

# KEEPING CURRENT

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## Mortgage granted by defendant facing trial judgment set aside as a fraudulent conveyance

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Defendants facing the prospect of an unfavourable ruling at trial should be aware that any conveyances or payments to third parties during that time will be closely examined by the courts to determine if any badges of fraud are present.

In *WED Investments Limited v. Showcase Woodycrest Inc.*, [2021 ONSC 5614](#) (CanLII), a mortgage granted by a defendant corporation to another corporation owned by the same individual was set aside under the provisions of the Ontario [Fraudulent Conveyances Act](#) and [Assignments and Preferences Act](#).

In 2016, the plaintiff agreed to buy a property in Whitby, Ontario from the defendant corporation. The deal never closed. In May 2017 the plaintiff sued for breach of contract and registered a certificate of pending litigation (CPL) to protect its claim to purchase the property.

At trial in November 2020, the plaintiff elected to pursue its claim in damages rather than seeking title to the property, and it consented to an order discharging the CPL. The CPL was lifted on

December 23, 2020, and, that same day—unbeknownst to the plaintiff—the defendant registered a \$2 million mortgage on the property in favour of a related corporation.

In January 2021, the plaintiff obtained judgment against the defendant in the amount of \$3.2 million: *WED Investments Limited v. Showcase Woodycrest Inc.*, [2021 ONSC 237](#).

The plaintiff subsequently discovered the mortgage and brought an application to have it declared void and set aside.

A conveyance will be void under [s. 2](#) of the [Fraudulent Conveyances Act](#) if it was made “with intent to defeat, hinder, delay or defraud creditors.” A conveyance will be void under [s. 4\(1\)](#) of the [Assignments and Preferences Act](#) if it was made when a person was insolvent or knowingly on the eve of insolvency with the intent to defeat, hinder, delay or prejudice creditors.

There was no question that the registration of the mortgage was a “conveyance” for the purpose of both

statutes. Further, the plaintiff had standing to bring the application as a future creditor even though the mortgage was registered before the trial judgment was released.

Accordingly, the issue was whether the defendant intended to defeat or hinder the plaintiff's ability to secure its judgment when it agreed to the registration of the mortgage. In assessing the matter, the court grouped a non-exhaustive list of "badges of fraud" into three broad categories:

- (i) The relationship between the parties to the conveyance;
- (ii) The nature of the conveyance; and
- (iii) The timing of the conveyance.

With regard to the relationship between the parties to the conveyance, there was a "very close" relationship between the mortgagor and the mortgagee since they were both controlled by the same individual, who was the sole director and officer of the two corporations, which he used in his land development business. The defendant mortgagor was incorporated solely to purchase and develop the property, which was its only asset.

Since the defendant had no independent source of income to pay the balance of the property's purchase price, the mortgagee corporation agreed to loan it up to \$2 million. As security for the loan, the mortgagee was given the right to register a mortgage on the property, and the individual owner signed the loan agreement on behalf of both companies.

However, notwithstanding the close relationship between the corporations, the court found that there was nothing suspicious about the loan agreement as it was entered into in 2015 for

legitimate business reasons. The mortgagee corporation had advanced the defendant more than \$1 million in 2015 to cover the balance of the purchase price. Between 2015 and 2019, the mortgagee periodically advanced additional funds to the defendant to pay its mortgage and to cover the costs to develop the property. The close relationship did not itself mean the mortgage was fraudulent.

Instead, the key issue for the court was whether the timing of the registration of the mortgage while the trial judgment was under reserve gave rise to an inference of fraudulent intent. The court found that it did for several reasons.

The mortgage was not registered on the property when the loan agreement was signed in 2015, although the mortgagee had the right to do so. The defendant claimed that there was no need for the mortgage to be registered when it first bought the property because no work was being done to develop it and the property had sufficient value to satisfy the mortgage.

In 2016, the defendant secured a new mortgage for \$2.4 million and paid out the VTB. One of the terms of the new mortgage was that the defendant could not register a second mortgage on the property without the lender's consent. There was no evidence that the defendant mortgagee ever sought this lender's consent to register its mortgage in second position.

The statement of claim regarding the aborted purchase was issued in 2017, and the CPL was registered at that time. Nonetheless, the defendant was able to refinance the property for a third time in June 2018 while the CPL remained on title. The plaintiff agreed to postpone enforcement of its CPL to allow the defendant to use the funds to pay off the prior first mortgage.



The new first mortgage did not include any term that prohibited the defendant mortgagee from registering its mortgage. It did not take any steps to do so.

When the CPL was removed from title in December 2020 the mortgage between the two defendant corporations was registered on title the same day.

The plaintiff discovered the mortgage had been registered on January 25, 2021, when it registered the trial judgment. Despite the ongoing litigation, the individual owner of the two defendant corporations had failed to advise the plaintiff that the defendant intended to register the mortgage.

The court accepted that the defendant did not think there was any need to register a mortgage on the property when it was first purchased, and that there was no need to register the mortgage in 2015 because the property was worth enough to satisfy the defendant's debts.

Nonetheless, the court found that the registration of the mortgage in 2020 was made with the intent to hinder the plaintiff's ability to secure its judgment should the trial judge rule in its favour.

There was no evidence that the defendant made any effort to register the mortgage before December 23, 2020. According to the individual owner of both companies, there was no need to secure the loan so long as the property (the defendant's only asset) had sufficient value to cover the mortgage loan.

It followed from that fact that the reason the owner decided to register the mortgage in December 2020 after leaving the loan unsecured for five years was that he felt there was a need to do so at that time. Based on the evidence, only two things changed between 2015 and 2020. First,

the mortgagee had advanced additional funds to the defendant mortgagor. Second, the defendant was facing a significant liability in its lawsuit with the plaintiff if the plaintiff obtained judgment.

Lastly, the court found that the defendant was on the eve of insolvency when the mortgage was registered based on the financial statements filed and the value of the property, if it was ordered to pay the plaintiff \$6.2 million in damages.

The owner had been content for the loan to remain unsecured when he thought that the defendant had assets to repay the loan. However, when he feared insolvency, he registered the mortgage to prefer his own claim to be paid ahead of the plaintiff. That is an unjust preference.

As a result, the court found that the registration of the mortgage was made with the intent to hinder, defeat or prejudice the plaintiff's ability to enforce its judgment if the trial judge ruled in its favour.

The registration of the mortgage on the property in favour of the defendant mortgagee was therefore void as against creditors under [s. 2 of the \*Fraudulent Conveyances Act\*](#) and under [s. 4\(1\) of the \*Assignments and Preferences Act\*](#).

### Contact us

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