

# Real estate claims trends: errors & insights

Real estate law accounts for the second highest number of legal malpractice claims in Ontario, after civil litigation. But real estate law is responsible for a higher percentage of claims costs than litigation – and the trends are up for both the count and cost of real estate claims.

Over the last ten years, real estate-related claims averaged 29 per cent of LAWPRO’s claims count (612 claims per year), and 30 per cent of our claims costs (\$19.7 million per year). On average, resolving a real estate claim cost LAWPRO \$43,325 over that period.

But Figures 1 and 2 below reveal that averages tell only part of the story. There has been considerable variation over the past decade. The number of real estate claims dipped to 425 in 2003 and rose to 651 in 2009. Claims costs dropped below \$12 million in 2001 but rose to over \$23.5 million in 2009.

As costs in the real estate area of practice have significantly increased, it is clear that real estate claims represent a major risk

for LAWPRO and the bar. As well, revenues from real estate transaction levies have decreased with the widespread use of title insurance. To effectively risk rate the program, as per our mandate, it was necessary to increase the real estate transaction levies to \$65 per transaction in 2010. Without the real estate transaction levy, real estate lawyers would be paying a base premium of \$9000 in 2011.

This article examines the most common real estate-related errors LAWPRO sees, and the steps you can take to reduce the likelihood of a claim.

## The most common errors

In the real estate area, the most common causes of claims are the following:

- lawyer/client communication failures;
- inadequate discovery of facts or inadequate investigation;

RE claims by count

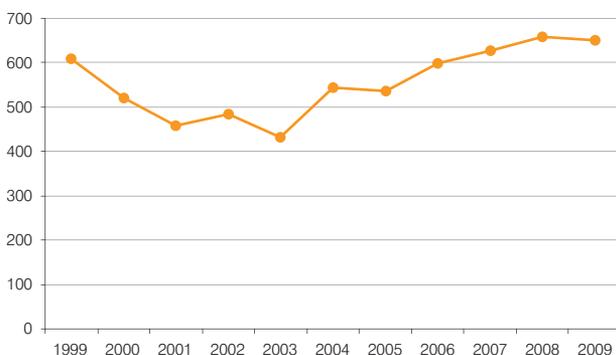


Figure 1: Claims count by area of law

RE claims by cost

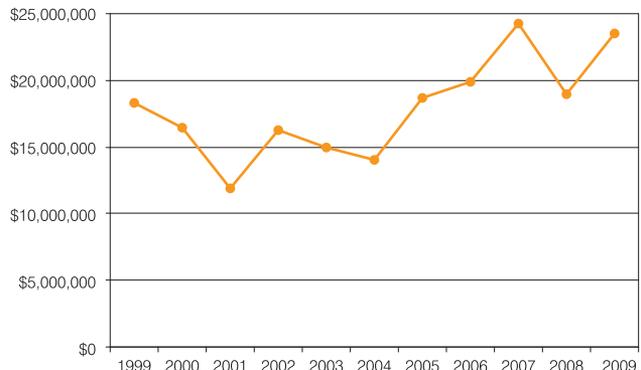


Figure 2: Claims costs (case incurred) by area of law

- failure to know or properly apply the law;
- conflicts of interest;
- fraud;
- clerical/delegation; and
- time- and deadline-related errors.

Figure 3 illustrates the relative proportion of these errors. What is surprising to most lawyers is that law-related errors rank third, well behind communication and inadequate investigation errors. Lawyer/client communication-related errors are actually the most common, representing 40 per cent of the errors in the real estate area.

There are some interesting changes in the proportion of errors by type over the last ten years. As a percentage of the total number of real estate claims, law-related errors have declined in recent years. From 1999 to 2004, on average they accounted for 10 per cent of real estate claims, but from 2005 to 2009, they averaged only five per cent. In the latter period, clerical and conflicts errors are now exceeding law-related errors.

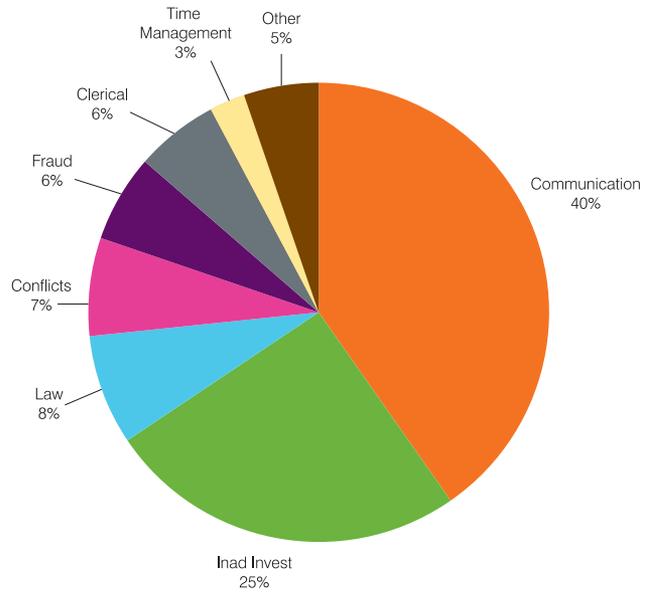


Figure 3: Real estate claims by type of error (1999-2009)

### Communications-related errors

The most common cause of malpractice claims on real estate files are lawyer/client communication-related errors. These fall into one of three general categories:

- A failure to inform the client or obtain the client's consent;
- A failure to follow a client's instructions; and
- Poor communication with the client.

A review of common fact scenarios for each type of error will give you a good understanding of why these errors happen and the steps you can take to avoid a communications-related claim.

#### FAILURE TO INFORM CLIENT OR GET CONSENT

The most common type of communications error on real estate files – 49 per cent of communications-related claims – involves a failure to obtain the client's consent or to inform the client. Examples of this type of error include:

- Failing to disclose material information to a lender client. Such material information could include, for example:
  - A recent transfer of the property for a lower amount.
  - A series of recent transfers of the property for escalating amounts.
  - The existence of outstanding tax arrears or arrears on a mortgage in priority.
  - The fact that the deposit was paid by someone other than the purchaser or is a "phantom deposit" (i.e., although the agreement of purchase and sale indicates there was a deposit, no deposit was actually made).
- Failing to inform a client about restrictions on land use contained in a subdivision agreement.

- Failing to review the survey and to discuss the risks or problems it reveals with the client.
- Failing to explain the location of a condominium parking space to a client. The number posted for a parking space in the parking garage may not correspond with that parking unit's number on the condominium plan.
- Failing to inform a client who selects title insurance about the searches that the lawyer will not be performing and the type of information that these searches would reveal about the property, such as zoning, encroachments or survey issues.
- Failing to inform a client who does not select title insurance about the post-closing protections provided by title insurance that the client is not receiving (e.g., regarding post-closing encroachments onto the property and fraud).
- Failing to inform a client well before closing about any significant problems arising out of requisitions going to the root of title that might result in the transaction being aborted.

#### FAILURE TO FOLLOW CLIENT'S INSTRUCTIONS

A "failure to follow client instructions" is the second most common communications-related error and accounts for 41 per cent of communications-related claims. It really amounts to nothing more than a simple failure to follow a client's specific instruction. The most frequent scenarios for this error include:

- Not inquiring about or following through on the client's intentions for future use of the property. For example, not doing the necessary zoning searches or getting title insurance with a future use endorsement. The client may intend to build a swimming pool, but sewers or utility easements may make this impossible. Zoning may not permit a home-based business or multiple dwelling units.

- Failing to ensure that the condominium unit shown on the plan meets the client's expectations, (e.g., whether it overlooks a lake or a parking lot.)
- Failing to do a proper title search and review the survey to ensure that the access route to an otherwise "landlocked" rural property that a client is relying on is properly deeded and reflected on title.
- Failing to inform a client about possible environmental contamination arising from the existing or a prior use of the property (e.g., as a gas station or dry cleaning operation) that might interfere with the client's intended future use.

#### POOR COMMUNICATION WITH CLIENT

Poor communication with the client is the third most common communications-related error and causes 10 per cent of this type of claim. Common scenarios for this error include:

- Failing to ensure that the client understands what you are telling him/her and that you understand what he/she is telling you, particularly if there is a language barrier.
- Failing to ensure that the client understands clearly what you will be doing as the lawyer and what the client is responsible for doing.
- Failing to establish clearly who your client is, (e.g., where two or more family members have an interest in the transaction.)

### Avoiding communications errors

When it comes to avoiding or reducing the likelihood of a communications-related claim, the importance of putting things in writing cannot be over-emphasized. While the failure to have written confirmation of instructions and advice is not negligence in and of itself, such written communication can be extremely helpful in defending you in the unhappy event that a claim is made against you (or about you to the Law Society, or if you are defending your account before an assessment officer).

Why is having something in writing so helpful? Because more often than not, this type of claim involves the lawyer recalling that one thing was said or done, or not said or not done, and a disappointed or upset client who alleges something different.

This type of claim is very hard for LawPRO to defend successfully. At the end of the day it essentially comes down to a question of credibility. Judges tend to prefer the client's evidence, as the client usually has a much better recollection of what transpired and what was said.

Remember, most clients are only involved in one or two real estate deals in their lifetimes, so they tend to remember exactly what happened. On the other hand, lawyers who have done hundreds or thousands of deals tend to have little or no recollection about what happened on a specific transaction, especially one in the distant past.

And unfortunately, we frequently find inadequate documentation in the lawyer's file to back up the lawyer's version of what occurred.

All too frequently, we see files with no notes or correspondence documenting what was said and done, and on occasion, even files with no reporting letters whatsoever.

Fortunately, communications-related errors are among the easiest to prevent. You can significantly reduce your claims exposure by documenting your work:

- Confirm the information that your client provided to you, your advice to the client, the client's instructions to you, and what steps were taken on those instructions.
- Document the time spent reviewing the title search, and note what issues were discussed with the client. This can be done in your notes, and in interim or final reporting letters, or even in an e-mail message. Admittedly, you can't document everything on every file, but taking the time to document unusual things or issues that seemed to concern the client can be very helpful in the event of a claim, especially if you have a difficult or demanding client.

#### CONSIDER DOCKETING TIME

Most real estate lawyers do not track or docket the time they spend on real estate files. This is a shame, as there are two benefits of doing so.

First, by tracking lawyer and staff time you can determine the actual amount of time you are spending on each file – a critical piece of information for determining if you are making any money on each real estate deal you complete.

Secondly, even taking just a few seconds to make detailed docket notes can be a lifesaver. "Conference with client re: condo purchase, including re: parking space and locker" is much better than just "Conference with client re: condo purchase"; "Conference with client re: review of subdivision agreement, including restrictions on future building" is much better than just "Conference with client re: subdivision agreement." Weeks, months or even years after a deal is completed, detailed docket notes such as these can serve to confirm that particular issues were discussed with the client.

### Inadequate discovery of facts or inadequate investigation

The second most common malpractice error in the real estate area is "inadequate discovery of facts or inadequate investigation." Examples include:

- Misreading (or not reading) a survey, search, or reference plan.
- Not noticing inconsistencies in condominium unit numbering between the agreement of purchase and sale and the condominium plan.
- On a condominium purchase, failing to ensure that the parking space and locker specified in the agreement of purchase and sale are actually for sale and that the legal description of both units is correct.
- On a condominium purchase, failing to ensure that the parking space and locker are specified in the title insurance policy.

- Failing to carefully review a condominium status certificate and to bring any deficiencies to a client's attention.
- Not doing a title search on a commercial lease.
- Not fully researching sublimits and other restrictions on title insurance that affect coverage.
- Giving an undertaking to discharge a mortgage as vendor's solicitor, but failing to carefully review and ensure the accuracy of the discharge statement – in particular, failing to ensure that the statement reflects all the amounts owing by the vendor to the lender that are secured by the mortgage.
- In condominium purchases, failing to ensure that the draft transfer and mortgage, and the title insurance policy if there is one, include the correct PIN, unit and level numbers for parking spaces and lockers.
- Failing to follow up on a requisition to clarify whether outstanding tax arrears are for municipal taxes or retail sales tax.

Don't take shortcuts – they can and will come back to haunt you. Lack of attention to details also arises when there are time pressures created by other lawyers or clients – and details get missed or drafting errors occur. Take the time to do the job right, even if it takes a bit longer or involves coming back on another day.

### Failure to know or properly apply the law

The third most common type of error in the real estate area is a failure to know or apply the law, accounting for eight per cent of the number of claims between 1999 and 2009. The good news here is that law-related claims seem to be on a downwards trend over the last several years. The law-related mistakes we most frequently see are the following:

- Failing to fully understand or properly apply the part-lot control provisions of the *Planning Act*.
- Failing to know about or fully understand s. 3(9) of the *Land Transfer Tax Act* regarding tax deferrals on transfers of property between affiliated corporations.
- Not being sufficiently aware that different types of searches are required depending on the type of property being purchased (e.g., single unit vs. multi-unit, commercial vs. residential).

### Conflicts of interest

Conflicts of interest accounted for seven per cent of real estate claims reported between 1999 and 2009. Of concern is the fact that conflicts claims are on the rise.

Examples include:

- Acting where you have a personal interest in the transaction, for example:
  - Acting for the mortgage lender where you have a personal interest in the property, (e.g., a mortgage in priority on the property).
  - Acting for the vendor of the property where you have a personal interest in the purchase.

- Acting for more than one party/entity
  - Acting for vendor and purchaser (for example, when it contravenes Rule 2.04.1 of the Rules of Professional Conduct).
  - Acting for two or more family members or related family business entities.
  - Acting for both a corporation and one or more of its individual directors or shareholders.
  - Acting for a borrower and guarantor of a mortgage.

When it comes to avoiding conflicts, you need to be vigilant from the very start of the matter. Follow firm conflicts checking procedures religiously. In most cases, law firm conflicts checking systems seem to catch potential conflicts, and the warning is ignored because of poor judgment and/or greed. Don't fall into this trap – listen to your instincts. Ask yourself – who is my client? Is there a real or potential conflict? Also, remember that you probably can't objectively judge your own conflicts – get input from someone who is outside the matter.

Lastly, take appropriate action when real or potential conflicts arise. This includes declining the retainer or getting off the matter if it is appropriate to do so, even if it means turning down work from a good client or a matter that will involve substantial fees.

### Fraud

Fraud is the fifth most common cause of claims in the real estate area, but in recent years it has overtaken law-related and conflicts claims to move into third place. Fraud accounted for only five per cent of the number of real estate claims from 1999 to 2004; from 2005 to 2009 it was responsible for eight per cent.

Note also that while fraud accounts for six per cent of the *number* of real estate claims, it is responsible for 12 per cent of the cost of those claims – and fraud costs are also going up. From 1999 to 2004, fraud accounted for only eight per cent of the cost of real estate claims. From 2005 to 2009, it accounted for 15 per cent.

Here are the common types of real estate frauds:

**Fraudulent discharges:** A “borrower” asks a lawyer to help with a mortgage loan. The lawyer's search reveals that a previous mortgage has been discharged. The lawyer registers a new mortgage, apparently in the first position. But the discharge turns out to be fraudulent, registered by someone in cahoots with the “borrower.” Once the fraud is discovered, the old mortgage is put back into priority so that there is not enough equity to cover the (now) second mortgage.

**Value frauds:** A series of phony sales results in an artificial increase in the value of a property for the purpose of obtaining higher value mortgages than can be supported by the true equity in the property.

**Identify theft:** Usually targeting elderly homeowners, the fraudsters find homes that are unencumbered, prepare false identification and transfer the property to a co-conspirator who obtains a mortgage.

**Bogus bank drafts on mortgage deals:** Fraudsters get real estate lawyers acting on mortgage deals to run counterfeit bank drafts through their trust accounts. A new client or lender contact allegedly from a major bank asks a lawyer to act on a mortgage matter. Mortgage instructions and/or a bank draft drawn on a major bank look legitimate. In some instances, the fraudsters have stolen the identity of a legitimate property owner. The instructions and the draft turn out to be counterfeit.

**Shelter frauds:** An individual who doesn't qualify for a mortgage enlists the help of a "friend." For a payment, the friend acts as the borrower/purchaser and takes title to the property – effectively selling his good credit. The person who hired him moves into the property and promises to make the mortgage payments. When this person defaults on the mortgage payments, the friend may sue the lawyer, claiming that he was not aware of what he was getting himself into, and that the lawyer knew (or should have known) that he was buying on behalf of another and should have made him aware of the consequences of defaulting on the mortgage. The lender may also claim against the lawyer for failing to disclose all the relevant information s/he knew (or should have known).

Examples of lawyers' errors include:

- Not diligently checking the identification of a new and previously unknown client to help prevent identity theft fraud.
- Not challenging and investigating the bona fides of a power of attorney that is suspicious on its face.

- Not doing further investigation after discovering frequent activity on title in a short period of time.
- Not informing the lender about such frequent activity. If after being so informed, the lender opts to proceed and advance the mortgage funds, not confirming in writing with the lender that s/he has decided to proceed.
- Not taking steps to confirm that a purchaser client is planning to live in the property where there is reason to believe that s/he does not intend to do so and is merely pretending to be a legitimate purchaser on behalf of someone else, e.g., where the client does not seem to know much about the property being purchased or appears to be taking instructions from others who are not part of the transaction.

**Deposit fraud:** The newest and latest variation of real estate bad cheque fraud involves an aborted promise to pay a deposit. We have seen at least a dozen of these frauds attempted in locations all over the province – on multiple occasions in Toronto and Ottawa – and also in London, Thunder Bay and Keswick.

In this scam, a "client" is looking to purchase property, either a specific property or one that a lawyer or real estate agent is to help the client locate. In the latter scenario, parameters are provided, e.g., a three-bedroom house with a pool in downtown London priced between \$500,000 and \$750,000.

The client will be new to the firm and may appear to come from a trusted referral source, either a real estate agent or another

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## Why so many real estate claims in a title insurance world?

Title insurance is now widely used in residential transactions in Ontario, but the number and cost of real estate-related claims have been climbing steadily in recent years.

Why is this happening? Among the reasons are the following:

- Title insurance only covers the purchaser's side of the transaction. It does not address claims by vendor clients.
- Title insurance is still less common in commercial real estate transactions – which can result in very costly claims.

- Claims that arise from transactions completed a decade or more ago are often not covered by title insurance.
- Lawyer/client communication and inadequate investigation errors – the two largest types of errors leading to real estate claims — are less likely to be covered by most title insurers, although it can depend on how the loss manifests itself.
- Not all real estate transactions are title-insured. Purchasers are not required to buy title insurance and may prefer to rely on a lawyer's opinion on title.

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The increase in the cost of real estate claims can be attributed in part to the significant increase in real estate property values over the last few years. Average house prices rose 22 per cent in Ontario between 2005 and mid-2010, for example. So when problems arise on properties on which there is no title insurance (as is the case with transactions completed years ago), losses are often significant.

Similarly, claims on commercial real estate – where title insurance is not as widely used – also tend to be more costly than in the past, again because of the significant increase in property values.

### **WHY IS THERE AN E&O CLAIM WHEN THE TRANSACTION IS TITLE-INSURED?**

But even where there is title insurance, claims may occur for a variety of reasons.

Some claims may result from improper delegation to, and inadequate supervision of, support staff. For example, a lawyer may end up securing the wrong type of title insurance policy, e.g., a single-unit policy for a multi-unit property or a residential policy for a commercial property. A problem subsequently surfaces, the title insurer legitimately denies coverage – and the client sues the lawyer.

A claim may arise because a lawyer fails to include in the application for a title insurance policy all the interests appurtenant to the property being purchased, e.g., a right-of-way or the parking and locker units in a condominium transaction. As a result, these interests are not covered by the policy.

Many claims are the result of lawyer/client communication errors related to title insurance.

LAWPRO has seen claims against lawyers for not recommending title insurance to clients and for obtaining title insurance without fully informed consent. We have even seen claims occur because a lawyer simply fails to purchase a title insurance policy, although instructed to do so by the client!

A common client communication error is failing to ask about a purchaser client's plans for the property being purchased and to apply for an appropriate future use endorsement to the title insurance policy, if necessary.

The client may be buying a parcel of vacant land, for example, with the intention of building a large “dream home” on it. However, in the absence of a specific future use endorsement, a title insurance policy only insures what exists on the date of closing, i.e., a vacant lot. If the client later discovers that because of setback requirements, s/he will only be able to build a much smaller house, the policy will not likely respond – and the client will come after the lawyer.

Another communication error that may lead to a claim is failing to explain exceptions and exclusions to the client. If the title insurer denies coverage because of an exception or exclusion, the client may assert that the lawyer never told him or her about it.

Failing to advise a client about a title insurer's sublimit on the amount of coverage for a specific issue and /or in a specific geographical area can also lead to a claim.

The widespread use of title insurance does not prevent a lender client from making a claim against a lawyer for failure to disclose material information that would have affected its decision to enter into a mortgage transaction and advance funds.

Traditional title insurance (that is, without legal service coverage) will protect the lender if a mortgage is fraudulent and invalid, but most title insurance policies will not protect the lender if the mortgage is valid and enforceable, but there has been “value fraud” – i.e., the transaction has been engineered to obtain a greater amount of mortgage financing than is justified by the true value of the property.

In the latter case, if the lender enforces the mortgage and suffers a shortfall, it may contend that the lawyer failed to inform it about important information relating to the true value of the property and seek to recover its loss from the lawyer.

Any proposed real estate transaction that doesn't come to fruition can be the subject of a claim against a lawyer. Title insurance – even if contemplated – is not available to help in this situation, because if a deal doesn't close, no title insurance policy is purchased.

lawyer. The client will be overseas, most commonly in the U.K., and will provide copies of identification, including passport, driver's licence, business card, etc. In some cases the identification documents provided were allegedly notarized by someone who turned out to be a fake lawyer who claimed to work at a genuine U.K. law firm.

There is an elaborate workup to the deal, including loads of email or phone communications and even signed agreements of purchase and sale. The communications will be very sophisticated, and a great deal of background information will be provided. In one case, on the strength of the reputation of the lawyer involved, a house inspection was done after an agreement of purchase and sale was signed but before a deposit was paid.

A deposit in an otherwise reasonable amount will be promised but will not be delivered.

Closing will be imminent, and the client will be unreachable for a short while. When the client is again reachable, there will be some excuse provided (e.g., medical issues), and then a very large cheque will show up – far in excess of the promised deposit and in some instances more than the purchase price. This cheque sometimes will come from a third party (frequently some kind of investment advisor) and will be counterfeit. The client will then ask for part of the funds to be returned to the client or paid to a third party (e.g., for medical expenses, to buy furniture) and will instruct the lawyer to wire the money offshore.

### Clerical and delegation errors

Clerical and delegation errors also account for six per cent of the number of real estate claims. It is disconcerting to LAWPRO that these errors are on the rise. Typical examples include the following:

- Not meeting with the client. Delegating the entire file/transaction to a law clerk.
- Failing to meet with the client to explain all the legal consequences of the transaction, such as the nature and consequences of a mortgage.
- Failing to establish clear law office policies and procedures regarding what the lawyer will do and what the law clerk will do in a real estate transaction.
- Failing to inform a client about title insurance and searches.
- Failing to review the statement of adjustments for clerical errors.
- Giving the lawyer's personalized e-reg™ pass phrase to a law clerk. This is a violation of the Rules of Professional Conduct and may lead to a denial of coverage in the ordinary course, subject to some fraud protection under the Real Estate Practice Coverage Option.
- Failing to register a discharge of mortgage (vendor's lawyer).

### Time- and deadline-related errors

Time- and deadline-related errors are the seventh most common type of error we see in the real estate area. They fall into one of two distinct types: (1) not completing tasks in an appropriate amount of time (i.e., procrastination) causes 60 per cent of real estate claims in this area, and (2) missing deadlines or limitation periods causes 40 per cent of real estate claims in this area.

The procrastination-related errors we frequently see include:

- Failing to respond to requisitions well before closing, e.g., re: outstanding writs of execution.
- Failing to respond to requisitions that go to the root of title well before closing.

Commonly missed deadlines or limitation periods include:

- Failing to submit requisitions on time.
- Failing to complete the required searches before closing.

As a piece of general advice, it would be a good idea to review your file before closing it and/or putting it into storage to ensure that nothing still needs to be done. If there is, you should ensure that you complete the outstanding work, if it is part of your retainer. If it is not, confirm in writing to the client that it is the client's responsibility to complete the work.

### Even if no allegations are made...tell us!

If you become aware of a potential claim, you should immediately report it to LAWPRO, even if no allegations of negligence are made.

Putting us on notice will help us help you, and will most likely help reduce the damages on any potential claim. We may retain counsel to assist you and protect your interests, including helping you draft an affidavit and attending with you if you are examined as a witness. And remember, best practice is not to turn your file over without a court order. We can help ensure that the court order is worded appropriately to protect your interests. It is interesting to note that we close about 84 per cent of our real estate claims without any indemnity payments.

### Your marching orders

You can't totally eliminate the risk of a malpractice claim. However, you can substantially reduce your risk of a claim by improving your lawyer/client communications and documenting your work. Review and consider the types of errors that occur in the real estate area, and set aside time to integrate the various risk management strategies outlined above into your practice.

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