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KNOWLEDGE

What happens when a rogue, acting as agent of an innocent bank, misrepresents to a mortgagor the effect of a mortgage? One answer to that question can be found in the reasons for decision in Bank of Nova Scotia v. Villafuerte, a 2007 decision of the Ontario Superior Court of Justice.

Bad Facts

In 2003, daughter went to work as a legal assistant for a lawyer. They got along so well that they married in December 2004. Shortly thereafter, lawyer asked daughter's mother to take title to a residential property that he was planning to purchase. Lawyer explained that he had a credit problem and that it would be just a formality to put the house and mortgage in her name.

Mother was unsophisticated; she loved and trusted her son-in-law completely. Accordingly, she accepted what he said at face value and agreed to the favour.

In February 2005, mother signed an agreement of purchase and sale to purchase a house from the wife of lawyer's law clerk. Lawyer then left the country for two months and informed mother that the law clerk would be handling the transaction.

The law clerk prepared the mortgage application to the bank. It contained numerous inaccuracies, actually numerous lies. Law clerk drove mother to the bank, where she signed the mortgage and other related documents. Mother did not read the application or the mortgage

documents. After all, she trusted her son-in-law; he had told her that the mortgage would entail no personal liability.

Of course, the mortgage went into default; the bank sold the property and was left with a \$109,000 deficiency. Lawyer agreed that he had misled mother. The Law Society found that he had engaged in professional misconduct and lawyer was allowed to resign his membership in the Bar.

We were never told about the subsequent relationship between daughter and lawyer.

Motion

Mother defended the bank's action. If this action went to trial, all of mother's assertions would be in issue and the bank would be able to attack mother's credibility – because, as far as we are concerned, some of her claims were unbelievable. However, the bank brought a motion for summary judgment. On this type of motion, the bank had to demonstrate that there was no genuine issue for trial. In essence, it was stuck with the assertions that mother made.

Mother did not claim that she did not know what she was signing. Had she relied on that defence alone, she would have been unsuccessful. She knew she was signing a mortgage and the fact that she did not bother to read the mortgage application and documents was her problem, not the bank's.

Rather, mother

claimed that lawyer was the bank's agent and that his fraudulent misrepresentations should be attributed to the bank.

If an agent (e.g. lawyer) acts in the course of his employment, a principal (e.g. the bank) may be held liable for the agent's fraud or misrepresentation, even if the principal is unaware of the facts.

The bank argued that this principle did not apply to the facts of the case.

Authority

The bank argued that lawyer acted outside the scope of his authority. Its retainer letter to lawyer specified that lawyer was retained to prepare and register a mortgage; lawyer had to disclose to mother that he was acting for both the bank and her; and lawyer could not act for the bank if he had a financial or other relationship with mother. Therefore, the bank argued that when lawyer failed to tell mother that he was acting for the bank and when he failed to tell the bank that he had a financial interest in the transaction, he breached his retainer and was acting outside the scope of his authority.

The judge held that if this argument was correct, a principal could never be liable for the misrepresentations of its agent. The argument, she said, ignored the premise that a principal could be liable even if it was unaware of the agent's wrongdoings. The law presumes that the agent acted contrary to the principal's instructions; the only question is whether the agent's actions were "so outside" of his authority that the principal ceased to be responsible.

The judge noted that the representations related to the very transaction for which lawyer was retained – the mortgage. Accordingly, although the bank did not know of or approve the representations, the transaction and the representations were sufficiently connected that mother raised a genuine issue for trial.

Timing

The bank also argued that the representations had to be made while lawyer was the agent of the bank and that lawyer's lies occurred before the bank had retained him to act.

The judge held that the misrepresentations may first have been made before the bank retained lawyer, but the misrepresentations continued to the moment that mother signed the mortgage documents, after the bank had retained lawyer.

Result

We are not convinced that the motions judge was correct; she seemed to distinguish another decision in the Court of Appeal on questionable grounds. Regardless, the bank's motion was unsuccessful and the matter will either be settled or move on to a trial.

This scenario does not apply just to a rogue lawyer acting for a bank. It can be applied equally well to a rogue bank manager or mortgage broker. There may be little that a financial institution can do if its agents are dishonest.

Speculation

Let's take the last case one step further and assume that, instead of lawyer telling mother that she would not be liable, he instead told her that she could be liable but that, in consideration

of her risk, he would give her \$10,000 upon the sale of the property. This is approximately what happened in Re Young, a 2006 decision of the bankruptcy registrar.

In Re Young, an uneducated handyman was duped into allowing himself to take title to and give a mortgage on a property. The rogue had agreed to make all mortgage payments and the handyman was to have been paid some money on the sale. Of course, the rogue took the mortgage money and left the handyman with the mortgage debt. The handyman went bankrupt and the defrauded bank opposed his application for a discharge.

The registrar agreed that section 173(1)(e) of the Bankruptcy and Insolvency Act applied. He held that the handyman's actions were rash and hazardous. He felt that individuals not only must live within their means, they must also conduct business within

their capabilities. The handyman had little formal education, had little experience with real property, and should not have entered into the transaction. Accordingly, the registrar denied an absolute discharge.

However, the registrar was sympathetic to the handyman. The bank had asked for a payment of \$50,000 as a condition of the discharge. The registrar held that this payment was far beyond the handyman's means; he was only making \$1,700 net per month. The registrar felt that the handyman's actions did not warrant a punitive discharge amount so as to sanction his conduct. He also noted that the bank had alleged, but had not proven, fraud against the handyman.

Accordingly, the registrar imposed a three-month delay for an absolute discharge and made no order for payment as a condition of the discharge. In essence, the handyman won and the bank lost.

Speigel Nichols Fox LLP

44 Peel Centre Dr., Suite 400
Brampton, Ontario L6T 4B5
Tel: 905-791-6262
Fax: 905-791-6446
www.ontlaw.com

Jonathan Speigel*+
Brian Nichols
Irving Fox*
Ian Latimer*
Robert McIntyre
Susanne Balpataky*
Carrie Kennedy*
Paul Roth

- * members of litigation/collection group
- + certified by Law Society as a specialist in both civil litigation & construction law
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