ELEVATING UNDERTAKINGS TO THE TOP FLOOR

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A lawyer's undertaking is a personal promise and responsibility, as well as a professional and legal obligation. While there are rules and professional standards governing undertakings and real estate practice (see Appendix A), what is critical is that lawyers exercise extreme caution when giving or accepting undertakings and appreciate their obligation to ensure that undertakings are fulfilled.

Providing and accepting undertakings is a necessary part of a real estate practice that has inherent risks. In order to minimize this inherent risk, the practitioner should consider the following:

- Don't accept an undertaking that can't be fulfilled
- Honour your undertakings scrupulously
- Follow-up on undertakings given and accepted
- Confirm an undertaking in clear and unambiguous terms
- If you don't intend to accept personal responsibility, make that clear
- If you are unable or unwilling to honour a trust condition imposed by someone else immediately return the subject of the trust condition
- Seek and provide documentation that your undertaking has been fulfilled
- Don't accept an undertaking from staff or a corporation that is not a law corporation under the *Legal Profession Act*[7].

What follows is a discussion on how to:

- Minimize the risks associated with providing and accepting undertakings in a real estate context
- Follow up on undertakings in order to complete and close a file

CURRENT PRACTICE IN NOVA SCOTIA

In real estate transactions in Nova Scotia, it is common practice to accept the undertaking of a vendors solicitor to payout the mortgage(s) recorded against the property and to record a release or mortgage at the Registry of Deeds or Land Registration Office. There is currently no protocol that requires the solicitor provide any verification that the undertaking to payout has been completed other than providing a discharge which can take months to obtain. In accepting this unverified undertaking of another solicitor, it is the purchaser's solicitor's certificate and ultimately all our premiums that are at risk if the undertaking to payout is unfulfilled. The undertaking to provide the release itself, while still important, is often subject to institutional delays. The risk, both to individuals and the group of insureds, that we want to minimize is the risk that an undertaking to payout remains unfulfilled. What follows is a discussion of the experiences of the British Columbia and Newfoundland and Labrador Law Societies in relation

to fraud of three of its members and the catastrophic consequences of their failure to fulfill undertakings.

FRAUD AND UNFULFILLED UNDERTAKINGS

In British Columbia and Newfoundland and Labrador, Law Societies have paid millions of dollars to claimants as a result of member fraud and breach of undertakings to payout undischarged mortgages. In Newfoundland and Labrador, more than $5 million has been paid out[8] and in British Columbia $31.5 million has been paid with another 17.6 million pending in adjourned claims[9]. While Newfoundland and Labrador's payout is smaller numerically, it's impact per capita is much more significant than British Columbia given the smaller pool of practising members. William H. Goodridge, Q.C., in a paper entitled "Large Thefts - The Incident and the Aftermath in Newfoundland and Labrador" put the Newfoundland and Labrador loss in perspective to other jurisdictions on a proportionate basis[10]. On a proportionate basis, the Newfoundland and Labrador loss would be $74 million in British Columbia and $18 million in Nova Scotia[11].

BRITISH COLUMBIA

In 2002, Martin Wirick, a lawyer practising in British Columbia since 1979 resigned from the Law Society, reporting that he had made some "serious errors in his practice."[12] Ron Usher, a staff lawyer with the Law Society of British Columbia, in his August 15th, 2005, CLE paper and presentation for the Canadian Bar Association, National Real Estate Law Section in Vancouver, British Columbia, noted, Mr. Wirick's "serious errors" turned out to involve hundreds of files and many millions of dollars.[13]

In an Affidavit filed in relation to Mr. Wirick's bankruptcy and attached to Mr. Usher's paper, Mr. Wirick set out the following background information[14]:

- He practised as a lawyer in British Columbia since 1979
- His practice was primarily in real estate conveyancing
- Prior to 2002, he had not been subject to any disciplinary action
- He made a modest living practising law. He and his wife's home and possessions were modest
- He had always paid his taxes and practice debts
- By 1999, he had worked for eight years without taking a vacation longer than a week and was under financial stress from his practice as well as emotional stress
- On a sale, when representing a long-time and trusted client, he made an error in his calculations on the adjustments resulting in him being $20,000 short on funds required to payout the first and second mortgage
- Wirick advised his client he was $20,000 short of funds necessary to close the transaction and asked his client to provide him with the funds necessary to close
- The client asked Wirick not to pay off the second mortgage but rather hold the funds he did have to pay the second mortgage until the client sold a second property he was completing from which he would provide funds to payout the second mortgage

- Wirick trusted his client to do what he said he would do and didn't pay off the second mortgage
- On his client's request, Wirick subsequently released the funds he had been holding in trust from the first transaction to the client to complete the construction of a second property as Wirick wanted the second property to be completed so he would get funds to payout the first transaction
- Matters snowballed and his client kept buying and building properties with Wirick not paying out mortgages. This cycle continued for three years.
- In May 2002, it became clear to Wirick that matters couldn't continue any longer as the banks were beginning to understand what was happening. Wirick sat down and determined over $40 million dollars was owed. He self reported to the Law Society of British Columbia on May 19th, 2002

In his Affidavit, Mr. Wirick also stated he made no profit other than "legal fees for the modest legal work that I did."[15]

Ron Usher at page 2 of his article discussed the practising climate in which Mr. Wirick's fraud was perpetrated:

> The practices of the real estate bar had evolved at a time when mortgage discharges were obtained locally and promptly. By the time of the Wirick affair, lengthy delays in delivery of discharge documents had became the norm. As a result, the litany of excuses given for the failure to obtain a discharge was believable to inquiring lawyers.[16]

What brought the Wirick matter to light was the insistence by a lawyer of the fulfillment of Wirick's undertaking - with the lawyer refusing to accept the "institutional delay" explanation.

In relation to institutional delays in providing mortgage discharges, B.C's climate is not unlike our own.

Because of Mr. Wirick's unfulfilled undertakings and the financial and professional impact this had on confidence in lawyers' undertakings, the Law Society of British Columbia established a Conveyancing Practices Task Force to examine what had happened and to make recommendations for change. The resulting recommendations are discussed by both Ron Usher in his August 15th, 2005, CLE paper and by Adam Whitcombe in his paper titled "Managing Catastrophic Loss: The Public Perception"[17]

In his paper, Mr. Usher quite rightly points out that the focus should change from the receipt of the discharge to verification by one lawyer to another of the payout of the mortgage by providing documentation that is completely within the control of the lawyer.[18]
Two significant practice changes that were implemented as a result of recommendations from the British Columbia Conveyancing Practices Task Force are:

- that vendors' lawyers on closing have to promptly provide to purchasers' lawyers

documentation verifying the payout of existing mortgages and
- a lawyer must report to the Society if they or another lawyer involved with the transaction have not filed a discharge within 60 days of the closing.

Now, a lawyer paying out any existing mortgages is required to provide to the purchaser's lawyer:

1. A copy of the payout cheque
2. A copy of the payout statement as provided by the lender;
3. A copy of the transmittal letter that accompanied the cheque; and
4. Evidence of delivery. (e.g. copy of delivery slip or date stamped letter from institution confirming receipt)

This approach results in both lawyers having on file documentation that the money was handled in the agreed manner.

Also, as discussed by Adam Whitcombe at page 5 of his paper, what has come to be known as the 30/30 Rule (30 days to obtain the discharge/30 days to file) became effective in March, 2003.[19] The Rule States:

> 3-89 A lawyer must deliver to the Executive Director within 5 business days a report in a form approved by the Executive Committee when
> (a) the lawyer delivers funds to
> (i) a mortgage to obtain a registerable discharge of mortgage, or
> (ii) another lawyer or a notary on the undertaking of the other lawyer or notary to obtain and register a discharge of mortgage; and
> (b) 60 days after the closing date of the transaction giving rise to the delivery of such funds, the lawyer has not received
> (i) a registerable discharge of mortgage from the mortgagee, or
> (ii) satisfactory evidence of the filing of a registerable discharge of mortgage as a pending application in the appropriate land title office from the other lawyer or notary.[19]

While these practices will not stop all the real estate conveyancing fraud, the British Columbia Task Force felt that this procedure would have required Mr. Wirick to prepare a very large number of fraudulent and forged documents in order to facilitate his activities.

NEWFOUNDLAND AND LABRADOR

In Newfoundland and Labrador, the breaches of undertakings relating to undischarged mortgages involved a two man law practice, William J. Parson's Law Offices. The payout has been more than $5 million. Given the small size of the Newfoundland and Labrador bar, the impact has been enormous.

An audit of the Parson's Law Offices conducted in May, 2004, confirmed there were a series of undischarged mortgages dating back approximately two years. Undischarged mortgage monies had been paid out to a real estate developer, Myles-Leger Ltd, by the law firm. Approximately 13% of all practicing insured members in Newfoundland and Labrador had real estate transactions and undischarged mortgages with Parsons' Law Offices when this scandal broke.

The Law Society and its insurer agreed to cover losses under its Errors & Omissions policy. Claimants against the policy were the individual members (purchaser's solicitors), deemed negligent for not providing discharges to their clients. Deductibles obviously became a concern for these members. Some had eight to twelve transactions for which a claim could be made. Escalating deductibles and insurance premium surcharges would have made one member in particular liable personally for almost a million dollars in penalties over five years. It was eventually agreed that the payment of deductibles would come from insurance cash reserves of the Society. This resulted in an overall increase in insurance costs for Newfoundland and Labrador's members.

Because of the Parsons case, the practice in Newfoundland and Labrador has changed, resulting in split cheques being payable to the vendor lawyer on closing- a separate cheque(s) written for the mortgage(s) to be paid out and the remaining balance to close. The vendor obtains written consent from the client to provide a mortgage payout statement and payout number to the purchaser's solicitor. While this adds yet another step in the closing process and more paperwork for the purchaser's solicitor involved, it does help to reduce the risk of a mortgage not being paid.

SHOULD NOVA SCOTIA CHANGE ITS PROTOCOL

Some take the view that Nova Scotia is yet another disaster waiting to happen. In one recent matter before the Society's Complaints Investigation Committee an audit of a practice revealed close to 150 unfulfilled undertakings, some going back many years. It is common for the Society to find dozens of undertakings in lawyers' offices frequently many years old and often with no means in place to track them. It is also common for lawyers to "layer" undertakings, in other words, to give an undertaking premised on the assumption that an earlier undertaking will be fulfilled. Both giving and accepting such an undertaking reflects the reality in which many lawyers now practice. In such circumstances, common sense dictates that we need a protocol developed that will allow lawyers to know that what they believe to be done and which has been promised to be done by undertaking will in fact be done. The British Columbia practice merits serious consideration.

REAL PROPERTY ACT - RELEASES AND DISCHARGES BY THE COURT

Section 28 of the *Real Property Act*[20] provides the mechanics for obtaining a discharge on a Chambers application where the holder of an encumbrance cannot be found, is dead and there is no duly authorized personal representative available to them or where for any other cause a property release or discharge of the encumbrance cannot be obtained without undue delay or

expense.

BANK DELAYS

As the purchaser's solicitor's certificate is at risk if a mortgage remains undischarged, timely follow-up for mortgage releases is important.

Locally a common complaint from practitioners is the delay in obtaining releases from secondary "high interest" mortgagees, especially where the initial mortgagee has been bought out by another company. The longer the delay in following up on these releases the more effort is required. Frequently the company requires a mortgage number before it will search its records to determine if it will provide a release. Follow-up letters and calls are necessary to clear up these unreleased mortgages and unfulfilled undertakings.

For "ancient" releases still not received, the solicitor should prepare the release and forward it to the mortgagee together with supporting documentation that confirms the mortgage has been paid together with particulars of the property and mortgagors.

- THEREFORE if written requests to the lender continue to be ignored, the solicitor should advise the mortgagee that a Chambers application will be made pursuant to the *Real Property Act* and that costs will be sought for such an application. If requests for a release continue to be ignored, the application should be made.

As the mortgage number is critical in follow-up, the purchaser's lawyer in the opening letter to the vendor's lawyer should request this information so that it is on file.

- THEREFORE the vendor, before providing this should obtain written authorization from a client to do so.

Even when a release is received, there can be problems with a release if name of the mortgagor, mortgagee or recording particulars are incorrect.

- THEREFORE check these particulars immediately if there is an error - return the discharge immediately and follow-up with telephone calls to the lender.

On a go-forward basis, solicitors should implement systems to ensure that every undertaking is fulfilled on a timely basis. The undertaking should be recorded in a time management system for appropriate follow-up. Files should not be closed until all undertakings have been fulfilled.

UNDERTAKINGS POST LRA

It is also critical under the *Land Registration Act*[21] that solicitors fulfill an undertaking in a timely fashion. As with all undertakings, it is prudent in accepting an undertaking to impose a time period within which undertakings must be fulfilled and set out what happens if the undertaking is not fulfilled within the required time frame.

With respect to undertakings to provide and register discharges, the undertaking should clearly set out which parcel or parcels the discharge of mortgage will apply (for example parent and/or infant parcel). Section 60 of the *Land Registration Act*[22] provides a mechanism for the Registrar to cancel or amend the recording of a security interest relating to a parcel. This provision states:

60 (1) Where there are reasonable and probable grounds to believe that
(a) all of the obligations under the security interest have been performed
(b) the holder of the security interest has agreed to release all or part of the collateral
(c) the security interest does not affect the parcel in the register; or
(d) no security interest exists.

The debtor named in the security interest, a person who has or had a registered interest in the parcel to which the security interest purportedly relates or the solicitor of the debtor or the person with the registered interest may serve a written demand on the holder of the security interest, by registered mail or as otherwise prescribed by regulation, requiring the holder to discharge the interest so far as it relates to the parcel or to discharge the interest so far as it relates to the collateral agreed to be released or not included in the security interest.

(2) Where the secured party fails to comply with a demand made pursuant to subsection (1) within thirty days after it is served, the person making the demand may require the registrar to cancel or amend the recording in accordance with the demand upon proof of service of the demand.

(2A) repealed 2004 c. 38, s. 19.

(3) Notwithstanding subsection (2), a registrar shall not cancel or amend a recording if an order of the court is provided by the secured party permitting the continuance of the recording on such terms as may be specified in the order.

(4) An order pursuant to subsection (3) shall be recorded.

(5) After having been served with a demand pursuant to subsection (1), a secured party may apply to the court and the court may order the continuance of the registration as if the demand had not been made on such terms as the court thinks just or may order the discharge or amendment of the security interest.

(6) No fee or expense may be charged by a secured party for compliance with a demand pursuant to subsection (1) unless the charge was agreed to by the parties before the demand was given. *2001, c. 6, s. 60;2002, c. 19, s. 24; 2004, c. 38, s. 19.*

Other than paying for the recording there are no costs associated with this process. The recording cost may be money well spent as staff time in follow up is likely to exceed the cost of the registration. I am advised that some lawyers are using this mechanism frequently under LRA to release mortgages when a financial institution is too slow to provide the release.I wonder if it might not be wise for other lawyers to consider using this provision. It seems to me to be an expeditious way to rid the parcel register of security interest that have been paid out and to allow lawyers to close files which are now kept open solely to await releases.

Undertakings to rectify registered interests should be fulfilled quickly - probably within five

working days. Follow-up on the undertaking should begin immediately. Timeliness of follow up is directly related to ability to fulfill undertakings. Files should not be closed until confirmation has been received that the rectification has been completed.

ILLUSTRATIONS

Attached as Appendix B are cases that illustrate how Courts have ruled in a selected number of "undertakings" cases.

OTHER UNDERTAKINGS AND ESCROW CONDITIONS

I have addressed primarily undertakings in relation to releases of mortgages. However, as we are all aware, there are frequently other undertakings or escrow conditions associated with a closing that must be scrupulously adhered to such as holding funds in escrow pending receipt of keys, closing documentation, oil top off slips, etc., as well as holding keys pending receipt of funds. As well, the hold back of funds for deficiencies or builders liens must be maintained on the agreed terms. All conditions and undertakings must be scrupulously honoured. If during the course of a transaction there is an amendment to an undertaking or trust condition, this amendment should be documented in writing.

CLOSING TIPS

In closing, to minimize your risk when giving or accepting undertakings, consider the following tips:

- Seek and provide verification that an undertaking has been fulfilled
- Obtain client's written authorization to release information relating to mortgage - i.e. mortgage numbers, mortgage name and address
- Don't accept an undertaking from anyone other than a lawyer
- Don't accept an undertaking that can't be fulfilled
- Honour your undertakings scrupulously
- Follow-up on undertakings given and accepted
- Post LRA - make sure mortgage release covers parent parcel as well as other parcels if applicable
- Confirm particulars of parties names and recording references on releases before recording
- Establish what happens if undertakings are unfulfilled within a specified time period
- Diarize and time manage undertakings given and received
- Don't close a file unless all undertakings have been fulfilled

Notes

1. The Legal Ethics and Professional Conduct Handbook, online: Nova Scotia Barristers' Society < http: //www.nsbs.org/legalethics/toc.htm>.
2. *Ibid.*
3. Practice Standards for Real Property Transactions in Nova Scotia, online: Lawyers' Insurance Association of Nova Scotia <http://www.nsblcf.ca/standards/preface.html>.
4. Legal Profession Act, S.N.S. 2004, c. 28.
5. *Ibid.*
6. *Ibid* at note 3.
7. *Ibid* at note 4.
8. William H. Goodridge, "Large Thefts - The Incident and the Aftermath in Newfoundland and Labrador" (Paper presented to the Federation of Law Societies of Canada Annual Conference and General Meeting, 6 November 2004) [unpublished].
9. Law Society of B.C. "What's New" - http://www.lawsociety.bc.ca/utilities/wirick/whatsnew_wirick-scf.htm.
10. *Supra* note 10.
11. *Ibid* at 1-2.
12. Ron Usher, "Trust, but Verify" - Fraud Reduction and Awareness for Law Firms" (Paper presented to the Canadian Bar Association, National Real Estate Section, 15 August 2005) [unpublished] at 1.
13. *Ibid* at 1.
14. *Ibid* at [3] - [16].
15. *Ibid* at [17].
16. Usher, *ibid* at 2.
17. Adam Whitcombe, Director of Policy, The Law Society of British Columbia, "Managing Catastrophic Loss: The Public Perception" [unpublished].
18. Usher, *Ibid* at 2.
19. Whitcombe, *Ibid* at 5.
20. *Real Property Act,* R.S.N.S. 1989, c. 385.
21. *Land Registration Act,* S.N.S. 2001, c. 6.
22. *Ibid.*

APPENDIX "A"

PROFESSIONAL AND LEGAL OBLIGATIONS OF AN UNDERTAKING

Legal Ethics

A solicitor's undertaking is a personal promise and responsibility. It is also a professional and legal obligation. Undertakings and duties to other lawyers are outlined in Chapter 13 of The Legal Ethics and Professional Conduct Handbook[1]. In particular, commentary 13.6-13.9 and 14 state:

> **13.6** A lawyer has a duty to:
>
> (a) not give or request an undertaking that cannot be fulfilled;
> (b) fulfill every undertaking given; and
> (c) scrupulously honour a trust condition once accepted[1].
>
> **13.7** A lawyer has a duty to confirm an undertaking or a trust condition in writing and in unambiguous terms.
>
> **13.8** A lawyer who does not intend to accept personal responsibility has a duty to make that intention clear in the undertaking. In the absence of such a statement the person to whom the undertaking is given is entitled to expect that the lawyer giving it will honour it personally[2].
>
> **13.9** If a lawyer is unable or unwilling to honour a trust condition imposed by someone else, he or she has a duty to immediately return the subject of the trust condition to the person imposing the trust condition unless the terms can be forthwith amended in writing on a mutually agreeable basis[2].

Failure to fulfill an undertaking has, in Nova Scotia, resulted in a finding of professional misconduct.

PROFESSIONAL STANDARDS

Real Property Transactions in Nova Scotia

Standard 3.4 of the Practice Standards for Real Property Transactions in Nova Scotia deals with discharges of mortgages and requires that "A lawyer must examine all mortgages recorded affecting a parcel. A lawyer must, in a timely fashion, obtain and record discharges for those mortgages being discharged[3]."

LEGAL PROFESSION ACT AND REGULATIONS

Section 23 (1)(e) of the *Legal Profession Act*:

"Any undertaking given by or on behalf of a corporation carrying on the practice of law that, where given by a practicing member, would constitute a specific undertaking, is deemed to be a lawyer's undertaking given by the corporation and the practicing lawyers who give it, sign it or authorize it".[4]

Part 8.2.2 of the regulations[3] made pursuant to the *Legal Profession Act*[5] proclaimed May 31st, 2005 requires members practicing real estate law to comply with the standards of practice applicable to real estate law including those set out in Practice Standards for Real Property Transactions in Nova Scotia[6].

Part 9 of the regulations deals with Professional Responsibility.

9.1.3 (c) (i) states:

When considering complaints or charges, the Complaints Investigation Committee and a hearing panel may determine that conduct constitutes

> (c) professional misconduct if it involves conduct in a lawyer's professional capacity that tends to bring discredit upon the legal profession including:
> (i) violating or attempting to violate one of the provisions in Legal Ethics and Professional Conduct (1990) or a requirement of the Act on these regulations.

APPENDIX "B"

1. *Polischuk et al v. Hagarty (1984)* 49 O.R. (2d) 71, 14 D.L.R. (4th) 446 (C.A.).

2. *Eng v. Chahoud* (1999), 180 N.S.R. (2d) 274 (C.A.).

3. *Mailman Projects Ltd. v. Herman* (1989), 93 N.S.R. (2d) 91 (Co. Ct.).

4. *Cain (c.o.b. Cain, Gzik & Dandie) v. Genereux (c.o.b. Genereux and Associates),* [1981] O.J. No. 726 (H.C.J.)(QL).