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• WTF* HAPPENED TO MY MORTGAGE?

(*WTF IS THE ACCEPTED LEGAL ABBREVIATION FOR *WHERETOFORE*, AND ANY PRESUMPTION TO THE CONTRARY IS THE READER'S ALONE.) •

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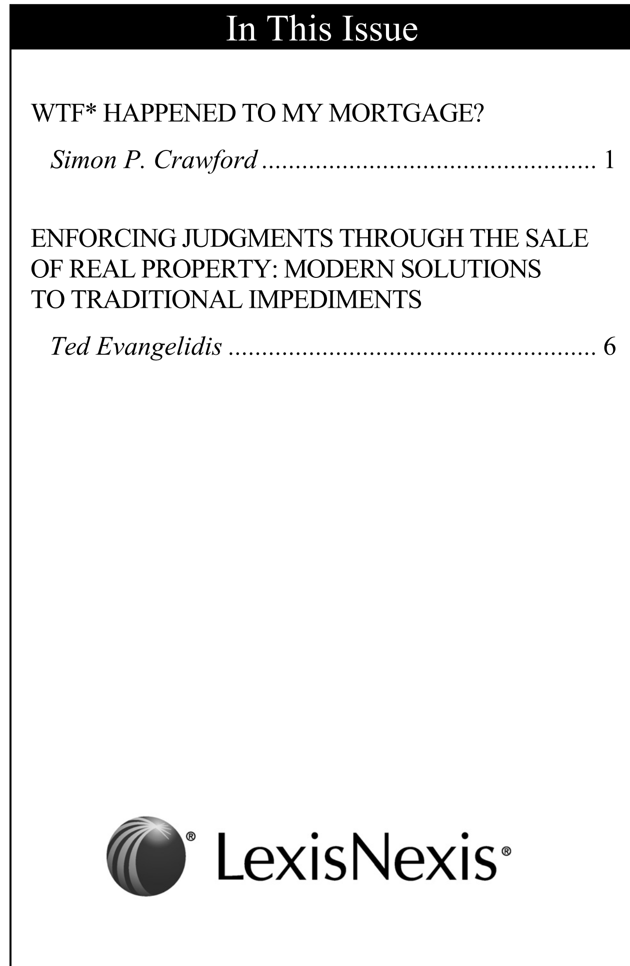

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In 2015, and just before his retirement, Justice Murray of the Ontario Superior Court of Justice left us with a challenging legal decision that, for the time being at least, will matter to mortgage lenders.

The reason it will matter is because mortgage lenders rely on one fundamental thing when they issue a commitment letter for a mortgage: good title. And good title is something that a lender, its lawyer, and its title insurer get comfort on from the land titles registry. The land titles registry, therefore, is the root of our confidence in the state of title. Registered instruments are, by virtue of their being on the registry, fixed in place, reliable, and immutable. And we expect that only a handful of statutory exceptions to title, deemed trusts, or liens can colour our certainty on the priority of a registered mortgage.

The case this short article considers is *CIBC Mortgages Inc. v. Computershare Trust Company*.[1]

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Our main characters in this particular story are Mr. and Mrs. Lowtan, whom we will consolidate into one person and ominously call "the Malfeasants".

The Malfeasants owned a home on the sleepy suburban street called Chipmunk Crescent, in Brampton.

In 2008, the Malfeasants applied to (and received from) Computershare a first mortgage in the approximate amount of $280,000 to refinance existing mortgage debt. A mortgage was registered on title on November 21, 2008.

Nine months later, on August 26, 2009, without the consent or knowledge of Computershare, the Malfeasants somehow, managed to fraudulently register a discharge of the Computershare mortgage on title to the Property.

However, our Malfeasants, being relatively clever, continued to pay the monthly debt service payments to Computershare for the next four and a half years.

Almost two years passed, and in March 2011, the Malfeasants, through a mortgage broker, applied to CIBC for a first mortgage. In their financial disclosure the Malfeasants omitted any reference to their Computershare debt, and on July 28, 2011, CIBC provided a mortgage loan to the Malfeasants in the amount of $252,800, and took what it believed to be a first ranking mortgage of the property.

Then, a year and a half later in December 2012, the Malfeasants approached Secure Capital for a second mortgage. Their application (of course) disclosed the existence of the CIBC mortgage but again made no reference to the fraudulently discharged Computershare mortgage.

All along, Computershare was receiving its monthly debt service payments happily, and I

like to think was probably still sending the Malfeasants an annual Holiday card. Secure Capital approved and granted a second mortgage to the Malfeasants for $32,000, and registered what it believed to be a second ranking charge on December 11, 2012.

On February 1, 2013, the Malfeasants defaulted on both the CIBC mortgage and the Secure Capital Mortgage.

By April 12, the Malfeasants had stopped making debt service payments to Computershare, and so Computershare discovered that its mortgage had been fraudulently discharged.

By April 25, the Malfeasants had made an assignment into bankruptcy and had vacated the house.

Notices of sale were issued, and the three lenders made their applications to court.

The proceeds of a court-ordered sale of the property amounted to $298,000, which is to say (if you are not doing the math):

1. 94 per cent of the amount owing to Computershare;
2. 96 per cent of the aggregate amounts owing to CIBC and Secure Capital; and
3. means that all three outstanding mortgages combined were 190 per cent of the available sale proceeds.

One more important fact: All three lenders are innocent. No lender was complicit. No lender participated in the fraud, knew about the fraud, or should have known about the fraud.

Before we consider the decision, a little refresher on the *Land Titles Act*[2] and the law of deferred indefeasibility might be helpful.

The land titles system was established in Ontario in 1885, and its general purpose, and what we all rely on, is that it provides the public with security of title and facility of transfer.

The sanctity of title is established by a register and the guarantee of the government that (subject to certain statutory exemptions) the person named on the register is the owner and has perfect title subject only to registered encumbrances.

And so there are three main principles or concepts that underlie the land titles system and its registry:

a) The Mirror Principle. That is, that the register is a perfect mirror of the state of title;

b) The Curtain Principle. That a purchaser (or a lender) need not investigate the history of past dealings with the land and search behind the register; and

c) The Insurance Principle. That the state guarantees the accuracy of the register and compensates any person who suffers a loss as a result of inaccuracy.

And common law courts have applied these principles when interpreting the *Land Titles Act* and have come up with what is called the "doctrine of deferred indefeasibility of title". It's called that because lawyers want to make things appear daunting and mysterious.

There are a couple of concepts built into the principle. First, it includes the concept that the registration of an instrument on title cannot make an invalid or fraudulent instrument valid in favour of the purchaser named in the instrument (*i.e.*, a transfer or a mortgage). So, for example, if you are the buyer of a property, and the seller signed the transfer fraudulently, you as the buyer cannot point to the transfer and claim that the "registration" of the transfer protects you from the true owner. Why? Because as the recipient of the fraudulent instrument you were

closest to the fraud (even if you are innocent), and you had an opportunity to investigate and avoid the fraud.

However, if having purchased the property for consideration, you were to then, in good faith, sell the property to a third party who had no notice of the fraud, the doctrine of deferred indefeasibility will protect that end purchaser from the claims of the true owner, on the basis that the end purchaser has the right to rely on the register and need not look behind it.

Or to put it another way, the recipient of title under a fraudulent instrument cannot rely on its registration to defeat the true owner, but if it sells the property to another, that other end purchaser can. Why? Because the recipient of the fraudulent instrument was closest to the fraud (even if innocent) and had an opportunity to investigate and avoid the fraud, whereas the end purchaser had no opportunity to investigate or discover the fraud.

And intuitively, I think you will agree that this makes sense in a world of forgeries and fraudulent instruments. A mortgage lender should have a duty to investigate its borrower, its signature, its identity, and its capacity (which is why lenders and their lawyers have strict "know your client" rules and underwriting standards), and it makes sense that if you accept a fraudulently executed mortgage, you should bear some risk of being defeated by a claim of the true owner.

The idea that the person who receives title or an interest under a fraudulent instrument may be defeated by the true owner….but an ultimate third-party buyer, one step removed from the fraudulent instrument, may not be so defeated. It may rely on the registry and on the transfer, even if fraudulent, as forming its root of title.

The court calls that mortgagee in the middle the "intermediate owner".

It's the one person who could have investigated the fraud and is vulnerable to a claim, even though its mortgage is registered.

In our case, the court found that not ONLY was the discharge of the Computershare mortgage a fraudulent instrument, but the NEW mortgage in favour of CIBC was also a fraudulent instrument…..not in the sense that it contained an impersonation or identity theft or forgery….but because it was wrongly trying to convey an interest that the Malfeasants no longer owned.

What does this mean?

It means that because the court found that CIBC was the co-called Intermediate Owner. CIBC was determined to be the lender closest to the fraud; the one that received its interest under a fraudulent instrument and therefore (apparently) could have investigated the fraud.

Accordingly, Computershare had its mortgage reinstated, the CIBC mortgage was determined to rank second, and Secure Capital ended up in third.

Now, if you don't immediately understand the importance of that, I will spell it out. The court's decision means the following:

1. Lenders cannot just rely on the register to be satisfied that a prior mortgage discharge was valid granted, even if the discharge has nothing to do with the lender's advance.
2. According to the court, CIBC apparently could have investigated the fraud somehow. The court said that "for example, an inquiry as to how [the Malfeasants] were able to pay off the Computershare mortgage given their financial circumstances might have raised

concerns".[3] This means (it would seem) not only having a view of the borrower's current financial situation but also an understanding and reconciliation of their historical major dealings with the property.

3. It means that the level of diligence that lenders have to put into the circumstances of the loan they are granting has been somehow elevated by this case. It begs such questions as
   (a) Must lenders always get additional evidence of how past registered transactions were funded? Do lenders need copies of old record books? payout statements? financial records? old certificates of incumbency?
   (b) Do lenders need to call their prior lending institutions to ensure that they confirm what is evidenced on title with respect to prior mortgages or other dealings? In other words, do lenders need to pull back the curtain of the registry?
   (c) Will lenders' solicitors start qualifying their opinions on title because they cannot give an absolute answer based on the title registry anymore?
   (d) And if a lender can no longer just rely on the register, how far back does it need to investigate?

As you can see these kinds of questions quickly lead to the unraveling of the "Mirror" and "Curtain" principles described earlier, because this decision means that the absolute protections afforded by the registry are not only eroded but potentially altogether undermined.

Here are my two cents:

1. If the case is correct on a technical interpretation of the statute, then it is correct technically only and entirely incorrect as a law of general application. Which it to say, that it is bad law. Nonetheless, for the time being, it is the law.
2. The notion that a purchaser or mortgagee cannot hide behind the fact that its mortgage or transfers is registered where the fraud was discoverable is not bad law. Those are the forgery and identity theft cases….and those would have applied here had the mortgages been forged or had they been granted by strangers. But the mortgage documents were, in and of themselves, sound, and their fraudulent nature was undetectable. They were granted by the owners, and there was nothing <u>about the mortgage documents themselves</u> that CIBC could have discovered. The fact that the mortgages were one step in the larger fraud should not have put CIBC to the obligation to investigate old registered instruments (such as the Computershare Discharge) that, on their face, had nothing to do with the new mortgages.
3. If we are to take this case seriously, and for now we have to, then there are risks here that lawyers cannot absorb for lenders with a title opinion, and which can be underwritten as only either internal risks of the lender or external risks to be title insured. It is really quite that simple. In a commercial loan scenario, each of these three innocent lenders, if they had title policies, would have coverage in these circumstances. But the overriding point is that title insurance is the only available external product to fully address the risks raised in this case.
4. As for next steps, I would suggest as follows:

- First, stay tuned. This case is going to appeal in 2016, and, in my view, it should be overturned. If it isn't, and the legislature doesn't fix the problem, then we will have a whole new set of things to discuss later this year.

- Second, in the meantime, err on the side of title insurance; and
- Third, lenders should refresh their internal underwriting diligence, with this case in mind. Remember the court's words that CIBC should have looked at the Malfeasants' historical financial record to determine how they could have afforded to obtain the Computershare discharge, and ask yourself whether your "know your lender's clients' client" and underwriting diligence would have rooted out that fraud.

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[*Editor's note*: **Simon P. Crawford** has acted on some of Canada's largest dollar value real estate transactions and on many of the country's landmark commercial, retail, sports and entertainment, and residential projects. Shortlisted by every major Canadian and international legal guide, including *Chambers Global*, *Canadian Legal Lexpert Directory*, *Euromoney Expert Guide*, and *Best Lawyers in Canada* as one of Canada's leaders in real estate law, Simon advises Canada's sophisticated real estate investors on private equity matters, fund formation, joint ventures, income trusts, purchase and sales, and property development.]

[1] [2015] O.J. No. 403, 2015 ONSC 543.
[2] R.S.O. 1990, c. L.5.
[3] *Supra* note 1, para. 58.

• ENFORCING JUDGMENTS THROUGH THE SALE OF REAL PROPERTY: MODERN SOLUTIONS TO TRADITIONAL IMPEDIMENTS •

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The Traditional Model: Enforcing Judgments through the Sheriff's Sale Process

So you've obtained a judgment against a debtor that owes you a significant amount of money but refuses to make payments. In traditional fashion, you obtain a writ of execution with the understanding that the sheriff will seize and sell the judgment debtor's house or any other real property owned by the debtor as a means of satisfying the judgment. Obviously, this situation represents a worst case scenario to an extent, but is often the only avenue available to a creditor when faced with an uncooperative debtor.

As part of the usual enforcement process in selling real property, as creditor, you first request a mortgage discharge statement from any relevant mortgagees with mortgages registered on title. This phase of the process is in fact necessary, as it allows the sheriff to identify outstanding balances owed to various third parties—debts that will influence the distribution of the property pie. You assume this will not be a significant hurdle until the mortgagees are contacted and refuse to provide a discharge statement without the debtor's consent. The root of the mortgagee's reluctance is simple: according to federal privacy laws the statements contain "personal information" of the debtor such that their disclosure is prohibited, absent consent. Not surprisingly, the debtor has little incentive to grant such permission, as they are likely in no hurry to assist or push the process along. The practical implication is that you are now forced to engage in examinations in aid of execution of the debtor

to obtain the information you need, which can be protracted, inefficient and expensive, with no assurance of a positive end result.

A Novel Alternative: Enforcing Judgments through Judicially Supervised Sales

Such was the state of Ontario's judgment enforcement execution regime until late 2015. Enter the recent case of *Canaccede International Acquisitions Ltd. v. Abdullah* [*Canaccede*],[1] delivered on September 9, 2015, which has potentially redefined the model to be applied by judgment creditors in pursuing the enforcement of unsecured judgments through the sale of a debtor's real property. In *Canaccede*, the applicant was a judgment creditor of five named respondents, all of whom chose not to oppose the proceedings. Based on the applicant's submissions, the Court considered the viability of approving a judicially supervised sales process as a means of circumventing the pitfalls associated with the traditional sheriff's sale process. The Court conceded that such an approach has never before been endorsed, but also made note that there is no provision in the *Execution Act*[2] that imposes the sheriff's sale model as an exclusive and absolute prescription. Rather, based on the doctrine of equitable execution and the court's inherent jurisdiction to "make an appropriate order that will do justice between the parties", the Court ruled that a judicially supervised sales process may constitute the preferred approach in many cases.

In that regard, the Court held as follows:

1) as a prerequisite to seeking an order for sale from the court, an order must be obtained directing a reference hearing to delineate the issues and establish the proper procedure to be followed in conducting the sale of the property; and
2) assuming that the referee determines that the respondent(s) have an interest in the land that may be sold to satisfy the debt, an order for sale by private contract must follow.

The initial reference hearing would involve all interested parties, including any mortgagee(s), who must disclose mortgage discharge statements to the creditor(s) as a natural byproduct of the hearing in order to get paid. Thus, the process potentially sidesteps the privacy issues that tend to bog down the traditional model. This procedure also preserves the rights of the respondents and others with an interest in the land to show cause as to why it would be unjust or inequitable to require the sale. Therefore, practically speaking, fairness between the parties is not impinged, while access to justice for judgment creditors is heightened.

The Present Climate: Analyzing the Impact of *Canaccede*

It is noteworthy to point out that *Canaccede* was heard by the Ontario Superior Court of Justice and was not appealed by the respondents. Additionally, relatively recent case law has diverged from the ruling in *Canaccede*. For example, in the case of *Royal Bank of Canada v. Trang* [*Trang*],[3] the Ontario Court of Appeal affirmed that absent consent, mortgage discharge statements constitute "personal information" and are therefore protected from disclosure and production by a third-party mortgagee. The Court of Appeal promoted the traditional model, ruling that creditors can include consent terms within their loan agreements in an effort to pre-empt the possibility of consent issues arising following a default. Clearly, this method can be

harnessed only if the creditor turned their mind to the issue during loan negotiations.

Although *Trang* was delivered nine months prior to *Canaccede*, it has not been overturned such that it is arguably binding authority for lower courts such as that in *Canaccede*. Perhaps more fundamentally, the Court in *Canaccede* admitted that the process it endorsed is not rooted in established practice. Rather, its foundation rests upon the notion of using the common law as an evolutionary tool to meet and overcome legal and practical impediments that lack substantial utility. In the circumstances, it is difficult to determine which approach will gain popular support moving forward.

Future Developments: The Ultimate Authority of the Supreme Court of Canada

The answer as to which approach will govern will be delivered in definitive fashion by the Supreme Court of Canada (the "S.C.C.") in the coming months. This is because the applicants in *Trang*, unlike the respondents in *Canaccede*, sought leave to appeal their case, which was granted on July 16, 2015. The appeal has been tentatively set for an April 27, 2016 hearing date. At the time leave to appeal was granted, *Canaccede* had not yet burst onto the legal scene. Now, it carries the potential to influence any decision reached by the S.C.C. with respect to the proper approach to be endorsed and followed when enforcing unsecured judgments against a judgment debtor's real property.

While there are no guarantees in the appellate process, it is clear that the traditional model employed by many creditors in enforcing judgments, at least with respect to third parties, has been fundamentally disturbed. Until the dust settles, judgment creditors should consider the position promoted by *Canaccede* in implementing the execution of their unsecured judgment(s) rather than passively acquiescing to the costly and inherently unpredictable sheriff's sale process.

Stay tuned …

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[*Editor's note*: **Ted Evangelidis** is the head of the Commercial Litigation Practice. He would like to thank Jason Hayward, Student-at- Law, for his assistance in preparing this article.]

[1] *Canaccede*, [2015] O.J. No. 4635, 2015 ONSC 5553.
[2] R.S.O. 1990, c. E.24.
[3] *Trang*, [2014] O.J. No. 5873, 2014 ONCA 883.