

# Real Estate Fraud in Ontario



## Judges rarely speak out on today's hot topics.

A recent exception: Justice Randall Echlin in *Rabi v. Rosu*,<sup>1</sup> declaring "Ontario is currently experiencing a serious mortgage fraud plague."<sup>2</sup>

What triggered that plague? Ontario's way of going high-tech, for starters. Unlike BC, Ontario adopted an open model of registering documents electronically. No need for deeds/mortgages to be digitally certified/signed by an authorized lawyer/Notary before hitting parcel registers.

Ontario also favoured England's *Land Transfer Act* over a true Torrens system when enacting the *Land Titles*

*Act* (the *LTA*)<sup>3</sup> in 1885. Another factor: new life for a neglected amendment. And the final ingredient: a Court of Appeal decision that sent the province into a tizzy.

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In Ontario, "the principle of deferred indefeasibility was firmly entrenched."<sup>4</sup> At common law, fraudulent documents were a nullity. Section 155 of the *LTA* echoes that. So a deed from Frankie the fraudster to Bob the buyer (Owen being the property's Real Owner) was null and void, even if Bob was "innocent."<sup>5</sup>

Same result for a fraudulent mortgage from Frankie to Bob.

But a legal fiction surrounded Bob's status in a subsequent transaction. If Charlie dealt with Bob as the supposed owner of a property, and Charlie was an innocent buyer or lender, Charlie acquired a valid deed (or an enforceable mortgage), although the deed to Bob was null and void.

What about Owen, the innocent Real Owner whose title (or equity) was stolen? With deferred indefeasibility, the twin nightmares of title theft and mortgage fraud are real.<sup>6</sup> Compounding the problem, the Land Titles Assurance Fund is a fund of last resort. Claimants must first exhaust their remedies before seeking payment.

Ontario courts recently applied deferred indefeasibility to fraudulent documents in *Durrani v. Augier*<sup>7</sup> and *The Toronto-Dominion Bank v. Jiang*.<sup>8</sup> Mortgages in both cases from a fraudulent borrower to an "innocent" lender were valid and enforceable against the Real Owner.<sup>9</sup>

1 2006 CanLII 36623 (Ont. S.C.) at paragraph 2

2 Two distinct activities are often called "mortgage fraud": (a) "title theft," where a fraudster steals a Real Owner's title, and (b) true "mortgage fraud," where a fraudster only scoops the Real Owner's equity but not his or her title. When referring to both offences, the term "real estate fraud" will be used.

3 R.S.O. 1990, c. L.5. Automating titles also involved converting them into *Land Titles* parcels. That job is about 90 percent complete. See Teranet Income Fund, Notes To The Interim Consolidated Financial Statements, September 30, 2006, page 34, available from [www.sedar.com/FindCompanyDocuments.do](http://www.sedar.com/FindCompanyDocuments.do).

4 Neave, Marcia; *Indefeasibility of Title in the Canadian Context*; *University of Toronto Law Journal*, Vol. 26, No.2 (Spring 1976), 173-192 at page 178

5 "Innocent" means *bona fide*, for valuable consideration, and without notice of the fraud. But is that notice actual or constructive? A clearer definition of "innocent" emerges from *Rabi v. Rosu*: no knowledge of a fraud after conducting reasonable due diligence. Willful blindness won't cut it anymore. Lenders will be judged by what they know, and what they ought to know. "Notice" means both actual and constructive notice.

6 An issue judicially acknowledged in *Durrani v. Augier*, footnote 9, paragraph 78

7 (2000), 50 O.R. (3d) 353

8 2003 CanLII 38078 (Ont. S.C.)

9 Compare that with *Credit Foncier Franco-Canadian v. Bennett* (1963), 43 W.W.R. 545, where the BC Court of Appeal held that a forged mortgage is a nullity and invalid against a Real Owner's title.

Ontario's *LTA* also includes section 78(4), an amendment introduced in 1960. It deems a registered document "to be effective according to its nature and intent." Section 155 expressly provides that a registered document, even if fraudulent and void at common law, is "subject to the provisions of this Act with respect to registered dispositions for valuable consideration." As Section 78(4) trumps section 155, immediate indefeasibility remained a distinct possibility.<sup>10</sup>

Matters remained dormant until November 2005 and the Court of Appeal's stunning decision in *Household Realty Corporation Ltd. v. Liu*.<sup>11</sup> From "a plain reading of s. 155 and s. 78(4)," the court ruled that fraudulent deeds/mortgages, "having been given for valuable consideration and without notice of the fraud are, once registered, effective and can be relied on."<sup>12</sup> Deferred indefeasibility was dead; long live immediate indefeasibility. Sort of, as the court pussyfooted around adopting those specific words or principles.

By eliminating one step in the validation process, immediate indefeasibility made it easier for fraudsters to strip Real Owners of their title/equity. Real Owners were more vulnerable and defenceless than ever before. Unintentionally, the Court of Appeal had sided with the fraudsters

For months the Ontario government was a deer paralyzed in the headlights. It ignored the simmering public backlash until fraudulent transactions involving innocent Real Owners like Susan Lawrence, Elizabeth Shepherd, and Paul Reviczky became media darlings in Summer 2006. To quell the uproar, Minister of Government Services Gerry Phillips tabled Bill 152<sup>13</sup> (*Ministry of Government Services Consumer*

*Protection and Modernization Act*) on October 19, 2006.

But that move reeked of desperation. A month earlier, opposition MPP Joseph Tascona had upstaged him by stick-handling a private member's bill on real estate fraud through second reading. (Disclosure: I was a consultant on Tascona's Bill 136,<sup>14</sup> *Restore the Deed Act*.)

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Bill 152 would define "fraudulent person" to include forgers, fraudsters, and fictitious persons, and "fraudulent instrument" (a document where "a fraudulent person purports to receive or grant an estate or interest in land"). It also would reverse the Court of Appeal decision in *Household Realty*.

Quoting from Bill 152's explanatory notes, "a fraudulent instrument will not have any effect on the title register. Instruments registered subsequent to a fraudulent instrument are deemed to be effective." By reinstating deferred indefeasibility, Real Owners could again be victimized by a title rip-off or could be stuck with a mortgage they never signed.

What would Bill 136 do differently?

1. Grant only specified real estate professionals licensed access onto the electronic registration system
2. Have written notices sent to Real Owners and lenders once documents are registered,

following the Saskatchewan model.<sup>15</sup>

3. Let registrars refuse registrations that "may prevent fraud," as in New Brunswick<sup>16</sup>
4. Issue Personal Identification Numbers to Real Owners and lenders. Their use would be a precondition to registration.
5. Recast the Land Titles Assurance Fund as a fund of first resort. Until then, Justice Echlin warned in *Rabi v. Rosu*, "victims of the system are essentially re-victimized."<sup>17</sup>
6. Require a signed original Power of Attorney (plus a witness's affidavit) for land transactions, similar to Alberta<sup>18</sup>
7. Cancel fraudulent deeds and mortgages, plus all subsequently registered documents that are dependent for their validity on a fraudulent instrument, even if a subsequent buyer or lender was innocent. Both immediate and deferred indefeasibility would be replaced by "no-fraud" indefeasibility. Title would be restored to the Real Owner in its pre-fraud state, even retroactively. Real Owners would not lose their titles to fraud or find them encumbered by mortgages they never signed. Given those high-profile media cases and the recent surge in title insurance applications by existing homeowners, this alternative seems to have public support.

Issuing unqualified title opinions under no-fraud indefeasibility could be very difficult, because title interests would be subject to cancellation in the face of a prior fraud. But parcel registers in Ontario aren't a complete and accurate mirror of the current state of title.

<sup>10</sup> See footnote 4

<sup>11</sup> 2005 CanLII 43402 (Ont C.A.). For some inexplicable reason, a similar decision of the Ontario Court of Appeal, *R.A. & J. Family Investment Corp. v. Orzech*, 1999 CanLII 3739 (Ont C.A.), received no notoriety for 6 years.

<sup>12</sup> See footnote 11, paragraph 43

<sup>13</sup> Available at [www.ontla.on.ca/documents/Bills/38\\_Parliament/session2/b152.pdf](http://www.ontla.on.ca/documents/Bills/38_Parliament/session2/b152.pdf)

<sup>14</sup> Available at [www.ontla.on.ca/documents/Bills/38\\_Parliament/session2/b136.pdf](http://www.ontla.on.ca/documents/Bills/38_Parliament/session2/b136.pdf)

<sup>15</sup> Land Titles Regulations, 2001, R.R.S. 2000, c. L-5.1, Reg. 1 section 22

<sup>16</sup> *Land Titles Act*, S.N.B. 1981, c. L-1.1, section 36

<sup>17</sup> See footnote 1 at paragraph 51

<sup>18</sup> *Alberta Registries Land Titles Procedural Manual* POA-1 issued 2004-11-15, page 2

With so many statutorily approved unregistered overriding interests,<sup>19</sup> the mirror has cracks.

Also, fraud has long been recognized as a nonstatutory overriding interest in the *LTA*. Chief Justice Bora Laskin of the Supreme Court of Canada acknowledged that in *United Trust Co. v. Dominion Stores Ltd.*<sup>20</sup>: “Fraud is, of course, an exception to the integrity of the register under the Ontario Act.”

Days before public hearings were launched on Bill 152, Minister Phillips proposed “three additional steps”<sup>21</sup> to combat real estate fraud:

- a) streamline the Land Titles Assurance Fund (without saying “fund of first resort”);
- b) allow only lawyers to register deeds electronically. Parties like

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19 Section 44 of the *LTA*

20 [1977] 2 S.C.R. 915 at paragraph 67

21 Letter from Minister Gerry Phillips to the Standing Committee on Social Policy, dated November 22, 2006

title insurers must satisfy criteria that’s yet to be set, to register mortgages and other documents;

- c) strengthen current standards on Powers of Attorney.

**Unlike most crimes, real estate fraud produces two innocent victims: Real Owners and buyers.**

Unlike most crimes, real estate fraud produces two innocent victims: Real Owners and buyers. Legislators then face a tough policy choice. In a battle of innocents, which “innocent” will the law favour? Which “innocent” is more innocent, an innocent Real Owner or an innocent buyer? The answer to that question will ultimately decide the indefeasibility issue.

Mr. Justice Echlin understated the problem. Ontario is actually suffering from two plagues today—the mushrooming crisis of real estate fraud

and a chaotic state of the law.

**Note:** As of November 30, 2006, a decision is pending on Susan Lawrence’s appeal (reconsidering the *Household Realty* case); Bills 136 and 152 are stuck at second reading; and Minister Phillips’ “additional steps” are simply proposals. Updated information will be provided in a future edition. ▲

**Alan G. Silverstein** is one of Canada’s best-known real estate lawyers. Certified as a Specialist in Real Estate Law by the Law Society of Upper Canada, Alan has written five books and hundreds of articles on real estate. A frequent guest on radio and TV, he is regularly quoted by the print media. Alan is also an elected Bencher at the Law Society of Upper Canada. After 29 years in private practice in the Toronto Area, Alan joined Emergis Inc. in March 2006 as Director, National Legal Engagements, to head up the adoption of the Assyst Real Estate mortgage software by real estate lawyers and Notaries.