

Less Than an Ideal Situation: Commitment Letters – When Are They Not Commitments?

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One issue that often concerns lenders is their requirement to advance funds under a commitment letter when the borrower has not met all of the lender's funding conditions. Tied to this concern is what fees, if any, can the lender charge and recover if funds are never advanced to the borrower. The recent Ontario Court of Appeal decision *MarshallZehr Group Inc. v. Ideal (BC) Developments Inc.* provides some clarity on these matters.

Facts

Ideal (BC) Developments Inc. and its affiliates (collectively, Ideal) executed a Commitment Letter on November 8, 2018 (the Commitment Letter) with MarshallZehr Group Inc. (MZ) pursuant to which MZ was prepared to provide Ideal with financing for a residential real estate project. Pursuant to the Commitment Letter, Ideal was to have fulfilled the lender's initial funding conditions before any funds were advanced by MZ. On January 23, 2019, MZ notified Ideal that it was terminating the Commitment Letter as Ideal was unable to satisfy the initial funding conditions. One of the key initial funding conditions was that Ideal was to obtain a standstill and postponement for an existing mortgage, in form satisfactory to MZ, which the parties could not agree on. The fees payable under the Commitment Letter included stand-by fees, legal and consulting fees, and lender fees.

Summary Judgment Decision

MZ brought the initial action seeking payment for fees and expenses in connection with the Commitment Letter. Ideal defended the action and counter-claimed for damages caused by MZ's wrongful termination of the Commitment Letter. MZ then moved for summary judgment, which was granted by the motion judge.

Appeal

Ideal appealed to the Ontario Court of Appeal (the Court) on two grounds:

- MZ was not entitled to terminate the Commitment Letter by relying on the cancellation provision; and

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- the fees and expenses to which MZ was entitled upon termination of the Commitment Letter were wrongly calculated.

Decision

First Ground of Appeal: DISMISSED

Ideal argued that MZ wrongfully terminated the Commitment Letter because it failed to give Ideal notice that it had committed an event of default and did not afford Ideal an opportunity to cure such default. The Court rejected this submission. The Commitment Letter covers two points in time in the relationship between MZ and Ideal: (i) the pre-funding period, which includes the period from the date of execution to the closing of the transaction by the initial advance of funds, and (ii) the post-funding period, which includes the period following the initial advance of funds to the end of the term of the loan. The Court found that the Commitment Letter contained a provision providing MZ with a unilateral right to cancel the Commitment Letter, without notice, in its sole and unfettered discretion (the Cancellation Right) which related to the pre-funding period, and the default and demand provisions (Default Provisions) contained in the Commitment Letter related to the post-funding period.

Ideal also argued that the parties' inability to agree on the standstill and postponement should have been dealt with by the Default Provisions. The Court rejected this and ruled that failure by Ideal to provide security documents in a form satisfactory to MZ materially altered the level of risk MZ agreed to take on and that gave MZ sufficient reason to rely on the Cancellation Right.

Second Ground of Appeal: UPHELD IN PART

MZ was correctly awarded standby interest on the funds that were advanced in trust to its counsel pre-closing, as the Commitment Letter clearly stipulated this was to accrue on any unadvanced portion of the loan and will become due and payable on the date the loan is advanced or upon the termination of the Commitment Letter without any advances having been made. MZ was also correctly awarded all reasonable expenses (legal fees and consultants' fees) and the good faith deposit pursuant to the cancellation provision. The Commitment Letter clearly stated these were to be payable regardless of whether Ideal proceeds with the transaction.

The Court did not agree with the motion judge on awarding MZ lender's fees. The Commitment Letter provided that lender's fees were to be deducted from the initial advance of funds. As such, Ideal was found to be correct in its submission that the fees were not earned until the funds were advanced. The damage award against Ideal was reduced accordingly.

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Key Takeaway

The Court found that the agreed upon initial funding conditions reflected many of the limits to the risk that MZ was prepared to assume in lending to Ideal. When viewed in the context of the entire agreement, the Cancellation Right appeared to be designed, in part, to bring the relationship to an end if Ideal was unable or unwilling to satisfy the pre-conditions to lending. Faced with a potential borrower who was not prepared to conclude an agreement within the Commitment Letter's agreed-upon risk limits, the Cancellation Right was available for MZ to use to avoid such unbargained for risk.

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