REAL ESTATE FRAUD: WHO SHOULD BEAR THE LOSS?: A look at the liability of lending institutions in the context of real estate fraud cases

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Introduction

"Real estate fraud" is a very broad word used to describe different types of fraud and deceit faced by the real estate industry[1]. The frauds can range from obtaining a mortgage under false pretences (such as by relying on a fraudulent appraisal, which exaggerates the value of a property) to using stolen or false documents to transfer a registered owner's title to a fraudster, who then either transfers the property on to an innocent buyer or obtains a mortgage on the property and then absconds with the closing or mortgage funds. Notwithstanding the form of fraud, the consequences are always serious. Horrified homeowners are left to deal with a mortgage that they neither wanted nor obtained the benefit of. Lending institutions are left with little security on hundreds of thousands (sometimes millions) of dollars advanced. Lawsuits (and disciplinary proceedings) are the inevitable result. Sadly, by the time an action is commenced, the fraudsters are often not a source of recovery, having long since disappeared or having no assets left with which to satisfy a judgment even if they can be identified at all. Fingers then point in different directions among seemingly "innocent" parties, each accusing the other of failing to take steps to prevent the fraud from occurring. The courts are left to untangle the mess and decide who, as between "innocent" victims, should have to bear the responsibility.

This paper will focus on the role of lending institutions in real estate fraud cases, and particularly, the courts' approach as to who, as between the lending institution and a second seemingly "innocent" party, should bear the loss. The paper will conclude with a commentary

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[1] *4th Annual Title and Off-Title Searching Program: Land Registration System Update – Ministry of Government Services Consumer Protection and Service Modernization Act, 2006 and the Real Estate Fraud Action Plan*, by Kate Murray, January 14, 2008

on the prospects of foisting some liability from a lawyer back onto a lending institution in cases where a fraud is alleged, or at the very least attempting to limit the damages sought against the lawyer, who is accused of falling the below the requisite standard of care.

Types of Real Estate Fraud

There are two main types of fraud prevalent in the real estate industry – mortgage fraud (also referred to as value fraud or "Oklahoma fraud") and title fraud (also referred to as identity fraud).

Mortgage fraud predominantly affects financial institutions and other lenders. Often, the fraudster acquires a property which is then "flipped" (or sold) various times to other "purchasers." In the course of these flips, the value of the property is artificially inflated. The mortgage lender is deceived into advancing funds in a higher amount than would otherwise have been available, in respect of property whose real worth falls below the value of the funds advanced. Often, there are fraudulent appraisals submitted in support of the mortgage application which reflect an inflated property value. When the fraudster absconds with the funds, the mortgage institution is left attempting to recover what it can through power of sale proceedings. Invariably, there is a shortfall between the funds advanced and the funds recovered through this process.[2]

In other cases, the fraudsters approach an unwitting dupe and request that this person "lend" his or her name to the transaction as purchaser and mortgagor. The excuses given are varied and can include the allegation that the genuine purchaser has a bad credit history and simply needs the use of someone else's name to obtain a mortgage. The dupe, or "straw purchaser", as they have come to be known, is assured that he or she will not have to make any mortgage payments or pay any legal or other fees associated with the transaction. He or she is assured that "soon" after the transaction closes, the title and mortgage documents will be rectified. The straw purchaser receives a monetary payment in return for his or her troubles, generally in an amount not exceeding $10,000. The mortgage lender extends a mortgage, only to

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[2] Ibid. at page 7-3

discover that the apparent mortgagor is not the actual owner of the property and has little or no ability to make the mortgage payments. Again, power of sale proceedings follow. Again, costs are incurred. Again, there is a shortfall, often significant.

By contrast, title or identify fraud, predominantly hurts individual homeowners. Title fraud occurs when a fraudster using stolen identity or forged documents transfers title to a property to his or her name, without the true owner's knowledge, and then acquires a mortgage (or sells) the property.[3]

In the last decade or so, the legal community has seen an influx of fraud cases. Given that almost all transactions involving land require the involvement of a lawyer, many, if not the vast majority of these frauds involve lawyers. A number of these practitioners knowingly participated in the fraudulent scheme or were wilfully blind as to the circumstances surrounding the transactions, in both cases, for monetary gain. Many of them have faced disciplinary proceedings (and criminal charges). Many of them have been disbarred.

In other cases, lawyers have been sued not for their explicit involvement in the fraud but for their alleged negligence in failing to prevent the fraud from occurring. *Yamada v. Mock*[4] is an example. The third party solicitor in that case was retained to act on behalf of both parties to a mortgage transaction. The parties instructed the solicitor to place a mortgage on title to the matrimonial home of Mr. Nguyen and his wife, Mrs. Yamada (in whose name title to the property was held.) The solicitor met with Mr. Nguyen and his "wife" and obtained signatures in respect of the transaction, not realizing that the role of Mrs. Nguyen's wife was being played by

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[3] Supra at footnote #1, page 7-3
[4] 1996 CanLii 8024 (ON SC)

an imposter. The mortgagee ultimately sued the solicitor for allegedly failing to protect his interests and ensuring that he had valid security.

The issue for the court to decide was whether the solicitor had taken reasonable steps to protect the mortgagee's interests in the transaction. At paragraph 8 of the decision, Justice Day stated as follows:

> *Should a solicitor anticipate that the person appearing before him in a transaction with major financial consequences may be an imposter? While the solicitor should not be expected to act as guarantor, he or she should take reasonable steps to protect the interest of the party which he or she is serving. While the eliciting of identification may not prevent fraud, it would make it more difficult... Both parties are innocent. As between them, who should bear the risk? Mr. Miller [the lawyer] could easily have sought identity.*

Judgement issued in favour of the mortgagee against the lawyer (and the fraudster) for the amount of principal and interest due and owing under the mortgage.

Lending institutions v. innocent home owners

Like lawyers, lending institutions have come under scrutiny in cases of real estate fraud. Like lawyers, they have been accused of failing to take the proper steps to prevent the fraud from occurring. As was true in *Yamada*, above, the courts have been called upon to consider who, as between two (or more) seemingly innocent parties (for example, the homeowner whose property had been mortgaged on the one hand and the lending institution that advanced the funds on the other), should have to bear the loss.

The 2006 decision *Rabi v. Rosu*[6] is a prime example. The plaintiffs Rabi and Shafiel were the owners of a condominium unit in Toronto, which they purchased in 2001 and which they lived in with their children. By 2004, there were no mortgages or encumbrances on the property. In May 2004, individuals posing as Rabi and Shafiel purported to sell the condominium unit to Ion Rosu (also a fraudster.) The fraudsters enlisted the services of a real estate lawyer to act on behalf of all parties. They presented identification documents (driver's licenses, social insurance cards) which appeared to be valid. They presented an agreement of purchase and sale, which also appeared to be valid and which purported to sell the condominium unit to Rosu for the price of $270,000.

The real estate lawyer took steps to close the transaction, including arranging for a mortgage from the Toronto-Dominion Bank, transferring title to the property to Rosu and registering the charge on title. Rabi and Shafiel only discovered the fraud a year later, when they received a City of Toronto tax bill that listed Rosu as the owner of the unit. By then, the fraudsters had long absconded with the funds.

Rabi and Shafiel brought an application to have the title restored back to their name. They also sought to set aside the fraudulent mortgage. The bank agreed that the transfer of property to Rosu was invalid but disagreed that the mortgage was not a valid charge and should not have to be repaid.

The court found in favour of the plaintiffs on the basis, *inter alia*, that since the transfer was void, the fraudulent owner (who obtained title in the fraudulent transfer) did not have any title to charge. Therefore, the fraudulent charge was also void. Justice Echlin found that "Rabi

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[6] 2006 CanLii 36623 (ON SC)

and Shafiel did nothing in any way to bring this nightmare upon themselves." By contrast (at paragraph 22),:

> *...the bank acted pursuant to its "usual procedures" and advanced money to a fraudster in the absence of an interior inspection of the premises to be mortgaged (which would likely have averted the fraud), having chosen to delegate the due diligence to a mortgage broker. It is also extremely curious that the condominium unit in question at 28 Hollywood Avenue was listed as having a locker and two parking units, and yet the fraudulent sale did not refer to these nor did it offer any explanation for the absence of such transfers. Finally, it was odd that there was no deposit. All of these should have raised questions for the lender....*

At paragraph 30 of the decision, the court added:

> *In this day and age of impersonalized mortgage lending and borrowing in which the banks download the appraisal process to a mortgage broker who, in turn, does as little as possible to maximize proof, such frauds can and will occur. I cannot help but observe that there ought to have been more care taken in advancing a sum in excess of one quarter of a million dollars.*

The charge granted by Rosu to the bank was declared void and unenforceable.

A year later, the case of *Reviczky v. Meleknia*[7] came before the court, which dealt with a contest between not two but three "innocent" parties. The plaintiff, Paul Reviczky, was the owner of a residential property in Toronto, which he used for rental income. In 2006, (when Mr. Reviczky was 88 years old), he rented the property to a couple who alleged to be renting the property on behalf of other individuals about to arrive in Canada. The fraudsters paid three months of rent for the property up front. Months later, Mr. Reviczky discovered a hydro bill in the name of one Mr. Meleknia. Further inquiries revealed that Mr. Meleknia had purchased the property some two months earlier from a fraudster, purporting to sell the property under a

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[7] 2007 CanLii 56494 (ON SC)

fictitious power of attorney. Mr. Meleknia had financed the purchase of the property largely through a mortgage obtained from the HSBC Bank. Mr. Reviczky (the true owner), Mr. Meleknia (the purchaser) and the bank (who had advanced the mortgage funds) all appeared to be the victims of the fraud.

Relying on the principal of deferred indefeasibility, the court held that the bank's mortgage was not a valid charge as against the true owner of the property and deleted it from title.[8] Justice Macdonald found that the bank (through its solicitor) had failed to scrutinize the power of attorney in circumstances where doing so would likely have avoided the fraud. At paragraphs 36 – 37, the court stated as follows:

> *Consequently, I find that if the Power of Attorney had been reviewed by or on behalf of the bank prior to closing, the bank would have known that the donor thereof, at 88 years 7 months of age, gave a Power of Attorney valid until his death, which could be revoked at any time and which was to continue in effect despite the donor's lack of mental competence, but which had been witnessed by only one witness.*
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> *Review of the Power of Attorney prior to closing therefore would have led to several questions about its validity. If the fraudster were questioned about the validity of the Power of Attorney through his solicitor, he likely would have abandoned the fraudulent scheme, to avoid apprehension and prosecution. Alternatively, if Mr. Reviczky were questioned to determine whether he was alive just prior to closing, whether he had revoked the Power of Attorney or whether he was mentally competent at relevant times, its invalidity would have been revealed. In either case, the bank would have avoided the fraud.*

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[8] Pursuant to immediate indefeasibility, as soon as a document obtained by fraud is registered on title, it becomes enforceable and indefeasible (other than as against fraudster.) On the theory of deferred indefeasibility, there are three classes of parties: the original owner (who has no knowledge of or involvement in the fraud), the intermediate owner (who dealt with the fraudster); and the deferred owner (who subsequently acquired the property without knowledge of the fraud.) Between these three classes of owners, only the intermediate owner has the opportunity to detect or avoid the fraud. For a fulsome discussion of the deference between these two concepts, see *Isaacs v. Royal Bank of Canada*, 2010 ONSC 3527 (CanLii) at para. 52

The court found that the bank's charge was not a valid charge or Mr. Reviczky's property and directed the Land Registrar to delete the bank's charge from title. Mr. Reviczky was awarded his costs of the application.[9]

In the same year, the well-publicized case of *Lawrence v. Maple Trust Company*[10] was decided by the Court of Appeal. A fraudster posting as Ms. Lawrence (the owner of a Toronto residential property) purported to sell her home to a purchaser named Thomas Wright (also a fraudster) pursuant to a forged agreement of purchase and sale. Mr. Wright applied to Maple Trust to fund the purchase of the property. Maple Trust approved the mortgage application and advanced funds in excess of $290,000. A fraudulent transfer in favour of Mr. Wright was registered, together with a mortgage in favour of Maple Trust. The authentic Ms. Lawrence subsequently discovered the fraud some months later when she attended at her local bank to discuss an actual sale of her home. The application judge had set aside the transfer of the property to Mr. Wright but refused to set aside the mortgage (which would obviously have grave financial consequences for the real Ms. Lawrence.) The Court of Appeal disagreed and allowed the appeal. In a pithy preamble to the written endorsement, Gillese J.A. wrote as follows:

> *Ownership of a person's home is fraudulently transferred. The property is then mortgaged. In a contest between the two innocent parties – the homeowner and the lender of mortgage monies – who wins? This appeal answers the question in favour of the homeowner*[11].

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[9] The rights of Mr. Meleknia appear to have been dealt with in another context. According to the court's analysis, the bank was the intermediate whose interests were defeasible in favor of the true owner, Mr. Reviczky. However, Mr. Meleknia was technically a bona fide purchaser for value without notice. It appears that Mr. Meleknia did not insist on retaining title to the property and resolved any issues with Mr. Reviczky in a different proceeding.

[10] 2007 ONCA 74 (CanLii)

[1111] Ibid. at para. 1

The Court of Appeal found that Mr. Wright never took title to the Property because he obtained it by fraud. He was therefore not a registered owner. Only a registered owner could give a valid charge on the land. Again applying the principle of deferred indefeasbility, the Court of Appeal stated, at paragraph 68:

> *Maple Trust is the intermediate owner of an interest in the Property. It had an opportunity to avoid the fraud. It did not take from a registered owner. Therefore, despite registering the charge, Maple Trust loses in a contest with the true registered owner, Ms. Lawrence. Accordingly, the charge against the Property in favour of Maple Trust should be set aside.*

Notably, although the banks had been criticized for failing to meet due diligence requirements in cases such as *Rabi* and *Reviczky*, the decision in *Lawrence* did not turn on the concept of fault. Although Ms. Lawrence had originally alleged lack of due diligence on the part of Maple Trust, she agreed to abandon these allegations at the hearing of the appeal. Instead, the court focused on who had an *opportunity* to avoid the fraud, as opposed to who fell below the standard in preventing the fraud from occurring.

Lending Institution v. Straw Purchaser

The party who is in the best position to avoid the fraud, however, will not *always* be the financial institution. The analysis is fact-driven and depends on many factors, including whether the borrower, although unaware of the fraud, obtained a benefit for participating in the fraudulent scheme. Numerous cases are illustrative of this point, among them, *National Bank of Canada v. Meneses*[12].

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[12] 2008 CanLii 25064 (Ont. S.C.J.)

In or around 2005, Oldemiro Demeneses was approached by a family friend with a business proposal. He was asked to complete "some paperwork" in respect of a property that was to be purchased, renovated, leased to new tenants and eventually resold. In exchange for signing the "paperwork" he was promised payment of $5000. Oldemiro declined the offer but suggested that his son, Danny Meneses (then 22 years of age and working as a manual labourer) might be interested. He was.

Danny was told which lawyer to see in respect of the transaction and which bank branch to attend to apply for the mortgage financing. He was advised that all mortgage payments would be made by Reliance Financial Corporation or its principals and that he would have no personal liability whatsoever.

Danny did as he was told. He applied for the mortgage. His father, Oldemiro, provided a guarantee. Months after the transaction closed, Reliance defaulted on the mortgage payments. It was discovered that the property in question had been purchased in 2004 and thereafter, flipped at an inflated purchase price. Danny and Oldemiro were left holding the proverbial bag and were both sued by National Bank of Canada for amounts owing under the mortgage (Danny in his capacity as mortgagor and Oldemiro in respect of the guarantee). The bank moved for summary judgment.

Danny argued that he had never seen an agreement of purchase and sale, had never visited the property prior to closing and had never received the keys to the property. He blamed the bank for failing to exercise greater due diligence, including failing to obtain an appraisal of the property which he argued would have uncovered the flip. Both Danny and Oldemiro pleaded

that they were innocent victims of a fraud and also blamed their lawyer for allegedly failing to explain to them the consequences of what they were signing.[13]

The bank, meanwhile, relied on the fact that Danny and Oldemiro had signed numerous documents in connection with the charge, including an acknowledgement that they received the standard charge terms, a statement of disclosure (setting out the cost of borrowing), and an acknowledgement and direction (reflecting the amount of the mortgage and enabling it to be registered electronically). Moreover, Danny personally signed an agreement for an advance secured by a mortgage (indicating that all principal and interest would become due and owing in the event of default) and a statutory declaration, wherein he indicated that the property would be owner-occupied by him. He also received the payment of $5000 that he was promised for lending his name to the transaction.

The court found that the defendants were not induced to enter into the transaction through the misrepresentations of their solicitor (who had acted for both the defendants and the bank.) Even if they managed to prove that the lawyer had failed to explain the consequences of the documents they had signed, however, they would not have a defence to the bank's action on the security. With respect to the alleged lack of due diligence on the part of the bank, the court found as follows at paragraph 36:

> *...Oldemiro in his affidavit expresses the defendants' position that that Bank ought to have taken more care in advancing almost $300,000.00 and should have exercised due diligence to prevent the fraud from being perpetrated. These arguments relate to steps that the Bank might have taken to ensure the defendants' capacity to repay the loan and to confirm the value of the security. However, a lender owes no duty to a borrower with respect to the making of the loan and specifically, no duty to a customer to advise the*

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[13] The defendants were granted leave to commence a third party action against their lawyer, Reliance Financial Corporation and others. It is not known to the writers whether the third party action was actually commenced and if so, how it was disposed of.

> *customer not to undertake the loan...Similarly, the failure of a bank to follow its internal lending practices does not by itself render a loan unenforceable...Finally, there was no requirement that the Bank obtain an appraisal of the Property for the purpose of warning the defendants that their security might not cover the loan...*

The court granted summary judgment in favour of the Bank.

This case is illustrative of the notion that everyone is expected to be vigilant of mortgage fraud and that stupidity is no defence to a subsequent lawsuit. In retrospect, the few thousand dollars paid to the straw purchasers paled in comparison to the costs of dealing with the mortgage and the legal fees associated with the resulting lawsuit. Clearly, an individual who willingly assumes the risk of dealing with a property that he has never seen for the sake of making a quick profit is expected to bear the consequences of his or her actions.

The issue of lender liability in the context of a mortgage fraud most recently came before the court in *Isaacs v. Royal Bank of Canada.*[14] The facts are somewhat surprising. In 2004, Ms. Isaacs was in Tim Hortons with her spouse, discussing their finances. A man who had been sitting nearby approached the couple. He introduced himself as "Mike". Mike advised that he could assist the Isaacs, left his telephone number and encouraged them to call. Unfortunately, Ms. Isaacs did.

"Mike" advised Ms. Isaacs that he knew of someone who wanted to purchase a house but who apparently had a poor credit rating. Mike offered to pay the Isaacs $4000 if one of them agreed to co-sign the mortgage. After six months', the Isaacs' name was to be removed from the mortgage altogether. Ms. Isaacs initially agreed to the deal. Some time later, she changed her

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[14] 2010 ONSC 3527 (CanLii)

mind and advised that she was no longer interested. The offer of payment to Ms. Isaacs was then increased from $4000 to $6000. Ms. Isaacs accepted the offer.

Ms. Isaacs attended at the office of a certain "Ms. Briggs", purporting to be mortgage broker. Ms. Isaacs signed some documents (although she later alleged that she did not read them.) She understood that Ms. Briggs would be sending the documents to the Royal Bank. Ms. Briggs again advised Ms. Isaacs that she would be technically liable as a co-signor for six months only, although during this entire period, the real borrower would be making the payments. There is no indication in the endorsement that Ms. Isaacs made any substantial inquiries into the identity of the real borrower or that she took any steps to satisfy herself of his financial wherewithal.

Ms. Isaacs then attended at the Royal Bank and met with a mortgage specialist. Ms. Isaacs signed numerous documents, including a mortgage application, which indicated that the borrowers were Ms. Isaacs and Mark Forrest (whom Ms. Isaacs had never met) and the property in question was 48 John Stoner Driver in Toronto (which Ms. Isaacs appears to have never seen.) Ms. Isaacs did not tell the Royal Bank mortgage specialist about the $6000 payment she would be receiving for her role in the transaction. She later alleged that she was not asked. Ms. Isaacs then attended at a lawyer's office to sign "legal documents" (which turned out to be a disclosure statement setting out the cost of borrowing, and an acknowledgment of the receipt of standard charge terms). She met only with a secretary and according to her version of events, signed whatever was given to her, without explanation.

Based on the documents, the Royal Bank advanced the funds. Ms. Isaacs and Mr. Forrest were both listed as borrowers on the mortgage. The transaction closed, title to the property was

taken jointly in the names of Ms. Isaacs and Mr. Forrest, and Ms. Isaacs was paid $6000, as promised. The very next month, the mortgage went into default. A fraud was soon discovered.

As it turned out, the property was dilapidated and worth only about $220,000 (as opposed to the $284,900 shown in the agreement of purchase and sale.) The account statements and T4 form sent to the Royal Bank by Ms. Briggs (the alleged mortgage broker) in support of the mortgage application were fraudulent. Ms. Isaacs' own information had been manipulated. In reality, Ms. Isaacs earned $35,000 per year, and not $56,724 as shown on her alleged T4 form. The mortgage broker, realtor and lawyer all appeared to have received unusually high fees[15]. The fraudsters vanished with the funds.

Ms. Isaacs began making the mortgage payments herself and then listed the property for sale. She received an offer of $210,000 which she accepted, conditional on the Bank's agreement to accept that sum in full satisfaction of her liabilities. The Bank refused. The mortgage then went into default, the Bank sold the property for $225,000, sued Ms. Isaacs for the shortfall owing under the mortgage and moved for summary judgment. Ms. Isaacs argued that the Bank had been in the best position to discover the fraud. She portrayed herself as an uneducated, unsophisticated "victim", in contrast to the Bank – a large, sophisticated commercial lender.

Justice Molloy did not accept Ms. Isaacs' arguments. The court found that Ms. Isaacs was an adult, competent person. If she had taken the trouble to read the documents she had signed, she would immediately have known that the transaction was not what she had understood it to be. By contrast, the Bank would not have known by reading the same documents that anything was amiss. As such, Ms. Isaacs, not the Bank, was in the better position to discover the fraud.

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[15] The 2010 decision indicates that the lawyer involved was suspended by the Law Society and was facing disciplinary charges for his role in the transaction.

The court dismissed Ms. Isaacs' arguments that the bank ought to have been more diligent. Ms. Isaacs had argued, among other things, that the Bank failed to consider the history of the transactions involving the property, had failed to obtain its own appraisal and had failed to explain the nature of the documents she had signed. Justice Molloy found as follows (at paragraphs 39 – 41):

> *There is no fiduciary duty owed by a Bank to a borrower – their relationship is strictly that of a debtor and creditor...*
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> *Therefore, there was no obligation on the Bank to explain the documents to Ms. Isaacs or verify that she knew what she was getting into. The Bank was not required to protect Ms. Isaacs from others who were deceiving her without the knowledge of the Bank. It was not the Bank's role to provide advice to Ms. Isaacs or to protect her interests. The Bank made no misrepresentations to Ms. Isaacs and Ms. Isaacs placed no reliance on the Bank...*
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> *A lender has no obligation to obtain an appraisal before it extends mortgage financing. If it obtains an appraisal, it does so for its own protection, not for the protection of the borrower. ..*

The court found that although Ms. Isaacs was not privy to the fraud, she was not a truly innocent victim either. Albeit unknowingly, she had assisted the fraudsters to perpetrate the fraud and was paid for doing so.

Justice Molloy's findings were upheld by the Court of Appeal. In its endorsement dated January 28, 2011[16], the Court of Appeal found as follows (at paragraphs 6 to 10):

> *The Bank's conduct, at its highest, was careless. But the appellant's conduct was more than careless. It involved affirmative action on her part that facilitated the fraud. This is a significant distinction between the nature of the parties' conduct.*
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> *...In this case, as we have said, both parties were careless. However, both parties were not innocent of any wrongdoing. On these facts, where the carelessness of one party involves active participation in the fraudulent scheme and results in the wrongdoing being able to inflict the loss, that party must bear the burden of the loss.*

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[16] *Isaacs v. Royal Bank of Canada*, 2011 ONCA 88

The appellant relies on several "deferred indefeasibility" cases to argue that, as the Bank's carelessness in this case was at least equal to that of the appellant, the Bank should not be permitted to "escape" all contributory liability for the outstanding mortgage debt.

In our view, these cases do not assist the appellant. They involve theft of the identities of the persons who had no involvement in the fraudulent activity that effect the frauds. In contrast, as we have indicated, in this case the appellant's participation was part of the fraudulent scheme itself. Her actions directly contributed to the Bank's advance of funds to its detriment.

This approach has been followed in jurisdictions other than Ontario as well. In *MCAP Service Corporation v. Molina-Tan*[17], the defendants were approached by a woman purporting to be a real estate broker with an investment opportunity. She suggested that the defendants purchase a condominium unit in Calgary and then hold it in their names, briefly, until the property was resold. The defendants were assured that they would not have to pay any of the costs or legal fees associated with the transaction and that their involvement in the deal was "risk free." In return for lending their names to the transaction, the defendants would receive payment of $4000.

The defendants attended at a "person's" office (it was acknowledged that this was not a In lawyer) and signed various documents which they were told were standard and which they did not need to review. They received payment of $4000, as promised. After the closing, the mortgage went into default and the fraud was discovered. Among other things, the property was worth far less than the price indicated in the agreement of purchase and sale.

The plaintiff lender sold the property under power of sale and then sued the defendants for the shortfall between the value of the property and the amount outstanding on the mortgage. The lender was successful in obtaining summary judgment. The Tans argued, among other

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[17] 2009 ABQB 472 (CanLii)

things, that the lender had failed to conduct due diligence. The closing documents indicated a down payment of $17,000, which they had never made. The unit was described as having been renovated recently when the defendants understood that it had not been (although they had never visited the property). Comparable listing agreements showed that this listing in question was not comparable at all. According to the Tans, proper inquiries on the part of the lender would have revealed these discrepancies.

In keeping with the *Isaacs* type of analysis, the court dismissed the defendants' arguments that the lender had failed to meet its due diligence requirements. The court explained that the responsibility of the lender to carry out due diligence was an important factor in cases involving innocent victims of identity theft. The Tan defendants in this case were not entirely innocent. The lender did not owe them a duty to ensure that it did not loan more money to the defendants than was appropriate. At paragraph 21:

> *...the conditions placed on the advancement of a loan are the lender's and the lender can choose to enforce, alter or waive them. Furthermore, there is no obligation on lenders to look beyond the documents provided to them in apparent good faith.*

A similar result occurred in *RBC v. Parmar*[18] – a case decided by the Supreme Court of British Columbia in 2005. The Royal Bank of Canada was the mortgagee in a transaction which named Ravinder Parmar as mortgagor. Parmar alleged that he had been approached by an acquaintance seeking to purchase a property in Parmar's name. In return, Parmar was offered (and ultimately received) payment of $5000. Parmar signed "paperwork" in connection with the transaction, including mortgage-related documents. He claimed to not have read them and to not

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[18] 2005 BCSC 1155 (CanLii)

appreciate the consequences of what he had signed. Sometime after the closing, Parmar became concerned that "something was not right." The fraud was then discovered. The bank sought judgment against Parmar for the difference in value between the funds advanced and the funds realized after sale of the property.

Parmar defended the proceeding against her on the basis, *inter alia*, that the bank had failed to conduct proper due diligence. She argued that she had not actually paid the $10,000 deposit indicated on the purchaser's statement of adjustments. Moreover, the 2004 tax information assessed the property value at $85,900. By contrast, the agreement of purchase and sale indicated that it was being sold (not even a year later) for $130,000. The court found in favour of the Bank. With respect to the alleged lack of due diligence on the part of the bank, the court stated as follows (at paragraphs 18-21):

> *I have concluded that there is no triable issue arising in respect of the plaintiff's allegations, that is, that the Royal Bank of Canada acted without completing its required due diligence. I have concluded that that is so because the Royal Bank of Canada owed no duty to Ms. Parmar, the borrower, to ensure that it completed its due diligence. ..*
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> *...In my opinion, there was no obligation on the Royal Bank of Canada to have the property being mortgage appraised. The bank had no obligation to ensure that the Royal Bank of Canada only advanced on the security of the mortgage, monies that were less than the value of the property. There was no other obligation from the Royal Bank of Canada to Ms. Parmar.*
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> *Ms. Parmar was borrowing money from the bank. The bank owed her no duty of care to ensure that it did not loan to her more monies than business considerations would suggest were appropriate.*

Parmar had also argued that she had a cause of action against the bank in negligence. (This was based on the allegation that one of the bank's employees was involved in the mortgage fraud and that as a result, the bank was vicariously liable for his actions.) The court left open the possibility of a law suit against the Royal Bank but concluded that to the extent Parmar had a

cause of action against the bank, she would have to pursue it in a separate action, independent of the foreclosure proceedings.

Clearly, the results of these cases were guided by policy considerations. No doubt it would seem fundamentally unfair, if not downright shocking, to see elderly Mr. Reviczky or the plaintiffs Rabi and Shafiel – a young couple with children – saddled with a mortgage they neither knew about nor had the benefit of. By the same token, there is a sense of "justice" – if we can call it that – in holding parties such as Ms. Isaacs or Mr. Meneses accountable for their role in the mortgage fraud (albeit as unwitting dupes.) The willingness of these parties to sign documents that they did not take any care to read, in respect of properties which they did not visit, in relation to people that they did not know, all for the sake of making a few thousand dollars is remarkable and deserving of rebuke. However, what is curious in these cases is the notion that the liability (or lack thereof) of the lending institution is defined less by what the lenders did or did not do and more by who the other parties were and what role, if any, they played in the mortgage fraud. Compare, for example, the failure of the bank to obtain an appraisal, which was raised in both *Rabbi v. Rossu* and *Isaacs v. Royal Bank of Canada.* In *Rabbi,* the court criticized the respondent bank for "its simple failure to obtain an in-person appraisal[19] which would presumably have uncovered the fraud. Meanwhile, in *Isaacs* the court held that the bank had no obligation to obtain an appraisal before extending mortgage financing.[20]

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[19] See paragraph 47 of decision. "…it was incumbent upon the bank to exercise due diligence which might be able to prevent the fraud. Clearly it did not. Its simple failure to ensure that a proper in-person appraisal involving contact with the occupants of the subject premises would have uncovered the fraud…"

[20] See paragraph 40 of *Isaacs v. RBC* where the court stated that "If it [the lender obtains an appraisal, it does so for its own protection."

A lender's lack of due diligence may be a factor in cases where truly "innocent" home owners are concerned (i.e. whose homes have been mortgaged from under them, without knowledge or participation on their part), although, as set out above, such cases turn on the notion of who had the opportunity to avoid the fraud and not necessarily who fell below the standard of care. A lender's lack of due diligence will *not* be a defence to mortgage enforcement proceedings vis a vis a dupe "straw" purchaser. This does not mean, however, that the "dupe" is without remedies. In many cases, we can expect the straw purchaser to commence proceedings in negligence, which will likely include allegations that the solicitors who acted for the purchaser fell below the standard of care.

To what extent is it, or will it be possible, for real estate lawyers to successfully argue contributory negligence to foist some liability back onto the lender? To date, the writers have been involved in numerous lawsuits where solicitors been sued for their alleged negligence in the context of real estate fraud. In virtually all of the cases, the solicitors have defended, and counterclaimed, on the basis that the lender in question failed to carry out it's appropriate due diligence. In at least one of the cases, the bank agreed to extend mortgage financing to the same party who had defrauded a bank years earlier. In another case, the properties sought to be mortgaged (in respect of which false appraisals were provided) were located literally a stone's thrown away from the bank. A simple drive-by inspection would have revealed that the properties were dilapidated and worth substantially less than the values in the agreement of purchase and sale. The notion that the lending institutions would be free of all liability in such circumstances seems incomprehensible. However, none of these cases have proceeded to trial. There are a number of reasons for this, including the fact that most parties are eager to keep the

negative publicity of a real estate fraud (and their potential shortcomings in detecting it) to a minimum, thereby encouraging an early out-of-court resolution. The desire to avoid a negative precedent is also a relevant consideration.

Aside from contributory negligence, it will be open to lawyers to attempt to limit their liability on the basis of the principle that a lawyer is not a guarantor of the mortgage and should only be responsible for the reasonable losses incurred by the lender to realize on its security. Cases determined outside of the fraudulent context, such as *Royal Bank of Canada v. Slopen*[22], have held that a lawyer who has been negligent in the context of a mortgage transaction should be responsible for the losses incurred by the lender to realize on the security of the mortgage, to the extent that those expenses would otherwise have not been incurred. The reduction in amounts payable on this theory may not, however, be substantial.

No doubt, the law with respect to real estate fraud, including lender liability, will continue to develop as homeowners, lending institutions and courts continue to deal with the issue. In the meantime, all players will do well to stay vigilant.

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[22] 2009 CanLii 55300 (ON SC)