THE LAWYER'S DAILY

The Lawyer's Daily | 111 Gordon Baker Road, Suite 900 | Toronto, ON M2H 3R1 | www.thelawyersdaily.ca
Phone: (800) 668-6481 | Fax: (905) 479-3758 | John.Carson@lexisnexis.ca

Real Estate

Courts won't be fooled on equitable subrogation in a mortgage context

By **Ray Mikkola**

Ray Mikkola

(March 23, 2018, 8:57 AM EDT) -- Subrogation is the legal principle pursuant to which a person may have the right to accede to the rights of another. For example, when an insurer pays a claim of the insured, the insurer may be subrogated to the rights of the insured for the purpose of making any claim which the insured could have made against any other party. In a mortgage context, subrogation allows a person who pays out a mortgage to be entitled to the benefits of the mortgage. Because typically the mortgage has been discharged, the rights of the person are available only in equity.

The principle of equitable subrogation was recently considered in *L-Jalco Holdings Inc. v. Beverly Ann MacPherson* 2017 ONSC 4055, a decision of Justice Graeme Mew on a motion for summary judgment brought by the defendant. The property was the subject of two mortgages: a first mortgage in favour of Dwight Powell in the amount of $499,070.73 and a second mortgage to MacPherson for $49,900. MacPherson had postponed her mortgage to the Powell mortgage.

In 2008, the owner asked MacPherson to postpone her second mortgage to L-Jalco, who it was proposed would become a new first mortgagee. The details and identity of the new first mortgagee were not set out. She refused to postpone. Despite her refusal, the owner gave L-Jalco a new mortgage, the proceeds of which were used to pay out the Powell first mortgage together with property tax arrears of about $75,000. The L-Jalco mortgage was registered for the original principal amount of $1,100,000. It included other properties of the owner, and it stipulated for a much higher rate of interest than the Powell mortgage. L-Jalco paid out the Powell mortgage which was discharged.

The owner defaulted on the L-Jalco mortgage, and the property was sold under its mortgage. On closing, MacPherson delivered a discharge of her mortgage, assuming that she would be paid out. When she was not, litigation ensued as to the respective entitlement of L-Jalco and MacPherson to the sale proceeds. She brought a motion for summary judgment. L-Jalco argued that it was unaware of the Macpherson mortgage, but that in any event it was entitled to priority over the MacPherson mortgage as it had provided the funds to pay out the old Powell mortgage, thereby claiming equitable subrogation.

The court refused to apply equitable subrogation and granted judgment to MacPherson, holding as follows:

- Equitable subrogation will not be ordered if it results in an injustice. In this case, the court found that MacPherson had expressly refused to postpone her mortgage and that L-Jalco "consciously elected" not to pay her out and "knowingly took the risk of not addressing another secured party's prior charge". The judge rejected L-Jalco's submission that it was only through inadvertence that a discharge or postponement of the MacPherson mortgage had not been obtained and registered;
- L-Jalco's awareness of the MacPherson mortgage could be "deemed" knowledge through its agents;

- The higher interest rate in the L-Jalco mortgage would have "depleted the borrower's resources to a greater degree than the Powell Mortgage". L-Jalco went into possession of the property, collected rents, proceeded against the guarantors, and issued the notice of sale, all without notice to MacPherson who, the judge found, was under the impression throughout that her "mortgage was secure". By the time MacPherson found out what had happened, the court noted that it was "… too late. The cupboard was bare, cleaned out by the plaintiff". These findings countered the argument that subrogation, if ordered, would not have prejudiced MacPherson as her mortgage was already subject to the Powell mortgage; and
- Although this was MacPherson's summary judgment application, L-Jalco had the onus of establishing its entitlement to the availability of equitable subrogation.

Interestingly, the court did not consider, and it appears that no argument was put forward regarding, the possible application of the doctrine of marshalling. This could have entitled MacPherson to "piggyback" on the L-Jalco blanket mortgage on other properties also owned by the owner. The court was not prepared to put L-Jalco in the same position it would have been had it taken an assignment of the Powell mortgage or to award L-Jalco super priority status for having paid out the property tax arrears.

Clearly, an applicant for equitable subrogation must come to court with "clean hands." While applicants for equitable subrogation are not disentitled to a remedy by reason of their inadvertence or mistake (indeed, inadvertence and mistake are common in equitable subrogation cases), a court will not look favourably upon a party which embarks on a course of conduct apparently designed to compel a court to apply an equitable remedy. The court specifically held that equitable subrogation should be denied where a party knowingly takes the risk of not dealing with a prior charge.

Ray Mikkola is a partner with the firm of Pallett Valo LLP.

Photo credit / sorbetto ISTOCKPHOTO.COM