

**ONTARIO
SUPERIOR COURT OF JUSTICE
Commercial List**

B E T W E E N:

**DBDC SPADINA LTD.,
and THOSE CORPORATIONS LISTED ON SCHEDULE “A” HERETO**

Applicants

- and -

**NORMA WALTON, RONAULD WALTON, THE ROSE & THISTLE GROUP
LTD. and EGLINTON CASTLE INC.**

Respondents

- and -

**THOSE CORPORATIONS LISTED IN SCHEDULE “B” HERETO, TO BE
BOUND BY THE RESULT**

**SUPPLEMENTAL REPORT TO THE TENTH REPORT OF THE MANAGER,
SCHONFELD INC.**

**(Motion for approval and vesting order with respect to
875/887 Queen Street East returnable July 15, 2014)**

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TO: **SERVICE LIST**

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Court File No.: CV-13-10280-00CL

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**SUPPLEMENTAL REPORT TO THE TENTH REPORT OF THE
MANAGER, SCHONFELD INC.
(Motion for approval and vesting order with respect to 875/887 Queen Street East
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I. Introduction

1. This is the Supplemental Report to the Tenth Report of Schonfeld Inc. (the “**Manager**”) in its capacity as Manager of certain companies listed at Schedule “B” to the Order of Justice Newbould dated November 5, 2013 (the “**Companies**”)¹, together with the properties owned by the Companies (the “**Properties**”).²

A. Purpose of this Report

2. The Manager has brought a motion for, among other things:

- (a) an approval and vesting order (the “**875 Queen Approval and Vesting Order**”) in respect of the sale transaction (the “**875 Queen Transaction**”) contemplated by the Agreement of Purchase and Sale dated as of December 20, 2013 (the “**Original Purchase Agreement**”), as amended by agreements dated as of January 30, 2014; March 31, 2014; April 4, 2014; April 10, 2014; April 17, 2014; April 22, 2014 and June 27, 2014 (collectively, the “**875 Queen Agreement**”) and as further amended by an agreement dated July 9, 2014 (the “**Eighth Amendment**”), between Harhay Construction Management Ltd. (“**Harhay**”). and the Manager in respect of the Property known municipally as 875 and 887 Queen Street East in Toronto, Ontario (collectively, the “**875 Queen Property**”). The Original Purchase Agreement and the Eighth Amendment are attached as Confidential Appendix “A” and “B”, respectively; and
- (b) an Order permitting the confidential appendices to this Report (the “**Confidential Appendix Brief**”) to be filed under seal without being served on the Service List.

3. A summary of the 875 Queen Transaction was previously provided in the Tenth Report of the Manager dated June 4, 2014 (the “**Tenth Report**”). The Manager previously brought a motion seeking the 875 Queen Approval and Vesting Order returnable June 10, 2014. Prior to the return of that motion, an issue arose regarding the priority of the mortgages registered against

¹ Schedule “B” was amended by Order dated January 16, 2014.

² The Manager was discharged from certain responsibilities with respect to certain of the Properties pursuant to an Order dated April 1, 2014.

the Property at 887 Queen Street East. On June 10, 2014 the parties agreed to adjourn the motion until the priority issue could be determined. This issue has now been resolved and interested stakeholders have reached an agreement that will allow the matter to proceed. The purpose of this Report is to provide an update with respect to the 875 Queen Transaction and the Manager's recommendation that this Honourable Court grant the relief described in the Manager's Notice of Motion.

B. Terms of reference

4. Based on its review and interaction with the parties to date, nothing has come to the Manager's attention that would cause it to question the reasonableness of the information presented herein. However, the Manager has not audited, or otherwise attempted to independently verify, the accuracy or completeness of any financial information of the Companies. The Manager therefore expresses no opinion or other form of assurance in respect of any of the Companies' financial information that may be in this Report.

C. Confidentiality

5. In the Manager's judgment, disclosure of some of the documents appended to this Report would negatively impact the Manager's ability to carry out its mandate by, among other things, interfering with the integrity of any subsequent sales process in respect of the 875 Queen Property if the 875 Queen Transaction is not completed. In particular, and without limiting the generality of the foregoing, it is the Manager's judgment that it would impair the Manager's ability to maximize realization of the 875 Queen Property were any information to be made public concerning any discussions of sale processes or values of this Property among the Manager, the parties or any of their advisers and/or any possible bidders for the 875 Queen Property or any of the Properties. Accordingly, a number of Appendices to this Report have been identified as confidential appendices and will be filed in a separate Confidential Appendix Brief. The Manager respectfully requests an Order authorizing it to file the Confidential Appendices under seal and without serving the Confidential Appendix Brief on the Service List.

II. The 875 Queen Transaction

A. Interested Parties

6. The 875 Queen Property is owned by two of the Companies, Red Door Developments Inc. (which owns 875 Queen Street) and Red Door Lands Ltd. (which owns 887 Queen Street) (collectively, “**Red Door**”). The following encumbrances are registered on title to the 875 Queen Property:

- (a) an option to purchase the retail portion of any potential development of the 875 Queen Property in favour of Trinity Urban Properties Inc. (“**Trinity**”);
- (b) a mortgage in the amount of \$7,000,000 in favour of RioCan Mortgage Corp. (“**RioCan**”), which is the first mortgage on 875 Queen Street and the second mortgage on 887 Queen Street (the “**RioCan Mortgage**”); and
- (c) a mortgage in the amount of \$1,200,000 in favour of Woodgreen Management Inc. (“**Woodgreen**”), which is the first mortgage on 887 Queen Street (the “**Woodgreen Mortgage**”).

B. The Woodgreen Mortgage

7. The Woodgreen Mortgage is a vendor take-back mortgage. Following the security review undertaken by the Manager’s counsel, Goodmans LLP (“**Goodmans**”), and reported in the Tenth Report, the Manager concluded that the amount of \$800,000 owed to Woodgreen was secured by the Woodgreen Mortgage and that the balance of the debt owed to Woodgreen, in the amount of approximately \$400,000, was unsecured. The facts underlying this conclusion are reported at paragraphs 76-80 of the Tenth Report.

8. In Reasons for Decision dated June 27, 2014 (the “**June 27 Reasons**”), the Honourable Justice D.M. Brown determined the priority issue, holding that the principal sum of \$1.2 million was secured by the Woodgreen Mortgage. The June 27 Reasons are attached as Appendix “1”.

9. Following the release of the June 27 Reasons, the Manager and Harhay proceeded to negotiate an amendment to the 875 Queen Agreement. On July 9, 2014, the Manager and Harhay executed the Eighth Amendment, reflecting revised terms that will provide for a payout

of the full amount of the Woodgreen Mortgage and an assumption by Harhay of the outstanding obligations pursuant to the RioCan Mortgage.

C. The Second Offer

10. On July 4, 2014, the Manager received an offer to purchase the 875 Queen Property from Bill Mandelbaum in trust (the “**Second Offer**”). The Second Offer is attached as Confidential Appendix “C”.

11. The purchase price offered by Mr. Mandelbaum is superior to the price of the 875 Queen Transaction if it is completed in accordance with its terms. However, the 875 Queen Agreement is a binding contract. In addition, Harhay is prepared to close the 875 Queen Transaction on July 17, 2014. In contrast, the Second Offer is subject to, among other things, a broad due diligence condition that allows Mr. Mandelbaum to withdraw the Second Offer if he, in his sole discretion, is not satisfied with the 875 Queen Property. The Second Offer does not provide a timeline nor an outside date for completion of the transaction.

12. The Manager is bound by the terms of the 875 Queen Agreement to seek court approval of the 875 Queen Transaction and is, in any event, of the view that completion of the 875 Queen Transaction is the best option available to stakeholders.

D. Timing of the Transaction

13. The expected closing of the 875 Queen Transaction is July 17, 2014.

E. Stakeholder positions

14. The Applicants support completion of the 875 Queen Transaction. Ms. Walton has previously advised that she does not approve the completion of the 875 Queen Transaction.

15. The 875 Queen Agreement requires that Harhay recognize the option, registered on title in favour of Trinity, to purchase the retail portion of the 875 Queen Property. The Eighth Amendment provides that the proceeds of the 875 Queen Transaction must be sufficient to pay in full all amounts owing pursuant to the Woodgreen Mortgage and the RioCan Mortgage, any outstanding realty taxes necessary to effect the transfer of the 875 Queen Property and the broker

commission on the sale. The Eighth Amendment further provides that Harhay will assume the amount outstanding under the RioCan Mortgage.

16. Both Woodgreen and RioCan have advised that they support completion of the transaction on these terms.

F. Proposed Distribution of Sale Proceeds

17. The Manager has asked Goodmans to provide an opinion with respect to the validity of the RioCan Mortgage and the Woodgreen Mortgage. As noted in the Tenth Report, Goodmans has advised that the RioCan Mortgage and the Woodgreen Mortgage are validly registered.

18. The Manager understands that the RioCan Mortgage will be assumed by Harhay on closing of the 875 Queen Transaction. The Manager recommends that the proceeds of the 875 Queen Transaction, net of closing costs, be used to pay out the Woodgreen Mortgage. The Manager does not expect that the 875 Queen Transaction will generate any surplus funds available for distribution to other creditors of Red Door.

III. Conclusion and Recommendations

19. As reported in the Tenth Report, the 875 Queen Transaction is the result of a broad, transparent and competitive marketing process. The Manager's overall marketing strategy was reported to interested stakeholders and this Honourable Court in the Manager's Second Report and was implemented successfully. In light of the foregoing, and for the reasons expressed in the Tenth Report, the Manager recommends that this Court approve the 875 Queen Transaction.

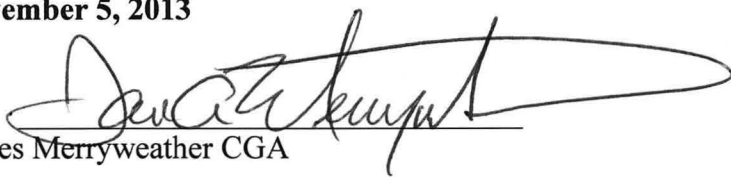
All of which is respectfully submitted this 11th day of July, 2014.

SCHONFELD INC.

**In its capacity as Manager pursuant to
the Order of Newbould, J. dated
November 5, 2013**

Per:

James Merryweather CGA



SCHEDULE "A" COMPANIES

1. Dr. Bernstein Diet Clinics Ltd.
2. 2272551 Ontario Limited
3. DBDC Investments Atlantic Ltd.
4. DBDC Investments Pape Ltd.
5. DBDC Investments Highway 7 Ltd.
6. DBDC Investments Trent Ltd.
7. DBDC Investments St. Clair Ltd.
8. DBDC Investments Tisdale Ltd.
9. DBDC Investments Leslie Ltd.
10. DBDC Investments Lesliebrook Ltd.
11. DBDC Fraser Properties Ltd.
12. DBDC Fraser Lands Ltd.
13. DBDC Queen's Corner Ltd.
14. DBDC Queen's Plate Holdings Inc.
15. DBDC Dupont Developments Ltd.
16. DBDC Red Door Developments Inc.
17. DBDC Red Door Lands Inc.
18. DBDC Global Mills Ltd.
19. DBDC Donalda Developments Ltd.
20. DBDC Salmon River Properties Ltd.
21. DBDC Cityview Lands Ltd.
22. DBDC Weston Lands Ltd.
23. DBDC Double Rose Developments Ltd.
24. DBDC Skyway Holdings Ltd.
25. DBDC West Mall Holdings Ltd.
26. DBDC Royal Gate Holdings Ltd.
27. DBDC Dewhurst Developments Ltd.
28. DBDC Eddystone Place Ltd.
29. DBDC Richmond Row Holdings Ltd.

SCHEDULE "B" COMPANIES

1. Twin Dragons Corporation
2. Bannockburn Lands Inc. / Skyline – 1185 Eglinton Avenue Inc.
3. Wynford Professional Centre Ltd.
4. Liberty Village Properties Ltd.
5. Liberty Village Lands Inc.
6. Riverdale Mansion Ltd.
7. Royal Agincourt Corp.
8. Hidden Gem Development Inc.
9. Ascalon Lands Ltd.
10. Tisdale Mews Inc.
11. Lesliebrook Holdings Ltd.
12. Lesliebrook Lands Ltd.
13. Fraser Properties Corp.
14. Fraser Lands Ltd.
15. Queen's Corner Corp.
16. Northern Dancer Lands Ltd.
17. Dupont Developments Ltd.
18. Red Door Developments Inc. and Red Door Lands Ltd.
19. Global Mills Inc.
20. Donalda Developments Ltd.
21. Salmon River Properties Ltd.
22. Cityview Industrial Ltd.
23. Weston Lands Ltd.
24. Double Rose Developments Ltd.
25. Skyway Holdings Ltd.
26. West Mall Holdings Ltd.
27. Royal Gate Holdings Ltd.
28. Royal Gate Nominee Inc.
29. Royal Gate (Land) Nominee Inc.
30. Dewhurst Development Ltd.
31. Eddystone Place Inc.
32. Richmond Row Holdings Ltd.

33. El-Ad (1500 Don Mills) Limited
34. 165 Bathurst Inc.

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CITATION: DBDC Spadina Ltd. v. Walton, 2014 ONSC 3732
COURT FILE NO.: CV-13-10280-00CL
DATE: 20140627

SUPERIOR COURT OF JUSTICE – ONTARIO

COMMERCIAL LIST

RE: DBDC Spadina Ltd. and Those Corporations Listed on Schedule A Hereto, Applicants

AND:

Norma Walton, Ronauld Walton, The Rose & Thistle Group Ltd. and Eglinton Castle Inc., Respondents

AND:

Those Corporations Listed on Schedule B Hereto, To Be Bound by the Result

BEFORE: D. M. Brown J.

COUNSEL: S. Roy, for the Applicants

M. Dunn, for Schonfeld Inc., Manager and Inspector

R. Dodokin, for Woodgreen Management Inc.

V. DaRe, for RioCan Real Estate Investment Trust and Trinity Urban Properties Inc.

HEARD: June 26, 2014

FURTHER REASONS FOR DECISION – 875/887 QUEEN STREET EAST

I. Priority dispute between two mortgagees

[1] Most of the evidence concerning the priority dispute between the two mortgagees on 887 Queen Street East, Toronto, was set out in my Reasons released June 20, 2014 (2014 ONSC 3732). RioCan Mortgage Corp. holds a first mortgage on 875 Queen for a face amount of \$7 million, under which \$6.2 million has been advanced. That mortgage is also registered in second

place on 887 Queen. The first mortgagee of 887 Queen, Woodgreen Management Inc., holds a vendor take-back mortgage with a face amount of \$1.2 million.¹

[2] These Reasons are a continuation of, and are based upon, the June 20 Reasons, and they must be read in conjunction with those other reasons.

[3] In the June 20 Reasons I requested that Mr. Jory Kesten, the principal of Woodgreen, give brief *viva voce* evidence addressing the concerns about his evidence identified in the June 20 Reasons and affording RioCan the opportunity to test those explanations by way of *viva voce* cross-examination. Mr. Kesten did so.

II. The *viva voce* evidence of Kesten

[4] Kesten testified that he is a lawyer by training with extensive experience in commercial real estate and corporate matters.

[5] In paragraph 10 of the June 20 Reasons I found that as of July 6, 2012, Woodgreen had actual notice that a \$7 million second mortgage in favour of RioCan would be registered behind its charge on the 887 Queen property. That finding was based on communications received at the time by Woodgreen's counsel. Kesten testified that he had not received at the time either of the communications sent to his counsel in 2012. However, come July 9, 2013, Kesten "highly suspected" that there were other encumbrances behind the Woodgreen VTB Mortgage, but the name of RioCan did not come to his mind nor was he aware that a mortgage with RioCan made provision for the use of an advance specifically to pay down the Woodgreen VTB Mortgage. I accept Kesten's evidence on that point.

[6] In paragraph 18 of the June 20 Reasons I wrote:

[18] Pausing here, I would note that Kesten, in paragraph 9 of his June 9 affidavit, deposed: "Prior to the due date (July 2013) for the first \$400,000.00 principal payment, Woodgreen invited Red Door to defer the due date for the first principal payment for another year." I find that evidence difficult to reconcile with the contents of Kesten's July 5 email calling for payment of the principal instalment.

[7] In his *viva voce* evidence Kesten explained that on July 5, 2013, he received a phone call from Ms. Tammy Griffith-Cooper, an employee of The Rose & Thistle Group, asking for a statement that the Woodgreen VTB Mortgage was in good standing. Kesten agreed to do so and, at that time, informed Griffith-Cooper that his family would be prepared to leave the funds due for the first \$400,000 mortgage payment outstanding for another year. According to Kesten, that was the background to Walton's July 9, 2013 email stating: "Tammy mentioned to me that you may not need repayment of the full \$400,000..." I accept Kesten's explanation of this point.

¹ At the June 26 hearing it was clarified that Red Door acquired 875 Queen Street East from the United Church of Canada, not from Woodgreen.

[8] In paragraph 28 of the June 20 Reasons I wrote:

[28] I have several concerns with this evidence of Kesten:

- (i) In his affidavit, Kesten leaves the impression that he did not know in July, 2013, that the cheque was drawn on the Fogler Rubinoff law firm. Yet Walton, in her July 9, 2013 email to Kesten at 3:28 p.m., had informed him that the cheque was from Fogler's;
- (ii) Kesten also attempted to leave the impression in his affidavit that because the cheque was not accompanied by a letter and because the amount of the cheque – \$399,152.50 – was not the precise amount of the deferred mortgage payment of \$400,000, he was not aware that the funds were a mortgage advance. Yet Walton, in her 3:28 p.m. email to him, specifically told him that “Fogler's deducted their fees off the \$400,000 so the exact amount of the certified cheque is the \$399,152.50...”

[9] As to these points, Kesten testified that earlier in the morning of July 9, 2013, he had learned from one of Walton's emails that Red Door might need Woodgreen to deposit a certified cheque and then issue one for repayment. He told Walton that he preferred that she arrange to cancel the cheque. He so advised her because he did not want confusion to arise should Woodgreen accept the cheque when he had already agreed with Walton to defer the first \$400,000 payment.

[10] When Walton emailed just after noon that she had not been in time to prevent the lawyer from certifying the cheque, Kesten said it took him a little while to think the issue through. He was aware from the year before that there might be another encumbrance on the property and he did not want this payment to be viewed as a repayment of the first mortgage. That led him to send his July 9, 2013, 3:06 p.m. email to Walton asking her to execute an acknowledgement that the cheque to Woodgreen was in error and was not intended to be a payment against the outstanding first mortgage.

[11] Kesten testified that Walton's 3:28 p.m. email referring to the cheque from Foglers was the first reference to Foglers which he had seen. He thought nothing of it other than Foglers must have been part of the process facilitating the requisition of a \$400,000 cheque. At that time Kesten did not know that the Fogler's cheque was an advance by RioCan to fund the first \$400,000 repayment of the Woodgreen VTB Mortgage. I accept Kesten's evidence on the point.

[12] In sum, the *viva voce* evidence given by Kesten clarified and explained the issues identified in the June 20 Reasons and I accept his narration of the events.

III. Findings of fact and analysis

[13] As a result, taking into account the evidence as a whole, I make the following findings of fact:

- (i) When Kesten was asked by Walton on July 9, 2013, to help out Red Door by facilitating a “swap” of cheques which would start with Woodgreen depositing the

Fogler's certified cheque made payable to it, Kesten did not know that the cheque constituted an advance by RioCan to fund Red Door's first \$400,000 repayment under the Woodgreen VTB Mortgage;

- (ii) At that time Kesten most probably knew or suspected that some mortgage had been registered behind the Woodgreen VTB Mortgage against the 887 Queen property;
- (iii) Kesten was alive to the risk that by depositing the certified cheque, even followed by the issuance of a cheque-back to Red Door, Woodgreen could be taken to have accepted payment of the first \$400,000 due under the Woodgreen VTB Mortgage, so he required Walton to prepare an acknowledgement that the issuance of the certified cheque to Woodgreen was in error and was not intended to be a payment against the first mortgage;
- (iv) As a result, by depositing the certified cheque, Woodgreen did not intend to accept a payment against its first mortgage; to the contrary, it intended that the deposit be expressly recognized by Red Door, its borrower, as not constituting a payment.

[14] These findings of fact, in my view, determine the priority dispute between RioCan and Woodgreen. Although Woodgreen, as mortgagee, accepted and deposited a cheque presented by its mortgagor, Red Door, (before immediately re-paying it), Woodgreen expressly disclaimed that its acceptance of the cheque constituted a payment against the first mortgage. That fact distinguishes this case from *Delory v. Guyett*² where the mortgagor provided a cheque to the authorized agent of the mortgagee for the express purpose of paying off the mortgage. Although it transpired that the agent, a lawyer, was a bad apple and made off with the money, the Court of Appeal held that payment by cheque to an agent before his authority was revoked constituted good payment to his principal. That is not this case.

[15] The evidence clearly showed that (i) Woodgreen had no intention of accepting the certified Fogler's cheque as a payment against its first mortgage, (ii) clearly expressed that intention to its mortgagor, (iii) obtained a written acknowledgement of that intention or purpose from its mortgagor, and (iv) proceeded to re-pay the funds at once to its mortgagor. In sum, Woodgreen merely facilitated a swap of cheques; it did not accept payment against its mortgage or make a new advance of funds to its mortgagor.

[16] Kesten, in his 8:53 a.m. email to Walton on July 9, 2013, stated that Woodgreen would "simply agree that the maturity of the first principal instalment will be extended to July 6, 2014, at the same interest rate and monthly payment. Otherwise the terms of the Mortgage remain unamended." RioCan submitted that the events of July 9, 2013, resulted in an amendment to the Woodgreen VTB Mortgage which affected its priority.

² (1920), 47 O.L.R. 137 (C.A.)

[17] I give no effect to RioCan's argument. The amendment Kesten agreed to concerned the date for payment of the first instalment; it was not an extension of the maturity date of the Woodgreen VTB Mortgage, as was clear from Kesten's July 9 email. In any event, even an extension of the maturity date of the senior mortgage does not affect the mortgage's priority vis-à-vis a subsequent encumbrance. As was stated by Grange J. in *Reynolds Extrusion Co. Ltd. v. Cooper*:

I think the proper way to approach the matter is to consider the position of the second mortgagee. He is bound by the terms of the prior encumbrancer as known to him when he entered into his contract with the mortgagor. If that prior mortgage contains a clause entitling the mortgagee to charge greater interest or the mortgagor to an extension then the subsequent mortgagee must accept the amendments when they are made. *If the mortgage does not contain such terms the subsequent mortgagee cannot be bound by the subsequent agreement. This does not, however, as I view it, give priority to the subsequent mortgagee...* The mortgage must continue to have priority to the extent of the original contract of which the subsequent mortgagee had notice...The subsequent mortgagee cannot be affected by an extension agreement entered into without notice to him. It follows, therefore, that he should be entitled to require the original contract to be carried out. If the mortgagor does not pay off the prior mortgagee at the original maturity date, the subsequent mortgagee can require him to do so and if he fails the subsequent mortgagee can himself pay it off and foreclose or sell according to its original terms. *This way the subsequent mortgagee remains unaffected by the amending contract to which he was not a party, but he obtains no windfall in the form of priority of encumbrance from the mere failure to obtain his consent to the amendment.*³

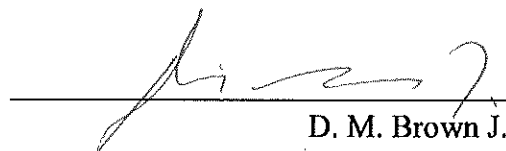
IV. Summary and costs

[18] For these reasons, I grant the motion of Woodgreen and declare that the principal sum of \$1.2 million remains outstanding under the Woodgreen VTB Mortgage registered in first place against the 887 Queen property.

[19] The other issues raised by counsel during the hearing regarding the allocation of sale proceeds and the inclusion of Woodgreen in the January 20, 2014 order of Newbould J. can await the return of the Manager's sale approval motion.

³ (1978), 21 O.R. (2d) 416 (H.C.J.), pp. 419-420.

[20] As to the costs of this priority motion, I would encourage the parties to attempt to settle them. If they cannot, Woodgreen may serve and file with my office written cost submissions, together with a Bill of Costs, by Friday, July 4, 2014. Any party against whom Woodgreen seeks costs may serve and file with my office responding written cost submissions by Friday, July 11, 2014. The costs submissions shall not exceed three pages in length, excluding the Bill of Costs.



D. M. Brown J.

Date: June 27, 2014

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Applicants

NORMA WALTON, et al
Respondents

Court File No. CV-13-10280-00CL

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Proceeding commenced at Toronto

**SUPPLEMENTAL REPORT TO THE
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File No. 14-0074