

SPECIAL REPORT



ON FRAUD

Real estate fraud: bold, outrageous
... and you're the target

Bold, outrageous and highly organized:

The new face of real estate fraud

Real estate fraud – like other types of fraud – has been a reality for the real estate bar for as long as lawyers have engaged in conveyancing. Typically, real estate fraud involved a homeowner, anxious for funds, obtaining a mortgage loan against property that the borrower owns but where an imposter executed the mortgage as co-owner or consenting spouse. Often, the culprit is caught; frequently, the lawyer acting on the loan did not ask for or obtain photo-identification of both parties to be satisfied as to the identities of the signing parties.

Recently a new type of fraud has surfaced: A more sophisticated, intricate, organized and often difficult to detect fraud. Lawyers, by virtue of their pivotal role in conveyancing, are integral to the success of these disturbing new types of fraud. Sometimes, they are even drawn into the schemes, lured by the promise of quick and generous fees.

For this special issue on fraud, we have tapped into the expertise resident both within LawPRO and within the ranks of our defence counsel. Later in this section, David Clark, a claims examiner with LawPRO, describes some typical fraudulent schemes that lawyers should be aware of.

The focus of this section, however, is on real estate fraud. These newest brands of fraud in real estate transactions are far more outrageous and bold, appear to be highly organized and tend to strike at people totally unrelated to the fraudsters. They are both sophisticated and yet simple.

One type, described in some detail on the next page by Sid Troister, is not easily detected, if detectable at all. Even the most diligent lawyer can be easily duped. Every lawyer is vulnerable to it.

The second type of real estate fraud, described in detail by Bob Potts and Mirilyn Selznick, on pages 11 and 12, is a variation of the “flip” scam. But again, the level of sophistication, intricacy and duplicity are surprising and disturbing.

Diligence no match for determined fraudsters

By Sidney Troister
Torkin Manes Cohen Arbus LLP

The first kind of real estate fraud is perhaps the most disturbing; stripped of its essence, it is simple. But its execution is so sophisticated that often even the highest level of diligence on the part of a lawyer would not detect that something was amiss.

The scenario

Mr. and Mrs. Smith buy a new home in an upscale subdivision in Newmarket for \$500,000 in the summer of 2000. They give a mortgage to the Bank for \$350,000. Their property is registered in the Land Titles system. They live in the property.

Their home has been targeted by the fraudster, perhaps with the help of someone in a real estate broker's office who knows when properties get bought and sold. In December, 2000, the fraudster, presumably with some assistance from a well-trained law clerk or other paralegal, does the following.

First, the fraudster prepares, and then registers a Deed from Mr. and Mrs. Smith to Mr. X and declares that the purchase price is \$550,000. He pays Land Transfer Tax on \$550,000. Mr. X is now the registered owner of the property. He has had Mr. and Mrs. Smith's signatures forged, he has signed a Land Transfer Tax affidavit which appears to have been sworn, he names a law firm as preparer of the Transfer and he names a new law firm as the lawyers who prepared

the Land Transfer Tax affidavit and who will appear to have acted for him on the purchase.

A week later, he prepares a discharge of mortgage from the Bank using phony names as signing officers and naming either the Bank's mortgage processing centre or a law firm as the preparer of the document. He may even include the name or initials of a lawyer in the law firm on the document. He registers the discharge.

Mr. X is now the registered owner of the property free and clear of encumbrances. (In some cases, the fraudster uses his own name as transferee. In other cases, Mr. X is a fictitious name or the name of some other innocent person).

The fraudster then goes to a mortgage broker or a bank and applies for a loan of \$275,000 against this property. The fraudster will indicate that he buys and sells real estate frequently, buys for cash and then obtains his financing later, and is willing to pay a sizeable mortgage brokerage or placement fee if a mortgage can be arranged easily and quickly.

The broker finds a lender who is more than happy to lend on 50 per cent of the value of this relatively new house. Mr. X may also tell the broker or lender that the property has just been rented out to tenants and he doesn't want the tenants disturbed by someone

doing an interior inspection or appraisal of the property. Given the loan-to-value ratio, the lender or broker will decide that a drive-by appraisal is sufficient. Forged documents, including income references from an employer, are provided, or alternatively Mr. X indicates that he is self-employed so that there is no employment record. Any sense of an inflexible lender will move the fraudster to some other lender.

The lender appoints the usual lawyer it uses for these types of deals to do the legal work on the mortgage loan. The lender sends out its typical commitment and letter of instructions. The fraudster, who is now the borrower, indicates that he wants the deal done quickly and is most flexible about who does the legal work for the lender. In order to expedite the deal, he is content that whoever the lender wants can do the deal.

The lawyer receives the instructions and searches title. The lawyer discovers that Mr. X is the registered owner, free and clear and that he bought the property a few days or weeks ago. If the Land Titles system hasn't fully recorded the deed to Mr. X and the mortgage discharge yet, the lawyer will review them to see that they are satisfactory. They will be flawless documents. He searches realty taxes and discovers that the taxes are up to date but of course the tax certificate indicates

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Lawyers as pawns: The warning signs

In this type of scam, the fraudster seems to understand the real estate business and the way lawyers, mortgage brokers and lenders work. He knows that:

- (a) lenders will happily lend on 50 per cent of value;
- (b) brokers will happily fund mortgage money on this basis;
- (c) lenders will probably waive detailed appraisals on this basis;
- (d) lawyers will rely on the Land Titles system to assume that there is good title;
- (e) lawyers ask for photo identification;
- (f) everyone is prepared to expedite transactions where premium fees are paid;
- (g) everyone is prepared to expedite transactions where the client promises more deals in the future.

The lawyer seems to have acted reasonably. He has followed the acceptable standard of searching title, relying on the title register and obtaining identification. Could the lawyer have done anything to prevent the fraud? The experience, from a review of a number of these frauds, reveals some similarities but they are not exclusive to these frauds. Many of our most reliable and legitimate clients exhibit similar conduct. Surely, our job is not to be a detective, especially when presumably, the lender has already approved the borrower for a loan.

Nonetheless, some recurring conduct includes:

- (a) the borrower very recently purchased the property on an all-cash basis and is now borrowing against the property;



- (b) the borrower has his deed but no other purchase documents. He has no survey. (In one fraud, the fraudster even had a survey);
- (c) the borrower's lawyer who acted on the purchase is not acting on the loan or acting for the borrower;
- (d) the borrower instructs you not to contact the lawyer who acted on his recent purchase;
- (e) the borrower is in a very big hurry. The turn-around time on the deal is one to three days;
- (f) the borrower may not have placed fire insurance on his house;
- (g) the mortgage brokerage fee seems generous on what should be a simple residential loan;
- (h) part of the mortgage advance is directed to third parties, including foreign exchange companies or off-shore recipients;
- (i) the borrower indicates that he is quite active in real estate investing and does deals like this frequently; more deals may come your way.

– Sidney Troister

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Mr. and Mrs. Smith as owner. That is simply explained since Mr. X recently bought the property and the records at the tax office have not been changed. The lawyer searches executions and they too are clear.

The lawyer may ask the borrower whether he has a survey of the property. Most likely he does not. The lawyer might think about calling the lawyer who appears to have acted on Mr. X's purchase recently, but the borrower will instruct him not to do so, explaining he and the lawyer had a falling out or he doesn't want his purchase lawyer contacted. It may well be that the lender will waive the survey since this is a relatively new house and what kind of problems could there be in any event? There can't be much risk given the loan-to-value ratio. Possibly, the lawyer will get title insurance to insure over the absence of a survey. Some title insurers don't require a survey on whole lots on a plan of subdivision.

The lawyer prepares the usual mortgage documents. Of course, Mr. X is anxious to get the deal done and has already pressed the broker and the lawyer to expedite matters because he "needs the money for another deal" or "is going out of town."

The borrower attends at the lawyer's office to sign documents. The lawyer asks for and sees his driver's licence or other photo identification as proof of

identity. Sure enough, there is Mr. X's picture on the driver's licence. The address on the driver's licence is not the property address, which makes sense; the borrower has indicated that it is an investment property. The birth date on the driver's licence matches the birth date of Mr. X on his deed.

Mr. X may also advise the lawyer that he deals frequently in real estate and there may be more deals to follow. Mr. X receives his \$275,000 loan from which the brokerage fee is paid to the broker, the lawyer deducts his fees from the advance and Mr. X receives his advance. Mr. X then deposits \$20,000 into a bank account to cover the postdated cheques that he has written to cover the mortgage payments that will be made on this mortgage for the next few months. The balance of the funds is given directly to Mr. X, or is directed by Mr. X to a foreign exchange office, converted into U.S. dollars and moved offshore.

In the meantime, in each case a lawyer has certified to the new lender that it has a first mortgage on the property. The bank, whose mortgage is discharged from title, is still receiving payments from Mr. and Mrs. Smith who live in the house but who do not have title. When the new mortgage goes into default, and demand is made on the occupants, everyone starts scratching their heads wondering who has what and who is to blame.

The outcome

This scenario, with some variations, has been discovered in the greater Toronto area, to titles in Toronto, Peel and York Region, more than 10 times to the best of our knowledge. In one situation, Mr. X did this five more times over a five-month period on different properties. After about six or seven months, the money in the bank account ran out and the five new mortgages were in default. Mr. X had stolen \$1.5 million. In another case, \$850,000 was stolen on two mortgages over three months. In yet another case, \$700,000 was stolen on two mortgages in two weeks.

This fraud can happen anywhere. There is little or nothing that would make this loan transaction suspicious in the ordinary course. Presumably, the lender has already checked out the borrower. Even then, Mr. X is the registered owner of the property under Land Titles; he produced acceptable photo identification. What circumstances would there have to be for the lawyer to blow the whistle on a straight forward residential mortgage loan?

Unfortunately, real estate lawyers seem to be necessary pawns in the fraud because they act for the new lenders and they certify title and the validity of the mortgages that they register. The legal issues that arise, not only in this type of fraud but in any fraud, forgery and imposter cases, including such questions as who is entitled to relief and what is the role of the lawyer, are complicated.

Avoiding the claim: What can you do differently?

Obtain photo identification

Insofar as lawyers protecting themselves from negligence claims is concerned, these cases clearly emphasize the need to obtain photo identification of borrowers.

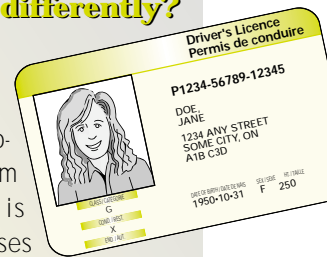
In *Yamada v. Mock*, the court clearly said that lawyers cannot prevent fraud but can make it a little more difficult for the fraudster and should at least obtain identification from the borrower. That seems to be the current standard of care for lawyers. Failing to do so will no doubt bring a claim against the lawyer in a fraud or imposter case.

Lawyers should ensure that they keep copies of the identification in the file. It is critical to proving that you met the standard of care that you have the evidence in your file of your confirmation of the borrower's identity.

Know your client

Be mindful of who your client is. When you have been retained by a lender, and are accommodating the borrower by having him sign at your office, you might want to make it clear that you are not acting for him in any way. You don't want any one alleging that your acting for the borrower in any way amounts to your vouching for his identity.

– Sidney Troister



The Land Titles Register: Can it be relied on?

What may be more shocking than the brazen conduct of the fraudsters is the damage done by the fraud and how the authorities react to it.

The lawyer's first reaction is probably that this is a case for the Land Titles Assurance Fund since, of course, Land Titles guarantees titles and guarantees against fraud. Surely, the new lender and the lawyer were entitled to rely on the title register to take a mortgage from Mr. X. Surely Land Titles has responsibility for registering and vouching for the deed to Mr. X and the bank's mortgage discharge.

Most lawyers would, without hesitation, come to the defence of a lawyer who clearly followed accepted conveyancing practice. The lawyer relied on the Land Titles system that guarantees title to the registered owner and received photo identification from the borrower.

Unfortunately, the Land Titles system does not make guarantees, or if it does, it does so in a very limited way. The Land Titles system operates on certain legal principles and on statutory provisions contained in the *Land Titles Act*.

The two major principles of Land Titles, the mirror principle (the title register reflects ownership) and the curtain principle (one does not have to look behind the title of the person shown as registered owner) do not operate without qualification when there is fraud. A forged document is null and void even in Land Titles and, but for certain provisions in the *Land Titles Act*, it has no effect. It is for this reason alone that lawyers



giving opinions on the validity and enforceability of documents should consider confirming the identity of signing parties.

The ability of lawyers to rely on the title register in Land titles has its theoretical roots in the interpretation of the *Land Titles Act* and the application of one of two doctrines: immediate indefeasibility and deferred indefeasibility.

Immediate indefeasibility

The doctrine of immediate indefeasibility would find that once Mr. X was registered as owner of the land, he is, in fact, the owner, even if he became the registered owner fraudulently. That, however, does not appear to be the law in Ontario. The person who has fraudulently been registered as owner does not acquire good title. The title register does not guarantee good title to the fraudster simply by virtue of being named the owner on title.

Deferred indefeasibility

With deferred indefeasibility, however, while Mr. X doesn't get title simply by being the registered owner, anyone who innocently deals with him as the registered owner, regardless of how Mr. X became the registered owner, and without actual notice of the fraud will acquire an interest in the land. It is the second person relying on the registered title and not the fraudulent titled owner that gets title. An indefeasible title is deferred to the innocent person dealing with the person registered as owner.

In our case, Mr. X never gets title to the property just because he is registered as owner. The mirror principle and the right to rely on the title register breaks down. However, the new lender can obtain a valid interest in land and can rely on the mirror principle and the curtain principle to obtain a valid interest in land since the lender relies on deferred indefeasibility. A good example of this

principle is set out in the recently reported *Durrani* case where an innocent bank's mortgage was valid even though the borrower was held ultimately not to be the owner of the property.

However, there is a catch to this doctrine of deferred indefeasibility which explains why imposters, signing for registered owners, can never create valid interests in land.

The *Land Titles Act* specifies that only the person registered as owner can charge land. Thus, the new mortgage is valid according to the law of deferred indefeasibility only if the person who is the registered owner has signed

the mortgage. If the person who is registered on title as Mr. X did not exist and Mr. X was a fictitious name and the fraudster used forged identification, the mortgage is invalid and deferred indefeasibility does not apply.

Similarly, if there was a real Mr. X, but the person who attended at the lawyer's office was an imposter for Mr. X, then the mortgage is invalid according to the doctrine of deferred indefeasibility and the *Land Titles Act* because only the registered owner has the right to charge the property. This is the common problem when Mr. X appears with his imposter spouse to sign a mortgage. The real spouse did not

charge the property; the lender gets no interest in land.

If, however, the real Mr. X took title and signed the documentation, then the new mortgage would qualify for deferred indefeasibility. The new mortgage is valid *vis a vis* the bank mortgage. As for the owners who are no longer registered as owners, they are entitled, presumably, to be reregistered as owners but now they are subject to the mortgage that they had nothing to do with and their mortgage to the bank, on which they are still liable presumably on the covenant, is not registered on title.

What about the Land Titles Assurance Fund?

Many lawyers would react to these types of frauds by looking for relief from the Land Titles Assurance Fund.

The Land Titles Assurance Fund is a creation of the *Land Titles Act*; it is not an insurance company and it is not title insurance. An application to the fund can be made where a person has been "wrongfully deprived of land or of some estate or interest in land through fraud."

The threshold question, however, is whether the applicant had an interest in land that was lost through fraud. Since deferred indefeasibility operates only where one deals with the true registered owner, a mortgage signed by an imposter for the then registered

owner is invalid and the lender never receives an interest in land. Since the lender has lost no interest in land (since he never had one), the lender does not qualify for compensation under the Act. This is another reason why obtaining identification of the parties is so critical. To rely on the Land Titles system, one must be certain they are dealing with the registered owner. It is the reason why in all of the imposter cases, typically an owner signing a mortgage with an imposter spouse, the defrauded lender gets no compensation from the fund. The fund has jurisdiction only where one had an interest that has been lost.

Even if the party had an interest in land that was lost, the *Land Titles Act*

does not make compensation easy. The fund is an assurer of last resort. In order to qualify for compensation, the applicant must first attempt to recover from the wrongdoer or from any other sources of compensation as may be available. Moreover, the Fund cannot compensate where the claimant is seen to have substantially contributed to its own loss.

In simple terms, one can rely on the Land Titles register only when one is dealing with the registered owner and not with an imposter. As for the government standing behind the system and guaranteeing good title, as the old song said, "It ain't necessarily so."

– Sidney Troister

FLIP: When all that glitters is not gold

By Robert J. Potts & Mirilyn R. Selznick
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The second type of fraud is equally sinister but complicated by the fact that the lawyer is often complicit in completing the fraud.

The scenario

A lawyer with too much time on his hands finds himself face-to-face with a golden opportunity: He may be a real estate agent, a financial advisor, or just someone who seems to have a lot of connections. The lawyer has never met this person before, but is told this person has the ability to bring in a lot of business, either directly or through another person the lawyer may or may not ever get a chance to meet. This person is the "mastermind."

The lawyer wonders only briefly why a sole practitioner in his position would be chosen by this client, but his concerns are soon allayed when promises of high fees in exchange for quick processing of real estate transactions are presented.

The real estate deals start coming to the lawyer directly from the mastermind. They may appear somewhat unusual in that they appear to all have short closing dates that require immediate processing, often without time to conduct proper searches. Often there is a flip involved, in which the financial institution has agreed to lend money on the higher purchase price of the flip agreement. The lawyer often acts for all parties. But all directions and information come from one party: the mastermind.

Typically, the scam works like this: Jane Doe is a legitimate vendor with property for sale. The mastermind of the fraudulent scheme submits an offer to purchase the Doe property with Mr. Smith posing as the purchaser.

A purchase price is agreed on, as is a closing date for the transaction (the "original agreement"). The mastermind, Mr. X, then prepares a second agreement of purchase and sale whereby:

- Smith sells to Black for a price in excess of the original purchase price (the "flip agreement");
- or
- Doe sells to Black for a price in excess of the original purchase price (the "fake agreement").

In situations where there is a flip agreement, both the original agreement and the flip agreement are sent to the lawyer for processing.

In situations where there is a fake agreement, the bank is usually provided with a copy of the fake agreement as part of an application to obtain mortgage financing on the basis of the higher consideration;

In both cases, the bank lends money on the strength of the higher purchase price contained within the flip agreement or the fake agreement.

In that regard, the mastermind also provides the bank with false information about the proposed borrower Black, such as false letters from employers allegedly verifying Black's income, false social insurance numbers, and false addresses, etc.

Once the mortgage funds have been paid out by the bank, and the mortgage has been registered on title, the mastermind rents out the property and makes the monthly mortgage payments presumably using the rental proceeds.

It is believed that both Smith and Black are "straw men" posing as ven-

dors and/or purchasers and that the true purchaser is the mastermind.

The police and some of the financial institutions involved have been alerted to these fraudulent schemes and have conducted their own investigations into the matters.

As a result of these fraudulent transactions, a number of financial institutions have been left "holding the bag" when the mastermind stops making the monthly mortgage payments and the property is sold under power of sale for significantly less than the principal amount of the loan.

The issue of liability coverage

LAWPRO has also become involved when the financial institutions seek to hold their lawyer responsible for the shortfalls. LAWPRO's involvement starts with the retention of coverage counsel in order to determine whether the lawyer was a willing participant in the fraudulent scheme, wilfully blind to it, or merely an innocent dupe when processing the transactions involved. There is no coverage under the LAWPRO professional liability policy for situations in which lawyers were involved in fraudulent activities.

As one can, no doubt, imagine, these fraudulent schemes can be very costly to LAWPRO, both in terms of coverage investigations and, if necessary, in terms of liability payments.

So the next time you are sitting in your office on a rainy day, keep in mind that if an opportunity presents itself that seems too good to be true, it just may be.

The warning signs of flip frauds

In conducting its own investigations into these matters, LawPRO, through its adjusters and coverage counsel, has noted the following indicia of the fraudulent scheme:

- new "client" starts to send numerous real estate files to lawyer;
- the new client appears to be in control of the files:
 - he/she sends the agreement(s) of purchase and sale to the lawyer;
 - he/she is the primary contact for any issues that arise prior to closing;
 - he/she provides the particulars of:
 - * who is to take title to the property;
 - * the date of birth of the transferees;
 - he/she often arranges insurance on the property;
 - he/she arranges the "sign up" meeting with the vendor/purchasers;
 - the "sign up" meetings often take place in "odd" locations;
- there is usually one real estate agency that appears time and time again on the agreements of purchase and sale;
- the lawyer is consistently told to act for the ultimate purchaser on the flip agreement (and/or, in some cases, the vendor and purchaser on the flip agreement);
- the lawyer is never contacted directly by his so called "purchaser (or purchase and vendor) clients" e.g. with respect to discussing the transaction, arranging a closing meeting, requesting an extension, discussing mortgage particulars, etc.;
- when and if the lawyer actually meets his purchaser (or purchaser and vendor) client, it is apparent that this so called purchaser (or purchaser and vendor) is very much being directed by the mastermind;
- the bank loans money on the strength of the higher consideration in the flip agreement;
- the funds to close the transactions often come only from the bank;
- if the purchaser does provide any closing funds, those funds are minimal and usually are not drawn from the purchaser's bank account (i.e. often there are money orders or cash payments involved);
- the same purchasers and vendors often reappear time and time again on various transactions;
- signatures on closing documents often do not match signatures on the corresponding agreements of purchase and sale;
- the Land Transfer Tax Affidavits invariably show the higher consideration;
- the Land Transfer Tax Affidavits are either sworn by the lawyer or commissioned by the lawyer;
- Draft Transfer/Deeds showing the lower consideration are signed by the original vendor and then altered just prior to registration so that the consideration matches the consideration set out in the Land Transfer Tax Affidavit (i.e. the higher consideration);
- the mortgages are usually CMHC insured;
- the lawyer is often instructed by the mastermind to pay the excess mortgage proceeds to the mastermind, despite the fact that he/she has no apparent interest in the transaction;
- in some situations, the mastermind instructs the lawyer to use the mortgage proceeds for another purchase;
- there is often an absence of written directions re: funds in the files; the lawyer is often told that such written directions are unnecessary;
- the mastermind often assures the lawyer that he or she need not contact the lender about the flip or the fact that the lender is loaning money on the higher consideration;
- the transactions often involve short time frames, last-minute changes in meetings, dates and documents;
- In some instances, the lawyer is paid exorbitant legal fees for each transaction.

– R.J. Potts & M.R. Selznick

The shapes fraud can take

By David Clark
LawPRO Claims Examiner

There are hundreds – even thousands – of ways to commit fraud. From counterfeiting to “fixed” games of chance, from stock market “pump and dumps” to telephone scams, the schemes are too numerous to list here. Set out below are the main categories of fraud you could encounter. These categories are not mutually exclusive and often overlap. Furthermore, the fraudulent schemes may be more elaborate than the basic descriptions provided here. But do not be fooled by a professional looking office or glossy, well-designed investment prospectuses. In each case, the fraudster disappears with most of the “invested” money.

Affinity Fraud

The first task that the successful fraudster must face is gaining his victim's trust. After trust is established, he then presents the scheme in whatever form it takes. It may be as simple as a request for a loan to him or a third party.

In most cases, the fraudster lacks any legitimate credentials or real experience on which he can build the basis for trust. Instead, a common way to gain trust is for the fraudster to cite some connection – ancestry, religion, race or common experience – shared with you. Not too surprisingly, the con artist has no hesitation in fabricating whatever facts are needed to establish these “links”.

“Ponzi” Scheme or Bubble Scheme

Here, the fraudster promotes an investment opportunity

that offers huge returns in a “can't-lose” scheme – such as investments in gold mines, oil and gas leases, finance companies, or cosmetics or whatever is the current popular trend in legitimate investments. He may even go so far as to prepare glossy brochures with graphs and charts outlining the expected returns.

In fact, there is no investment (or a worthless one). Profits are not derived from the investment; instead money from later investors is diverted to pay off earlier investors. These early investors often tend to reinvest their money. Having just received a huge return on their investments, they can innocently become recruiters for other participants with “look how it worked for me” testimonials. As the inflow of new investors slows, it becomes impossible to pay out the earlier investors at the rates of return promised, and the Ponzi Scheme collapses.

Pyramid Scheme

A close relative of the Ponzi scheme, this time the fraudster peddles a scheme that is based on investing in a business enterprise that the investor/victim can buy into and run.

Typically, victims are given the opportunity to sell a product which, on a closer look, is of poor quality (although some schemes dispense with having a product entirely!). What is important to this scheme is that new investors are charged a membership fee or must make an initial up-front investment of some kind. They are then encouraged or expected to recruit new investors from whom they will earn commissions or a finder's fee.

Because investors must find several investors before any substantial return is realized, the pressure to keep recruiting is significant. But many investors learn only after they've put up their money that product support or quality is so low and sales so insignificant that the only way to make any money is to recruit other distributors.

Like the Ponzi Scheme, the money does not come from the underlying business opportunity. Up-front investment money from later investors is diverted to pay off the recruitment commissions for earlier investors. And like the Ponzi Scheme, the Pyramid Scheme must collapse when the pool of new investors dries up (and it will) since to keep going, and for everyone, particularly new members, to make money, there must be a never-ending supply of recruits.

Business Opportunity Fraud

In this scheme, con artists capitalize on the typical franchising model: A franchisee pays fees in exchange for licenses to a recognized company or product name, training and on-site assistance, and an established product supply. But while he's quick to collect the fees, the fraudster fails to provide the services in return.

The most common hook is earnings misrepresentation: investor/victims are told that they will realize a certain return within a given timeframe. Not surprisingly, the claims are not matched by reality. Examples include vending machines or rack displays put in low traffic areas.

Another method is training claims. Most investors welcome the opportunity to gain training relevant to the start-up and maintenance of the intended franchise business or to gain access to an ongoing support network. The fraudsters collect the training "fees" and then disappear, or provide worthless training.

Advance Fee Fraud

This kind of fraud is based on the promise of providing a service or a product for a fee which must be paid beforehand. This particular scam has hundreds of variations with just as many kinds of services promised: processing loans, forwarding special or "inside" informa-



tion, finding lost bank accounts, providing lists of scholarships. Sometimes, the fee is not requested up front, but only required after the victim is involved and the fraudster sees a real opportunity to make money. The common element: the product or service is never delivered or is worthless.

Perhaps the best example is the Nigerian Fraud, or 419 Scam (named after the section of the applicable Nigerian Criminal Code) which itself involves a number of different forms.

Typically, a "Nigerian official" contacts the victim with a story about finding overpayments or secret profits from a government agency or contractor. The official says he needs your help to move the money out of the country – and suggests he deposit money in your bank account in return for a 30 per cent "commission." At first, he needs no money from you, but once you're committed, the problems suddenly crop up. He needs money to cover certain expenses (i.e. bribes, processing fees, etc.). He will even go to great lengths to show how he is putting up his own money.

This is what makes it an advance fee fraud. You are now expected to pay money before you will get a return.

Many people who encounter a description of the Nigerian Fraud deem it unlikely of success. However, it is estimated that it collects over \$1 million per day within the United States and is the subject of special federal legislation there. People in Canada have also been victims and several large losses involving lawyers, accountants, bankers and brokers are known.

Recovery Room Scam



This is perhaps the most mean-spirited kind of fraud. In essence, the fraudster contacts someone who is known to have been the victim of a fraud and offers to try and recover some of the loss, or at least assess the likelihood of recovery. Another version involves the fraudster offering to run the worthless business opportunity for a fee.

The end result is that nothing is ever recovered for the victim after what can be very elaborate – and costly – efforts by the fraudster. Note that this fraudster is often working as a team with the original fraudster.

How to identify a fraudster

People who commit fraud come from all walks of life and fit nearly every kind description. However, most share certain personality traits that you can watch for. Generally, they are narcissistic, self-centred and have a large ego. They are grandiose, making unrealistic or even fantastic promises. Fraudsters have feelings of entitlement. They believe that somehow they are special and entitled to "the good life." Whether they achieve this with their own money or someone else's is irrelevant. Lastly, they lack conscience or remorse. Indeed, when con artists are caught, they often claim that they are somehow the victim and that someone else is the true villain.

How to identify a suspicious investment

Con artists work on people's greed. That is how they get and keep their victims' attention. If someone makes promises on rates of return that no one else comes close to, be wary.

You should also be alert to claims by someone of a "guaranteed no-risk" investment with few details. No investment is without risks and an honest salesperson should be willing to discuss the risks, and the details (i.e. commissions, fees, how returns will be paid out, etc.). If answers are vague or lack common sense, be careful.

Con artists also create an urgency to invest. They do not want to give their potential victims time to think about what is being said or to investigate whether the promises being made are true. A common technique is to claim that an investment is selling out quickly and that the money must be paid now or the opportunity will be lost. "And why shouldn't it be selling out?", says the con artist. "That is just proof of how great and solid this investment opportunity really is!" If an opportunity is being presented with this kind of pressure – watch out.

How to avoid being a victim of fraud

The best protection against fraud is common sense. Use only licensed investment brokers or advisers. Ask detailed questions. Evasive answers should be a red flag.

You should verify any claims made by a promoter. Call government agencies which the promoter claims he or the investment is registered with or monitored by. Be careful to use several independent sources. Elaborate fraudsters have set up legitimate sounding companies and even offices with government-like names to "certify" the strength of what is really a fraudulent investment.

Investigate the individual offering the investment and his company. Talk to other investors about their experiences, and check out the marketplace for the product which will be sold. If a franchise is involved, check out the background of the franchisor and look into the litigation history of the parent company and its representatives. Most importantly, get all earnings projections and other promises in writing. If the person you are dealing with refuses, there may be a reason.

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