

Mortgage Fraud: Who Has Priority In A Dispute?

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29 March 2017

A recent Ontario Divisional Court decision, *CIBC Mortgages Inc. v Computershare Trust Company of Canada*, 2016 ONSC 7094 (CanLII)[1] (“*Computershare*”), confirms that a mortgage lender may lose priority if their mortgage is fraudulently discharged by the mortgagor. As a result, mortgage lenders may wish to implement a system to monitor whether their mortgages remain registered on title to a mortgaged property.

In the facts resulting in the *Computershare* decision, the homeowners had provided a purchase money mortgage in the amount of \$280,801 to Computershare when they purchased the property in December, 2006. In August, 2009, the homeowners caused an unauthorized party to register a fraudulent discharge of the Computershare mortgage. However, Computershare was not aware of this because the homeowners continued to make mortgage payments to Computershare as usual until January, 2013.

In the meantime, however, the homeowners obtained a new private mortgage, followed by another mortgage from CIBC for \$252,800, which was used in part to discharge the private mortgage. In December, 2012, the homeowners obtained a further mortgage from Secure Capital MIC Inc. for \$32,000.

The homeowners subsequently defaulted on all three mortgages, vacated the property, and made an assignment into bankruptcy. The property was sold under power of sale for \$297,754, resulting in proceedings between Computershare, CIBC and Secure Capital regarding priority to the available proceeds, which were insufficient to cover all three mortgages.

Pursuant to the *Land Titles Act*, R.S.O. 1990, c. L.5 (the “*LTA*”), registered instruments such as transfers, charge/mortgages, and discharges thereof, which are found to be “fraudulent” are void and may be deleted from title. The definition of a “fraudulent instrument” in the *LTA* includes an instrument (a) “under which a fraudulent person purports to receive or transfer an estate or interest in land”; and (b) “that perpetrates a fraud as prescribed with respect to the estate or interest in land affected by the instrument”.

In the application at first instance,[2] Mr. Justice Murray determined that the Computershare mortgage maintained priority on the basis that it had been fraudulently discharged by a “fraudulent person” within the meaning of the *LTA*. For this determination, Murray J. held that the homeowners made a false document (the registered discharge of the Computershare mortgage), and although they were the real homeowners of the property, they were not the owners of the “interest in land” which they conveyed to CIBC since they had fraudulently conveyed to themselves the Computershare interest in the property and then held themselves out to CIBC as the registered owners of the property whose interests were not subject to any registered encumbrance. Murray J. concluded that Computershare maintained first priority over the subsequent lenders and rectified title accordingly (with Computershare in first position and CIBC and Secure Capital in second and third position rather than being deleted completely).

At least one subsequent decision, *Tiao v Leone et al*, 2016 ONSC 3015 (CanLII) (“*Tiao*”), shared this reasoning and found that a fraudulently registered discharge ought to be deleted and the mortgage reinstated with priority over all subsequent mortgages. However, in contrast to the *Computershare* fact scenario, the homeowner in *Tiao* was found to have been unaware that the fraudulent discharge was registered.

While the Divisional Court in *Computershare* did not refer to the *Tiao* decision, the involvement of the homeowners in the registration of the fraudulent instrument appears to have been a determinative factor. Indeed, the Divisional Court focused on only one issue: whether the CIBC mortgage met the criteria for a “fraudulent instrument.” The Court found that it did not since the homeowners were not “fraudulent persons” who had knowingly and falsely held themselves out to be the owners of the property. Rather, they were the true owners of the interest in land affected by the mortgage and their ownership was validly registered.

Heavily influencing the decision is the concept that the Land Titles Act is based on the “mirror principle” (the register being a perfect mirror of the state of title) and the “curtain principle” (a purchaser need not investigate the history of or behind the title). CIBC had no notice of the fraud perpetrated on Computershare and, in this theory, reasonably relied on the clear state of title when deciding to advance mortgage funds to the homeowners. Computershare therefore lost priority to the subsequent mortgages even though it too was an innocent victim of a fraud.

In the circumstances, the Divisional Court was faced with a priority dispute over three innocent lenders and focused on whether the subsequent mortgages were fraudulent instruments rather than on whether the discharge which deleted Computershare’s mortgage from title was a fraudulent instrument. Computershare would likely have recourse to the Land Titles Assurance Fund and potential recovery from any persons who were intentionally or negligently involved in the fraud. However, mortgage lenders may wish to take heed of the decision and take steps to proactively monitor their mortgage registrations going forward in order to avoid the consequences of a fraudulently deleted charge/mortgage.

[1] The writer understands that the decision is not being further appealed to the Ontario Court of Appeal.

[2] *CIBC Mortgages Inc. v. Computershare Trust Co. of Canada*, 2015 ONSC 543 (CanLII)

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