Court File No. CV-14-10493-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

IN THE MATTER OF Section 101 of the
Courts of Justice Act and Section 243 of the *Bankruptcy and Insolvency Act*

B E T W E E N:

TREZ CAPITAL LIMITED PARTNERSHIP and COMPUTERSHARE TRUST COMPANY OF CANADA

Applicants

and

WYNFORD PROFESSIONAL CENTRE LTD. and **GLOBAL MILLS INC.**

Respondents

FURTHER SUPPLEMENTARY MOTION RECORD
Motion Returnable April 28, 2015

March 3, 2015

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TAB 1

Court File No.: CV-14-10493-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
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BETWEEN

TREZ CAPITAL LIMITED PARTNERSHIP and COMPUTERSHARE TRUST COMPANY OF CANADA

Applicants

and

WYNFORD PROFESSIONAL CENTRE LTD. and GLOBAL MILLS INC.

Respondents

AFFIDAVIT OF DENISE LASH
(Sworn on March 2, 2015)

I, **Denise Lash**, of the City of Toronto, MAKE OATH AND SAY AS FOLLOWS:

1. I am a partner at Aird & Berlis LLP and am Chair of Aird & Berlis LLP's Condominium Corporation Group. I have practiced in the area of real estate and condominium law in Ontario for twenty-four years. Throughout that time, I have represented condominium corporations, condominium developers, condominium purchasers and vendors, and mortgagees. Copies of my curriculum vitae and Acknowledgement of Expert's Duty are attached hereto as **Exhibit "A"**. As such I have knowledge of the matters to which I hereinafter depose. Where such knowledge is based on information and belief, I have stated the source of the information and verily believe it to be true.

2. I have been retained by the lawyers for Metropolitan Toronto Condominium Corporation No. 1037 ("**MTCC 1037**") to review the Motion Materials (as hereinafter defined) and to provide

my opinion on the steps taken by Trez Capital Limited Partnership (the "**Lender**") and its counsel in reviewing the Status Certificates (as hereinafter defined).

3. In preparing to swear this Affidavit, I have reviewed and considered the following materials, copies of which were provided to me by counsel to MTCC 1037, and to which I refer in this affidavit (collectively the "**Motion Materials**"):

- the Motion Record of MTCC 1037 in these proceedings dated January 30, 2015 containing the Affidavit of Daleechand Naraine sworn January 14, 2015 and the Exhibits thereto;
- the Affidavit of Gaetano Coscia sworn February 9, 2015 (the "**Coscia Affidavit**") and the Exhibits thereto;
- the Affidavit of Robert Cohen Q.C. sworn February 10, 2015 (the "**Cohen Affidavit**") and the Exhibits thereto;
- the Supplementary Affidavit of Daleechand Naraine sworn February 15, 2015; and
- the Affidavit of Audrey Loeb sworn February 20, 2015 (the "**Loeb Affidavit**") and the Exhibits thereto.

CONSUMER PROTECTION

4. As consumer protection legislation, a significant purpose of the *Condominium Act, 1998* (the "**Act**") is to protect innocent owners from suffering the consequences of misconduct, whether by individual owners, a developer, or the board of directors. Inherent within the consumer protection nature of the Act is the protection of innocent owners from fraud perpetrated by a director of MTCC 1037.

5. Jurisprudence has consistently emphasized the importance of protecting the interests of the innocent owners (see for example *Metropolitan Toronto Condominium Corporation No. 1385 v. Skyline Executive Properties Inc.*).

6. The Act prescribes a form of certificate (a status certificate) as a mechanism for reflecting the true state of affairs of a condominium corporation and to protect the interests of innocent purchasers or mortgagees. A status certificate is intended to ensure that a prospective purchaser (or in this case, mortgagee) has access to all material information relating to not only the condominium unit(s) that the purchaser may be acquiring, but also to the condominium corporation itself. A status certificate is not meant to be used as a means to conceal the condominium corporation's financial position or to be used as a mechanism to commit fraud.

7. Upon receipt of a status certificate it is industry practice for a reasonable recipient of same to make further inquiry with the condominium corporation where the certificate indicates there may be an issue with the condominium corporation's governance or financial stability.

STATUS CERTIFICATES

8. A status certificate must contain the statements prescribed in Section 76(1) of the Act and Ontario Regulation 48/01 together with all prescribed supporting documentation. Pursuant to subsection 76(1) of the Act, the following documents or statements, among others, are required to be attached to the status certificate in order for it to be compliant with the Act:

(a) s. 76(1)(i) – a copy of the budget of the Corporation for the current fiscal year, the last annual audited financial statements and the auditor's report on the statements; and

(b) s. 76(1)(m)(ii) – a statement with respect to the balance of the Corporation's reserve fund as of no earlier than the end of a month within 90 days of the date of the status certificate.

9. Subsection 76(1) does not provide that the information stated in the certificate "trumps" any information or statements contained in the accompanying attachments; rather, the attachments must be read in conjunction with the information stated in the status certificate.

10. Subsection 76(1)(j) requires the condominium corporation to list several specified types of agreements to which the condominium corporation is a party. Pursuant to subsections 76(7) and (8), a recipient can request to review or obtain copies of these agreements for "information purposes", thus distinguishing this type of information from the information that is required to be included and/or attached to the status certificate.

11. The information contained in the status certificate and the attachments thereto contain material information with respect to the condominium corporation's governance, financial position, reserve fund adequacy and information pertaining to the individual unit. The Act does not draw a distinction between the attachments and the paragraphs in the status certificate form; both form part of the material information contained in the status certificate pursuant to the Act and need to be evaluated as a whole and read in conjunction with each other.

12. The Act contains a remedial provision with respect to incomplete status certificates.

(a) s. 76(4) – If a status certificate that a corporation has given under subsection (1) omits material information that it is required to contain, **it shall be deemed to include a statement that there is no such information**.

13. Subsection 76(6) of the Act also provides that a mortgagee or purchaser of a unit who receives a status certificate is entitled to rely on the information contained, or deemed to be contained in the status certificate. Notwithstanding the ability to rely on a status certificate, however, relying on a status certificate that has clear defects on its face or that does not provide the financial information required in the prescribed form does not meet the standards that have been followed by solicitors for mortgagees and purchasers. It would be contrary to industry practice for a mortgagee to rely on a status certificate that has out dated financial statements or financial information.

14. In addition, and contrary to the assertion in paragraph 23(c) of the Loeb Affidavit wherein Ms. Loeb asserts that the Act does not permit a recipient of a status certificate to rely on the attachments to a status certificate, a recipient of a status certificate is entitled to rely on the entire status certificate, including all of the attachments thereto, as outlined in section 76 of the Act.

15. In her textbook, *Condominium Law and Administration* at page 9-4, Ms. Loeb confirms that "**the status certificate must be complete not only with respect to the responses contained therein but also with respect to the documents which are to be delivered with it**". Since a status certificate includes the attachments, section 76(6) of the Act applies equally to the entire status certificate.

RED FLAGS ON THE STATUS CERTIFICATE

16. Several issues or potential issues, including significant breaches of the Act, were clear on the face of the status certificates provided by MTCC 1037 with respect to units owned by Wynford Professional Centre Ltd. (the "**Status Certificate**") that should have alerted the Lender and/or its counsel to potential issues with the information contained therein. Upon receipt and

review of the Status Certificate, the Lender or its solicitor should have, at a minimum, made further inquiry with respect to the potential issues.

1. NON-ARM'S LENGTH RELATIONSHIPS

17. In 2011, it was discovered that Channel Property Management Ltd. (a condominium management company), and several affiliated entities (collectively, "**Channel**"), defrauded its condominium corporation clients resulting in substantial losses to the condominium corporations and several claims against Channel (see *Metropolitan Toronto Condominium Corporation No. 710 v. Khan*, *Metropolitan Toronto Condominium Corporation No. 943 v. Khan*, and *Metropolitan Toronto Condominium Corporation No. 831 v. Khan*). As a result of these proceedings, condominium corporations, mortgagees, unit owners and the lawyers who act for them were alerted to the potential issues with respect to conflicts of interest and fraud perpetrated by property managers and directors. In light of this, the Lender and its solicitor should have been more diligent by taking additional steps before advancing the borrowed funds.

18. The Lender was or ought to have been aware that Norma Walton was affiliated with all of the following: the management and board of directors of MTCC 1037, the owner of the majority of units in MTCC 1037, the recipient of the loan, and the signatory of the status certificate. Further, all of the representations relied on by the Lender and its solicitor in the transaction were signed and/or provided by Norma Walton and/or affiliated parties.

19. In these circumstances, it was incumbent for the Lender, in addition to the Lender's lawyer, to be alert to the potential red flags or issues that could arise in the transaction.

2. RESERVE FUND BALANCE

20. A status certificate must include the balance of the condominium corporation's reserve fund as of no earlier than the end of a month within ninety days of the date of the status certificate pursuant to subsection 76(1)(m)(ii) of the Act. Since the Status Certificate was issued on January 18, 2013, the Status Certificate should have included an amount as of no earlier than October 31, 2012.

21. Nevertheless, and contrary to the Act, the Status Certificate specified an amount as at December 31, 2010, a date over two years before the date the Status Certificate was drafted. Pursuant to subsection 76(4) of the Act, paragraph 13 of the Status Certificate is therefore deemed to include the following statement, or a statement substantially similar: "**There is no information with respect to the amount in the Corporation's reserve fund**."

22. The requirement for a condominium corporation to maintain a reserve fund is mandatory, not permissive, pursuant to section 93 of the Act. The reserve fund ensures that a condominium corporation maintains sufficient financial reserves on hand to address both anticipated and unanticipated future repairs, maintenance or other expenses. The condominium corporation is required to perform a reserve fund study of the condominium corporation (typically carried out by an arm's length engineer) every three years to ensure that there are sufficient funds to meet the major repairs and replacements of the common elements and assets of the condominium corporation when needed.

23. The delivery of a status certificate with no information as to the amount in the reserve fund, or with financial information that is greater than two years old, should constitute a significant red flag for any prospective purchaser or mortgagee. Until such time as the deficiency in information (and non-compliance with the Act) is resolved to the satisfaction of

counsel, it is not possible to rule out fraud, misappropriation, or misrepresentation with respect to amount of monies in the reserve fund as possible causes for the deficiency. In this case, at the very least, the Lender or its solicitor should have requested additional information or otherwise made inquiries to MTCC 1037 with respect to the deficiency. Based on my experience in the condominium industry, it is industry practice for a purchaser or mortgagee, or its counsel, to seek clarification where a reserve fund balance is missing or out of date.

24. Contrary to the assertion in paragraph 10(c) of the Cohen Affidavit, the Status Certificate did not provide that the reserve fund was in good order. The Status Certificate provided that the reserve fund was in good order in 2010. The nature of reserve funds are such that they fluctuate depending upon the required major repair and replacement of the common elements and assets of the condominium corporation. Drastic changes in the state of the reserve fund are possible, particularly for a building registered on October 6, 1992 (see registered declaration of MTCC 1037) and it would be negligent to rely on a reserve fund balance from October 2010 to determine whether MTCC 1037 was in a good financial position as of January 8, 2013.

25. The reserve fund can and often does have a significant impact on the financial stability of a condominium corporation. As such, prior to purchasing or financing a condominium unit, it is incumbent on a purchaser or mortgagee to review the balance of the reserve fund to in order to evaluate the balance against the anticipated expenditures and contribution to the reserve fund.

3. ANNUAL AUDITED FINANCIAL STATEMENTS

26. The Act requires the condominium corporation to cause audited financial statements to be prepared annually, within six months of the fiscal year end. Specifically, section 67(1) of the Act, requires the condominium corporation's auditor to make an annual report with respect to

the financial statements of the condominium corporation. Section 69(1) of the Act requires the board of directors to approve the financial statements and auditor's report and place these documents before each annual general meeting. Section 45(2) of the Act provides that the annual general meeting must occur within six months of the end of each fiscal year of the condominium corporation.

27. In line with the consumer protection purpose of the Act, the Act recognizes the importance of a condominium corporation's financial stability to prospective purchasers and mortgagees; subsection 76(2)(i) of the Act requires the Corporation to provide a copy of "the last audited financial statements and the auditor's report on the statements" in the status certificate. The audited financial statements are the single most important indicator of the overall financial health and position of a condominium corporation and, as such, form an integral part of the status certificate.

28. Paragraph 33 of the Status Certificate provides as follows: "The following documents are attached to this status certificate and form part of it: ... (b) a copy of the budget of the Corporation for the current fiscal year, its last annual audited financial statements and the auditor's report on the statements".

29. The "last audited financial statements" to be included must be the audited financial statements from the most recent fiscal year unless those are incomplete and the corporation is still within six months of the fiscal year end and has not yet had its annual general meeting. In that case, the audited financial statements for the prior year are attached.

30. Audited financial statements from earlier than the immediately preceding fiscal year would not constitute audited financial statements as required by the Act to be included in the prescribed status certificate form, contrary to Ms. Loeb's assertion in paragraph 23 of the Loeb

Affidavit that the "last annual audited financial statements" as provided for in the prescribed status certificate form were included in the Status Certificate.

31. The Act cannot be interpreted in a manner that would permit non-compliance by a condominium corporation with the requirements to obtain annual financial statements. Accordingly, the reference to the last audited financial statements refers to the audited financial statements completed in accordance with the requirements of the Act.

32. In light of the foregoing, by failing to include the "last annual financial statements" as required by the Act, there was a clear breach of the Act on the face of the status certificate; a breach that should have led the Lender or its solicitor to make further inquiry to MTCC 1037, particularly when combined with the issues with the non-arm's length parties involved and the out of date information with respect to the reserve fund balance.

THE NEED TO MAKE FURTHER INQUIRY

33. Although a mortgagee is entitled to rely on a status certificate, one who relies on a status certificate with breaches of the Act on its face and which lacks material information that is required to be included in the status certificate with respect to the up-to-date reserve fund balance and recent audited financial statements cannot have a reasonable expectation that there are no financial issues with respect to the Corporation. At the very least, and in accordance with industry practice, a mortgagee receiving such a status certificate should, if it wishes to protect its interests, ask questions or make further inquiry until it is reasonably satisfied that there are no issues which may affect its interests. In my view, it would fall below minimum acceptable standards of practice for a lawyer to not inquire further with respect to a status certificate that contains out of date information or that states "there is no information with

respect to the reserve fund" and "there is no information with respect to the recent audited financial statements".

34. In the circumstances, and contrary to the assertions in paragraphs 16, 17 and 24 of the Loeb Affidavit and paragraph 17 of the Cohen Affidavit, this was not a situation where one might say that there was no need to "look behind" the Status Certificate. To the contrary, the Status Certificate here was defective on its face in material respects and demanded further inquiry in so far as the annual audited financial statements and up to date reserve fund amounts were not provided.

35. In *Stafford v. Frontenac Condominium Corp. No. 11* ("***Stafford***"), attached as Exhibit "H" to the Loeb Affidavit, the status certificate at issue disclosed a potential increase in common expenses with respect to balcony repairs. According to the Court in *Stafford*, a recipient of a status certificate with actual knowledge of potential issues should make further inquiries. As a result, the court denied the purchasers relief from paying their proportionate share of a special assessment.

36. In the present case, the clear defects on the face of Status Certificate should have alerted the mortgagee to significant potential financial issues with respect to MTCC 1037. Potential liability existed with respect to the financial stability of MTCC 1037 and the mortgagee, who had or ought to have knowledge of same, and failed to make the necessary inquiries; this was unreasonable.

37. In this regard, the Law Society has prepared a guideline titled "How to Prepare Closing Documents in a Residential Condominium Transaction", attached as **Exhibit "B"**. Although the guideline applies specifically to residential transactions, the same principles can be applied to the present circumstances. According to the guideline, as part of a purchaser's due diligence,

the most current budget, "at the very least, the amount in the reserve fund", and comments by the auditors in the audited financial statements should be reviewed. Neither the amount in the reserve fund nor the comments by the auditors were reviewed by the Lender or its solicitor.

38. A recipient of a status certificate which is deemed to provide that there is no information with respect to the amount in the reserve fund and no information with respect to the recent annual financial statements should, acting reasonably and responsibly, make further inquiries.

39. If inquiries were made and financial statements were not provided and/or were incomplete, that should have been a significant red flag to the recipient of same necessitating further inquiry. If inquiries were made and financial statements were produced, same would have disclosed significant arrears in common expense receivables. Although the financial statements would not identify the specific unit owners who were in arrears, the arrears in common expense receivables should have been a significant red flag to the recipient of the financial statements; this would again lead a reasonable recipient of same to make further inquiries.

40. In my experience, having regard to all of the circumstances, where a sophisticated mortgagee, represented by its solicitor, is contemplating a loan of $9,850,000, it would be unreasonable for the mortgagee to not make further inquiries with respect to the out of date financial information and to not request access to the most recent financial statements and the current reserve fund balance.

LENDER'S DUE DILIGENCE

41. As a condition precedent to the loan, paragraph 22 of the commitment letter from Trez Capital Limited Partnership to Wynford Professional Centre Ltd. (the "**Commitment Letter**")

outlines the Lender's steps to fulfil its own due diligence and requires specified items to meet the Lender's approval. Paragraph 22(i) of the Commitment Letter provides as follows:

> "*Historical operating statements for the Subject Property for the previous two years, the current year-to-date (if available) as well as the current year operating budget.* ***On file***." [my emphasis]

42. Although the Lender alleges, at paragraph 16 of the Coscia Affidavit, that it does not look specifically into any "condominium related issues" as part of its initial due diligence, a review of the operating statements of MTCC 1037 was nevertheless included in the scope of its initial due diligence.

43. However, I understand that at the time the Commitment Letter was executed, the operating statements for the most recent fiscal year were not completed. The 2010 audited financial statements and the most recent reserve fund study were attached to the Commitment Letter.

44. The Lender's Initial Due Diligence, according to the Commitment Letter, was to include a review of the two most recent annual operating statements. Had the Lender conducted its due diligence as appears to be alleged based on my review of paragraph 22(i) of the Commitment Letter (reference made to the inclusion of the phrase "On file" in paragraph 22(i)), the Lender would have observed significant financial issues and the arrears receivable, which would have, at the very least, resulted in further inquiry.

45. At paragraph 16 of the Coscia Affidavit, Mr. Coscia admits that the Lender would not have issued the Wynford Commitment had it been aware of the arrears or allegations of fraud. Again, had the Lender conducted its due diligence in accordance with what appears to be its

ordinary practice, it would have learned of the significant financial issues, and would therefore likely not have provided the financing.

46. The case of *XDG Ltd. v. 1099606 Ontario Ltd.* ("***XDG***"), a copy of which is attached hereto as **Exhibit "C"**, helps illustrate the importance of conducting due diligence in accordance with usual practice with respect to mortgage transactions. In *XDG*, where the lender failed to act in manner consistent with its usual practice in conducting due diligence prior to providing a mortgage, good faith could not be established by the lender.

47. At paragraph 52, the Court stated: "Here, a property inspection would, in a manner of minutes, reveal the construction project on the Dielcraft property and caused further inquiry. The normal request for financial statements would have led to finding the income tax liability." The Court went on to say: "Even the simplest of investigations would have revealed the construction project and led GECC to make further inquiry. They would easily have determined Mr. Rehani was not being truthful." Similarly, a review of the financial statements by the Lender, in accordance with its due diligence outlined in the Commitment Letter, would have caused further inquiry.

48. In *XDG*, consideration was given to the level of sophistication of the lender. At paragraph 55, the Court stated that the lender was a "sophisticated financial institution that well knows the necessity of a due diligence investigation". As a sophisticated lending institution dealing with a $9,850,000 transaction, the Lender and its solicitor knew or ought to have known the necessity of up to date financial statements and should have conducted its ordinary due diligence. Failure to do so constituted wilful blindness. Moreover, even an unsophisticated party should have made further inquiry upon receipt of the Status Certificate.

49. The Court commented on the importance of taking additional precautions or being alert to potential issues when a transaction involves several non-arm's length parties. Specifically, it was problematic that the lender failed to make further inquiry, notwithstanding its knowledge of the relationship between the involved parties. The Court stated, at paragraph 55, that the lender "knew enough about the relationship between [the parties] ... that necessitated further inquiry." Similarly, the Lender should have made further inquiries as a result of the relationship between the parties.

50. In light of all of the foregoing, it is my opinion that it was unreasonable that the Lender and/or its solicitor did not make further inquiries with respect to obvious defects on the face of the Status Certificate. The Lender and/or its solicitor failed to exercise the necessary due diligence by relying on the 2010 financial statements and by proceeding in the absence of up to date information about the reserve fund. In my opinion, both defects constituted red flags which, when combined with the nature of the relationship between Norma Walton and the affiliated parties involved in the transaction, ought reasonably to have necessitated further inquiry by the Lender. It is my opinion that the Status Certificate, on its face, raised significant concerns with respect to the financial operations of the Corporation and further inquiries should have been made by the Lender and/or its solicitor.

SWORN before me at the City of Toronto, this 2nd day of March, 2015.

A Commissioner, etc.

Joshua Milgram

Denise Lash

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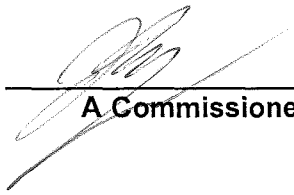
Lawyers for Metro Toronto
Condominium Corporation No. 1037

TAB “A”

THIS IS EXHIBIT "A" REFERRED TO
IN THE AFFIDAVIT OF DENISE LASH
SOLEMNLY AFFIRMED BEFORE ME THIS
2nd DAY OF MARCH, 2015



A Commissioner, etc

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Respondents

ACKNOWLEDGEMENT OF EXPERT'S DUTY

1. My name is Denise Lash. I live at Toronto, in the province of Ontario.

2. I have been engaged by or on behalf of McDonald Sager Manis LLP to provide evidence in relation to the above-noted court proceeding.

3. I acknowledge that it is my duty to provide evidence in relation to this proceeding as follows:

   (a) to provide opinion evidence that is fair, objective and non-partisan;

   (b) to provide opinion evidence that is related only to matters that are within my area of expertise; and

   (c) to provide such additional assistance as the court may reasonably require, to determine a matter in issue.

4. I acknowledge that the duty referred to above prevails over any obligation which I may owe to any party by whom or on whose behalf I am engaged.

Date March 2, 2015

Signature

NOTE: This form must be attached to any report signed by the expert and provided for the purposes of subrule 53.03(1) or (2) of the *Rules of Civil Procedure*.

RCP-E 53 (November 1, 2008)

DENISE LASH

DENISE **LASH**
PARTNER

ONTARIO BAR ADMISSION: **1990**

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Denise Lash is a partner and member of the firm's Real Estate Group and Chair of the Condominium Corporations Group. Prior to joining A&B, Denise was the Chair of the Condominium Group at another major Canadian law firm.

PRACTICE

Denise practises in the area of real estate with a strong focus on condominium law. She provides a wide range of services to both condominium corporations and real estate developers.

Denise is a prolific writer and lecturer, and is sought after by many media outlets for her expertise. She has been a regular columnist for Metro News, *Canadian Real Estate magazine*, Newinhomes.com (*Toronto Star*), Condo Report for the Real Estate News, CondominiaMagazine.com and *Home News* (Condo Edition). Articles she has written have appeared in *Condo Life Magazine*, *New Dreamhomes & Condominiums Magazine*, *The Condo Voice*, *Condo Business Magazine* and *Condominium Manager Magazine*. Denise has been a guest on CBC Radio, AM 640 Toronto Radio, AM 740 Prime Time Radio and CFRB Newstalk 1010. She has also appeared on Global TV, Breakfast Television and various local Rogers Television shows. More recently Denise appeared on a series of on-line video interviews for the Globe and Mail with Rob Carrick.

In 2006, Denise was the host of MondoCondo TV, a national program broadcasted on CH, TVtropolis and Global TV.

Denise is the editor of and frequent contributor to condoreporter.com, a blog which features timely commentaries on the latest developments in condominium law in Ontario.

A frequent lecturer, Denise volunteers her time to promote condo education. She was the founder of the Toronto Condo Show, the first condominium consumer show and conference in Canada designed to provide advice and information to the condo consumer.

Denise is a member of the TowerWise Energy Efficiency Committee, a committee organized by the Toronto Atmospheric Fund to promote energy education for high-rise buildings. She is also past Chair of the Condominium Management Standards Council of the Association of Condominium Managers of Ontario's ACMO 2000 Committee; past national director, vice-president (Toronto chapter), and Associate and Fellow (ACCI and FCCI, respectively) of the Canadian Condominium Institute.

Denise currently sits on the Canadian Condominium Institute Tarion Condominium Advisory Committee and is a former member of the Ministry of Consumer Services Expert Panel on Condo Manager Qualifications.

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Building Industry and Land Development Association (BILD)
Canadian Condominium Institute (CCI)
Community Associations Institute (CAI)
Urban Land Institute

EDUCATION

LL.B., University of Victoria, 1988
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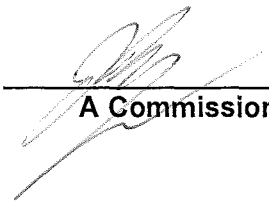
TAB “B”

THIS IS EXHIBIT "B" REFERRED TO
IN THE AFFIDAVIT OF DENISE LASH
SOLEMNLY AFFIRMED BEFORE ME THIS
2nd DAY OF MARCH, 2015



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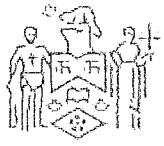

The Law Society of Upper Canada | Barreau du Haut-Canada

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How to Prepare Closing Documents in a Residential Condominium Transaction

Updated May 2010

This How-To-Brief deals solely with the preparation of closing documents in respect of a residential **re-sale** condominium transaction and does not deal with closing documents in a residential **new** condominium transaction.

1. Things to consider prior to the preparation of closing documents

- In the majority of cases, the solicitor will be receiving a fully executed copy of an Agreement of Purchase and Sale (the "APS") directly from their client or their client's real estate agent. Ideally, the APS will be conditional on the review of the status certificate and any and all related condominium documentation. The status certificate should be reviewed by the solicitor in detail and the solicitor should ensure that the dwelling unit, parking and/or locker unit(s) set out in the status certificate correspond to those that are referred to in the APS. The solicitor should also review the most current budget of the condominium corporation in order to determine, at the very least, the amount in the reserve fund and whether same is adequate, having due regard to any comments in the status certificate about the adequacy of the reserve fund, and, in particular, if there is a reserve fund study and what its impact is on the amount of the reserve fund, as well as any comments by the auditors of the audited financial statements.
- The purchaser's solicitor should advise the purchaser of the options available to protect the purchaser's title interest (i.e., title insurance versus a solicitor's opinion on title.).
- The purchaser's solicitor should recommend that the purchaser procure an insurance policy that covers betterments and improvements to the dwelling unit. This insurance coverage is separate and apart form the master condominium insurance policy provided by the condominium corporation, which only covers the standard unit as defined in the declaration

and its schedules and the description plan sheets, which specifically set out the boundaries of a condominium unit. It is important for the purchaser's solicitor to point out to the purchaser the standard unit definition described in any Standard Unit By-Law registered on title. This will enable the solicitor to advise the purchaser of his or her repair and insurance obligations.

- Closing documents should be reviewed in detail to ensure that they are consistent with what is being provided in the APS and that there are no representations or warranties being made by the vendor in the closing documents that are superfluous or not contemplated in the APS.
- The purchaser's solicitor should review the surveyor's plans and appropriate plan sheets filed in the Land Registry Office in order to confirm with the client, prior to the time of closing, the location of the residential unit and the parking and locker spaces, and whether the parking and locker spaces are units, part of the common elements or exclusive use common elements.
  The purchaser's solicitor should also confirm that the unit or units described in the APS (and the parking and locker unit(s), if applicable) correspond to those set out in the surveyor's plans and plan sheets and the registered title of the vendor, so that the purchaser is actually acquiring what they think they have bargained for under the APS.
- Solicitors should try to send draft closing documents well in advance of closing so that the wording of same can be agreed upon prior to their execution so as to ensure that there are no surprises on the eve of closing.
- **Client Identification and Verification**
  The solicitors are required to identify and verify the identity of their client's and any third party who instructs or has the authority to instruct the client, and to keep records of the information obtained or examined in accordance with By-Law 7.1 of the Law Society of Upper Canada's By-Laws (see link to this By-Law in the Resources section of this How-To Brief).

2. Vendor's closing documents and a brief description thereof

The following closing documents are typically prepared by the vendor's solicitor (unless otherwise provided by the APS or agreed upon by the respective solicitors to a transaction. (See web links to sample documents in the Resources section of this How-To Brief.)

- **Electronic Transfer**
  The electronic transfer is usually prepared by the vendor's solicitor electronically using the Teraview software and messaged to the purchaser's solicitor or their law clerk so that the land transfer tax statements can be filled in on behalf of the purchaser(s). The vendor's solicitor should ensure that the transfer includes the correct PINs for the dwelling unit and any ancillary parking and/or locker unit(s) to be conveyed in the transfer, and should cross reference same with what is being conveyed in the APS. *The Planning Act* statements should not be checked off, nor should the tax statements be filled in under the tax branch of the electronic transfer. The tax statements and all tax information should be completed by the purchaser's solicitor (or their law clerk). Recent legislative amendments provide that the transfer ultimately has to be signed for completeness by the solicitor for the vendor and the solicitor for the purchaser.
- **Acknowledgement and Direction**
  This document is produced by the Teraview software in Teranet. An acknowledgment and direction executed by the client authorizes the solicitor to enter in the Document Registration Agreement (hereinafter referred to as the "DRA", as more particularly described below), with the purchaser's solicitor, and also acts as an acknowledgment that the contents of the transfer have been explained to the vendor and that the execution of same has the same effect as if the electronic transfer was actually signed by the vendor.

- **Document Registration Agreement**
  The DRA is a form of escrow agreement in which solicitors agree on behalf of their clients to exchange funds, closing documents, keys, etc. (the "Escrow Deliveries") before the registration of any instruments on title. The solicitor on each side agrees to hold onto the Escrow Deliveries until such time as the registration is confirmed and to return such items to the other party's solicitor should the transaction not be completed for any reason.
- **Statement of Adjustments**
  This statement sets out the credits and debits for each of the purchaser and the vendor. The vendor will be credited with the sale price (as per the APS), and the purchaser will be credited with any deposits paid or any vendor take back mortgage amounts (if applicable). Taxes will most likely be adjusted on an annual basis and common expenses will be adjusted on a monthly basis. The credits and debits will be determined by the vendor's solicitor ascertaining whether the taxes and common expenses have been paid, and when. The calculation of debits and credits will culminate into a balance due on closing which is payable by the purchaser on the closing date.
- **Vendor's Undertaking/Bill of Sale/Direction/Warranty and GST Certification**
  This document is a hybrid document that deals with a plethora of closing issues, including but not limited to: (a) providing the purchaser with an undertaking to readjust any items on or omitted from the Statement of Adjustments after closing, (b) a warranty regarding urea formaldehyde foam insulation which confirms that during the time vendor owned the property, they did not insulate it with insulation containing urea formaldehyde, (c) a bill of sale with respect to any chattel items sold pursuant to the APS, (d) a certificate confirming that no goods and services tax is payable on the sale of the property, and finally, (e) a direction to the purchaser and their solicitor to make the balance due on closing payable to the vendor's solicitor or as they may otherwise direct. Only those warranties that are expressly intended not to merge on closing should be included in the warranty so that warranties that are intended to merge on closing, would.
- **Solicitor's Redirection Re: Funds**
  This document is prepared by the vendor's solicitor and addressed to the purchaser and their solicitor and it provides that the balance due on closing is to be paid to one or more parties (for example, a real estate brokerage on account of commission, a bank on account of a discharge of a mortgage, the vendor's solicitor on account of legal fees, etc.).
- **Affidavit re: Writ of Execution**
  This affidavit confirms, among other things, that the vendor is not one and the same person as a judgment debtor named in a writ of execution with a similar or same name. Similar name executions in the sum of $50,000.00 or over require a solicitor to personally swear a separate affidavit confirming that their client is not one and the same as the judgment debtor. Solicitors should only swear such affidavits after having satisfied themselves that the vendor is not one and the same as the judgment debtor. This is usually achieved by the solicitor writing to the judgment creditor's solicitor and providing the Social Insurance Number and date of birth of the vendor and requesting confirmation that the vendor is not one and the same as the judgment debtor named in the writ of execution.
- **Vendor's Statutory Declaration**
  This document confirms the vendor's compliance with certain provisions of the *Family Law Act*, the *Income Tax Act*, and any other matters contemplated in the APS. In the condominium context, this document also usually includes a declaration that the vendor has not received notice convening a special meeting of the unit owners of the property respecting certain matters relating to the common elements and the condominium corporation.
- **Electronic Discharge of Charge**
  This document is often prepared electronically by the vendor's solicitor pursuant to their undertaking to discharge any existing mortgage(s) on title to the property within a reasonable time after closing, after having paid out any outstanding encumbrances from the sale proceeds upon completion of a transaction. However, there has been an increasing trend

whereby institutional lenders are preparing and registering their own discharges internally and charging the client a fee in respect of same on the final mortgage payout statement. Whether the solicitor is preparing this on behalf of an institutional lender or a private lender, an acknowledgment and direction must also be executed by a representative or authorized signing officer of the lender, authorizing the discharge of the charge.

- **Solicitor's Undertaking re: Discharge of Charge**
  This type of undertaking is typically delivered by the vendor's solicitor to the purchaser's solicitor when undertaking to discharge an institutional mortgage from title. It usually provides that the vendor's solicitor will pay out and arrange for the registration of a discharge in respect of any outstanding institutional mortgages within a reasonable time after closing. Private mortgages (i.e., mortgages that are not in favour of institutional lenders) should be discharged on or before closing. Solicitors should refer to the provisions of the APS and the Law Society guideline regarding discharges of mortgages.
- **Consent to act re: Joint Retainer**
  This document should always be in a solicitor's file (whether acting for the purchaser or the vendor) in situations when the solicitor is acting for more than one party. The document provides, among other things, that in the event of a conflict, the solicitor must cease to act for one or both parties depending on the nature and the severity of the conflict. If the solicitor decides to act for one of the parties in a conflict situation, they must do so only accordance with the *Rules of Professional Conduct* (hereinafter referred to as the "*Rules*"). This document is not to be sent to the purchaser's solicitor as part of the closing package, but should remain in the vendor's solicitor's file.

The following closing documents are typically prepared by the vendor's solicitor (unless otherwise provided by the APS or agreed upon by the respective solicitors to a transaction); however, these documents are used less frequently than the aforementioned documents

- **Mortgage Discharge Statement**
  These statements are usually prepared by lenders (in the institutional mortgage context). The vendor's solicitor in this case should request a discharge statement well in advance of closing. If a private mortgage is registered on title (and the mortgage is not intended to be assumed by the purchaser), same must be discharged on or before closing, since an undertaking to discharge a private mortgage (or a mortgage from a non-institutional lender) will not be acceptable after closing. In this case, the solicitor for the vendor should contact the lender's solicitor and request a mortgage discharge statement. The lender's solicitor will prepare a mortgage discharge statement and ensure that the principal and interest outstanding is set out therein, and that any interest penalties as well as a per diem rate of interest is included so that the vendor's solicitor knows how much interest to add to the payout amount to account for the payout not being made on time. The solicitor for the lender should always ensure that a discharge statement for a private lender is always executed by the lender(s) personally, or one or more authorized signing officer(s), if the lender is a corporation. The vendor's solicitor will most likely redirect a portion of the balance due on closing directly to the lender's solicitor in accordance with the balance owing on the mortgage discharge statement, so that the lender's solicitor can attend to the registration of the discharge. Sometimes, arrangements are made involving all three solicitors (the purchaser's solicitor, the vendor's solicitor, and the lender's solicitor), with respect to payout arrangements, timing, and ultimate responsibility for the registration of the discharge.
- **Solicitor's undertaking to pay arrears of condominium common expenses and/or realty taxes (as the case may be)**
  This type of undertaking usually requires the vendor's solicitor to hold back the appropriate funds from the closing proceeds and remit them to the condominium corporation and/or the appropriate tax department (as the case may be), within a few days of the completion of the transaction. Once the payouts that are the subject of the undertaking are fulfilled, the

solicitor should notify the solicitor/purchaser to whom the undertaking was addressed, and confirm that payment has been made (while enclosing proof of payment), and that the obligations pursuant to the undertaking have been fulfilled.

- **Polaris Form Transfer/Deed of Land**
  This is the paper form of transfer which will rarely be used since virtually every land registry office in Ontario has been fully automated by Teranet. The solicitor must ensure that the Transfer/Deed of Land is executed by the vendor, that the PIN's for the dwelling unit and any ancillary parking and/or locker units are properly set out in box 3, and that the condominium corporation number and the appropriate registry land registry office is properly set out in box 5. The correct name(s) of the purchaser(s) and date(s) of birth should also be set out. Once again, the *Planning Act* boxes should **not** be checked off.
- **Polaris Form Discharge of Charge/Mortgage**
  This is the paper form of Discharge of Charge/Mortgage, which will rarely be used since virtually every land registry office in Ontario has been fully automated by Teranet. The solicitor must ensure that the discharge is executed by the lender, that the PIN's for the dwelling unit and any ancillary parking and/or locker units are properly set out in box 3, and that the condominium corporation number and the appropriate registry land registry office is properly set out in box 4. The registration number of the charge to be discharged should be set out in box 5. In box 6, the solicitor should select whether the discharge is a partial or final discharge. Any related deletions (such as a discharge of a notice of assignment of rents) should be set out in box 7. The solicitor should ensure that the discharge is executed by the lender (if an individual) or an authorized signing officer of the lender (if a corporation).
- **Assignment of Lease(s)**
  When there are leases that affect the property being purchased, this document will take the form of either a general assignment of all the leases in the building or specific assignments of each lease. The written assignment will transfer the benefits of covenants contained in the leases.
- **Direction to Tenants and Tenants Acknowledgments**
  This document is to be used in situations where the purchaser is assuming existing tenancies. The direction informs the tenants that as of a certain date (usually the closing date of the purchase transaction), the property will be sold and that the tenant(s) should direct all rental payments to the particular name or entity and address as set out in the notice. A purchaser's solicitor may request an indemnity from any vendor (as landlord) for any breach under the lease existing prior to closing, for which the tenant may make a claim against the successor landlord (which is the purchaser). Alternatively, a vendor's solicitor may request an indemnity from the purchaser (the new landlord), to give the vendor a corresponding indemnity for any claims that the tenant makes against the vendor because of the purchaser's (the new landlord's) breach or default which the vendor may be responsible for by virtue of the vendor's privity of contract with the tenant. These reciprocal indemnities are usually difficult to procure if same are not provided for under the APS.

3. Purchaser's closing documents and a brief description thereof

The following documents relate to the Purchaser's closing documents pertaining to the purchase portion of the transaction only. (See web links to sample documents in the Resources section of this How-To Brief.)

- **Acknowledgement and Direction**
  This document is produced by the Teraview software in Teranet. An acknowledgment and direction executed by the purchaser authorizes the solicitor to electronically sign and register the electronic transfer and enter into the DRA on behalf of the purchaser, with the

vendor's solicitor. The acknowledgment also states that the contents of the transfer have been explained to the purchaser and the execution of same has the same effect as if the electronic transfer was actually signed by the purchaser.

- **Document Registration Agreement**
  The DRA is a form of escrow agreement in which solicitors agree on behalf of their clients to exchange the Escrow Deliveries before the registration of any instruments on title. The solicitor on each side agrees to hold onto the Escrow Deliveries until such time as the registration is confirmed and to return such items to the other party's solicitor should the transaction not be completed for any reason.
- **Direction re: Title**
  This document sets out (for the vendor and their solicitor) how the purchaser wishes to take title to the property. The purchaser should also set out the dates of birth of any and all purchasers as well as the purchaser's address for service. If there is more than one purchaser, the manner in which they wish to take title must also be specified (i.e. as joint tenants or tenants and common). The purchaser's solicitor should advise the vendor's solicitor in advance of the closing (usually with the requisition letter) of the manner in which the purchaser wishes to take title in order to give the vendor a chance to prepare the transfer. The direction re: title is signed by the purchaser prior to the closing and delivered to the vendor's solicitor on closing. The direction re: title must be signed by the purchaser(s) named in the agreement of purchase and sale. One common mistake made by solicitors is that when a purchaser requests that title be taken in the name of X, the purchaser's solicitor erroneously insists on X executing all of the purchaser's closing documents. This practice is not correct. The original purchaser is still responsible for executing the undertakings and directions, and nothing is to be signed by transferee X. Transferee X's name is to be simply engrossed on the transfer and nothing more.
- **Undertaking to Re-Adjust**
  With this document, the purchaser is providing the vendor and their solicitor with an undertaking to readjust any items on or omitted from the Statement of Adjustments after closing.
- **Consent to act re: Joint Retainer**
  This document should always be in a solicitor's file (whether acting for the purchaser or the vendor) in situations when the solicitor is acting for more than one party. The document provides, among other things, that in the event of a conflict, the solicitor must cease to act for one or both parties depending on the nature and the severity of the conflict. If the solicitor decides to act for one of the parties in a conflict situation, they must do so only accordance with the *Rules*. This document is not to be sent to the vendor's solicitor as part of the closing package, but should remain in the purchaser's solicitor's file. Furthermore, a purchaser's solicitor should require the purchaser to execute this document at the commencement of the retainer and not on the eve of closing with the rest of the closing documents, since if there is ever a conflict between the respective purchasers at any time prior to closing, an executed consent to act re: Joint Retainer will assist to insulate the solicitor from any adverse consequences arising from the conflict. Where the purchaser's solicitor accepts employment from more than one party in a transaction, he or she must comply with rule 2.04(6) and advise the parties of the above information. This should be done in the initial letter to the parties wherein the purchaser's solicitor requests the parties to acknowledge their approval of this situation by signing the enclosed Consent to act re: Joint Retainer and returning it to the purchaser's solicitor's office. Otherwise, the solicitor must get the parties to sign this document with the balance of the closing documents.
- **Acknowledgment and Direction re: Title Insurance**
  This document is an acknowledgment and authorization from the purchaser to their solicitor (and law firm) consenting to the procurement of a title insurance policy instead of a solicitor's opinion on title.

The following documents relate to the Purchaser's closing documents pertaining to the mortgage portion of the transaction only (if applicable), and should not be delivered to the vendor's solicitor on closing. The terms `**purchaser**` and `**borrower**` will be used interchangeably in this section. (See web links to sample documents in the Resources section of this How-To Brief.)

- **Acknowledgement and Direction**
  This document is produced by the Teraview software in Teranet. An acknowledgment and direction executed by the borrower authorizes the solicitor to electronically sign and register the electronic charge on behalf of the borrower. The acknowledgment also states that the contents of the charge have been explained to the borrower and the execution of same has the same effect as if the electronic charge was actually signed by the borrower.
- **Electronic Charge**
  The electronic charge is usually prepared by the purchaser's solicitor pursuant to the instructions received by the lender. The purchaser's solicitor should ensure that the charge includes the correct PINs for the dwelling unit and any ancillary parking and/or locker unit (s) to be charged, and should cross reference same with what is set out in the electronic transfer, and what is being conveyed in the APS. The correct *Family Law Act* statements must be made, and the solicitor should ensure that any schedules to be attached are scanned and imported into the electronic charge.
- **Acknowledgment of Receipt of Standard Charge Terms**
  This document is simply an acknowledgment by the borrower that they have received a copy of the standard charge terms. The actual standard charge terms are attached to the acknowledgment. Institutional lenders will usually have their own form of standard charge terms which are incorporated by reference into the electronic charge.
- **Consent to Act Re: Conflict**
  In residential real estate transactions, it is quite common for the solicitor for the purchaser to also act as the solicitor for an institutional lender, without there being a violation of the *Rules*. It would be prudent practice for the solicitor to ensure that the borrower executes an acknowledgment of conflict, which document confirms that the solicitor will be acting for both the purchaser and the lender and that the solicitor cannot keep any information received in connection with the transaction confidential, insofar as the other party is concerned, and that in the event that a material conflict between the borrower and lender materializes that cannot be resolved, then it may be necessary for the solicitor to discontinue acting for one or both parties, depending on the nature and the severity of the conflict.
- **Direction to Lender**
  This document is executed by the borrower and addressed to the lender directing the lender to make the net loan proceeds payable to the solicitor's law firm in trust.

The following documents are typically prepared by the purchaser's solicitor; however, these documents are used less frequently than the aforementioned documents.

- **Polaris Form Charge/Mortgage of Land**
  This is the paper form of charge which will rarely be used since virtually every land registry office in Ontario has been fully automated by Teranet. The solicitor must ensure that the charge is executed by the borrower(s), that the PIN's for the dwelling unit and any ancillary parking and/or locker units are properly set out in box 3, and that the condominium corporation and the land registry office number is properly set out in box 4. The salient terms and provision of the charge should be set out in box 9, as well as the standard charge terms reference number, which should be set out in box 8. All borrowers should execute and date the charge and any consenting spouse should also execute the charge in the event that the property being charged is a matrimonial home.
- **Affidavit of Residence and Value of Consideration [also known as the Land Transfer Tax Affidavit (the "LTTA")]**
  This is the paper form of LTTA, which is usually prepared by the purchaser's solicitor when

also utilizing the Polaris form of Transfer/Deed of Land. The LTTA should be executed by the purchaser(s) and commissioned. Three copies of the LTTA will be attached to the transfer when the transfer is submitted for registration (in duplicate). It may be prudent practice for a purchaser's solicitor to have the LTTA executed by the purchaser even when dealing in the realm of electronic registration. This practice affirms the validity of the information that the purchaser is providing to their solicitor, and that the solicitor is relying in to include in the tax statements of the electronic transfer on behalf of the purchaser.

4. Post-closing matters

When acting for the purchaser, the solicitor should ensure that:

- the property manager for the condominium corporation is notified that the property has been sold to the purchaser (as of the closing date) and that the purchaser should be noted as the new owner for the purposes of the condominium's voting record (Note: a copy of the registered transfer should be included in the written correspondence to the property manager so that the property manager can update their records accordingly on behalf of the condominium corporation);
- the tax department is notified that there has been a change in ownership (Note: a copy of the registered transfer should also be sent to the tax department in the jurisdiction in which the property belongs);
- the final mortgage report to the lender is delivered within 60 days of the registration of the mortgage in accordance with subrule 2.02(14) of the *Rules*; and
- the final reporting letter to the purchaser is prepared and delivered to the purchaser on a timely basis.

When acting for the vendor, the solicitor should ensure the following:

- Closing funds should not be released to the vendor(s) until confirmation is received by the purchaser's solicitor or law clerk that the transfer has been registered.
- Any commissions owing to the real estate agent (if applicable) out of the closing proceeds are to be paid out to the real estate brokerage.
- The final reporting letter to the vendor is prepared and delivered to the vendor on a timely basis.
- All outstanding undertakings given on closing are fulfilled within the specific timelines set out in the respective undertakings.
- Confirm the registration of the discharge and the discharge particulars to the client of any outstanding mortgages not being assumed.

Resources

- Vendor's Closing Documents for Residential Condominium Transactions
- Purchaser's Closing Documents for Residential Condominium Transactions
- Acknowledgement and Direction re Title Insurance
- Acknowledgement of Receipt of Standard Charge Terms
- Affidavit as to Writs of Execution
- Confirmation of Identification
- Consent to Act Re Conflict
- Consent to Joint Retainer
- Direction Re Title

- Direction to Lender
- Direction to Tenants
- Vendor's Undertaking, Bill of Sale, Direction, GST Certification and Warranty
- Document Registration Agreement
- Purchaser Authorization and Acknowledgement
- Purchaser's Undertaking to Readjust
- Redirection Re Funds
- Solicitor's Undertaking re Discharge of Charge
- Solicitor's Undertaking to Pay Arrears of Condominium Common Expenses
- Statement of Adjustments
- Vendor's Statutory Declaration
- Teranet
- Teraview

Statutes and Rules

- *Rules of Professional Conduct*
- *Planning Act*
- *Family Law Act*
- *Income Tax Act*
- Law Society of Upper Canada - New Client Identification and Verification Requirements
- Law Society By-Law 7.1, Part III, Client Identification and Verification

TAB “C”

THIS IS EXHIBIT "C" REFERRED TO
IN THE AFFIDAVIT OF DENISE LASH
SOLEMNLY AFFIRMED BEFORE ME THIS
2nd DAY OF MARCH, 2015

A Commissioner, etc

2002 CarswellOnt 4535
Ontario Superior Court of Justice

XDG Ltd. v. 1099606 Ontario Ltd.

2002 CarswellOnt 4535, [2002] O.J. No. 5307, 121 A.C.W.S. (3d) 18, 23 C.L.R. (3d) 67, 41 C.B.R. (4th) 294

XDG Limited, Plaintiffs and 1099606 Ontario Limited and General Electric Caoutak Canada Inc., Defendants

Gordon J.

Heard: July 9-12, 2002
Judgment: December 23, 2002 *
Docket: 1424/99

Counsel: I. Duncan, M. Van Bodegom for Plaintiff, XDG Limited
A. Speciale for Plaintiff, William Green Roofing Ltd.
L. Ricchetti for Defendant, General Electric Capital Canada Inc.
No one for 1099606 Ontario Limited

Subject: Corporate and Commercial; Property; Contracts; Torts; Insolvency

Related Abridgment Classifications
For all relevant Canadian Abridgment Classifications refer to highest level of case via History.

Headnote

Mortgages --- Nature and form of mortgage — Mortgage as security for other debts

Defendant numbered company ("109") purchased property and leased it to E Corp. — R was sole director, officer and shareholder of 109 and president of E Corp. — In 1998 and 1999, lien claimants provided services and materials to leased property — When contractors were not paid for work, claims for lien were registered in October 1999 — E Corp. was financed under credit agreement by GECC, which was large lending institution well known in commercial finance business — In March 1999, GECC determined E Corp. was in default position under credit agreement and amended agreement resulting in 109 providing guarantee and mortgage on leased property in favour of GECC regarding indebtedness of E Corp. — Both 109 and E Corp. were declared bankrupt in 2000 and leased property was sold resulting in insufficient funds to pay lien claimants and mortgage holder — In proceedings by lien claimants to determine priority between lien claimants and mortgage, issue arose as to whether mortgage was void as result of contravening s. 20 of Business Corporations Act — Mortgage was void — Purpose of s. 20(1) is to prevent dissipation of corporate assets that might otherwise prejudice financial position of creditors and shareholders — GECC, inconsistent with its usual practice, failed to perform due diligence investigation of 109 — E Corp. and 109 were affiliated corporations and guarantee and mortgage provided by 109 constituted financial assistance within meaning of s. 20(1) — Evidence indicated that when mortgage was granted, 109 failed both solvency and balance sheet tests under ss. 20(1)(c) and (d) of Act — GECC's failure to conduct due diligence test was wilful blindness by GECC and therefore GECC was not lender for value within meaning of safe harbour provision in s. 20(3) of Act — Business Corporations Act, R.S.O. 1990, c. B.16, ss. 20, 20(1), 20(1)(c), 20(1)(d), 20(3).

Fraud and misrepresentation --- Fraudulent conveyances — Fraudulent intent — Presumption of fraudulent intent — General

Defendant numbered company ("109") purchased property and leased it to E Corp. — R was sole director, officer and shareholder of 109 and president and controlling shareholder of E Corp. — In 1998 and 1999, lien claimants provided services and materials to leased property — When contractors were not paid for work, claims for lien were registered

in October 1999 — E Corp. was financed under credit agreement by GECC, which was large lending institution well known in commercial finance business — In March 1999, GECC determined E Corp. was in default position under credit agreement and amended agreement resulting in 109 providing guarantee and mortgage on leased property in favour of GECC regarding indebtedness of E Corp. — Both 109 and E Corp. were declared bankrupt in 2000 and leased property was sold, resulting in insufficient funds to pay lien claimants and mortgage holder — In proceedings by lien claimants to determine priority between lien claimants and mortgage, issue arose as to whether mortgage was void as being fraudulent conveyance under Fraudulent Conveyances Act — Mortgage was void — GECC, inconsistent with its usual practice, failed to perform due diligence investigation of 109 — Evidence indicated that when mortgage was granted 109 failed both solvency and balance sheet tests under ss. 20(1)(c) and (d) of Business Corporations Act — R, knowing poor financial situation, caused 109 to guarantee indebtedness of E Corp., company of which he was president and controlling shareholder, to provide collateral mortgage security on leased property which was 109's only real asset — R's actions were facilitated by wilful blindness of GECC in not performing due diligence investigation — In circumstances, there was prima facie presumption of intent on part of GECC to defeat current and future creditors which GECC was unable to rebut — GECC could not save situation by claiming it acted in good faith since wilful blindness was not good faith — Fraudulent Conveyances Act, R.S.O. 1990, c. F.29 — Business Corporations Act, R.S.O. 1990, c. B.16, ss. 20(1)(c), (d).

Fraud and misrepresentation --- Fraudulent preferences — Intention to prefer

Defendant numbered company ("109") purchased property and leased it to E Corp. — R was sole director, officer and shareholder of 109 and president and controlling shareholder of E Corp. — In 1998 and 1999, lien claimants provided services and materials to leased property — When contractors were not paid for work, claims for lien were registered in October 1999 — E Corp. was financed under credit agreement by GECC, which was large lending institution well known in commercial finance business — In March 1999, GECC determined E Corp. was in default position under credit agreement and amended agreement resulting in 109 providing guarantee and mortgage on leased property in favour of GECC regarding indebtedness of E Corp. — Both 109 and E Corp. were declared bankrupt in 2000 and leased property was sold, resulting in insufficient funds to pay lien claimants and mortgage holder — In proceedings by lien claimants to determine priority between lien claimants and mortgage, issue arose as to whether mortgage was void as being unlawful assignment or preference under s. 4 of Assignments and Preferences Act — Mortgage was void — GECC, inconsistent with its usual practice, failed to perform due diligence investigation of 109 — Evidence indicated that when mortgage was granted, 109 failed both solvency and balance sheet tests under ss. 20(1)(c) and (d) of Business Corporations Act — R, knowing poor financial situation, caused 109 to guarantee indebtedness of E Corp., company of which he was president and controlling shareholder, to provide collateral mortgage security on leased property which was 109's only real asset — R's actions were facilitated by wilful blindness of GECC in not performing due diligence investigation — In circumstances, there was prima facie presumption of intent on part of GECC to defeat current and future creditors which GECC was unable to rebut — Assignments and Preferences Act, R.S.O. 1990, c. A.33, s. 4 — Business Corporations Act, R.S.O. 1990, c. B.16, ss. 20(1)(c), (d).

Construction law --- Construction and builders' liens — Priorities — General principles

Defendant numbered company ("109") purchased property and leased it to E Corp. — R was sole director, officer and shareholder of 109 and president and controlling shareholder of E Corp. — In 1998 and 1999, lien claimants provided services and materials to leased property — When contractors were not paid for work, claims for lien were registered in October 1999 — E Corp. was financed under credit agreement by GECC, which was large lending institution well known in commercial finance business — In March 1999, GECC determined E Corp. was in default position under credit agreement and amended agreement resulting in 109 providing guarantee and mortgage on leased property in favour of GECC regarding indebtedness of E Corp. — Both 109 and E Corp. were declared bankrupt in 2000 and leased property was sold, resulting in insufficient funds to pay lien claimants and mortgage holder — Plaintiff claimants brought action for declaration that they were entitled to priority over mortgage — Action allowed — GECC, inconsistent with its usual practice, failed to perform due diligence investigation of 109 — Failure to conduct due diligence test was wilful blindness by GECC — GECC gave no satisfactory answer to explain this neglect — In circumstances it would be unconscionable and inequitable to allow mortgagee to obtain priority based on its wilful blindness or negligence — Due diligence investigation

would have led GECC to decide against mortgage security on leased property — Assignments and Preferences Act, R.S.O. 1990, c. A.33, s. 4 — Business Corporations Act, R.S.O. 1990, c. B.16, ss. 20(1)(c), (d).

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s. 2 — considered

s. 3 — considered

ACTION by lien claimants for declaration that they had priority over mortgage with respect to leased lands.

***Gordon J.*:**

1 A trial of this consolidated construction lien action was directed to determine the priority as between the lien claimants and the mortgagee with respect to certain lands in the City of Kitchener described as the "Dielcraft property".

Background

2 109606 Ontario Limited ("109") was incorporated on 30 November 1994. In December 1994 it purchased the Dielcraft property for $1,515,000. The property was leased to Euro United Corporation ("Euro United"), commencing 1 April 1995 for the purposes of storing raw material and finished product.

3 Mr. Sam Rehani was the sole director, officer and shareholder of 109. He was also the controlling shareholder and president of Euro United.

4 In 1998 and 1999 the lien claimants provided services and material to the Dielcraft property. Various contractors were involved, commencing with certain demolition work to the ultimate renovation, being the raising of the building roof. In the fall of 1999 the contractors left the job site as they were not being paid by 109. Claims for lien were registered on title commencing in October 1999.

5 Euro United, and related companies operating under a similar name in different jurisdictions, was financed by General Electric Capital Canada Inc. ("GECC") pursuant to a credit agreement dated 13 November 1998. By the end of March 1999 GECC determined Euro United was in a default position regarding certain covenants in the credit agreement. In April 1999 an amendment to this agreement resulted in 109 providing a guarantee and mortgage on the Dielcraft property in favour of GECC regarding the indebtedness of Euro United.

6 Euro United temporarily corrected its default position, but by August 1999 GECC determined there were significant problems. On 24 November 1999 GECC demanded payment from Euro United and 109. In December 1999 KPMC Inc. was appointed interim receiver of Euro United and 109. In June 2000, both companies were declared bankrupt and KMPG Inc. was appointed trustee of their estates. Sale of the property by the trustees was authorized in January 2002.

7 The sale proceeds are held by KPMG Inc. pending the outcome of this litigation. There are insufficient funds to pay the lien claimants and the mortgage holder.

Issues

8 Pursuant to the order of Sills J., granted 17 December 2001, the statement of issues identified the following:

1. Section 20 of the Ontario *Corporations Act*. Is the mortgage invalid or void as against the plaintiffs as a result of contravening section 20 of the Ontario *Business Corporations Act*?

2. Section 4 of the *Assignments and Preferences Act* and section 2 of the *Fraudulent Conveyances Act*.

Is the mortgage invalid or void as against the plaintiffs as an unlawful assignment or preference or as a fraudulent conveyance?

3. Section 78 of the *Construction Lien Act*.

(a) Was the mortgage registered prior to the time when the first lien arose in respect of the subject improvement, and, if so, to what extent does the mortgage have priority under section 78 of the Construction Lien Act?

(b) Was the mortgage registered as a subsequent mortgage, and, if so, to what extent does the mortgage have priority under section 78 of the *Construction Lien Act*?

Analysis

(i) Section 20 Business Corporation Act

(a) 109 and GECC

9 Euro United was involved in the manufacture and sale of plastic injection mould products, such as patio furniture. Some of their product was supplied to large retail stores in Canada and the United States. According to Mr. Paul Feehan, Senior Vice President of GE Capital Commercial Finance, Inc., a related company to GECC, Euro United was growing rapidly. Mr. Feehan, who was involved in the underwriting of Euro United's financing by GECC, reported the growth in sales went from $10,000,000 in 1996 to $102,000,000 in 1998.

10 The Canadian Imperial Bank of Commerce was the lending institution providing financing to Euro United. GECC, acting as agent for a syndicate of lenders, including itself, provided new replacement financing in November 1998 consisting of a revolving line of credit in the notional amount of $127,000,000 and a term loan of $50,000,000. The line of credit authorized from time to time was based on a formula pertaining to receivables and inventory.

11 Mr. Feehan, and others at GECC, conducted a due diligence investigation of Euro United from July to November 1998. The new financing terms were set out in the credit agreement dated 13 November 1998. GECC acquired security on the assets of Euro United.

12 GECC was aware of Euro United leased the Dielcraft property from the outset. A Landlord's Waiver and Consent, signed by Mr. Rehani on behalf of 109 and Euro United, dated 16 November 1998, was one of the documents in the security package. A copy of the lease was attached to this document indicating an annual rent to be paid by Euro United in the sum of $700,000 on a net net basis commencing 1 April 1996 and ending 31 March 2002. GECC was also aware Mr. Rehani controlled both companies.

13 By the end of March 1999, less than five months after the advance on the credit agreement, GECC became aware Euro United was in a default position. Amongst other items, Euro United had overstated its receivables, resulting in an overadvance on the line of credit of $15,300,000. In addition, Euro United had paid Mr. Rehani $525,000, apparently with respect to his shareholder loan, and purchased and mortgaged their head office property in Oakville, both items lacking the required consent of GECC. At this point in time, GECC's exposure was $89,900,000 on the line of credit and $50,000,000 on the term loan.

14 Mr. Feehan, and others involved in the financing, met with Mr. Rehani on 5 April 1999. Mr. Rehani offered to add his real estate, the Dielcraft property, as collateral and indicated its value to be $7,000,000 to $8,000,000. There was an indication equity investors might become involved in Euro United. Mr. Feehan said GECC wanted to resolve the existing financing problems and move forward in their relationship with Euro United. He also acknowledged GECC wanted to buttress its existing security to cover Euro United's indebtedness.

15 On 6 April 1999 Mr. Feehan reported to his superior, setting out the issues and possible solutions. In addition to taking security on the Dielcraft property, he recommended a two percent bonus on the indebtedness and a $200,000 fee to charged to Euro United as well as acquiring an option to purchase equity on favourable terms. Mr. Feehan testified GECC had not yet concluded to retract its financing, that Euro United was thriving and although it had significant management and administrative problems, he felt GECC should "take the risk" and provide bridge financing.

16 Nevertheless, in his written report dated 5 April 1999, he told his superior:

> Therefore we recommend that GECC choose the least disruptive solution because it allows Advent to work towards our quickest and easiest exit (i.e. Lehman). In addition, GECC is receiving additional boot collateral and is getting paid for its risk with an equity opportunity in the future.

17 Upon receipt of approval from his superior, Mr. Feehan submitted a written proposal to Mr. Rehani on 9 April 1999. It was accepted the same date.

18 The security documentation was prepared and signed by 14 April 1999, within five days of the accepted proposal. The mortgage was registered on 15 April 1999. The documentation appears to have been prepared by the solicitors for GECC, McMillan, Binch, although it is noted Euro United and 109 were represented by Bennett Jones. Mr. Rehani signed all documentation for 109, including the guarantee for $11,5000,000 and the mortgage for $300,000,000. Numerous declarations and other documents were also executed by Mr. Rehani, including an insolvency certificate.

19 Mr. Feehan stated the amounts described in the guarantee and mortgage were determined by GECC's solicitors. The $11,500,000 stated in the guarantee resulted from Mr. Rehani's representation the value of 109's assets was $12,000,000 with only $100,000 in liabilities. The $300,000,000 referred to in the mortgage was to cover loans of the syndicated loan agreement although Mr. Feehan was not clear on this explanation.

20 The GECC proposal dated 9 April 1999 permitted it to conduct a due diligence investigation. For some unexplained reason, GECC chose not to make any inquiry with respect to 109. According to Mr. Feehan, GECC relied exclusively on the representations of Mr. Rehani.

21 In due course, GECC receive the executed security documents from its solicitors. There was no reporting letter regarding certification of title with respect to the Dielcraft property. Mr. Feehan indicated a certification was required and mistakenly assumed it was provided by the solicitors for 109.

22 GECC did not request financial statements from 109, nor did they conduct a credit check. They were unaware 109 had never filed income tax returns. GECC did not inspect the Dielcraft property nor did they obtain an appraisal.

23 The proposal contained a provision whereby GECC would release its mortgage if 109 obtained another mortgage, so long as the proceeds therefrom of at least $4,000,000 were contributed to Euro United as equity and applied to reduce the line of credit with GECC. This item was not included in the amending agreement.

24 Mr. Feehan said his only concern was the Dielcraft property be worth at least $4,000,000. He was not concerned with Mr. Rehani's representations as to the property value, nevertheless, no inquiry was made to appraise the property.

25 City Management & Appraisals Ltd. provided an appraisal report dated 3 April 2000 to KPMG Inc., in which they estimated the market value, as of 1 June 1999, at $3,190,000. This valuation appears to be accepted by the parties as the market value on 15 April 1999. The stated value, however, may be high as the appraiser also estimated market value as of 1 April 2000 to be $5,000,000, yet the property only sold for $2,896,000 in January 2002. There may have been intervening market conditions affecting the sale price although no evidence was presented.

26 Mr. Feehan also said GECC had no reason to question the representations made by Mr. Rehani although he offered to explanation. Without due diligence, it is equally reasonable to say GECC had no reason to believe those representations.

27 The declarations and certificates signed by Mr. Rehani, on or before 14 April 1999, as part of the security documents required by GECC contained numerous errors or, perhaps, deliberate false statements, examples of which are as follows:

(a) there was no change in the financial condition 109 which would have a material adverse effect on its ability to pay GECC and all rental payments where current when, in fact, Euro United had not paid its rent for at least four months and, therefore, 109 had no income;

(b) no material or services had been provided to the property, nor contracts signed, nor estimates given or, alternatively, all amounts have been paid in full and no liens have arisen within the meaning of the *Construction Lien Act* when, in fact, 109 had entered into substantial contracts in excess of $3,000,000 to renovate the building, work had started in August or September 1998, there were monies owing to one contractor, and, accordingly, liens had arisen;

(c) there were no encumbrances against the assets of 109 when, in fact, Engel Canada had an outstanding debenture or general security agreement;

(d) the value of assets was inflated and liabilities were not disclosed;

(e) 109 was up-to-date in filing income tax returns when, in fact, 109 had never filed a return since incorporation in 1994 and, further, there was significant, income tax owing.

28 All of these errors or misrepresentations would have been discovered on a due diligence investigation. GECC and its related companies are well known in the commercial finance business. They specialize in large commercial loans starting at $5,000,000. They are a sophisticated lending institution. Failure to perform a due diligence investigation of 109 is inconsistent with GECC's normal practice.

29 On 27 April 1999 Mr. Feehan was informed 109 and Euro United had increased the rental payment required from $700,000 to $1,400,000 per annum. No explanation was requested. Mr. Feehan was still unaware rent was not being paid.

30 Equity investors contributed $70,000,000 to Euro United over the two months following 15 April 1999 and the overadvance was paid off by 25 May 1999. GECC, however, did not release its mortgage on the Dielcraft property.

31 In August 1999 Euro United requested an overadvance of $300,000. GECC refused. Mr. Feehan said Euro United was growing rapidly without the proper financing to support the growth. In fact, this was similar to the comment he made in April 1999.

32 Mr. Feehan stated GECC discovered the construction project on the Dielcraft property in November 1994 when Mr. Rehani made mention of it, he says, for the first time.

33 On 24 November 1999 GECC demanded payment from Euro United and 109. The end result was the bankruptcy of these companies and the ultimate sale of assets by the trustee.

(b) Subsection 20(1). Business Corporations Act

34 Subsection 20(1) of the Ontario *Business Corporations Act*, as at the relevant time of the events, said:

20(1) Financial assistance by corporation —

Except as permitted under subsection (2), a corporation with which it is affiliated, shall not, directly or indirectly, give financial assistance by means of a loan, guarantee or otherwise,

(a) to any shareholder, director, officer or employee of the corporation or affiliated corporation or to an associate of any such person for any purpose; or,

(b) to any person for the purpose of or in connection with a purchase of a share, or a security convertible into or exchangeable for a share, issued or to be issued by the corporation or affiliated corporations.

where there are reasonable grounds for believing that,

(c) the corporation is or, after giving the financial assistance, would be unable to pay its liabilities as they become due; or

(d) the realizable value of the corporation's assets, excluding the amount of any financial assistance in the form of a loan and in the form of any secured guarantee, after giving the financial assistance, would be less than the aggregate of the corporation's liabilities and stated capital of all classes.

35 The parties acknowledge 109 and Euro United were affiliated corporations and the guarantee and mortgage provided by 109 constituted financial assistance within the meaning of subsection 20(1).

36 The purpose of subsection 20(1), in part, is to prevent the dissipation of corporate assets that might otherwise prejudice the financial position of creditors and shareholders: see: Wayne D. Gray, *Corporate Guarantees*, 1999, Law Society of Upper Canada, Continuing Legal Education Lectures.

37 The initial determination is the amount of the financial assistance. The guarantee says $11,500,000, the mortgage says $300,000,000. There is some merit in relying on the amount stated in the mortgage, insofar as the mortgage is central to the issue in this litigation; however, I am of the view such is misleading. The explanation provided for this sum bears little, if any relationship to the actual credit agreement amendment. Further, 109's liability is from the guarantee, the mortgage only providing collateral security.

38 GECC suggests the financial assistance is limited to $4,000,000, relying on its 9 April 1999 proposal which allowed for such payment, but on strict conditions. This provision was not inserted in the amendment to the credit agreement, the guarantee or any of the security documents delivered on 14 April 1999. Further, GECC has always claimed entitlement to the full amount of the guarantee, namely $11,500,000, as confirmed by its demand letter on 24 November 1999 and, as well, Mr. Feehan's testimony at trial.

39 Accordingly, I find the amount of financial assistance was $11,500,000.

40 The test in subsection 20(1)(c) and (d) is an objective one, that is, were there reasonable grounds on 15 April 1999.

41 The practical difficulty regarding a review of the financial problems of Euro United and 109 is that much of the evidence relates to subsequent events. Their ultimate bankruptcy, however, cannot be relied upon as the basis for finding a breach of this statutory provision. There are, however, a number of matters that existed on 15 April 1999 and are relevant to this issue. The evidence established the following facts:

(i) 109 had no income as Euro United had not paid its rent for at least four months;

(ii) the only prior source of income for 109 had been rental payments from Euro United which it relied on to meet its obligations;

(iii) 109 had an outstanding debt to Engel Canada, subsequently calculated by KPMG to be $279,913, as at 30 June 1999;

(iv) 109 had never filed income tax returns and there was income tax owing, subsequently calculated by KPMG to be $1,441,200 as at 30 June 1999;

(v) similarly, there was goods and services tax owing by 109, subsequently calculated by KPMG to be $26,618 as at 30 June 1999;

(vi) it is reasonable to assume 109 had other ongoing expense in the normal course of business, particularly if Euro United was also not paying the property related expense;

(vii) 109 had $102,275 on deposit in its bank account;

(viii) the property was valued at $3,190,000;

(ix) other assets of 109 were described as rent owing from Euro United and monies owing from its shareholder, Mr. Rehani, but there was no evidence these were tangible assets;

(x) 109 had entered into construction contracts in excess of $3,000,000, much of it for future work, and, although contractors had been substantially paid to date, there were holdback monies owing to one contractor;

(xi) the GECC mortgage prevented the property being used by 109 as security to fund the construction project.

42 On 15 April 1999, 109 was not paying, nor was able to pay, its outstanding liabilities. It had no income and significant debt had accumulated. Even if Euro United had been paying rent, there would be insufficient income to pay liabilities. The construction project, commenced some months prior, would require substantial funding which could not come from income. The guarantee and mortgage to GECC compounded the situation by preventing use of the property as security for funding to pay liabilities.

43 In addition, the value of 109's assets on 15 April 1999, excluding the amount of the financial assistance, was less than its outstanding liabilities. The construction expense alone was equal to or exceeded the property value. The outstanding income tax liability suggests it was only a matter of time before failure would occur.

44 In my review of the evidence, it appears 109 failed the solvency and the balance sheet tests without having to take into account the financial assistance provided in the guarantee and mortgage, although it is possible 109 might have been able to meet most of its liabilities if Euro United was paying its rent and it could mortgage the property to fund the construction. Neither event occurred, nor was there evidence to suggest it would occur.

45 Nevertheless, consideration must given to whether there were reasonable prospects of GECC calling on the guarantee as of 15 April 1999. In this regard, the comments by Farley J. in *Clarke v. Technical Marketing Associates Ltd. (Trustee of)* (1992), 8 O.R. (3d) 734 (Ont. Gen. Div.) at p. 750:

> It does not seem to me that the words 'after giving the financial assistance' under either s. 44(1)(c) or (d) mean that the tests have to be applied on the assumption that the corporation giving the guarantee has had to make payment. The guarantee has been given as financial assistance when it was entered into and not when it might actually be called upon (or as if it had been called upon). Thus a guarantee would no appear to impinge upon the 'cash flow' requirement contemplated by s. 44(1)(c) if given on a naked basis.
>
> However, one has to go back to the lead-in words 'where there are reasonable grounds for believing that'. This implies that one must form a reasonable opinion based on the facts of each case to see what the likelihood would be of the guarantee being called upon in the future so as to constitute it a 'liability' which must be paid as part of the 'liabilities as they become due' (s.44(1)(c).

46 The guarantee had only just been signed and, therefore, it might be said 109, Euro United and GECC were optimistic the financial problems at Euro United had been resolved, however, a more detailed analysis is required. GECC was buttressing its security, as acknowledged by Mr. Feehan. Within two months, equity investors inject $70,000,000 into Euro United and the overadvance is paid in full. The basis for the extra security appears resolved yet GECC does not release 109.

47 Despite Mr. Feehan's expressed optimism on 15 April 1999, it is clear GECC wanted more security as they were contemplating further default by Euro United. This is the only conclusion that can be drawn from Mr. Feehan's report on 5 April 1999 "our quickest and easiest exit". There was no acceptable evidence to the contrary and, therefore, I conclude the guarantee must be considered a liability in the solvency test under subsection 20(1)(c). It is also included on the basis it prevented 109 mortgaging the Dielcraft property to fund the construction project.

(c) Subsection 20(3), Business Corporations Act

48 Subsection 20(3) of the Ontario *Business Corporations Act*, as at the relevant time of the events, said:

> (3) Validity of Contract — A contract made by a corporation in contravention of this section may be enforced by the corporation or by a lender for value in good faith without notice of the contravention.

49 GECC seeks to rely on this safe harbour provision.

50 It is apparent, on the evidence, GECC did not have actual "notice of contravention." The question is whether it can rely on the representations of Mr. Rehani and its failure to perform a due diligence investigation on as stated in the subsection, was GECC "a lender for value in good faith."

51 109 received no benefit from the guarantee and mortgage. The sole purpose of these documents, as said by Mr. Feehan, was so secure past indebtedness of Euro United. Monies may have been advanced by GECC to Euro United after 15 April 1999 but such was merely a continuation under the revolving letter of credit. Given the subsequent injection of funds by equity investors and the payment of the overadvance, GECC's failure to release 109 clearly demonstrates the purpose of this additional security to cover past indebtedness of Euro United. Therefore, in my view, GECC was not "a lender for value" within the meaning of subsection 20(3) as it relates to the financial assistance.

52 Further, failure to conduct a due diligence investigation cannot be used to establish "good faith" in the circumstances of this case. GECC made no attempt to investigate 109 which was inconsistent with their corporate practice as demonstrated in their inquiry in 1998 with respect to the Euro United application for financing. Here, a property inspection would, in a matter of minutes, reveal the construction project on the Dielcraft property and caused further inquiry. The normal request for financial statements would have led to finding the income tax liability. GECC also knew Mr. Rehani was responsible for several covenant breaches which ought to have raised concerns about his honesty.

53 In this regard, I adopt the comment by Huband J.A. in *Petro-Canada v. Cojef Ltd.*, [1992] M.J. No. 575 (Man. C.A.) where, at p. 2, he said:

> There is merit in the argument that Petro-Canada cannot turn a blind eye toward the obvious. Moreover, Petro-Canada must be judged, not on the basis of an unsophisticated lender, but as one whose business it is to extend credit on the basis of guarantees. Petro-Canada is aware of the hazards of relying on a guarantee which proves unenforceable by virtue of sec. 42(1). It cannot claim the benefit of sec. 42(3) by ignoring the obvious and neglecting to ask questions.

54 *Upper Mapleview Inc. v. Stolp Homes (Veterans Drive) Inc.* (1997), 36 B.L.R. (2d) 31 (Ont. Gen. Div.), is comparable in many respects to the case at bar. In discussing this issue, Swinton J. also indicated the defendant "should not be held to the same standard of sophistication as Petro-Canada".

55 GECC is a sophisticated financial institution that well knows the necessity of a due diligence investigation. As such, it cannot rely on the suggestion a solvency certificate satisfies the test. GECC knew enough about the relationship between 109, Euro United and Mr. Rehani that necessitated further inquiry. The evidence clearly indicated GECC made no inquiry, not even a property inspection or search of title, and, further, there was an urgency in completing the transaction.

56 In this regard, the statement by Carthy J.A. in *Assaad v. Economical Insurance Group*, [2002] O.J. No. 2356 (Ont. C.A.), at p. 4, is appropriate:

> Suspicions combined with blindness adds up to an absence of good faith.

57 Mr. Wayne Gray, in his paper *Corporate Guarantees*, supra, offered this conclusion, at p. 3-39:

> Thus a prudent lender should not expect to rely on the safe harbour provision. Instead, it will take all steps available to it to ensure that it not only has on notice of the contravention but that it can also, if necessary, produce compelling evidence to a court that the lender addressed its mind to the statutory requirements and reasonably satisfied itself that the corporation providing the financial assistance was not contravening the provisions of its incorporation statute. Unless the lender takes appropriate steps so that it can adduce such evidence should the issue arise in litigation, it will risk encountering significant enforcement difficulties if its primary security from the borrower should become insufficient to meet the borrower's obligations.

58 GECC took no steps and, therefore, has no evidence to demonstrate its good faith. Reliance on Mr. Rehani's representations and failure to conduct a due diligence investigation was, in my view, willful blindness by GECC.

(d) Summary

59 In summary, I find 109 failed both the solvency and balance sheet test under subsections 20(1)(c) and (d) and, further, GECC cannot rely on the sale harbour provision of subsection 20(3). Accordingly, I find the mortgage from 109 to GECC is void as against the plaintiffs, as a result of contravention of section 20, *Business Corporations Act*.

(ii) Section 2, Fraudulent Conveyances Act Section 4, Assignment and Preferences Act

60 Although Mr. Rehani did not testify, it is likely he was optimistic, on 15 April 1999, Euro United and 109 would be successful business ventures. Optimism, however, is not evidence of good intentions. The mortgage to GECC, if it stands up, has the actual effect of defeating creditors. An objective analysis of the circumstances is necessary to determine if either, or both, of these statutory provisions apply.

(a) Section 2 Fraudulent Conveyances Act

61 Section 2 of the *Fraudulent Conveyances Act* says:

> Every conveyance of real property or personal property and every bond, suit, judgment and execution heretofore or hereafter made with intent to defeat, hinder, delay or defraud creditors or others of their just and lawful actions, suits debts, accounts, damages, penalties or forfeitures are void as against such persons and their assigns.

62 The financial circumstances of 109 were identified previously. In April 1999 Mr. Rehani, sole director, officer and shareholder of 109, knowing the financial situation, caused 109 to guarantee the indebtedness of Euro United, a company of which he was the president and controlling shareholder, and to provide collateral mortgage security on its only real asset. Mr. Rehani's actions were facilitated by the willful blindness of GECC. Mr. Rehani was not truthful. He deliberately misrepresented the situation to GECC. GECC failed to make any inquiry.

63 At issue, therefore, is whether there was an intent to defeat or delay creditors, such as the lien claimants, some of whom had already commenced work on the Dielcraft property by 15 April 1999. There was no direct evidence of intent, however, as West J. said in *Home Savings & Loan Corp. v. Mathews* (1995), 49 R.P.R. (2d) 79 (Ont. Gen. Div.), at p. 87, "Intent can be inferred from the surrounding circumstances."

64 Over the years, the case law has referred to suspicious circumstances demonstrating "badges of fraud": see, for example *Solomon v. Solomon* (1977), 16 O.R. (2d) 769 (Ont. S.C.); and *Prodigy Graphics Group Inc. v. Fitz-Andrews*, [2000] O.J. No. 1203 (Ont. S.C.J.).

65 The evidence established the following, which may be appropriately considered in this analysis:

(i) the conveyance by 109 was in support of a related party, Euro United;

(ii) Mr. Rehani controlled both corporations;

(iii) 109 received no consideration;

(iv) the property conveyed was all of 109's real assets;

(v) 109 had existing and substantial debt such as for income tax, for creditors and was incurring future and substantial liability for creditors regarding the construction project;

(vi) the conveyance was completed with considerable haste, within five days;

(vii) disclosure to GECC was incomplete and in error which could have been discovered upon investigation;

(viii) Mr. Rehani had already committed acts of dishonesty regarding payment on his shareholders loan and acquisition and mortgaging of other property without the consent of GECC;

(ix) The conveyances exceeded the property value;

(x) Euro United was in financial difficulties, having defaulted on the credit agreement within five months of the advance; and,

(xi) There was good reason for GECC and Mr. Rehani to consider Euro United and 109 were insolvent, or about to be.

66 As Cameron J. said in *Prodigy Graphics*, supra, at p. 22:

The badges of fraud are of evidentiary value in determining the issue of intent but are not conclusive evidence of fraud. Fraudulent intent is a matter of fact to be determined in the circumstances of each case or the basis of the evidence as a whole: *Meeker v. Cedar Products v. Edge* (1968), 12 C.B.R. (N.S.) 49 (B.C.C.A.).

Once the suspicious circumstances raise a prima facie presumption of intent to hinder, defeat or defraud a creditor, the court may find the intent unless the presumption is displaced by corroborative evidence of the bona fides of the debtor in the suspect transaction: *Kingsbridge Grand Ltd. v. Vacca*, [1999] O.J. No. 4914 citing *Koop v. Smith* (1915), 51 S.C.R. 554; *Applecrest Investments Ltd. v. Toronto Masonry (1986) Ltd.*, [1997] O.J. No. 436; *Rinaldo v. Rosenfeld*, [1999] O.J. No. 4665.

67 In *Petrone v. Jones* (1995), 33 C.B.R. (3d) 17 (Ont. Gen. Div.), Wright J. at p. 20 provided this comment:

In the absence of any direct proof of intention, if a person owing a debt makes a settlement which subtracts from the property which is the proper fund for the payment of those debts, an amount without which the debts cannot be paid then, since it is the necessary consequence of the settlement that some creditors must remain unpaid, it is the duty of the judge to direct a jury that they must infer the intent of the settler to have been to defect or delay his creditors. (*Sun Life Assurance Co. v. Elliott* (1900), 31 S.C.R. 91). ...

Further: even if the plaintiff did not intent to defeat, hinder or delay their creditor but effected the transfer with a view to defeating, hindering or delaying potential future creditors his defence would still fail.

68 There are strong suspicious circumstances, or badges of fraud, as noted previously. Mr. Rehani knew of the construction project and the cost of same. He knew Euro United was not paying rent to 109. He knew 109 required the property to be mortgaged for the construction project expense as rent, if paid, was insufficient. He knew 109 already had significant liabilities, particularly for unpaid income tax. In spite of this knowledge, he caused 109 to pledge its only asset to GECC to secure Euro United's existing indebtedness. The only logical inference is that Mr. Rehani used 109 to support the financial difficulties of Euro United and, in so doing, used the property from which the contractors would look for payment.

69 Therefore, there is, in my view, a prima facie presumption of intent to defeat current and future creditors. GECC is unable to rebut this presumption as they failed to conduct a due diligence investigation and, therefore, had no knowledge, but should have, of the true circumstances on 15 April 1999.

70 Section 7 of the *Act* says:

3. Section 2 does not apply to an estate or interest in real property or personal property conveyed upon good consideration and in good faith to a person not having at the time of the conveyance to the person notice or knowledge the intent set forth in that section.

71 109 received no consideration for the conveyance. In *Courtesy Chevrolet Oldsmobile Ltd. v. Dhaliwal* (1987), 67 C.B.R. (N.S.) 72 (Ont. H.C.), Austin J. at p. 79 indicated:

> The jurisprudence makes it clear that where there is no 'good consideration', then the intent of the transferor alone is relevant.

72 Further, GECC cannot rely on section 3 for the same reasons as with respect to subsection 20(3) of the *Business Corporations Act*. Willful blindness is not good faith.

73 The plaintiffs argue a conveyance from 109 to Euro United for no consideration would be void under section 2 and, as the conveyance from 109 to GECC has the same effect, it should also be void. I agree. Substance, not form, is the determining factor.

(e) Section 4, Assignments and Preferences Act

74 Subsection 4(1) of the *Assignments and Preferences Act* says:

> 4(1) Subject to section 5, every gift, conveyance, assignment or transfer, delivery over or payment of goods, chattels or effects, or of bills, bonds, notes or securities, or of shares, dividends, premiums or bonus in any bank, company or corporation, or of any other property, real or personal, made by a person when insolvent or unable to pay the person's debts in full or when the person knows that he, she or it is on the eve of insolvency, with intent to defeat, hinder, delay or prejudice creditors, or any one or more of them, is void as against the creditor or creditors injured, delayed or prejudiced.

75 Subsection 4(1) includes a solvency test. As previously noted, under section 20, *Business Corporation Act*, 109 was, in my view, insolvent on 15 April 1999. 109 was also insolvent as defined in subsection 2(1) of the *Bankruptcy and Insolvency Act*: see also *Robinson v. Countrywide Factors Ltd.* (1977), 23 C.B.R. (N.S.) 97 (S.C.C.), at p. 136.

76 On 15 April 1999, 109 had no income and had existing liability for income tax and other debts. Construction work had commenced and there was an outstanding debt to one contractor. 109's liabilities exceeded its assets. The conveyance to GECC compounded 109's insolvency.

77 The evidence supports a prima facie case for insolvency of 109 and there is, therefore, a presumption of intent to defeat creditors, as noted in the analysis under the *Fraudulent Conveyances Act*. No evidence was presented to rebut the presumption.

78 Subsection 5(5)(d) of the Act says:

> Nothing in this Act,
>
> ellipsis;
>
> > (d) invalidates a security given to a creditor for a pre-existing debt where, by reason or on account of the giving of the security, an advance of money is made to the debtor by the creditor in the belief that the advance will enable the debtor to continue the debtor's trade or business and to pay the debts in full.

79 No advance was made to 109. The pre-existing debt was Euro United's. There was no evidence to suggest any advance to Euro United would enable 109 to continue its business and pay its debts in full. Indeed, the evidence showed otherwise as confirmed by subsequent events. GECC, therefore, cannot rely on subsection 5(5)(d).

(f) Summary

80 In summary, I find the mortgage from 109 to GECC is void as against the plaintiffs, as a result of contravention of section 2 of the *Fraudulent Conveyances Act* and section 4 of the *Assignments and Preferences Act*.

(iii) Section 78, Construction Lien Act

81 Subsection 78(1) of the *Construction Lien Act* says:

(1) Except as provided in this section, the liens arising from an improvement have priority over all conveyances, mortgages or other agreements affecting the owner's interest in the matters.

Other subsections provide exceptions to this general priority in favour of construction liens. It is, therefore, necessary to determine if the mortgage to GECC is prior or subsequent to the construction liens.

82 In *Boehmers v. 794561 Ontario Inc.* (1993), 14 O.R. (3d) 781 (Ont. Gen. Div.); affirmed (1995), 21 O.R. (3d) 771 (Ont. C.A.), Killeen J. said:

> Section 78(1) is the overarching principle of the regime of the Act for the determination of priorities. It is, if you will, the central interpretative principle for the adjudication of conflicts of this type before the court in this case. Surely, it necessarily implies that, in cases of conflicts, as here, the burden must be on the mortgagee to persuade the court that it somehow falls clearly within a specified exception to the generalized priority of the liens.

83 The comment by Rosenberg J. in *697470 Ontario Ltd. v. Presidential Developments Ltd.* (1989), 69 O.R. (2d) 334 (Ont. Div. Ct.) is also of assistance where, at p. 337, he said:

> Accordingly, while the Act may merit a liberal interpretation with respect to the rights it confers upon those to whom it applies it must be given a strict interpretation in determining whether it does in fact apply: *Clarkson Co. Ltd. v. Ace Lumber Ltd.* (1963), 36 D.L.R. (2d) 554 (S.C.C.)

84 Before proceeding to consider whether the mortgage was prior or subsequent, a preliminary finding is necessary as to whether there was one improvement or several improvements. "Improvement" is defined in the *Act* as:

> (a) any alteration, addition or repair to, or
>
> (e) any construction, erection or installation on any land and includes the demolition or removal of any building, structure or works or part thereof, and 'improved' has a corresponding meaning.

85 Various contractors provided services and materials for 109 at the Dielcraft property at different times. 109 entered into specific contracts with Jannick Electric Limited ("Jannick"), Aim Waste Management Limited ("Aim") and XDG Limited ("XDG"). Numerous subcontractors were also involved.

86 In the summer of 1998 Mr. Raymond El Jarnal, vice-president of Euro United and general manager of 109, began inquiring of contractors and consulting engineers as to renovations of the building located on the Dielcraft property. Several contractors expressed an interest and provided quotations for various components of the intended project. Contracts were then negotiated with the successful firms.

87 Jannick was on site in early September or perhaps August 1998 to disconnect electrical services. Aim commenced demolition work on 15 September 1998. Negotiations with XDG continued to January 1999 at which point Mr. El Jamal presented XDG with a draft contract. Giffel's Associates Limited ("Giffels"), 109's consulting engineers, prepared the contract in final form based on the terms as already negotiated. Although the written contract is dated 15 April 1999, it is on the same terms as negotiated and agreed to and, therefore, I find the contract between 109 and XDG was orally entered into in early January 1999.

88 XDG employees and others were on site on 7 June 1999, however, actual work was commenced on 3 March 1999 when Mr. Wayne Nosal of Design Plus started to prepare the architectural drawings. XDG employees also commenced work on its metal fabrication drawings on the same day.

89 The ultimate goal of the project was to raise the roof on the building, a large undertaking. XDG was to perform the actual work, however, demolition and electrical disconnection was required before they could commence work on site. In my view, therefore, this appears to be one project, or improvement, not several, as suggested by GECC.

90 Additional evidence confirms this observation. Aim was initially approached by another contractor in July 1998 to provide a quote for part of the project. 109 eventually contracted directly with Aim on 10 September 1998. Jannick's proposal to 109, dated 28 August 1998, stated it was "...to assist you in raising of your roof...". Also, the minutes of meeting on 19 November 1998, prepared by Giffels, refers to one project with numerous components.

91 Accordingly, I find there was one improvement. A comparison can be found in the situation in *Moffatt & Powell Ltd. v. 682901 Ontario Ltd.* (1992), Kirsch's C.L.C.F., 61.3 [49 C.L.R. 205 (Ont. Gen. Div.)] where Misener J. said:

> The 'construction' (and therefore the 'improvement') that Kuco undertook on the lands in question here was the erection of a three-storey residence for the elderly that contained 66 separate suites. All 16 lien claimants contracted with Kuco to perform work or services or to supply materials of that 'construction' (and therefore for that 'improvement'). Therefore, all performed work or services in respect of the same 'construction' — and therefore the 'same improvement.'

Section 15 of the *Act* says:

> 15. A persons' lien arises and takes effect when the person first supplies services or materials to the improvement.

92 Jannick was on site to disconnect electrical services, likely in August 1998, however, the evidence was not clear. Aim was on site to commence demolition on 15 September 1999. Therefore, the first lien arose at least by 15 September 1998 and, accordingly, the mortgage from 109 to GECC was a subsequent mortgage, and I so find.

93 Subsections 78(5) and (6) of that *Act* say:

> **78(5) Special priority against subsequent mortgages —**
>
> Where a mortgage affecting the owner's interest in the premises is registered after the time when the first lien arose in respect of an improvement, the lien arising from the improvement have priority over the mortgage to the extent of any deficiency in the holdbacks required to be retained by the owner under Part IV.
>
> **(6) General priority against subsequent mortgages —**
>
> Subject to subsections (2) and (5), a conveyance, mortgage or other agreement affecting the owner's interest in the premises that is registered after the time when the first lien arose in respect of the improvement, has priority over the liens arising from the improvement to the extent of any advances made in respect of that conveyance, mortgage or other agreement, unless,
>
> (a) at the time when the advance was made, there was a preserved or perfected lien against the premises; or
>
> (b) prior to the time when the advance was made, the person making the advance had received written notice of a lien.

94 As previously stated, the mortgage was provided as collateral security with respect to the prior indebtedness of Euro United. No advance was made to 109 nor did 109 benefit in any manner whatsoever. The statutory provisions refer to amounts advanced, not amounts secured: See *561861 Ontario Ltd. v. 1085043 Ontario Inc.* (1998), Kirsh's C.L.C.F. 78.50 [1998 CarswellOnt 2935 (Ont. Bktcy.)]

95 In *Marsil Mechanical v. A Reissing-Reissing Enterprise Ltd.* (1996), Kirsh's C.L.C.F. 78.40 [1996 CarswellOnt 301 (Ont. Gen. Div.)], Klowak J. said:

> In considering the definition of 'advance' it seems to me that, for purposes of the *Construction Lien Act*...it must mean when the owner, or the owner's delegate, acquires actual control of the money.

96 Accordingly, I find there was no advance under the mortgage from 109 to GECC and, therefore, the lien claimants have priority pursuant to section 78 of the *Construction Lien Act*.

Conclusion

97 KPMG Inc., trustee in bankruptcy of 109, filed a statement of defence in this action but did not participate in the trial for obvious reasons. Representatives of 109 and Euro United were not called as witnesses by the participating parties. The issues dealt with the relationship between those corporations and GECC and, as well, the lien claimants. The plaintiffs were able to establish their case based upon the documents and oral testimony.

98 In many respects, GECC required testimony of representatives of 109 and Euro United. Although there was sufficient evidence for the findings made, there is a strong argument to also rely on findings of adverse inference as against GECC for failure to call these witnesses.

99 One theme was central to all issues in this litigation; that is, GECC's failure to perform its usual and customary due diligence investigation with respect to 109. There was no satisfactory answer for this neglect. GECC is a sophisticated lending institution. It normally performs due diligence. Was its failure to do so an oversight or was GECC scrambling to gain additional security for a customer they knew was on the edge of failure?

100 It would be unconscionable and inequitable to allow a mortgagee to obtain priority based upon its willful blindness or negligence. Even the simplest of investigations would have revealed the construction project and led GECC to make further inquiry. They would easily have determined Mr. Rehani was not being truthful.

101 A due diligence investigation would, in my view, have led GECC to decide against mortgage security on the Dielcraft property.

102 A trial of issues was directed to determine the priority as between the lien claimants and the mortgagee. There were secondary issues that arose during the trial pertaining to the validity and quantum of some liens. Those issues were beyond the scope of the trial.

103 In result, the plaintiffs are entitled to a declaration the lien claimants have priority over the mortgage from 109 to GECC, subject to proof as to validity and quantum of the liens for which a further trial, if necessary, is directed.

104 If the parties cannot agree on the issue of costs, written submissions are required. The party seeking costs shall serve such submissions within 28 days of the release of this decision. The responding party shall have 14 days to serve submissions and a further 7 days is allowed for reply. All written submissions are to be filed by the last day for reply.

Action allowed.

Footnotes

* Additional reasons at (2003), 2003 CarswellOnt 1316, 41 C.B.R. (4th) 315 (Ont. S.C.J.) .

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TREZ CAPITAL LIMITED PARTNERSHIP - and - **and COMPUTERSHARE TRUST COMPANY OF CANADA**
Applicants

WYNFORD PROFESSIONAL CENTRE LTD. and GLOBAL MILLS INC.
Respondents

Court File No. CV-14-10493-00CL

ONTARIO
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Proceedings Commenced at Toronto

FURTHER SUPPLEMENTARY MOTION RECORD

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