

When an absconding fraudster runs a mortgage scam on an innocent homeowner and on a bank, or as against two banks, which of these innocent victims should bears the loss? The recent decision of the Ontario Divisional Court (ODC) [*CIBC Mortgages v. Computershare*, 2016 ONSC 7094] analyses this issue. This decision also sets out the ground rules for the circumstances in which fraud in a transaction can overcome the integrity of the land registry system under the Ontario **Land Titles Act (LTA)**.

The LTA is based on a Torrens-type system of property registration in which the registration of the property interest is the single factor which governs property interests. In Torrens system, once an interest in property has been registered on title, that interest defeats all subsequently registered interests, and ALL unregistered interests. Such a system protects the interests of innocent purchasers (or lenders) who rely on the (property) register. It is not necessary for a purchaser or a mortgagee to “look behind” the title in order to verify the validity of the current transaction, or of past transactions. To the extent that some people might lose their legitimate property interests by reason the apparent “tyranny” of a Torrens system, these systems generally set up some sort of statutory compensation scheme for these innocent victims. The *Computershare* case, and its older cousin, *Lawrence v. Maple Trust* [2007 O.J. No. 381 (ONCA)], consider that, in some cases, the integrity of the LTA registry can be overcome by reason of fraud; there will still be an innocent victim, but it may not be the person with the registered interest! This point was enhanced by relevant amendments to the LTA, as discussed below.

In *Lawrence v. Maple Trust*, an imposter posing as the homeowner forged a purchase and sale agreement by which the property was sold to another fraudster, W. W. then obtained a mortgage from Maple Trust. Both W’s “purchase” and Maple Trust’s mortgage of the property were registered. The true owner later learned of these events and applied to the court to have the conveyance and the mortgage set aside. The application judge found that the mortgage was valid, since Maple Trust had advanced funds without notice of the fraud, and because of the inviolability of the LTA registry. The ONCA overturned this decision and held that the LTA system in Ontario was not a true Torrens system, but rather was a hybrid of sorts that allowed for exceptions in some cases of fraud.

The Court looked at the LTA and considered various theories. Under the common law or “registry theory”, a person cannot pass better title than what he has. If title was obtained through fraud, that title could never form the root of a good and valid claim. Under the “immediate defeasibility” theory, the LTA would create a system of “title by registration and not a system of registration of title”. Once an instrument was registered, it would be effective even if procured through fraud. This is the notion behind the original “Torrens” system of land titles that was developed in Australia in the late 1800s; that the fundamental purpose of a Land Titles system is to protect those who rely on title as effected by registration.

Then there is “deferred indefeasibility” theory; a halfway house between the other two. Under this theory, there are three classes of parties: the original owner, the “intermediate” owner, who is the person who dealt with the person responsible for the fraud, and the deferred owner, who is a *bona fide* purchaser, or encumbrancer (like a mortgagee) for value without notice of the fraud who takes from the intermediate owner. Under this theory, registration of a void (fraudulent) instrument does not cure its defect so that neither the fraudulent instrument nor its registration can give good title. However, if that intermediate owner then sells to a new person; a so-called “deferred” owner who takes without notice of the fraud, then this deferred owner will take good title.

In *Lawrence v Maple Trust*, the ONCA held that the deferred indefeasibility theory should apply to the LTA due to the language of the Act itself, but also because of fairness considerations: as between two otherwise innocent victims of a fraudster, the intermediate owner of an interest in property (the person who dealt with the fraudster) had the opportunity to avoid the fraud. Thus, in a contest between this “intermediate owner”, Maple Trust, who dealt with the fraudster, and thus, theoretically, had the opportunity to avoid the fraud, and the original owner (who had no such opportunity), the original owner’s claim should prevail.

This decision arguably seemed to be one in which the result was determined first and the reasoning necessary to come to that result came afterwards. The relatively deep pockets of Maple Trust may also have played a factor, since Maple Trust simply relied on the integrity of the registry only to have this blow up in its face. From a public policy point of view, however, few would argue that an innocent homeowner, who was the victim of identity theft, if made to bear the loss, would suffer far more than Maple Trust, and therefore, the homeowner should have some recourse.

The Ontario government took notice of this. In 2006, in order to make it clear that the defined indefeasibility theory should prevail, the Legislature amended the LTA. The new section 78(4.1) states explicitly that the registration of a “fraudulent instrument” will not defeat another legitimate interest, whether registered or not. While the term “fraudulent instrument” was defined in this 2006 amendment to the LTA, clever lawyers can find ambiguity anywhere, and this issue was then litigated in the recent case of *CIBC Mortgages v. Computershare*. In that case, the fraudsters were the legitimate owners of a property. They managed to have a legitimate first mortgage, held by Computershare, deleted from the registry, after which they obtained a mortgage from CIBC. The fraudsters defaulted, the property was sold and there was not enough money to pay out both CIBC and Computershare. In a contest between the two innocent parties, Computershare and CIBC, CIBC had the only registered interest. The issue then was whether CIBC’s registration was of no effect on the basis that it was a “fraudulent instrument”, since it was fraudulently given by the property owners, who knew very well that they had fraudulently caused the deletion of the Computershare registration.

The application judge found in favour of Computershare for the reason that the CIBC mortgage arose out of a fraud perpetrated by the property owners. This judge found that the CIBC mortgage was a “fraudulent instrument”. The ODC (who heard the case instead of the ONCA, which declined jurisdiction) reversed. It considered the concepts of “intermediate” and “deferred” defeasibility Court and considered the plain wording of the new amendments to the LTA. The Court found that even though they were fraudsters, the property owners still had the ability to pass good title and to grant encumbrances. These owners, therefore, were not “fraudulent persons” under the LTA, and the CIBC mortgage was not a “fraudulent instrument” as defined in the LTA. Thus, Computershare’s unregistered interest lost out to CIBC registered interest. Bad luck for Computershare who presumably then advanced a claim to the Compensation Fund!

The moral of the story here is that fraud may overcome a registered interest under the LTA, but you need to consider the facts carefully, and recognize that innocent parties can still lose out at the end of the day to other innocent parties.

**Reid Lester April 6, 2018**