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Interim report of the Conveyancing Practices Task Force

FOR DISCUSSON AND COMMENT

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INTRODUCTION

The Task Force

On June 29, 2002 the Benchers of the Law Society appointed the Conveyancing Practices Task Force to explore and report out on conveyancing issues. This review became important in light of recently disclosed practice irregularities of Vancouver solicitor, Martin Wirick in connection with one of his vendor clients.

Over the past month, the Task Force has held several meetings and attended a joint meeting of the Banking Law Section (Vancouver) and Real Property Section (Vancouver) of the Canadian Bar Association (BC Branch). The Committee has also sought to meet with representatives of the lending community to obtain their input to the work of the Task Force. While we did meet with one delegation, it became clear that a broad involvement of other representatives from the lending community is important to effectively address the issues.

As a result of its work to date, the Task Force has concluded that — to better protect the public — there is a need to change certain conveyancing practices and to improve the financial protections that cover real estate transactions. Lending institutions and some members of the public have expressed concern over the reliability of lawyers' undertakings and the financial losses that can result from a breach of undertaking, and we have a responsibility to address these issues seriously.

This report sets out the background to the issues before the Task Force, identifies problems that need to be addressed and proposes solutions for further consideration by the Law Society in consultation with the profession, the lending community and the public.

The Law Society investigation of Martin Wirick

Martin Wirick, a Vancouver solicitor, voluntarily resigned his Law Society of B.C. membership on May 23, 2002. He is now a former member and his practice is under custodianship. The Law Society has a complaints investigation underway, including a financial audit, to look into allegations of substantial financial and procedural irregularities in his real estate practice.

On July 30 the Discipline Committee authorized a citation (a formal discipline charge leading to a hearing) against Mr. Wirick. The citation alleges that Mr. Wirick breached his undertaking and misappropriated trust funds in that he failed to apply the funds to the

payout and discharge of certain mortgages, but rather paid out the funds contrary to his undertaking.

Mr. Wirick, though a former member, remains subject to the Law Society's complaints and discipline process. The events surrounding his practice are extraordinarily complex; the investigation is continuing and will likely take some time to complete.

The Task Force wishes to emphasize that its report must not be taken in any way to pre-judge Mr. Wirick, notwithstanding his voluntary resignation. Discipline proceedings, professional liability insurance claims and Special Compensation Fund claims are all regulatory issues for the Law Society and it is premature to reach any conclusions about Mr. Wirick's guilt, dishonesty or liability at this time.

Nevertheless, the situation raises serious questions, and it would be imprudent to ignore the fact that our present conveyancing regime is vulnerable to isolated acts of dishonesty that can have consequences of a magnitude far beyond those in the reasonable contemplation of practising lawyers. The areas for concern are addressed in the next section of this report.

CONVEYANCING PRACTICE:
BACKGROUND, PROBLEMS AND POSSIBLE SOLUTIONS

Current conveyancing practices in B.C.

In every conveyance, the legal work is divided among the lawyers acting for the purchaser, vendor and lender. This division of responsibilities is governed by law, contract, Law Society rules and traditions of practice.

In B.C. the payout and discharge of existing mortgages almost invariably falls to the lawyer representing the vendor. The standard contract of purchase and sale in real estate transactions provides for this, taking into account the reality that the vendor usually needs the purchase proceeds to pay off existing mortgages. In our system, this is achieved through the exchange of undertakings (professional promises) between the lawyers to support the exchange of money and documents. In a typical residential transaction, the vendor's lawyer undertakes to discharge any existing mortgages from title and receives funds for this purpose from the purchaser's lawyer.

The problems with current practice

Reliance on lawyers exchanging undertakings to receive and pay out funds and to register and obtain discharges of documents in the financing and conveyance of real property has worked successfully for many years for the vast majority of real estate transactions in B.C.

But it is not infallible. When it fails, the consequences can be serious.

This is particularly true of the system's full reliance on vendors' lawyers to discharge existing encumbrances on title. It is possible for an unscrupulous vendor client, acting in concert with a lawyer who is prepared to breach his undertaking, to register a number of charges, each in an amount of 75% or more of the equity (and in total representing two, three or more times the value of the property.)

The *Land Title Act* and *Property Law Act* provide that the first registered (and advanced) mortgage has priority over mortgages registered subsequently. In the scenario noted above, the junior mortgages, whose proceeds were intended to repay the mortgages ranking in priority to them, would secure little or no remaining equity in the property.

The financial institutions that advance the mortgage financing in this situation each expect that the lawyer will ensure that they receive a valid charge on the property. If the lawyer does not fulfil that expectation, those institutions look to the legal profession for redress.

The problem is exacerbated when there is an innocent purchaser acquiring a property that is subject to multiple mortgages as described above. That innocent purchaser and his or her lawyer similarly expect the vendor's lawyer to repay and discharge existing encumbrances on title from the proceeds of sale.

In these circumstances, a further mortgage is often registered. The proceeds of that mortgage, when combined with the purchaser's equity payment, constitute payment of the required purchase price. If these funds are not used to pay out previous charges, but rather are diverted from their intended purpose, a registered purchaser and his or her mortgagee are both left looking to the legal profession for answers. The registered ownership interest of the purchaser, and the new mortgage, will necessarily be subservient to the priority of the multiple mortgages described above. For such a homeowner, there is little comfort available in the short-term at least. We will address that pressing concern later in this report.

These risks are not limited to the registration of multiple mortgages. We understand that there are instances in which discharges of mortgages can be forged and the proceeds diverted. There are also instances where powers of attorney may possibly be misused to an inappropriate outcome.

To the extent that these events occur, even in the rarest of situations, the losses to purchasers and lending institutions can be serious. For that reason, this report considers new preventive safeguards in conveyancing practice. We note that the risks outlined in this report apply, not only to lawyers, but also to notaries public and need to be considered seriously by both professions.

Possible solutions to conveyancing problems: the two-cheque system and other changes

The Benchers believe that B.C. lawyers are entitled to some guidance on how to modify current practices so as to minimize, if not eliminate, the identified risks. For that reason, the Task Force was charged with a responsibility to report out, at least in a preliminary fashion, by July 26, 2002.

The tight deadline limits the depth of analysis in this interim report. The Task Force has not yet had sufficient time to fully canvass the constituent groups involved and, most importantly, the lending institutions have not yet been appropriately engaged in these discussions. We will continue to monitor developments and report out as needed. We are also committed to working, at least in an advisory capacity, on the follow-up to any suggestions adopted from this report.

From our consultations within the legal profession, it is clear that some lawyers believe a single instance of breach of trust should not lead to a wholesale revision in the manner in which lawyers have historically and successfully conducted real property transactions.

It is the view of the Task Force, however, that present practices will not survive. Absent some dramatic change in practice, the parties who have traditionally relied on the sanctity of undertakings and reliability of the legal profession to honourably conclude transactions will direct a change in practice of their own design. While that may be the outcome despite our work, the Task Force believes that expeditious follow-up on this interim report can lead to restored confidence and comfort of those who are impacted by the failing of current practices.

The Task Force is responsible for re-examining both conveyancing practice and the management of certain financial risks in real estate transactions in light of recent events. The suggestions we make in this interim report are presented as options and, except where noted, without either emphasis or recommendation. In our view, these suggestions will serve to significantly reduce, if not in some cases eliminate altogether, the financial risks identified.

The two-cheque system

This change in practice would, on its face, appear to be the most compelling. It does, however, have its own difficulties. Under a two-cheque system, purchasers' lawyers would deal directly with vendors' encumbrancers and, on closing, would provide separate cheques payable to the respective parties entitled to receive the proceeds. In the simplest transaction, the vendor's lawyer would receive a cheque for the proceeds of sale, over and above the amount required to retire an existing mortgage, and would receive a second cheque in the amount of the mortgage, payable directly to the mortgagee.

There is, of course, no need for a transfer of title for the two-cheque system to work effectively. For that reason, while the Task Force refers to purchasers' lawyers throughout this segment, we speak equally to mortgagees' lawyers when those lawyers are acting to refinance an existing mortgage.

The Task Force is unclear at this time whether the second cheque payable to the mortgagee should be routed through the vendor's lawyer or delivered directly to the mortgagee with the concomitant entitlement to a discharge of that mortgage (as the principal balance and accruing interest are paid in full.)

One difficultly with the approach of the purchaser's lawyer sending payment directly to a mortgagee under this model is that it remains the vendor's responsibility to ensure the mortgage is repaid in full. The commonly occurring problem of additional daily accrued interest would likely provide some difficulty. This is particularly so if the additional accruing interest resulted from a failure of the purchaser's lawyer to deliver payout proceeds within the timeframe provided in the mortgage (a timeframe that is often inconsistent with the timeframe for payment of the purchase price under the contract of purchase and sale.) It is apparent that this aspect of the two-cheque approach will, initially, require a separate and specific negotiation in each case to provide for all possible contingencies.

It is possible that a cheque made payable to a mortgagee, but delivered to the vendor's lawyer, is vulnerable to fraudulent endorsement. That possibility must also be addressed when considering the pros and cons of the two-cheque approach. On balance, the regime would likely require the purchaser to pay the required amount directly to the vendor's lender. However, the purchaser would not relieve the vendor or his or her lawyer from the obligation to make up any deficiency in the payout amount from the remainder of sale proceeds or other funds available to the vendor.

To the extent that this approach is inconsistent with the language of the contract between the parties, it is clear that any closing structured around a two-cheque approach will require either an amicable negotiation among lawyers to amend the terms of the contract, or, alternatively, a change in the standard form contract used to accomplish the purchase and sale of real property. It is possible that the vendor's lawyer would seek to *require* that the purchaser's lawyer accept the undertaking of the vendor's lawyer to clear the title of existing encumbrances. The language of the contract may even support this position, at least to the extent that a contract can seek to impose obligations on the lawyers as non-parties. The Task Force is of the view, however, that despite contractual language to the contrary, it would not be appropriate for a lawyer to seek to require that another lawyer accept his or her undertaking.

In the short term, the two-cheque approach suffers from the obvious deficiency that the contractual arrangements may not permit a unilateral amendment to the manner in which the transaction is to be completed. While the traditional "meet me at the Land Title Office" method of closing (to meet to exchange funds and documents) is often offered as a response, the current standard form contract does not permit that option either.

The Task Force has determined that it would be inappropriate for the Law Society to impose practice directives that may be inconsistent with the contractual obligations of the parties for whom the lawyers are acting. For that reason, it would not be appropriate for the Law Society to mandate a particular response, such as the two-cheque approach. If there is no inconsistency with contractual conditions, however, the Task Force considers that the two-cheque approach is a proper practice to adopt.

The contract problem identified by the apparent inconsistent practice can be resolved almost immediately by the lending institutions requiring their customers, as a condition of the mortgage loan approval, to close the transaction under the two-cheque approach. This will require individual purchasers returning to the bargaining table to seek an amendment to their contract of purchase and sale. In most cases, however, that would be at a time when conditions precedent remain outstanding in the contract relating to the purchaser's ability to obtain financing.

It would perhaps be appropriate to provide some immediate guidance to the real estate industry in the form of a practice alert bulletin, or some similar notification, to encourage parties to obtain legal advice prior to concluding the purchase and sale contract to ensure that an appropriate closing regime can be included in the contract. It might also be appropriate to craft some language that reflects the two-cheque system for inclusion in

standard form purchase and sale contract. This could be accomplished through new contracts or by addenda to existing contracts.

Critics of the two-cheque regime argue that it intrudes into matters that are subject to claims of confidentiality by vendors who would be required to share intimate information on their registered financial encumbrances. It is the view of the Task Force that, while this privacy concern is real, it cannot prevail in the face of the more compelling need for security in the closing of real property transactions.

The Task Force observes that parties providing responses to requests for a mortgage payout often do so in contravention of the clear requirements of the provisions of section 33 of the *Property Law Act*, RSBC 1996, c377. This provision provides as follows:

> **Statement from mortgagee**
>
> **33** (1) Despite an agreement to the contrary, a mortgagor is entitled to receive from a mortgagee, on written request delivered to the mortgagee,
>
> > (a) a statement of the amount payable under the mortgage to obtain its discharge, and if appropriate, of the amounts of principal, interest, any other sums payable and any cost of the discharge,
> >
> > (b) a statement of the balance payable under the mortgage on a date stated in the request, with particulars of the amounts of principal remaining unpaid, interest due and accrued and any other sums secured by the mortgage, and
> >
> > (c) if the mortgagor is entitled to a discharge, a discharge of the mortgage executed in a form registrable under the *Land Title Act* and otherwise a statement in writing of the terms on which the mortgagee will give a discharge, including, if appropriate, particulars of the money payable for principal, interest and any other sums.
>
> (2) The mortgagee's statement must be given free of charge.

An examination of repayment statements provided by financial institutions reveals that institutions take frequent refuge in the "E & O E" disclaimer when providing that information. This practice does not appear to be permitted by law, and is one that introduces an unnecessary risk into the two-cheque system.

The Task Force recommends that the lending community recognize this concern and appreciate the need to provide prompt and reliable information when requested to do so in compliance with section 33. In order for the two-cheque system to have efficacy, it is necessary that the repayment statements provided and relied on by a purchaser's lawyer be final and accurate.

There will be circumstances in which the proceeds of sale (or refinancing) will be insufficient to retire existing encumbrances. This can occur without any impropriety and will require particular attention when closing a transaction pursuant to the two-cheque regime. It will be necessary in these circumstances to ensure that the vendor has made available to the purchaser's lawyer funds which, when added to the proceeds of sale generated by the purchaser and the purchaser's mortgagee, are sufficient to retire existing encumbrances. This issue will raise its own problems both in terms of timing and the disclosure of otherwise confidential information.

It is clear to the Task Force that the closing of real estate transactions under this change in practice will require additional time and resources by lawyers and their staff. We note that conveyancing fees in residential transactions have already been reduced by market pressures to such extremely low levels that the work necessary to accomplish a proper closing and appropriate conveyancing practices cannot be economically undertaken. The public and the lending community need to appreciate that these added assurances come at a cost that will have to be reflected in the cost of conveyancing fees.

Flagging suspicious transactions

As another step in ensuring the security of transactions, lawyers should be alert to abnormalities on title or in conveyancing practices. The existence of a number of recently registered mortgages against the same title is just one example of the type of circumstance that should trigger further enquiry. Any suspicious circumstances, if not fully and appropriately explained, should be the subject of further investigation.

Diligent follow-up on discharges

The Task Force must point out that the vulnerabilities of current conveyancing practices are in part the result of a systemic breakdown in the manner in which lending institutions process discharges of mortgage. Unfortunately, many months can elapse between repayment of the mortgage and the delivery to the lawyer of the discharge. The hiatus in title thus created is vulnerable to the abuses described in this report. We recommend that the Law Society encourage lawyers to seek evidence of mortgage discharges on an aggressive timetable and with appropriate diligence. If mortgages are not discharged in an appropriate time-frame, lawyers are encouraged to promptly investigate further.

FINANCIAL PROTECTIONS:
BACKGROUND, PROBLEMS AND POSSIBLE SOLUTIONS

The Law Society's Special Compensation Fund

The Special Compensation Fund is a public protection fund that compensates people for loss suffered through theft by a lawyer acting in that capacity. The Fund is one important way that B.C. lawyers have for many years demonstrated their collective commitment to protect the public from the dishonest actions of a very small number of lawyers. The Fund is for claims of defalcation and is separate from the professional liability insurance carried by all B.C. lawyers in private practice for negligence (malpractice) claims.

The adjudication of claims is made by the Special Compensation Fund Committee, based on specific criteria under the *Legal Profession Act*. Payment from the Fund is discretionary.

A claimant to the Special Compensation Fund may, at the discretion of the Special Compensation Fund Committee, be asked to obtain a civil judgment against a lawyer as a way of substantiating an allegation of theft. When disciplinary proceedings are underway against a lawyer and misappropriation is alleged, the Committee will generally await the outcome of those proceedings, but it retains discretion to decide a claim in advance. In doing so, it considers all of the circumstances, including such factors as clear evidence of defalcation and hardship to the claimant.

Current problems

The profession can be justifiably proud of the Special Compensation Fund and the protection it has offered the public for the past 53 years.

However, the Law Society now faces unprecedented circumstances. Flowing from real estate transactions in which Mr. Wirick acted on behalf of a particular vendor, there are parties who have not obtained the property interests they expected and, in a few situations, individual homeowners are unable to move into their homes as result.

The Special Compensation Fund can be expected to face a number of pressing claims in a very short period of time.

The Law Society must commit to ensuring that the interests of the public remain protected, both currently and in any similar situations that may be encountered in the future. This is difficult to ensure without innovative changes.

The Task Force flags two main weaknesses in the current structure of the Special Compensation Fund:

- First, the Fund is not designed to respond to claims in an expedited fashion. It is a fund of last resort. Claimants may be required to exhaust other civil remedies, such as by obtaining judgment against the defaulting lawyer, before making a claim. The investigation and adjudication of a claim may take considerable time.

- Second, the Special Compensation Fund Committee has discretion whether or not to pay a claim, even one that meets the basic criteria for payment. This discretion means that financial protection is not certain.

The Task Force suggests changes to the Law Society's financial protection scheme to respond more quickly and with greater certainty to cover specified risks, in keeping with public expectations.

Possible changes

Title insurance

Title insurance companies now offer lending institutions policies to protect the lender's mortgage security, even if there are intervening charges, non-financial encumbrances or specified title defects. Title insurance policies may also be offered to protect the individual purchasers, for an additional cost.

The Law Society and its various committees examining title insurance over the years have previously taken the view that title insurance is not an appropriate product in the vast majority of conventional real estate transactions, reasoning that the value of title insurance does not warrant the cost. This view has been based on the traditional reliability of conveyancing practices, the financial protections offered by lawyers and the integrity of the Torrens land registry system, including the Land Title Office assurance fund.

However, since title insurance can cover loss occasioned by the practice deficiencies outlined in this report, the Law Society needs to re-examine its position, at least in the short-term. As an interim measure pending an appropriate solution, the Task Force recognizes that title insurance will be an option available to lawyers and their clients in some transactions. Moreover, it may become a requirement of financial institutions.

The Task Force cannot prevent financial institutions from adopting title insurance, but does expect that the cost will significantly exceed the benefits provided. This is particularly true for any customers of financial institutions who are required to purchase policies that offer protections only for the lender.

Fidelity insurance

Fidelity insurance is intended as a protection both for B.C. lawyers and the public.

A fidelity insurance program of the Law Society would be structured and delivered in a manner to provide ultimate certainty in the reliability of solicitors' undertakings. It would not be limited by the statutory restrictions that apply to the Special Compensation Fund.

The transactions to be protected by fidelity insurance will need to be addressed, in particular whether the insurance should extend beyond Land Title Office transactions. It will also be important to determine whether the protection would relate only to those losses occasioned by a lawyer's breach of undertaking, or whether it should include fraud generally. These issues require further thought and wider debate.

Broader protection would likely result in some duplication of the coverage presently within the mandate of the Special Compensation Fund Committee. We have indicated further in this section a need for a flexible interaction with this Fund.

We see fidelity insurance as meeting two purposes:

- First, to provide a certain resource to which B.C. lawyers can have recourse to resolve financial obligations they have to clients and others that flow from known breaches of undertaking; and

- Second, to provide a more nimble vehicle for providing compensation in the future.

The method of establishing a fidelity insurance regime has not been fully developed. We expect it to be funded by a premium in the nature of a transaction fee, whether levied as a disbursement paid by the client or paid by the lawyer from fee revenue. It should be tax-neutral to lawyers regardless of approach, as disbursements would be a simple flow-through and any sums paid by way of a premium levy to the Law Society would be a deduction from fee revenue.

We need also to consider an upper limit for the protection. This would be an amount known to all parties seeking to rely on this system. Other insurance alternatives for larger scale transactions could be contemplated, as we understand to be the case today. The Task Force makes no specific limit recommendation, although a per-transaction limit of $3 million on the insurance has been considered. That number could easily be as low as $1 million and as high as $5 million.

The initial fidelity insurance premium could be established as a levy on real property transactions processed by lawyers, perhaps featuring a two-tier premium to reflect that a transaction might involve 1) both a transfer and a mortgage or 2) just a transfer or a mortgage. A precedent for this approach to insurance can be found in Ontario. The Law Society of Upper Canada introduced a $50 levy on real property transactions, charging that amount to both vendor and purchaser and using the proceeds to fund the professional liability insurance program in Ontario.

Based on recent Land Title statistics in B.C., a premium in the order of $30 to $40 per transaction would garner revenues in the order of $8 to 10 million a year. While a

properly conceived, actuarially based program will need to be developed, it appears that such a level of fidelity insurance funding would provide for both existing and prospective problems.

Some within the financial industry take the view that title insurance is the only viable long-term solution to the ills engendered by the occasional default in solicitors' undertakings. The Task Force, however, views fidelity insurance as a response that provides similar protection for lending institutions and the public, at a significantly reduced cost. We are of the view that protection should be capable of extending beyond transactions covered by title insurance.

It is perhaps appropriate at this juncture to contemplate a process by which the Law Society Special Compensation Fund would participate in this new approach. While it is contemplated that the fidelity insurance would garner funds to offset any currently contemplated losses, it is also reasonable to seek a co-operative approach with the Special Compensation Fund and its insurer.

An institutional alternative

Throughout our work, the Task Force considered the simple solution of standing behind lawyers' undertakings, come what may. The suggestion has much to commend it.

The proposal is to respond to all legitimate claims with a full indemnity. If the funds required to do that were to exceed current resources, the funds for this proposal would have to come from a special levy on members of the Law Society. The amount to be levied would depend on the available funds from other sources, such as the Special Compensation Fund and recoveries.

This approach was taken by the Law Society of Alberta about 20 years ago to respond to a $6 million defalcation. Their special levy was in the order of $1,100 per lawyer (in addition to the per-lawyer annual contribution to the defalcation fund). These proceeds, combined with insurance and recoveries, was sufficient to satisfy the claims against the Society's defalcation fund at that time.

Introducing a special levy may prove divisive in B.C. in that lawyers who have no stake in solicitors' work would be called on to pay an equal share of the costs.

The advantage of this approach, however, is in its ease of administration, relative flexibility to permit an expeditious response and the immediate relief of the consequences suffered by clients who have been victimized in these circumstances. The loss of confidence would be reversed and it is likely that we would see "business as usual" within a reasonably short time after formally adopting this approach.

NEXT STEPS

The Task Force has put forward suggestions in this interim report — both with respect to changes in lawyer practice and financial protections in real estate transactions — as the basis for engaging the lending community in meaningful discussions for reform. We have a unique opportunity to enhance co-operation between the legal profession and lending institutions, both now and in the future.

The concerns identified in this report as to the vulnerabilities of conveyancing practice and the need to augment financial protections also apply to notaries public in B.C. There are many issues that need consideration and the Task Force recommends that the Benchers give it the mandate to explore coordination of its work with that of the Society of Notaries Public.

Action is now required.

First, there is a pressing need for both the legal profession and lending institutions to cooperate in helping those few individuals who face a housing crisis as a result of recent events. We recommend that the Law Society negotiate appropriate assurances for institutional lenders in these transactions that would permit them to step aside from the debates over title and mortgage priority to allow individual homeowners to receive first consideration.

We propose that financial institutions seek their remedies through a collateral process and that individual homeowners be compensated as expeditiously as possible.

As to the whole of this report, we expect the Law Society's ability and willingness to pursue discussions will depend on an expressed willingness of financial institutions to change the way they do business with the legal profession in real estate practice. We see a need for the Law Society to engage the lending community at its highest level. We are looking forward to working with the financial institutions, the Credit Union Central of B.C., the Canadian Bankers Association and the Canadian Institute of Mortgage Brokers and Lenders to ensure that changes in legal practice and in lending practices complement each other effectively.

As part of the framework for future discussions, the Society is seeking a number of critical commitments from the financial institutions — specifically for those institutions:

- To provide prompt and reliable discharge information;
- To expeditiously process and deliver discharges of financial encumbrances once these have been repaid;
- To adopt the Western Law Societies Conveyancing Protocol for residential transactions (which allows allow financial institutions the flexibility of foregoing

a building survey when funding a mortgage loan if there are no known building location defects);

- To take responsibility for any lending deficiencies that have contributed to, or are contributing to, losses arising out of the Wirick situation;

- To participate in sharing losses when there is shared responsibility and, under this new approach, to recognize a responsibility to share globally in underwriting these losses.

If lending institutions accept the conveyancing protocol (eliminating survey certificates and saving costs for the purchaser) and the legal profession implements fidelity insurance, there would be sound protections in place and overall cost savings for members of the public

The Task Force is distributing this report with approval of the Benchers and welcomes comment from those within the legal profession, from financial institutions and from other interested members of the public. Please send comments to:

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