hon James M Flaherty).
[5] 30 & 31 Vict, c 3 ss 91 & 92.
[6] RSC 1985, c I-15 [*IA*].
[7] RSO 1990, c L4 [*LRRA*].
[8] RSO 1990, c M40 [*MA*].

the principal before the mortgagor fell into arrears.[9] As a result, a mortgagor who is required to immediately repay the whole principal of the mortgage upon default could argue that the mortgagee is not entitled to levy an extra charge for this involuntary prepayment. The requirement for immediate repayment of the whole principal upon default is known as acceleration.

In a number of early cases, such penalties were held to be unenforceable.[10] This argument by the mortgagor was later rejected in *Mastercraft Properties Ltd v El Ef Investments Inc*,[11] where the mortgage contract had been modified to provide for either three months' notice or interest in lieu of that notice. In *Mastercraft Properties*, the Ontario Court of Appeal distinguished the earlier decisions and upheld the right of the mortgagee to enforce what was effectively a disguised penalty. The Court stated, "The obvious purpose of such a stipulation is to give the mortgagee the benefit, when the mortgagor defaults, of a reasonable period during which to arrange for the alternate investment of its funds."[12] A later Ontario decision, *O'Shanter Development Company Ltd v Gentra Canada Investments Inc*,[13] affirmed this point, noting that it would be an anomaly if the prepayment charge was not enforceable upon default. If prepayment charges were extremely vulnerable to litigation, a mortgagor could avoid the prepayment charge in his or her mortgage "simply by allowing the mortgage to go into default and forcing the mortgagee to take steps to realize on its security."[14] The *Interest Act* does not explicitly prohibit the clauses allowed in these cases, but section 10 has some effect.

The only section within the *Interest Act* that explicitly addresses prepayment charges is section 10. Section 10(1) stipulates:

> Whenever any principal money or interest secured by mortgage on real property or hypothec on immovables is not, under the terms of the mortgage or hypothec, payable until a time more than five years after the date of the mortgage or hypothec, then, if at any time after the expiration of the five years, any person liable to pay, or entitled to pay in order to redeem the mortgage, or to extinguish the hypothec, tenders or pays, to the person entitled to receive the money, the amount due for principal money and interest to the time of payment, as calculated under sections 6 to 9, together with three months further interest in lieu of notice, no further interest shall be chargeable, payable or recoverable at any time after the payment on the principal money or interest due under the mortgage or hypothec.[15]

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[9] *IA*, *supra* note 6, s 8.
[10] See, e.g., *459745 Ontario Ltd and Wideview Holdings Ltd*, (1987), 59 OR (2d) 361 (HC).
[11] (1993), 14 OR (3d) 519 (CA), leave to appeal to SCC refused, (1994) 1 SCR ix [*Mastercraft Properties*].
[12] *Ibid* at 523.
[13] (1995), 25 OR (3d) 188 (Sup Ct) [O'Shanter].
[14] *Ibid* at 194. This point was re-iterated in *259121 Ontario Inc v Canada Trust Co*, [2007] OJ 1007 (Sup Ct) at para 9.
[15] *IA*, *supra* note 6, s 10(1).

This provision provides for a flat three-month interest prepayment charge without regard to the prevailing market interest rates, but it only applies to mortgages with terms of five years or more on property not owned by a corporation. Significantly, over 95 per cent of mortgages in Canada are contracted for a term of five years or less and, therefore, do not fall under section 10.[16] It is likely that section 10 may contribute to why banks rarely issue mortgages with a term greater than five years because the charges for shorter-term mortgages are unregulated and remain at the discretion of the lender.

Section 10(2) goes on to stipulate that this provision does not apply if the mortgagor is a corporation or a joint stock company.[17] Therefore, the right of prepayment in section 10(1) will likely prevail when a large, unincorporated grouping such as a real estate investment trust is the mortgagor. Provided the owners are not all corporations, there is no restriction on the number of individuals who are owners.[18]

The evasive actions taken by banks in response to section 10 have resulted in an unregulated system that is problematic for consumers, particularly when the mortgage market is relatively concentrated and oligopolistic. In a concentrated market, companies compete by image and advertising but avoid genuine competition on substantive matters. This is because these companies are aware that it would be a race to the bottom that reduces profits. The banks, whose primary motivation is earning a profit, in effect set the terms of the mortgages. In Canada, the current banking system is more concentrated than in the past. While a number of smaller players remain in the market, most mortgages are issued by the "Big Five" banks: Royal Bank of Canada (RBC), Toronto-Dominion Bank (TD), Bank of Nova Scotia (Scotiabank), Bank of Montreal (BMO), and Canadian Imperial Bank of Commerce (CIBC).[19] Therefore, section 10(1) does not protect most Canadian borrowers from an unregulated and highly concentrated market. Furthermore, a provision analogous to section 10 has existed since 1910 despite the fact that mortgages with a fixed rate for 25-year terms were the norm for many decades following 1910.[20]

Where mortgages are paid off early, a lender may suffer a loss if interest rates fall and she has to re-lend the money at a lower rate. Thus, due to section 10, banks must price mortgages with terms greater than five years at higher rates to reflect the risk associated with early prepayment. This is evident in the yield curve of government bonds,

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[16] Allan Crawford, Césaire Meh, and Jie Zhou, "The Residential Mortgage Market in Canada: A Primer" Financial System Review (December 2013) Bank of Canada, online: <http://www.bankofcanada.ca/wp-content/uploads/2013/12/fsr-december13-crawford.pdf>.
[17] *IA*, *supra* note 6, s 10(2).
[18] See: *Litowitz v Standard Life Assurance Co (Trustee of)* (1996), 30 OR (3d) 579 (CA).
[19] *Canadian Banks*, "The Big Five Banks in Canada" (2015), online: <http://www.bankingcanada.net/big+five+banks+in+canada/>.
[20] *An Act respecting Mortgages of Real Estate* SO 1910, c 51 at s 15, as amended by *An Act respecting Mortgages of Real Estate*, RSO 1914, c 112 [*ARMRE*].

where the cost of a 10-year mortgage does not greatly differ from that of a five-year one, but the interest rate on it does.[21]

In summary, while the *Interest Act* provides some protection for consumers with regard to interest and prepayment charges, banks have taken advantage of loopholes and gaps in the law to the detriment of consumers, which has resulted in an unregulated system. Despite the promises made by the federal government in the 2010 budget,[22] no progress has been made.

Land Registration Reform Act

The second statute relevant to mortgage law is the *LRRA*, which marks the advent of electronic registration of titles and charges in Ontario. Historically, a mortgage was a conveyance of the property by the borrower to the lender, with an equitable right of redemption on repayment of the money owing. While this common law principle was abolished by the *LRRA*, section 6(3) of the Act protects the rights of the lender as if the principle had not been abolished.[23] Specifically, section 6(3) states that "a chargor and chargee are entitled to all the legal and equitable rights and remedies that would be available to them if the chargor had transferred the land to the chargee by way of mortgage, subject to a proviso for redemption."[24] This section is the vital link that allows remedies in the *Mortgages Act* to apply to a charge. While the term "mortgage" continues to be used colloquially, the *LRRA* has replaced it with the term "charge."[25]

Furthermore, section 8 of the *LRRA* delineates the filing of standard "charge terms," which is how the Act refers to the mortgage contract. Each standard contract has a catalogue number that is used to refer to the contract when a charge is registered on the title of a property.[26] Since section 8 does not impose any conditions on what the charge terms may be, complete freedom of contract is preserved. If the parties to a contract are of roughly equal bargaining power, then freedom of contract is a reasonable policy. However, the lending relationship is highly unequal between banks and most borrowers, whether they are individuals or large commercial borrowers.

As Ontario's first new piece of legislation dealing with mortgages in nearly a century, the *LRRA* does not amend any of the substantive rights of lenders and borrowers.

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[21] For example, on September 23, 2014, RBC offered a 5 year mortgage at 4.94%, and a 10 year mortgage at 6.75%, a difference of 181 basis points. At the same time, the yield on 10 year Government of Canada bonds was only 53 basis points higher than the 5 year bond yield. The 128 basis point (181 minus 53) difference no doubt reflects a pricing in of the risk that, at the 5 year mark, the borrower will take advantage of the *Interest Act* provision, and replace this mortgage with a new 5 year one, unless 5 year rates at the time are over 6.75%.
[22] Canada, Department of Finance, *Archived – Minister of Finance Announces Review of Financial Institutions Legislation* (20 September 2010), online: <http://www.fin.gc.ca/n10/10-083-eng.asp>.
[23] *LLRA*, *supra* note 7, s 6(3).
[24] *Ibid*.
[25] *Ibid*, s 1.
[26] *Ibid*, s 8(6).

Rather, these rights remain governed by the longstanding and essentially unchanged *Mortgages Act*.

Mortgages Act

The third relevant statute is Ontario's *Mortgages Act*. The Act predominantly addresses enforcement of mortgages and provides specific rights to both the lender and the borrower. The Act also briefly addresses prepayment charges. For example, section 18 mirrors the terms of section 10 of the federal *Interest Act* and allows the prepayment of any mortgage for a term of five years or more, with only three months' interest as a prepayment charge.[27]

While section 17(1) of the *Mortgages Act* addresses prepayment charges, it does so in the context of default and, therefore, in considerably different terms:

> Despite any agreement to the contrary, where default has been made in the payment of any principal money secured by a mortgage of freehold or leasehold property, the mortgagor or person entitled to make such payment may at any time, upon payment of three months interest on the principal money so in arrear, pay the same, or the mortgagor or person entitled to make such payment may give the mortgagee at least three months' notice, in writing, of the intention to make such payment at a time named in the notice, and in the event of making such payment on the day so named is entitled to make the same without any further payment of interest except to the date of payment.[28]

The above provision confers a right on the mortgagor to repay, but it does not permit the mortgagee to demand a payment. Despite this, numerous modern judicial decisions have interpreted this provision to impose a substantial penalty on a mortgagor who defaults on repayment. As with most of the Act, it has been part of the statute since 1910 and the language has remained essentially unchanged since then. In the original printed statutes, the marginal note beside the section (section 15 at the time) suggests that the drafters of the legislation intended the literal meaning of the section to apply: "[m]ortgagor in default to be entitled to redeem on giving three months' notice, or on paying three months' interest in lieu of notice."[29] While marginal notes are not binding, they are often accepted as an aid to statutory interpretation.[30] This marginal note specifically provides the mortgagor with the right to provide notice or repay. The note provides nothing with respect to the mortgagee's right, which suggests that the provision does not permit the mortgagee to demand payment, despite subsequent interpretations. Furthermore, this was

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[27] *IA*, *supra* note 6, s 18.
[28] *MA*, *supra* note 8, s 17(1).
[29] *ARMRE*, *supra* note 20. The only difference between Section 15 in the 1910 Act and the current Section 17 is that the 1910 version restricted this privilege to mortgages taken out after the 12th day of June, 1903.
[30] See: *R v McIntosh*, [1995] 1 SCR 686 at para 70; see also: *R v Wigglesworth*, [1987] 2 SCR 541 at para 19.

likely intended to be a benefit for the mortgagor due to the facts that it only provides for the mortgagor and that the mortgagee has no recourse. Therefore, it appears that the legislature intended to provide a benefit to the borrower in the form of the right to delay repayment without penalty, as long as notice of late payment has been given.

In Ontario, defaulters have frequently pleaded in court that three months' notice can be given in lieu of three months' interest. For example, in *Parkhill et al v Moher et al*,[31] the principal of the mortgage was due, but the mortgagor could not raise the money until approximately one month later. The mortgagee sought a penalty, but the court ruled against it and invoked section 17:

> [A prepayment charge] is applicable where the mortgagor attempts to force payment upon the mortgagee, but where the mortgagee is enforcing payment by action after maturity, the payment will not be unexpected and the mortgagee must be contemplated to have need of it, or a better opportunity for reinvestment.[32]

The court would not allow a prepayment charge where the mortgage had matured; payment in full was thus expected by the mortgagee. In other words, the mortgagee could not charge for a mortgage that was not prepaid.

More than 30 years later in 2009, in *Mohtashami v Letichever*[33] (*Mohtashami*), the court came to a different conclusion despite similar facts. In this case, the mortgagor sought a refund of a $15,000 penalty paid under protest to discharge a mortgage on which he had defaulted. The mortgagor was unsuccessful in relying on section 17. In a terse eleven paragraph decision, the court dismissed the borrower's application and allowed the penalty charge, relying on the decision in *Mastercraft Properties.*[34] However, *Mastercraft Properties* is distinguishable on its facts. In *Mastercraft Properties* the borrower argued that the prepayment charge represented a violation of the *Interest Act*. The borrower did not rely on the argument that there was notice, and the court specifically allowed the charge as a payment in lieu of notice.[35]

In *Mintz v Mademont Yonge Inc*,[36] Pepall J carefully considered how earlier cases such as *Mastercraft* had interpreted section 17. She held that a mortgagor who knows payment is going to be late and gives proper notice can use section 17 to avoid paying the additional three months of interest. However, in the absence of such notice, the three-month penalty must be paid if the principal repayment is late:

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[31] (1977), 17 OR (2d) 543 (Sup Ct).
[32] *Ibid* at 546.
[33] [2009] OJ 60 (Sup Ct).
[34] *O'Shanter*, *supra* note 13.
[35] *Ibid* at 523.
[36] 2010 ONSC 116.

> In the case before me, Mademont did not give three months' notice. Having failed to do so, Mademont is required to pay an additional three months' interest . . . any other result would do violence to section 17 of the *Mortgages Act*.[37]

Justice Pepall's approach appears to be the accepted interpretation of the statute.[38] The statutory provision is now often used as a means to impose penalties on borrowers, despite the original intention to provide benefits. Furthermore, the inconsistent interpretations of section 17 found in decisions such as *Mohtashami*, call for a legislative amendment to clarify its intention and application.

II. THE COMMON LAW APPROACH TO MORTGAGES IN ONTARIO

This section considers mortgages in the context of the common law and the standard terms used in practice. In particular, prepayment and due-on-sale provisions will be examined. Surprisingly, the due-on-sale clause, a term found in almost all mortgages, has rarely been litigated. However, the recent certification attempts of several class actions related to penalty provisions indicate that litigation may be forthcoming.

Prepayment Charges

In contract law, penalty clauses incurred upon breach or default are generally unenforceable.[39] When a buyer has defaulted, a seller can only keep a buyer's deposit when it is a reasonable estimate of liquidated damages. If there are no damages resulting from the breach, a penalty amount cannot be kept. This was elucidated by Laskin CJC in *HF Clarke Limited v Thermidaire Corp Ltd*:

> The primary concern in breach of contract cases . . . is compensation, and judicial interference with the enforcement of what the courts regard as penalty clauses is simply a manifestation of a concern for fairness and reasonableness, rising above contractual stipulation.[40]

Furthermore, although the parties can "make the predetermination . . . it must yield to judicial appraisal of its reasonableness in the circumstances."[41]Thus, where a penalty is not a reasonable estimate of damages, it is not reasonable and should not be enforced.

This principle is not easily applicable to situations where the mortgagor wants to pay off the mortgage early. Essentially, the mortgagor is asking the mortgagee to grant something that the mortgagor is not contractually entitled to—to accept payment and discharge the mortgage early. There is no breach of contract *per se*, but rather a payment

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[37] *Ibid* at para 18.
[38] See *Centre d'Apprentissage et de Formation + de Cornwall (Re)*, 2013 ONSC 2749 where the reasoning in *Mintz v Mademont Yonge Inc*, *infra* note 40, was cited with approval at paras 17-19.
[39] See: John D McCamus, *The Law of Contracts* (Toronto: Irwin Law, 2012) at 964-965, 968-972.
[40] [1976] 1 SCR 319 at 331.
[41] *Ibid*.

in lieu of notice. The mortgagor is not in breach of contract until it fails to make monthly payments. The major Canadian banks use similar terms for calculating the prepayment charge.[42] In all cases, the minimum prepayment charge is three months' interest, regardless of the duration remaining on the term of the mortgage. If interest rates fall compared to the existing interest rate in the mortgage, the standard mortgage contract calls for the prepayment charge to be even larger. If a prepayment charge was included in the contract, the bank will then re-lend the money at a lower interest rate and will require the mortgagor to fully compensate it for the "interest rate differential" over the remaining term of the mortgage.[43] This prepayment scheme is justified under the general principle of contract law: damages in breach of contract should compensate for loss of expectation interest.

Conversely, the one-sided nature of the agreement detracts from the reasonableness of this justification. For example, where the current market rate is higher than the mortgage rate, it is beneficial to the bank to have its money repaid early. The bank will likely re-lend the funds to a new customer at a higher rate, but the bank is not required to discount the principal amount to be repaid by the borrower. Economically, the repayment may be a windfall to the bank, even without a prepayment charge. Where the rates are significantly higher, there may be less demand for mortgage loans. However, the bank will likely be able to lend its money elsewhere at a higher rate. Such a one-sided situation is unlikely to occur where both parties have equal bargaining power.

There is one mitigating feature of the standard mortgage contract: where the borrower has sold one house and is buying another, he or she may be allowed to keep a lower interest rate by transferring the current mortgage to the new property. This option may not be helpful for some sellers, such as "empty-nesters" who are downsizing and do not need a mortgage on the new property. If the property being purchased has an existing mortgage, there may be at least one prepayment charge. Regardless, while the existence of a prepayment charge in a mortgage contract complicates the sale and purchase of homes, most homeowners would not be able to move without financing and without paying the prepayment charge.

In *1259121 Ontario Inc v Canada Trust Co*[44], a mortgage went into default and the mortgagor argued that the three months' interest prepayment charge was a contractually unenforceable penalty. The court held that it was a payment in lieu of notice. The mortgagor was not completely unsuccessful. This particular mortgage provided for an additional $15,000 administrative charge in the event of a default, which the court held was not a reasonable estimate of liquidated damages. As a result, the court

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[42] See: *RBC Royal Bank* "Form 3997: Standard Charge Terms (Fixed)", Royal Bank of Canada online: <http://www.rbcroyalbank.com/RBC:r1e3BKwYUAsBxAB@@v0AAADG/legalforms/download/3997(04-2013).pdf>. The standard charge terms from BMO, CIBC and Scotiabank all have essentially identical terms.
[43] See: *ibid*, where the calculation is set out in the standard charge terms
[44] (2007), 58 RPR (4th) 58 (Ont Sup Ct) [*1259121 Ontario*].

did not allow this additional charge. In *1259121 Ontario*, the mortgagor went into default in February of 2006, only a few months after taking out a five-year mortgage the previous November, during a time of rising interest rates. Given the rising interest rates, if a mortgage was paid in full in June, the bank could re-lend it at a higher interest rate and end up financially better off than if the mortgage had not gone into default. This reasoning undermines the argument that the prepayment charge was a necessary compensation in lieu of notice. As with the previously mentioned case, if the injured party can immediately mitigate its damages and avoid all loss, no notice is required and compensation is not necessary. There was no reported argument raised by the mortgagor regarding this issue.

As a result of these financial realities, in a period of rising interest rates, any prepayment charge may be unreasonable. Although housing sales and mortgage borrowing may drop in periods of high interest rates, lenders still benefit from early repayment because they will likely re-lend the funds at higher interest rates in the government bond market.[45] In such a situation, borrowers could argue that the contract is unconscionable. As La Forest J stated, "[a]n unconscionable transaction arises in contract law where there is an overwhelming imbalance in the power relationship between the parties."[46] Given the high costs of litigating against a bank compared to the amount of money involved for the typical mortgagor, mortgagors would hesitate to pursue individual remedies. However, unfairness in mortgage contracts is the type of claim that could conceivably become the subject matter of class actions.

The Due-on-Sale Clause

Prepayment charges are a standard feature of mortgage contracts and apply regardless of the motivations of the mortgagor. In the majority of situations, prepayment is required because the property is being sold. When a property is sold, the parties to the transaction may be able to avoid the prepayment charge if the purchaser assumes the existing mortgage. Where market interest rates have risen, this option is particularly attractive for both the mortgagor and the purchaser of the property. However, this mutually beneficial arrangement is often prevented by the due-on-sale clause, which purports to allow the lender to refuse permission for the buyer to assume the mortgage. In their book *Real Estate Law*, Reiter, McLellan, and Perrell view such clauses suspiciously:

> [S]ome fear that "approval of purchasers" clauses may violate the doctrine of "clogging the equity of redemption" and use due-on-sale clauses instead. Some people claim that mortgagees have been inserting and relying on due-on-sale clauses for the purpose of terminating the loan if current interest rates are above

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[45] See: Paul Cardinal "Factors that Determine Mortgage Rates in Canada" *FCIQ* (February 2011), Fédération des chambres immobilières du Québec online: <http://www.fciq.ca/pdf/mot_economiste/en/me_022011_a.pdf> for a discussion of the close correlation between mortgage rates and government bond rates [Cardinal].

[46] *Norberg v Wynrib*, [1992] 2 SCR 226 at para 30.

the loan rate when mortgaged property is sold, thus requiring new financing to be procured at higher rates.[47]

Due-on-sale clauses also once again illustrate the uneven bargaining power of the mortgage contract. The standard form of charge provides that the lender has discretion to refuse the purchaser's consent to assume the mortgage. The putative reason for withholding consent is that the lender does not approve of the purchaser's credit. These evaluations are not only subjective but they also provide the potential for a conflict of interest for the lender. For example, even if the purchaser's credit is sufficient, it may be economically beneficial for the lender to refuse the transfer and receive its remaining balance. In this scenario, the mortgagee receives the extra three months of interest from the prepayment charge imposed on the seller, and, in a situation of rising rates, the mortgagee may be able to re-lend the money at a premium, albeit with fewer borrowers due to the higher rates.

The discretionary nature of the lenders' decisions in these loan agreements is concerning. A more equitable contract would ideally state some objective criteria. Professor Joseph Roach suggests that due-on-sale clauses ought to be more important for lenders in the western provinces, where the mortgagee's statutory right to sue on the covenant is more limited.[48] He notes, however, that "there are relatively few reported cases in Canada," having found only eleven dealing with the question of enforceability.[49] Given their ubiquity, it is remarkable how infrequently due-on-sale clauses have been subject to litigation in Canada.

a) Ontario Statutes and Common Law Rules

As the contract is framed, if the due-on-sale clause is violated, acceleration may be imposed, wherein the borrower is required to pay off the entire mortgage. Following this conveyance, the question arises as to whether or not a bank could require the purchaser to immediately pay off the whole principal or face foreclosure. The *Mortgages Act* provides no clarity on this issue.

Specifically, section 20(2) of the Ontario *Mortgages Act* provides that "the mortgagee has the right to recover from the grantee the amount of the mortgage debt in respect of which the grantee is obligated to indemnify the mortgagor."[50] In this context, indemnification can be characterized as adjusting for any deficiency after a property has been sold under power of sale. The statute remains ambiguous with respect to the breadth of this obligation and whether this requirement to indemnify would allow the mortgagee to enforce an acceleration of the mortgage against the grantee. Under the *Mortgages Act*,

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[47] Barry Reiter, Bradley H McLellan & Paul M Perell, *Real Estate Law*, 4th ed (Toronto: Emond Montgomery, 1982) at 897.
[48] Joseph E. Roach, *The Canadian Law of Mortgages*, 2nd ed (LexisNexis Canada, 2010) at 441.
[49] *Ibid* at 443.
[50] *MA*, *supra* note 8, s 20(2).

a mortgage is a conveyance of the land where all that the mortgagor possesses is the equity of redemption.[51] The Act does not address a situation where the mortgagor has transferred the equity of redemption. Further, there are no provisions in the Act that require notification to the lender that the owner of the equity has changed. The Act neither explicitly authorizes nor forbids the lender from setting conditions on this issue.

The *Mortgages Act* places clear limits on the lender's entitlement to acceleration. For example, sections 22 and 23 suspend any contractual provisions regarding acceleration, even after the borrower has gone into default. Section 22(1) provides that a mortgagee cannot enforce acceleration of the mortgage despite any agreement to the contrary, if the mortgagor pays arrears and costs to come back into good standing. Moreover, even after an action for possession has commenced, section 23(1) gives the mortgagor a chance to make outstanding payments and, again, despite any agreement to the contrary, acceleration of the mortgage is barred.

The *Mortgages Act* also strictly regulates the remedies available to the mortgagee in the event of a default.[52] For example, there are requirements as to the time period of notice provided and the form of the notice.[53] The aim of the Act appears to be to avoid acceleration as much as possible. For example, section 22(1) provides that, in order to avoid acceleration, "the mortgagor may perform such covenant or pay the amount due under the mortgage."[54] In this case, the amount due is the whole amount of the principal, thus creating a scenario of acceleration in order to avoid acceleration. Arguably, an acceleration clause that offers the mortgagor no corrective mechanism is contrary to the intent of the Act. This issue does not seem to have been addressed in Ontario courts, but the courts have paid some attention to other issues associated with mortgage contracts.

Historically, equity has treated mortgage contracts as distinct from ordinary contracts:

> The principle that a man who enters into a contract should be held to his bond has been frequently said with varying degrees of eloquence in many arguments and many cases. This principle does not override certain principles developed by the Courts of equity . . . provisions in an agreement prohibiting the alienation of land are void and the rigidity of this principle is not tempered by the willingness of the alienee to be so restricted even though such restriction may be reasonable.[55]

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[51] *Ibid*, s 10.
[52] *Ibid*, s 20.
[53] See: *ibid*, ss 31-34 & 39. See also: ss 22-23 for relief from default before and after action.
[54] *Ibid*, s 22(1).
[55] *Laurin v Iron Ore Company of Canada*, [1977] 19 Nfld & PEIR 111 (Nfld Sup Ct) at paras 96-98 [*Laurin*]; quoted with approval in *Canada Mortgage and Housing Corporation v Hong Kong Bank of Canada* (1990), [1991] 75 DLR (4th) 307 (Alta CA) at 316.

In *Tiernan v Bird's Eye Cove Farm Ltd*,[56] the British Columbia Court of Appeal declined to enforce acceleration of a mortgage following breach of a due-on-sale clause on equitable grounds. The court concluded that "the covenant that was breached does not appear to be one of great moment."[57] Specifically, the court referred to the fact that the property was worth substantially more than the mortgage debt, and it found that the lender was not prejudiced by the sale. This decision was made under the auspices of British Columbia's *Law and Equity Act*. The Act provided that, notwithstanding any written terms in a contract, "the court may impose any terms as to costs, expenses, damages, compensations and all other matters it considers appropriate."[58]

In Ontario, the law is not quite as explicit, but the Ontario *Courts of Justice Act* notes "where a rule of equity conflicts with a rule of the common law, the rule of equity prevails."[59] Ontario courts regularly apply equitable principles in deciding how contracts are enforced.[60] A number of state courts in the United States have likewise rejected due-on-sale clauses on equitable grounds.[61] In *Briar Holdings Ltd v Bow West Holdings Ltd*,[62] the Alberta Court of Queen's Bench observed that, "American authorities dealing with a 'due-on-sale' clause . . . appear to be based on the equities of a particular situation and the power of a court in equity to relieve against forfeiture."[63] In response to the findings of several state courts that due-on-sale clauses were unenforceable and subsequent lobbying by lenders in opposition to these findings, a federal statute was enacted to uphold due-on-sale clauses.[64] Under the Supremacy Clause of the *United States Constitution*, Congress may deliberately pass legislation to pre-empt state laws.[65] Despite the enactment of that pre-emptive federal law, Richard Hayden has suggested that "[s]tate courts must be free to determine that the enforcement of an otherwise valid due-on-sale

[56] (1982), 41 BCLR 14 (CA). Unlike in Ontario's *Mortgages Act*, the BC statute contains an explicit obligation to indemnify for "covenants express or implied": *Property Law Act*, RSBC 1979, s 20.
[57] *Ibid* at para 21.
[58] RSBC 1996, c 253, s 25(2).
[59] *Courts of Justice Act*, RSO 1990, c C-43, s 96(2).
[60] See: *306793 Ontario Ltd in Trust v Rimes* (1990), 25 OR (2d) 79 (CA) which cited Lord Wilberforce in *Johnson et al v Agnew*, [1979] 2 WLR 487 (HL) at 496: "It is an appropriate case for a court of equity to say: 'As a matter of discretion, this contract should not now be enforced specifically, but, in lieu of the decree for specific performance, the court will award the plaintiff such damages as have been suffered by her in consequence of the defendant's breach'" at 82, citing *McKenna v Richey*, [1950] VLR 360 (HL) at 376.
[61] See: David A. Gauntlett, "*Wellenkamp v Bank of America*: Invalidation of Automatically Enforceable Due-on-Sale Clauses" (1979) 67(4) Cal L Rev 886; See also W. Wade Berryhill, "The Due-On-Sale Clause: A Marriage Gone Sour – A Checklist for the Practitioner" (1981-1982) 16 U Rich L Rev 35.
[62] [1981] 16 Alta LR (2d) 42 (QB).
[63] *Ibid* at para 17.
[64] *Preemption of Due-on-Sale Prohibitions*, USC tit 12 §1701j–3 (2012); see also: D. Barlow Burke, *Real Estate Transactions: Examples and Explanations*, 4th ed (Portland, Aspen Publishers, 2006) at 261 for a discussion of this statute.
[65] See US Const art VI cl 2.

clause is unconscionable as a matter of state contract law, when, for example, it is used solely to collect interest."[66]

Broadly, the aim of contract law is that "where a party sustains a loss by reason of a breach of contract, he is, so far as money can do it, to be placed in the same situation, with respect to damages, as if the contract had been performed."[67] The Supreme Court of Canada modernized this long-standing rule in *Bank of American Canada v Mutual Trust Co*,[68] stating that there is no longer a moral stigma to a deliberate breach of contract as long as the appropriate payment is made for the actual damages suffered:

> Efficient breach is what economists describe as a Pareto optimal outcome where one party may be better off but no one is worse off, or expressed differently, nobody loses. Efficient breach should not be discouraged by the courts. This lack of disapproval emphasizes that a court will usually award money damages for breach of contract equal to the value of the bargain to the plaintiff.[69]

Provided the new purchaser maintains the regular payments, there may be no damage that the bank can claim, particularly without evidence of damage. It must be noted, however, that the bank has a process for approving loans and borrowers: where the mortgage has been transferred to the purchaser without permission, the bank has not approved the purchaser and the purchaser has not entered into a covenant to repay the debt. This lack of apparent damage was highlighted in the recent case *Huttonville Acres Ltd (cob Forest Homes) v Archer*,[70] in which the purchaser of a building lot in an exclusive community breached her contract by re-selling the land for a profit. The defendant admitted to breach of contract, but the plaintiff could not show that it had suffered any damages, and, consequently, the "innocent party" was required to pay costs.

In contract law, the rules of damages indicate that the wronged party must be compensated so that it is as if the contract had been performed. The wronged party, however, cannot enforce the specific terms of the contract unless a court grants specific performance. If the bank insisted on immediate repayment of the mortgage, rather than only claiming for the damages it actually suffered, the bank would be making a claim for specific performance. This is notable because in *Semelhago v Paramadevan*,[71] the Supreme Court of Canada changed the rules of equity. In this case, the Court announced that for real property, specific performance should not "be granted as a matter of course absent

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[66] Richard J Hayden, "The 'Due-On-Sale' Clause in Washington After *De La Cuesta* and Garn: Has Washington Been Left A Loan?" (1984-1985) 20 Gonz L Rev 511 at 542.
[67] *Bank of America Canada v Mutual Trust Co*, [2002] 2 SCR 601 at para 27, citing *Haack v Martin,* [1927] SCR 413 at 416 [*Bank of America*].
[68] *Ibid*.
[69] *Ibid* at para 31.
[70] [2009] OJ No 4139 (Sup Ct); aff'd 2011 ONCA 115.
[71] [1996] 2 SCR 415.

evidence that the property is *unique* [emphasis added]."[72] As a result, specific performance is now restricted to where the plaintiff can prove that monetary damages are inadequate because of the unique characteristics of the property in question.[73]

Where a bank holds several thousands of mortgages, it is difficult to argue that the bank is *uniquely* interested in the characteristics of any particular mortgagor's property. Provided the monthly mortgage payments are forthcoming, the identity of the party issuing the payment, be it the original mortgagor or a third party, should be irrelevant. It should be noted, however, that the purchaser has not entered into a covenant with the bank to repay the debt. It is inequitable to mandate specific performance and require the mortgagor to pay the balance remaining on the mortgage before maturity (and pay a prepayment charge for doing so) simply as a result of selling their property.

It can be argued that the bank does suffer some inconvenience due to an unauthorized transfer. The bank had vetted the original mortgagor's creditworthiness but does not have this opportunity with the purchaser, who may be less creditworthy. However, while there is no privity of contract between the bank and the purchaser, this is offset by the bank's ability to sue the original mortgagor for any future deficiency because the bank retains privity of contract with the mortgagor. Under section 20 of the *Mortgages Act*, if there is a deficiency where the value of the property drops below the amount of the mortgage, the bank can choose to sue either the purchaser or the original mortgagor, whichever party is most solvent.[74] The sale of a small percentage of the mortgaged properties would not be likely to significantly increase the bank's risk in its portfolio.

The inconvenience suffered by a bank may be less than that suffered by the borrower if a due-on-sale clause is enforceable, which is significant in regards to the principle of efficient breach discussed above.[75] For most mortgagors, the subject matter of the mortgage is their only real property. Thus, they could suffer major disadvantages from being forced to pay a prepayment charge, including not being allowed to keep the lower interest rate (in a rising interest rate environment) and possibly encountering more difficulty in selling the property. Given the imbalance of inconvenience, it is unlikely that a due-on-sale clause would exist in mortgages if these contracts were negotiated between parties with equal bargaining power. A court of equity ought to take such factors into account. This argument does not apply to an individual mortgagee because, in such a scenario, a transfer of the property might create a significant increase in risk for the mortgagee. For example, in *Griffiths v Zambosco et al*,[76] the sellers provided a vendor take-back mortgage. The property was subsequently re-sold, and the new purchaser

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[72] *Ibid* at para 22.
[73] See: *Southcott Estates Inc v Toronto Catholic District School Board*, 2012 SCC 51 at paras 38-40.
[74] *MA*, *supra* note 8, s 20.
[75] *Bank of America*, *supra* note 67.
[76] (2001), 54 OR (3d) 397 (CA).

defaulted, resulting in a loss for the mortgagees. They successfully sued their solicitor for negligence for omitting to insert a due-on-sale clause. Whether a due-on-sale clause was enforceable does not affect this outcome, as most mortgagors would not think of trying to contest it.

b) Case Law Dealing with Due-on-sale Clauses

While due-on-sale clauses are likely rampant in Ontario, there is limited jurisprudence on the matter. The only direct Ontario authority is from 1960—*Bahnsen v Hazelwood*,[77] where the mortgage contained a term stating that "[i]n the event of sale before the herein mortgage has been discharged the said mortgagor must pay an amount agreeable to both parties of the existing mortgage and the new purchaser must be approved by the mortgagee herein."[78] The Court of Appeal ruled that this term constituted an improper restraint on alienation and was therefore void.[79] Moreover, the Court ruled that the provision "cannot affect either the right of the vendor in this application to convey good title to the purchaser or the right of the purchaser to receive such title unaffected by the stipulation to which I have referred."[80]

Two later cases in Ontario have been cited as examples of judicial acceptance of due-on-sale clauses, although neither is a case of a mortgagee trying to force a mortgagor to pay off the principal before selling a property. First, in *Valley Vu Realty (Ottawa) Ltd et al v Victoria & Grey Trust Co* (*Valley Vu*),[81] the mortgagor wanted to get relief from a high interest mortgage without paying a penalty. Rather than defaulting, the mortgagor assigned the property to a related party without authorization from the mortgagee in the hopes of triggering the due-on-sale clause to permit him to pay off the principal on the mortgage. The mortgagee argued that the due-on-sale clause would only be triggered if it had been asked for approval to transfer the property and had refused, but in this case, the mortgagee had never been asked for its approval. The question of the general enforceability of a due-on-sale clause was not argued.

Second, in *Weeks v Rosocha,* the Ontario Court of Appeal ruled that the seller could only force a due-on-sale clause on the purchaser when there was prior disclosure.[82] *Weeks* can hardly stand as a precedent to validate a due-on-sale clause; the lender, RBC, was not a party to the action, and the defendant purchaser admitted that she had no intention of applying to have the transfer approved.[83] The Court of Appeal did not make

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[77] [1960] OJ No 21 (CA) [*Weeks*].
[78] *Ibid* at para 1.
[79] *Ibid* at paras 4-5.
[80] *Ibid* at para 5. The latter part of the statement appears to suggest that the mortgagee could not require the purchaser to pay off any portion of the principal, since he is "unaffected by the stipulation." The court also stated at para 6 that the order by the lower court went beyond what is required but little analysis was provided on this point.
[81] (1984), 44 OR (2d) 526 (HC), aff'd (1984), 47 OR (2d) 544 (CA).
[82] (1983), 41 OR (2d) 787 (CA) at 791-792.
[83] *Ibid*.

any direct comment on the validity of a due-on-sale clause. The due-on-sale clause in a mortgage can be a disadvantage because of the uncertainty it can cause for the purchaser. Both *Valley Vu* and *Weeks* illustrate that due-on-sale clauses have yet to be firmly addressed by the Courts. This reality underlines the need for legislative clarification.

c) Due-on-sale Clause: a Restraint on Alienation?

The common law embodies various public policy principles that can render contract terms void if they are to the contrary. One such public policy goal is to allow real property to be "alienated" (sold) when there is a willing buyer and seller. Consistent with this, a long-standing principle of mortgage law finds a term that constitutes a restraint on alienation is void and unenforceable.[84] A restraint on alienation occurs "where there is a condition annexed to a grant or devise of land in fee simple . . . it will be void as being repugnant to that estate."[85] Moreover, case law illustrates that a sale in violation of a due-on-sale clause is a valid conveyance, meaning that the buyer still receives good title.[86] It is unclear if this principle can be extended to further weaken the enforceability of such a clause and, in particular, the acceleration and due-on-sale provisions.

If an acceleration clause is enforceable, a due-on-sale clause means the property cannot be sold unless the potential purchaser has access to alternative financing. Therefore, the due-on-sale clause is tantamount to a restraint on alienation because the sale of the property is obstructed by it. This is, however, how commerce works: if a buyer cannot get financing, then, the buyer cannot afford it. The due-on-sale clause's potential to constitute a restraint on alienation warrants greater attention, given the regular fluctuations in Canada's financial system. In the years since the financial crisis of 2008, the North American financial system has had abundant financing available. This has not been the case in the past, and it is unlikely to continue in the future.[87]

In summary, a clause that prohibits sale of a mortgaged property should not be upheld, as it would be a restraint on alienation. The sale of the property must be permitted even if subject to a mortgage with a due-on-sale clause. The issue then becomes the recourse available to a lender if the clause is breached. If a lender can impose arbitrarily large penalties, including acceleration, then the lender has the power to impose its will and, in effect, enforce the due-on-sale clause. Such a situation is contrary to equitable principles of contract law.

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[84] *Laurin*, *supra* note 55.
[85] *Stevens v Gulf Oil Canada Ltd et al* (1976), 11 OR (2d) 129 at 155.
[86] *Hongkong Bank of Canada v Wheeler Holdings Ltd.*, [1993] 1 SCR 167. Canada Mortgage and Housing Corporation (CMHC) wanted to preserve the low income character of the property and sought, unsuccessfully, to block the sale. Acceleration was not an issue, as CMHC did not seek it.
[87] See: Peter Spiro, "Was Your Mortgage Made in Bangladesh?" *Huffington Post* (30 April 2013) Huffpost Business online: <http://www.huffingtonpost.ca/peter-spiro/bangladesh-factory-collapse_b_3174852.html> for a discussion of the global financial forces affecting mortgage rates.

Class Action Litigation Related to Mortgage Penalties

Class actions for financial service claims in Canada are a relatively new and a growing phenomenon. Although they provide an avenue of redress for individual mortgagors, class actions are a risky route because they are costly and time-consuming for the plaintiff lawyers, as well as subject to strict procedural requirements that plaintiffs may struggle to meet.[88]

In 2006, a class action was filed against several lenders in Ontario: *Arabi v Toronto-Dominion Bank*.[89] In this case, the plaintiffs challenged the calculation of the prepayment charge on the grounds that the banks were not giving the mortgagors credit for the annual prepayment allowance that was included in their mortgage contracts. This class action was not certified, because it did not meet the test for certification in Ontario's *Class Proceedings Act*.[90] The plaintiffs were unable to meet the requirements to ascertain an identifiable class and to identify common issues. The judge accepted that banks sometimes use discretion to waive or reduce penalties and determined that it could not be assumed that all potential class members had suffered sufficiently similar damages. As a result, the judge ruled that the claims of different individuals were too diverse for a class action to be the preferable procedure because "class members could not be identified without individual examinations of each person's circumstances."[91]

This ruling was followed by *Sherry v CIBC Mortgage Inc* (*Sherry*), which was certified recently in British Columbia for a claim regarding mortgage penalties.[92] The CIBC mortgages contained a term that allowed a prepayment charge based on the difference between the interest rate in the mortgage and the current interest rate. The relevant contracts stated that the determination of the applicable comparison rate and the calculation of the prepayment charge would be done "using a method determined by [the bank] from time to time at our discretion."[93] Moreover, the prepayment charge was based on the rate currently posted by the lender, rather than some objective third party, and was, therefore, subject to manipulation. The statement of claim alleges that, because of these terms, the prepayment charge term is void for uncertainty. A similar claim has been filed in Ontario.[94]

While initially this cause of action does not appear viable, evidence about mortgage rate fluctuations increases the plausibility of the claim. For example, the underlying cost of funds for the lender depends on rates in the bond market, so one can

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[88] See: Ontario's *Class Proceedings Act, 1992*, SO 1992, c 6 s 5(1) [*CPA*].
[89] *Arabi*, *supra* note 3.
[90] *CPA*, *supra* note 89, s 5(1).
[91] *Arabi*, *supra* note 3 at para 48.
[92] 2014 BCSC 1199.
[93] *Ibid* at para 18.
[94] *Jordan and Danao v CIBC Mortgages Inc* (7 Oct 2011), London 5303/11 CP (Ont Sup Ct) (Statement of Claim) Siskinds LLP, online: <http://www.classaction.ca/CMSFiles/PDF/Consumer/CIBC/2011_10_07_-_Issued_Statement_of_Claim.PDF>.

compare the five-year mortgage rate with the five-year government bond yield.[95] Monthly data reveal that the difference of the mortgage rate over the bond yield since 2000 has averaged about 3 percentage points.[96] However, occasionally, there can be large deviations, as seen in *Sherry* where it varied from a low of about 2 percentage points to a high of about 5 percentage points. Therefore, if an individual took out a mortgage near the low point of this cycle and subsequently needed to redeem it when the spread was high, he or she could pay a very large prepayment charge, even if there has been little or no increase in general interest rates. Thus, the claim that the contract is void for uncertainty is reasonable.

Class actions rarely proceed to trial; "[i]n Ontario, out of hundreds of class actions that have been commenced, only 17 have led to common issues trials."[97] Once the appeals related to certification itself have been exhausted, settlement is the typical method of resolution. Class actions can be expensive for plaintiff law firms to manage over time, particularly when they face a deep-pocketed adversary such as a bank. It remains to be seen whether the plaintiffs in this action can manage to prevail.

III. CONCLUSION

New legislation is necessary to regulate prepayment charges in mortgages. While prepayment charges may be reasonable in some circumstances, there are many situations where they are arbitrary, unfair, and possibly unconscionable. A prepayment charge is appropriate where a borrower has agreed to pay a high rate of interest for a fixed number of years and wants to alter the deal when market interest rates have fallen. In this case, it would be unfair to the lender to discharge the mortgage without compensation for the loss in income. The mortgagee may well be indebted to investors who hold fixed interest rates such as Guaranteed Investment Certificates (GICs) that match the mortgage term.

Prepayment fees can also be unfair to the borrower. For example, a borrower who wishes to prepay a mortgage is usually required to pay a charge of three months' interest without reference to whether that is an accurate measure of the cost to the lender. Indeed, this charge remains even when prepaying the mortgage is beneficial to the lender because market interest rates are rising. In such a case, there is no provision for the lender to compensate the borrower. There is, however, some element of choice in this situation with regards to the negotiated terms of the mortgage and the sale of the mortgaged property. The borrower is choosing to sell rather than wait until the mortgage matures. Furthermore, the borrower could make the sale conditional on the purchaser being

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[95] Cardinal, *supra* note 45.
[96] Statistics Canada, *Table 176-0043 - Financial market statistics*, (Ottawa: StatCan) (CANSIM).
[97] Law Commission of Ontario, "Review of Class Actions in Ontario: Issues to be Considered by the Law Commission of Ontario" (November 2013) at 12, online: <http://www.lco-cdo.org/class-actions-issues-to-be-considered.pdf>.

approved to assume the mortgage. Despite this element of choice, legislation would still play an important role in consumer protection.

Due-on-sale clauses also need to be addressed in Canadian mortgage law. In the standard mortgage contract, prepayment charges and due-on-sale clauses appear as two separate terms. In practice, however, they are closely connected because a sale of a property is the most common reason for paying off a mortgage before the end of its term. Frequently, this prepayment is forced on the borrower under the belief that the due-on-sale clause is binding. In addition, banks may decide not to approve a new purchaser for its own pecuniary benefit, where it has more to gain by a refusal if interest rates have risen. This manipulation is not unexpected or even unreasonable on the bank's part, as the bank is acting in its best interest for its business, but it is problematic for mortgagors and purchasers.

The ubiquity of this highly unequal clause indicates an imbalance in bargaining power between lenders and borrowers. If Ontario courts were to hold that due-on-sale clauses are enforceable, this would likely be problematic as these clauses place a significant burden on borrowers. As such, Ontario courts and the legislature must seek to find a balance between consumer protection to limit unreasonable burdens on borrowers and the protection of banks' finances in recognition of the fact that banks are businesses. If legislation were enacted to address this, a reasonable compromise would be to base the transferability of mortgages on objective criteria such as the size of the down-payment provided by the buyer, rather than leaving it purely to the discretion of the lender. In so doing, the imbalance in bargaining power between lenders and borrowers may be reduced.