Property, Equity and Trusts 2

The Principle of Indefeasibility

Introduction

Indefeasibility of title means the register is the definitive record of all land interests, and thus, the registered proprietor is immune to claims contrary to the register.

- The idea of Torrens Title was to create a ‘register’ which reflected all current proprietary rights on a piece of land.
- The register, which is run by the state, ‘guaranteed’ its own accuracy, and thus put an end to the need to investigate the chain of title.
- Because the state guarantees the registered proprietor’s title, he has indefeasible title, thus creating the ‘principle of indefeasibility.
- This type of system is commonly known worldwide as a system of registration of title.

Indefeasibility Provisions

The State's guarantee, and thus the principle of indefeasibility, are given effect in a few key provisions in the Real Property Act 1900 (NSW) (note: indefeasibility of title is not a term mentioned in the legislation, it was developed by the courts).

- s 42 (known as the 'key indefeasibility provision') - the proprietor listed on the register holds the land free of any interests which are not listed on the register (there are exceptions).
- Doesn't apply in the case of fraud.
- s 43 (known as the 'notice provision') - once a person completes a transfer from the real proprietor, he is free from any trust or unregistered interests, even if he had notice of that interest (there are exceptions).
- Doesn't apply in the case of fraud.
- Note: this is essentially the overruling of the usual priority doctrine for earlier equitable interests vs. later legal interests.

There is also a less important s 43A, which deals with situation where there is a competition between a person holding an earlier equitable interest, and a person who has obtained a later equitable interest through a dealing with the registered proprietor (ie, whose interest is registrable, but has not yet been registered). For the purposes of such a scenario, the equitable interest of the person dealing with the registered proprietor is treated as a legal interest.

- Note: this is essentially the overruling of the usual priority doctrine for earlier equitable interests vs. later equitable interests.
Immediate and Deferred Indefeasibility

These doctrines are concerned with a situation where a person (the 'forger') forges the signature of the real proprietor on a transfer and sells the property to an innocent purchaser. Both the real proprietor and the purchaser are innocent, and both want the property. There are two (opposing) approaches to such a situation:

- **Immediate indefeasibility** - the purchaser obtains indefeasible title once he registers the transfer regardless of the fact that the document was invalid. He becomes immediately indefeasible.

- **Deferred indefeasibility** - the purchaser's title is defeasible and can be 'set aside' if the real proprietor makes a claim. However, if the purchaser transfers his title to a new purchaser (bona fide and for valuable consideration) before any such claim is made, that new purchaser's title does become indefeasible. Thus, the indefeasibility is deferred until a new bona fide purchaser arrives.

**The Dilemma (theory)**

The opposing doctrines ultimately reveal a dilemma in the law regarding which rights should be protected more:

- Immediate indefeasibility promotes "dynamic security" (or 'ease of transaction'), which protects the reasonable expectations of the purchasers that they will acquire good title. Good dynamic security facilitates easy and cheap transfers (because the purchaser doesn't have to investigate) and thus encourages people to buy assets.

- Deferred indefeasibility promotes "static security" (or 'security of title'), which protects the interests of property owner and makes their right secure (by protecting them from third party claims etc).

- Both concepts are extremely important, and it is hard to find a balance between them in this particular scenario.

- For example, the doctrine of immediate indefeasibility, which protects of the purchaser during the purchase, would also increase his susceptibility to to loss, theft or forgery of his title during his ownership. Essentially, there is a irreconcilable tradeoff.

**Applicable Law**

In *Frazer v Walker* (from NZ), the court held that the doctrine of immediate indefeasibility prevails. This was then confirmed by NSW legislation in s 45 of the *Real Property Act 1900* (NSW).

- This means that a purchaser registered through fraud, error, or by means of a void instrument nevertheless grants the purchaser indefeasible title immediately (as long as the purchaser didn't cause the fraud).
These issues, and what happens in the case where the first purchaser uses fraud, are discussed in *Breskvar v Wall*:

- Registration creates title even if the situation is within the exceptions listed in the act (such as fraud). The difference is that the title is subject to the rights on the defrauded vendor (ie, the title is defeasible).
- The fraud creates an equitable interest on the part of the defrauded vendor, which is not barred by the legislation because there is an exception made for fraud. The vendor can thus cancel the registration of the purchaser.
- However, once the purchaser transfers his title to a third party (bona fide and good consideration), it becomes a question of priorities.
- If the third party completes registration entirely, then he obtains indefeasible title.
- If the third party doesn't complete registration before the original vendor bring a claim, the vendor's earlier equitable interest would prevail over the third party's later equitable interest unless the vendor's conduct helped encourage the third party's false assumption (that the title vested with the fraudulent purchaser).

Note that *Breskvar* was decided before the introduction of s 43A, which would now settle the dispute.

**Indefeasibility of the Terms in a Registered Instrument**

A question arose whether all terms in a registered document (eg, a covenant) would become indefeasible once registered.

This was discussed in *Mercantile Credits v Shell Co of Australia*

- In basic terms, if the term touches upon the estate or interest (ie, it is a part of the interest), the priority (or indefeasibility) of the registered instrument will extend to the term.
- However, if the term is merely a personal which in no way affects the estate or interest (for example, a covenant of guarantee), the priority will not extend.

*Mercantile Credits* was since affirmed in *Karacomiakis v Big Country Pty Ltd*, in which the court held that a covenant to pay rent is an essential and intimate part of the interest created upon registration.

- However, indefeasible interests such as a covenant for renewal will expire if the time for their exercise expires.
- For example, a tenant has a covenant for renewal after a lease, but has vacated the lease without exercising that option (to the effect that it can be said that the right has expired due to the passage of time). The covenant for renewal will be deemed as expired and not be counted as a registered interest that could affect a future purchaser or mortgagee.

**Indefeasibility in a Void Mortgage**
The mortgages discussed above were mortgages in which the amount of money advanced to the mortgagor in return for the security was specified in the mortgage itself (which is the registered instrument). However, there are also ‘facility’ (or ‘all monies’) mortgages, which are mortgages which don't specify the amount of money advanced (because it is specified in a separate loan agreement etc).

The question arises as to what happens when the sign the signature of the registered proprietor has been forged for the loan agreement, and he has not actually received any money for the mortgage (ie, similar scenario to the ones above, but different because there is a separate agreement, which is merely personal and not registered, and then also void for forgery). This was discussed in Yazgi v Permanent Custodians Ltd:

- If the separate, personal loan agreement was subject to forgery, than it would be void insofar as it applies to the victim of the forgery.
- If the personal agreement is void, than the victim wasn't due (and didn't receive) any money in return for the mortgage - the mortgage isn't securing anything.
- If the mortgage isn't securing anything, than the victim can discharge the mortgage insofar as it applies to their interest.
- Note: clearly, the existence of the separate loan agreement results in a completely different result to the one seen above in Frazer etc. The fact that the amount specified wasn't in the registered instrument (the mortgage) and instead in another agreement allows the victim of the forgery to not be barred by the laws of indefeasibility.

**Volunteers**

There has been a debate as to whether a volunteer also enjoys the same indefeasibility that a purchaser does (or whether he is affected by prior equitable interests etc).

- Note that under the old system, a purchaser was protected as long as there was no notice, whilst a volunteer was not protected at all.
- Some academics argue that since the Torrens system aims to protect (inter alia) purchasers during transactions, there is no reason that it should protect a volunteer (since he does not bear the financial risk that a purchaser does).

Originally, the indefeasibility provisions did not extend to volunteers. This was altered in Bogdanovic v Koteff:

- The old authorities have been supplanted by Frazer and Breskvar, which both imply that no distinction should be drawn between purchasers and volunteers with regards to indefeasibility.

Interestingly, a Victorian court (as opposed to the NSW court in Bogdanovic), reached an opposing conclusion in Rasmussen v Rasmussen,
Facts: the plaintiff argued that some of the defendant property (which he received as a volunteer) was held on constructive trust for him (the plaintiff). The court accepted that a constructive trust existed.

Held: Bogdanovic is rejected, and King is still good law. in Vic, indefeasibility only applies to purchasers for value, and volunteers are not protected from prior equitable claims. Therefore the defendant, as a volunteer, was not protected from the prior claim of the plaintiff.

In conclusion, many of the states differ on this point of whether volunteers enjoy indefeasibility. The High Court has arguably resolved this issue through some obiter dicta in Farrah Constructions Pty Ltd v Say-Dee Pty Ltd, in which it indicated that volunteers do obtain indefeasibility, and no distinction is made between volunteers and purchasers.

The Fraud Exception

A person who has relied on fraud in order to register himself as a proprietor will not enjoy indefeasibility.

Introduction

The laws of indefeasibility do not apply in an instance where the registered proprietor has relied on fraud. The legislation explicitly states that the operation of the indefeasibility provisions (eg, s 42 and s 43) is excepted in the cases of fraud.

A good illustration of the fraud exception is Loke Yew v Port Swettenham Rubber:

- One type of fraud is where a party promises that an unregistered interest will be preserved (in order to induce another party to agree to a transaction) and then goes back on that promise.
- In such a case, the fraudulently party will come within the fraud exception made in the legislation and thus would not enjoy indefeasibility.

Mere Notice is Not Fraud

The fact that a purchaser is aware that there are unregistered or equitable interests (which will become barred once when he completes registration) will not make him guilty of fraud.

- This is given effect by 'the notice provision' (s 43).

Fraud Must Be Operative

It is important to note that an exception will only be made for fraud if the fraud is 'operative' - in other words, if the fraud actually caused a person to act in a way that is detrimental to himself. If the fraud resulted in no harm, it won't affect indefeasibility.

Carelessness or Failure to Make Inquiries

This section deals with a situation in which a party is alleged to be a sort of 'accomplice' to the fraud of another because it failed to check a document properly. Carelessness in examining a document for fraud,
or the failure of a party to make inquiries (even if they were reasonable), will not make a registered proprietor guilty of fraud.

This was discussed in *Assets Co Ltd v Mere Roihi*:

- A person who fails to discover the fraud of another because he didn't make inquiries is not guilty of fraud.
- The fraud must be 'brought home' to the party - ie, the party must be a part of the fraud in a way to come within the exception.
- However, if the person had suspicions that there might be fraud, and then didn't make inquiries so as to not find out and thus tied down by law (this is called *willful blindness* - shutting one's eyes to avoid implications), then they are guilty of fraud.
- A person who honestly believed that a transfer is legitimate and free from fraud is not guilty of fraud.

Note that this means that the concept of 'constructive knowledge' (knowledge which should and could have been discovered by making normal inquiries) does not apply to fraud. Actual knowledge is necessary.

This ruling was affirmed in *Pyramid Building Society (in liq) v Scorpion Hotels Pty Ltd*, which also went further and stated that:

- What would be characterised as 'negligence' (eg, failure to make inquiries) will not be extended to mean 'willful blindness'. Willful blindness requires more than mere negligence or the failure to make inquiries.

**Fraud and Agency**

A party can sometimes be guilty of fraud because its agent was acting fraudulently.

This was explained in *Schultz v Corwill Properties Pty Ltd*:

- There are two possible agency situations:
  1. The agent himself has acted fraudulently.
  2. If the agent was *acting within the scope of his actual or apparent authority* (given to him by the principal) then the principal will be guilty of fraud.
- The agent has learned of the existence of fraud by another.
- If the agent has *actual* (as opposed to constructive) knowledge of fraud, then the agent will be presumed to have communicated to the principal all information that he gained 'in the course of carrying out the transaction' (the big requirement is of actual knowledge).

**False Attestations**

Another common example of fraud and agency is when an agent (such as a bank officer) falsely attests a signature (confirms it to be valid when it is not). That rule is that if an agent *honestly believed* that the impersonator was the right person/the signature was not forged, he will not be guilty of fraud.

This was discussed in *Russo v Bendigo Bank Ltd*: