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Mortgage proceeds paid to fraudster's lawyer, in trust, covered under title insurance policy

By Stephen Thiele

Thanks to the ability to produce believable fake identity documents, real estate fraud continues to plague Ontario and to cause headaches for lawyers.

Although the legal profession has made many positive amendments to its Rules of Professional Conduct to prevent real estate fraud, imposters continue to convince lenders and lawyers that they are legitimate homeowners.

In general, lawyers are protected from their failure to properly ascertain the identity of a client through their professional liability insurance policies, while lenders, like new home buyers, purchase title insurance to protect themselves against a loss perpetrated by fraud.

However, some of these frauds involve significant sums, making insurers, particularly title insurers, reluctant to pay. Indeed, some title insurers have included restrictive exclusion clauses in their private mortgage title insurance policies to reduce their risk and exposure in the event of fraud.

But as recently seen in *Nodel v. Stewart Title Guaranty Co.*[1] a private mortgage lender who pays the proceeds of a loan to a fraudster's lawyer, in trust, will be entitled to coverage under the lender's mortgage title insurance policy even though the fraudster redirects payment to other parties and does not receive the proceeds in his or her hands.

In *Nodel*, an imposter posing as a real homeowner sought to obtain a $1.1 million mortgage through a mortgage broker. In turn, the mortgage broker contacted the lender. The loan's purpose was purportedly for investment rather than refinancing.

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The necessary mortgage documentation was signed and both the lender and the imposter hired separate lawyers to complete the mortgage transaction. The lender sought to obtain mortgage title insurance to protect his loan from fraud.

The insurer immediately flagged the transaction for review because the borrower's lawyer was on a "flash list" of real estate lawyers and had a prior discipline history with the Law Society of Upper Canada.

Due to concerns about fraud, the insurer, without advising the lender's lawyer, conducted an investigation into the transaction.

Yet the insurer confirmed the imposter's driver's licence and social insurance number, lifted the flag and issued the title insurance policy to the lender.

The mortgage transaction was then completed, with the lender's lawyer sending the mortgage proceeds to the imposter's lawyer, in trust, and registering the necessary mortgage on title to the property of the real homeowner.

Meanwhile after receiving the funds, the imposter's lawyer was instructed by his client to disburse the proceeds to various third parties. The lender's lawyer was never told who the ultimate recipients of the funds would be, believing that by making payment to the imposter's lawyer, in trust, meant that the ultimate recipient was the client of the imposter's lawyer. Indeed, it is well-established law that money held in a lawyer's trust account belongs to the lawyer's client.

The fraud was then discovered, the mortgage was deleted from title and the lender, who had now lost the proceeds of his loan as a result of the fraud, sought recovery under the title insurance policy.

The title insurer relied on an exclusion clause contained in the policy that removed coverage for fraud if the loan proceeds were not "paid" to one of the listed parties stated therein, including the "registered title holder", and thus refused to compensate the insured lender.

In essence, the title insurer argued that under the exclusion even though the lender had paid the loan proceeds to the imposter's lawyer, in trust, the lender was required to pay the "registered title holder".

The insurer submitted that the loan proceeds are paid to the "registered title holder" if the cheque is made out to them or wired to their bank account directly.[2]

The insurer also contended that payment to a lawyer, in trust, was only acceptable if the receiving lawyer undertook to disburse the loan proceeds directly to one of the approved parties listed in the exclusion. No such undertaken had been given by the imposter's lawyer to the lender's lawyer.

The court rejected the title insurer's arguments and held that the exclusion was unclear and ambiguous.

Focusing on the meaning of the word "paid" and the relevant surrounding circumstances, the court found that the exception permits payments to a lawyer, in trust, for his or her client.

The court noted that the regulatory regime under the Rules of Professional Conduct and common practice supported the interpretation led by the lawyers acting for the lender and the lender's lawyer.

We argued, among other things, that the exclusion did not apply because payment of the loan proceeds to the imposter's lawyer, in trust, was payment to the "registered title holder". The court determined that this argument was reasonable and commercially sensible.[3]

More specifically, the court concluded that:

> the exception does not incorporate the unexpressed requirement that cheques must be made payable to a listed approved party, or wired to them directly, or the subject of a special undertaking from their lawyer. By not expressing the manner of payment, the exception permits multiple payment methods including disbursing the funds to the lawyer, in trust for his or her client.

The successful lender and his lawyer were represented by Gardiner Roberts' litigation lawyers **Gavin Tighe** and **Alexander Melfi**. Gavin and Alexander were assisted in the preparation of their written legal argument by the firm's director of legal research, **Stephen Thiele**.

About the Author

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1. 2017 ONSC 890
2. at para. 51
3. at para. 59