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Keep a Sharp Lookout—Civil Forfeiture and Seeing the Risks in Suspicious Real Estate Transactions

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KEEP A SHARP LOOKOUT—CIVIL FORFEITURE AND SEEING THE RISKS IN SUSPICIOUS REAL ESTATE TRANSACTIONS

A CFO process primer and the risks associated with marihuana grow op (MGO) property transactions

I. A Primer on the Civil Forfeiture

Forfeiture, whether it arises from civil or criminal litigation, is an ancient remedy dating back to the Norman conquest of Britain. Forfeiture is, quite simply, a judicially authorized change in legal ownership. The original version fell into disfavour during the Industrial Revolution as did other legal processes that did not provide for due process.

Two hundred years later, the concept of forfeiture for public misdeeds was spurred by the excesses of gangsters during the US experiment with alcohol prohibition in the 1920s. However, it was not until the 1980s that forfeiture was renewed in Canada, originally as part of an international response to transnational crime. Most developed nations developed legislation and law enforcement units to deal with the proceeds of organized crime. Canada, for its part, developed added forfeiture to the Criminal Code and created Integrated Proceeds of Crime units within the RCMP. As a result, certain crimes could trigger a parallel forfeiture process that ran in conjunction with a criminal prosecution.

However, criminal forfeiture became fraught with procedural and practical difficulties. It never lived up to its intended promise and two decades later, it is almost exclusively used in only major drug prosecutions.

These limitations, and the frustration with the vast extent of criminal proceeds being enjoyed by organized crime, led to a re-examination of civil forfeiture. Ontario led the way in 2000, and BC followed in 2005. Alberta came along at the end of 2008. These provinces used the existing civil litigation system, now featuring a modern litigation system that involves the critical elements of due process; an impartial tribunal and the ability to employ fact finding processes that ensure full answer and defense is available to the litigants.

In Canada, the civil forfeiture process is familiar to those who practice commercial law. The process employs two stages that are similar to well established creditor remedies: an initial asset preservation order application without notice to determine if a threshold for court intervention has been established, and an ultimate hearing on notice that engages all interested parties in a determination of the merits of the action.

By statue, once the CFO establishes a prima facie case, on the balance of probability, the onus shifts to the defendant (in some cases termed the respondent) to establish that they were not aware of, or associated with, the illegal activity or asset.

Typically, the referrals originate with police. The goal of a police investigation is to gather evidence that can prove a case beyond reasonable doubt. As a result, when police refer a case to a CFO, there is often plenty of evidence that can prove a case to the lower civil threshold of balance of probabilities. This explains, in part, the extremely high success rate of CFOs—usually exceeding 95%. Revenues from the forfeitures are used to support victims' and crime prevention programs.

In BC, the CFO will get involved when the following factors are relevant:

1. sufficient public interest in proceeding;
2. sufficient and strong evidence;
3. relevant economic factors are present.

With real estate files generally, they will look for a minimum of $75,000 to $100,000 in equity. However, in the case of houses that are a hazard to the neighborhood (crack houses), they have taken action when there is little equity.

In regard to remediation, they don't. There is no recognized standard anywhere to remediate to, and therefore, no guarantee that if a house is remediated, the government will be free from future claims. Therefore, every house sold is sold as is with clear warnings as to the history of the property.

II. The Risks: Costs, Ethics, and Imputed Knowledge Hazards

A. Costs: Economic and Otherwise

An awareness of the costs is critical to practitioners because the odds are that they will be involved in an MGO property transaction. Even 10 years ago, the BC expert, Professor Plecas found the rate of MGO incidents was nearly 1 per every 1,000 British Columbians. Since that 1,000 includes people that do not own homes, and practitioners deal with ones that do, it is inevitable that they are going to, unwittingly or not, become involved in a MGO real estate transaction.

According to the *Globe and Mail* this year, 15,000 residential power accounts in BC showed signs of being a MGO. This reflects the profit opportunity in the business: each plant is worth $1,000 and an average bungalow grow op has up to 700 plants. A crop can be grown every three months. Essentially, a MGO in a residential home is a million dollars a year money maker.

However, every payoff has a price.

MGOs regularly burst into flames, incinerating themselves and others. Grows encourage home invasions. Grows inflict immense damage to the building and occasion costly remediation. In BC there is mandatory disclosure of a property's status as a grow op, reduced resale, mandatory remediation charges and the potential for demolition. These costs often exceed $100,000.

If that wasn't enough of a downside there are the criminal sanctions that have now been enacted with amendments to the *Criminal Code*. Added to this are the sanctions imposed by local governments. BC lower mainland municipalities armed with hydro use stats that ferret out unusually high power consumption employ inspectors to examine properties, and if evidence of an MGO is found, assess inspection fees from $3,200 to $5,200.

Also, on a wider scale, grows support organized crime that makes vast profits that support other criminal enterprises, like cocaine trafficking and gun running that ruin thousands of lives and

undermines the safety of our neighbourhoods. Who are the victims? Pickton, Svekla and other mass murderers in Canada prey on sex trade workers who are trying to fund their cocaine habit.

The BC CFO, like its partner CFOs across Canada, are involved in the sale of ex-MGOs, and experience confirms that even if remediated, ex-MGOs are heavily discounted for sale—sometimes up to 30%.

Homeowners have plenty of reason to be concerned, so what about practitioners?

B. Ethics

First, there's the obvious moral and ethical obligation to a client. If a client brought a "Nigerian scam" letter into your office, would you assist them by setting up a client trust account to enable the scheme and your client's victimization? If a client ran into your office with a gun in one hand, and a canvas bank deposit bag stuffed with foreign currency in the other, all the while surrounded by a cloud of red dye powder, (consistent with a fresh bank robbery) would you take the foreign money and exchange it for them?

As the saying goes, "D-uh."

Yet, these elements, a client either being a potential crime victim, or an active participant in a criminal scheme, exist with clients purchasing, selling, placing a mortgage on, or otherwise dealing with an MGO.

It's a tragedy of our modern era that your role, as the facilitator and guide of what is ordinarily a happy event in your client's life, the purchase or sale of a home, has to be screened for possible criminal taint. The BC Law Society Code of Conduct is explicit: "Rule 6 - a lawyer must not engage in any activity that the lawyer knows or ought to know assists in or encourages any dishonesty, crime or fraud."

And the commentary about fraudulent scheme is equally applicable to participation in any transaction that may be criminal: "A lawyer who represents a client conducting a fraudulent scheme is guilty of professional misconduct, even if he does not know the scheme is fraudulent, if he provides services to the client, receives money into his trust account, and recklessly makes representations to others about the scheme."

Therefore, the ethical considerations are clear. You have to be vigilant, but how good does your eyesight have to be?

C. Imputed Knowledge

Pretty good in fact. This arises not just from the ethical and moral background, but from the broad responsibility imposed by the *Criminal Code* (the "*Code*") and civil forfeiture legislation, the *Civil Forfeiture Act*, S.B.C. 2005, c.29 (the "*CFA*"). The net cast by the *Code* is astoundingly broad and captures anyone who encourages, participates or assists the commission of an offence. The doctrine of "willful blindness," means what it says, and it too has been recognized in the criminal case precedent.

So too does the *CFA*. Its s. 6(2) reflects the doctrine that willful blindness will result in forfeiture of proceeds (proceeds are the fruits of the illegal activity, instruments are the means). The case is somewhat different with instruments; however, even if you didn't directly engage in the activity, s. 12 and 13 make your knowledge of, and the receipt of a benefit, a trigger for forfeiture.

In total, the practitioner bears three points of personal exposure: ethical, criminal, and civil liability. These realities, and the steps to minimize risks, will increase your workload too. This time may not, in a flat fee billing arrangement, be recouped. For some clients this exercise may take five minutes, for others, two hours.

Although the areas of exposure are obvious for practitioners who deliberately, or through carelessness, participate or assist in a real estate transaction involving a MGO, there is exposure even for those who do not. Imagine that you represent a client who advances financing for a property that you should have known was a MGO? Or, you act for a client that unwittingly accepts a MGO property as part of a package of collateral to secure a guarantee, the house burns down and the insurer refuses to pay?

At the very least, even if you're not charged, you or your client may be sued. You could have to personally bear the cost of being a litigant in a civil proceeding. After all, its civil litigation and the plaintiff can cast a wide net. "Sue everyone," we're told in law school in order to avoid being sued for not naming a potential party and missing a limitation. You may have to file affidavits, lists of documents, and even attend examinations. Although 75% of CFO actions are undefended, a significant number still result in active litigation involving these steps.

III. Risk Management

A. A Case Illustration of the Potential and Actual Risks

Still, you must be wondering, "how can it happen to me? - someone comes in to sell or buy - how am I to know that this transaction involves a MGO?"

Indeed, that is the question. And it's not just about facilitating growing ops; it's also about laundering money. The *Code*, as usual, has a sweeping definition of laundering, and prohibits anything that transfers interest in a proceed. Of course, MGOs are proceeds as well as instruments of crime. So the question isn't just, "how do I know it's a MGO file," but, also, "how do I know I'm not laundering money from one?"

Fortunately, it's not hard to tell if you or your client is at risk.

The basic business model of MGO schemes involves multiple properties and frequent purchases and sales by people who do not have the apparent means to fund the transaction. There is often no obvious or legitimate justification for the frequency of transactions, or the rapid rate of mortgage retirement and refinancing.

The nature of the client is also a giveaway. Seventy percent of the time MGOs are put into the name of a nominee, occasionally a non-existent person (all the more reason to comply with know your client—KYC—rules) but more commonly a family member, and often one whose means are non-existent. CFO war stories are replete with accounts of the 20 year old homeowner who claims that they financed the purchase of a home with their babysitting money.

Typically, MGO operators conduct several transactions in a short period of time. Their stated ability to support a home will not have improved, yet the same people, whose means seemed barely able to support the purchase of one house, are coming to you again with another purchase. In this common scenario, the questions should loom larger for the lawyer.

The nature of the business model—the improbable purchase, often of multiple homes by persons of little apparent means—contains the seeds of its own undoing. Also, when queried, the sheer improbabilities of the scenarios spouted by criminals are also a giveaway. In the world of AML (anti money laundering), KYC and a modest ability to analyze the stated purpose of a transaction and measure it against conventional and probable purposes, is 90% of the game.

The level of imagination used by MGO operators in explaining the acquisition of properties is ludicrously low. In one case, a young nail salon technician, when examined as to the source of a $250,000 down payment for a rural acreage property, replied that relatives had bestowed this as a gift. We overlooked the fact that she, an erstwhile polisher of nails in the BC lower mainland, claimed the

purpose of the transaction was to set up a purebred cattle operation in Alberta's beefbelt. Also, we overlooked the untimely arrest of her co-purchaser who, on the day of closing, was stopped by the RCMP in Avola on the Yellowhead, and his cube van found to be chock full of pot plants and grow gear.

Instead, at the examination in Vancouver, our counsel pressed for the names of the relatives so that the veracity of the story could be confirmed—or not.

"Which of your relatives gave you the money?"

"I don't know," was the reply.

"What were the names of the people who gave you the money?" said our counsel, not sure if this question had been understood.

"I don't know their names," was the reply.

Apparently, the question had been comprehended.

We later speculated that this family adhered to a strict policy of philanthropic anonymity and attended at her front door with a bag of cash wearing *lone* ranger masks, before disappearing into the sunset, secure that their loved one would forever ask, "who were those masked men and women?"

A lawyer facilitated this deal. Did they wonder why a nail technician from the lower mainland was getting involved in a cattle operation in cowboy country? How was the $250,000 paid? Who did it come from? Her account, or someone else's?

Another example comes from closer to your home.

You, or your assistant, will usually find out your client's occupation, their age, how they are intending to finance the purchase, or what the reason is for the sale. It's all part of KYC. If it makes sense, you've done your due diligence and you've avoided the risk. The typical wage middle age wage earner, with regular employment is someone we've all seen, and a transaction with this type of client will ordinarily bear little risk.

However, if the wage earner starts to amass a number of properties, rents them out through a person who is known to them only by a first name, who makes no inspection of the properties, or any inquiries, who does not report the income, whose properties were previously identified as MGOs, then they, and anyone associated with these transactions, are at risk. This fact situation is the basis of the BCSC decision of *BC (Director of Civil Forfeiture) v. Rai*, 2011 BCSC 186, a decision of the Honourable Mr. Justice Silverman.

In *Rai*, Silverman J. found no actual knowledge on behalf of Rai, the landlord and owner of three properties that housed MGOs, and employed the willful blindness concept in the course of ordering forfeiture of 2 out of 3 properties.

Put yourself in the situation of a lawyer acting for someone extending financing to Rai. Let's say, you don't think to ask the client, the landlord like Rai, for proof of his rental receipts. After all, most banks don't require proof of rental receipts, so why should you?

However, it's an easy way to verify the story given to you by the landlord mortgagor and an easy way to protect your bank client. Just the asking may be enough. If the mortgagor gives the usual MGO operator excuse, "I don't have any records," then that's an important warning sign.

If you don't take reasonable steps to avoid this risk, imagine the phone call to your client telling them that the house has been restrained because it was an MGO. Imagine explaining that the value of their collateral is likely impaired by mould damage, and they may lose it entirely to the CFO. Imagine, at the very least, explaining how they'll have to file an affidavit explaining their knowledge, or lack of it. Imagine the affidavit they file saying that they relied on you for advice and you let them down.

Further, imagine having to address the question of who will pay for the lawyer time? Imagine the other possible conversation, about who will pay bank's costs if they become enmeshed in CFO litigation when they are named as a defendant along with Mr. Rai.

Could this happen? In BC?

Yes, and yes. The litigation is underway even as we speak.

B. Risk Avoidance for Lawyers: A Summary of AML Steps

Awareness and risk assessment is the key to avoiding exposure. Law firms should use the same approach that the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* has imposed on banks, and other groups.

Essentially, AML steps represent a risk analysis based on what is really just another expression of common sense. For example, does the purchaser have the means to acquire the asset? Are they too young, too old, insufficiently sophisticated or not sufficiently educated to have the means? There are plenty of cases where students and seniors, with no income, and especially young people whose second language is English, are placed on title. Is there a good reason to expect persons who would have difficulty obtaining significant employment being able to afford an $800,000 home? Ask, and assess the response.

Ask yourself also, why is the transaction happening? In a BC case before the courts, the BC CFO is seeking forfeiture of the bank's interests on the basis that they should have known they were financing a MGO. In that case there were allegedly multiple transactions, involving a group of persons, in a property that was repeatedly used as a MGO. This illustrates the need for lawyers to question the business need for the transaction and its underlying rationale.

Also, what is the employment or business that will support the payments? This has also come up in the litigation involving the banks and the BC CFO. Also, is this a case of re-financing? Why would this be done if especially so close on the heels of the initial mortgage? Also, can the business support the acquisition? The largest criminal enterprise case the Alberta CFO has examined involved a meat store owner whose income was hovering on the poverty line, yet he possessed two Lamborghinis, houses in a luxury subdivision and a shopping mall.

Would you lease a Lamborghini to a butcher who made $30,000 per year? Would you help him obtain financing for a shopping mall? Someone at a bank, and a law firm, did. (The properties are now subject to a court restraint order.) The gap between the means of a small business, and the magnitude of the asset purchased, is a general clue that the transaction is suspicious and should be avoided.

Obviously, the manner of payment matters too. Cash, or bank drafts in names of persons who are not being placed on title, or monies from a small business that is too puny to justify the type of asset purchased, are other warning signs. In general, any inability to identify details, or give cogent explanations for the persons involved, the manner of payment, the reason for acquisition, are hallmarks of a laundering scheme.

Finally, do not discount the dangers of assisting a potential client who flamboyantly displays all the signs of being a criminal. Many criminals do not hide their lack of legitimate income, and often expect that nothing will happen to their assets. A public display of criminal behavior, with little concern for confiscation, is evident in episodes like the September 1, 2011 teenage *Fast and Furious* supercar street race in Vancouver suburbs. Criminals routinely buy exotic cars with cash, or put large cash sums over $10,000 into conventional banks; they won't be necessarily be camouflaging their activities when they deal with a law firm.

In these cases, it's easy for a lawyer to decline to take on a file.

IV. Conclusion and Forecast: Increasing Pressure on all Service Providers

Several factors guarantee the expansion of CFO programs and impacts on service providers like lawyers who facilitate asset transfers. International pressure to address proceeds of crime will continue to increase. So too will public demand for a visible response. Police continue to be enthusiastic about civil forfeiture. Initial complaints about civil forfeiture have been largely replaced by public support. Organizations that help vulnerable citizens welcome CFO grant funds and provide positive feedback to the political sphere. Finally, the principal legal challenges to forfeiture were overcome in 2009. Since then every active CFOs has increased the scope of their legislation.

Therefore, home buyers, vendors, financial institutions, landlords, title holders, interest holders (mortgage holders), leasing companies, rental companies, and property service suppliers will continue to be drawn into CFO legal actions. They will have to meet factual and legal thresholds, incur internal costs, and in many cases, they will lose their interests and will be subject to pay legal costs.

The CFO programs are growing in sophistication and skill. Larger files are in the works and increased integration with law enforcement agencies will bring CFOs into contact with service providers like law firms. More lawyers will become enmeshed as defendants, but more will learn to seek advice from practice advisers and CLE programs such as this one. These lawyers will successfully practice, and they and their clients will thrive, even as the business environment changes.

In total, there will be an increasing need for lawyers to become aware of AML issues, and will have to determine in each case what constitutes the right level of diligence in order to avoid imputed knowledge. There is a risk assessment to be made at the individual lawyer and law firm level - lawyers must learn how to operate safely in the changed environment, work within the regulatory scheme, or take their chances and pay the price.

Keep a sharp look out in the future. Willful blindness, as ever, will be no substitution for realistic risk assessment and decisive action.