

focus

on Financial Services



FRASER MILNER CASGRAIN LLP

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THE DANGERS OF UNDUE INFLUENCE

In the recent *Rowatt* case, the Ontario Court of Appeal reminded lenders that they should be very careful when taking a guarantee from a borrower's spouse. In *Rowatt* the husband had taken out a loan to finance his mortgage investment business. Mrs. Rowatt signed a guarantee of her husband's loan and a collateral mortgage on the matrimonial home which was registered in her name. The guarantee and mortgage were later replaced with a conventional mortgage for a higher principal amount. Mr. Rowatt went bankrupt. When Mrs. Rowatt eventually stopped making payments on the conventional mortgage, the lender sued to enforce the mortgage. At trial, the court said that the lender could enforce the mortgage against Mrs. Rowatt.

Mrs. Rowatt appealed the trial decision. She claimed that since the lender took no steps to ensure that she fully understood and freely entered into the mortgage, the mortgage should not be enforceable against her. The court discussed the concept of undue influence in transactions involving spouses (or those in like relationships). The court said that a lender is put on notice and inquiry when one spouse is guaranteeing the debts of the other. Therefore, **the lender must take reasonable steps to try to ensure that the guarantor spouse understands the transaction and is entering into it freely.** If the lender fails to take those reasonable steps, it is presumed that the spouse benefitting from the guarantee had undue influence over the guarantor spouse. This is based on the relationship of the parties and the disadvantage to the guarantor spouse. In *Rowatt* there was sufficient evidence to show that Mrs. Rowatt understood the mortgage and entered into it freely, so the lender was entitled to enforce the mortgage.

If you would like to discuss the presumption of undue influence, the steps a lender should take when dealing with a borrower's spouse, or the *Rowatt* case, please contact **Heldi Clark** of our Toronto office at (416) 863-4626.

INVENTORY CREDITORS: DO YOU KNOW WHERE YOUR PROCEEDS ARE?

Are you a supplier of inventory to a debtor in Saskatchewan? If so, you should check very closely the type of account into which the debtor is depositing its inventory sale proceeds. In *GE Capital*, a Saskatchewan court confirmed that any proceeds deposited by the debtor into an operating account that has a negative balance will be considered as payments by the debtor of that account debt. It does not matter that an inventory supplier may have a perfected security interest in the inventory and its proceeds.

In *GE Capital*, the debtor had an operating line of credit with a bank. The operating line of credit never attained a positive balance. The debtor was a farm equipment supplier. GE Capital supplied farm equipment to the debtor for resale. The debtor deposited the equipment sale proceeds to the line of credit account for the purposes of crediting the proceeds against the outstanding balance of the operating line of credit (in effect paying a debt). **As a result of language in the Saskatchewan *Personal Property Security Act*, and even though the bank may have been aware of the security interest of GE Capital, the bank took priority over GE to the proceeds.**

There is an equivalent provision in the *Alberta Personal Property Security Act*. However, to date there has been no consideration of this section by an Alberta court. There is no equivalent provision in the *Ontario Personal Property Security Act*.

If you would like to discuss this case, please contact **Stephanie Campbell** of our Calgary office at (403) 268-7186.

THE IMPORTANCE OF BEING PERFECT

In the recent B.C. case of *A and R Rent A Benz Ltd.*, the court dealt with the **priorities between the crown attempting to seize personal property as part of a criminal investigation and a bank as a secured creditor of the accused's company.**

Undercover police officers arrested P. and T. (the suspects) after they purported to sell the officers narcotics. The suspects arrived for the transaction in a car owned by A and R. The car was seized upon the arrest. At the time of the arrest, T. was the sole director and officer of A and R. The bank had a registered GSA securing a loan to the company. The loan was in default.

All parties to the proceedings agreed that the bank had a valid security interest in the vehicle. It was perfected by registration three months before the criminal activity took place.

The Crown said that if it couldn't take the car ahead of the bank, that would indirectly allow the company to profit from the crimes of its sole director by reducing the company's indebtedness to the bank. The court disagreed. The bank had an interest in the vehicle as security for an existing obligation. To award the bank possession of the vehicle would simply even the slate since nothing new would be gained by the company. The bank came to the proceedings with "clean hands". Because its loan was in default it was entitled to possession of the vehicle and all the vehicles in the company's inventory. They were collateral under the GSA.

The court also said the Crown could not seize the vehicle because there was no evidence that the vehicle was purchased with stolen money or drug money. In addition, the Court recognized the strong policy reasons for protecting those who have legally enforceable security interests in personal property in such circumstances.

This case is a reminder to secured parties to ensure that perfection of their security interests occurs as early as possible in order to preserve their priority. If the bank had not been diligent in ensuring that perfection occurred as early as possible, their registration might have occurred after the criminal activity took place and the court may have allowed the Crown's application.

If you would like further details on this case or on issues relating to the perfection of security interests, please contact **Janelle Dwyer** of our Vancouver office at (604) 622-5163.

NEW 2002 ISDA MASTER AGREEMENT

Since our last newsletter which touched on this subject (Issue No. 57), interest in the new Master Agreement has been gaining momentum and our offices have been busy responding to client inquiries. There has also been an excellent response to client specific presentations on the new Master Agreement. Over the next several weeks the Toronto,

Montreal and Calgary offices will be making presentations to many of our derivatives clients.

If you are interested in arranging for a presentation on the new Master Agreement, or on other derivatives issues, please contact any of the following people: **Tom Pepevnak** in our Calgary office at (403) 268-7198; **Russ Kowalyk** in our Toronto office at (416) 862-3478; **David Zacks** in our Vancouver office at (604) 443-7149; **Robert Turner** in our Edmonton office at (780) 423-7226; and **Allan Mass** in our Montreal office at (514) 878-8813.

WHO AND WHAT IS NEW AT FMC:

Donald B. Houston is joining FMC as a partner in our Toronto office. Don practises in the area of competition law and litigation with particular emphasis on competition matters. Don is recognized in several publications, including: International Who's Who of Competition Law, World's Leading Competition and Antitrust Lawyers, Chamber's Guide to the World's Leading Lawyers and the LEXPERT directory.

Randy Hughes (Competition law), Co-Chair of the firm's National Competition Law Practice Group, recently presented at a National Insight Conference entitled "Canada's Changing Competition Regime". Randy co-presented in a session entitled, "*Efficiencies and International Implications: Superior Propane*".

Jamie Knight (Employment and Labour) recently presented at the "Workplace Privacy Conference 2003" presented by University of Toronto and Lancaster House Publishing on "*Employee Medical Information: statutory requirements, best practices*."

WHAT WE'VE BEEN DOING IN FINANCIAL SERVICES:

Here are just some of the recent transactions on which our various offices across Canada have worked:

- A co-operative effort between our Toronto and Calgary offices in assisting to establish a natural gas trading program for a leading Canadian financial institution
- Advising on Canadian legal issues (including advice on key insurance and transportation related matters) affecting the pledge of precious metals by an international refining company as security for a credit facility established by a large European-based financial institution
- Assisting a large U.S. based bank through its branch operation in Canada with a \$50,000,000 warehousing facility for a large European-based manufacturer of automobiles to help facilitate, among other things, the introduction of a new line of products to dealers across Canada