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# MIABC Annual Legal Report

*Annual General Meeting, 2009*

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## Legislation Update

### 1. Legislation Passed with Royal Assent

**A. Amendments to *Bankruptcy and Insolvency Act*, and introduction of *Wage Earner Protection Program Act***

The legislation which involves the provision of priority to employees of bankrupt companies for unpaid wages and unfunded pension liabilities over prior secured creditors and in the case of unfunded pension liabilities priority over prior secured creditors' real property security, the details of which were discussed in the 2006 and 2007 MIABC Legal Reports, was quietly brought into force in July 2008 without significant change. The provisions establishing a super-priority for unpaid wages and unfunded pension amounts over previously registered and advanced security was not modified despite significant lobbying to the contrary by the banking and secured creditor community. It remains to be seen whether or not there will be a constitutional challenge to the priority aspects of the legislation.

**B. *Business Practices and Consumer Protection (Payday Loans) Amendment Act, 2007*, S.B.C. 2007, c. 35**

Parliament passed *An Act to Amend the Criminal Code (Criminal Interest Rate)*, S.C. 2007, c. 9, which exempted payday loans from the restrictions of the *Criminal Code* regarding the criminal interest rate provisions. In response, the B.C. legislature has enacted the *Business Practices and Consumer Protection (Payday Loans) Amendment Act, 2007* which comes into force on November 1, 2009. The Act will limit the total cost of payday loans, require payday loans to be in writing, permit a cancellation period to the borrower, limit specific practices of lenders and provide specified remedies to borrowers in the event that there are lender violations.

**C. *Vancouver Charter Amendment Act, 2009*, S.B.C. 2009, c. 1**

This emergency legislation passed first, second and third reading and attained Royal Assent all on January 18, 2009. It permitted the City of Vancouver to undertake borrowing and other financial arrangements regarding the Olympic Village being constructed for Vancouver/Whistler 2010.

**D. Amendments to *British Columbia Housing Management Commission Regulation*, B.C. Reg. 490/79**

This regulation pursuant to the *Ministry of Lands, Parks and Housing Act*, R.S.B.C. 1996, c. 307 has been amended by B.C. Reg. 156/2008 and 160/2008 which provides BCHMC with the expanded powers of a public housing agency over and above the powers conferred upon it under the *Housing Act.* These regulations came into force June 25, 2008.

**E. Amendments to *Real Estate Development Marketing Act*, S.B.C. 2004, c. 41**

Policy Statements 14 and 15 from FICOM expanded the scope of disclosure statements required on projects where filings would be required after November 1, 2007. Policy

Statement 14 dealt with the requirement for disclosure statements on pre-sale properties, while Policy Statement 15 increased the disclosure required re conflict of interest and developer background.

**F. Amendments to rules from Canada Mortgage and Housing Corporation ("CMHC")**

In the latter half of 2006, CMHC began insuring residential mortgages with amortization periods of 40 years and in some cases, financing 100% of the cost of the property. CMHC announced that as of October 15, 2008, the maximum amortization period it would insure for high ratio loans would be 35 years (low ratio loans can still be amortized over 40 years), and the owner would require a minimum of 5% down payment on the property. There were also concurrent changes to minimum credit scores for qualifying borrowers and new loan documentation standards.

## 2. Proposed Legislation

**A. *Strata Property Amendment Act, 2009* — Bill 8**

This proposed amendment is wide-ranging, from provisions regarding the owner-developer through to governance by a strata corporation and suits by the strata corporation. This bill has passed third reading.

**B. *Canada Not-For-Profit Corporations Act* — Bill C-4 (2009)**

The current not-for-profit regime is administered on a federal level through the *Canada Corporations Act,* an Act that has remained almost unchanged since 1917. The proposed legislation, which was re-tabled in January 2009 after the proroguing of Parliament killed the previously tabled Bill C-21 in December 2008, will bring the rights, obligations and organization of federal not-for-profits more into line with that of modern for-profit corporations, plus enhance the framework with new transparency and accountability requirements which reflect modern concerns with corporate governance.

**C. *Commercial Tenancy Act***

The Commercial Tenancy Reform Project was formed in 2007 and produced a report with recommendations in the fall of 2008. The intention is that the outdated legislation and the disparate common law on the subject will be transformed into a single Act which will be capable of addressing modern commercial tenancy issues which were not contemplated previously.

**D. *Companies' Creditors Arrangement Act* and DIP Financing**

The recent credit issues and subsequent downturn in the real estate development industry has led some owner-developers to employ a novel approach to a very old statute. The *Companies' Creditors Arrangement Act ("CCAA")* was intended to allow large corporations with numerous creditors an opportunity to restructure and continue operating as a going concern, without the necessity of assigning into bankruptcy. The statute sets the threshold for a large corporation by requiring a minimum amount of debtor debt of $5 million. Presently, most moderate-size developers in British Columbia will meet the "larger corporation" threshold since $5 million in debt is all that is technically required.

A debtor seeks *CCAA* protection by applying to the court, often without notice to any creditor. If the preliminary *CCAA* order is made, then the order is served on all creditors and the parties are at liberty to argue the issues before the court at a review hearing (normally 30 days but it can be shorter). The preliminary order will appoint a monitor (who is a trustee in bankruptcy) to review the affairs of the debtor through the *CCAA* period. The debtor may also obtain debtor in possession ("DIP") financing where the court permits an infusion of cash into the debtor's business to allow the restructuring plan to happen. The DIP financing is normally (a) at a high interest rate and subject to large lending and legal fees, and (b) secured to the assets of the debtor with first priority, notwithstanding that before the CCAA order, other creditors may have had mortgages or other security for their loans.

# MIABC Annual Legal Report

The effect of this from a secured lender's perspective may be very unsatisfactory. The borrower can go to court and receive an order staying enforcement of the lender's security, incur legal and monitor's fees (plus the monitor's legal fees) in priority to the lender's security, and obtain fresh financing at secondary (higher) rates again in priority to the lender's security. All of this can be accomplished (at least initially) without notice to the lender.

Recently the court has had an opportunity to review certain aspects of this practice in situations where developer debtors have mortgagee creditors but no other creditors of any real importance. A developer applying for *CCAA* protection is basically forestalling a foreclosure proceeding and seeking to control the insolvency itself, instead of permitting the secured creditors to decide how the security will be enforced. Here are the main issues that have been decided recently:

(a) Without Notice Applications

Although the *CCAA* permits without notice applications (s. 11), as there is often a crisis or urgency for the debtor to obtain the *CCAA* protections before assets are seized, the court has recently cast a new light on notice to creditors when applying for *CCAA*. *Re Marine Drive Properties,* 2009 BCSC 145 established that there should exist some reason for urgency if the *CCAA* initial application is to be brought without notice. It is not sufficient simply because the matter is under *CCAA* that it can be brought without notice. It is also insufficient that the secured creditors may be seeking to enforce their security.

(b) General Principles Against Application of *CCAA*

*Re Encore Developments Ltd.*, 2009 BCSC 13 recently set a standard for seeking the protection of the *CCAA*, especially if attempted without notice. Here the *CCAA* initial order and DIP financing were obtained with what the court later determined was inadequate disclosure to the court. There was no equity in the properties owned by the debtor, there were no ongoing projects, no employees and no public interest to be upheld. On review of the initial order, the Court found no reasons existed to make a *CCAA* order, the without notice application was unnecessary, the cost of the *CCAA* plan would be born by the secured creditors and the DIP financing terms were onerous. The Court set aside the initial order (including the DIP financing) due to the extraordinary elements in this case (including a suggestion of bad faith and deliberate non-disclosure by the debtor). The court has since issued a new model order incorporating the issues of this case.

(c) Liquidations in *CCAA*

The purpose of the *CCAA* is to enable an arrangement between debtor and creditor to enable a company to remain in operation for the future benefit of all parties. It seems to be counterintuitive to suggest that *CCAA* can be used to liquidate the assets of the debtor. *Re Cliffs Over Maple Bay Investments Ltd.*, 2008 BCCA 327 is a case where the developer was given notice by its secured creditors of their intention to enforce the mortgage security over a development. The debtor obtained a *CCAA* initial order to freeze the creditors while the debtor went about trying to liquidate the assets. The Court upheld the right of a debtor to use the *CCAA* to liquidate, but set aside the order due to the fact that the debtor had no intention to reach a compromise or arrangement with the creditors from the outset. It is acceptable to make liquidation a part of the plan, but it is not acceptable to use the *CCAA* simply to freeze creditors while the debtor goes about realizing on its own assets. In real estate development insolvency, there is no legitimate benefit in having a debtor effectively foreclose on itself, in lieu of a mortgagee, particularly where enormous costs arise from the process to the diminishment of the mortgagee's recovery.

# Caselaw Update

## 1. Mortgage Fraud

A significant change in the law in B.C. relating to mortgage fraud occurred in April, 2009 with the decision of the B.C. Court of Appeal in *Gill v. Bucholtz*, 2009 BCCA 137.

Before this decision, lenders were clearly at risk where they held a forged mortgage in a case involving identity theft. However, in a situation where property had been fraudulently transferred and then mortgaged by the fraudster to an innocent lender, the lender's mortgage was enforceable against the true owner who could then make a claim against the title assurance fund. Unfortunately for lenders, as a result of the *Gill* decision, mortgages obtained in this scenario will be void.

### *Gill v. Bucholtz, 2009 BCCA 137*

The facts of the case are simple. A fraudster representing himself as the true owner transferred the owner's property to a second fraudster Gurjeet Gill ("Gill"), who then mortgaged the property twice. Both lenders were unaware of the fraud and in advancing funds relied on the state of title showing Gill as the registered owner. Both lenders also confirmed the identity of Gill prior to advancing funds.

When the fraud was discovered, the true owner commenced legal proceedings to recover his title to the property free of the mortgages which had been fraudulently granted.

There was no doubt that the true owner of the property should have his title restored. This was by virtue of section 23(2)(i) of the B.C. *Land Title Act,* which allows a person who has been deprived of land and who is able to show fraud in which the registered owner has participated, to challenge the fraudster's title as registered owner and recover title to his or her lands.

The real question for the Court was whether the mortgages remained valid charges on the title.

At the trial level, the Court concluded that the mortgages were valid charges, as the lenders had dealt with the registered owner in good faith and with consideration and as such were entitled to rely on the title as it stood at the time they accepted the mortgages and advanced funds, without the need to investigate the registered owner's title to determine whether it was legitimately obtained. In other words, the Court agreed with the lenders' position that between the time the fraudster took title and the time the true owner discovered and remedied the fraud, the fraudulent title holder could grant valid charges such as a mortgage, provided the lender was unaware of the fraud and relied on the title as it stood at the time it accepted its security.

The Court of Appeal disagreed with the lower Court's interpretation of the *Land Title Act.* According to the Court of Appeal, section 23(2)(i) of the *Land Title Act* which provides an exception to the "indefeasible" or conclusive quality of a registered owner's title and which allowed the true owner in this case to recover title to his lands, could not be interpreted so as to allow the fraudster the right while he remained on title as registered owner, to deal with the property and grant valid charges such as a mortgage. The Court of Appeal held that these provisions of the *Land Title Act* did not extend to protect the interests of mortgagees and other chargeholders in this manner.

In concluding that the mortgages were invalid, the Court of Appeal also relied on section 25.1 of the B.C. *Land Title Act,* which states that *"Subject to this section, a person who purports to acquire land or an estate or interest in land by registration of a void instrument does not acquire any estate or interest in the land on registration of the instrument".* The Court noted that while there is an exception in section 25.1 for innocent purchasers who unknowingly purchase a fee simple interest involving a void transfer, there is no similar protection for innocent mortgagees and other chargeholders acquiring a charge by registration of a void instrument.

This decision means that lenders, in order to be sure that they hold a mortgage which cannot be invalidated because of fraud, will need to confirm that the registered owner granting the mortgage legitimately obtained his or her title from the previous owner in good faith and with consideration. The risk of a mortgage being invalidated because of fraud in which the registered owner has participated, would appear to be low where title has been held by the registered owner for some time. However, where title has recently changed hands, further investigation and due diligence might be required to confirm the validity of the registered owner's title. Title insurance may also be a practical option.

### *Re Oehlerking Estate, 2009 BCCA 138*

This is another recent case with facts similar to *Gill v. Bucholtz* in which a bona fide mortgagee advanced mortgage proceeds on the security of a mortgage granted to it by a party who acquired title by participating in a fraud. The appeal case was heard concurrently with the appeal in *Gill v. Bucholtz*. For the same reasons set forth in the *Gill v. Bucholtz* the court held the mortgage to be invalid. This lawyers in this case are applying for leave to appeal the decision to the Supreme Court of Canada.

### *Homewood Mortgage Investments Ltd. v. Lee, 2008 BCSC 512*

<u>Forged</u> mortgages, where a fraudster impersonates the identity of the real owner and grants a mortgage, are unenforceable against the real owner. This principle was confirmed in the April, 2008 decision of the B.C. Supreme Court in *Homewood Mortgage Investments Ltd. v. Lee.*

The owner in this case was a mentally incompetent woman whose affairs were being handled by her children, who sought a declaration that the mortgage and assignment of rents that had been registered against the mother's property were forgeries and unenforceable. The lender Homewood Mortgage Investments Ltd. ("Homewood") sought a declaration that the charges were valid.

The Court determined it was clear the owner never authorized or signed the mortgage in question, nor did she receive any of the mortgage proceeds. The Court concluded the mortgage and assignment of rents were forgeries and therefore unenforceable.

In reaching this conclusion, the Court applied the 1963 decision of the B.C. Court of Appeal in *Credit Foncier Franco-Canadien v. Bennett* [1963] B.C.J. No. 16. In that case, a fraudster forged a mortgage which was subsequently assigned twice by registered assignments. Credit Foncier was the second assignee and contended that the mortgage, although a forgery, was valid in the hands of the first assignee and valid in the hands of Credit Foncier who had purchased the mortgage in good faith.

The Court of Appeal in the *Credit Foncier* case held that the effect of a forged mortgage must depend on section 41 (now section 26(1)) of the *Land Title Act*. Section 41 provided that:

> *"The registered owner of a charge shall be <u>deemed to be entitled</u> to the estate or interest in respect of which he is registered, subject only to such exceptions and registered charges as appear existing on the register." (emphasis added)*

The *Credit Foncier* decision turned on the meaning to be given to the words "deemed to be entitled" in section 41 (now section 26(1)) of the *Land Title Act*. Credit Foncier contended that the words "deemed to be entitled" meant that it was "<u>irrebuttably presumed</u>" that the mortgage was a valid charge owned by Credit Foncier as registered assignee of the mortgage.

The Court of Appeal in *Credit Foncier* disagreed, noting from some earlier cases that the word "deemed" is capable of meaning "<u>rebuttably</u> presumed", or <u>presumed until the contrary is proven</u>. In other words, registration raises only a rebuttable presumption that the mortgage is a valid charge, which is rebuttable by evidence of the fraud. In the result, the mortgage was declared a nullity by virtue of the forgery and remained a nullity notwithstanding the subsequent registered assignments.

It is worth noting that the B.C. Supreme Court's decision in *Homewood* predates the B.C. Court of Appeal's decision in *Gill v. Bucholtz*. As a result of the decision in *Gill*, it is submitted that a Court faced with a forged mortgage scenario would now also rely on section 25.1 of the *Land Title Act* discussed above to support its finding that a forged mortgage was void.

The result of the decision in *Homewood* is a lesson to lenders to carry out their due diligence in processing mortgage applications and obtaining mortgages in order to try and prevent this type of fraud from successfully occurring. Title insurance may also be an option for protection against this risk.

## 2. Builders Lien Holdbacks

The next case is of interest because it confirmed that a lender is entitled to interest on funds held back as holdback funds pursuant to the B.C. *Builders Lien Act*.

### *Interior Equity Corp. v. Graham, 2007 BCSC 1135*

The case arose out of a foreclosure proceeding. The issue was the amount owing under the lender's construction mortgage, specifically whether the borrower was liable to pay interest on sums totalling $52,500 held back by the lender as a builders lien holdback.

The loan documentation provided for a builders lien holdback of 15% from the lender's advances, but was silent as to whether interest accrued on the holdback funds.

The first five draws were paid to and disbursed by the lender's solicitor, who returned any holdback funds to the lender. The final draw, less the holdback amount, was forwarded directly to the borrower. The lender held the holdback funds totalling $52,500 in its pooled funds and did not establish a separate account.

The borrower's position was that the holdback funds had not been "advanced", that is, paid to or for the benefit of the borrower and should therefore not attract interest. The borrower maintained that by retaining the holdback funds in a pooled account, the lender was able to lend these funds out to others and that in such circumstances it would be unfair to charge the borrower interest.

The Court was not directed to any caselaw directly on point, but found some assistance in the decision of the Ontario Supreme Court in *Ialongo v. Serm Investments Ltd., [2007] O.J. No. 789 (Ont. Superior Court),* which set out an exception to the general rule that a lender can only claim interest from the time money is advanced. The exception is that:

> *"if the mortgagee keeps the money ready, he ought to have the interest agreed upon, and the most the mortgagor can expect is that…the mortgagee shall allow him such interest as the bank may have allowed him pending completion of the transaction. No doubt such a contract should be clearly made out, as it may work a hardship on the mortgagor…"*

The Court noted that the retention of a lien holdback is an onerous obligation for a lender to assume. A lender who holds back funds is obliged to perform the duties of an "owner" with respect to the holdback funds while also having an eye to the rights of the owner and any lien claimants. The Court noted the funds are, by the terms of the *Builders Lien Act,* impressed with a trust.

The Court concluded that in the circumstances of the case, the lender was under a contractual and statutory duty to "keep the money ready" for the borrower or for his account and should therefore be entitled to interest upon it from the date of the lender's advances.

This decision also highlights the practice point that because it is sometimes arguable whether funds have actually been "advanced", it is always good practice where funds are held back by a lender for purposes other than holdbacks under the *Builders Lien Act*, to conduct a current lien search of title prior to releasing the funds held back to the developer/borrower. A title search clear of liens will ensure that the funds held back enjoy the priority the lender intended. Otherwise, the lender may find itself having to establish that the funds held back were "advanced" and therefore entitled to priority over subsequent registered liens under the provisions of section 32(2) of the *Builders Lien Act.*

## 3. Sections 73 and 73.1 of the *Land Title Act*

In 2007 we reported on a proposed amendment to section 73 of the *Land Title Act* which became law in May, 2007, and which was intended to remedy the problems created by the B.C. Court of Appeal's decision in *International Paper Industries v. Top Line Industries Inc.,* (1996) 135 D.L.R. (4th) 423 relating to section 73 of the *Land Title Act.*

By way of background, section 73 of the *Land Title Act* states that:

*73 (1) <u>Except on compliance with this Part</u>, a person must not subdivide land into smaller parcels than those of which the person is the owner for the purpose of:*

*(a) transferring it, or*

*(b) leasing it, or agreeing to lease it, for life or for a term exceeding 3 years.*

The "Part" referred to in section 73(1) is Part 7 of the *Land Title Act,* which sets out the procedure for obtaining approval for the subdivision of land. Section 73(6) states that an instrument in contravention of section 73(1) cannot be registered. Thus, in order for long term leases to be registered, the leased portion was either to be formally subdivided or an explanatory plan prepared by a surveyor and signed by the appropriate approving officer. Section 73(3) provides an exception to the subsection (1) requirements in the case of a lease of a building or part of a building.

In the *Top Line* case, the landlord for various reasons wanted the lease with its tenant declared invalid. It argued that the lease contravened section 73 and should therefore be declared a nullity. The Court of Appeal in *Top Line* expanded what was previously viewed as merely a prohibition against registration in section 73 and held the lease to be invalid and void because it was in breach of the section 73 requirements. The Court held that compliance with that section was required whether or not the lease was registered.

The *Top Line* decision made the lease review process much more problematic for term lenders. Oftentimes such lenders would be left with some degree of uncertainty as to the enforceability of a pad lease for a stand alone operation such as a McDonald's or a Tim Hortons or the enforceability of a lease involving a major tenant of an entire building such as a Safeway, Canadian Tire or Home Depot where the lease was entered into prior to the completion of the building in question leaving it open to interpretation that the lease was a land lease and therefore in breach of section 73 as opposed to a lease of a building which is exempted from the requirements of section 73.

Against this background, section 73.1 was added to the *Land Title Act* which states as follows:

*"73.1 (1) A lease or an agreement for lease of a part of a parcel of land is not unenforceable between the parties to the lease or agreement for lease <u>by reason only that</u>*

*(a) <u>the lease or agreement for lease does not comply with this Part</u>, or*

*(b) an application for the registration of the lease or agreement for lease may be refused or rejected.*

In other words, a lease over 3 years of an unsubdivided portion of land is not unenforceable between those parties merely because they contravene the registrability provisions of section 73. The registrability of the instrument will be the only issue, not the contractual provisions or enforceability between the parties.

### *Idle-O Apartments Inc. v. Charlyn Investments Ltd., 2008 BCSC 849*

The B.C. Supreme Court had occasion to consider the effect of section 73.1 on a long term lease of unsubdivided land in *Idle-O Apartments Inc. v. Charlyn Investments Ltd.*

The dispute involved land on Lake Osoyoos that was subject to a lease dated September, 1978.

In 1999, a dispute arose between the landlord and the tenant over whether the lease required landlord consent for construction of a new building on the leased property by the tenant. It was only then after consulting with lawyers about their dispute, that the parties learned that the lease contravened section 73 of the *Land Title Act* and was therefore invalid because of *Top Line.* Until that time, both parties assumed the lease was valid and operated in accordance with its terms.

Negotiations to settle the dispute were unsuccessful and eventually, the landlord made formal demand that the tenant deliver up possession of the lands on the grounds that the lease contravened section 73 and was therefore invalid.

This was the landlord's position at the hearing in the action in June, 2006 before section 73.1 of the *Land Title Act* came into force. Section 73.1 came into force in May, 2007, and as no final

# MIABC Annual Legal Report

determination in the case had been made by the Court, counsel made further arguments in February, 2008.

The landlord's position was that section 73.1 should have no impact on the outcome of the case. As the lease contravened section 73 at the time it was entered into, it was invalid from the beginning and section 73.1 should not operate retroactively to give validity to an invalid lease. The landlord argued section 73.1 was written in the present tense and should only apply to leases entered into after May, 2007.

The tenant's position was that section 73.1 was intended to remedy the hardships caused by the *Top Line* decision, and that it should apply to all leases, no matter when they were made, so long as no final determination of the matter had been made by a Court before the amendment came into force. In addition, section 73.1 applied to the lease gave effect to the clear intention of the parties from the time the lease was entered into.

The Court agreed with the tenant that section 73.1 was passed to bring fairness and equity to precisely a situation like that before the Court, and concluded that the 1978 lease was a valid lease.

From a lender's point of view, this is good news. However, caution should still be exercised given the specific wording in section 73.1 which arguably suggests enforceability only between the parties. The section states that a lease or an agreement for lease "is not unenforceable <u>between the parties</u> to the lease or agreement for lease" by reason only that section 73 is not complied with. This at least raises some question as to whether a lender can take the benefit of the provision.

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