July 8th, 2008

A Textbook First Year Property Law Case on the Fraud Exception to Indefeasibility

By Jonnette Watson Hamilton

Cases Considered:

1198952 Alberta Ltd. v. 1356472 Alberta Ltd., 2008 ABQB 386

ALM Holdings Ltd. owned the Jasper Block, which is part of the Edmonton Historic Resource Management Program . It is a three storey Edwardian-era brick building on the north side of Jasper Avenue in central downtown Edmonton. 651730 Alberta Ltd. rented a part of the Jasper Block for a restaurant, the Fantasia Noodle House Restaurant. 1198952 Alberta Ltd. rented another part of the Jasper Block for a store, called Raleigh Foods. ALM sold the Jasper Block to 135647 Alberta Ltd. The question in this case was whether or not the purchaser, 135647 Alberta Ltd., was bound by ALM's leases to the Noodle House and Raleigh Foods. The tenants sought a declaration from the court that the purchaser's title to the Jasper Block was subject to their leases. The purchaser sought an order forcing the Noodle House and Raleigh Foods to vacate their premises in the Jasper Block.

The Noodle House lease was from January 1, 2005 to December 31, 2009, a five year term, with an option to renew. The Raleigh Foods lease was from November 1, 2005 to October 31, 2010, another five year term, also with an option to renew. Neither Noodle House nor Raleigh Foods registered their leasehold estates or filed a caveat claiming an interest in the Jasper Block against ALM's title. The problem arose because under the *Land Titles Act*, R.S.A. 2000, c. L-4, a lease that is unregistered, either by way of the tenant obtaining a leasehold title registered in the Land Titles Office or protecting it by way of caveat, is not enforceable against a purchaser who buys the landlord's title if the lease is for a term of more than three years.

The offer to buy the Jasper Block was made by 1272857 Alberta Ltd. and accepted in June 2007. 1272857 later nominated 135647 Alberta Ltd. to take over as purchaser of the Jasper Block. Sid M. Tarrabain is the sole Director of both of those numbered companies. Copies of the Noodle House and Raleigh Foods leases were provided to Tarrabain in June 2007. Before the purchase closed, the purchaser told ALM that they were taking the position that the two leases were not binding on the purchaser. ALM did not appear to have passed that information on to its tenants. On November 27, 2007, title to the Jasper Block was issued in the name of 135647 Alberta Ltd. The purchaser's offer for the Jasper Block had contemplated ALM providing assignments of the

leases to the purchaser, but this was not done until January 2008 due to an oversight on ALM's part.

The Noodle House and Raleigh Foods forwarded their December 2007 and January 2008 rent cheques to the purchaser, 135647 Alberta Ltd. but the purchaser rejected them. Instead, the purchaser served Notices to Vacate on the tenants on the basis that they had failed to register their interests in the Jasper Block against the title to the property.

Section 61(1) of the *Land Titles Act*, essentially requires that any lease for a term of more than three years must be registered against title. It states:

> 61(1) The land mentioned in a certificate of title granted under this Act is, by implication and without any special mention in the certificate of title, subject to . .
>
> (d) any subsisting lease or agreement for a lease for a period not exceeding 3 years, if there is actual occupation of the land under the lease or agreement. . . . (emphasis added)

By implication, there needs to be "special mention" on titles of leases for periods exceeding three years; otherwise, the land is not subject to the leases.

At common law, before the invention of our Torrens system of land title registration in the 1850s, a purchaser who had notice of interests such as these five year leases would have been bound to honour them. At common law, the fact that the purchasing numbered company had been given copies of the Noodle House and Raleigh Foods leases and knew about their existence would have been enough - the leases did not have to be registered against the title for someone with knowledge to be bound by them. However, the *Land Titles Act* changed the common law on this point. The focus of the judgment by Mr. Justice Kenneth G. Nielsen was therefore on section 203(2):

> 203(2) A person contracting or dealing with or taking or proposing to take a transfer, . . . from an owner is not, except in the case of fraud by that person,
>
> (b) affected by any notice, direct, implied or constructive, of any trust or other interest in the land that is not registered by instrument or caveat, any rule of law or equity to the contrary notwithstanding.
>
> (3) The knowledge of the person that any trust or interest that is not registered by instrument or caveat is in existence shall not of itself be imputed as fraud.

Section 203(2) says, in effect, that a purchaser such as 135647 Alberta Ltd. is not affected by knowledge of the two unregistered leases, unless the purchaser is guilty of fraud. Section 203(3) goes on to specify that knowing about unregistered interests such as the Noodle House and Raleigh Foods leases and acting to register title to the Jasper Block in the name of 135647 Alberta Ltd., even while knowing that doing so would defeat the two leases, is not fraud. In other

words, the Noodle House and Raleigh Foods were required to protect themselves by registering their interests against the title to Jasper House and, if they did not do so, then 135647 Alberta Ltd. could take advantage of their failure to protect themselves.

As Justice Nielsen notes, the leading Alberta case on interpreting section 203 of the Land Titles Act is the unfortunate and difficult Alberta Court of Appeal decision in *Holt Renfrew and Co. Ltd. v. Henry Singer Ltd. et al* (1982), 20 Alta. L.R. (2d) 97. Justice Nielsen's summary of the facts of the *Holt Renfrew* case (at para. 26) does not do justice to the circumstances in that case that so raised the ire of the five man appellate bench that all five wrote separate opinions. However, on one point about interpreting section 203, there was unanimity: knowledge of the existence of an unregistered interest, coupled with knowledge that the unregistered interest will be defeated by concluding the transaction, is not sufficient to constitute fraud. In the words of Justice McDermid (at page 107), "[t]here must be an additional element." All subsequent cases applying section 203 have been concerned to locate this "additional element."

Was there more in this case than mere knowledge of the unregistered leases and knowledge that they would be defeated by registration of title in the name of the purchaser? Was there an "additional element" that would constitute fraud on the part of 135647 Alberta Ltd.? The Noodle House and Raleigh Foods argued that the terms of the Offer to Purchase made it clear that the purchaser was buying the Jasper Block subject to their interests as tenants. Clause 2(l) of the Offer to Purchase provided the following warranty by ALM as vendor:

> All of the leases relating to the Property are valid and subsisting, no defaults exist by any tenant or the Vendor under the leases and no disputes exist between the tenants and the Vendor. The Vendor discloses and the Purchaser acknowledges that the Vendor has a verbal obligation to Fantasia Noodle House to supply and install a screen door to the rear entrance of the Fantasia Noodle House premises and the Vendor shall complete this work within 10 days of the acceptance of this Agreement.

In Clause 3(b), ALM promised to provide the purchaser with copies of all leases of premises in the Jasper Block. These clauses in the Offer to Purchase were, the tenants said, the "additional element."

Clause 4(a)(ii) of the Offer to Purchase provided time for the purchaser to review the leases and other documents and then said "it is a condition precedent to the agreement resulting from the acceptance by the Vendor of this Offer that the Purchaser is in its sole discretion satisfied with the results of such inspections and reviews" (emphasis added). Schedule B to the Offer to Purchase set out "Permitted Encumbrances," i.e., encumbrances on the title that the purchaser would accept, but neither lease was noted. No reason was given for their omission.

Justice Nielsen found it significant that the Offer to Purchase specifically referred to the Noodle House in clause 2(1) and that copies of the leases were provided to the purchaser. With respect,

however, Clauses 2(l) and 3(b) are promises by ALM, not the purchaser. At most, they indicate the purchaser had knowledge of the leases. Section 203 is explicit that knowledge is not enough.

Justice Nielsen also thought it significant (at para. 33) that the "Offer to Purchase was in fact made subject to a condition in favour of the Purchaser in relation to the Leases." This appears to be a reference to Clause 4(a)(ii), quoted above. However, what was the condition in that clause? It was that the purchaser be "satisfied with the results" of its review of the leases. Mr. Justice Nielsen speculates (at para. 33) that "[t]he copies of the Leases were, no doubt, provided to the Purchaser so as to enable it to satisfy itself that the Tenants had the financial wherewithal to honour the terms of the Leases." However, Clause 4(a)(ii) merely states that the purchaser had to be satisfied with the results of its review, a very ambiguous statement. The purchaser might have been satisfied by its review that it would not be bound by tenants it did not want. The purchaser had, after all, notified ALM before completion that it did not consider itself bound by the two leases.

Justice Nielsen concludes (at para. 34) that "There can be no doubt that 1272857 and its nominee, the Purchaser, had knowledge that the Property was subject to all of the leases of premises within the Property including the Leases to the Tenants." What does it mean to say the purchaser knew the Jasper Block was "subject to" the leases? The purchaser knew the leases existed, knew they were for terms of more than three years and therefore had to be registered in order to bind it, and knew the leases were not registered and therefore could be defeated. They even told the vendor so. But section 203 says knowledge of the existence of an unregistered interest, coupled with knowledge that the unregistered interest will be defeated by concluding the transaction, is not sufficient to constitute fraud. Where is the additional element?

Justice Nilesen held that the case before him was "on all fours" with the decision in *Scandia Meat Market Ltd. v. KDS Investment Co. Ltd.* [1977] 1 W.W.R. 542, an oral decision on an agreed statement of facts that was referred to by the Court of Appeal in *Allarco Group Ltd. v. Suncor Inc. et al* [1987] 5 W.W.R. 159. Scandia Meat Market was decided before *Holt Renfrew* and so a stamp of approval from the Court of Appeal in *Allarco*, decided after *Holt Renfrew*, would be relevant. However, all that the Court of Appeal in *Allarco* says about *Scandia Meat Market* is that it is accurately summarized in its headnote, which they quote in its entirety. That headnote, in a portion not quoted by Justice Neilsen, notes that the agreement for sale between the owner of the land and the purchaser provided that vacant possession was to be given at a certain time "subject to the rights of the present tenants if any". It was the purchaser's agreement that possession was subject to the rights of the existing tenants that was the "additional element" in *Scandia Meat Market*. Or, as was said in *Scandia Meat Market* itself, "It is going one step further than having mere knowledge because Nelco at no time intended to sell more than it could." No *bona fides* vendor intends to sell more than it can so the important point has to be that the vendor and purchaser in *Scandia Meat Market* actually agreed not to sell except "subject to the rights of the present tenants if any." How are those facts "on all fours" with Clause 4(a)(ii) in the Jasper Block case, which merely states that the purchaser had to be "satisfied" with the results of their review of the documents? Where is any obligation to the Noodle House or Raleigh Foods undertaken by the purchasers?

In *Allarco* itself, the agreement between the vendor and purchaser stated "Paris will purchase the assets and liabilities of Chartered in Fort McMurray." The liabilities included leases in the shopping mall that Paris purchased. That enabled the court to state, "[w]hen the words 'assets and liabilities' are considered in the context of this transaction, it is clear that liabilities included leases of the land at Fort McMurray." Again, a purchaser undertook obligations and that was the "additional element."

That additional element, it is submitted, is lacking in this case. Justice Nielsen concludes (at para. 36):

> There is no question that the Leases were binding as between the Vendor and each of the Tenants. Further, the Vendor transferred to the Purchaser all of its estate and interest in the Property. That estate and interest was subject to the Leases. In my view, the Purchaser agreed to purchase only what the Vendor was able to sell.

On that basis, Justice Nielsen found the purchaser guilty of fraud and not entitled to title free from the claims of the Noodle House and Raleigh Foods. With all due respect, this interpretation seems to deprive s. 61(1)(d) of the *Land Titles Act* of meaning, as well as s. 203(2) and (3). The former section states that land is subject to "any subsisting lease or agreement for a lease for a period not exceeding 3 years" without being mentioned on the title. This decision makes land subject to leases for periods exceeding three years without their being mentioned on the title, on the basis of a general proposition of law on the effect of a transfer of land that is summarized in s. 7(1) of the *Law of Property Act*, R.S.A. 2000, c. L-7: ". . . every instrument transferring land operates as an absolute transfer of all right and title that the transferor has in the land at the time of its execution . . .".

No matter how unfair or inequitable it might seem that a purchaser of land can refuse to honour leases made by the vendor if the tenants fail to register their interest against the title, that is the way the *Land Titles Act* was written. Section 203(2) could not be plainer, explicitly stating knowledge is not enough to constitute fraud, "any rule of law or equity to the contrary notwithstanding." Justice Nielsen's decision reminds me of Supreme Court of Canada's Chief Justice Rinfret's decision in the famous *Canadian Pacific Railway Co. v. Turta*, [1954] S.C.R. 427. Referring to the phrase just quoted from s. 203(2), the Chief Justice began his dissent by noting: "Interpreted as suggested by the respondents, the [*Land Titles Act*] would do away with all traditional principles of law and equity. Indeed, I am not sure that it does not boast of such intention . . .".