

Clear register not a guarantee of validity for innocent “intermediate owner” who grants mortgage after fraudulent dischargeⁱ

As between innocent mortgagees, which has priority when a fraudulent discharge of a first mortgage makes way for additional mortgages?

A fraudulent discharge is discovered

After a “second mortgage” it issued to Brampton homeowners in December of 2012 went into default in February 2013, lender Secure Capital issued a notice of sale. CIBC, which believed itself to be the first mortgagor on the property, followed suit in June.

In mid-April of the same year, Computershare Trust Co. discovered that the mortgage that it had granted to the homeowners in November 2008 – years before the CIBC and Secure Capital mortgages were granted – had been fraudulently discharged in August 2009. Despite the discharge, the homeowners had continued to make payments on the Computershare mortgage until the spring of 2013.

Homeowners presumed to be the perpetrators

The individuals whose signatures appear on the discharge are not registered as lawyers or paralegals in Ontario, and the numbered corporation that submitted the discharge for registration was unknown to Computershare and did not have authority to bind it. While the court could not determine with certainty how the discharge had been successfully submitted for registration or precisely who was behind it, the facts were consistent with a fraud perpetrated by the homeowners or their associates. The court found that the fraudulent discharge was made to allow the homeowners to misrepresent the property as unencumbered for the purpose of obtaining the CIBC, and later, the Secure Capital mortgages.

The lenders seek rulings on validity and priority

The lenders brought applications, tried together, to assert the validity of their respective charges, and for a determination of priority (CIBC and Computershare each argued that their mortgages had first priority; Secure Capital argued that its mortgage was a second, not a third mortgage).

The court found that all three lenders were innocent victims of fraud, and that all three were entitled to relief as against the homeowners, but that only the Computershare mortgage was a valid instrument.

CIBC and Secure Capital mortgages were invalid instruments

Despite finding that CIBC and Secure Capital were innocent of wrongdoing, the court characterized the instruments registering the mortgages granted to them as invalid.ⁱⁱ In making this finding, Murray J. relied on the *Land Titles Act* (LTA)ⁱⁱⁱ definition of a fraudulent person as one who “...holds oneself out in the instrument to be, but knows that the person is not, the registered owner of the estate or interest in land affected by the instrument.” Because the homeowners had given a mortgage to Computershare and that mortgage had not been legitimately discharged, they “did not own the interest in the property purported to be conveyed to CIBC and to Secure Capital.” As a result, the homeowners were fraudulent persons within the meaning of the LTA and the new CIBC and Secure Capital mortgage registrations were invalid instruments.

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This analysis, Murray, J. explained, is consistent with the decision in the 1908 case *In re Skill and Thompson*,^{iv} which stood for the principle that: "... it is not one [of the purposes of the LTA]... to protect the registered owner against his own obligations, much less against his own fraud."

While this principle did not preclude CIBC or Secure Capital from recovering as against the homeowners in this case, it is an important finding because, had the fraud not been discovered at this juncture, the characterization of the CIBC and Secure Capital mortgage registrations as invalid would have been relevant to the rights of a subsequent interest-holder.

How does the invalidity of the three instruments affect priority?

Murray, J. did not remove the CIBC and Secure Capital mortgages from title, but found that the next issue for resolution was "which innocent party should have the priority of its charge adversely affected" by the fraudulent discharge.

Each lender sought to rely on the provisions of the LTA in arguing for priority. CIBC and Secured Capital relied on s. 78(4), which seems to suggest that the register can be taken at face value:

78(4) When registered, an instrument shall be deemed to be embodied in the register and to be effective according to its nature and intent, and to create, transfer, charge or discharge, as the case requires, the land or estate or interest therein mentioned in the register.

Computershare relied on ss 78(4.1-2), which refer to fraudulent instruments:

78(4.1) Subsection (4) does not apply to a fraudulent instrument that is registered on or after October 19, 2006

78(4.2) Nothing in subsection (4.1) invalidates the effect of a registered instrument that is not a fraudulent instrument described in that subsection, including instruments registered subsequent to such a fraudulent instrument.

Interplay between s. 78(4) and 78(4.1), and "deferred indefeasibility"

The interplay between the subsections of s. 78 was examined by the Court of Appeal in *Lawrence v. Maple Trust Company*.^v The decision in *Lawrence* affirmed the recognition, in Ontario, of the theory of "deferred indefeasibility" in cases involving "innocent" transactions that follow fraudulent ones.

The theory of deferred indefeasibility is designed to place the onus of avoiding a fraud on the party best-placed to discover it, and to protect parties who are not in a position to detect a fraud when they rely on the register.

In *Lawrence*, lender Maple Trust purported to obtain an interest as mortgagee from an individual who had obtained title to the subject property by fraud. Despite being unaware of the fraud, Maple Trust was held to be vulnerable to a claim by the true owner. However, the court held that, had Maple Trust conveyed its interest to an innocent third party, that party would have obtained good title because it was too far removed from the fraud to discover it. The third party's good title would have been supported by "deferred indefeasibility": while the intermediate owner (Maple Trust) was not entitled to rely on the register, a subsequent owner would have been.

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Applying *Lawrence* to the present case

In applying the decision in *Lawrence*, the court found that in this case, the CIBC was an intermediate owner for the purpose of the theory of deferred indefeasibility: "...CIBC acquired an interest in title from a fraudster, and had an opportunity to investigate the transaction and avoid the fraud."^{vi} As a result, CIBC's interest was subject to Computershare's prior claim, making the ranking of the mortgages as follows: Computershare first, CIBC second, and Secure Capital third.

How could CIBC have investigated the validity of the transaction? The court suggested that "an inquiry as to how the [homeowners] were able to pay off the Computershare mortgage given their financial circumstances might have raised concerns."

This finding – that the new lender was NOT entitled to rely on the contents of the register (contrary to what s. 78(4) of the LTA would seem to suggest) is likely to send a chill up the spine of lawyers who represent lenders in real estate transactions. But while chilling, this caveat is not new: not only was it the basis for the decision in *Lawrence*, it was, the court noted, in a textbook – *Falconbridge on Mortgages* – that many real estate lawyers may have on their office shelves:

A purchaser in good faith is entitled to rely upon the register and need not go behind the title of the registered owner, but of course, he must satisfy himself that an instrument purporting to be made by the registered owner is itself a valid instrument. Registration will not render an invalid instrument valid in favor of the purchaser therein named.^{vii} [my emphasis]

In other words, even if a prospective lender is itself free of fraudulent intent, it will create an invalid instrument by relying (even "innocently") on the register, if the register has been fraudulently manipulated by the borrower.

The moral of the story

The take-away warning from this case, (and from *Lawrence*) is this: a lender that relies on the results of a title search as the sole evidence of a borrower's ability to grant an interest in land does so at its peril, and so should take additional steps to investigate the transaction. For example, the lender should:

- satisfy itself that the borrower is who he or she purports to be;
- inquire about the financial circumstances of the borrower; *and also*
- think critically about the borrower's reasons for seeking the loan, which may mean making inquiries about previous encumbrances of the property, where the money to discharge them came from, and why the borrower wishes to re-encumber the property now.

While assessing the creditworthiness of the borrower is the lender's ultimate responsibility, the lender's lawyer – especially where he or she also represents the borrower – may be in a position to observe "red flags" of fraud, and has a duty to act on these concerns. Faced with suspicions about a transaction, lawyers cannot safely rely on the register of title alone, but must make (or recommend) appropriate investigation of the circumstances of the transaction.

ⁱ [CIBC Mortgages Inc. v. Computershare Trust Co. of Canada](http://canlii.ca/t/gg3vw), 2015 ONSC 543 (CanLII), <<http://canlii.ca/t/gg3vw>> retrieved on 2015-05-01

ⁱⁱ Supra note 1 at para. 51

ⁱⁱⁱ [R.S.O. 1990, Chapter L.5](#)

^{iv} [1908] O.J. No. 41, 17 O.L.R. 186

^v [2007 ONCA 74 \(CanLII\)](#), 84 O.R. (3d) 94.

^{vi} Supra note 1 at para. 58

^{vii} W.B. and R. H. McLaren Rayner, *Falconbridge on Mortgages*, 4th edition, Canada Law Book Limited, 1977, at page 202.