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## NON-DISCLOSURE REVISITED

In our December 2006 newsletter, we discussed section 178 of the Bankruptcy Act and the facts that must be found to determine whether there is fraud that would preclude a bankrupt's debts being expunged in a bankruptcy. This concept is worth another look to determine what happens in the following situation:

1. A debtor borrows money on a line of credit secured by a mortgage against property;
2. When the mortgaged property is sold, the debtor pays all money owed under the line of credit and the financial institution discharges the mortgage;
3. The financial institution inadvertently fails to close the line of credit;
4. The debtor takes advantage of the mistake of the financial institution and obtains more funds under the line of credit; and
5. The debtor assigns into bankruptcy owing money under the line of credit.

These facts were the subject of a court action in The Toronto-Dominion Bank v. Cushing, a 2007 decision of the Supreme Court of British Columbia.

## History

TD granted a line of credit (LOC) to the debtor. A mortgage over the debtor's house secured the LOC and resulted in a lower interest rate than would attach to an unsecured LOC. Further, TD may not have given the LOC at all without the security.

A few years later, the debtor sold the mortgaged property and paid \$181,000 to repay the LOC and discharge the mortgage. The debtor then moved from B.C. to Alberta and acquired another house. She obtained a first mortgage from another financial institution and drew on the LOC for her down payment. She stated that she believed that she could continue to use the LOC because she was going to use the new house for security. However, she never did. She drew about \$172,000 on the LOC.

She sold the Alberta property and paid the net proceeds of the sale to reduce the LOC to \$78,000. By that time, she had no assets and her income was minimal.

In the next nine months, she drew another \$69,000 on the LOC, usually to pay credit card balances that she had run up. Occasionally, she would draw on the LOC to transfer money to her bank account and then use the bank account to keep the LOC in good standing.

Finally, TD realised that its security was gone and froze the LOC. Within two months of TD's demand for repayment, the debtor assigned into bankruptcy. The LOC comprised 90% of her debts in the bankruptcy.

Section 178(1)(e) of the Bankruptcy and Insolvency Act states that there is no discharge from "*any debt or liability for obtaining property by false pretences or fraudulent misrepresentations.*"

TD commenced an action claiming that the debtor obtained the funds under the LOC by way of false pretences. For whatever reason, it did not also claim that she obtained the funds by way of fraudulent misrepresentation.

## Fraud

The judge referred to the Criminal Code for guidance regarding both fraud and fraudulent pretence. He noted that section 380 of the Code deals with fraud. The constituent elements of the act of fraud are:

1. Use of deceit, falsehood or other fraudulent means;
2. Deprivation of a specific person; and
3. A causal link between the two.

The Supreme Court of Canada has adopted a very wide test for "other fraudulent means". They encompass all means that could properly be stigmatised as dishonest.

## False Pretences

Section 360 and 361 of the Criminal Code deal with false pretence representations. There are four elements to prove false pretences. The representation must be:

1. About a past or present fact;
2. By words or otherwise;
3. Known to be false to the person who made it; and
4. Made with fraudulent intent to induce another to act on it.

The difference between fraud and false pretences is that the latter relates to past and pre-

sent representations whereas the former also relates to representations that could deal with the future (e.g. buy now because this swamp land is being developed next year). Fraud is a broad offence and encompasses false pretences.

## Fit the Mould

The judge analysed the debtor's actions.

The core of a false pretence is that a person has pretended that something is so when it is not. The debtor pretended that there was security for the LOC when she knew there was not. To the judge, this was a false representation in fact.

Further, the judge noted that a representation can be implied from acts or conduct. Accordingly, he held that the debtor made the fraudulent representation when she began to use the LOC knowing there was no longer any security for it. She knew that a secured LOC had a preferred rate of interest and that TD should have closed the LOC.

The judge stated that, to determine whether the debtor acted with fraudulent intent, he could examine the conduct of the debtor and infer intention from her conduct and, more importantly, from the absence of other conduct. This accords with a statement in Communication Technology Credit Union v. Schell, a 2006 decision of the Ontario Superior Court of Justice. The judge in that case held that non-disclosure, concealment, or strategic silence could also amount to fraudulent misrepresentation. This, we suggest, would apply equally well to determine whether somebody obtained credit through false pretences.

The judge noted that the debtor was underemployed and unable to gain credit other than by way of credit cards and had kited the credit cards and the LOC to give TD the impression that she was still worthy of credit.

The judge also noted that the definition relating to false pretences only needs the accused to induce somebody to do or omit to do something relying on the misrepresentation. It is not necessary that there be intent to obtain something at the time of the misrepresentation; that is, the obtaining of property might have happened in the past and taken place quite legitimately, but if a person then does something that would improperly cause the other party to act or not to act in a certain way, that is sufficient to fall within the definition.

The judge felt that the

debtor made the false representations dishonestly to induce TD not to cancel the LOC to which she knew she was no longer entitled. The judge held that the debtor knew that she was not entitled to draw on the LOC after the security was sold.

## Upshot

Although fraudulent misrepresentation may be more encompassing than false pretences, in this case the facts fit both equally well.

The judge found that the debtor obtained the LOC advances by means of false pretences and, therefore, although the debtor had been discharged from bankruptcy, her debt to TD was not expunged. It seems that the debtor went through the entire bankruptcy process to wipe out only 10% of her debts. Her debt to TD remained alive and well.

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