Court File No. CV-19-616261-00CL

***ONTARIO***
**SUPERIOR COURT OF JUSTICE**
(COMMERCIAL LIST)

**IN THE MATTER OF SECTION 60 OF THE TRUSTEE ACT, R.S.O. 1990, C. T. 23, AS AMENDED, AND RULE 10 OF THE ONTARIO RULES OF CIVIL PROCEDURE, R.R.O. 1990, REG. 194, AS AMENDED**

**AND IN THE MATTER OF HI-RISE CAPITAL LTD. AND IN THE MATTER OF ADELAIDE STREET LOFTS INC.**

# FACTUM OF THE RESPONDENT, SUPERINTENDENT OF FINANCIAL SERVICES

(Motion Returnable April 4, 2019 Before the Honourable Mr. Justice Hainey)

April 2, 2019

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**AND IN THE MATTER OF HI-RISE CAPITAL LTD. AND IN THE MATTER OF ADELAIDE STREET LOFTS INC.**

## PART I - OVERVIEW

1. The Respondent Superintendent of Financial Services ("the **Superintendent**") responds to two issues raised by the Applicant Hi-Rise Capital Inc. ("**Hi-Rise**") as follows:

   (a) the request by Hi-Rise for an administrative charge securing the fees of its counsel in priority to the rights of the syndicated mortgage investors ("**SMIs**") under a second mortgage against the Adelaide Property (as defined in the Applicant's materials); and

   (b) the request that Hi-Rise be relieved of its obligations under the relevant agreements with the SMIs and be authorized to give discharge of the second mortgage in favour of the SMIs if a majority in number of the SMIs representing two thirds in value vote in favour of the proposed Transaction and Distribution described in the Applicants materials.

2. The Superintendent does not support the granting of a charge in favour of Hi-Rise for its legal fees. Hi-Rise and its related entities have collected millions of dollars in fees out SMI funds but have failed to construct the building which was the subject matter of the SMIs investment.

3. The Superintendent does not believe that HRC or this Court have the ability to alter the contractual rights between the SMI's and Hi-Rise. Section 13 of the loan participation agreements (each an 'LPA') entered into with each SMI provides as follows:

> "[13] It is further understood and agreed, that HRC is hereby empowered to give a good and valid discharge or assignment of the Loan without the consent of the Participants in the Loan, **provided all monies due under the Loan as originally agreed upon or as amended, together with all other costs and charges, have been fully repaid or will be fully repaid under the terms of any discharge or assignment**."(Emphasis added).

4. The agreements between Hi-Rise and the SMI's do not contain any voting mechanism by which investor rights can be altered. The Applicant seeks to create these rights and impose them on dissenting investors through this motion for advice and direction. There is no authority which supports this attempt to amend and compromise contractual rights without the consent of the parties to the contract.

5. The Applicants have chosen not to use the provisions of the Companies Creditors Arrangement Act ["**CCAA**"] to implement a compromise of SMI rights through a plan of arrangement and the voting mechanism provided in the CCAA. The CCAA provides a mechanism to 'cram down' dissenting investors. That right does not exist outside of a CCAA process.

## PART II - THE FACTS

6. The Adelaide Project and a number of other similar projects were devised, promoted, developed, and administered by a vertically integrated series of companies owned and controlled by Jim Neilas and his family.

7. On the Adelaide Project, Hi-Rise was the mortgage brokerage and administrator for the syndicated mortgage loans under which consumer investors are lenders. These loans were for the Adelaide Project owned by Adelaide Street Lofts Inc. and developed by Neilas Inc., both corporations controlled by Mr. Neilas.

8. Hi-Rise acted as the trustee for the loans made by the SMI's to Adelaide Street Lofts as borrower. In other words, the trustee for the consumer lenders and the borrower were both controlled by the same ownership group.

9. The Applicant's materials do not disclose the fees charged by Hi-Rise and Neilas Inc. in connection with the Adelaide Project. As there is no operating business to generate revenues to pay fees, the fees came out of the proceeds of the consumer loans.

10. The Responding Application Record contains some information on the level fees charged by Hi-Rise and the developer. These documents reveal that Hi-Rise was receiving mortgage administration and marketing fees totaling 10.5% of the principal outstanding plus commissions of 14% of the amounts invested. In addition, Neilas Inc. as developer was receiving a fee of $250,000 per quarter.

11. The affidavit filed in support of the Application discloses at paragraph 35 that the principal outstanding to the SMI's is $52,242,500 plus accrued interest of $12,696,938.

12. Applying the percentages in the paragraph 10 above to the principal amount owing to the SMIs, one can extrapolate that Hi-Rise received fees of 24.5% of $52,242,500 or $12,799,412 and Neilas Inc. received developer fees of $1 million per year. Hi-Rise will know the actual quantum of the fees received.

## PART III - THE ISSUES

### ISSUE 1: Should Hi Rise be Granted a Charge for its Lawyers Fees in Priority to the Interests of the SMIs

13. Hi-Rise is uncertain about its entitlement to a charge for its fees in priority to payment of amounts owed to the SMIs and seeks guidance from the Court. There is nothing in the contractual documents that contemplates payment of fees on motions for advice and directions. What is happening here is that Mr. Neilas as borrower wants the lenders to consider an as yet undisclosed proposal which may involve a compromise of lender rights and payment of something less than is owed, and he wants the lenders to pay the lawyers' fees to do this.

14. This request is made in circumstances where the Neilas entities have apparently received in excess of $13 million in fees from the funds entrusted to them on a failed project on which construction has not even started.

15. This is a fundamentally inequitable request and amounts to adding insult to the injury already sustained by the consumer lenders by virtue of default on their loans. The Court should not exercise its discretion to grant a charge in favour of Hi Rise in the circumstances.

**ISSUE 2: Can investor rights be compromised in the process proposed by the Applicant**

16. The answer to this issue lies into trite propositions of contract law:(i) a contract cannot be unilaterally amended by one of the counterparties; (ii) as a matter of contractual interpretation, specific language overrides general language that is in conflict with the specific.

17. Each of the SMI's entered into separate but (almost) identical contractual arrangements with Hi- Rise.

18. The material clause is reproduced at paragraph 3 above and provides that the syndicated mortgage cannot be discharged unless there is payment in full of the amount owed. Hi-Rise did not make any provision in its standard form contracts with the SMI's to permit alteration of rights by any voting mechanism among the SMI's collectively. Each is a separate set of promises between Hi-Rise and the individual SMIs that can only be amended by consent of the contracting parties.

19. The case law cited in the Applicant's factum does not establish any jurisdiction in the Court to impose a voting regime on the SMI's in order to overcome the objection of dissenters to the will of majority.

20. The *Innvest* case at Tab 4 of the Applicant's brief authorities involved the consideration of plan of arrangement provisions in section 192 of the *Canada Business Corporations Act*. At paragraph 9, Justice Brown, as he then was, made specific reference to the requirement of the applicant to meet the applicable statutory criteria, including in that case, whether the proposal constituted an "arrangement", and whether the plan of arrangement was fair and reasonable. Both of these concepts are found in the plan of arrangement provisions in the CBCA. No such statutory underpinning exists in this case.

21. The applicants are free to pursue a CCAA proceeding in order to take advantage of the double majority voting mechanism contained there in order to overcome the objections of dissenters.

22. It is respectfully submitted that this Court has no jurisdiction to impose a voting mechanism on the SMIs outside CCAA process.

ALL OF WHICH IS RESPECTFULLY SUBMITTED this 2nd day of April, 2019.

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HI-RISE CAPITAL LTD

Applicant

and

**SUPERINTENDENT OF FINANCIAL SERVICES et al.**

Respondents

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Proceedings commenced at Toronto

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