

Equity's Darling: The Bona Fide Purchaser for Value in Real Estate Priority Conflicts

Coined by courts as "Equity's Darling", the law of Equity is said to have a special affinity for the bona fide purchaser for value ("BFP"). The BFP defence is the exception to the common law rule of *nemo dat quod non habet*, which translates to "no one gives what they don't have". While one cannot generally transfer more property rights than one has to a third party (such as a fraudster trying to sell property they do not own), the BFP can actually obtain good title to one's property despite a prior fraudulent transaction in the conveyancing chain. Although this is beneficial to the innocent BFP acting in good faith, what about the innocent original owner now deprived of title to their property? In legal priority conflicts of multiple innocent competing parties, why has Equity chosen to protect the BFP at the expense of all others?

The BFP defence's full name is "bona fide purchaser for value without notice of a pre-existing equitable interest", as briefly noted in April in *Toronto-Dominion Bank v Canada*, 2020 FCA 80. In that case, it was held that secured creditors could not utilize the BFP defence to avoid paying a borrower's \$67,854 GST debt, as it would "eviscerate" deemed trust provisions in the Crown's favour. Such statutorily-mandated provisions are meant to protect the government's tax revenues, and the court noted the *Excise Tax Act* did not mention the BFP defence here while discussing creditor priority. If the BFP defence had been available, and operating because the property had been purchased for value (i.e. it was paid for and not just gifted), its effect would have been to strip away the Crown's pre-existing equitable interest in the unremitted GST deemed trust.

To illustrate how the BFP defence applies when non-government parties are involved in real estate priority conflicts, consider the following fact pattern. Say two fraudsters pretend to be the registered owners of a property with a fair market value of \$400,000, after learning the retired true owners will be out of the country for several months. The property is subject to a \$50,000 private mortgage for which pre-authorized payments have been set up. Hoping to cash in quickly, the fraudsters sign an agreement to sell the property for \$350,000 to a third party in the business of renovating homes. Unaware of the fraudster's scheme, the third party just sees a good deal, wants to spruce up the property quickly, and then flip it to a new buyer for a profit.

The fraudsters then forge a mortgage discharge statement and use it to close the sale transaction. After a Transfer/Deed is

registered, the private mortgage is fraudulently discharged. Title appears clear. The lender is unaware of its lost security. Renovations are then done, the property is re-listed for \$450,000, and a second Transfer/Deed is registered after the property is innocently bought by a single working mother of two children. In order to pay for it, the single mother takes out a \$350,000 mortgage with the Toronto-Dominion Bank ("TD") and a \$50,000 second private mortgage. When the original owners return to Canada, they are surprised to see strangers living in their now-modified home.

Who has priority? Is it the original owners? On balance, are they not quite innocent? Their only crime appears to be travelling during retirement, which has now lost them a \$350,000 property interest. However, what crime has the single mother committed? She only bought a renovated home, unaware of its sordid history. What about TD and the two private lenders? Like the single mother and the original owners, none of these parties dealt directly with the fraudsters. Accordingly, how could they have become aware of the fraud? All of them are very innocent.

Nonetheless, Equity still saves the BFP single mother first. The new private lender's and TD's mortgages are also valid with second and first priority on title, respectively. The original owners and the first private lender are not so lucky. Pursuant to s.78 of the *Land Titles Act* (the "Act"), even though the first Transfer/Deed is void as it conveyed a fraudulently acquired property interest, the second Transfer/Deed is not, as nothing invalidates "instruments registered subsequent to such a fraudulent instrument". Thus, the single mother actually has good title to the property at the expense of the retired original owners.

S.78 of the *Act* establishes a scheme of deferred indefeasibility with respect to such fraudulent instruments. As explained in *CIBC Mortgages Inc v Computershare Trust Co of Canada*, 2015 ONSC 543, this scheme involves three types of owners: an original owner, an intermediate owner (like the home renovator who dealt directly with the fraudster), and a deferred owner (like the single mother who acquired her property interests as a BFP from the intermediate owner). While an intermediate owner has an opportunity to investigate the transaction and avoid the fraud, a deferred owner does not as they are further removed from the fraudster and are thus somewhat “more innocent”. Accordingly, deferred owners are afforded protections by the *Act* that accord with Equity’s Darling.

In *CIBC Mortgages Inc*, a pre-existing mortgage had also been fraudulently discharged and concealed from title. However, as neither of the two new mortgagees had actual notice of the pre-existing mortgage that originally had first priority, the court held that they were entitled to rely on two principles underlying the *Act* – the mirror principle and the curtain principle. The former principle holds that the land’s parcel register is a “perfect mirror”

of the state of title overall, while the latter principle states that purchasers need not investigate the land’s past dealings to see if there is fraudulent conveyance in the chain (partially because this would lead to soaring due diligence costs). Instead, prospective purchasers or encumbrancers are entitled to rely on the parcel register to provide “actual notice”, and need not search behind it.

Technically, as the court mentioned on similar facts, the original private lender’s mortgage interest would have third priority behind TD and the new second mortgage. Afterwards, any remaining funds would seemingly first go to the single mother to make her whole and then to the retired original owners. If the property perhaps later doubled in value, all innocent parties may be able to recoup their losses. Accordingly, while it may be fun to imagine Equity as a white knight saving his BFP damsel in distress, “Equity’s Darling” is mostly just a memorable metaphor that involves a shorter name for the BFP defence. In reality, Equity has simply chosen to favour the BFP amongst multiple innocent parties competing for priority, while perhaps benignly neglecting original owners with pre-existing interests.



Harjot Atwal is a member of the Commercial Real Estate Practice.

Pallett Valo LLP Commercial Real Estate Practice

We have experience in all areas of Real Estate Law, from the most complex joint ventures and land development projects to routine commercial purchase, sale and mortgage transactions. We assist our clients as they structure and negotiate their projects, and we strive to creatively and effectively overcome any obstacles which arise during the course of a transaction. Our "outside the legal box" thinking and practical, business approach allows us to best serve and protect our clients.

Areas of Practice Include:

- Commercial and Residential Land Development
- Commercial Transactions
- Construction Contracts
- Leasing
- Rezoning and Minor Variance Applications
- Builder Sales
- Condominium Development
- Joint Ventures
- Severance Applications
- Mortgage Financing

Contact Members of our Commercial Real Estate Practice:

Harjot Atwal

hatwal@pallettvalo.com • (905) 273.3022 ext. 321

Andréa Brinston

abrinston@pallettvalo.com • (905) 273.3022 ext. 219

Steven Pordage

spordage@pallettvalo.com • (905) 273.3022 ext. 286

Murray Box

mbox@pallettvalo.com • (905) 273.3022 ext. 240

Ray Mikkola

rmikkola@pallettvalo.com • (905) 273.3022 ext. 276

PALLETT VALO LLP
Lawyers & Trade-Mark Agents

This article provides information of a general nature only and should not be relied upon as professional advice in any particular context. For more information about Commercial Real Estate, contact a member of our **Commercial Real Estate Practice** at 905.273.3300.

If you are receiving this bulletin by mail and you would prefer to receive future bulletins by email, visit www.pallettvalo.com/signup or send an email to marketing@pallettvalo.com.

Pallett Valo LLP will, upon request, provide this information in an accessible format.

77 City Centre Drive, West Tower, Suite 300, Mississauga, Ontario L5B 1M5 • 1.800.323.3781