



RealEstateBrief

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In This Special Issue

In this special issue, Bruce McKenna reviews issues arising from real estate fraud and the potential for title insurance to provide protection to property owners. There have been a number of examples of fraud covered recently in the press and some matters have gone to trial. Bruce reviews some of these fact situations and decisions.

Real Estate Title Fraud – Is Title Insurance The Answer?

Introduction

As real estate lawyers, we are often asked about real estate fraud and whether or not our clients ought to purchase title insurance for their own properties. Our clients see numerous advertisements and promotions by the title insurance industry emphasizing the fraud protection that a policy can deliver. Obviously, there is no general answer to that question, other than to give the most conservative advice, which is that a residential title insurance policy does provide some fraud protection which an owner does not get from other sources. So, if you are unconcerned about the cost, get your lawyer to do a title search and purchase a title insurance policy. However, clients do not want to spend money unnecessarily, so it is important to review the specific facts before giving advice. What I can do in this *Brief* is describe what a particular real estate lawyer, who knows a lot about title insurance and about his Toronto home, would do.

Purchasing a Property

If our real estate lawyer were purchasing a house he or she would always title insure. There are a series of matters which are covered by a title insurance policy that deal with events that occur after the date of the purchase. These include fraud and forgery after the policy date, matters that are obviously not protected by the lawyer's usual title opinion given effective as of closing. There may also be some cost savings that can be achieved from title insurance (as the title insurer will give

protection for survey matters and some unregistered rights without requiring a survey and certain off-title inquiries). However, as the real estate lawyer is aware of what the policy covers and that a title insurance policy is not a guarantee but an indemnity, he or she would want to have their lawyer investigate closely any matters that were material to the use and enjoyment of the property to be purchased.

For example, we recently dealt with people who had bought a property that was much smaller than they thought it was when looking at the site (a fenced area backing on a ravine was not part of the title to the purchased lot). It was the smaller lot and not the larger fenced area that was actually purchased and title insured. The purchasers' lawyer had needed to examine a survey and discuss it with the purchasers to ensure that the purchasers were actually getting what they thought they were buying. On the specific facts, the title insurance survey coverage did not assist.

In another case, a client thought it was getting parking spaces for two cars at the purchased property and the policy did cover that. However, while the title insurer indemnified the client – offered compensation for the lower value due to the loss of the parking space – it was not obliged to obtain the second parking space, even though that was something which materially affected the property's use and enjoyment. Understanding what a title insurance policy covers and does not cover is important.

Your Current Property

How do you go about deciding whether you should obtain title insurance coverage when you already own your property?

Those who do not like the product make the following argument. Virtually all property in Toronto and well more than half of the property across Ontario is now registered under the *Land Titles Act*. Once title is recorded in a Land Titles parcel register, it is set and cannot change. There is no adverse possession or possessory rights under the *Land Titles Act*, so essentially you can only lose an interest in your property from this date forward in certain limited ways specified under the *Land Titles Act*. As well, the *Land Titles Act* has Section 155, which expressly provides that any registered disposition or mortgage that if unregistered would be fraudulent and void is, despite registration, still fraudulent and void. On top of that, there is a Land Titles Assurance Fund (the “Fund”) to deal with mistakes. So why would you even consider title insurance?

The opposing view is that a residential title insurance policy provides coverage after the date of the policy for forgery where someone else claims an interest in or a lien against the property. That clearly covers the real estate fraud we are reading about in the newspapers – forgery or identity fraud where someone purports to be the owner and then conveys the property to him or herself or a third party or mortgages the property. In addition, a title insurance policy, as an indemnity insurance policy, includes a duty to defend your title – to deal with the litigation related to such fraud. With title insurance you will not have to pursue any action yourself and then make a claim against the Fund. As well, since the *Land Titles Act* guarantees the title shown on its Parcel Register, if an innocent purchaser or mortgagee obtains an interest in the property after a fraud, it is protected. A true owner can lose his title or be subject to a mortgage under the *Land Titles Act* after a fraud.

When would the real estate lawyer with extensive experience with title insurance purchase a title insurance policy on an already-owned property to take advantage of that coverage? To understand we need to discuss the case law a bit.

Fraud Risk Under the *Land Titles Act*

I will run through a few cases that have been decided under the *Land Titles Act* in the last decade. These give an impres-

sion of the likely result that the innocent owner faces in the case of fraud.

The first is *Durrani v. Augier*, (2000) 50 O.R. 3rd 353. There, the Durrani owned and occupied a house. Augier forged a collateral loan agreement which was registered against the property under the *Land Titles Act* and fraudulently obtained a default foreclosure judgment and writ of possession. Augier used a real estate agent in attempts to sell the property and when those attempts failed (because the legitimate purchasers could not visit the property that was occupied by the Durrani), the property was sold to the children of the real estate agent who registered a mortgage in favour of a bank, hiding the true circumstances from the bank. The court concluded that the conveyance to the children by Augier was

void as it was fraudulent and that the purchaser was not a *bona fide* purchaser for value without notice. However the court concluded that the bank, as a *bona fide* mortgagee for value without notice, had a valid mortgage against the property. The court directed the bank to stay enforcement proceedings and to apply to the Fund for compensation (i.e. funds to pay off the mortgage). The court directed the Registrar to restore the Durrani’s title.

The fraudulent technique used in *The Toronto-Dominion Bank v. Jiang*, (2003) 9 R.P.R. 4th 114 was very similar except that Jiang registered a fraudulent transfer, purportedly from the owners who occupied the property, the Shins, and then put on a mortgage

in favour of The Toronto-Dominion Bank. Following the Durrani case, the court concluded that the transfer was void and title was to be rectified to be put in the Shins name but that The Toronto-Dominion Bank mortgage was valid. In this case the action of The Toronto-Dominion Bank was not stayed and the court acknowledged that the risk that the bank might claim for possession lay with the Shins until they had received sufficient payment under the Fund to pay the balance owing under the mortgage.

The third case was the slightly earlier one of *R.A. & J. Family Investment Corporation (“RA”) v. Orzech*, (1999) 44 O.R. 3rd 385. RA had a valid mortgage which was fraudulently discharged and a new mortgage was given to a bank.

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The property was later sold under a power of sale by the bank and then mortgaged by the new owners to a new first mortgagee. The property was then mortgaged to a trust company and the existing first mortgage was fraudulently postponed to this new trust company mortgage. The court held that while RA's mortgage was fraudulently discharged, the bank got a valid mortgage and the conveyance of title by the bank was effective, with RA having a claim against the original borrower and/or the Fund. Similarly, while the postponement was a forgery, the trust company was a *bona fide* mortgagee for value and the former first mortgagee therefore only had a claim against the Fund. Accordingly, the trust company was entitled to the net proceeds of sale of the property.

The final case is a more recent Ontario Court of Appeal decision in *Household Realty Corp. v. Liu*, (2005) OJ No. 5001, which affirmed the earlier decision in *CIBC Mortgages Inc. v. Chan*, 20 R.P.R. (4th) 151. In this case, Liu and his wife, Chan, owned a property as joint tenants. Liu was out of the country on business for extended periods of time. Chan forged Liu's signature on a Power of Attorney and then used it to register a mortgage in favour of a bank and later Household Realty. The lower court held that both mortgages were valid under the *Land Titles Act*. After the lower court decision, there was some argument by commentators that the *Land Titles Act* should not validate the mortgages because they were not properly signed by the "registered owner," but the Court of Appeal held that the bank and Household Realty, who did not participate in the fraud, were *bona fide* mortgagees for value and were entitled to have their mortgages declared valid. Mr. Liu was left with his property subject to the mortgages he had not signed.

The result of these cases is that an "innocent" purchaser or lender's interest is valid even if obtained pursuant to a fraud, and a fraudulent purchaser or lender's interest is invalid. A lender or owner whose interest is lost or encumbered to an "innocent" purchaser or lender by a fraud must look to the person who committed the fraud and then the Fund for compensation.

In each case, the innocent owners, the Durranis, the Shins and Liu, were in the position that their interest was subject to mortgages and were left with making a claim against

the Fund for their monetary loss. The Lenders, RA and the Trust Companies, lost their security and needed to look to the Fund. While I am pretty comfortable that the Durranis, the Shins, RA and the trust company would be entitled to compensation, it is clear that the Land Titles Assurance Fund is a fund of last resort and the harmed owner or lender would need to pursue all other remedies before they would be entitled to compensation. That process takes some time and expense. While it can be appealed, a claim against the Fund is not guaranteed to be successful and there is discretion in the Director of Titles to make decisions about the appropriateness of the claim and the costs to be compensated.

An example of that is the *Syvan Developments Limited* ("Syvan") and *First American Title Insurance Company* decision of the Deputy Director of Titles in October of 2005. There

was a clear error made when bringing the property into Land Titles which showed the property as having the benefit of a right-of-way. That right-of-way had been previously discharged when the property was recorded under the registry system, a discharge that was missed when the Land Titles Parcel Register was created. However, the Director concluded that Syvan was not entitled to compensation because Syvan (or his lawyer) should have discovered that the right-of-way was actually physically blocked by a ramp and made further inquiries. Clearly Syvan could not rely on the parcel register without checking further.

I can see the Fund denying a claim by Mr. Liu, holding that the fact that Chan used a fraudulent Power of Attorney to sign the mortgages leaves a claim by Liu against Chan, not a claim against the Fund. I am unsure if the Fund would pay even if Chan was declared bankrupt, considering the fraud to be a "family" problem.

Conclusion

We have seen an example recently where owners leased their property and the tenant fraudulently conveyed title to himself and then sold the property to a third party. The innocent third-party purchaser visited the property when submitting an offer and the purchaser even took possession and occupied the house for a period of time after closing. Based on the case law the pur-

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chaser and lender would be entitled to maintain their interests as a *bona fide* purchaser and mortgagee for value without notice. The innocent original owners would have to make a decision based on a determination as to whether the Fund would insist that the original owners fight the declaration requested by the mortgagee and purchaser that their current title be confirmed. The case law indicates the original owners would not likely succeed. If the original owners did fight, would they be entitled to their lost costs? Obviously that is a tough position for the original owners, the innocent victims of a fraud, to be placed.

There is no question that the obligation of the title insurer to defend the insured's title would deal with those costs and decisions in any event, and there is merit in an existing owner of property buying title insurance against the risk. However, the particular real estate lawyer in question would not buy title insurance himself as long as he or she remains in occupation with a clearly identified ownership and no unusual title dealings. The risk of fraud is minimal, a purchaser would find it almost impossible to be "innocent" and the real estate lawyer is not particularly intimidated by the possibility of litigation or disputes. However, if the real estate lawyer lived in Florida for six months of the year and/or leased the property, he or she would purchase a title insurance policy to avoid the added disadvantage that title to the property could be lost as a result of a fraud. When occupancy is given up, unless you are very scrupulous and extremely comfortable with the persons who are occupying the property, the risk of fraud increases. There is a shift from the risk being remote to the property becoming a possible target for fraud. In those cases purchasing title insurance is prudent.

It should be noted that while I have emphasized possible difficulties with the Fund, there are also potential difficulties

with a claim under a title insurance policy. It is only an indemnity, so you will get paid for your loss, not get to keep your property, and a title insurer is not obligated to pay an insured until all litigation has been finally concluded. In fact, the 2005 *Syvan* and *First American Title Insurance Company* claim suggests a strong reason for a title insurer to delay payment until the entire process is completely finished. In that case, even though it was not necessary to reach the conclusion because the claim of Syvan had been denied, the Deputy Director of Titles also concluded that a title insurer was not entitled to bring a subrogated claim after having paid the owner of the property. That decision was made on the basis that, since the Fund is a fund of last resort, if Syvan had already received compensation from First American Title Insurance Company it was not necessary for the Fund to pay Syvan. I think that is a bad decision, that everyone should be entitled to rely upon the Land Titles system and, in my view, the Fund must have been making other payments on subrogated claims over the years to entities such as CMHC and GMAC. However, that decision will make it difficult for a title insurer to compensate its insured at an early stage. Until that issue is cleared up, paying the cost of defending title and protection against the risk of a poor decision by the Fund will be the primary benefits the insured receives.



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