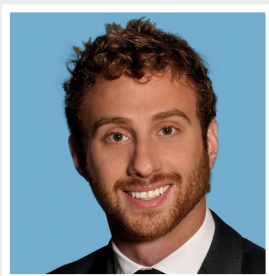


## Ontario Divisional Court Reviews Priorities Among Mortgagees that were Victims of Mortgage Fraud



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In a recent decision, *CIBC Mortgages Inc. v Computershare Trust Co. of Canada* (2016 ONSC 7094 (Div. Ct.) ("Computershare"), the Ontario Divisional Court dealt with a priority dispute between innocent mortgagees that were victims of a fraud. The issue before the court was whether a first mortgagee whose mortgage was fraudulently discharged was entitled to have its interest reinstated in first priority ahead of two mortgagees that, unaware of the fraudulent nature of the discharge of the first mortgage, registered respective mortgages in what they believed were first and second position.

The Divisional Court overturned the application judge's decision by finding that the fraudulently discharged first mortgage would be reinstated in third position, subsequent to the two mortgages registered after the fraudulent discharge. Arriving at this decision, the Court analyzed the relevant provisions of the Ontario *Land Titles Act* ("LTA") and fundamental elements of our land titles system.

### The Practical Impact of the Decision

Lenders can generally rely on previously registered discharges of mortgages shown on the title register.

Had the Divisional Court not overturned the application judge's decision, one would not have been able to take at face value previously registered discharges shown on the title register, given that they could have been fraudulently registered. The Divisional Court's decision relieves innocent parties from the obligation to verify the authenticity of previously registered discharges as part of their due diligence.

In any event, lenders are well advised to obtain title insurance coverage for their mortgages to help protect against the risk of fraud.

### The Facts

Dhanraj Lowtan and Sumatie Lowtan purchased property in Brampton in 2006. In 2008, the Lowtans borrowed \$280,801 from Computershare and granted Computershare a first priority mortgage on the property. In 2009, the Lowtans

fraudulently registered a discharge of Computershare's mortgage, however, they continued making the monthly payments to Computershare. Accordingly, Computershare remained unaware that its mortgage had been discharged. In 2011, the Lowtans granted a mortgage to CIBC in the amount of \$252,800. In 2012, the Lowtans granted a mortgage to Secure Capital Mic Inc. in the amount of \$32,000. CIBC and Secure Capital respectively believed that they had first and second priority mortgages.

By the first week of February 2013, the Lowtans defaulted on all three mortgages and, in April 2013, Computershare discovered that its mortgage had been fraudulently discharged. The Lowtans vacated the property, made assignments into bankruptcy, and the property was sold by CIBC with the consent of Computershare and Secure Capital. When the proceeds of the sale were insufficient to satisfy all three debts, Computershare, CIBC, and Secure Capital all commenced applications in the Superior Court for a determination of priorities as between the three mortgages.

### Application Judge's Decision

In *CIBC Mortgage Inc. v Computershare Trust Co. of Canada* (2015 ONSC 543), the application judge held that Computershare's mortgage would be reinstated in first priority and that the CIBC and Secure Capital mortgages ranked second and third, respectively. In his analysis, the application judge reviewed the provisions of the LTA and the theory of deferred

indefeasibility set out in the case law, including, most notably, the Ontario Court of Appeal decision in *Lawrence v. Maple Trust Company* (84 OR (3d) 94 (ONCA) ("Lawrence").

The application judge found that the Lowtans were "fraudulent persons" within the meaning of the LTA, as they did not in fact own the first mortgage "interest in land" which they purported to convey to CIBC and Secure Capital but held themselves out as owners of such interest. On this basis, the application judge determined that the mortgages to CIBC and Secure Capital were "fraudulent instruments", since the LTA defines a fraudulent instrument as an instrument under which a fraudulent person purports to transfer an interest in land. Under the LTA, fraudulent instruments are not effective.

The application judge categorized CIBC and Secure Capital as "intermediate owners" according to the "theory of deferred indefeasibility". The theory of deferred indefeasibility holds that there are three classes of parties: (i) the original owner of the interest in the property; (ii) the intermediate owner (i.e. the party that dealt directly with the fraudster in obtaining its interest in the property); and (iii) the deferred owner (i.e., a *bona fide* purchaser or encumbrancer for value without notice who takes its interest from the intermediate owner). The theory provides that only the deferred owner can defeat the original owner's title because the intermediate owner has the

opportunity to deal directly with the fraudsters, to investigate the transaction, and to avoid the fraud, while the deferred owner does not have such opportunities. The theory further provides that registration of a void instrument does not convey good title. However, good title can be obtained by a deferred owner that takes title from an intermediate owner.

On this analysis, the application judge found that CIBC and Secure Capital were intermediate owners, having obtained their interests in the property from fraudulent instruments granted by the Lowtans. Notwithstanding that CIBC and Secure Capital were *bona fide* encumbrancers for value without notice, the application judge found that Computershare's interest in the property defeated the interests of CIBC and Secure Capital. Computershare was, therefore, determined to hold the first priority mortgage. CIBC appealed.

### Divisional Court's Decision

The Divisional Court disagreed with the application judge's findings and concluded that CIBC held the first priority mortgage. Accordingly, CIBC was entitled to the first proceeds distributed from the sale of the property.

While the Divisional Court acknowledged that the Lowtans perpetrated a fraud on CIBC and Secure Capital by concealing the existence of the Computershare mortgage, this did not make the Lowtans "fraudulent persons". The

Court held that “to be fraudulent persons in this circumstances, the Lowtans had to have knowingly and falsely held themselves out, in the two mortgages, to be the registered owners of the affected estate or interest.” However, the Court found that the Lowtans did not falsely hold themselves out since they were in fact the true owners of the property in fee simple and therefore were entitled to grant mortgages against the property. The Court held that the application judge made a palpable and overriding error of fact when he found that the CIBC and Secure Capital mortgages were fraudulent instruments.

In its analysis, the Divisional Court reviewed the theory of deferred indefeasibility in light of the amendments made to the LTA that were not considered in the *Lawrence* decision. With these amendments, the LTA explicitly establishes a system of deferred indefeasibility, which works to invalidate only fraudulent instruments. Subsequently registered instruments that are not fraudulent are not rendered ineffective.

As a result of its finding that the Lowtans were not fraudulent persons, the Court found that CIBC was not an intermediate purchaser of a fraudulently acquired interest registered on title, and was entitled to rely on two basic principles of the land titles system, the “mirror principle” (that the register is a perfect mirror of the state of title) and the “curtain principle” (that one need not search behind the title).

### **Implications of the Divisional Court’s Decision**

After the application judge’s decision, an increased burden was placed upon lenders and their lawyers to closely investigate previous transactions, to go behind the “curtain” (i.e. search behind title) and to ensure that the lender’s priority was not jeopardized by a fraud perpetrated on a previously discharged mortgage. The Divisional Court’s decision, however, in reinforcing the mirror and curtain principles, suggests that lenders and their lawyers are entitled to rely on the register and are not subject to this increased due diligence

burden. Although it remains to be seen whether the Divisional Court’s decision will be strictly followed in future decisions, on a practical note, given that title insurance typically provides coverage for losses resulting from fraud, lenders and their counsel are well advised to obtain title insurance for their mortgages in order to mitigate risks relating to fraud and attempt to avoid getting entangled in a mortgage priority dispute such as was dealt with in *CIBC Mortgage Inc. v Computershare Trust Co. of Canada*.

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