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November 29, 2008

Fraudster's house 'sale' ends up costing bank

The fallout from mortgage fraud cases in recent years continues to occupy the attention of lawyers, judges and the innocent parties involved.

Back in 2006, Paul Reviczky rented out a house he owned on Sheppard Ave. W. to a person who turned out to be a fraudster. Using a forged power of attorney in favour of Reviczky's non-existent grandson, the bogus tenant listed the property for sale on the Multiple Listing Service.

The house was eventually sold to Pegman Meleknia without the knowledge of the true owner, and the "tenant" disappeared with the sale proceeds.

Real estate lawyer Satwant Singh Khosla had acted for Meleknia, the innocent purchaser. HSBC Bank Canada financed the transaction by giving Meleknia a first mortgage that was title-insured by Stewart Title Guaranty Company.

On closing, HSBC advanced the mortgage money to Khosla, who deposited it into his trust account at the Royal Bank of Canada. Khosla then drew a certified cheque in favour of Paul Reviczky for $429,861.06, representing the balance of the purchase price.

The cheque was certified by RBC and handed over to the fraudster on closing. He forged the signature of Paul Reviczky on the back of the cheque, and deposited it into an account at the Korea Exchange Bank of Canada (KEBOC) in the name of Aaron Paul Reviczky, the fictitious grandson. He then disappeared with the money.

It took two separate court hearings last year for Reviczky to get clear title restored to his own name. Last December, a court ruled that the HSBC mortgage, which financed Meleknia's purchase, was invalid because the bank failed to scrutinize the bogus power of attorney. Following that ruling, Stewart Title paid off and discharged the HSBC loan. At the same time, it also reimbursed Meleknia for his losses in purchasing a house that the seller didn't own.

To my surprise, the story did not end with that ruling. Another court case was waiting in the wings.

At the conclusion of last year's litigation, Stewart Title was out-of-pocket all of the money it had paid to HSBC and Meleknia.

Khosla, representing Stewart Title's interest in recovering the money, sued the Korean bank to recover its losses. In the lawsuit, Khosla alleged that by clearing the cheque on the basis of a forged and unauthorized endorsement, KEBOC was liable for damages of $429,481.26 for conversion in other words, wrongfully taking the money.

KEBOC denied that improper conversion of the funds had taken place. Instead, it pointed the finger at Khosla, the lawyer who wrote the cheque in the first place.

Last May, Khosla applied to the Superior Court for what is known as a summary judgment on its claim against the bank, without having to go to trial.

Khosla argued that the act of conversion is one of "strict liability," which means that the bank would be responsible for cashing the cheque with the forged endorsement, no matter what actions it took or how careful it was.

Earlier this month in Toronto, Justice Frances Kiteley released her decision and agreed with Khosla. KEBOC was held responsible for conversion and was ordered to pay Khosla $429,481.26 plus interest since May, 2006, and costs of $6,000.

Those funds will be paid over to Stewart Title, which had reimbursed HSBC for its losses due to the fraudulent sale of the property and the invalid mortgage from the innocent buyer.

This means that the big loser in the case is not Reviczky, Meleknia, Khosla, HSBC or Stewart Title, but instead the bank which cashed the lawyer's trust cheque on the basis of a forged endorsement.

Since the fraudulent sale of the Reviczky property, the Ontario government has made it much more difficult to use a power of attorney in real estate transactions. Hopefully, in future, the occurrence of this type of fraud will be greatly reduced.

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Khosla v. Korea Exchange Bank of Canada, 2008 CanLII 56011 (ON S.C.)

Date:	2008-11-03
Docket:	06CV320635PD3
URL:	http://www.canlii.org/en/on/onsc/doc/2008/2008canlii56011/2008canlii56011.html
Noteup:	Search for decisions citing this decision

Reflex Record (related decisions, legislation cited and decisions cited)

Legislation cited (available on CanLII)

- Bills of Exchange Act, R.S.C., 1985, c. B-4

Decisions cited

- Boma Manufacturing Ltd. v. Canadian Imperial Bank of Commerce, 1996 CanLII 149 (S.C.C.) [1996] 3 S.C.R. 727 (1996), 140 D.L.R. (4th) 463 (1996), [1997] 2 W.W.R. 153 (1996), 27 B.C.L.R. (3d) 203
- Fok Cheong Shing Investments Co. Ltd. v. Bank of Nova Scotia, 1982 CanLII 57 (S.C.C.) [1982] 2 S.C.R. 488 (1982), 146 D.L.R. (3d) 617
- Reviczky v. Meleknia, 2007 CanLII 56494 (ON S.C.) (2007), 88 O.R. (3d) 699 (2007), 287 D.L.R. (4th) 193

COURT FILE NO.: 06CV320635PD3

DATE: 20081103

ONTARIO

SUPERIOR COURT OF JUSTICE

B E T W E E N:	)	
	)	
Satwant Singh Khosla	)))	Martin Sclisizzi, for the Plaintiff
Plaintiff	)	
- and -	)	
	)	
Korea Exchange Bank of Canada	)))	Avrum D. Slodovnick, for the Defendant
Defendant	))	
	)	**HEARD:** May 22, 2008

Kiteley J.

[1] This is a motion for summary judgment brought by the plaintiff pursuant to Rule 20.04(1) that turns on the principle that conversion is a tort that attracts strict liability. The defendant has brought a cross-motion for leave to add a counterclaim.

Background

[2] In March 2006, Paul Reviczky rented his residential property to a fraudster. In April 2006, posing as a relative of Reviczky with the authority to sell the property under a power of attorney, the fraudster listed the property for sale. The fraudster accepted the offer of Meleknia. Mr. Khosla acted as solicitor for the purchaser. The purchaser borrowed most of the purchase money from HSBC Bank Canada on the security of a mortgage registered against title to the property. While Mr. Khosla was aware that the vendor was selling through a power of attorney, he did not requisition proof of authenticity and validity.

[3] The transaction closed on May 15, 2006. HSBC Bank Canada advanced funds to Mr. Khosla who deposited the funds into his trust account at the Royal Bank of Canada. Pursuant to a direction given by the lawyer on behalf of the fraudster, Mr. Khosla made a cheque payable to Paul Reviczky for $429,481.06. It was certified by the RBC and delivered to the lawyer for the fraudster who delivered it to the fraudster.

[4] During the previous month, using apparently authentic identification, the fraudster had opened an account at the Korea Exchange Bank of Canada (KEBOC) in the name of Aaron Paul Reviczky . The cheque was not negotiated by Paul Reviczky. The fraudster forged the signature of Paul Reviczky and deposited the cheque to that account. KEBOC sought and obtained verification from the Royal Bank regarding the certified cheque before accepting it for deposit. KEBOC was not privy to or familiar with the sale of the property, and had no notice of any power of attorney. The fraudster withdrew the monies from the

KEBOC account before the fraud was discovered.

[5] The title insurer, Stewart Title, paid the purchaser and HSBC and Meleknia the amounts that had been advanced.

[6] Stewart Title, standing in the shoes of HSBC, brought an application to maintain the mortgage on title. In December 2007, Macdonald J.[1] issued a declaration that the bank s charge was not valid and he directed the Land Registrar to delete the charge from the parcel register.

[7] Khosla issued a statement of claim alleging that by collecting the cheque on a forged and unauthorized endorsement, KEBOC was liable for damages in the amount of $429,481.26 for conversion. KEBOC filed a statement of defence denying that conversion had occurred; alleging that Khosla had, inter alia, been negligent and was estopped from making the claim; asserting that KEBOC was a holder in due course and had paid upon a forged endorsement without notice and without negligence; pleading that Khosla was no longer the true owner of the cheque because the cheque was issued to the payee and consideration had been received for it; and relying on s. 20(5) of the Bills of Exchange Act[2] (*BEA*).

[8] KEBOC issued a third party claim against the lawyer[3] who acted for the fraudster and the listing realtor and listing agent. The third parties have defended and the realtor and agent filed a crossclaim that was also defended.

The Issue

[9] Counsel for the plaintiff argues that this is a simple legal issue. Conversion is a strict liability tort. KEBOC s only possible defence, s. 20(5) of the *BEA*, is not available because the payee of the cheque, Paul Reviczky is not fictitious nor is he non-existing. There are no material facts in dispute and no credibility issues. This is a question of law that ought to be determined in favour of the plaintiff on this motion.

[10] Counsel for the defendant takes a far different position best illustrated by quoting paragraph 3 of the factum:

> The Plaintiff has narrowly framed this action, and this motion for Summary Judgment, as a simple claim for damages for conversion based on a fraudulent endorsement, and asks the Court to therefore disregard (and to treat as legally irrelevant) the broader context of this case and the equities between the parties. The Defendant KEBOC asks the Court to do precisely the opposite.

[11] The factum and submissions vigorously argue that the motion should be dismissed because the payee is fictitious and KEBOC could treat the cheque as payable to bearer and allow negotiation by delivery without endorsement; alternatively, if s. 20(5) is not available, counsel for KEBOC argues that there is a genuine issue for trial as to which of two innocent parties is to suffer from the fraud.

Analysis

[12] For purposes of this analysis, KEBOC is the collecting bank. Khosla is the drawer of the cheque. The Royal Bank of Canada is the drawee. Paul Reviczky is the payee.

[13] The tort of conversion is the wrongful interference with the goods of another. As the Supreme Court held[4] in the banking context:

> A bank converts an instrument, including a cheque, by dealing with it under the direction of one not authorized, by collecting it and making the proceeds available to someone other than the person rightfully entitled to possession. It should be noted that the tort of conversion is one of strict liability.

[14] As drawer of the cheque, Khosla is the possessor. I agree with counsel for the plaintiff that KEBOC converted the cheque drawn by Khosla by making the proceeds available to the fraudster. KEBOC is liable unless it can establish a defence that raises a genuine issue for trial.

[15] Section 20(5) of the BEA provides that where the payee is a fictitious or non-existing person, the bill may be treated as payable to bearer . A cheque that is payable to bearer can be negotiated by simple delivery to the bank. An endorsement is not required. The collecting bank is not liable if it negotiates a bearer cheque on delivery even if the cheque has a forged endorsement. On the other hand, the collecting bank can negotiate a cheque payable to order only if the cheque is both delivered and endorsed.

[16] KEBOC takes the position that the payee was fictitious, the cheque was a bearer cheque and on delivery, KEBOC became a holder in due course and was entitled to negotiate the cheque despite the endorsement forged by the fraudster.

[17] *Falconbridge*[5] is the source of four often repeated propositions with respect to fictitious payees. To illustrate the point, in his factum, counsel for the plaintiff replaced Paul Reviczky for the legendary Martin Chuzzlewit :

> If Paul Reviczky is the name of a real person, intended by Khosla to receive payment, the payee is neither fictitious nor non-existing, notwithstanding that Khosla has been induced to draw the bill by the fraud of some other person (the person posing as Paul Aaron Reviczky) who has falsely represented to Khosla that there is a transaction in respect of which Paul Reviczky is entitled to the sum mentioned in the bill.

[18] Khosla s affidavit indicates that he intended the cheque to be negotiated by the true owner of the property. There was no cross-examination on that evidence. As para. 46 of *Boma* indicates, whether the payee is fictitious depends on the intention of the drawer.

[19] I agree with counsel for the plaintiff that *Falconbridge s* 4th proposition illustrates that the cheque drawn by Khosla payable to Paul Reviczky was not payable to a fictitious person. Paul Reviczky existed. Section 20(5) does not apply. KEBOC cannot treat the cheque as payable to bearer. The cheque was not validly negotiated since it was payable to order and bears a forged endorsement.

[20] Counsel for KEBOC also relied on s. 165(3) of the *BEA* that provides that where a cheque is delivered to a bank for deposit to the credit of a person and the bank credits the person with the amount of the cheque, the bank acquires all the rights and powers of a holder in due course of the cheque.

[21] In *Boma*, the Supreme Court rejected this argument on the basis that the cheque could be deposited without endorsement only as long as a payee or endorsee is entitled to the proceeds of the cheque. Delivery is only effective when made by an authorized party[6]. I agree with counsel for the plaintiff that since the cheque was not delivered to KEBOC by Paul Reviczky, the cheque was not delivered within the meaning of s. 39(1). KEBOC is not a holder in due course.

[22] Counsel for KEBOC observes that *Boma* and *Westboro* were both decisions of trial judges and therefore they illustrate that intention is a genuine issue for trial. As indicated above, the evidence of Kholsa s intention is not controverted. Simply because it was a triable issue in another case does not make it a triable issue here.

[23] Counsel for KEBOC also attempts to distinguish *Boma* on the basis that the bank there knew it was accepting a third party cheque without endorsement and liability was found because it failed to follow its own policies, whereas here, KEBOC did follow all institutional protocols. I agree with counsel for the plaintiff that the cheque here is not a third party cheque.

[24] In its factum and in submissions, counsel for KEBOC sought to position the issue between the parties as a determination of which of two innocent parties is to suffer for the fraud of a third. At paragraph 5(k), KEBOC asserts that this motion amounts to narrowly emphasizing the technical point of KEBOC as a collecting bank while disregarding the role the plaintiff paid in the fraud not being avoided. At paragraph 7 of its factum KEBOC relies on the principle enunciated by the Supreme Court of Canada, that, as between two innocent victims of a fraud, the one who is better suited to avoid the fraud must bear the loss. KEBOC argues that if any of the plaintiff or the third parties had questioned the power of attorney, the fraudulent scheme would have been exposed and the cheque would not have been drawn or negotiated. On that basis, KEBOC asserts that it is contrary to principle for a plaintiff to make a claim based on a situation created by his own negligence or carelessness.

[25] Furthermore, after reciting the allegations of errors and omissions on the part of the plaintiff and against the third parties (some of which constituted findings of fact by the trial judge in *Reviczky v. Meleknia, supra*), the factum at paragraph 13 argues that since the plaintiff (and others) caused and created the event on which the plaintiff s claim against KEBOC is made, it would be in the interest of justice to reserve any judgment as to liability and apportionment of liability, until all of the parties are before the court at trial. At paragraph 29, the factum contains the observation that what irks one s sense of justice here is that the plaintiff in this motion seeks to distinguish between the owner and the fraudulent attorney while, during the transaction, when he had the opportunity to do so, the plaintiff failed to exercise proper diligence. In paragraph 35, the factum includes the submission that to treat KEBOC as a holder in due course under section 165(3) in relation to the plaintiff would do no injustice .

[26] Counsel for KEBOC attempts to distinguish *Boma* and *Fok*[7] on the basis that they were fraudulent bookkeeper cases whereas this case dealt with title fraud that has become insidious and pervasive and demands heightened diligence particularly on the part of lawyers in real estate transactions. He takes the position that this case falls outside *Falconbridge s* illustrations and should be decided on the basis of which of the two parties was able to prevent the risk.

[27] KEBOC concedes that it is the collecting Bank. While the factum and the submissions contained repeated assertions of the unjustness and unfairness visited on KEBOC if the motion is granted, if a negotiable instrument is involved, the *BEA* applies. The principles applicable to negotiable instruments are relevant, not the principles applicable to negligence and contributory negligence.

[28] In *Boma*[8], the Supreme Court made the following observation on allocation of risk:

> To some, the allocation of risk in the bills of exchange system may seem arbitrary, but in my view a necessary and coherent rationale sustains this allocation. With respect to forged endorsements, for example, no party in particular is in any better position to detect the fraud than any other. It is a risk that all parties must bear, including collecting banks. It is a price that must be paid if one wishes to enjoy the significant benefits of the bills of exchange scheme, not the least of which is, from the bank s perspective, the facilitation of huge numbers of financial dealings conducted rapidly, and without overwhelming transaction costs. While the banks are accorded the important advantage of holder in due course status in many situations, it would not be appropriate, as the respondent would have it, to exempt any party, including collecting banks, from all exposure to the risk and consequences of fraud.

[29] This motion requires the application of legal principles articulated in ss. 20(5), 39 and 165(3). These are questions of law, not equity. Absence of fault by the collecting bank, the presence of due diligence and the presence of contributory negligence on the part of the drawer are irrelevant. Even if I accept for purposes of the motion that Kholsa was in a better position than KEBOC to detect the fraud and that KEBOC exercised due diligence, KEBOC s defences to the claim for conversion cannot succeed. KEBOC is strictly liable to Khosla for conversion. There are no genuine issues for trial.

[30] In its factum, KEBOC takes that position that once the plaintiff s cheque was certified by the RBC, the drawer was released and the certifying bank became solely liable on the cheque, such that the plaintiff was no longer the true owner of the cheque. In addition, it argues that to the extent that an insurer is behind the plaintiff s action, the plaintiff is no longer the true

owner of the cheque. Suffice it to say that these submissions are based on a misconception of the law as it relates to certification of cheques and as it relates to subrogation.

Motion to amend the Statement of Defence and Stay of Execution

[31] In its original statement of defence, KEBOC had pleaded set-off and equitable set-off. In response to the plaintiff s motion, the defendant brought a motion for leave to amend the statement of defence by adding a counter claim to parallel those claims for set-off. Counsel takes the position, quite apart from the application of the *BEA,* that KEBOC is entitled to set off on the grounds that the plaintiff was in a superior position to prevent the fraud.

[32] In the alternative, the KEBOC s factum asserts that if the plaintiff s technical argument succeeds on the motion, then the court should order the amendment and should order a stay of execution pending disposition of the third party claim and the proposed counterclaim. Again it is asserted that it would be in the interest of justice to stay the enforcement of judgment pending the Court s opportunity to apportion liability in accordance with considerations of fairness, equity, and the emerging judicial policy regarding title fraud .

[33] While counsel for the plaintiff concedes that rules 26 and 27.07(1) are mandatory, he argues that such an amendment would not alter the outcome of this motion.

[34] While there is a motion to amend, there is no motion to stay pending resolution of the counterclaim. For the reason indicated by counsel for KEBOC, I am prepared to entertain the request for a stay without a formal notice of motion and on the basis of the affidavit of Park filed in response to the plaintiff s motion. However, I am not persuaded that a stay is in order on this record.

Claim for interest

[35] In the statement of claim, the notice of motion and the factum, counsel for the plaintiff claims prejudgment interest from May 16, 2006 (the date when the cheque was negotiated) to September 20, 2006 (the date that KEBOC was notified of the conversion) and thereafter compound interest to the date of judgment or payment. There is no justification for compound interest. No submissions were made on the point. While pre-judgment interest pursuant to the *Courts of Justice Act* is not controversial, the basis upon which compound interest from September 20, 2006 might be awarded has not been established.

ORDER TO GO AS FOLLOWS:

[36] The motion on behalf of the plaintiff is granted. Judgment to issue against the defendant for the sum of $429,481.26 together with pre-judgment interest pursuant to the *Courts of Justice Act* from May 16, 2006 to the date of these reasons and post-judgment interest pursuant to the *Courts of Justice Act* thereafter.

[37] On consent of counsel as to the amount of costs, the defendant shall pay costs of the action (including the motion) fixed at $6000.00.

[38] Leave is granted to amend the statement of defence to add a counterclaim in accordance with tab 2A of the defendant s motion record, subject to any motion on behalf of the plaintiff to strike the counterclaim as disclosing no cause of action against Khosla.

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Kiteley J.

Released: November 2008

COURT FILE NO.: 06CV320635PD3

DATE: 20081103

ONTARIO

SUPERIOR COURT OF JUSTICE

B E T W E E N:

Satwant Singh Khosla

Plaintiff

- **and**

Korea Exchange Bank of Canada

Defendant

REASONS FOR JUDGMENT

Kiteley J.

Released: November 2008

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[1] *Reviczky v. Meleknia et al., and Caplan, Intervenor* 2007 CanLII 56494 (ON S.C.), (2007) 88 O.R. (3d) 699

[2] *Bills of Exchange Act*, R.S.C. 1985, c. B-4

[3] Gavin Tighe, counsel for the Third Party Caplan attended but did not participate in the motion.

[4] *Boma Manufacturing Ltd. v. Canadian Imperial Bank of Commerce* 1996 CanLII 149 (S.C.C.), (1996) 140 D.L.R. (4th) 463 at para. 83

[5] *Banking and Bills of Exchange*, 6th ed. (Toronto: Canada Law Book, 1956) pp.468-69

[6] S. 39(1) *BEA*; *Westboro Flooring & Decor Inc. v. Bank of Nova Scotia* (2004) 71 O.R. (3d) 724, paras. 27-29

[7] *Fok Cheong Shing Investments Co. v. Bank of Nova Scotia* 1982 CanLII 57 (S.C.C.), [1982] 2 S.C.R. 488

[8] *Boma*, *supra* para 80