

# focus

## on Financial Services



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### IBC STANDARD MORTGAGE CLAUSE ESSENTIAL

The Supreme Court of Canada has decided that an insurance company cannot void coverage afforded to a mortgagee if the mortgagee fails to notify the insurer that a property has been vacated by the mortgagor. In *State Farm Fire and Casualty Co.*, the insurer denied coverage to mortgagees because they did not advise the insurer that the owners of the insured house destroyed by fire had vacated the property after the mortgagees commenced power of sale proceedings.

The insurer pointed out that the policy contained a provision permitting the insurer to void or amend the insurance contract based on any material change to the insurer's risk within the control and knowledge of the insured, unless the insurer was promptly notified in writing of such change. The insurer argued that this provision required the mortgagees to report the vacancy to the insurers. **The Court found that the Insurance Bureau of Canada ("IBC") standard mortgage clause superseded all other conflicting terms, including the term requiring the mortgagees to give notice of the vacancy to the insurer.** The IBC standard mortgage clause provides that the insurer will not terminate or alter the policy to the detriment of the mortgagee without providing the mortgagee with the prior stipulated written notice.

The Court reasoned that the provision allowing the insurer to void coverage could not be reconciled with the IBC standard mortgage clause, which provided that the mortgagees' coverage would remain in force despite any act of the mortgagor, including the act causing the material change to risk – the mortgagor's vacancy. The case

underlines the importance to mortgagees of ensuring that a mortgagor's insurance policy includes the IBC standard mortgage clause.

If you would like more information on this case, please contact Lori Lyn Chanda of our Toronto office at (416) 863-4543.

### GUARANTOR'S LIABILITY UPON A MORTGAGE RENEWAL

The Ontario Court of Appeal has upheld a finding of a guarantor's liability for a shortfall following the mortgagee's sale of property, despite the fact that the guarantor did not consent to a renewal of the mortgagor's loan. In *AGF Trust Company v. Muhammad*, the mortgagor's wife guaranteed payment of the mortgage after receiving independent legal advice. At maturity, the mortgagor agreed to renew the mortgage loan at a reduced rate of interest. It was a condition of renewal that the guarantor consent to the renewal. The mortgagor's wife refused to consent and the mortgagor forged her signature on the renewal document. The mortgage subsequently fell into arrears and the mortgagee sold the property and claimed the shortfall from the mortgagor's wife in her capacity as guarantor.

**The Court found that the guarantor's consent to the renewal was not necessary because the guarantee clause in the mortgage contained clear and unambiguous language binding the guarantor until the monies originally advanced were paid in full.** The forgery was irrelevant because her consent to a renewal was not required.

The Court rejected the guarantor's argument that the guarantee clause applied only to extensions and not renewals of the credit facilities. In a similar case, inconsistency between the guarantee provisions and mortgagor renewal provisions led the Court to determine that the guarantee applied only to extensions and not renewals, and judgment against the guarantor was set aside. Because there was no inconsistency in the wording of the mortgage in *AGF Trust Company v. Muhammad*, liability under the guarantee continued in either event.

If you would like further information on this case, please contact Natasha Wong of our Toronto office at (416) 863-4495.

#### **BANK LIABILITY FOR CHEQUE PAYMENT ERRORS**

Two recent fraud cases demonstrate that courts are attributing a higher degree of responsibility to banks for payment of cheques. These cases relate to the tort of conversion, which can arise where a bank makes funds available to someone other than the person rightly entitled to possession of the funds, or where a bank processes a cheque under the direction of an unauthorized person.

In *Zellers Inc.*, the Ontario Court, General Division, held a bank liable for honouring a cheque issued to joint payees that was endorsed by only one of the payees. The court stated that, except in limited circumstances, the *Bills of Exchange Act* (the "BEA") requires all payees to which a cheque is issued to endorse the cheque before the bank may negotiate it, unless one payee has authority to endorse for the others. The payees listed on a cheque will be presumed to be joint payees unless there is clear and unambiguous evidence to the contrary.

In *Westboro Flooring*, an employee defrauded his employer by depositing corporate cheques payable to a valid (albeit former) supplier into an account opened by the employee in a name *similar* to the name of the supplier. The Ontario Court of Appeal found the depositing bank liable for the tort of conversion noting in its decision that none of the cheques were endorsed by the payee and the name of the payee on the cheques did not match up with the name used by the employee to open the account.

Although they were not successful in these cases, limited defences to the tort of conversion, as outlined in the Supreme Court of Canada decision *Boma Manufacturing*, are available to a bank. One such defence is the "fictitious payee" argument. Whether a payee is fictitious ultimately depends on whether the drawer of the cheque intended for the named

payee to receive payment. If a cheque is made payable to a fictitious payee (that is, a payee which does not exist), the cheque may be treated as payable to bearer and negotiated without endorsement by simple delivery to the bank. A bank may also be able to argue the "holder of course defence" if, despite no endorsement, the person delivering the cheque to the bank is a legitimate payee or endorsee. A third possible defence available to a bank is that the drawer of the cheque did not submit written notice to the bank within one year after learning of a forged endorsement on its cheque.

If you would like further information on these cases, please contact Jeffrey Smolkin of our Toronto office at (416) 863-4763.

#### **SEMINARS AVAILABLE ON LENDING AND INSOLVENCY ISSUES**

The Toronto office Financial Services Group has developed a series of seminars that may be of interest to our clients. The seminars are geared toward those working in the financial services industry who do not have a legal background.

The range of seminar topics includes: loan agreements and commitment letters, personal property security and priorities, real property security, security in Quebec, derivatives, tax issues in lending, cross-border lending issues, standstill and monitoring agreements, sale of real and personal property under security and sale of distressed debt. Other topics of special interest are also available upon request.

We encourage you to contact us if you are interested in having us attend your office or function or, alternatively, attending our offices for a seminar. Please contact Natasha Wong at (416) 863-4495 or any lawyer in our Toronto office to arrange a date and time.

#### **WHO AND WHAT IS NEW AT FMC?**

Lori Lyn Chanda and Natasha Wong have taken over as co-editors of the *Focus on Financial Services* newsletter. We invite our readers to give us their comments or suggestions on the newsletter. The sender of the best comment or suggestion, in the opinion of the editors, will be entitled to their choice of a round of golf, spa service or lunch with the FSG lawyer of their choice. Please send any comments in an email addressed to [natasha.wong@fmc-law.com](mailto:natasha.wong@fmc-law.com).