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Real Estate Newsletter

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B.C. Court of Appeal Renders Judgment Regarding Effect of Fraud on Mortgage Enforceability

by Brenda M. Lightbody

When a property has been fraudulently transferred and then mortgaged to an innocent lender, will the mortgage be enforceable against the “true” owner? Unfortunately for lenders, the answer is no, according to the decision of the B.C. Court of Appeal in *Gill v. Bucholtz*, 2009 BCCA 137, released on April 6, 2009.

The facts of the case are simple. A fraudster representing himself as the true owner transferred the owner’s property to a second fraudster Gurjeet Gill (“Gill”), who then mortgaged the property twice. Both lenders were unaware of the fraud and in advancing funds relied on the state of title showing Gill as the registered owner. Both lenders also confirmed the identity of Gill prior to advancing funds.

When the fraud was discovered, the true owner commenced legal proceedings to recover his title to the property free of the mortgages which had been fraudulently granted.

There was no doubt that the true owner of the property should have his title restored. This was by virtue of section 23(2)(i) of the B.C. *Land Title Act*, which allows a person who has been deprived of land and who is able to show fraud in which the registered owner has participated, to challenge the fraudster’s title as registered owner and recover title to his or her lands.

The real question for the Court was whether the mortgages remained valid charges on the title.

At the trial level, the Court concluded that the mortgages were valid charges, as the lenders had dealt with the registered owner in good faith and with consideration and as such were entitled to rely on the title as it stood at the time they accepted the mortgages and advanced funds, without the need to investigate the registered owner’s title to determine whether it was legitimately obtained. In other words, the Court agreed with the lenders’ position that between the time the fraudster took title and the time the true owner discovered and remedied the fraud, the fraudulent title holder could grant valid charges such as a mortgage, provided the lender was unaware of the fraud and relied on the title as it stood at the time it accepted its security.

The Court of Appeal disagreed with the lower Court’s interpretation of the *Land Title Act*. According to the Court of Appeal, section 23(2)(i) of the *Land Title Act* which provides an exception to the “indefeasible” or conclusive quality of a registered owner’s title and which allowed the true owner in this case to recover title to his lands, could not be interpreted so as to allow the fraudster the right while he remained on title as registered owner, to deal with the property and grant valid charges such as a mortgage. The Court of Appeal held that these provisions of the *Land Title Act* did not extend to protect the interests of mortgagees and other chargeholders in this manner.

In concluding that the mortgages were invalid, the Court of Appeal also relied on section 25.1 of the B.C. *Land Title Act*, which states that “*Subject to this section, a person who purports to acquire land or an estate or interest in land by registration of a void instrument does not acquire any estate or interest in the land on registration of the instrument*”. The Court noted that while there is an exception in section 25.1 for innocent purchasers who unknowingly purchase a fee simple interest involving a





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void transfer, there is no similar protection for innocent mortgagees and other chargeholders acquiring a charge by registration of a void instrument.

This decision means that lenders, in order to be sure that they hold a mortgage which cannot be invalidated because of fraud, will need to confirm that the registered owner granting the mortgage legitimately obtained his or her title from the previous owner in good faith and with consideration. The risk of a mortgage being invalidated because of fraud in which the registered owner has participated, would appear to be low where title has been held by the registered owner for some time. However, where title has recently changed hands, further investigation and due diligence might be required to confirm the validity of the registered owner's title. Title insurance may also be a practical option.

If you would like more information on the content of this newsletter, or on other lending matters, please contact Michael P. Shane at mshane@rbs.ca or at 604.661.9223 or Brenda M. Lightbody at blightbody@rbs.ca or at 604.661.9262.

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