



April 2009

CLIENT ALERT: FRAUD DECISION IMPACT ON LENDERS

1) THE DECISION

On April 6, 2009, the B.C. Court of Appeal overturned the 2008 trial judgment of *Gill v. Bucholtz*. This case dealt with the fraud exception to indefeasibility of title in s. 23 of the *Land Title Act* (the "Act"). The trial judgment had been quite favourable to mortgagees, in that it held their mortgages to be valid despite the existence of fraud clouding the title of the mortgagor.

The plaintiff and victim of fraud, Mr. Gill, was the registered owner of certain property (the "Property"). An unknown fraudster forged a transfer to the Property to a Miss Gurjeet Gill ("GG"). GG then granted a mortgage to Mr. and Mrs. Bucholtz, who advanced \$40,000.00 to GG. This mortgage was filed at the Land Title Office and registered along with the forged transfer.

GG also granted a second mortgage to a numbered company, who advanced \$55,000.00 prior to registration of the mortgage. (The Land Title Office refused to register the second mortgage as Mr. Gill had since filed a caveat on the Property, however, for the purposes of the case, the parties agreed to treat the second mortgage as validly registered).

None of the mortgagees had knowledge of the fraud perpetrated by the unknown fraudster and GG.

Although it was clear that Mr. Gill was entitled to the return of title from GG, the question was whether the mortgagees were entitled to have their mortgages continue to encumber the title of the Property, as valid charges.

The trial judge held that the indefeasibility of title provided for in the Act gives a registered title holder "the indefeasible right to deal with the property." The mortgagees were thus entitled to rely on title, which at the relevant time had shown GG as registered title holder. Thus, Mr. Gill's title remained encumbered by the mortgages, and Mr. Gill would have had to seek compensation from the Land Title and Survey Authority's Assurance Fund (the "Assurance Fund") for repayment of the mortgages.

The Court of Appeal reversed this ruling. It found that s. 23 of the Act created an exception to the indefeasibility of title, but only in cases of fraud with respect to title to fee simple belonging to a registered owner, and not to mortgages or other lesser interests.

A mortgage granted by a registered owner who is only registered on title via fraud can pass no interest, as the fraudster has no interest to give, and the mortgage is therefore void. Section 25.1(1) of the Act establishes that such a mortgage remains void even if registered at the Land Title Office.

The s. 23 exception for fraud protects the true owner from mortgages granted by a person who has obtained title by fraud or forgery. The Court of Appeal consequently ruled that the mortgages should be cancelled as charges on the Property.

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The Court of Appeal expressly recognized that, in terms of policy, this had the effect of placing the cost of fraud perpetuated against mortgagees onto the lenders themselves, and not onto the public (as the tax paying funders of the Assurance Fund).

The result in this case is to place an onerous burden on mortgagees to satisfy themselves that the party granting them the mortgage is entitled to do so. The mortgagee can no longer simply rely on the fact that the proposed mortgagor is registered on title in the Land Title Office. This significantly undermines the protection of the Torrens land registration system for lenders.

2) PROTECTIVE MEASURES

In light of the Court of Appeal's decision in *Gill v. Bucholtz*, lenders will need to consider the measures they are presently taking to protect themselves against fraudulently granted mortgages. Most lenders have already implemented enhanced identity verification procedures, typically requiring the borrower's solicitor or notary to review and make copies of recognized identification documents (driver's licences, passports, etc.). However, fraudsters have historically responded to increased vigilance with increasingly sophisticated technology to forge identification documents, so no document review system will ever be entirely foolproof.

Accordingly, lenders may consider requiring title insurance coverage for all mortgage loans. For residential mortgages, with most policies in the \$150-\$250 range, title insurance coverage would not impose a significant transaction cost on to the borrower, especially if the title insurance is obtained in lieu of a new survey certificate. However, with larger commercial loans the policies can be quite expensive, so lenders will need to do a cost-benefit analysis and assess their relative competitiveness in the marketplace and the frequency of commercial mortgage fraud cases before imposing that cost on to a borrower.

Our Financial Services Group would be pleased to discuss with you in greater detail the implications of *Gill v. Bucholtz* to your risk management protocols.

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