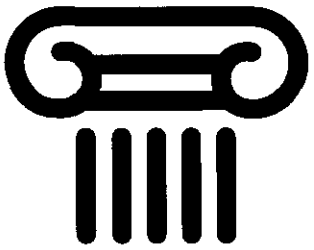

ALBERTA
LAW REFORM
INSTITUTE

MORTGAGE REMEDIES IN ALBERTA

Report No. 70

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ALBERTA LAW REFORM INSTITUTE

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ALBERTA LAW REFORM INSTITUTE

The Alberta Law Reform Institute was established on January 1, 1968, by the Government of Alberta, the University of Alberta and the Law Society of Alberta for the purposes, among others, of conducting legal research and recommending reforms in the law. Funding of the Institute's operations is provided by the Government of Alberta, the University of Alberta, and the Alberta Law Foundation.

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ACKNOWLEDGEMENTS

This report represents the completion of the Institute's work on Mortgage Remedies, following the publication of Report for Discussion No. 9 in April of 1991. The area is a complex one, involving difficult legal issues intertwined with legal procedure and industry practices. Janice Henderson-Lypkie is the counsel who has had charge of this project, starting with the completion of the Report for Discussion and continuing through to the publication of this final report. The report represents two large tasks for which the Board owes a great debt of gratitude. The first is the extensive consultation which has taken place with industry and legal representatives. The second is the necessity to segregate the issues so that the Board has been fully informed and comprehensively advised so as to make the necessary policy decisions. The report, under Ms. Henderson-Lypkie's guiding hand, represents not only a clear exposition of the existing law which will benefit the profession but also a perceptive analysis of the issues that underlie this area.

The Institute is also grateful for the assistance of the two members of the Project Advisory Committee who have been consulted extensively on this project as it has developed. Mr. Michael Penny and Mr. Lyndon Irwin have both been generous with their time and talent and their contribution has improved the final product. Within the Institute, Mr. Eric Spink has been a sounding board for many of the proposals and we have relied on his practical experience in the foreclosures area.

HOW TO READ THIS REPORT

Chapters 1 to 5 describe the law and practice in this area. They pick up on the materials which were first published in 1991 in the Report for Discussion. Chapter 4 has been expanded to include recent developments since 1991, and Chapter 5 includes statistics that have become available since the time of the publication of the Report for Discussion.

Those who wish to cut immediately to the Recommendations could start with Chapter 6 which deals with the two primary issues of the existence of deficiency judgment protection and the requirement of a judicially supervised sale procedure.

Table of Contents

CHAPTER 4 — EXISTING LAW AND PRACTICE

PART I — SUMMARY OF REPORT

SCOPE OF THIS REPORT

This report considers mortgages of land in Alberta, and the remedies that the law makes available to both the lender and the borrower in the event of default under such a mortgage. We review the existing Alberta law and practice in this subject area. We then recommend certain changes which we think could usefully be made to that body of law.

In this report "borrower" refers to the person who grants the mortgage. "Lender" refers to the party that lends the money on the security of a land mortgage. A "transferee" is someone who buys land that is charged by a mortgage.

MORTGAGE REMEDIES LAW IN ALBERTA: THE EXISTING LAW

Mortgage remedies law has deep roots in the past. Most of the remedies of the borrower and lender were developed by the English Court of Equity before 1870. We trace the development of Alberta law from the English Court of Equity to Alberta at the turn of the century and on to the present time.

Since 1939, Alberta has restricted the lender's right to sue on the covenant to pay given in the mortgage. In that year, Alberta enacted legislation that restricted a lender's remedies to the land. A lender could ask the court to sell the land or the lender could take title to the land through foreclosure; but a lender was prohibited from suing any borrower on the covenant to pay given in the mortgage. If the value of the land was less than the debt owing, the lender was unable to sue the borrower for this deficiency. Over time, Alberta has reduced the scope of this restriction. Today, a lender can enforce a covenant to pay given by a corporate borrower and can sue to collect any deficiency. The lender is still prohibited from bringing an action on a covenant to pay given by an individual borrower.

In certain circumstances, the lender can also sue a person who has bought the land subject to the mortgage. The law governing when such a person will be protected from action by the lender is very complicated. It can be summarized in general terms as follows. Assume an individual

grants a mortgage of land and later sells the mortgaged land. If an individual buys the mortgaged land, that individual will at all times be protected. If a corporation buys the mortgaged land, the corporation receives deficiency judgment protection for a limited time. The protection exists until such time as the corporation enters into a renewal agreement with the lender in which the corporation covenants to pay the mortgage debt. The protection is lost on the giving of the renewal.

Now, assume a corporation grants a mortgage of land and later sells the mortgaged land. If a corporation buys the land, that corporation is not protected. If an individual buys the land, that individual is given immediate protection only if the land is residential land upon which the individual or a family member resides or is farm land upon which the individual or a family member carries on farming operations. No other individuals are protected initially. Every individual receives protection when entering into a renewal agreement with the lender in which the individual covenants to pay the mortgage debt.

The legislation which restricts the lender's right to sue on the covenant of payment does not apply to mortgages granted or insured under the National Housing Act and its predecessors. Although there is still some uncertainty on this issue, we believe that Crown lenders are also not bound by the legislation which restricts the lender's right to sue certain persons for any deficiency.

This brief foray into mortgage remedies law illustrates that the course of legislative amendment and judicial interpretation has created a complex body of law that lacks consistency and rationality.

RECOMMENDATIONS FOR REFORM

The general direction of reform

We recommend that Alberta retain judicial supervision of the foreclosure process because this system goes the furthest to ensure fair treatment of the borrower, the lender, and subsequent encumbrancers. The key to fair treatment is sale of the land at a fair value. Judicial supervision is needed to ensure price adequacy in foreclosure sales in times of fluctuating land prices.

Our review shows that while deficiency judgment protection has some negative effects (i.e. walk-aways and dollar dealers), it generally protects thousands of homeowners who, through no fault of their own, lose their jobs and homes at a time when land values are substantially reduced by recessionary forces. Whether one finds this desirable or not depends on one's philosophical views, but the political choice and policy of providing deficiency judgment protection for homeowners and farmers has prevailed in Alberta continuously since 1939.

Protection of homeowners and farmers is legitimate public policy and does not harm essential Alberta interests. In our opinion, abuse of the system by walk-aways and dollar dealers does not justify repeal of deficiency judgment protection. Procedural changes have largely solved the problem of dollar deals and the relatively small number of walk-aways seen in 1982-85 does not justify repeal of deficiency judgment protection for all homeowners.

In the final analysis, whether a government chooses to create deficiency judgment protection is really a political decision, and one best left to politicians. Mortgage remedies law should be reformed within the existing legislative policy of protecting homeowners and farmers from deficiency judgments.

Recommendations — substance

1. **Judicial supervision of foreclosure actions**: Alberta should retain judicial supervision of the foreclosure process. Any power of sale granted by an individual to a lender should be void. A power of sale granted by a corporation would be valid. The lender, however, could not transfer the land free and clear of subsequent encumbrances by exercising the power of sale.

2. **Deficiency judgment protection**: Deficiency judgment protection should exist for all individuals (be they a borrower or a transferee) who own residential land or farm land charged by a mortgage where that individual or a family member has in good faith:

(i) in the case of residential land, used that land as a residence, or

(ii) in the case of farm land, used that land for carrying on farming operations

at anytime during which that individual is or was a registered owner of the mortgaged land. No other individuals and no corporation should receive deficiency judgment protection. The protection of a transferee would no longer depend upon the identity of the borrower. (Individuals receiving deficiency judgment protection are called "protected individuals".)

The Crown should be bound by all the legislation that governs mortgage remedies, subject to any exception the Crown may wish to make for specific crown agencies. This recommendation should apply to the Crown in right of Alberta, and, if possible, to the Crown in right of Canada.

We are divided in opinion as to whether a mortgage given to secure a loan made or insured under the National Housing Act should be exempt from deficiency judgment protection. We recommend that the Legislature examine whether an exception should be made for such mortgages.

Any waiver of the proposed protection should be void.

3. **Section 62 of the Land Titles Act**: The scope of the covenant to pay implied by Section 62 of the Land Titles Act should be broadened. The transferee should covenant with the lender to pay certain sums secured by the mortgage, namely: principal money, interest, annuity, rent charge, taxes, insurance premiums, and all reasonable sums paid by the lender to maintain or preserve the property. These sums would be payable at the rate and at the time specified in the mortgage.

4. **Attornment clauses**: Any attornment clause given by a protected individual in a mortgage charging residential land or farm land should be void. No exceptions should be made for mortgages granted to the Farm Credit Corporation, mortgages securing loans given or insured under the National Housing Act, or mortgage granted to the Crown or any of its agents.

5. **Due-on-sale clauses**: The existing law on the enforcement of due-on-sale clauses in Alberta is adequate. The legislation governing mortgage remedies should list the factors the court can consider when giving relief against the operation of a due-on-sale clause.

Recommendations — procedure

We discuss the advantages and disadvantages of the Rice order procedure that was extensively used in Alberta in the 1980s. A Rice order is an order in a foreclosure action which approves sale of the land to the lender and grants a judgment for the deficiency. Although we recognize that the Rice order procedure is not perfect, we see it as a justifiable method of ensuring that lenders are paid what is owing to them. We are no longer of the view that the court must attempt to sell the land to the public before entertaining the lender's offer to purchase the land. This is a matter best left to the court's discretion. However, the Rules of Court should list the factors the court should consider when deciding when an attempt at sale is warranted. Practice should not evolve to the point where the court routinely gives immediate Rice orders without thought to whether it is appropriate to the situation.

The court should have the ability to offer land for sale at a time and place, in a manner, after any advertisement of sale, and at any price that the Court considers proper. It should not be restricted to any particular method of sale or manner of advertisement. It certainly should not be restricted to sale by tender and advertising in the newspaper. Rule 689 should be repealed.

We make other minor recommendations for change to foreclosure procedure (including the right to an immediate foreclosure order in the case of residential land or farm land where there is no equity in the land) and discuss the matter of transition.

THE CHANGES BROUGHT ABOUT BY THESE RECOMMENDATIONS

The recommendations are designed to tailor deficiency judgment protection to those needing it, namely, homeowners and farmers and to remove such protection from those who do not need it, namely, individuals who are investors and corporations. The result is that the scope of deficiency judgment protection is reduced. For example, under the existing law, an individual who grants a mortgage charging commercial land, such as an apartment building, receives deficiency judgment protection. Under the proposed regime, an individual who grants such a mortgage would be liable on the covenant to pay given in the mortgage.

Another important difference is that deficiency judgment protection would no longer depend upon the identity of the original borrower. For example, assume an individual grants a mortgage on land and then sells the land to a corporation. Under the present law, that corporation receives deficiency judgment protection up until the time of renewal because the borrower is an individual. Under the proposed regime, the corporation would never receive protection and the lender could pursue any cause of action it had against the corporation.

The recommendations will also significantly speed up the foreclosure process.

PART II — REPORT

CHAPTER 1
INTRODUCTION

A. History and Scope of the Project

A mortgage is one form of security over land. The borrower (also known as the mortgagor) undertakes to repay a sum of money advanced by the lender (also known as the mortgagee). Default by the borrower triggers a series of remedies available to the lender under the mortgage. Since 1939 Alberta has, in some fashion or another, restricted the exercise of these remedies that exist under the general law. A series of legislative amendments passed over the years has led to extremely complex legislation and to a loss of focus on who is being protected and why. The time has come for this body of law to be reconsidered in its entirety. This project was undertaken to perform this task.

In April 1991, the Alberta Law Reform Institute published Report for Discussion No. 9, *Mortgage Remedies in Alberta*. This document was designed to generate discussion as to reform of mortgage remedies in Alberta. It did this by summarizing the present law and its history and making tentative recommendations for change on substantive and procedural issues relating to mortgage remedies. The seventeen organizations and individuals listed in Appendix A responded to the report by giving us their views on how reform should proceed in this area. Two commentators were members of the general public and the rest were lenders and organizations or lawyers representing lenders. The input of each commentator has been considered in the preparation of this final report.

B. Terminology

In an effort to make this report more easily understandable to individuals who do not have legal training, we have deviated from the traditional terminology of "mortgagor" and "mortgagee". Instead, we use the terms borrower and lender. "Borrower" will refer to the person who grants the mortgage. "Lender" will refer to the party that lends the money on the

security of a land mortgage. For ease of reference, we will assume all lenders are corporations and refer to them as such. In this report, the term "borrower" is interchangeable with "mortgagor" and the term "lender" is interchangeable with "mortgagee". Most of the legal literature in this area use the terms "mortgagor" and "mortgagee". Expect to see these terms used in the quotations referred to throughout the report.

We have also adopted the terms "transferor", "transferee", and "deficiency judgment". The transferor is the person who sells the land that is charged by a mortgage. The transferor can be the borrower or some subsequent owner. The transferee is the person who purchases the mortgaged land from the transferor. A deficiency is the difference between the amount owed by the borrower and the amount realized upon sale of the land in the foreclosure action. A deficiency judgment is a judgment for the deficiency.

C. Outline of the Report

Mortgage remedies is one area of the law deeply rooted in the past. Understanding the proposed reform is not possible without some understanding of the history of mortgage remedies in Alberta and a detailed knowledge of the existing law. With this in mind, we include in the final report chapters from the report for discussion dealing with the existing law and its historical development.

Chapter 2 describes the general nature of the problems associated with designing a system of mortgage remedies. Chapter 3 paints a broad picture of the historical development of the existing law. Chapter 4 contains a detailed summary of the existing law. Chapter 5 examines how the existing law operated in the surge of foreclosures experienced in the 1980s. Chapter 6 considers the general direction for reform. Chapters 7 and 8 set out our final recommendations for reform on matters of substance and procedure.

CHAPTER 2
THE GENERAL NATURE OF THE PROBLEM

A. Introduction

Mortgages of land have, in one form or another, been known to all Western legal systems for many hundreds of years. It might therefore be thought surprising that this area of the law should have continued to be complex, to have defied attempts at uniformity amongst jurisdictions, and to have attracted great controversy. Indeed one leading commentator was moved to suggest that:

> Possibly there will never be a completely satisfactory answer to the perennially disturbing relations between mortgagor and mortgagee. It has been said that if the Prime Ministers of England met in after life, they would have at least one problem in common to discuss: the Irish problem, and the not completely satisfactory methods they used in dealing with it. In like manner, it is possible that if all the judges and legislators in the history of Anglo-American jurisprudence could come together they would discuss the mortgage problem without end and without answer.[1]

The continued existence of legal difficulties and controversy over several centuries in many jurisdictions in relation to a subject of daily importance suggests that there must be deep rooted problems inherent in designing any fair and effective system of lenders' remedies. In later chapters we will outline the law in Alberta and the difficulties which have arisen in this jurisdiction, but it may be useful to sketch, at the outset, in relatively attenuated form, the basic nature of the fundamental questions which have given rise to these ongoing concerns.

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1 Skilton, *Government and the Mortgage Debtor*, at 206 cited in Osborne, *Mortgages*.

B. The Pendulum Phenomenon

A close study of the legalities surrounding mortgage remedies in the common law world reveals that over the centuries the pendulum has swung slowly from side to side. There have been periods of history, and places, where the view has prevailed that lenders are fair and lenient, and that in consequence such lenders should be accorded a power to resort quickly and effectively to whatever real estate has been encumbered by a mortgage. The expectation is, apparently, that if a mortgage can be foreclosed promptly and efficiently without opportunities for borrowers to cause delays, then lenders will be even more fair and lenient, and the supply of credit will be less inhibited.

At other times and in other places, the general view has prevailed that there are so many mortgages upon residential, agricultural and commercial properties that they affect the economic state of the particular jurisdiction to such an extent that it is socially desirable that all foreclosures should be effected only under the cloak of some judicial agency and under controlled conditions.

This tug of war between a viewpoint that sees a mortgage as a purely commercial transaction, on the one hand, and a viewpoint that sees it as a transaction that has traditionally attracted some degree of leniency through centuries of human experience, on the other hand, gives rise to a host of social, economic and political questions. These questions are complicated even further by conflicting interests, sectional differences of view, elements of tradition within a particular jurisdiction, and some natural degree of adherence by most people to the system with which they are most familiar.

If there is any learning to emerge from this eternal tug of war, it would seem to be that mortgage law is local law. Moreover, it is a body of law marked by impermanence. That is, each jurisdiction must continually adjust the pendulum for itself, according to its particular view of its own social and economic needs and its own present vision of justice. It would follow, for law reform purposes, that any suggestions for reform should probably be directed more to actual social and economic conditions within a given jurisdiction, than to the evolution of highly rationalized remedies which are said to be good for all times and all places. To view the matter any other way is to burden the draftsman with a task which has defied the

very best legal minds (and which is probably undesirable in any event). This is the task of finding a universal solution.

C. Second Level Problems

Even assuming that a consensus can be arrived at with respect to the large issues of policy suggested in the foregoing section there are a series of subsidiary questions of some importance. How much (if any) protection do borrowers really need in the course of the forced realization of mortgaged properties? Is the certainty of purchaser's title and protection of the borrower's interest gained through a court-supervised exercise worth what it costs? Is it necessary or desirable that the foreclosure of a farm or home be of the same summary character as the foreclosure of a speculative commercial property purchased by a corporation which had no other rationale for its existence and no other assets? In short, is it necessary to differentiate between different classes of property or kinds of transactions when designing mortgage remedies?

The answers given to these questions have also varied from jurisdiction to jurisdiction. This worldwide experience again suggests a need to pay close attention to the local situation in drafting laws, and that conditions or solutions adopted elsewhere—whilst not irrelevant—may not be apposite to the particular jurisdiction under review.

D. Overall Objectives

Notwithstanding the difficulties inherent in reaching a working consensus on the foregoing questions, it is possible to extract from the debates that have surrounded such questions some commonality in the objectives sought to be promoted by an appropriate system of mortgage remedies. These can be summarized under six heads. No particular priority should be assumed amongst these objectives from the order in which they are presented here.

(1) The extension of credit

It is in the interest of every member of a given jurisdiction that there should be a suitably liberal extension of credit at relatively low interest rates and on reasonably lengthy terms. Such credit is necessary to finance

homes, farms and factories. If lenders find that it is particularly difficult because of artificial legal restrictions to recover loans secured against land, equity ratios may be altered, interest rates may rise and lenders may take legal action immediately upon default. The supply of credit to individuals will then be affected, and ultimately, if wide spread defaults occur, a whole property market may itself be affected.

(2) The prevention of unconscionable judgments

Throughout the history of mortgage law there has been a concern that there should not be unconscionable excess judgments against the borrower. This concern seems to be greatest in those jurisdictions which experience repeated periods of sharp fluctuation in land values brought on by economic conditions.

If we assume that in the "normal" transaction the lender is prudent and the borrower is honest, but that some misfortune then makes it impossible for the borrower to honour his or her obligations, and the sale of the property does not cover the amount owing on the mortgage, on whom should the loss fall? Society has three choices. It can treat the lender as an insurer and have the lender absorb the loss or, more likely, pass that loss on to a number of future borrowers. In the alternative, society can say that the borrower must stand behind the loss in the form of a personal judgment. The third possibility is that differentiation is required—that in some kinds of cases personal liability should be set to one side, but not in others.

On what criteria should the choice between these alternatives turn? This is a question to which we will return to in detail in Chapter 6.

(3) The importance of adequate transitional arrangements

Mortgage foreclosures have a dramatic, disruptive effect. A home is lost or a farming operation terminated. If there is a shortage of rental accommodation, a family may be placed in difficult circumstances. If a crop is standing at the time of foreclosure, it may not be properly tended or harvested. In one way or another most systems of mortgage remedies have sought to accommodate these realities.

(4) The stability of sales

If a borrower defaults, and, with whatever safeguards are deemed desirable, the lender is enabled to sell the property, it is critical that the person who purchases the mortgaged property receive a secure, unencumbered title. If there is any kind of doubt about the title the transferee is to receive, or if, at some later point of time the sale can on some basis or other be impeached, the potential buyer may not in fact buy. The value of real property as security would then be reduced, and, ultimately, the credit system itself could be seriously inhibited. Thus, designers of systems of mortgage remedies have taken some pains to ensure that, whatever restrictions there may be on the exercise of a lender's right to sell, the sale itself should be legally protected and incontrovertible.

(5) The reduction of costs

Both when a mortgage document is drawn up, and in foreclosure proceedings, the costs of that "transaction" fall to the borrower or his or her property. Substantial legal costs are, from an economic perspective, inefficient. They may operate, in the first instance, as a disincentive to borrowing. At a later point of time, legal costs associated with a default may further diminish the borrower's ready cash or equity. And assuming (as is often the case) that the borrower has nothing left from which these costs may be recovered, the lender must absorb them or pass the costs on to other consumers in the form of higher interest rates or administration fees.

(6) The minimization of losses

If there has to be a forced realization of mortgaged property, it is in the interests of both the lender and the borrower that their losses be minimized. Whatever procedures are adopted should encourage the opportunities to realize the property at the best possible price in the circumstances. The importance of sale of land at fair value cannot be overemphasized.

E. Conclusion

Every jurisdiction, in designing its mortgage laws, has to weigh and balance several complex factors. These factors include the following:

(i) the need for secure and certain lending transactions to induce the general availability of credit for the purchase and development of land and the various enterprises which take place thereon;

(ii) the desirability that defaulters not be saddled by insurmountable debt loads for the rest of their lives;

(iii) when a sale is required in the event of default,the need for:
- reasonable procedure for repossession of property
- sales at fair value
- security of title for the third party who purchases the land;

(iv) the desirability of keeping costs of enforcing remedies to a minimum.

Given that "no subject of legislation has deeper roots in the past or more complex problems in the present",[2] it can hardly be surprising that so many reasonable persons have differed on precisely how these elements should be combined. Most draftsmen seem to have appreciated that there is a trade-off involved in designing a system of mortgage remedies: the greater the protection offered a borrower, the less efficient the system as a whole. Most systems, as might be expected, appear to aim for a balance between adequate protection and efficiency. Whether that balance is achievable, or in fact achieved, is another matter. Against that general perspective we turn now to the evolution of Alberta mortgage remedies.

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[2] Reeve, "The New Proposal for a Uniform Real Estate Mortgage Act" (1938) 5 Law & Contemporary Problems 564.

CHAPTER 3
THE DEVELOPMENT OF ALBERTA MORTGAGE REMEDIES

A. Introduction

Alberta mortgage law has a long and complicated heritage. In the simplest terms, Alberta inherited the substantial body of English judge-made law and some English statutory provisions relating to mortgages. This body of law was modified in some respects by certain legislative enactments passed during that period when Alberta was jurisdictionally part of the Northwest Territories of Canada. Then there is a substantial amount of legislation enacted since Alberta became a province of the Dominion of Canada on 1 September 1905. The proper interpretation of some of the provisions of this legislation has been the subject of literally hundreds of reported cases, some of which have been fought to the Supreme Court of Canada. In this chapter, we outline the general course of the development of this entire corpus of law, with a particular emphasis on how and why the several remedies presently available to lenders in Alberta assumed their present shape. A more detailed consideration of the present dimensions of each of these remedies is set out in Chapter 4.

B. Mortgages at Common Law

Under the early English common law the mortgage was originally a pledge of land.[3] A complicated procedure and judgment was required to complete a transfer and vesting of the title in the lender. Subsequently, the law became "stern and unrelenting".[4] A mortgage was treated at common law as vesting title to the affected land in the lender. The lender became the owner, though its title could be affected by the fulfilment of a condition subsequent: the payment of the mortgage debt on the day specified. Already the law had made one complete revolution of the cycle from a mortgage as merely a security device to a mortgage as an absolute commercial transaction.

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3 See Chaplin, "The Story of Mortgage Law" (1890) 4 Harv. L. Rev. 7.

4 *Longwith* v. *Butler* (1845) 8 Ill. 32 cited in Reeve, *supra*, note 2 at 568.

When the common law stood at this point, the lender required no remedy. There were no rights in the borrower to redeem the land, and no formal steps to foreclose the "interest" of the borrower were required. The borrower was left naked. Lenders' "remedies" attained the highest order of, but harshest, efficiency they were ever to enjoy.

The consequences of such a legal theory were far reaching. The lender was (in the absence of an express provision to the contrary) entitled to possession. If payment was not made on "the law day" (the day fixed for payment) the property became absolutely that of the lender, and the borrower ceased to have any interest in the estate. A mortgage literally means a "dead pledge" and, as Littleton put it, nonpayment of the money made the mortgaged land, "dead to [the borrower] upon condition".[5]

C. The Intervention of Equity Courts

The draconian consequences of this doctrine could not stand the test of time. English courts of equity began to espouse the notion (first established in Roman law) that a borrower was still entitled to redeem notwithstanding a breach of the covenant to pay on the law day.

The philosophy of this development was straightforward and turned on the notion that a mortgage is merely a security. Hence, the forfeiture of the property smacked of a penalty and a court of equity could (consistent with its traditional jurisdiction)[6] relieve against a forfeiture on terms that the borrower paid all outstanding costs, interest and principal. Courts of equity went further. A borrower could not "contract out" of the right to redeem, since, in the words of the famous maxim: "once a mortgage, nothing but a mortgage and always a mortgage".

This further reversal of the position of borrowers and lenders was attended by much of the rancour which still attends the attempted

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[5] *Littleton's Tenures in English*, lib. iii, (Littleton, Colorado: Fred B. Rothman & Co., 1985), c. 5, para. 332.

[6] See Kerly, *An Historical Sketch of the Equitable Jurisdiction of the Court of Chancery* (Cambridge: University Press, 1890) at 250-51.

modification of legal settlements today. As a leading writer on equity has noted:[7]

> These doctrines of Courts of Equity were at first strenuously resisted, and found little public favour owing to the rigid character of the common law and the sturdy prejudices of its advocates. We are told by Lord Hale that in the 14th year of Richard II, Parliament would not admit of an equity of redemption; although it seems not long after to have struggled into existence. Even as late as the latter part of the reign of Charles II, the same great judge was so little satisfied with encouraging an equity of redemption, that in the case before him for a redemption he declared that by the growth of equity on equity the heart of the common law is eaten out and legal settlements are destroyed. And perhaps the triumph of common sense over professional prejudices has never been more strikingly illustrated than in the gradual manner in which Courts of Equity have been enabled to withdraw mortgages from the stern and unrelenting character of conditions at common law.

However, the same kind of debate has continued to surface from time to time whenever the terms of the uneasy truce between borrowers and lenders is breached, as for instance, through moratoria legislation.

It should also be noted that once an equity of redemption was established, that "right" soon became further elevated into an intangible interest of some value vis-a-vis third parties: the equity of redemption could be left by will or reached by creditors. The equity of redemption became a property right *in rem* (that is, one exercisable against the whole world).

The practical consequence of the evolution of this English judicial philosophy was that a lender faced with default had two substantial remedies. The first was an action in debt for the money owing under the mortgage. The second remedy was the right to resort to the secured property after the borrower's interest had been "closed out" by way of foreclosure.

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[7] *Story's Equity Jurisprudence* (2nd ed.) (London: Stevens & Haynes, 1892), para. 1014.

The existence of these two remedies of itself created certain serious subsidiary problems. What is the relationship (if any) between these two remedies? Does one remedy have to be exhausted before the other is invoked? If not, there is the possibility of double recovery by the lender. If there is to be some primacy between these remedies, which is to be exercised first? It is not necessary to outline here the answers the courts gave to these questions. The important point is that once more than one remedy is available to a party to a law suit, the law has to evolve quite complicated controlling rules as to the relationship of remedies among themselves.[8]

English jurisprudence also faced another serious difficulty in the administration of these remedies. Prior to the jurisdictional reforms of the 1870s, an action in debt was a matter for the common law courts. The borrower's right of redemption, however, had been developed in Chancery. This involved two separate court systems operating under quite different systems of civil procedure and philosophies.

In the result, beginning in the 1850s there were a series of important reforms which led, ultimately, to all mortgage remedies being potentially exercisable by both common law and equity courts, thus, avoiding a troublesome and inefficient duplicity of proceedings.

Another important remedial reform was the Chancery Amendment Act of 1852,[9] which first authorized the Court of Chancery in any foreclosure suit to direct a sale of the mortgaged property to a third party instead of a foreclosure.

In the result, by the 1870s, English jurisprudence had finally arrived at a position which had some semblance of intellectual coherence and practical utility. A mortgage was only a security and the borrower had a right of redemption. A lender had essentially the choice of three alternative

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[8] For a most useful historical survey of the law on these questions see *Humble Investments Ltd.* v. *Gold Properties Ltd.* (1982), 21 Alta. L.R. (2d) 40 (Q.B., Master Funduk).

[9] 15 & 16 Vict., c. 86, s. 48. It had been held that the provision is still in force in Alberta. See *Credit Foncier Franco-Canadian* v. *Studholme* (1983), 27 Alta. L.R. (2d) 116 (Q.B., D.C. MacDonald J.), and *Humble Investments* (*supra*, note 8). But see now *Canada Permanent Trust Co.* v. *King Art Developments Ltd. et al.*, [1984] 4 W.W.R. 587, 54 A.R. 172 (C.A.).

routes to follow—an action in debt, a judicial sale of the property, or foreclosure. These alternatives all involved court supervised processes.

Canadian law inherited both the tradition and the formal learning of this corpus of English law. There is no Canadian jurisdiction which recognizes the older "pure" form of common law mortgage. All legislative schemes in the common law provinces in Canada have accepted that there must, in one way or another, be a suitable method of "closing out" the borrower's right to redeem before the "final" remedy of foreclosure by the lender may be invoked. In short, Canadian law accepted the philosophy originated by equity, but as might be expected, the more mechanical processes associated with carrying out that philosophy differ from jurisdiction to jurisdiction. Canadian jurisdictions have begun to evolve their own distinctive systems.

D. Legislation and Procedure in the Northwest Territories

Until 1905 Alberta was a district of the Northwest Territories. Under the Northwest Territories Act[10] the laws of England as they existed on 15 July 1870 were to apply throughout the Territories except as they were repealed, altered, varied, modified, or affected by an Act of the United Kingdom applicable to the Territories, or by the Parliament of Canada, or by any Ordinance of the Lieutenant Governor in Council under the Act, or by the Legislative Assembly. The same statute provided for the establishment of the Supreme Court of the Northwest Territories, which exercised the same jurisdiction as that of the High Court in England.

The result was that in the very early days of settlement in what is now Alberta, the body of English jurisprudence noted in the foregoing paragraphs applied. However, given the sparse nature of settlement, the mortgage question did not become of any importance until after the first Dominion Land Act of 1872[11] and the subsequent surveying and homesteading had begun.

One of the principal concerns in any newly settled jurisdiction is the establishment of a suitable system of title to land. In 1886 Canada enacted

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10 R.S.C. 1886, c. 50, s. 11.

11 S.C. 1872, c. 23.

The Territories Real Property Act, 1886[12] that was based on the Torrens system of title for the Northwest Territories. This Act was superseded by the Land Titles Act, 1894[13] that was also based on the Torrens system of title. The 1894 Act contained quite extensive provisions relating to mortgages, some of which have been carried forward—albeit sometimes in recast language—into present day Alberta legislation. Section 74 of that Act treated a mortgage as merely a charge on the land. A mortgage was, consistent both with the scheme of a Torrens statute and the equity concept of a mortgage, to have effect only as a security, and was not to operate as a transfer of the property.

The Land Titles Act, 1894 itself detailed the process to be followed in the event of default on a mortgage. Until 1898 that Act empowered the lender to sell the land if the borrower's default continued for one month. The entire process of "realization" was to be supervised by the court.[14] The steps to be taken were clear and explicit and involved three sequential stages. The lender had to apply for leave to issue "a notice in writing [requiring the borrower] to pay, within a time to be specified in the notice [the money owing]".[15] If payment was not made, the lender "under and subject to the direction of the judge"[16] could sell the relevant land "by public auction or by private contract, or by both modes of sale".[17] The lender could execute a transfer and registration of the transfer would give the purchaser title which was "freed and discharged from all liability on account of the mortgage . . . or of any mortgagee or encumbrance registered subsequent thereto".[18] If default was made for six calendar months in payment of moneys owing under the mortgage and the highest bid at the public auction was not sufficient to satisfy the money secured by the mortgage the court could then make an order for foreclosure. The making of an order absolute by the court was, however, conditional upon the land

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12 S.C. 1886, c. 26.

13 S.C. 1894, c. 28.

14 *Ibid.* s. 75.

15 *Ibid.* s. 74.

16 *Ibid.* s. 75.

17 *Ibid.* s. 75.

18 *Ibid.* ss 75 and 76.

being offered for sale again over a specified period of time. It was only after this entire process was followed that a final order of foreclosure could be made, the effect of which (when registered) was to vest the land in the lender.[19] The Act was silent as to the liability of the borrower on his or her personal covenant, thereby leaving that matter to be governed by the general law.[20]

In 1898 the Canadian Parliament repealed the sections which empowered the lender to sell the land under the supervision of a judge. In their stead, was enacted legislation that made judicial supervision of the enforcement process mandatory. The lender could no longer sell the land.[21]

Such a statute is important because it sets a framework of expectations. Any departure from the previous norm will then have to be justified by hard evidence of specific problems arising under that scheme, or a completely new scheme must be so demonstrably superior to the old that no rational legislator could refuse to enact it. The subsequent history of Alberta mortgage law has been one of piecemeal modification to the basic pattern established almost a century ago.

E. Alberta Legislation (to World War I)

Under the Alberta Act, the laws, orders and regulations which had theretofore existed in the territory now covered by the new province, were to continue until they were repealed, altered, varied, modified or affected by an appropriate legislative authority.[22]

Between 1895 and 1914 Alberta's population grew from 30,000 to 470,000. Something over 60% were farmers.[23] As might be expected, in

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19 *Ibid.* s. 77.

20 By virtue of sections 3 and 21 of the *Judicature Ordinance* (1898) C.O., c. 21, the procedure and practice of the Supreme Court of the Northwest Territories was to be "as nearly as may be" that exercised in the Supreme Court of Judicature in England as of January 1, 1898.

21 *An Act further to amend the Land Titles Act, 1894*, S.C. 1898, c. 32, ss 11 and 12.

22 S.C. 1905, c. 3, s. 16.

23 McGregor, *A History of Alberta* (Edmonton: Hurtig, 1981) at 206.

such an explosive, expansionary economy, getting the essential scheme of land titles resolved was a matter of urgent priority.

Alberta enacted a Land Titles Act in 1906[24] and retained the essential philosophy of the 1894 Northwest Territories legislation of the same name, and indeed, many of the same provisions relating to mortgages. Proceedings for sale of land had to be taken in a court of competent jurisdiction; sale by the lender was not permitted.[25]

In 1907 the Supreme Court of Alberta was established, and in order to remove any doubt as to its jurisdiction, that court was given all the jurisdiction of the Court of Chancery in England relating to mortgages.[26]

As far as procedure is concerned Alberta received the Northwest Territories Judicature Ordinance[27] mentioned earlier. The new Supreme Court Act gave certain powers to the Lieutenant Governor and the Judges to make Rules of Court. In 1908 the Judges apparently formulated some informal rules relating to the procedure for the foreclosure of mortgages but there is no copy extant. These rules are however mentioned in some reported judgments, and their mere existence suggests that the profession may have felt a need for more detailed procedures.[28] In any event, the first full Alberta Rules of Court were passed by an Order in Council on 12 August 1914. Under these Rules, proceedings relating to possession of land, foreclosures or redemption under a mortgage were to be commenced by originating notice in the Supreme Court.[29]

In 1914 Alberta passed a Foreclosure and Sale Act.[30] Under the Act, proceedings could be commenced by filing a notice of default in the Land

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24 S.A. 1906, c. 24.

25 *Ibid.* s. 62.

26 The Supreme Court Act, S.A. 1907, c. 3, s. 10.

27 *Supra*, note 20.

28 See e.g. *Sun Life Assurance Co.* v. *Widmer* (1916), 9 W.W.R. 961, 963 per Harvey C.J. and *Security Trust Co. Ltd.* v. *Sayre and Gilfoy* (1919), 3 W.W.R. 635, 636 per Harvey C.J.

29 Alberta Rules of Court, 1914, Rule 432(b).

30 S.A. 1914, c. 6.

Titles Office, and subsequent remedies could be obtained from a Master. This procedural excursus was clearly *ultra vires* section 96 of the British North America Act (in that it purported to elevate the Masters—within this limited subject area—into superior court judges). In the event, the Act was soon declared unconstitutional by the Alberta Supreme Court, Appellate Division in *Colonial Investments* v. *Grady*.[31] This was the first of what was to become a succession of constitutional set backs to Alberta mortgage legislation.

F. World War I to the Depression

Faced with this constitutional impediment, the province in 1915 quickly enacted amendments to the Land Titles Act.[32] The essential scheme of this legislation was that upon default, a lender could give notice to the borrower. If default continued for one calendar month, the lender could enter into possession. The notice was also to be filed in the Land Titles Office and served upon persons having certain kinds of registered interests in the land. If default continued for two months after the service of the notice, the lender was "authorised and empowered" to sell the land "by public auction or private contract or by such modes of sale and subject to such terms and conditions as to expenses or otherwise as the registrar [of Land Titles] may think fit".[33] The lender could execute the transfer and title would vest in the purchaser free and clear of any "mortgage, lien, charge or encumbrance registered subsequent thereto".[34]

If default after notice continued for six months, and the highest bid at public auction did not satisfy the lender, the lender could make application to the registrar for a foreclosure order. The Act also gave the judges of the Supreme Court or a Master power to stay any sale under the Act. The provisions empowering the lender to sell the land under the supervision of the registrar were repealed in 1934 and were never re-enacted.[35]

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31 (1915), 24 D.L.R. 176 (Alta. S.C.A.D.).

32 S.A. 1915, c. 3.

33 *Ibid.* s. 2 – 62a(6).

34 *Ibid.* s. 2 – 62a(7) and (9).

35 See S.A. 1934, c. 13, s. 2 and S.A. 1935, c. 15, s. 3.

During the war years the province enacted several pieces of legislation aimed at suspending action on servicemen's mortgages until after the war or the discharge of those servicemen.[36]

Of much more lasting impact on the development of mortgage remedies, however, were certain developments which accompanied war-time amendments to the Land Titles Act. First, in 1916 an amendment was made to the Land Titles Act which provided that no execution should issue on a personal judgment until **after** the sale of the land or an order of foreclosure had been made.[37] Then in *Mutual Life Assurance Co. of Canada* v. *Douglas*,[38] the Supreme Court of Canada held that "the principal obligation to pay the [mortgage] debt is **not** satisfied . . . unless the amount realised is sufficient to liquidate the obligation . . .".[39] This was so even after a final foreclosure order is made.

The Provincial Legislature was not at all enamoured of the result, and at the very next sitting, passed two amendments to the Land Titles Act. First, the 1916 amendment was narrowed to refer only to the enforcement of a personal covenant judgment after sale.[40] That is, the reference to a foreclosure was deleted. Second, a new subsection made it plain that—contrary to the Supreme Court holding—a foreclosure was henceforth to operate as a full satisfaction of the debt.[41] In short, the legislature henceforth wanted a foreclosure to be a final satisfaction of the entire debt.

This left lending agencies in something of a quandary. They were faced with what is often referred to in Alberta as an election between "the money or the mud". The lender could pursue a sale, and if one was procured, take a deficiency judgment if necessary. Or, if a sale was not forthcoming, the lender could foreclose, and be left with no right to a deficiency judgment.

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36 See The Volunteers and Reservists Relief Act, S.A. 1916, c. 6 (later known as The Soldiers Relief Act, S.A. 1918, c. 25); The War Relief Act, S.A. 1918, c. 24.

37 S.A. 1916, c. 3, s. 15.

38 (1918) 57 S.C.R. 243 (S.C.C.).

39 *Ibid.* at 246 per Fitzpatrick C.J.

40 S.A. 1919, c. 37, s. 1.

41 *Ibid.* s. 4.

This set the stage for *The Security Trust Company Limited* v. *Sayre* and the so-called "Rice" order it spawned. In the *Sayre* case, the lender came up with an ingenious middle ground. When no bids were received, the lender (Security Trust) purchased the property **itself** and then argued that it was still entitled to a deficiency judgment. The case gave rise to a considerable conflict of judicial opinion. The Master allowed a deficiency judgment. A trial judge (Stuart J.) overturned it.[42] In the Appellate Division, the court reversed the trial judgment (2-1) and restored the Master's ruling.[43] In the Supreme Court of Canada the judges split 3-3, thereby, leaving the Appellate Division ruling intact.[44] The judges who upheld the Appellate Division ruling appear to have done so in large part on the grounds of non-interference with provincial practice, whereas the "dissenters" would have allowed the appeal on the merits. The result was that instead of an election between the money or the mud, the lender, by the closest of margins, established (in some circumstances) a right to both.

To complete the broad outline of this development, it should be noted that in 1924 the Supreme Court, Appellate Division took the matter somewhat further in *Trusts and Guarantee Company Limited* v. *Rice*.[45] In that case, the court confirmed that even after an abortive sale by auction, a plaintiff lender could bring in a proposal to take the property at a fair and reasonable appraised value. If the Master or judge approved the proposal, the lender could buy the property and subsequently, where so permitted, obtain a deficiency judgment. The court did however attach certain safeguards. In particular, it suggested that the defendant should be protected by a requirement that the price offered by the plaintiff be accepted (if otherwise fair) unless within a time fixed the defendant brought in a better one from a satisfactory purchaser.

In fairness to those judges who arrived at this result—and who have, on occasion, been criticised for so doing[46]—it could be observed that the

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42 *The Security Trust Company Limited* v. *Sayre*, [1919] 2 W.W.R. 863 (Alta. S.C.T.D.).

43 [1919] 3 W.W.R. 634 (Alta. S.C.A.D.).

44 (1920), 61 S.C.R. 109; (1921), 56 D.L.R. 463 (S.C.C.).

45 [1924] 2 W.W.R. 691 (Alta. S.C.A.D.).

46 See e.g., Leslie R. Meiklejohn, "The Rice Order—Is Sixty Years of Practice Wrong?" [1984] 22 Alta. L.R. 273. For a review of the general procedure adopted in Alberta

(continued...)

solution so arrived at was evolved in times of economic adversity when there was little or no available market. It is easy to suggest safeguards for borrowers on a rising or stable market. The intractable problems occur when there is wide-spread market dislocation of the type which has surfaced periodically in Alberta.

During the economic difficulties caused by the deflation that came after World War I, the government also passed certain moratoria legislation. This ran into constitutional road blocks,[47] but formed the basis of much of the late 1930s legislation. The Drought Area Relief Act of 1922[48] enabled the Lieutenant-Governor to establish any area of the province as a drought area. When so established, the leave of a judge was required for the sale or foreclosure of real property of a resident who was *bona fide* engaged in farming operations. The following year this Act was replaced by the Debt Adjustment Act of 1923,[49] which repealed the 1922 Act but repeated many of its provisions and applied them to resident debtors as well as farmers. Ultimately, this legislation (and the many amendments to it) was declared wholly *ultra vires* by the Privy Council in 1943[50] and was repealed by the Legislature in the same year.

G. The Great Depression and World War II

The depression of the 1930s was at least as severe in Alberta as anywhere else in North America. It is not necessary for present purposes to outline all the legislative or judicial responses which that catastrophic era evoked.[51] More than 50 acts or amendments to acts were passed which attempted to delay, suspend, adjust, compromise or postpone the rights of lenders and creditors. There was a total collapse of the market for both

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[46](...continued)
in this period see L.Y. Cairns K.C., "Foreclosure of Land Mortgages in Alberta by Way of Court Procedure" (1936-38) 2 Alta. L.Q. 193.

[47] For a general discussion of the constitutional position see P.W. Hogg, *Constitutional Law of Canada* (2d ed.) (Toronto: Carswell, 1985) at 477-81.

[48] S.A. 1922, c. 43.

[49] S.A. 1923, c. 43.

[50] *A.G. Alta.* v. *A.G. Canada*, [1943] 1 W.W.R. 378; [1943] A.C. 356.

[51] For a good general survey see J.R. Mallory, *Social Credit and the Federal Power* (Toronto: University of Toronto Press, 1954).

commodities and land. Essentially, both the provincial and federal governments responded to the prolonged emergency by enacting this corpus of legislation, all of which was aimed at keeping people in their homes and on their farms.

This legislation, quite apart from whatever relief it afforded individuals, left an important legacy to Alberta (and Canadian) legal development. The legislation provoked a good deal of litigation over its very constitutionality, and finally left the provinces with a body of learning as to just what they could and could not do in this subject area.[52]

Important Alberta provisions that were found *intra vires* or not disallowed during those years included amendments to the Judicature Act giving the Supreme Court the power to grant a stay of execution;[53] the enactment of a redemption period of one year (but with power in the court to extend or decrease the time);[54] the rendering void of attornment clauses;[55] and as perhaps the most permanent legacy, the restriction (in 1939) of the lender's right to the land itself and the prohibition against an action on a covenant for payment contained in the mortgage.[56] The wheel had turned full circle from World War I.

H. Oil and the Economics of Rising Expectations, 1946—1980

There was not, after World War II in Alberta, the wild inflation and subsequent deflation that occurred after World War I. Imperial #1 blew in at Leduc in 1947, and a new era began. Not surprisingly, the pendulum began to swing again, and some remedies began to be restored to lenders. In 1946 a mortgage given by a corporation to cover bonds, debentures or debenture stock was placed outside the provisions of the Judicature Act;[57] in 1948 an amendment to the same Act provided that if the consent of the

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52 See Hogg, *supra*, note 47; Mallory, *ibid.*

53 *The Judicature Amendment Act, 1932*, S.A. 1932, c. 22.

54 *The Judicature Amendment Act, 1942*, S.A. 1942, c. 37 and see *Roy* v. *Plourde*, [1943] S.C.R. 266.

55 *The Land Titles Amendment Act, 1939*, S.A. 1939, c. 79.

56 *The Judicature Amendment Act, 1939*, S.A. 1939, c. 85.

57 An Act to Amend The Judicature Act, S.A. 1946, c. 38.

debtor was obtained, land need not be advertised or offered for sale in an auction for foreclosure;[58] in 1954 redemption periods were reduced to six months for urban land and kept at one year for farm land;[59] attornment clauses were (in 1946) made valid again in a mortgage of business premises.[60]

In 1959 further refinement of procedure took place when special rules and forms for foreclosure were enacted in the Rules of Court.[61]

Through the 1950s and 1960s the growth of the oil industry led to a re-invigorated economy and greater commercial and entrepreneurial activity in the province. With a more diversified and expanding economy came a demand for more sophisticated forms of lending. If personal covenants could not be enforced, how could collateral securities, such as promissory notes and guarantees, be employed? This was a question which set the stage for the well-known *Superstein* case.[62]

In that case, a corporation granted to the lender a real property mortgage and a chattel mortgage. A director of the corporation personally guaranteed the loan secured by those mortgages. A number of issues were litigated including the critical question: did the prohibition (under the 1939 Amendment) against action on the personal covenant of the borrower negate the ability of the lender to have recourse against the guarantor? Ultimately, the Supreme Court of Canada held that the 1939 Amendment was a purely procedural prohibition. Consequently, it did not abrogate or destroy the borrower's covenant; it merely prevented action on the covenant. It did not prevent an action against the guarantor.

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58 An Act to Amend The Judicature Act, S.A. 1948, c. 47.

59 An Act to Amend The Judicature Act, S.A. 1954, c. 49.

60 An Act to Amend The Land Titles Act, S.A. 1946, c. 52.

61 Alberta Reg. 438/59.

62 *Credit Foncier Franco-Canadien* v. *Edmonton Airport Hotel Co. Ltd. & Superstein* (1964), 48 W.W.R. 641, aff'd [1965] S.C.R. 441.

Whilst this case was still being appealed, the Legislature amended (by the so-called "Simpson Amendment")[63] the Judicature Act to provide that the personal covenant **could** be enforced with respect to a sale of land to a corporation or a mortgage given by a corporation. The same statute, however, also made it plain that the homeowner's protection was not going to be watered down: a waiver of the protection created by the 1939 Amendment was to be against public policy and void.[64] A new era in Alberta mortgage law had begun: there was now differentiation between corporate mortgages, on the one hand, and mortgages given by an individual, on the other hand. The interesting question then was, could this distinction be made to work, and what (if any) effect would it have on the Alberta mortgage market?

One effect became apparent quite quickly. Many lenders began to require non-single family loans to be taken as corporate mortgages. The typical mortgage on a shopping centre or apartment complex or the like was required to be a mortgage granted by a corporation. Quite often the mortgage was also guaranteed by shareholders or persons having an interest in that corporation. In general, those kinds of transactions have been left outside the limitations or remedies contained in what is now Part 5 of the Law of Property Act.

Some other kinds of dealings, however, had the potential to give rise to difficulties. Many individuals bought homes subject to a mortgage granted by the corporate builder. Those homebuyers potentially (and sometimes unwittingly) exposed themselves to personal liability in so doing because of section 62 of the Land Titles Act. This section implies a covenant on behalf of the homebuyer to pay to the lender the principal and interest secured by the mortgage. In fact, for many years lenders did not habitually resort to the covenant implied by section 62 of the Land Titles Act in the case where an individual so assumed the mortgage. There were reasons for this. First, there were not many defaults and on a sharply rising market the owner could usually readily sell the property if financial difficulties did arise. Second, the real concern of lenders was with builders who defaulted **themselves** or with sales to purchasers who really should not have been

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[63] An Act to Amend The Judicature Act, S.A. 1964, c. 40, s. 4 (now s. 43(1) of R.S.A. 1980, c. L-8).

[64] An Act to Amend The Judicature Act, S.A. 1964, c. 40, s. 3 (now s. 41 (5) of R.S.A. 1980, c. L-8).

approved, or who had exhibited some fraud or misrepresentation. Thus, the lenders enforced this liability selectively and rarely (if at all) against honest purchasers of new homes who assumed builders' mortgages. Whether through forbearance on the part of lenders or an ongoing rising real estate market (or perhaps both), the personal covenant was rarely resorted to in the case of single family homes.

One other feature of the housing market that existed after the Second World War should be noted here. For a complex variety of reasons Alberta, like all other western jurisdictions, had to expand its housing supply. A combination of returning servicemen, the postwar "bulge" in population and subsequently a rapidly growing population drawn to the new resource industries created an abnormal demand for homes and business property. The old notion of requiring a high (perhaps as high as 50%) equity in a home or property came under real pressure, and new "high-ratio" or government backed schemes came into effect, particularly, in relation to the financing of residential property.

In 1945, the Legislature enacted The National Housing Loans Act (Alberta),[65] and mortgages granted under The National Housing Act, 1944 (Canada) were exempted from the (then controlling) Judicature Act provisions restricting the action on the covenant.[66] The precise rationale for this exemption[67] is difficult to determine. It may have been that public money was involved and the risk under high-ratio loans is greater. Or, it may be that a simple question of political equality was involved: if Alberta remedies were not put on an equal footing with the other Canadian jurisdictions (at least with respect to loans of this kind), National Housing Loans might not have been made available.

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65 *The National Housing Loans Act (Alberta)*, S.A. 1945, c. 6.

66 See now The Law of Property Act, R.S.A. 1980, c. L-8, s. 43(2).

67 Among the Alberta Masters there was disagreement on whether the exemption applied only to mortgages given to Canada Mortgage and Housing Corporation ("CMHC") or whether it applied to these types of mortgages and mortgages insured by CMHC. This controversy was put to rest by Lomas J. in *Thijssen* v. *Galusha*, [1985] 3 W.W.R. 169. He held that a loan insured under the National Housing Act and a loan made by CMHC under the National Housing Act were both exempt from application of ss 41 and 42 of the Law of Property Act, R.S.A. 1980, c. L-8.

A similar question arose in relation to the provincially created Alberta Home Mortgage Corporation[68] (which amalgamated with Alberta Housing Corporation to become Alberta Mortgage and Housing Corporation)[69] and the Alberta Agricultural Development Corporation.[70] These corporations are agents of the Crown. Though neither corporation is specifically exempted from the operations of sections 41 and 42 of the Property Law Act, the ability of those lenders to recover on the covenant appeared to have been preserved by a relatively unobtrusive route. Section 14 of the Interpretation Act (Alberta)[71] provides that an enactment is not binding on the Crown unless that enactment expressly states that it **shall** be binding. Since Part 5 of the Law of Property Act does not state that it binds the Crown, these corporations—as agents of the Crown—claimed immunity from Part 5 of the Law of Property Act.[72]

The net result was, therefore, that by the 1970s Alberta law had reached the position where the personal covenant of an individual borrower was **NOT** enforceable unless the lender was an agent of the Crown[73] or the mortgage was insured under the National Housing Act. The personal covenant given by a corporate borrower was enforceable. Lenders could also enforce the covenant implied by section 62 of the Land Titles Act on behalf of individuals who assumed corporate builders' mortgages. Collateral guarantees were enforceable on any mortgage.

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68 See now Alberta Home Mortgage Corporation Act, R.S.A. 1980, c. A-28.

69 Alberta Housing and Mortgage Corporation Act, S.A. 1984, c. A-325.

70 See now The Agricultural Development Act, R.S.A. 1980, c. A7.

71 See R.S.A. (1980), c. I-7.

72 *Alberta Agricultural Development Corporation* v. *Bonney* (1984), 39 Alta. L.R. (2d) 204 (M.C.).

73 In the late 1980s the Alberta Court of Appeal held that Alberta Mortgage and Housing Corporation was bound by sections 41 and 42 of the Law of Property Act: *Alberta Mortgage and Housing Corporation* v. *Ciereszko* (1987), 50 Alta. L.R. (2d) 289, leave to appeal to the S.C.C. denied 51 Alta. L.R. (2d) xii. As will be discussed in Chapter 4, a subsequent decision of the Supreme Court of Canada has undermined the position taken by the Alberta Court of Appeal, and the law may now be as it was before. See *Alberta Government Telephones* v. *Canadian Radio-Television and Telecommunications Commission*, [1989] 2 S.C.R. 225 and the discussion in Chapter 4.

Private mortgage guarantee companies were left in an awkward situation. These companies (since reduced to only one, namely the Mortgage Insurance Company of Canada) insured, and still insure, high-ratio mortgage loans. In the event of a deficiency these companies could not, and still cannot, seek a deficiency judgment against a borrower who is an individual.

I. The 1980s Recession: The Legislative Response

In 1980, as part of the general revision of the Alberta statutes, the provisions of the Judicature Act relating to the covenant were removed from that statute, and, along with some foreclosure provisions previously contained in the Land Titles Act, rearranged in Part 5 of the Law of Property Act. In addition, the exception for National Housing Act loans was moved from The National Housing Loans Act (Alberta)[74] to section 43(2) of the Law of Property Act.

Beginning about 1981, the Alberta mortgage industry began to encounter widespread mortgage defaults. The causes, nature and extent of these defaults will be discussed in more detail in a subsequent chapter. It is sufficient to note here that mortgage foreclosure actions rose alarmingly to some hundreds per month. Lenders began to press for the ability to recover on the covenant in those situations in which they could not lawfully do so and farmers pressed for moratoria legislation.

Three distinct problems began to emerge. First, the practice of lenders in not resorting to the covenant in those cases where they could lawfully do so began to break down, and deficiency judgments became more common. Second, the so-called "dollar dealers" problem came to light. Under these schemes, entrepreneurs would "purchase" a defaulting borrower's home for $1, and assume the mortgage. The hapless homeowner would pay rent to the dollar dealer for the period of months that elapsed until a foreclosure was effected. The dealer pocketed the rent; the (former) homeowner attempted to preserve his or her credit record, secure in the knowledge that action could not be taken on the covenant. Third, as the real estate market began to spiral down and homeowners found that their equity had, in many cases, disappeared. Some became "walk-aways"—that is,

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74 R.S.A. 1970, c. 255.

persons who abandoned their homes even though they had the ability to pay the mortgage payments, again secure in the knowledge that action could not be taken against them on the covenant.

The government's first attempt to deal with these escalating problems took the form of Bill 63 (1983). That Bill proposed a blanket prohibition on **all** claims on the covenant against any individuals. Thus, all individuals who assumed a mortgage granted by a corporation would have received the deficiency judgment protection and other protection afforded by section 41. There was widespread lender opposition to such a proposal, and because of that opposition the Bill was allowed to die on the Order Paper.

Bill 109 was introduced at the Fall 1983 Sitting of the Legislature. This new Bill, which attracted condemnation from many members of the Bar on account of its convoluted draftsmanship, will be discussed in more detail in later sections of this report. We deal with it here in broad outline only as part of our preliminary endeavour to establish a broad picture of the development of Alberta law in this subject area.

Essentially what the Legislature was concerned with in Bill 109 was to protect the homeowner who had assumed a corporate builder's mortgage from potential personal liability in the form of a deficiency judgment. The Legislature also seems to have wanted to treat farm lands in the same manner. At bottom, this involved a deliberate attempt by the Legislature to return to what had been for many years the unwritten practice within the province.

Bill 109 underwent considerable modifications during its gestation and passage into law.[75] As introduced, it contained two kinds of amendments. The first were a variety of housekeeping amendments (e.g. it enlarged the right of the borrower to mortgage statements). The second group of amendments attempted to legislate the pre-recession provincial practice with some important but narrow changes.

The legislation, as so enacted, has several features:

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[75] As passed, the Bill became the *Real Property Statutes Amendment Act, 1983 (No. 2)*, S.A. 1983, c. 97.

(1) The amendments extended the protection of sections 41 and 42 to individuals who purchased residential land or farm land that was subject to a mortgage granted by a corporation.[76] In the case of residential land, the protection was removed where neither the "individual nor any member of his family has ever used that land as his *bona fide* residence at any time during which that individual is or was a registered owner of [the] land".[77] In the case of farm land, the protection was removed where "neither that individual nor any member of his family has himself ever used that land for carrying on *bona fide* farming operations at any time during which that individual is or was a registered owner of [the] land". The legislation did not define "bona fide residence" but did define "member of his family", "residential land", "farm land" and "farming operations".[78]

(2) The transferor (ie. the corporate builder) was prohibited from seeking indemnity from a protected individual transferee.[79]

(3) Guarantors were to remain liable, notwithstanding that they might become a transferee of the land.

(4) In the most difficult amendments, the legislation addressed the operation of the implied covenants under section 62 of the Land Titles Act. (That section is a provision which creates a direct covenant between a lender and a subsequent transferee who takes title subject to the mortgage.) In essence, what section 43.3 attempted to do is to provide that where an individual becomes an owner, that person is to be ignored for the purposes of the operation of the various covenants that can arise. Thus, if Corporation W gives a mortgage over its land to Y, and then sells to X (an individual) subject to the mortgage, and X then sells to Z (another corporation) subject to the same mortgage, then, as a result of the amendments, Z covenants to pay the mortgage and to indemnify W (the first corporation) but X is protected. The legislation does not say so explicitly, but presumably this result arises only if X was a *bona fide* resident.

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[76] S.A. 1983, c. 97, ss 2(4) and 2(5).

[77] S.A. 1983, c. 97, s. 2(5) creating s. 43.4(2) of the Law of Property Act.

[78] *Ibid.*

[79] *Ibid.* [43.1].

Two general observations might be made on this legislation at this point. First, at the operational level the amendments are extraordinarily complex. Practitioners have encountered great difficulty both in deciphering the amendments and in resolving some new questions raised by the amendments themselves. Second, from the point of view of development of the law, the amendments demonstrate the extraordinary length to which the Legislature has been prepared to go to protect homeowners and farmers.

In the spring of 1984, the Legislature also enacted the Law of Property Amendment Act,[80] which had two broad objectives.[81] First, it attempted to cure certain problems arising out of the Bill 109. Second, it sought to curtail the activities of dollar dealers.

As to the first objective, certain amendments clarified where the onus of proof lies when exemption is sought from personal recourse on a corporate mortgage, and also made it clear that receivership is available not only in a foreclosure action but also in a lender's action to protect its interest.

As to the second objective, the legislation made it easier to go directly to a final order for foreclosure. That is, in certain specified instances (such as abandonment or a default a short time after a sale), the court could grant a foreclosure order without going through an attempt at judicial sale. This substantially reduced the time frame required to effect a foreclosure proper in these situations. Shortening the time during which dollar dealers would have title made the dollar dealers activities financially much less attractive. Yet, the legislation still left it open to individuals suffering financial difficulties the ability to "live out" their equity by staying on, rent free, in their homes until a final order for foreclosure is effected.

J. The 1980s Recession: The Judicial Response

Throughout this period the Masters and judges of the Court of Queen's Bench, and the Court of Appeal were called upon to rule upon literally thousands of court applications. Many of these applications involved practice points of some procedural nicety which ended up in the

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80 S.A. 1984, c. 24.

81 See *Alberta Hansard* (May 22, 1984) at 983.

law reports. Others involved matters of substance and had the potential for bringing about real change in the law. It is not necessary to survey the case law in detail here but one decision of the Court of Appeal of real importance should be noted insofar as it sets the framework for lenders' remedies for the foreseeable future.

This case is *Canada Permanent Trust Co.* v. *King Art Developments Ltd. et al.*[82] In that case, the lender attempted to enforce a mortgage securing $1,100,000 on some apartments in Bonnyville against the corporate borrower and several guarantors. As the matter progressed, a "Rice Order" was made in June 1982, selling the land to the lender for $430,000 and giving a deficiency judgment against the borrower and the guarantors.

Mr. Justice Laycraft, for the majority in the Court of Appeal, thought there were four issues, which he expressed thus:[83]

> 1. Does the guarantor of a debt secured by a land mortgage granted by a corporation remain liable for a deficiency judgment after the mortgagee has
>
> (a) obtained a final order of foreclosure, or
>
> (b) purchased the land at a court-conduced sale and obtained title?
>
> The second of these questions, in turn, involved the question: has the mortgagee who purchased the land, in substance, foreclosed the mortgage?
>
> 2. Should the court permit a mortgagee to tender at a court-conducted sale or should the procedure be that if the sale proves abortive the mortgagee is permitted to make a proposal to the court and on approval purchase the property (the so-called "Rice" order)? Should the value ascribed to the land be "forced sale for cash", "forced sale on terms", or "market value"?
>
> 3. When a debt is secured by land, must the court (or should it) refuse or stay judgment in an action

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82 [1984] 4 W.W.R. 587; 32 Alta. L.R. (2d) 1. All future page references will be to the Western Weekly Reports citation.

83 *Ibid.* at 629.

> on the personal covenant or against guarantors until the land has been sold?
>
> 4. Are the provisions of the Interest Act, R.S.C. 1970, c. I-18, which prescribe an interest rate of five per cent on judgments binding on the parties despite their contract that the rate of interest fixed by the mortgage should continue to apply after judgment?

The majority answered these questions as follows:

(1) Under the general law, a lender who has foreclosed cannot sue the borrower for the balance owing unless the lender is in a position to return the property. In Alberta, by virtue of section 44 of the Law of Property Act (which provides that a final order for foreclosure satisfies the mortgage debt), the lender cannot after foreclosure sue at all in any circumstances.

(2) A lender who purchases at a court-conducted sale is not in the same position as a lender who forecloses. A lender who purchases at a court-conducted sale can claim a deficiency judgment after credit of the sale proceeds and is not obligated to offer redemption of the property. This result is in no way affected by section 44 of the Law of Property Act.

(3) Without deciding whether it would somehow be possible to draft a guarantee which would leave a guarantor liable even after a final foreclosure, the majority held that the guarantees in the *King Art* case could not survive the satisfaction of the debt.

(4) As to the **procedures** to be invoked in the case of a lender bidding on or buying the land, the Chancery Procedure Act 1852 is no longer part of Alberta law. By virtue of Part 37 of the Alberta Rules of Court, the court "has ample and flexible power to order a sale of real estate and to fix terms suitable to each occasion". The Rice Order is one of these permissible procedures, as is allowing a lender to tender at a sale by tender. The majority was clearly minded to keep the procedures as flexible as possible. The object should be to encourage as many persons as possible to be bidders and to bid as high as possible.

(5) On the question of how to value the property being sold, the majority canvassed the difficult notions of "forced sale" and "forced sale on terms" which appraisers (and Masters) had been using in foreclosure actions. The majority suggested that appraisers define the term "forced sale" when they use it. For example, it would be better to state that forced sale value was "the price which the property would bring when the market knows it must be sold within four to six months". The term "forced sale on terms" is useless unless one also knows the terms. The majority appears to have treated the question whether a sale under a "Rice order" should be at market or some other value as one of discretion in the particular case.

(6) As to the relationship between remedies, a lender can take judgment and execute on the personal covenant (where it can lawfully do so) without first selling the land.

(7) It is not possible to contract out of the provisions of section 12 of the Interest Act,[84] which provides that interest on judgments shall be at the rate of 5%. The practical result is that the mortgage rate cannot be charged after judgment is taken on a personal covenant.[85] Hence astute practitioners will presumably delay taking personal judgments until the last possible moment.

Justice Moir, in an extensive dissenting opinion in the *King Art* case, was of the view that the "Rice Order" did not survive the statutory changes in 1934 and 1939 and some of the Rule changes in 1939, and was, in any event, a "bad thing". Sale, he thought, should be to a third party, and the courts should not countenance the acquisition of the property by the lender "in any manner whatsoever except by strict foreclosure". Justice Moir also had some reservations as to the timing and application of the various remedies among themselves.

The majority judgment in *King Art* has resolved some matters but opened up others. First, the Court of Appeal clearly favoured a high degree

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[84] R.S.C. 1985, c. I-15. Note: On July 31, 1992, Parliament repealed this section. On August 1, 1992, the Alberta Legislature proclaimed in force Section 6 of the *Judgment Interest Act*, S.A. 1984, c. J-05. This section deals with post-judgment interest where a judgment is given on or after August 1, 1992.

[85] Query whether it will be possible to contract out of section 6 of the Judgment Interest Act, S.A. 1984, c. J-05?

of discretion in the conduct of sales. Second, the Rice Order, on the majority judgments, still stands. Third, the issue of valuations is re-opened. What really is the difference between a sale at "market value" and a "forced sale" within a six month period?

In the 1980s, the other major development in case law involved the issue of whether Crown lending agencies are bound by Part 5 of the Law of Property Act. Discussion of this complicated issue is left to Chapter 4.

K. Conclusion

Is it possible to draw any general conclusions or issues for law reform purposes from this attenuated survey of a very complex body of legislation and case law? Certain points seem obvious enough.

(1) In terms of the development of Alberta law, no single topic has engendered such an extraordinary volume of legislation and litigation. The whole subject area has been treated as being of such overwhelming importance as to merit the volume of legislative and professional resources which have in fact been devoted to it over the last century. In good times or bad, it seems, Alberta legislates with respect to mortgages and judicial officers judge, as the seemingly endless tug of war between lenders and borrowers goes on.

(2) The assumption is, apparently, that this constant "fine tuning" will produce particular social and economic effects in the province. Whether this is in fact so would seem to give rise to considerable room for debate. For instance, even this broad legislative history indicates that there are some practices which emerge outside the legislative framework and operate as "informal law". The learning, if any, may be that this sort of process is not very effective as a regulatory mechanism.

(3) The one constant theme has been a dogged determination on the part of the Alberta governments of various persuasions to be seen as, and to try to be, in fact, protective of the individual homeowner and farmer against the vicissitudes of relatively volatile markets. How far such a stance is a creature of rational economic argument, or genuine humanitarian concern, or even plain populist politics, is not clear. Some elements of all these factors can be found in the debates in which legislators have engaged over

the last half century. In short, whatever it is based on, the attenuation of lenders' remedies appears to have become an article of faith with Alberta legislators of various political persuasions and to have passed into the realm of political and legal culture.

(4) In consequence, those who would wish to "open up" or more closely balance the system probably have an even heavier than usual burden of proof. Change, if it is to occur at all, would likely have to be incremental and will be met by insistent demand for hard evidence of the "need" for change.

(5) In terms of legal theory and draftsmanship, the attempt to implement the broad objective of creating protection for the individual homeowner and farmer has to date introduced great complexity and distortions into an important area of law. The problem here appears to be whether legal craftsmanship can ever satisfy the broad objective without falling prey to a degree of over-refinement which destroys the clarity and simplicity which is needed in the law. In short, there are serious issues for debate, in light of the events that have happened, first, as to whether the broad objective, if it is otherwise sound, can actually be made to work at anything like an acceptable cost. Second, if the broad objective is to stand and to be workable, the subject of lenders' remedies may need to be completely rethought in light of that objective and restated in a more useful way.

CHAPTER 4
EXISTING LAW AND PRACTICE

A. Introduction

In this chapter, we describe in greater detail the various remedies that are available to a lender and the relief that is available to a borrower, when default is made under a mortgage of land in Alberta. In doing so we reserve until Chapter 5 a consideration of the operational effectiveness of this body of law, and to Chapters 6, 7 and 8 our suggestions for law reform.

B. Remedies Available to the Lender

(1) General

When a borrower defaults on a mortgage, the lender has five possible remedies: an action on the covenant for payment; sale; foreclosure; taking possession; appointing a receiver.[86] Further remedies may be available if the lender holds guarantees or other collateral security for the mortgage debt. As will be discussed in detail below, the availability of lenders' remedies in Alberta is largely regulated by statute. In general, however, a lender may pursue all its remedies concurrently in one action.[87] It should be noted at this point that the term "foreclosure action" is commonly used to describe such an action even if that foreclosure may be sought only as an alternative form of relief. As stated by Kerans, J.A., "the word 'foreclosure' has come in Alberta to mean something more than that which it meant before . . . . It is a term of art to describe Albertan procedure for the enforcement of the remedies of a mortgagee."[88]

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[86] *Co-op Centre Credit Union Limited* v. *Greba*, (1984) 32 Alta. L.R. (2d) 389 (C.A.) at 390.

[87] See, for example, *Alberta Home Mortgage Corporation* v. *Fahlman*, (1983) 43 A.R. 50 (M.C.).

[88] *Co-op Centre Credit Union Limited* v. *Greba*, *supra*, note 86 at 393.

(2) Action on the covenant for payment

(a) The general restriction

As discussed in Chapter 3 of this report, since 1939 Albertan legislation has restricted to a greater or lesser extent a lender's common law right to enforce the personal covenant contained in a mortgage. The primary restrictions are now found in sections 41(1)(a) and (b) of the Law of Property Act,[89] which (with the references to agreements for sale deleted) provide as follows:

> In an action brought on a mortgage of land, whether legal or equitable, the right of the mortgagee is restricted to the land to which the mortgage relates and to foreclosure of the mortgage, and no action lies
>
> (a) on the covenant for payment contained in the mortgage, [or]
>
> (b) on any covenant, whether express or implied, by or on the part of a person to whom the land comprised in the mortgage has been transferred subject to the mortgage for the payment of the principal money payable under the mortgage.

These provisions constitute a procedural bar to recovery by a lender[90] on the personal covenant against either the original borrower or a transferee who has assumed the mortgage and become subject to the implied covenants set out in section 62(1) of the Land Titles Act.[91] They do not, however, have the effect of extinguishing the debt or satisfying the debt or making it an unenforceable debt. They merely preclude enforcing the debt by obtaining a personal judgment against the borrower or a transferee. Thus, where a guarantee has been given as collateral security for a mortgage debt,

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89 R.S.A. 1980, c. L-8.

90 Section 41(1) of the Law of Property Act bars an action brought by a mortgagee. It does not prevent an action by the mortgagor against the transferee on the implied covenant of indemnity: *In re Forster Estate*, [1941] 3 W.W.R. 449 (Alta. S.C.).

91 R.S.A. 1980, c. L-5.

the guarantor may still be liable under the guarantee even though the borrower is protected from liability on the covenant by section 41.[92]

(b) Scope of general restriction

(i) Interpretation of section 41(1)(a)

Section 41(1)(a) prevents the direct or indirect enforcement of the covenant to pay contained in a mortgage. The court will look at the circumstances surrounding the transaction to determine if, in substance, the liability sought to be enforced arises from the covenant to pay contained in the mortgage. If the action is an attempt to enforce the personal covenant in the mortgage, it is unenforceable by virtue of section 41(1)(a).[93]

For example, assume that a borrower secures payment of the loan by giving the lender a land mortgage and a promissory note. The court will examine the circumstances to determine if parties intended the obligation under the promissory note to have a wider reach than the obligation under the land mortgage. If the two obligations are indistinguishable, an action on the promissory note is an attempt to enforce the covenant to pay found in the mortgage. Therefore, the action is barred by section 41(1)(a). This is so even though there is a contractual term which states that the land mortgage is collateral to the promissory note.[94]

Contrast this to the situation where a lender lends $100,000 to a borrower largely in reliance on the individual's ability to pay. Payment is secured by land mortgages on a cabin and vacant lot which are together worth $25,000. Foreclosure of one of these mortgages will not satisfy the $100,000 debt or discharge the other mortgage. This is so because it is clear that at the time the transaction was entered into the parties intended that

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92 *Credit Foncier Franco-Canadien* v. *Edmonton Airport Hotel Co. Ltd. and Superstein*, *supra*, note 62, as interpreted in *Telford* v. *Holt*, [1987] 6 W.W.R. 385 (S.C.C.); *Wilton* v. *Royal Bank of Canada* (1991), 82 Alta. L.R. (2d) 237 (Q.B.).

93 *British American Oil Company Limited* v. *Ferguson* (1950), 1 W.W.R. (N.S.) 103 (Alta. S.C.A.D.); *Clayborn Investments Ltd.* v. *Wiegert* (1977), 3 Alta. L.R. (2d) 295 (C.A.); *Francois* v. *Vanderputt* (1985), 36 Alta. L.R. (2d) 106 (C.A.).

94 This was the fact situation in *Clayborn Investments Ltd.* v. *Wiegert*, *ibid.* Compare this to the case of *CIBC* v. *Andrejcsik* (1984), 30 Alta. L.R. (2d) 109 (Q.B.) where the trial judge found that the promissory notes and the equitable mortgage did not contain the same obligation because the promissory notes were broader in scope.

the land mortgage was partial security only. It was a personal loan with land mortgage as partial security.[95]

In essence, the court must determine whether the substance of the transaction is a land mortgage with certain collateral securities (so section 41(1) applies) or whether the substance of the transaction is a debt to which the land mortgage is collateral.[96] It is insufficient for the application of section 41(1) that the amount and terms of repayment of the land mortgage and other instrument are the same. This often is the case when there is one debt and several securities for payment of that debt.[97]

The bar on enforcement of the covenant to pay in the mortgage is not limited to lenders who have commenced foreclosure actions.[98] Therefore, when a third mortgage is extinguished from title by foreclosure proceedings brought by the second lender, the third lender cannot sue on a promissory note if the promissory note and the third mortgage contain the same obligation.[99]

(ii) Situations outside the scope of section 41(1)(a) LPA

Section 41(1)(a) can only have application when a plaintiff brings an action against a defendant in an attempt to enforce the covenant to pay contained in the mortgage. This means that the defendant must be a borrower. The section has no application in the following situations:

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95 This is the hypothetical scenario discussed in *Clayborn Investments Ltd.* v. *Wiegert*, *supra*, note 93 at 300. See also *Continental Bank of Canada* v. *Trim* (1985), 61 A.R. 133 (Q.B.), *Russell* v. *IPSCO Inc.* (1989), 100 A.R. 77 (Alta. C.A.), *Royal Bank of Canada* v. *Horn* (1990), 102 A.R. 321 (Q.B.), *Bank of Nova Scotia* v. *Bowsema* (1991), 79 Alta. L.R. (2d) 432, aff'd 85 Alta. L.R. (2d) 439 (C.A.), *A.A.D.C.* v. *F.R. Smith & Sons Ranching Ltd. et al* (1993), 146 A.R. 17 (Q.B.).

96 *Royal Bank of Canada* v. *Platts* (1987), 56 Alta. L.R. (2d) 275 (C.A.).

97 *Clayborn Investments Ltd.* v. *Wiegert*, *supra*, note 93 at 300 and *Royal Bank of Canada* v. *Platts*, *ibid.*

98 *Merit Mortgage Group Ltd.* v. *Sicoli*, [1983] 5 W.W.R. 381 (Alta. C.A.).

99 *Ibid.* The *Sicoli* case overrules comments made by Justice Morrow in the *Clayborn Investments Ltd.* case and similar comments made in *Provincial Treasurer of Alberta* v. *Lafrance* (1980), 13 Alta. L.R. (2d) 142 that had the mortgagee chosen to sue on the promissory note first there would be no bar to the action on note.

(1) when the covenant for payment found in the mortgage was given by someone other than the defendant;[100]

(2) when there is no covenant to pay found in the mortgage. This is a common occurrence in hypothecation agreements creating an equitable mortgage which charges the land as security for present and future debts owing by the borrower to the lender and where the covenant to pay cannot be implied into the hypothecation agreement;[101]

(c) Effect of section 41 on borrowers' liability under additional security

Lenders often require borrowers to give some form of additional security (ordinarily a promissory note) to secure the mortgage debt. If default on the mortgage leads to a foreclosure action, the lender will seek to recover on all the security it holds. When section 41 protects the borrower against an action on the covenant contained in the mortgage, the enforceability of the additional security may be affected.[102] In a line of cases commencing with *Clayborn Invt. Ltd.* v. *Wiegert*,[103] all involving debts secured by mortgages and promissory notes, it has been held that where the note and the mortgage contain the same obligation, the net effect of an action on the note is an action to recover the debt incurred under and by virtue of the mortgage. In the result, if section 41 bars an action on the covenant to pay in the mortgage, an action on the note will also be barred. If, however, the mortgage and the note do not secure the same indebtedness (e.g. where a land mortgage is granted only as additional security for

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100 *Robertshaw* v. *CIBC* (1985), 61 A.R. 192, 45 Alta. L.R. (2d) 256 (C.A.) and *Ukrainian (Calgary) Savings & Credit Union Limited* v. *Gacek* (1986), 70 A.R. 237 (Q.B.).

101 *Wainwright Savings & Credit Union Ltd.* v. *Fuder* (1976), 1 Alta. L.R. (2d) 188 (Q.B.) and *Provincial Treasurer of Alberta* v. *Lafrance* (1980), 13 Alta. L.R. (2d) 142 (Q.B.) but see the criticisms of these cases in *The Continental Bank of Canada* v. *Syal*, Edmonton No. 8403-14080 (Master Funduk) and F.C.R. Price and M.J. Trussler, *Mortgage Actions in Alberta* (Calgary: Carswell, 1985) at 407-09.

102 It should be noted that these comments apply only to additional security granted by the mortgagor himself, and not by a third party such as a guarantor.

103 *Supra*, note 93; followed in *Merit Mtge. Group* v. *Sicoli, supra*, note 98; *McLaren* v. *Calgary Federal Credit Union Ltd.* (1984), 32 Alta. L.R. (2d) 102 (Q.B.); *McLure* v. *Tadman* (1984), 34 Alta. L.R. (2d) 268 (Q.B.) and *Edmonton Savings & Credit Union* v. *Weir* (1988), 98 Alta. L.R. (2d) 144 (Q.B.), aff'd (5 May 1989) No. 8803-0505 (Alta. C.A.).

moneys previously advanced under a promissory note), then section 41 will not bar recovery under the note after foreclosure of the mortgage.[104] Whether or not the note and the mortgage contain the same obligation is a question for the court that must be determined on the particular facts of each case. Less uncertainty surrounds the situation in which the lender holds additional securities that may be realized without obtaining personal judgment against the borrower. As section 41 is not directed at the taking of additional securities where no personal covenant is sought to be enforced, it will not bar the lender from realizing on those securities should default occur under the mortgage.[105] A lender can enforce collateral chattel mortgages,[106] guarantees[107] and other land mortgages.[108]

(d) Exceptions to the general restriction

While the predecessor of section 41 was a blanket provision that protected all borrowers and subsequent transferees, a number of exceptions were carved out over the years and are now in effect. Among the most important of these exceptions are:

(i) Mortgages given to secure loans under the National Housing Act

These are specifically excluded from the protection of section 41 (and section 42 as well) by sections 43(2) and 43.1(4) of the Law of Property Act. "Loans under the National Housing Act" are not restricted to loans made by Canada Mortgage and Housing Corporation but also include loans made by

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104 *CIBC* v. *Andrejcsik, supra*, note 94, *Bank of Nova Scotia* v. *Eamon* (April 29, 1985), Calgary No. 8101-31301 (Alta. Q.B.) aff'd. (17 April, 1986) No. 17477 (Alta. C.A.), *Bank of Nova Scotia* v. *Patchett* (1985), 63 A.R. 218 (M.C.), *Bank of Nova Scotia* v. *Bailey* (1986), 45 Alta. L.R. (2d) 259 (M.C.), *Royal Bank of Canada* v. *Platts,supra*, note 96, *Rocky Credit Union Ltd.* v. *Schultz* (March 16, 1988), Edmonton No. 8703 17184 (M.C.), *First Calgary Financial Savings & Credit Union Ltd.* v. *Stecewicz* (1989), 94 A.R. 313 (Q.B.), *Pawluk* v. *Bank of Montreal* (5 April 1990), Appeal No. 10218 (Alta. C.A.), *Alberta Treasury Branches* v. *Bullock* (1992), 85 Alta. L.R. (2d) 439, *CIBC* v. *Secrist* (1993), 10 Alta. L.R. (3d) 342 (Q.B.).

105 *Krook* v. *Yewchuk*, [1962] S.C.R. 535.

106 *Ibid.*

107 *Credit Foncier* v. *Edmonton Airport Hotel Ltd. and Superstein, supra*, note 62.

108 *Francois* v. *Vanderputt, supra*, note 93.

approved lenders and insured by the Corporation.[109] This exception, therefore, leaves a significant number of borrowers and their transferees vulnerable to the enforcement of the personal covenant.

(ii) Mortgages given by corporations

These are specifically excluded from the protection of section 41 (and section 42 as well) by section 43(1)(b) of the Law of Property Act.[110] In 1964, when this exception was originally enacted,[111] its effect was to allow enforcement of the covenant not only against corporate borrowers but also against individuals who purchased land subject to a mortgage given by a corporation.[112] As discussed in Chapter 3, recent amendments to the Law of Property Act[113] have, with certain limitations, restored deficiency judgment protection to such individuals.

Under the present legislation, section 41 applies to individuals who purchase land subject to a mortgage granted by a corporation where:

(a) the land is residential land or farm land, and

(b) the individual or any member of his or her family has used the residential land as a *bona fide* residence or the farm land for carrying on *bona fide* farming operations at any time during which the individual was a registered owner of the land.

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109 *Thijssen* v. *Galusha*, [1985] 3 W.W.R. 169 (Alta. Q.B.) and *Royal Trust Corporation of Canada* v. *Vollan and Shtabsky* (1985), 61 A.R. 22 (Q.B.) and *The National Victoria & Grey Trust Co.* v. *Trofimenkoff* (1990), 104 A.R. 299 (Q.B.).

110 When discussing section 43(1)(b) the question of whether a subsequent transferee has renewed a mortgage is key. The discussion at this point assumes that no renewal agreement has been executed. The interpretation of section 43(1)(b) where a renewal has been given by a subsequent transferee will be discussed in detail later on in this report.

111 An Act to amend The Judicature Act, S.A. 1964, s. 4.

112 *Maritime Life Assurance Company* v. *Dyjack* (1984), 5 A.U.D. 1822 (M.C.).

113 See Real Property Statutes Amendment Act, 1983 (No. 2), S.A. 1983, c. 97, ss 2(4) and 2(5) which enacted ss 43(1.1), (1.2) and (3) and 43.1 to 43.4 of the Law of Property Act.

Where these two conditions are met, section 41 applies to such individuals to the same extent as if they had granted the mortgages.[114] If the transferee is not an individual or cannot otherwise bring himself or herself within the terms of the amendments, then section 41 will not apply to bar the lender from seeking a deficiency judgment against the transferee. Where a chain of title commencing with a corporate borrower contains both protected and unprotected transferees, the latter will remain subject to an action on the covenant by virtue of section 43 (i.e. the initial exclusion of mortgages given by corporations from section 41 protection). Where the borrower is an individual, however, or where at least one individual joins any number of corporate borrowers,[115] the section 43 exception cannot apply. Action on the covenant will be barred by section 41 even if the mortgage has been subsequently assumed by a corporation.

Individuals who renew mortgages granted by corporations have been given even greater protection than that created by section 43(1.1) as a result of a trilogy of decisions given by the Alberta Court of Appeal. These will be discussed in detail under the heading "Renewals".

(iii) Mortgages granted to the Crown

In the early 1980s, the Crown and its agents were enforcing covenants to pay found in mortgages granted to them. The conventional wisdom was that this was permissible because of section 14 of the Interpretation Act,[116] which provides that no enactment binds the Crown unless "the enactment expressly states that it binds Her Majesty". As the Law of Property Act does not state that the Crown is bound by Part 5 of the Act,[117] sections 41 and 42 do not apply to the Crown. Therefore, there is

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114 *Canada Trustco Mortgage Co.* v. *Coleman* (1985), 36 Alta. L.R. (2d) 316 (M.C.).

115 *Chateau Dev. Ltd.* v. *Steele*, [1983] 6 W.W.R. 15 (Alta. C.A.).

116 R.S.A. 1980, c. I-7, s. 14 reads: "No enactment in binding on Her Majesty or affects Her Majesty or Her Majesty's rights or prerogatives in any manner, unless the enactment expressly states that it binds Her Majesty".

117 The Law of Property Act is divided into 8 parts. Sections 39 to 45 make up Part 5 of the Act, which deals with the enforcement of mortgages and agreements for sale. Section 13 of the Act provides that the Crown is bound by Part 2 of the Act which deals with Common Parties Contracts and Conveyances. The other seven parts of the Act do not contain a similar provision.

no bar to enforcement of the covenant to pay found in a mortgage given to the Crown or its agents.[118]

In 1987, the conventional wisdom was upset by the Alberta Court of Appeal in two decisions: *Alberta Mortgage and Housing Corporation* v. *Ciereszko and Craik*[119] and *Farm Credit Corporation* v. *Dunwoody Limited (Trustee) and Holowach.*[120] In these decisions the court relied on *R.* v. *Murray*[121] as authority for the principle that, notwithstanding section 16 of the federal Interpretation Act, when "the federal Crown chooses to sue someone in relation to a matter that is not governed by any special prerogative rules, it must abide by the laws applicable to such matter in private disputes in the province in question".[122] This is referred to as the "Crown as litigant" exception to Crown immunity. The result in each case was that, notwithstanding section 14 of the Alberta Interpretation Act (which is very similar to section 16 of the federal Interpretation Act), the agent of the Crown was bound by sections 41 and 42 of the Law of Property Act and could not enforce the covenant to pay found in the mortgage.

In the future it is possible that these two decisions will be overturned because their authority has been seriously undermined by the Supreme Court of Canada decision in *Alberta Government Telephones* v. *Canadian Radio-television and Telecommunications Commission.*[123] In this decision the Supreme Court of Canada took the opportunity to review the doctrine of Crown immunity. The case involved section 16 of the federal Interpretation Act,[124] which provides that the Crown is not bound by a statute unless

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118 *Alberta Agricultural Development Corporation* v. *Bonney, supra*, note 72.

119 *Supra*, note 73.

120 (1988), 59 Alta. L.R. (2d) 279, leave to appeal to the S.C.C. denied.

121 [1967] S.C.R. 262.

122 Gibson, "Interjurisdictional Immunity in Canadian Federalism" (1969) 47 Can. Bar Rev. 40 at 50 which was quoted with approval by the Alberta Court of Appeal in *Farm Credit Corporation* v. *Dunwoody Limited (Trustee) and Holowach, supra*, note 120 at 286.

123 *Supra*, note 73.

124 R.S.C. 1985, c. I-21. Section 16 reads: "No enactment is binding on Her Majesty or affects Her Majesty or Her Majesty's rights or prerogatives in any manner, except only as therein mentioned or referred to in the enactment".

mentioned or referred to therein. The Court held that the words "mentioned or referred to" include:

> (a) expressly binding words
>
> (b) a clear intention to bind the Crown which is revealed from the terms of the statute itself
>
> (c) a clear intention to bind the Crown which is shown by the fact that the purpose of the statute would be wholly frustrated if the government was not bound. The Crown is bound if an absurdity results if it is not bound. An undesirable result is not the same thing as an absurdity.

The Crown can lose its immunity by operation of the doctrine of waiver which is also known as the benefit-burden exception. This doctrine is:[125]

> By taking advantage of legislation the crown will be treated as having assumed the attendant burdens, though the legislation has not been made to bind the crown expressly or by necessary implication. The force of the rule of immunity is avoided by the particular conduct of the crown and the integrity of the relevant statutory provisions, beneficial and prejudicial.

The Court agreed that there was some ambiguity in *R.* v. *Murry*. Yet, it considered that case to be an example of waiver of Crown immunity by virtue of the fact that the Crown had pursued a cause of action created by statute to which certain limitations applied.

The Crown may take the advantage of a statute and not be bound by all the burdens of the statute. The issue is not whether the benefit and burden arise under the same statute. The issue is whether there is a sufficient nexus between the benefit and the burden. The test is that established in *Sparling* v. *Quebec*:[126] Are the benefit and burden

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125 McNairn, *Governmental and Intergovernmental Immunity in Australia and Canada* (Toronto: University of Toronto Press, 1977) at 10.

126 [1988] 2 S.C.R. 1015 at 1025.

"sufficiently related so the benefit must have been intended to be conditional upon compliance with the restriction?". The Court emphasized that a fairly close connection must exist between the benefit and the burden. Otherwise, the result would be judicial repeal of section 16 of the Interpretation Act.

It is now clear that the "Crown as litigant" exception to Crown immunity does not exist. The foundation of the reasoning in the two Court of Appeal cases has been destroyed. The analysis that must now be applied is whether the Crown is expressly or by necessary implication bound by the Law of Property Act. If not, has the Crown waived its immunity by taking the benefit of the Law of Property Act? If so, are these benefits sufficiently related to the detriments (the procedural bars) created by the Law of Property Act so that the benefit must have been intended to be conditional upon compliance with the detriments.[127]

The application of the analysis established by the Supreme Court of Canada in *Alberta Government Telephones* v. *Radio-television and Telecommunications Commission* is revealing. The Law of Property Act does not expressly state that the Crown is bound by Part 5 of the Act. The purpose of Part 5 is not **wholly** frustrated if the Crown in not bound. Part 5 does not evidence a clear intention on the part of the Legislature that the Crown is bound. Logic dictates that Crown lenders are immune from operation of Part 5 of the Law of Property Act unless they waive this immunity.[128]

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127 This analysis has been applied in the following cases:
· *Province of Alberta Treasury Branches* v. *Hruschak* (1991), 83 Alta. L.R. (2d) 30 (Q.B., M.C.) re Interest Act
· *Province of Alberta Treasury Branches* v. *Grain King Canada Inc. and Austin* (April 23, 1992), Edmonton No. 9003 24594 (Alta. Q.B., M.C.) re Interest Act
· *Federal Business Development Bank* v. *Caskey* (Jan. 15, 1992), Edmonton No.9103 22147 (Alta. Q.B., M.C.) re Part 5 of the Law of Property Act.
· *Alberta Opportunity Company* v. *Snatic* (1992), 3 Alta. L.R. (3d) 199 (Q.B., M.C.) re Guarantors Acknowledgement Act
· *Rutherford* v. *Swanson et al.* (1993), 9 Alta. L.R. (3d) 328 (Q.B.) re Alberta Rules of Court 209 and 266.

128 There is a division of opinion among Alberta Masters as to whether this is the correct analysis to apply. The majority of Masters have adopted this analysis. For example, see *Federal Business Development Bank* v. *Caskey, ibid.* The minority of Masters continue to follow *Alberta Mortgage and Housing Corporation* v. *Ciereszko and Craik, supra*, note 73. For example, see *Alberta Agricultural Development Corporation* v. *Nelson* (May 13, 1991), Edmonton No. 910381 D (Alta. Q.B., M.C.)

Assuming that Part 5 of the Law of Property Act does not apply to the Crown, can a Crown lender lose its immunity by virtue of the doctrine of waiver? The immunity will be lost only if the Crown lender relies on Part 5. If it does not do this, it cannot have waived its immunity. A Crown lender can argue that it is not relying on Part 5. It is pursuing its remedies in common law and equity. At common law, the lender can sue the borrower on the covenant to pay contained in the mortgage. In equity, the lender has a right to enforce its security in land by having the court grant an order of foreclosure or by ordering the land sold to a third party. Historically, the Court of Equity's authority to sell land came from the Chancery Procedures Act, 1852.[129] Today, the court's power to sell land is found in Rules 495 to 497 and section 41(2) of the Law of Property Act. The court's power to sell land is not restricted to section 41(2).[130] As a result, when exercising its jurisdiction as a Court of Equity, the Court of Queen's Bench can sell the land under Rules 495 to 497. There is no need to use section 41(2).

However, if a Crown lender relies on section 41(2) (by relying on it in the Notice of Motion seeking an *in rem* judgment), then it may have waived its immunity. The issue is whether the benefit created by section 41(2) is so closely connected with the detriment created by 41(1) that the benefit must have been intended to be conditional upon compliance with the restriction. The connection is evident from a review of the history of the sections. In 1939, the Legislature enacted the predecessors of sections 41(1) and (2). The purpose of both subsections was to protect the interests of the borrower. Subsection (1) protects against deficiency judgments and subsection (2) protects the borrower's equity in the mortgaged property. The sections operate together to afford protection to borrowers. Therefore, if the lender relies on section 41(2) it must take the concomitant burden of section 41(1). A wise Crown lender will not rely on section 41(2) of the Law of Property Act as the court's authority to sell land. It will rely on the court's jurisdiction to sell land created by Rules 495 to 497.

If a Crown lender applies under section 45 of the Act for an order appointing a receiver of rents, has it waived its immunity? Applying the test established in *Sparling* v. *Quebec*, one asks two questions: Is the right to

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129 (15 & 16 Vict.), c. 86, s. 48.

130 *Canada Permanent Trust Company* v. *King Art Developments Ltd. et al., supra*, note 82 and *Scotia Mortgage Corporation* v. *Goss and Goss* (1987), 83 A.R. 15 (M.C.).

have the court appoint a receiver under this section related to the bar to proceeding on the covenant to pay? Is the relationship so strong that obtaining appointment of the receiver is conditional upon accepting the bar on the covenant to pay? There seems to be little connection between the benefit and the restriction. Furthermore, section 45 was enacted many years after the predecessors of sections 41(1) and (2) came into force.

The Crown can also claim immunity from the operation of the Interest Act,[131] which, until recently, limited the rate of post-judgment interest to 5% in the western provinces and continues to apply to judgments obtained before August, 1992. This Act does not provide that it binds the Crown. Therefore, if the above reasoning is correct, it is likely that the earlier decisions of *Alberta Home Mortgage Corporation* v. *Hill Investments Ltd.*[132] and *Provincial Treasurer of Alberta* v. *J. Woycenko & Sons Contracting Ltd.*[133] are still good law. These cases held that the Crown and its agents are not bound by the Interest Act because this Act does not say that it binds the Crown. We note that the Alberta Court of Appeal recently affirmed, without reasons, the decision of Master Funduk in *Provincial Treasurer of Alberta* v. *J. Woycenko & Sons Contracting Ltd.*[134] Thus, for judgments given before August 1, 1992, the Crown and its agents should be able to recover interest on deficiency judgments at the mortgage rate when the terms of the mortgage have so provided.[135] By virtue of section 6 of the Judgment Interest Act,[136] judgments given on or after August 1, 1992 will bear interest at the rate prescribed by regulation. Section 7 of that Act provides that the Crown is bound by the Act.

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131 R.S.C. 1985, c. I-15, s. 12. Note that sections 11-14 of the Interest Act were repealed on July 31, 1992: Miscellaneous Statute Law Amendment, 1991 S.C. 1992, c. 1, s. 146(2). By proclamation, section 6 of the Judgment Interest Act S.A. 1984, c. J-0.5 came into force on August 1, 1992. This section deals with post-judgment interest on Alberta judgments. Section 7 of that Act provides that the Crown is bound by the Act.

132 (1985), 36 Alta. L.R. (2d) 204 (Q.B.).

133 (1986), 73 A.R. 229 (M.C.).

134 *J. Woycenko & Sons Contracting Ltd.* v. *Provincial Treasurer of Alberta* (1990), 105 A.R. 159 (C.A.).

135 It is unclear whether judgments given before August 1, 1992 will be governed entirely by the old law or whether those judgments will bear interest at the prescribed rate from August 1, 1992.

136 S.A. 1984, C. J-0.5.

Having set out this analysis, we would be remiss if we did not refer to the activity of the Alberta Court of Appeal since the Supreme Court of Canada pronouncement. As of yet the Alberta Court of Appeal has not had an opportunity to give careful consideration to its two earlier decisions in light of the *Alberta Government Telephones* v. *Canadian Radio-television and Telecommunications Commission*. Obiter comments of the Court of Appeal indicate that the court is aware that the issue is in need of its attention. In *R.* v. *Bank of Canada and Canada Deposit Insurance Corporation*[137] the Alberta Court of Appeal said in a passing comment that the benefit-burden test set out in *Sparling* v. *Quebec* was stated by the Alberta Court of Appeal in *Alberta Mortgage and Housing Corporation* v. *Ciereszko* and *Farm Credit Corporation* v. *Dunwoody Limited*. With the greatest respect, this is difficult to accept. In *Farm Credit Corporation* v. *Enns*[138] the Court of Appeal reaffirmed its decision in *Farm Credit Corporation* v. *Dunwoody Limited*. Surprisingly, the Farm Credit Corporation did not challenge the authority of the earlier decision. As a result, the court did not reconsider its earlier decision in light of *Alberta Government Telephones* v. *Canadian Radio-television and Telecommunications Commission*. Unfortunately, the reaffirmation of the earlier decision in this context does not assist in clarifying the law. This is so especially in light of the decision the court reached in the *Woycenko* case.

(e) Liability under the covenant when action not barred

Default under a mortgage gives rise to two distinct causes of action: an action to realize on the security (the land) and an action in debt on the covenant for payment. Notwithstanding that the two may be brought together by means of a single statement of claim, they do not constitute a single cause of action. As a result, if section 41 does not apply, a lender may bring action on the covenant for a deficiency judgment after it has already obtained an order for sale of the mortgaged land. The principle of *res judicata* will not apply so as to bar the subsequent action.[139] Further, the claim for the deficiency need not be brought in the judicial district in which

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137 (9 Nov. 1989), Appeal # 8903-0694-AC (Alta. C.A.).

138 (1990), 73 Alta. L.R. (2d) 293 (C.A.).

139 *Century 21 Real Estate Ltd.* v. *Reykdal Invts. Ltd.* (1979), 9 Alta. L.R. (2d) 209 (T.D.).

the mortgaged land is located, as it is merely a claim in debt separate from the proceedings on the mortgage security itself.[140] The lender may pursue its claim on the covenant contemporaneously with the proceedings against the land; the lender is not required to wait until the land has been sold.[141]

In the early 1980s, it was thought that, if the mortgage so provided, interest on a judgment on the personal covenant would run at the mortgage rate. In *Canada Permanent Trust Co.* v. *King Art Developments Ltd. et al.*,[142] however, it was held that, in Alberta, section 12 of the Interest Act limited interest on judgments to 5%, even though the mortgage itself called for post-judgment interest at a higher rate.[143] In time, sections 11-14 of the Interest Act were successfully challenged as contravening section 15 of the Charter of Rights and Freedoms.[144] Consequently, on July 31, 1992, Parliament repealed these sections, and, on August 1, 1992, the Alberta Legislature proclaimed in force section 6 of the Judgment Interest Act.[145] Section 6 provides that "a judgment debt bears interest from the day on which it is payable by or under the judgment until it is satisfied, at the rate

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140 *First Investors Corporation* v. *Golden Flow Developments Ltd. and Deslauriers* (1981), 17 Alta. L.R. (2d) 395 (M.C.).

141 *Humble Investments Ltd.* v. *Therevan Development Corp.* (1982), 21 Alta. L.R. (2d) 40 (M.C.) and *Canada Permanent Trust Company* v. *King Art Developments Ltd. et al.*, *supra*, note 82, at 651-53. Before *King Art*, it was the practice of some masters and judges to grant in the Order nisi/Order for sale, judgment against the mortgagor on the personal covenant and against any guarantors. Execution on the judgment would usually be stayed until after the sale, when the amount of any deficiency would be ascertained. The Court of Appeal held that there is no rule that the court must stay execution on the judgment. Subject to the court's jurisdiction to stay an action, there is no rule that precludes a lender from enforcing the debt secured by the land in the order it chooses.

142 *Supra*, note 82.

143 One consequence of this decision was that lenders postponed applying for judgment on the covenant until the end of the foreclosure action. This tactic maximizes the recovery of interest at the mortgage rate.

144 *Bank of Montreal* v. *Rolseth* (1986), 66 A.R. 381; *Rafael* v. *Allison* (1987), 56 Alta. L.R. (2d) 79; *First City Capital Ltd.* v. *Ampex Canada Inc.* (1990), 115 A.R. 49 (C.A.); *C.I.B.C.* v. *Chang and Wong* (April 30, 1992), Calgary No. 920306 (Q.B., M.C.).

145 As of July 31, 1992, Parliament repealed section 12 of the Interest Act, R.S.C. 1985, c. I-15: Miscellaneous Statute Law Amendment Act, S.C., 1992, c. 1. On August 1, 1992, the Alberta Legislature proclaimed in force section 6 of the Judgment Interest Act, S.A. 1984, c. J-05. This section deals with post-judgment interest where a judgment is given on or after August 1, 1992.

or rates prescribed under section 4(3) . . . ". To date, the issue of whether parties to a mortgage can contract out of the operation of section 6 has not come before the courts. Therefore, courts are again awarding interest on judgments on a personal covenant at the mortgage rate, if the mortgage provides for this.

A mortgage is (amongst other things) a contract, and on contract principles the borrower's liability on the personal covenant survives the transfer of the mortgaged land to another, even if the latter assumes the mortgage. This is the common law position which prevails unless section 41 applies to bar action on the covenant. The borrower's liability terminates only if the lender specifically releases the borrower or if the terms of the mortgage are sufficiently altered by the lender and transferee so as to operate as a novation. By way of example, in a case where the borrower transferred the mortgaged land, and the transferee subsequently agreed with the lender to a change in the due date and an increase in the interest rate payable under the mortgage, it was held that there was no novation. The borrower, a corporation, was found liable on the covenant, albeit with interest at the original rate only.[146]

(f) Liability of transferees under section 62 of the Land Titles Act

Section 62(1) of the Land Titles Act reads as follows:

> In every instrument transferring land for which a certificate of title has been granted, subject to mortgage or encumbrance, there shall be implied the following covenant by the transferee both with the transferor and the mortgagee: That the transferee will pay the principal money, interest, annuity or rent charge secured by the mortgage or encumbrance, after the rate and at the time specified in the instrument creating it, and will indemnify and keep harmless the transferor from and against the principal sum or other money secured by the instrument and from and against the liability in respect of any of the covenants therein contained or under this Act implied on the part of the transferor.

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146 *Killips* v. *Leroda Management Ltd.* (1985), 63 A.R. 352 (Q.B.).

Section 63(1) goes on to provide that the covenants implied by section 62(1) may be negatived or modified by express declaration in the transfer instrument.

It will be noted that section 62(1) states that the transferee's implied covenant is with both the transferor and the lender. In this respect Alberta goes further than most other Canadian jurisdictions, where the law implies covenants by the transferee with the transferor only and not with the lender.[147] In such jurisdictions, the lender's right of action on the covenant is thus limited to the borrower. The latter can then look to his or her transferee for indemnity by virtue of the implied covenant. In Alberta, however, section 62(1) gives the lender the right of direct action against the transferee as well by creating privity between them. The transferee's liability under the implied covenant continues after he or she transfers the land to another who becomes the registered owner—even if the latter expressly covenants to pay the mortgage—but the Alberta courts have differed as to the nature and duration of the liability.[148]

To correctly interpret section 62, one must understand the law that existed before 1886.[149] At that time, when the borrower sold the property subject to the mortgage, ". . . the purchaser was held in equity bound to indemnify the vendor against his personal liability to the mortgagee under the covenant to pay contained in the mortgage".[150] The covenant to indemnify was raised in favour of the vendor and not in favour of the lender. The lender could not sue the purchaser directly. If the lender wished to pursue the purchaser, it had to obtain an assignment of the vendor's right to indemnity and pursue that cause of action.

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147 Manitoba, however, has a provision similar to Alberta's section 62(1). See Real Property Act, R.S.M. 1988, c. R-30, s. 77. British Columbia has a provision which is differently worded, but which brings about a similar implied covenant. See the Property Law Act, R.S.B.C. 1979, c. 340, ss 20.1(3) and 20.1(4).

148 See Price and Trussler, *supra*, note 101 at 157-58.

149 The Territories Real Property Act, 1886 S.C. 1886, c. 26 contained a provision which implied in a transfer of land a covenant of indemnity by the transferee in favour of the transferor. This was a codification of the obligation of indemnity first recognized by equity in *Waring* v. *Ward* (1802), 7 *Ves. Jun.* 333, 32 E.R. 136 (Ch.). With the enactment of The Land Titles Act, S.A. 1906, c. 24, s. 54, this provision was expanded to include the implied covenant by the transferee in favour of the mortgagee.

150 *Short* v. *Graham* (1908), 7 W.L.R. 787 at 790 (Alta. T.D.).

Section 62 codified this covenant of indemnity which arose between transferor and transferee and it avoided the circuity of action by creating privity of contract between the transferee and the lender.[151] The section did not create new personal liability for the transferee; it created a more direct route for the lender to enforce existing liability.[152] The result is that no covenant arises under section 62 between the transferee and lender unless a right to indemnity exists between the transferor and transferee.[153]

There are many situations in which the transferee is not bound in equity to indemnify the transferor against his or her personal liability to the lender and, therefore, no covenant arises under section 62 between the lender and the transferee.[154] This is so even though a literal interpretation of the section suggests the covenant arises. We do not propose to summarize all the situations in which a covenant has not arisen under section 62, but we shall discuss several such situations to illustrate this concept. No covenant arises under section 62 where:

(1) the transferor transfers less than his or her entire interest in the land[155] or transfers only some of the land charged by the mortgage,[156] (However, if the transferor transfers by one instrument of transfer the entire interest in all the lands charged by the mortgage to several transferees, each transferee is jointly liable for the covenant of indemnity arising from section 62.[157])

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151 *Short* v. *Graham* (1908), 7 W.L.R. 787 at 790 (Alta. S.C.); *Trusts and Guarantee Company Limited* v. *Monk* (1924), 21 Alta. L.R. 151 at 159, [1925] 1 W.W.R. 5 at 8 (Alta. S.C.A.D.); *Guarantee Trust Company of Canada* v. *Bailey* (1985), 59 A.R. 297 at 299 (C.A.); *AMIC Mortgage Investment Corporation* v. *Abacus Cities Ltd.* (1987), 56 Alta. L.R. (2d) 282 at 284 (C.A.).

152 *AMIC Mortgage Investment Corporation* v. *Abacus Cities Ltd.*, *ibid.*

153 *Guarantee Trust Company of Canada* v. *Bailey*, *supra*, note 151.

154 For a list of these situations see L.Y. Cairns, *supra*, note 46 at 204.

155 *In re Macdonald Estate*, [1925] 1 W.W.R. 1031 (Alta. S.C.A.D.).

156 *AMIC Mortgage Investment Corporation* v. *Abacus Cities Ltd, supra*, note 151 and *Fidelity Trust Company* v. *Signature Finance Ltd. and Radostits Investment Ltd.* (1990), 73 Alta. L.R. (2d) 289 (C.A.).

157 *Trust and Guarantee Company Limited* v. *Monk, supra*, note 144.

(2) the transferee purchases from a transferor who is not liable on the express covenant to pay found in the mortgage or assumption agreement or on an implied covenant to pay,[158]

(3) the lender has dealt with the borrower in such a way that the lender can no longer compel payment from the borrower,[159]

(4) the transferee takes the land as a trustee,[160]

(5) the transferee is unaware of the transfer[161]

(6) the transferee takes the land as security for a debt owed to the transferee by the transferor,[162]

(7) the transferee purchases at an execution sale.[163]

Two recent Court of Appeal decisions are examples of the second situation. In *Guaranty Trust Company of Canada* v. *Bailey*[164] the first mortgagee maintained that a final order of foreclosure obtained by a second mortgagee was an instrument transferring land and sought judgment

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158 *Guarantee Trust Company of Canada* v. *Bailey, supra*, note 151, and *Collingwood Invt. Ltd.* v. *Bank of Amer. Can. Mtge. Corp.* (1988), 58 Alta. L.R. (2d) 1 (C.A.).

159 See *Patterson* v. *Tanner* (1892), 22 O.R. 364; *Royal Trust Corporation* v. *Turner* (1985), 5 W.W.R. 362 (Alta. Q.B.). In the latter case, the lender accepted payout in bankruptcy in full satisfaction of the debt of the mortgagor. Since the lender could not compel the corporate mortgagor to pay the mortgage, the mortgagor had no right to indemnity from the transferee. Therefore, no covenant arises under section 62 between the transferee and the lender.

160 *Fraser* v. *Fairbanks* (1894), 23 S.C.R. 79; *Evans* v. *Ashcroft* (1915), 8 W.W.R. 899 (Alta. SCTD); *Gilbert* v. *Nestor*, [1923] 3 W.W.R. 15 (Alta. S.C.T.D.), *B.C. Land & Investment Agency Ltd.* v. *Montreal Trust Company*, [1935] 3 W.W.R. 566 (P.C.); *Laurentian Bank of Canada* v. *Chu*, [1991] 6 W.W.R. 563 (Alta. Q.B.), aff'd (Sept. 8, 1992), Edmonton 9103 0746-AC (Alta. C.A.).

161 *Davis* v. *Cavers*, [1923] 1 W.W.R. 274, *Wong* v. *Pandora Developments Ltd.* (1989), 101 A.R. 1 (Q.B.).

162 *Walker* v. *Dickson* (1892), 20 OAR 96; *Fullerton* v. *Brydges* (1895), 10 Man. R. 431 (C.A.); *Campbell* v. *Douglas* (1916), 54 S.C.R. 28, *Welsh* v. *Popham*, [1925] S.C.R. 549.

163 *Anderson* v. *Stasiuk*, [1927] 1 W.W.R. 49 (Sask.C.A.).

164 *Supra*, note 151.

against a subsequent transferee of the second lender on the basis of section 62(1). After discussing the authorities, the court concluded:[165]

> Section 62(1), therefore, creates a contingent liability between the transferee and mortgagee. The transferee's implied promise to the mortgagee is contingent upon there being a right of indemnification existing between the transferee and transferor. If the transferor is not liable to begin with, then there is no circuity of action upon which section 62(1) might act. Section 62(1) would not apply and no subsequent transferee could be held liable. Therefore, for section 62(1) to apply in the case at bar, it must be shown that a right to indemnification existed as between the respondents and Nelson, their transferor. This in turn involves showing that such a right existed between Nelson and Argosy [second lender] which, in turn, involves showing that Argosy was liable on the covenant to pay under the appellant's mortgage when they became registered owner by way of foreclosure. The issue becomes: Is Argosy liable to pay on the express or implied covenant arising from the first mortgage?

As the second lender was not a party to the first mortgage, it was not liable on the express covenant arising from the first mortgage. If the second lender was liable to pay, it was from the implied covenant arising from section 62. While allowing that a final order for foreclosure might be a transfer instrument, the court held that in this situation equity would not require the second lender to indemnify the borrower in respect of the first mortgage. The key fact was that the second lender was not a purchaser who had received credit for the debt owing under the first mortgage. Furthermore, when the second lender took title by foreclosure, there was no transferor that it was required to indemnify. Thus, it was held section 62(1) had no application and the lender had no claim against the subsequent transferee.

In *Collingwood Invt. Ltd.* v. *Bank of Amer. Can. Mtge. Corp.*[166] Mr. and Mrs. Osterlee granted a mortgage charging certain property. They

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165 *Supra*, note 151 at 301.

166 *Supra*, note 158.

sold the property subject to the mortgage to Mr. and Mrs. Leos, who in turn transferred it to Collingwood Investments Ltd. ("Collingwood"), the third lender. The assignee of the first lender sought judgment against Collingwood on the basis, *inter alia*, of section 62. This claim failed. The Court of Appeal held that if the transferor is not liable to the lender to begin with, no right of indemnification against the transferee would be implied. Here the Osterlees and the Leos were not liable for the deficiency because of the Law of Property Act. Therefore, Mr. and Mrs. Leos did not need a right of indemnity against Collingwood and a section 62(1) covenant cannot be implied on behalf of Collingwood in favour of the lender.

A lender who claims against a transferee on the basis of section 62(1) must prove that there was an "instrument transferring land" within the meaning of that section.[167] As liability flows from the implied covenant in the transfer instrument and not from ownership of the land, proof of ownership is not sufficient to establish the lender's claim; the lender must prove the instrument.[168]

(g) Renewals

(i) Section 43(1)(b)

Section 43(1)(b) provides that sections 41 and 42 do not apply to a proceeding for the enforcement of any provision of a mortgage given by a corporation. The interaction between sections 41, 43 and 43.1 to 43.4 was summarized by Chief Justice Laycraft in *Paramount Life Insurance Company* v. *Hilton* as follows:[169]

> 1. The general rule is that in an action brought on a mortgage of land, the mortgagee is restricted to remedies against the land itself (s. 41(1)). As a result the mortgagee cannot sue on:
>
> (a) a covenant for payment contained in the mortgage itself (s. 41(1)(a)) or

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167 *Alberta Home Mortgage Corporation* v. *Fahlman, supra*, note 87.

168 *Bank of Montreal* v. *Cameron* (1985), 67 A.R. 235 (M.C.) and *North West Trust Company* v. *Modest Investments Ltd.* (1987), 77 A.R. 282 (M.C.).

169 (1988), 58 Alta. L.R. (2d) 13 at 17.

(b) a covenant for payment of the principal given by, or implied on behalf of, a person to whom the land subject to the mortgage has been transferred (s. 41(1)(b)), including the covenant implied by section 62(1) of the *Land Titles Act*.

2. Section 43(1) removes this prohibition, but only in respect to "a proceeding for the enforcement of any provision of a mortgage given by a corporation". Therefore, the mortgagee may sue on a covenant given by or implied against a corporate mortgagor.

3. Section 43(1.1) reinstates the protection that was removed by section 43(1) where the mortgage was granted by a corporation which subsequently transferred the land to an individual. In this case, the mortgagee cannot sue the individual transferee on an implied or express covenant to pay. This reinstatement of protection is limited, however by section 43.4 to situations where the land transferred was the residence of the transferee or a member of the family or farm land as defined in section 43.4.

4. Section 43(2) removes the section 41 protection in respect to *National Housing Act* mortgages.

5. Section 43(3) provides a transitional provision, to extend section 43(1.1) to cases where action had been commenced but had not reached the order nisi stage when the section was enacted.

6. Section 43.1, in my opinion, simply makes certain the protection afforded the individual transferee by section 43(1.1) in respect to potential liability on the basis of the section 62(1) *Land Titles Act* covenant. It provides that the mortgagee cannot sue the individual transferee of land that is subject to a corporate mortgage on the basis of the covenant implied by section 62(1) of the *Land Titles Act*.

(Quote con't)

> 7. Section 43.2 provides that, even though the individual transferee of land subject to a corporate mortgage is not liable for the deficiency, the corporate mortgagor remains liable, as does a guarantor or other surety of the mortgage debt (even where the guarantor or surety becomes the individual transferee).
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> 8. Further evidence of legislative intent not to provide corporations with deficiency protection may be seen in section 43.3. Where land subject to a corporate mortgage is transferred to an individual and then retransferred to a corporation, the new corporate transferee does not receive the protection of section 43(1.1) or section 43.1, but is deemed to be the transferee of the original corporate mortgagor.
>
> 9. As noted earlier, section 43.4 limits the protection afforded to individual transferees of land mortgaged by a corporation to situations where the land involved was either residential or farm land as defined by section 43.4.

(ii) How should section 43(1) be interpreted?

(A) The interpretation of section 43(1) before *Royal Trust Company* v. *Potash*

Originally, the application of section 43(1)(b) depended on the character of the person who granted the mortgage.[170] If the borrower was a corporation, section 43(1)(b) removed the protection of section 41(1). Therefore, any individual who purchased commercial property (or residential property in which they did not reside) that was subject to a mortgage granted by a corporation would be liable for any deficiency owing after the land was sold.[171] This liability could arise in three different

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170 *Elmwood Holdings Ltd.* v. *Sinclair* (1986), 44 Alta. L.R. (2d) 128 (C.A.) citing with approval *Maritime Life Assur. Co.* v. *Dyjack, supra*, note 112; *First City Trust Company* v. *Mid-Continent Holdings Ltd.* (1982), 19 Alta. L.R. (2d) 21 (M.C.).

171 Law of Property Act, ss 43(1.1) and 43.3; *Maritime Life Assur. Co.* v. *Dyjack, ibid.*, *Canada Trustco Mortgage Company* v. *Stonewood Developments Ltd. and Tomlinson*, (August 12, 1983), Edmonton No. 8303-03295 (M.C.).

ways: from the covenant to pay contained in any assumption agreement entered into by the purchaser with the lender; from the covenant to pay arising from section 62 of the Land Titles Act; or from the covenant to pay found in any renewal agreement.[172] On the other hand, if the original borrower was an individual, section 43 had no application and 41 applied. The result was that a corporation which purchased land that was subject to a mortgage granted by an individual was afforded the protection of section 41. The corporation could not be sued for a deficiency judgment on a covenant to pay that it gave to the lender in an assumption agreement, and no covenant arose under section 62 of the Land Titles Act.[173]

This was the approach adopted by the Alberta Court of Appeal in *Elmwood Holdings Ltd.* v. *Sinclair and Northside Electric Ltd.*[174] Elmwood Holdings Ltd. (Elmwood) sold commercial property to Northside Electric Ltd. (Northside) by way of an agreement for sale. Northside assigned its interest under the agreement for sale to Mr. Sinclair ("Sinclair"). This assignment was a three party agreement in which Sinclair covenanted with Elmwood to pay according to the terms of the agreement for sale.

It was held that the court must determine if section 43(1)(a) or (b) applies by examining the character of the borrower or the purchaser under an agreement for sale. If the borrower or purchaser under an agreement for sale is a corporation, then the section applies. Section 43 applied in this case and section 43(1.1) provided no protection for Mr. Sinclair because this was an agreement for sale of commercial property. The court rejected the argument that the three party assignment agreement created a new agreement for sale between Elmwood and Sinclair. It also held that the principle underlying *Chateau Dev. Ltd.* v. *Steele*[175] only applies when a corporation and individual purchase land under one agreement for sale. That principle does not apply when a corporation purchases land by way of agreement for sale and then assigns that interest in land to an individual.

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172 *Central Trust Company* v. *Milchen and Messenger* (1986), 72 A.R. 321 (M.C.), affd. (1986), 47 Alta. L.R. (2d) 272 (Q.B.).

173 See *Collingwood, supra*, note 158 at 7.

174 (1986), 44 Alta. L.R. (2d) 128.

175 *Supra*, note 115.

The fact that Elmwood, Northside and Sinclair were all parties to the assignment agreement did not alter the nature of the agreement for sale.

(B) *Royal Trust Company* v. *Potash*

In *Royal Trust Company* v. *Potash*[176] the Supreme Court of Canada addressed the right of prepayment created by section 10 of the Interest Act. Mr Potash ("Potash") had given two mortgages to Royal Trust Company ("Royal") which each had a five-year term. The mortgages were renewed for a one-year period and then a further five-year period. The renewal agreements deemed that the date of the mortgage would be the maturity date of the existing loan. Two years after the second renewal, Potash tendered the principal and three months interest. Royal refused to accept the payment. Potash brought an action for an order of discharge of the mortgage.

Section 10 provides:

> 10(1) Whenever any principal money or interest secured by mortgage of real estate is not, under the terms of the mortgage, payable until a time more than five years after the date of the mortgage, then, if at any time after the expiration of such five years, any person liable to pay or entitled to redeem the mortgage tenders or pays, to the person entitled to receive the money, the amount due for principal money and interest to the time of payment, as calculated under sections 6 to 9, together with three months further interest in lieu of notice, no further interest shall be chargeable, payable or recoverable at any time thereafter on the principal money or interest due under the mortgage.

Potash argued that the purpose of the section was to ensure that all private mortgages were open after the first five years. Royal argued that the purpose of the section was to ensure the borrower was not "locked in" for more than five years.

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176 [1986] 2 S.C.R. 351.

Section 10 was enacted over one hundred years ago when the commercial reality was long-term mortgages in which the term and amortization period coincided. Today the commercial reality is short-term mortgages with long amortization periods. This does not preclude an interpretation of the section consonant with today's commercial realities if such an interpretation is compatible with the language of the section.

The Court rejected Potash's interpretation of the section because of the consequences of the interpretation. The result of having every private mortgage open after five years would be the necessity of arranging for a completely new mortgage each five years. Lenders would lose their priority over subsequent encumbrancers unless postponement agreements were obtained. This would cause unnecessary expense.

The Court held that it was clear from a review of the mortgage loan renewal agreement that what was renewed by the document was the loan and not the security. The renewal agreement did not create a new mortgage. It amended the maturity date, the interest date, the repayment terms, and the date of the mortgage. All other terms remained in force.

The Court construed section 10 as follows:[177]

> I have no difficulty in reading the word "mortgage" in section 10, in circumstances where renewals have been entered into, as the mortgage as amended. I do not believe that this puts any undue strain on the language or the sense. Accordingly, the phrase the "date of the mortgage" would mean in such a case the date of the mortgage as amended and the phrase "under the terms of the mortgage" would mean under the terms of the mortgage as amended. I believe that it is unnecessary to characterize the mortgage as a "new mortgage" for this purpose. The opening part of section 10(1) would then, in a case where there have been amendments to the original mortgage, be interpreted as if it read:
>
> > Whenever any principal money or interest secured by mortgage of real estate is not, under the terms of the mortgage (as amended)

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177 *Ibid.* at 370-71.

> payable until a time more than five years after the date of the mortgage (as amended) then, if at any time . . . .
>
> This would have the effect of permitting the mortgagor to pay the mortgage off at the end of each five-year renewal period which, in my view, is what the Legislature intended. It would also avoid the manifest injustice referred to by Wright J. in *Butcher* of permitting a mortgagor to collapse a mortgage immediately after executing a renewal agreement with full knowledge and intent. It is this consequence of the Ontario Law Reform Commission's interpretation which has caused judges and commentators alike to seek out an interpretation which would give a greater degree of business efficacy to the renewal agreement entered into by the parties.

The result is that "where the mortgagor elects not to exercise his right under section 10(1) but instead enters into an otherwise valid and enforceable renewal agreement which "deems" the date of the original mortgage to be the date of maturity of the existing loan and the term of the renewal agreement does not itself exceed five years, he cannot pay off the mortgage until the end of the five-year renewal period".[178]

The Court also held that a borrower could not contract out of or waive the protection created by section 10. However, in its opinion, Potash had not waived or contracted out of the protection afforded by section 10. Instead, he had chosen not to exercise his right to repay the debt at the end of the five-year period.

(C) Interpretation of section 43 after *Royal Trust Company* v. *Potash*

As a result of the *Potash* decision the Alberta Court of Appeal has interpreted section 43 differently in cases involving renewals. The new interpretation is found in:

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[178] *Ibid.* at 374.

- *Collingwood Invt. Ltd.* v. *Bank of Amer. Can. Mtge. Corp.*,[179]
- *Paramount Life Insurance Company* v. *Hilton*,[180]
- *Pioneer Trust Company* v. *Patrick*,[181] and
- *Standard Trust Company* v. *Steel and 100762 Canada Ltd.*[182]

These cases severely restrict the principles set out in *Elmwood Holdings Ltd.* v. *Sinclair*.

In *Collingwood Invt. Ltd.* v. *Bank of Amer. Can. Mtge. Corp.*, the Osterlees granted three mortgages on certain land. Bank of America Canada Mortgage Corporation ("Bank") took an assignment of the first mortgage. Collingwood Investments Ltd. ("Collingwood") was the third lender. The Osterlees sold the land to Mr. and Mrs. Leos. When the first mortgage went into default, Collingwood paid the arrears and took title. Collingwood signed a renewal letter in which it covenanted to pay all amounts now or hereafter owing under the mortgage as amended or renewed. In time Collingwood defaulted in payments owing under the first mortgage, and the Bank brought foreclosure proceedings in which it sought a deficiency judgment against Collingwood.

The court examined the three possible sources of liability for Collingwood: the mortgage, the covenant arising from section 62 of the Land Titles Act, and the covenant in the renewal letter. No liability arose from the mortgage because Collingwood was not the borrower. Nor did liability arise under section 62 of the Land Titles Act in these circumstances. A covenant arises under section 62 only when equity would imply a right in the transferor to be indemnified by the transferee. In this case, the transferors were individuals who were not personally liable on the mortgage. As the transferors were not personally liable, there was no right of indemnification because there was nothing to be indemnified against. Therefore, a covenant did not arise under section 62. In obiter, the court went on to hold that even if a covenant did arise under section 62, action on the covenant was barred by section 41(1)(b). The court cited *Elmwood*

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179 *Supra*, note 158.

180 *Supra*, note 169.

181 (1988), 61 Alta. L.R. (2d) 312.

182 (1991), 82 Alta. L.R. (2d) 1 (C.A.).

Holdings Ltd. v. *Sinclair* as authority for the proposition that it is the character of the original borrower, not the current owner, which governs the applicability of section 43(1)(b). In this case, given that the original borrowers were individuals, section 43(1)(b) would not operate and, therefore, section 41(1)(b) would be a bar to the action on the section 62 covenant.

Nevertheless, when discussing whether Collingwood was liable on the covenant to pay found in the renewal, the court seems to interpret section 43(1)(b) differently. First, it rejected the argument that the renewal agreement affected a novation. Had this argument been successful, Collingwood would have been substituted as the principal debtor and would have been a borrower who gave a mortgage within section 43(1)(b). Then, the court said that the covenant to pay found in the renewal agreement was a covenant that comes within the scope of section 41(1)(b). Therefore, the lender could not enforce this covenant unless section 43(1)(b) applies. In contrast to what it earlier said in this decision, the court held that section 43(1)(b) should be interpreted broadly. It rejected the narrow interpretation that section 43(1)(b) only permits enforcement of the covenant to pay found in the renewal agreement where the mortgage is granted by a corporation. Instead, the court held that **in situations involving a renewal agreement** "mortgage" as used in section 43(1)(b) means mortgages as amended and the section should be interpreted as if it read:

> Sections 41 and 42 do not apply to a proceeding for the enforcement of any provision of a mortgage {as amended} given by a corporation.

As the personal covenant of Collingwood contained in the renewal agreement was a provision of a mortgage (as amended) that was given by a corporation, it fell within section 43(1)(b). Therefore, section 41(1)(b) did not apply, and the covenant in the renewal agreement was enforceable.

When making this decision, the court was clearly influenced by the effect of a renewal agreement as discussed in the *Potash* decision. Also, it thought the broader interpretation would accomplish the Legislature's purpose expressed in Part 5 of the Law of Property Act of protecting individuals, but not corporations, from deficiency liability. In addition, the narrower interpretation would make lenders reluctant to offer to renew a

mortgage with a corporation. This would cause corporations to go to the unnecessary expense of arranging new financing.

On the day the Alberta Court of Appeal gave its decision in *Collingwood*, it also gave its decision in *Paramount Life Insurance Company* v. *Hilton*. In this case a corporation had granted a land mortgage on residential land to Paramount Life Insurance Company ("Paramount Life"). The corporation sold the land and title was registered in the name of Mr. Hilton ("Hilton"). Subsequently, Hilton executed an agreement renewing the mortgage for three years. Soon after executing the renewal agreement, Hilton defaulted on the mortgage and Paramount Life sought deficiency judgment against Hilton.

The court held that the legislative intent has always been to protect individuals, but not corporations, from the covenant to pay. The court held that the interpretation of section 43(1) providing that the character of the original borrower determines forever the applicability of the legislation does not accord with the legislative intent. The court adopted the interpretation of section 43(1)(b) given in *Collingwood*.

The court held that section 43(1.1) applies until there is a renewal agreement. In this case section 43(1.1) provided no protection to Hilton because he and his family had not resided on the property and the property was not farm land. However, once the renewal agreement was entered into with Hilton, section 43(1)(b) became inapplicable because the mortgage (as amended) was given by an individual not a corporation.

Applying the *Collingwood* analysis to the facts in *Paramount* raises some perplexing problems. Hilton would not be liable on the covenant to pay contained in the mortgage because he was not a party to the mortgage. Yet applying the reasoning in *Elmwood Holdings Ltd.* and *Collingwood*, Hilton would be liable on the covenant arising from the section 62. However, in the *Paramount* decision the court said no deficiency judgment could be obtained. Has the court overruled *Elmwood Holdings Ltd* or is the application of *Elmwood Holdings Ltd.* restricted to cases were there is an assumption agreement but not a renewal?

Next comes the Alberta Court of Appeal decision of *Pioneer Trust Company* v. *Patrick*.[183] In this case a corporation granted a mortgage on a commercial property to Pioneer Trust Company ("Pioneer"). The land was sold to Mr. Patrick ("Patrick"). Pioneer and Patrick entered into a mortgage extension agreement which increased the interest rate and extended the maturity date of the mortgage. Pioneer relied on *Elmwood Holdings Ltd.* and sued Patrick on the covenant arising from section 62 of the Land Titles Act. Patrick argued that this covenant and the covenant contained in the mortgage extension agreement were unenforceable by virtue of 41(1)(b).

A court composed of three different judges attempted to summarize what the decisions in *Collingwood* and *Paramount* stood for. Unfortunately, they stated that in *Collingwood* the covenant in the renewal agreement was unenforceable. This is clearly wrong. They went on to state, however, that in *Paramount* the court held that "any liability imposed upon an individual as a consequence of section 43(1) does not extend to a case where the parties originally understood that there would be a later renewal of the mortgage".[184]

In analyzing the facts before it, the court held that the parties to the mortgage contemplated that there would be renewals of the mortgage upon maturity by whoever happened to be registered owner at the time. Since this expectation existed and an extension agreement was actually entered into, the liability created by section 62 of the Land Titles Act or by the extension agreement escapes the effect of section 43(1) but not section 41(1). Pioneer could not sue Patrick on the covenant to pay given in the renewal agreement or implied by section 62 of the Land Titles Act. The court held that *Paramount* was not distinguishable on basis that it applies only when land was being developed as homes and it was expected that individuals would buy the properties to live in. The principles of that case apply to these facts involving a commercial property. This is so even though the lender thought the original corporate borrower would renew the mortgage.

The court distinguished the *Elmwood Holdings Ltd.* decision on the basis that it did not deal with a subsequent extension agreement.

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183 *Supra*, note 181.

184 *Supra*, note 181 at 317.

The last Court of Appeal decision dealing with this issue is *Standard Trust Company* v. *Steel and 100762 Canada Ltd.*[185] The numbered company granted a mortgage to Standard Trust Company which charged a condominium unit in a multi-unit residential building ("MURB"). The numbered company sold the condominium to Roy Steel who at no time resided in the property. Title was never transferred, but Steel's attorney executed an assumption agreement with Standard Trust Company on his behalf. The mortgage was never renewed, extended or amended. After default in the payments, Standard Trust Company sued Steel on the covenant in the assumption agreement and on the covenant implied by section 62 of the Land Titles Act.

Steel argued that *Central Trust Company* v. *Milchem* and *Elmwood Holdings Ltd.* v. *Sinclair* were overruled by the later decisions of the Court of Appeal, namely, the three decisions discussed immediately above. The Court of Appeal rejected this argument and took the opportunity to rationalize the decisions in this area.

After discussing all the decisions, Justice Stratton summarized the law as follows:[186]

> It was held in *Milchem* and *Elmwood* that it was the character of the person who granted the mortgage which determined whether section 43(1)(b) applied. But in *Paramount*, Laycraft C.J.A. made it clear that the character of the original mortgagor would not determine the matter forever. If a new mortgage is put in place by the parties, it is the character of the new mortgagor which determines the issue. For the purposes of the Act, mortgages which are renewed, extended or amended are to be considered new mortgages. The mortgage security has not changed, but the nature of the mortgage debt has been renegotiated and the parties have agreed to new terms which, from that point forward, are to govern the relationship. On the other hand, mortgages which are merely assumed do not change the relevant terms of the relationship. While one of the parties has changed, neither the

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185 *Supra*, note 182.

186 *Ibid.* at 7-8.

> mortgage security not the mortgage debt has been altered. The mortgagee has not agreed to forego his right of action on a deficiency. In the words of the Chief Justice (p. 19) [Alta L.R.]:
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> > Moreover, in each case where a corporation transfers to an individual land subject to a mortgage, section 43(1.1) will continue to be operative until there is a renewal agreement containing a covenant to pay. The intention of the parties to the contract will thus continue to govern, to the extent permitted by the section, until that time.

Justice Stratton made it clear that neither *Paramount* nor *Pioneer* is authority for the proposition that the test which ultimately determines the issue is the intentions of the parties. It is the existence of the renewal or extension agreement that is the key. "The parties' original intentions may be an indication that the mortgagee is willing to be bound by an agreement which does not allow for a deficiency judgment, but one must look to the actual agreement in place to determine the issue".[187]

The result was that the Court of Appeal affirmed the deficiency judgment against Steel. Justice Stratton concluded as follows:[188]

> If the individual mortgage simply assumes a corporate mortgage in the course of a *bona fide* commercial transaction, unless the individual fits within the resident's or farmer's exception (s. 43.4) there will be liability on a deficiency. If, however, the mortgagee agrees with the individual mortgagor that the terms of the agreement assumed should be altered by renewal, extension or amendment, then there will be no liability on the deficiency. There will be a new agreement in place with respect to the mortgage debt and by the terms of the statute the mortgagee will have accepted a mortgage granted by an individual, and the limited right of action which accompanies that mortgage.

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187 *Ibid.* at 9-10.

188 *Ibid.* at 10.

In obiter, Justice Stratton made it clear that there might be situations in which the individual who assumes a corporate mortgage will be protected even if he or she is not entitled to the farm or residence protection of section 43.4. The court will be reluctant to permit a mortgagee to avoid the statutory general prohibition against personal liability by adopting a scheme not in accord with *bona fide* commercial practice. Such a scheme exists when, as a condition of a loan made to an individual borrower, a corporation must be inserted artificially as the original mortgagor. Such artificiality was not present in this case.

The court distinguished *National Trust Company* v. *Mead*[189] because that case interpreted section 2 of The Limitations of Civil Rights Act (Saskatchewan), which restricts the mortgagee's remedy to the land when a purchase money mortgage is involved. The Saskatchewan legislation and the corresponding Alberta legislation differ in the way original mortgagors and transferees are treated. Alberta protects only certain individuals who assume corporate mortgages. Saskatchewan protects both the corporate borrower and subsequent transferee but the protection may be waived by a corporation.

Steel argued that the assumption agreement was in reality a guarantee and, therefore, unenforceable because it does not comply with the Guarantors Acknowledgement Act. The court rejected this argument by holding that Steel's obligation was a primary obligation, not a secondary obligation. Steel did not promise to answer for an act or default of another. He covenanted on his own behalf.

(iii) Conclusions

The Court of Appeal decision in *Standard Trust Company* v. *Steel and 100762 Canada Ltd.* goes a long way to clarify the law in this area. The law can be summarized as follows:

(a) Until someone other than the borrower renews, extends or amends the mortgage, the following is true:

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189 [1990] 5 W.W.R. 459 (S.C.C.).

(i) The application of section 43(1)(b) is determined by the characterization of the original borrower. The existence of an assumption agreement executed by a transferee does not change the characterization of the original borrower.[190]

(ii) Unless sections 43(1.1) and 43.4 provide protection, an individual who purchases land charged by a mortgage granted by a corporation will be liable for a deficiency judgment. The individual's covenant to pay contained in an assumption agreement and the covenant arising from section 62 of the Land Titles Act will be enforceable.[191]

(iii) A corporation that purchases land charged by a mortgage granted by an individual will not be liable for a deficiency judgment. Section 41(1)(b) bars enforcement of any covenant to pay given by a corporation in an assumption agreement.

(b) Where the original mortgage is renewed, extended or amended by someone other than the borrower, then:

(i) Section 43(1)(b) should be interpreted as if it read:

> Sections 41 and 42 do not apply to a proceeding for the enforcement of any provision of a mortgage (as amended) given by a corporation.

Such an interpretation reflects the legislature's intent to protect individuals, but not corporations, from personal liability for a deficiency judgment.

(ii) A corporation that purchases land charged by a mortgage granted by an individual will be liable on any covenant to pay the corporation gives to the lender in a renewal agreement. Once the corporation executes the renewal agreement, the covenant in the renewal agreement becomes a provision in a mortgage (as amended) granted by a corporation. Section 43(1)(b) is triggered. No covenant

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190 *Standard Trust Company* v. *100762 Canada Ltd.* (1990), 108 A.R. 336 (Q.B.), aff'd (1991), 82 Alta. L.R. (2d) 1.

191 *Ibid.*

arises under section 62 of the Land Titles Act because the borrower was an individual. However, the covenant to pay found in the renewal agreement will be enforceable.

(iii) An individual who purchases land charged by a mortgage granted by a corporation will not be liable on the covenant arising from section 62 of the Land Titles Act once he or she executes a mortgage renewal agreement. Upon execution of the renewal, the covenant for payment in the renewal agreement becomes a covenant for payment in the mortgage (as amended) given by an individual. Section 43 no longer has any application. Then section 41(1)(b) bars enforcement of the covenant arising from section 62 of the Land Titles Act and the covenant to pay found in the renewal agreement.[192]

(c) In *Collingwood* the court rejected the narrow interpretation of section 43(1) because it would make lenders reluctant to renew mortgages with a corporation buying land subject to a mortgage given by an individual. Also, it would result in the additional expense of arranging new financing. The court keyed on the maturity date of the mortgage. It is at that time that the lender can decide to offer to renew the mortgage with the new owner or to insist the new owner obtain other financing. A lender seeks an assumption agreement during the term of the existing mortgage and, therefore, an assumption agreement is different in that sense.

(d) In obiter, the court has suggested that it will not permit a lender to avoid the statutory general prohibition against personal liability by adopting a scheme not in accord with *bona fide* commercial practice. Such a scheme exists when a lender requires that, "as a condition of loan made to an individual borrower, a corporation must be inserted artificially as the original mortgagor".[193] In such a situation, the court may protect an individual who assumes a corporate mortgage even if he or she is not entitled to the farm or residence protection provided by sections 43(1.1) and 43.4.

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192 For example, see *Central Trust Company* v. *Stastny et al.* (1992), 5 Alta. L.R. (3d) 185 (Q.B.).

193 *Standard Trust Company v. Steel and 100762 Canada Ltd., supra*, note 182 at 9.

(h) Due-on-sale clauses

(i) What is a due-on-sale clause?

Lenders have not settled on a standard due-on-sale clause (also known as an optional maturity clause). Typically, the clause accelerates payment of the entire debt upon sale of the mortgaged property to a purchaser not approved by the lender.[194] A commonly found clause is the one that was interpreted in *Royal Bank of Canada* v. *Freeborn*[195] which provided:

> In the event of the Mortgagor selling, conveying, transferring, or entering into any agreement of sale or transfer of the Title of the property hereby mortgaged to a purchaser, grantee or transferee not approved by the Mortgagee then at the option of the Mortgagee, all moneys hereby secured with accrued interest thereon shall forthwith become due and payable. Further, should a purchaser, grantee, or transferee fail to (1) apply for and receive the Mortgagee's written consent, (2) personally assume all obligations of the Mortgagor and (3) sign the Assumption Agreement of the Mortgagee then the Mortgagee may at its option demand repayment of the principal amount of the mortgage with accrued interest thereon.

Lenders are concerned that the purchaser have the ability to make the payments and maintain the property. Due-on-sale clauses were originally designed to protect lenders from sale of the property to high-risk purchasers. Few due-on-sale clauses delineate the situations in which the lender can demand repayment of the debt upon transfer of the property. As a result, they have been enforced for reasons other than sale to a high-risk purchaser.

Some mortgages have a clause that prohibits sale without the consent of the lender. Breach of such a clause will typically constitute a default

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194 J.T. Robertson, "Neither a Borrower Nor a Lender Be: The Problem with Sales of Real Property Subject to Existing Mortgages" (1989) 38 U. of N.B. Law Journal 31 at 32 & 33.

195 (1974), 32 A.R. 380 (S.C.T.D.).

under the mortgage and allow the lender to accelerate the debt. These clauses perform the same role as a due-on-sale clause, and, as will be discussed later, are treated the same.

(ii) Validity of due-on-sale clauses

In several Canadian cases due-on-sale clauses have been attacked on the basis that they are void as a restraint on alienation. In Alberta the additional argument is made that these are personal clauses that do not run with the land. If the clause does not run with the land, it cannot be enforced against a subsequent purchaser. In the majority of cases these arguments have not been successful.[196]

In *Royal Bank of Canada* v. *Freeborn*,[197] the borrowers sold the property to the Freeborns. One month after the Freeborns took possession, the bank refused to accept them as purchasers. The bank declared that the entire debt was due and owing and commenced a foreclosure action. The purchasers argued that this clause did not run with the land and even if it did, it was void as a restraint on alienation. The court held that the section which is now section 62 of the Land Titles Act declares that the covenant to pay **at the time specified in the instrument** runs with the land. Therefore, the due-on-sale clause was not a personal clause. The lender could declare the whole amount of the mortgage due and payable when it did not approve of the purchaser of the land. The court did not decide whether the clause was a restraint on alienation. However, it must have come to the conclusion that it was not, because it gave relief from the enforcement of the clause. This would have been unnecessary had the clause been void as a restraint on the power of alienation. The court also held that due-on-sale clauses offended the section which is now section 150 of the Land Titles Act.

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196 See *Royal Bank of Canada* v. *Freeborn, ibid.*, *Briar Building Holdings Ltd.* v. *Bow West Holdings Ltd.* (1981), 16 Alta. L.R. (2d) 42 (Q.B.), *Marine Water Wells Ltd.* v. *Dobson & Co. Refrigeration & Air Conditioning Ltd.* (1982), 25 R.P.R. 240 (Sask. Q.B.), *Bigam* v. *Milne* (1983), 25 Alta. L.R. (2d) 179 (Q.B.), *Canada Permanent Trust Co.* v. *King's Bridge Apartments Ltd.* (1984), 48 Nfld. & P.E.I.R. 345 (Nfld. C.A.), *Weeks* v. *Rosacha* (1983), 28 R.P.R. 126 (Ont. C.A.), *C.M.H.C.* v. *Hongkong Bank of Canada et al.*, [1993] 1 S.C.R. 167. The only contrary decision is *Re Bahnsen and Hazelwood* (1960), 23 D.L.R. (2d) 76 (Ont. C.A.) which can be distinguished on the basis of the clause interpreted.

197 *Supra*, note 195.

In *Briar Building Holdings Ltd.* v. *Bow West Holdings Ltd.*,[198] the mortgage contained a similar clause. The court held that this clause did not prevent transfer of the land and, therefore, it was not a restriction on the power of alienation. The court also held that the clause did not amount to a clog on the equity of redemption. The clause did not affect the right to redeem or discharge the mortgage.

A recent decision of the Supreme Court of Canada also sheds light on the validity of due-on-sale clauses. In *Canada Mortgage and Housing Corporation* v. *Hongkong Bank of Canada et al.*,[199] Canada Mortgage and Housing Corporation (CMHC) made a low-interest loan under the National Housing Act, 1954 to both Town House Developments Ltd. and to Wellington Developments Ltd. The loans were made in the 1950s to assist in the construction of low-rental housing and were secured by a mortgage charging the respective housing development. In the operating agreement, which formed part of each mortgage, the borrowers covenanted not to sell or encumber the property without the approval of CMHC and covenanted to operate the building as low-rental housing for a 40-year period. A breach of these covenants constituted default under the mortgage and enabled CMHC to accelerate payment of the entire debt or to increase the interest rate.

In 1981, the borrowers each granted a second mortgage to the predecessor of the Hongkong Bank of Canada and, in 1988, sold the land by way of agreement for sale to a company that was not at arm's length. This sale agreement provided that title would be given free of the obligations created by the operating agreement. It also negatived the covenant that would otherwise have been implied in the transfer by section 62 of the Land Titles Act. CMHC did not consent to either the second mortgage or the sale. When default occurred upon the second mortgage, Hongkong Bank of Canada brought a foreclosure action and, in 1989, sought judicial sale of the property. CMHC opposed the judicial sale and made several arguments to support its position.

The primary arguments put forth by CMHC were based upon section 16(4)(g) of the National Housing Act, 1954. This section required every mortgage of this type to contain a clause prohibiting sale of the land unless

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198 (1981), 16 Alta. L.R. (2d) 42 (Q.B.)

199 *Supra*, note 196.

CMHC approved of the sale. CMHC argued, among other things, that this section must be interpreted as creating an implied statutory restriction on alienation if the policy of providing low-income housing was to be adequately served. The Supreme Court of Canada rejected this argument. It viewed section 16(4)(g) as requiring CMHC to obtain a contractual restraint on disposition. "Had Parliament intended the provisions of the Act to have extra-contractual force, it would not have used the contractual mechanism as distinct from simply legislating against alienation."[200]

In a round-about way, the Court came to consider the effect of the clause prohibiting sale. The purchaser who bought from Town House Developments Ltd. wanted to prepay the mortgage according to a prepayment clause in that mortgage. The purchaser could only do this if the borrower was not in default under the mortgage. If the clause prohibiting sale was void, then the sale did not constitute a default under the mortgage, and the purchaser could prepay the mortgage. If it was valid, the sale did constitute a default under the mortgage, and the purchaser could not prepay the mortgage.

When considering the clause prohibiting sale, the Court held:[201]

> To the extent that the policy against restraints on alienation applies to contractual provisions that are not annexed to the land so as to run with the land, it does not render such provisions unenforceable for all purposes. Contractual provisions are simply ineffective to prevent the owner of land from conveying a good title to a purchaser but other *in personam* remedies remain available. I agree with the Court of Appeal that the Crown is not immune from the rule against restraints on alienation and therefore is in the same position as other parties in this regard. Accordingly, it has been held that breach of such an agreement can constitute an event of default under a mortgage which entitles the mortgagee to accelerate payment at his option. In *Canada Permanent Trust Co.* v. *King's Bridge Apartments Ltd.* (1984), 8 D.L.R. (4th) 152, the Newfoundland Court of Appeal held that a covenant not to

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200 *Ibid.* at 197.

201 *Ibid.* at 206-07.

> alienate could not restrict the mortgagor's right to sell or otherwise dispose of the property but "none the less a proviso permitting an acceleration of the repayment of the principal sum and other moneys payable under the indenture of a mortgage is valid and is enforceable at the option of the mortgagee" (p. 155). Similarly, in *Re Valley Vu, supra*, a mortgagor who sold contrary to such a covenant was denied an order permitting prepayment of the mortgage and a discharge. In *Paul* v. *Paul* (1921), 50 O.L.R. 211, the Ontario Court of Appeal held that a provision in a conveyance of land which prohibited sale or mortgage without consent did not render a sale without consent void but that an action for damages lay for breach of the covenant. See also *Re Bahnsen and Hazelwood* (1960), 23 D.L.R. (2d) 76 (Ont. C.A.).In my opinion, the principle applied in these cases strikes the proper balance between two conflicting policies. On the one hand there is a policy against restraints on alienation which permits real property to circulate freely in commerce and preserves the right of the owner to dispose of it and on the other the law favours that bargains be kept and not breached with impunity. Accordingly, notwithstanding that the impugned provisions are not enforceable to prevent the transfer of a good title to the purchasers, non-compliance with their terms constitutes a breach of the agreement for the purpose of triggering other remedies which the mortgagee has under the mortgage.

The Court held the 1988 sale and the placing of the second mortgage constituted a default under the mortgage. The purchaser could not prepay the mortgage granted by Town House Development Ltd.

It follows that a due-on-sale clause would be valid and would not be seen as a restraint on alienation. This reasoning is also supported by other case law that suggests due-on-sale clauses are not void as a restraint on alienation.[202]

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[202] See the cases referred to in footnote 196.

(iii) Relief from enforcement of due-on-sale clauses

(A) Section 18(1) of the Judicature Act

Although Alberta courts have decided that due-on-sale clauses are valid, they are quick to grant relief from the effects of such clauses. They grant relief by exercising their jurisdiction under section 18(1) of the Judicature Act to grant a stay of a foreclosure action. They will grant such relief when there is no evidence that the purchaser will commit waste or cause the premises to fall in disrepair.[203] In granting such relief the court will also consider the following factors:

1) Does the lender have ample security in the land?
2) Are the terms of the mortgage unconscionable?
3) Will the lender suffer hardship if the stay is granted?
4) Will the purchaser likely default with respect to future payments?[204]

In *Royal Bank of Canada* v. *Freeborn*, Turcotte J. held that due-on-sale clauses are contrary to the principle expressed in what is now section 150 of the Land Titles Act. In his opinion, this section permits the assignment of agreements for sale, mortgages and encumbrances, and consent of the vendor, lender or encumbrancer is not required. He concluded that the section relates to the assignment of the borrower's interest in a mortgage because section 150(2) provides that the rights of the owner of the mortgage are not affected until notice in writing of the assignment is given to him or her.[205] In that case there was no formal assignment of the borrower's interest as borrower. There was a transfer of land, however, and what is now section 62 of the Land Titles Act did imply a covenant that the

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203 *Royal Bank of Canada* v. *Freeborn, supra*, note 195.

204 *Bigam* v. *Milne, supra*, note 196.

205 This view may be incorrect. The section deals with the assignment of a contract of sale of a mortgage, not with the sale of the mortgagor's interest in land. The mortgage contract creates a debt obligation for the mortgagor, not an assignable interest that vests in the mortgagor. How can this debt obligation be assigned by the mortgagor\debtor?

transferee would pay the lender.[206] It is not clear from the decision what affect this section has. It seems to be a further justification for granting relief under section 18(1) of the Judicature Act.

(B) Section 39 of the Law of Property Act

In *Royal Bank of Canada* v. *Freeborn*, the court queried whether it could grant relief under section 19 of the Judicature Act,[207] which is now section 39 of the Law of Property Act. This query was answered in *Marine Water Wells Ltd.* v. *Dobson & Co. Refrigeration & Air Conditioning Ltd.*[208] The purchaser sought relief under section 44(8) of the Queen's Bench Act. This section is similar to section 39 of the Alberta Law of Property Act. When referring to section 44(8) the court held:[209]

> The section provides relief to a mortgagor where there is a default in payment or the observance of a covenant related to payment. It permits the breach to be remedied and upon being remedied the mortgage is reinstated. The section deals only with breach of such covenants which can be performed. It has no application in this case as the property has been sold. The breach of the covenant cannot be remedied.

(iv) The American position

In the United States the typical mortgage is a fixed rate mortgage of 15 to 30 years. Such mortgages protect the borrower from fluctuating interest rates but expose the lender to greater risk of loss. In times of high interest rates, some lenders were faced with financial ruin. To save themselves from this, they started enforcing due-on-sale clauses so that they could capitalize on the interest rates. Lenders can do this in two ways. They can call the loan and lend out the proceeds at a higher interest rate.

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206 This point has been overruled by *Collingwood Invt. Ltd. v. Bank of Amer. Can. Mtge. Corp., supra*, note 158. In that case, the Court of Appeal held that an implied covenant would not arise under section 62 of the Land Titles Act where an individual mortgagor sells to an individual who in turn sells to a corporation.

207 R.S.A. 1970, c. 193.

208 *Supra*, note 196.

209 *Supra*, note 196 at 244.

Alternatively, they can insist the purchaser pay a higher interest rate. The ability of lenders to capitalize on interest rates varied from state to state and from state level to federal level. Courts in the majority of states allowed the clause to be exercised for any reason including the pursuit of economic gain for the lender.[210] In these states the enforcement of due-on-sale clauses became an inexpensive means of bringing lenders' loan portfolios up to existing market rates. Courts in a minority of states allowed enforcement of the clause only when it was necessary to protect against impairment of the lender's security or to prevent increase in risk of default.[211] From this viewpoint, the purpose of such a clause was to protect a lender's security from impairment. It was not to allow a lender to capitalize on interest rates. Therefore, the minority position viewed the latter as an illegitimate ground for enforcing such a clause. Legitimate grounds for enforcing such a clause included: (1) sale to a high-risk purchaser; (2) possible exposure of the secured property to waste or depreciation; and (3) refusal of the purchaser to enter into an assumption agreement with the lender.[212]

The restrictions on enforcement of due-on-sale clauses created by statute[213] and case law only applied to state chartered financial institutions. Federally chartered financial institutions were governed by regulations issued by three federal depository institution regulators. These regulations allowed use and unrestricted enforcement of due-on-sale clauses. The different treatment of financial institutions led to a competitive advantage for federally chartered financial institutions. To eliminate this competitive advantage, Congress enacted legislation that overrides any state law restricting enforcement of due-on-sale clauses. There is a period of time in which state law will apply, but at the end of that period there will be no restriction on the enforcement of due-on-sale clauses.[214]

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210 Joseph Gibson, III, "Due-on-Sale Clauses: Separating Social Interests from Individual Interests" (1982) 35 Vanderbilt Law Review 357 at 357-59 and Robertson, *supra*, note 194 at 36-39.

211 *Wellenkamp* v. *Bank of America* (1978), 582 P. 2d 970 (Supreme Court of California).

212 Robertson, *supra*, note 194 at 37.

213 See the statutes cited in footnote 128 of Joseph Gibson III, *supra*, note 210.

214 Edwin Schmelzer, "The Preemptions for Alternative Mortgage Transactions and Due-on-Sale Clauses in the Garn-St. Germain Act" (1985) 102 Banking Law Journal 256.

Although the debate on enforceability of due-on-sale clauses has now been ended by the federal legislation, it is still useful to review the American literature. American borrowers and transferees challenged the validity of due-on-sale clauses on two fronts. The first challenge was that the clause was void as a restraint on alienation. In states where foreclosure was still governed by the rules of equity, they also argued that the enforcement of the clause was inequitable where the lender is using the clause as a lever to increase profits. The purpose of the clause is to protect the security of the lender. It is inequitable to allow it to be used for some other purposes.

The policy arguments that supported unrestricted enforcement of due-on-sale clauses were the following:

1. A lender can enforce a due-on-sale clauses because otherwise it would be subject to a double risk. If interest rates increase, the lender is bound by its contract. Yet if interest rates decrease, the borrower can prepay the mortgage. The lender is left with funds that must be reinvested at a lower rate of interest. Allowing enforcement of due-on-sale clauses enables the lender to benefit when the interest rate rises. This offsets the borrower's ability to pay out the mortgage when the interest rate falls.[215]

2. A due-on-sale clause is not a restraint on alienation. All it does is prevent the borrower from getting an increase in price based on the existence of a below market interest rate. The borrower is always able to sell the property for the price that the property is worth if the purchaser must refinance at a higher rate.[216]

3. Even though the clause imposes a restraint, it is a reasonable one and therefore valid. A lender decides to make a loan on the basis of the value of the security and the qualities of the borrower. The right of the lender to protect its security by maintaining the identity and financial responsibility of the borrower is a legitimate business objective.[217]

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215 "Enforcement of Due-on-Transfer Clauses" (1978) 13 Real Prop., Prob. and Trust J. 891 at 896.

216 *Ibid.*

217 *Ibid.* at 910.

4. A due-on-sale clause is supportive of public policy. "Potential failure of savings and loans associations and loss of their depositors' funds should be of no less a concern to the courts than the inability of a property owner to transfer its mortgage at a premium when selling its property. Balancing portfolio return with cost and money is an important factor in the survival of lending associations. The due-on-sale clause is an important device in obtaining that balance."[218]

5. A party to a contract is bound by the terms of the contract. The court does not have the power or the desire to rewrite the mortgage contract containing a due-on-sale clause. The borrower is merely trying to keep the unbargained right to sell the loan.[219]

6. Allowing enforcement of every due-on-sale clause according to its terms creates needed certainty in commercial transactions. It avoids the necessity of a case-by-case analysis.[220]

7. It is economically irrational to have similar properties of different value because of something unrelated to their productivity, namely, an assumable mortgage. Yet if a property is charged by a mortgage with a below market interest rate, the property will have a higher value. Automatic enforcement of due-on-sale clauses would prevent this result.[221]

8. Many authors argue that a variable rate mortgage is a better device to deal with rising interest rates than a due-on-sale clause. Some authors question this statement.[222] If lenders know that such a clause is enforceable, they can base the interest rate on their market projections for the period the average owner lives in a house. This will be a much shorter period than the average term of a mortgage. For example, in California the

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218 *Century Federal Savings & Loan Ass'n v. van Glahn*, (N.J., 1976) quoted by W.B. Dunn and T.S. Nowinski "Enforcement of Due-on-Transfer Clauses: An Update" (1981) 16 Real Property Probate and Trust Journal 291 at 312.

219 "Enforcement of Due-on-Transfer Clauses", *supra*, note 215 at 907.

220 *Ibid.* at 908.

221 J. F. Bonanno, "Due on Sale and Prepayment Clauses in Real Estate Financing in California in Times of Fluctuating Interest Rates—Legal Issues and Alternatives" (1972) 6 U. San. Francisco L. Rev. 267.

222 "Enforcement of Due-on-Transfer Clauses", *supra*, note 215 at 930.

average home is sold every 4 or 5 years. The average mortgage term exceeds 15 years.[223] The interest rate based on this shorter period should be lower than the rate for the longer period. It is simply more difficult to gage the market for an extended period. This increased risk must be reflected in the interest rate.[224]

9. At the time the lender makes the mortgage loan, the borrower is concerned with the interest rate and the size of the monthly payment. He or she is not thinking of using the mortgage to facilitate an advantageous sale to a purchaser. It is wrong to think that the device used to purchase a home is also the device used to facilitate a sale.[225]

10. Due-on-sale clauses benefit only those who are lucky enough to find a low interest mortgage to assume and who have the funds to buy out the borrower's equity. Typically, it is only the well-to-do that have the funds to pay a large down payment. Automatic enforcement of due-on-sale clauses would eliminate this discrimination between the well-to-do and the less fortunate who must finance at the going higher interest rate.[226]

The policy arguments in favour of restricted enforcement of due-on-sale clauses include:

1. Some authority reasons that a lender can enforce a due-on-sale clause because it is subject to a double risk. This double risk is a fallacy. Most lenders put a clause in the mortgage that requires a borrower to pay three to six months interest if he or she prepays the mortgage. This makes it uneconomical for most borrowers to prepay the mortgage unless the interest rates fall substantially. In reality, a lender has the ability to enforce a due-on-sale clause if the interest rate rises but protects itself against loss due to prepayment when interest rates fall by insisting on a substantial prepayment penalty.[227]

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223 R.L. Cohen "Judicial Treatment of the Due-on-Sale Clause: The Case for Adopting Standards of Reasonableness and Unconscionability" (1975) 27 Stanford Law Review 1109 at 1111.

224 "Enforcement of Due-on-Transfer Clauses", *supra*, note 215 at 930.

225 Nelson, G.S., *Real Estate Finance Law*, 2nd ed. (1985) at 318.

226 *Ibid.* at 318-19.

227 Cohen, *supra*, note 223.

2. Lenders undertake the risk of extended inflation and a competitive money marketplace. Lenders must make their long-term projections on future economic conditions and set the interest rates on their long-term loans in accordance with these projections. The due-on-sale clause should not be used to provide further insurance against these foreseeable hazards.[228]

3. Automatic enforcement of due-on-sale clauses allows the lender to make a profit from an involuntary transfer arising out of the misfortunes of the borrower. Automatic enforcement would allow acceleration of the debt when there is a transfer to a spouse upon death of borrower, a transfer to the spouse who becomes co-owner, and a transfer to a spouse as settlement of a matrimonial property action.[229]

4. The borrower has a right to the benefit of the long-term low interest loan secured by a land mortgage that he or she has bargained for. It is poor law to say that because the lender will benefit from repayment, the borrower should be deprived of the increased marketability of the property and the increased value of the property attributable to the low interest long-term mortgage.[230]

5. Automatic enforcement of due-on-sale clauses harms the needy borrower. When a borrower encounters financial difficulty, he or she will struggle to make the mortgage payments but will have no money for upkeep and repair of the property. The risk of waste is greatest at this time. A sale to a credit-worthy purchaser will benefit the lender by eliminating the risk of waste and default. However, automatic enforcement of due-on-sale clauses would allow the lender to exact prepayment penalties from the needy borrower and loan fees and increased interest from the purchaser. This eats into the needy borrower's equity when it is most important to her or him.[231]

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228 *Ibid.* at 117.

229 Bonanno, *supra*, note 221 at 290.

230 "Half-way Mark Reached in the Demise of the Inequitable Application of the 'Due-on-Sale' Clause" (1975) 3 Pepperdine Law Review 111 at 119-20.

231 *Ibid.* at 121-22.

6. Automatic enforcement of due-on-sale clauses interferes with the owners ability to freely sell and transfer property.[232]

7. "The underlying purpose of any provision in a mortgage instrument is to protect the security of the lender, and unless the conduct of the borrower in transferring the property has posed a risk to that security purpose, enforcement will not be granted. It is the burden of the lender to prove a resulting impairment to one of its legitimate interests."[233] Obtaining a higher interest rate than that contracted for is not a legitimate interest of the lender.

8. The rule against restraints on alienation arose out of the need to protect society's interest in the unfettered transferability of real property. Courts should not focus on how the enforcement of due-on-sale clauses affects the borrower. Instead, courts should focus on how the enforcement of due-on-sale clauses affects society as a whole. One author argues that the clauses are restraints on alienation because they cause the borrower to stay in the property so the borrower can reap the benefit of his or her bargain.[234] This, in turn, may prevent the most efficient distribution of personnel throughout the United States. If the lender can protect its need to adjust to rising interest rates in other ways there is no need to allow automatic enforcement of due-on-sale clauses.

When considering whether the American policy arguments are applicable in Canada, one must remember the marked difference between the American and Canadian money markets. Although long-term mortgages on residential properties are still available in the United States, they have not been available in Canada for many years. Our market is characterized by short-term mortgages with amortization periods that greatly exceed the term of the mortgage. After the expiry of each term, the interest rate is changed to reflect the existing market rate. Another difference in Canada is the ability to prepay the mortgage. The American writers imply that the borrower can prepay the mortgage at any time. In Canada the right to prepay does not exist outside the contract except for mortgages with terms that exceed five years. Most mortgages that allow prepayment also provide

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232 *Ibid.* at 130.

233 "Enforcement of Due-on-Transfer Clauses", *supra*, note 215 at 909-10.

234 Joseph Gibson, III, *supra*, note 210.

for the payment of a penalty upon prepayment. In short-term mortgages this prepayment penalty has the effect of locking in the mortgage. That is, the size of the penalty (usually three to six months interest) makes it uneconomical to prepay the mortgage unless the mortgage rate falls dramatically. It is cheaper to wait until the term expires.

These differences in the money markets make inapplicable some of the American policies supporting automatic enforcement of due-on-sale clauses. In Canada lenders keep their mortgage portfolios up to date by using short-term mortgages. Due-on-sale clauses are not needed for this purpose. Also, in Canada lenders are not exposed to a double risk if due-on-sale clauses are unenforceable. Lenders get the advantage if market rates fall because the prepayment penalty acts as a lock-in for short-term mortgages. Lenders suffer a disadvantage when market rates rise.

(3) Sale

(a) Judicial sale of land

A foreclosure action is usually undefended. Commonly a defendant will file a demand of notice.[235] Where sections 41 and 42 of the Law of Property Act apply,[236] the lender will in due course ask for an order nisi/order for sale in accordance with section 41(2)(a), which (again with the references to agreements for sale deleted) reads as follows:

> In an action brought on a mortgage
>
> (a) the order nisi shall direct that if the defendant fails to comply with the terms of the order, the land that is subject to the mortgage is to be

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235 Rule 146 of the Alberta Rules of Court provides that where a defendant files a demand of notice, the plaintiff may proceed as if the defendant had failed to defend, except that he must receive notice of all subsequent motions against him and judgment cannot be obtained without prior notice to him. In a foreclosure action, the filing of a demand of notice is effectively an admission of liability, but it gives the defendant the right to appear and argue at any application before the court.

236 E.g., the mortgage was granted to secure a loan under the National Housing Act, or the mortgagee is the Crown or a Crown agent, or the original mortgagor was a corporation and the transferee does not qualify for protection under sections 43(1.1) and 43(3) of the Law of Property Act and there has been no renewal.

> offered for sale at a time and place, in a manner, after any advertisement for sale, and at any price the Court considers proper.

Where section 41(2)(a) applies and the borrower does not consent to an immediate order for foreclosure, the court cannot dispense with the requirement that the land be offered for sale and instead allow immediate foreclosure.[237] The sale aspect of the order nisi is not merely procedural but is a substantive requirement of the order. The manner, time and place of sale, however, are procedural matters within the court's discretion.

Where section 41(2)(a) does not apply (as, for example, in the case of a National Housing Act mortgage), the lender may apply for an immediate order for foreclosure, but the court still has the power to order a sale by virtue of Rule 495, which provides that:

> Where in any proceeding relating to any real estate it is necessary or expedient that the real estate, or any part thereof be sold, the court may order it to be sold and any party bound by the order and in possession of the real estate or in receipt of the rents and profits thereof may be compelled to deliver up the possession or receipts to the purchaser or such other person as the court directs.

In deciding whether to order a sale or to allow immediate foreclosure, the court will consider the extent of the borrower's equity, if any, and the interests of any subsequent encumbrancers.

Notwithstanding that the borrower or present registered owner is an individual and that section 41(2) would otherwise require that the mortgaged land be offered for sale, section 42.1 of the Law of Property Act[238] now authorizes the court to make an immediate order for foreclosure if the mortgaged land is transferred while the mortgage is in default or within four months prior to default, or if the land is abandoned or

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237 *First Investors Corp.* v. *64675 Alberta Ltd.* (21 November 1984), Edmonton No. 8403-13120 (Alta. Q.B.).

238 Section 42.1 was one of the 1984 amendments to the Law of Property Act that was aimed at frustrating "dollar dealers" (see Law of Property Amendment Act, S.A. 1984, c. 24, s. 2).

is undeveloped land other than farm land. Section 42.1 was enacted to counter the abuse of the system by dollar dealers.[239]

To return to the situation where section 41 applies to require a sale, or where the court exercises its power to order a sale, the order nisi/order for sale will fix a redemption period. This is the time during which the borrower, a subsequent encumbrancer or some other person entitled to do so[240] may redeem the mortgage by paying the amount outstanding. Section 42 of the Law of Property Act calls for a redemption period of one year from the date of granting of the order in the case of farm land and six months from such date in the case of land other than farm land. On application, however, the court may decrease or extend the redemption period having regard to the circumstances enumerated in section 42(2). In a case where the court orders a sale, but section 42 does not apply so as to determine the redemption period (e.g. the borrower is a corporation), the court will set a redemption period that is reasonable in the circumstances.[241]

If the mortgage debt has not been paid at the expiration of the redemption period, ordinarily, the land is then advertised for sale in the manner directed by the court. The court typically orders that there be sale by judicial listing or sale by tender. Tenders are not irrevocable and may be withdrawn at any time prior to acceptance by the court.[242] Although the purpose of advertising is to attract a third-party purchaser, it has been confirmed by the Alberta Court of Appeal that the plaintiff lender may tender in a judicial sale, either with or without leave of the court.[243] The reasonableness of any offers to purchase or tenders that are received is assessed on the basis of appraisals of the land contained in affidavits of

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239 See Chapter 3 at 32 & 35 and Chapter 6 at 160.

240 Other entitled persons include an assignee of the mortgagor's equity of redemption, an execution creditor who has filed a writ in the land titles office, a tenant of the mortgaged premises and a guarantor who has made payments on the mortgage.

241 *Tessier* v. *Van Ed Block Dev. Ltd.* (1982), 48 A.R. 81 (M.C.).

242 *Allen* v. *Greaves* (1982), 44 A.R. 300 (M.C.).

243 *Canada Perm. Trust Co.* v. *King Art Dev. Ltd. et al.*, *supra*, note 82.

value filed by the parties.[244] An offer or tender that is acceptable to the plaintiff lender (because it covers the amount owing under the mortgage) might be considered too low by the borrower or a holder of a subsequent encumbrance, who may oppose acceptance and ask for re-advertising. The final decision rests with the court.

If an offer or tender acceptable to the lender is received, the lender will apply for an order confirming sale. The pronouncement of such an order irrevocably terminates the borrower's equity of redemption.[245] It does not, however, extinguish the mortgage debt. Thus, if any deficiency remains after application of the sale proceeds, and if section 41 of the Law of Property Act does not apply to bar action on the personal covenant, the lender can obtain judgment against the borrower for the deficiency. This is true even where the purchaser of the mortgaged land is the lender himself.[246] If the lender holds a guarantee of the mortgage debt, then the lender can, of course, obtain judgment against the guarantor for any deficiency after sale regardless of whether section 41 applies.

(b) Direct sale to the lender

The lender is permitted to tender in a judicial sale. An alternative procedure, which culminates in the granting of a so called Rice order, was established in *Trusts & Guar. Co.* v. *Rice*[247] and confirmed in the *King Art* case.[248] This alternative procedure is available where judicial sale proceedings have proved abortive or the court otherwise considers it appropriate (e.g. where there is no possibility of redemption and it would be fairer to all parties to expedite the matter by a direct sale to the lender).

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244 The plaintiff mortgagee must file an affidavit of value, usually before applying for an order nisi/order for sale. The affidavit is to be sworn by an independent appraiser, who must state his qualifications, and his appraisal report is normally attached as an exhibit. A defendant may file his own affidavit of value if he disagrees with the plaintiff's. Such evidence of value is used by the court in fixing the redemption period and deciding whether to grant a final order for foreclosure, as well as judging the reasonableness of tenders.

245 *Morguard Mortgage Investments Limited* v. *Faro Development Corporation Ltd.*, [1975] 1 W.W.R. 737 (Alta. C.A.).

246 *Canada Perm. Trust Co.* v. *King Art Dev. Ltd. et al.*, *supra*, note 82.

247 *Supra*, note 45.

248 *Supra*, note 82.

This procedure allows the lender to place a proposal to buy the mortgaged land before the court. It is available only if both of the following conditions are met:

(a) The value of the property is less than the amount outstanding on the mortgage and any prior encumbrances.[249] If the value is the same or more, the appropriate remedy is a final order for foreclosure. At the same time, however, the property must be worth more than the amount owing on prior encumbrances.[250] If it is worth less, the lender should abandon its claim against the land and pursue whatever remedies it may have on the covenant to pay or other security.

(b) The lender's remedies must not be limited to the land. It must have recourse to covenants or other security so that it will be able to realize on any deficiency.

The court will not accept a lender's proposal to purchase at less than the fair value.[251] If the proposal is acceptable, the court will grant an order providing for sale of the property to the lender and a deficiency judgment. Where appropriate, execution of the order will be stayed (usually for two months) to allow the borrower or guarantors, if any, an opportunity to bring in a better offer. Except in cases where a stay is granted, sale to the lender under a **Rice** order irrevocably terminates the borrower's equity of redemption just as an order confirming a sale by tender does. If a stay is granted and the borrower does bring in a better offer, the sale to the lender is rescinded. If no better offer is brought forward, the borrower's equity of redemption is irrevocably terminated upon expiration of the stay of execution.[252] For a more detailed discussing of the Rice order procedure refer to Chapter 8.

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249 *Toronto Dominion Bank* v. *Olson* (6 October 1983), Edmonton No. 8203-26357 (Alta. Q.B.).

250 *Co-operative Mortgage Fund Ltd.* v. *K. Mac C Investments Ltd. and MacCrimnon* (1983), 43 A.R. 144 (M.C.).

251 Fair market value is an important factor to consider when determining the fair value. Yet, it is not the only factor. See *Manufacturers Life Insurance Company* v. *Daon Development Corporation* (1989), 65 Alta. L.R. (2d) 40 (C.A.).

252 *First Investors Corp. Ltd* v. *Golden Key Rental Co. Ltd.* (1982), 39 A.R. 592 (M.C.); *C.M.H.C.* v. *Edinburgh House Apartments Ltd. et al.* (1992), 112 A.R. 104, aff'd (1993), 135 A.R. 244 (Alta. C.A.).

(c) Private sale by lender

It is not unusual for a mortgage contract to give the lender the power to sell the mortgaged land upon default by the borrower. Under Alberta's present legislation, however, the lender's ability to exercise its contractual power of sale is limited. To begin with, unlike the old common-law mortgage, the Torrens system mortgage does not convey title to the mortgaged land to the lender. The lender has a charge on the land only. In order to pass title, the Land Titles Act requires a transfer of land executed by the owner (ss 56 and 68(1)) or by the holder of a power of attorney executed by the owner (s. 115). Further, even if the lender does hold a transfer executed by the borrower and the latter remains the registered owner, it has been indicated, in *Co-op Centre Credit Union Limited.* v. *Greba*,[253] that the lender cannot use the transfer to pass title to itself if section 41 of the Law of Property Act applies to the mortgage. The basis of this view is that section 41(2) requires a court-conducted sale and section 41(5) declares any waiver or release of the protection given by section 41(2) to be "against public policy and void". Thus, the Alberta Court of Appeal in *Greba* concluded that a lender cannot exercise any form of extrajudicial sale process where the borrower is an individual who is protected by section 41.

Where section 41 does not apply, a lender may exercise a contractual power of sale as long as the lender has the means of conveying title to the purchaser. The lender will be able to register a transfer of land and, thereby, convey title to the purchaser in two situations. First, in situations where the lender has in its possession a transfer executed by the borrower.[254] Second, where the borrower has granted a power of attorney to the lender which empowers him or her to execute the transfer on behalf of the borrower.[255] Where an irrevocable power of attorney is granted by a corporation in a mortgage and is to take effect when certain conditions occur, a lender must file a certificate setting out the information required by section 115(5) of the Land Titles Act. Registration of a transfer executed by the borrower or his or her attorney will not extinguish subsequent encumbrances.

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253 *Supra*, note 86.

254 *Ferris* v. *Nowitskey* (1951), 3 W.W.R. (N.S.) 49 (Alta. S.C.T.D.) aff'd (1951), 3 W.W.R. (N.S.) 702 (Alta. S.C.A.D.).

255 See section 115 of the Land Titles Act, R.S.A. 1980, c. L-5.

Again where section 41 does not apply, if the lender has a power of sale but does not have the transfer or power of attorney required by the Land Titles Act to pass title, it is possible for the lender to obtain the court's assistance in effecting an extrajudicial sale.[256] An application may be made by originating notice under section 180(1) of the Land Titles Act, which states:

> In any proceedings respecting land or in respect of any transaction or contract relating thereto, . . . the judge by decree or order may direct the Registrar to cancel, correct, substitute or issue any duplicate certificate or make any memorandum or entry thereon or on the certificate of title and otherwise to do every act necessary to give effect to the decree or order.

The court assists the lender by directing the Registrar to cancel the existing title and to reissue it in the name of the purchaser. The result is a conveyance of title (not a foreclosure) and the rights of other parties are not extinguished. If the lender seeks an order that the title be transferred free and clear of subsequent encumbrancers, the order must be refused. The court does not approve the sale or the sale price because it is not asked to and does not have the authority to do so. A borrower who wishes to challenge the propriety of the sale can do so in other proceedings. However, the lender must prove that there is a genuine sale for the court does not wish to be used as a tool in a fraudulent scheme.[257] In situations where the sale would appear to prejudice subsequence encumbrances, the order has been refused.[258]

In the majority of receiverships, the receiver, as agent of the lender, seeks an order transferring title free and clear of subsequent encumbrances,

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256 *Alberta Treasury Branches and Coopers & Lybrand Limited* v. *Ryan Construction Ltd.*, [1983] 3 W.W.R. 137, 24 Alta. L.R. (2d) 286; *Clarkson Company Limited* v. *Wiebe Hldg. Ltd.* (1983), 26 Alta. L.R. (2d) 390 (Q.B.); *First Investors Corporation Ltd.* v. *Regional Investments Ltd. and Pawluk* (1985), 58 Alta. L.R. (2d) 159 (C.A.); W.S. Connauton and R.I. Swainson, "The Power of Sale Contained in Security Documentation which is Granted by a Corporation", LESA, Banff Refresher Course, "Foreclosure Practice", 1985.

257 *First Investors Corporation Ltd.* v. *Regional Investments Ltd. and Pawluk, ibid.*

258 *Femco Fin. Corp. Ltd. and Thorne Ridell Inc.* v. *Femco Ventures Ltd. et al.* (1983), 43 A.R. 100 (Q.B.).

and therefore, the receiver cannot make application under section 180 of the Land Titles Act or merely register a transfer of land. Where there are subsequent encumbrances, the receiver often combines an action for a court appointment of the receiver with a foreclosure action. Both causes of action are pursued in one Statement of Claim. When it comes time to sell the land charged by the debenture, the receiver makes application for an order for an immediate sale to the interested purchaser. This is a remedy available to a lender where the borrower is a corporation. At that time the receiver must prove that the sale price is fair and that an immediate sale is justified.

(4) Foreclosure

(a) Where section 41(2) applies

As stated above, section 41(2)(a) of the Law of Property Act calls for an order nisi directing that the mortgaged land first be offered for sale. Section 41(2)(b) (with references to agreements for sale deleted) goes on to provide that:

> If the land is not sold at the time and place so appointed, the Court may either order the land to be again offered for sale or make a vesting order, and on the making of a vesting order, every right of the mortgagee for the recovery of any money whatsoever under and by virtue of the mortgage ceases and determines.

Thus, if the first advertisement for sale has not produced any acceptable tenders, the court may either order re-advertising or grant a vesting order (i.e. a final order for foreclosure). The latter course will usually be followed where the value of the land is less than the amount of the lender's claim. Conversely, where the value exceeds the claim, and the borrower or a subsequent encumbrancer so requests, the court will generally order that the land be re-advertised. In the event that this too fails to result in a sale, the court may refuse to allow a further re-advertising, notwithstanding evidence that the property is worth more than the mortgage debt. As stated in *Ball* v. *Group 77 Invts. Ltd.*,[259] if the land cannot be sold or cannot be sold for its value, an order for foreclosure should be granted.

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[259] (1982), 45 A.R. 149 (M.C.) at 151.

(b) Where section 41(2) does not apply

As previously discussed, in certain situations the court has the discretion to grant an immediate order for foreclosure without first requiring the land to be offered for sale. This discretion exists in the circumstances set out in section 42.1 of the Law of Property Act or if section 41 does not apply to the mortgage.

(c) Effect of a final order for foreclosure

(i) General discussion

Section 44(1) of the Law of Property Act provides that:

> The effect of an order of foreclosure of a mortgage or encumbrance is to vest the title of the land affected thereby in the mortgagee or encumbrancee free from all right and equity of redemption on the part of the owner, mortgagor or encumbrancer or any person claiming through or under him subsequently to the mortgage or encumbrance, and
>
> (a) the order operates as full satisfaction of the debt secured by the mortgage or encumbrance, and
>
> (b) the mortgagee or encumbrancee shall be deemed a transferee of the land and becomes the owner thereof and is entitled to receive a certificate of title for it.

As indicated in Chapter 3, section 44(1) was originally enacted in 1919 in response to the decision of the Supreme Court of Canada in *Douglas* v. *Mutual Life Assur. Co.*[260] By virtue of section 44(1), the granting of an order for foreclosure not only vests title to the mortgaged land in the lender free of all subsequent encumbrances but also extinguishes the debt secured

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[260] *Supra*, note 38, in which it was held that a mortgagee could sue on the covenant to pay contained in a mortgage after obtaining an order for foreclosure, as long as he was in a position to reconvey the land.

by the mortgage.[261] It does not merely bar action to recover the debt. Further, even if not barred by section 41, no deficiency judgment can then be obtained. If judgment has been obtained at an earlier stage in the proceedings, it will be satisfied by the operation of section 44 upon granting of the order.[262] It has, therefore, been noted that if a lender wishes to take a final order for foreclosure but has a guarantee or borrower's covenant on which it wishes to realize, the lender must first complete its realization on the guarantee, including execution on any judgment obtained against the guarantor.[263] This is of particular relevance where the borrower is a corporation as section 41 would not apply to bar an action on the covenant. If a foreclosure order is made, however, section 44 will effectively put an end to the lender's right to such an action by extinguishing the debt.

Section 44(1)(b) states that upon obtaining an order for foreclosure, a lender "shall be deemed a transferee of the land". In *Guarantee Trust Company of Canada* v. *Bailey*,[264] a lender obtained a foreclosure order and, thereby, took title to land subject to a prior mortgage. The Alberta Court of Appeal indicated that such a lender is not a transferee within the scope of section 62(1) of the Land Titles Act (i.e. the lender does not become liable under any of the implied covenants). It has also been held, however, that such a lender is a transferee within the scope of section 42.1 of the Law of Property Act, which provides for an immediate order for foreclosure in certain circumstances. Thus, in a case where a second lender took title by foreclosure and then immediately defaulted in payments on the first mortgage, the first lender was allowed to take advantage of section 42.1 to

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261 It has been held that the term "debt secured by the mortgage" encompasses any costs incurred by the mortgagee in taking legal proceedings to enforce the mortgage. Thus, in a case where the mortgagee had obtained a final order for foreclosure, its subsequent application for costs was dismissed. Notwithstanding that the mortgage provided for the payment of costs by the mortgagor on a solicitor-client basis: *Investors Group Trust Co. Ltd.* v. *Hroshi Invts. Ltd.* (1985), 36 Alta. L.R. (2d) 171, 59 A.R. 230 (M.C.).

262 In the *King Art* case, *supra*, note 82, the Alberta Court of Appeal confirmed that a court-ordered sale of the mortgaged land to the mortgagee does not constitute a final order for foreclosure, so that a deficiency judgment is available following such a sale (if not barred by section 41).

263 Price and Trussler, *supra*, note 101 at 233.

264 *Supra*, note 151.

short-circuit foreclosure proceedings against the second lender.[265] So a foreclosing lender can be a transferee for one purpose but not for others.

(ii) Foreclosure orders and guarantees

If a third party has guaranteed payment of the mortgage, the lender must consider what effect a foreclosure order will have on the liability of the guarantor. One starts with the proposition that the obligations of the borrower and guarantor are distinct and separate. In theory, it is possible to draft a guarantee of a mortgage so that the obligations of the guarantor exist after the debt is satisfied by a foreclosure order. Yet, it is hard to imagine such a clause.[266] To date, no guarantee has been sufficient to keep the guarantor liable.[267] For example, in *Style Properties Ltd.* v. *220293 Developments Ltd. and McKillop*,[268] a clause in the guarantee of the mortgage provided that the guarantor waives all defences except the defence that the sum claimed has actually been paid to the lender. The court held that the effect of the foreclosure order was to satisfy the debt secured by the mortgage. If the debt is satisfied, it is as if it had been fully paid. The guarantee, as drawn, did not survive the payment of the mortgage. Justice Stevenson dissented on the basis that the clause provided that actual payment was the only defence available to the guarantor. In his opinion, actual payment did not include notional payment.

Of most interest was the obiter comments made by the majority of the court. The majority thought that, at the very least, if the guarantee is to survive a final order of foreclosure, it must bring to the guarantor's attention the fact that he or she was waiving protection afforded under the Law of Property Act.[269] Even if this is done, the majority queried whether

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265 *First Investors Corp. Ltd.* v. *Rainbow Mtge. & Loan Fund Ltd.* (Sept. 10, 1984), Edmonton No. 8404-18461 (Alta. Q.B.).

266 *Canada Perm. Trust Co.* v. *King Art Dev. Ltd. et al., supra*, note 82 at 644.

267 *Herron* v. *Cardston Credit Union Ltd.* (1984), 54 A.R. 94 (C.A.); *Style Properties Ltd.* v. *220293 Developments Ltd and McKillop* (1986), 67 A.R. 154 (C.A.); *First National Mortgage Co. Ltd.* v. *L.J.V. Holdings Ltd.* (1989), 58 D.L.R. (4th) 234 (Alta. C.A.).

268 *Ibid.*

269 The Court of Appeal re-emphasized this point in *First National Mortgage Co. Ltd.* v. *L.J.V. Holdings Ltd., supra*, note 267.

it is against public policy to allow a guarantor to waive the protection of section 44(1) of the Law of Property Act. Furthermore, even if the guarantor's obligation survives foreclosure, the lender cannot sue unless it is in a position to convey title.

(iii) Foreclosure orders and leases

When rents are falling in the marketplace, a lender may wish to enforce leases that came into existence after the mortgage was granted. When rents are increasing in the marketplace, a lender generally will want vacant possession of the premises so that it will have the option of re-leasing the premises for a higher rent. When seeking a foreclosure order, the lender must decide if it wishes to enforce such leases. The wording of the foreclosure order will depend on the result it seeks.

The governing rule is ". . . where a lease takes effect as an interest in land subsequent to a mortgage of that property, an order for foreclosure will render the lease unenforceable unless it is expressly preserved in the order and privity between the mortgagee and lessee has been established".[270] The mere existence of a term in the foreclosure order preserving the lease is insufficient. Something more is necessary: privity of estate between the lender and tenant. Privity of estate between the lender and tenant is created when the landlord absolutely assigns his or her interest as landlord to the lender. When the assignment of the landlord's interest is drafted so that it does not survive the satisfaction or termination of the mortgage (caused by the acts of the parties or by the law), it cannot survive a foreclosure order.[271] An assignment of rents does not create privity of estate.[272]

It is not necessary that privity of estate exist before the foreclosure order. It is sufficient if the privity of estate arise at the time of the foreclosure order, as where the order itself contains an assignment of the

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270 *Re Manufacturer's Life Insurance Co. and J.K.P. Holding Co. Ltd.* (1986), 26 D.L.R. (4th) 461 at 466 (C.A.).

271 *Integrated Building Corp. Ltd.* v. *The Marcil Group Ltd.* (1989), 100 A.R. 318 (C.A.).

272 *Lavalin Services Inc.* v. *National Life Ass'ce Co. of Canada* (10 April 1984), Appeal #16008 (Alta. C.A.).

landlord's interest in the lease.[273] Query whether the court has any jurisdiction to assign the landlord's interest in a lease to the lender.

(d) Right of redemption after foreclosure

Section 44(5) of the Law of Property Act states that

> No order of absolute foreclosure made in an action shall be deemed to deprive any court of any power that the court had immediately before May 17, 1919, to reopen the foreclosure.

On May 17, 1919, what is now section 44(1)(a) of the Law of Property Act came into force. This section provides that the granting of a final order for foreclosure extinguishes the mortgage debt. Up to that time, the court had a discretion to allow redemption by the borrower after a foreclosure order had been granted. With the enactment of what is now section 44(1)(a), it could be argued that the borrower loses the right to redeem once a foreclosure order is granted because the debt is satisfied.[274] To preclude this argument, the legislature enacted in 1928 what is now section 44(5) of the Law of Property Act. This section confirms the court's jurisdiction in equity to reopen a foreclosure order and allow the borrower to redeem under proper circumstances.[275] In accordance with equitable principles, redemption will not be allowed if the lender has transferred title to the property to a *bona fide* purchaser prior to the offer to redeem, or if the borrower has waited too long to make the offer.[276]

As previously mentioned, the granting of an order approving and confirming a sale irrevocably extinguishes the borrower's equity of

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273 *Excelsior Life Insurance Co.* v. *C.I.B.C.* (1988), 59 Alta. L.R. (2d) 107 (C.A.).

274 In *Mackie* v. *Standard Trusts Co.*, [1922] 1 W.W.R. 566 (Alta. S.C.A.D.) this argument was made. The Appellate Division held that the mortgagor's right to redeem after foreclosure is not dependant on the existence of the debt. Even if it was, the mortgagor's right to redeem was complete before the subsection was enacted.

275 *Morguard Mtge. Invt. Ltd.* v. *Faro Dev. Corp. Ltd., supra,* note 225; *Guaranty Trust Company of Canada* v. *Berger*, [1972] 4 W.W.R. 148 (Alta. S.C.T.D.); *Brattberg* v. *Royal Bank of Canada* (1988), 64 Alta. L.R. 117 at 119 (C.A.).

276 *Mackie* v. *Standard Trusts Co., supra*, note 274 and *Brattberg* v. *Royal Bank of Canada, ibid.*

redemption. Thus, the court has no discretion to allow redemption after making such an order (unless the sale is to the lender and a stay of execution is granted). If the order is unimpeached, the court lacks the power to vary it or allow the borrower to redeem. It is only if the sale has been abortive and an order of absolute foreclosure has been made vesting title in the lender, that the equitable jurisdiction to permit redemption survives.[277]

(5) Taking possession

Under the common-law concept of mortgage (i.e. where a mortgage is a conveyance of the legal estate in the mortgaged land to the lender), the right to possession is part of the lender's legal estate. As such, that right is not in the nature of a remedy for enforcing the mortgage and is exercisable regardless of whether the borrower is in default.[278] Under Alberta law, however, a mortgage constitutes a charge only[279] and the lender has no such right to possession. In order to obtain possession in foreclosure proceedings, the lender must bring action for it. The actions for foreclosure and possession are usually combined; the prayer for relief includes a request for an order for possession.

An order for possession is ordinarily given at the end of the foreclosure action and only then is the lender entitled to possession of the mortgaged premises. This appears to be true even if the mortgage contract provides, as is often the case, that the lender may take possession upon default being made.[280] It is certainly true if the mortgage is one to which section 41 applies, at least, if reference is had to the decision of the Alberta Court of Appeal in *Co-op Centre Credit Union Ltd.* v. *Greba*[281] (which has already been discussed above with respect to the lender's power of sale). In that case the borrowers (individuals) had given the lender a registrable transfer of the mortgaged property with permission to register it upon

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277 *Morguard Mtge. Inv. Ltd.* v. *Faro Dev. Corp. Ltd.*, *supra*, note 225.

278 P.V. Baker & P. St. J. Langan, *Snell's Principles of Equity*, 28th ed. (London: Sweet & Maxwell, 1982) at 400-01.

279 Land Titles Act, R.S.A. 1980, c. L-5, s. 106.

280 Price and Trussler, *supra*, note 101 at 291-92.

281 *Supra*, note 86.

default under the mortgage. When default occurred, the lender registered the transfer and sought an order for possession. In refusing to grant the order, the court held that where section 41 applies, as it did here, a lender's right of possession is not exercisable except through foreclosure proceedings. The transfer was declared void. Where section 41 does not apply, however, it may be that in circumstances like those in the *Greba* case, a lender would be able to obtain title and possession by registering the transfer.[282]

If the mortgaged premises are occupied by a tenant under a lease registered prior to the mortgage, foreclosure of the mortgage will not affect the lease. Nor will an unregistered lease that is prior in time be affected, if it is for a term of three years or less and the tenant is in actual occupation.[283] If, however, a lease for more than three years is registered after the mortgage, then by section 98(4) of the Land Titles Act the lender is not bound by the lease unless the lender consents to it prior to its registration or subsequently adopts it. As discussed earlier, in foreclosure proceedings, a lender's course of action with respect to a subsequently registered lease will depend on whether or not it wishes to keep the tenant in the mortgaged premises. The lender can apply for an order for possession, which will require the tenant to vacate the premises. Alternatively, the lender can specify that the final order for foreclosure is to be taken subject to the tenancy and can then enforce the lease if, and only if, privity of estate exists between the lender and tenant.

If a lender takes possession without a court order, it runs the risk of becoming a mortgagee in possession.[284] As such, it must account to the borrower for any rents or profits collected during its possession and is liable for negligent management of the property and for waste. The lender's liability to account does not cease if it abandons the property, as the lender has no right to give up possession whenever it chooses.

When the mortgaged property is rented to third parties, the question of what constitutes possession arises, as the lender does not take actual

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282 *Ferris* v. *Nowitskey, supra*, note 254.

283 Land Titles Act, R.S.A. 1980, c. L-5, s. 65(1)(d).

284 See *Snell's Principles of Equity*, *supra*, note 278 at 405-06.

physical possession. In *Noyes* v. *Pollock*[285] the English Court of Appeal held that to go into possession, the lender must do more than just receive the rents. The lender must actually deprive the borrower of the control and management of the property. Because of the onerous liabilities attached to the status of mortgagee in possession, the courts have usually been reluctant to find that possession has been taken. In *Unican Development Corporation Limited* v. *Settlers Savings & Mortgage Corporation*,[286] however, it was held that by assuming full control over the rental property so as to prevent the borrower from exercising any control or management function, the lender had become a mortgagee in possession. Thus, it was liable to the borrower for the loss of income and reduction in value of the property that had occurred during its period of possession.

(6) Appointing a receiver

Unlike the remedies previously discussed, the appointment of a receiver does not necessarily involve enforcement of or realization on the lender's security. It may be exercised simply to protect that security.[287] In either case it is an interim measure that permits the lender to divert income produced by the mortgaged property from the borrower to the lender for application against the mortgage. Again unlike the other remedies, the lender can unilaterally appoint a receiver solely on the basis of the lender's contractual rights, although it has the option of applying for an order appointing a receiver as authorized by statute. The two conditions that must exist before the remedy is available, either from the court or under the mortgage contract, are: (1) the mortgage must be in default and (2) the mortgaged property must be producing rent.

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285 (1886), 32 Ch. D. 53.

286 (1984), 30 Alta. L.R. (2d) 66 (Q.B.).

287 Section 45(1) of the Law of Property Act specifically contemplates the appointment of a receiver "to enforce or protect the security or rights" under a mortgage. Further, in *Sterling Trust Corp.* v. *Petrosol Plaza Ltd.*, [1984] 3 W.W.R. 511 (Alta. Q.B.) at 517 reversed on other grounds (1984), 33 Alta. L.R. (2d) 212 (C.A.), it was held that a mortgagee who appointed a receiver under an assignment of rents was protecting his security only and not realizing on it so as to accelerate the mortgage.

(a) Private appointment

Debt instruments securing commercial loans (e.g. debentures and mortgages) usually empower the lender to appoint a receiver upon the happening of certain events, including default in payment. Such instruments then enumerate the powers of the receiver to collect rents and otherwise deal with the secured property. Should one of the specified events occur, the lender, upon notice to the borrower, is entitled to appoint whomever it wishes as receiver. The receiver so appointed must act in accordance with the terms of the debt instrument and is in law an agent (usually the instrument will provide that the receiver is the agent of the borrower, so as to relieve the lender from any responsibility for the receiver's acts). The receiver's primary duty is to protect the lender's interests with respect to the secured property. The receiver does have a duty to the other parties interested in the property (e.g. the borrower and other encumbrancers) to act in good faith and without fraud, but this duty is not fiduciary in nature. Upon completion of his or her duties, the privately appointed receiver is discharged by the lender. There is no formal procedure for such discharge.

(b) Court appointment

Where a lender has no power of appointment under the mortgage, or where private appointment is not appropriate in the circumstances (e.g. the receiver's powers under the instrument are inadequate or other encumbrancers are likely to attack the appointment), the lender can apply to the court for appointment of a receiver under section 45 of the Law of Property Act.[288] The remedy is an equitable one, and the court will, therefore, apply equitable principles in deciding whether to grant it. There is some authority to the effect that if a lender holds a valid mortgage and that mortgage is in arrears, then it is entitled to the appointment of a

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[288] The court has a general power under section 13(2) of the Judicature Act, R.S.A. 1980, c. J-1, to appoint a receiver "in all cases in which it appears to the Court to be just or convenient" to do so. Section 45 of the Law of Property Act, however, applies specifically to mortgage actions and amendments in 1984 have rectified several of its previous inadequacies. It is therefore most likely now that mortgagees seeking a receivership order in a foreclosure action will apply under section 45. The section applies to all mortgage actions, including those in which section 41 bars an action on the covenant.

receiver as of right.[289] As a rule, however, the Alberta courts have not taken this position. They have shown a reluctance to appoint a receiver where the applicant has a private power of appointment, unless there are exceptional circumstances.[290] Further, when exercising the discretion to appoint a receiver under this section, the court considers the following factors:[291]

> A useful summary of the circumstances that ought to be considered is found in *Bennett on Receiverships* at p. 91, as follows:
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> > . . . The court will consider whether irreparable harm might be caused if no order were made, the risk to the security holder, the apprehended or actual waste of the debtor's assets, the preservation and protection of the property pending the judicial resolution, the balance of convenience to the parties and the enforcement of the rights under a security instrument where the security holder encounters or expects to encounter difficulty with the debtor and others.

Whether there is equity in the property is an important factor to consider when determining if it is just and equitable to appoint a receiver. However, a receiver can be appointed in situations where the lender's security is not in jeopardy.[292] The order may be granted more expeditiously, however, if section 45(1.2) applies (i.e. the mortgaged land is sold while the mortgage is in default or during the four months before default occurs). In that case, the lender has an immediate right to a receiver and may apply for the appointment *ex parte*.[293]

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289 See Price and Trussler, *supra*, note 101 at 307.

290 *C.I.B.C.* v. *El Dorado Hldg. Ltd.* (1983), U.A.D. 396 (C.A.).

291 *Citibank Canada* v. *Calgary Auto Centre Ltd.* (1989), 98 A.R. 250 (Q.B.) at 258.

292 *Citibank Canada* v. *Calgary Auto Centre Ltd., ibid.* in which Justice McDonald overrules *N.A.Properties Ltd.* v. *Ronald J. Young P.C.* (1982), 20 Alta. L.R. (2d) 399 (M.C.) on this point.

293 Section 45(1.2) is another of the 1984 amendments to the Law of Property Act aimed at frustrating dollar dealers.

If a court grants an order appointing a receiver, it will usually appoint the applicant's nominee if it is satisfied that the nominee is competent and disinterested. Once appointed, the receiver is not an agent but an officer of the court and as such has a fiduciary duty towards all parties interested in the mortgaged property. The receiver has only those powers set out in the appointing order. (By section 45(1)(d), enacted in 1984, the powers that the court may grant a receiver were significantly broadened to include managerial powers.) A court-appointed receiver may be discharged by the court upon approval of his or her accounts, but notice of the application for discharge must be given to all interested parties. Thus, these parties have an opportunity to review the receiver's accounts and ensure that the funds collected by him or her have been properly distributed. The lender will usually apply for discharge of the receiver when applying for the final order for sale or foreclosure.

(7) Attornment clauses

Attornment is defined in Black's Law Dictionary (4th addition) as:

> . . . the act of a person who holds a leasehold interest in land, or estate for life or years, by which he agrees to become the tenant of a stranger who has acquired the fee in the land, or the remainder or reversion, or the right to the rent or services by which the tenant holds.

An attornment clause in a mortgage provides that the borrower agrees to become the tenant of the lender. It creates a fictional landlord and tenant relationship and a fictional rent debt equal to some specified amount. The rent is generally set as a yearly rent equal to the sum of 12 monthly payments of principal and interest, and the rent is payable in the same manner as provided by the mortgage. By establishing the landlord and tenant relationship, it gives the lender the right to distrain for rent under The Landlord and Tenant Act, 1709 (8 Anne), c. 18.[294] Distress is the right to enforce payment of a debt directly by seizure and sale of certain goods.

Under the common law, the borrower transferred the fee simple to the lender. Therefore, it was possible for the borrower to become the tenant

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294 *Re Tuxedo Savings & Credit Union Ltd. and Krusky* (1987), 35 D.L.R. (4th) 211 (Alta. C.A.).

of the lender. Under a Torrens system, it is not possible for the owner of the fee simple to be the tenant of the lender because the lender merely has a charge on the property. Therefore, the validity of such clauses must be legislated.[295] The legislation is found in Part 4 of the Law of Property Act, sections 35 to 37. The key words in section 37 are ". . . a mortgage . . . of business premises may contain a covenant or provision that the borrower . . . agrees to become the tenant of the mortgagee . . ., and in that case the relationship of landlord and tenant is validly constituted between those persons . . .".

(a) Enforcement of attornment clauses in Alberta

(i) Every attornment clause is void—section 35(1) of the Law of Property Act

Sections 118 and 119 of the Land Titles Act, R.S.A. 1970, c. 198 and provisions from the National Housing Act (Alberta), R.S.A. 1970, c. 255 were combined to become Part 4 of the Law of Property Act. Section 35(1) declares that attornment clauses are void. Sections 35(2) and 37 create exceptions to this declaration for mortgages given to Farm Credit Corporation, for mortgages given to secure a loan made under the National Housing Act and for mortgages of business premises.

(ii) Exceptions

(A) A mortgage in favour of the Farm Credit Corporation: 35(2)(a) of the Law of Property Act

Section 35(2) of the Law of Property Act states that nothing in the section applies to a mortgage of land in favour of "The Canadian Farm Loan Board or the Farm Credit Corporation . . .". This suggests that Farm Credit Corporation is able to enforce all attornment clauses found in mortgages given to the Corporation. This, however, is not the case. The availability of this remedy has been severely restricted by two Alberta Court of Appeal

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[295] Price and Trussler, *supra*, note 101 at 331-32.

decisions: *Tuxedo Savings & Credit Union Ltd.* v. *Krusky*[296] and *Farm Credit Corporation* v. *Enns*.[297]

In *Tuxedo Savings & Credit Union Ltd.* v. *Krusky*, the court analyzed the relationship between sections 37 and 41 of the Law of Property Act. It concluded that section 37 is not an exception to section 41. When section 41(1) of the Law of Property Act protects a borrower from suit on the covenant to pay, it also protects the borrower from suit under an attornment clause in the mortgage. In coming to this conclusion, the court reasoned as follows. The attornment clause creates a fictional landlord and tenant relationship and a fictional rent debt. The fictional rent debt is tied to the covenant to pay given in the mortgage. It is a repetition of the same. The fictional debt is not an additional security, although the right to distress might be. The enforcement of an attornment clause would violate the rule against indirect enforcement of the covenant to pay and does not fall within the "additional security" exception established in *Krook* v. *Yewchuk*.[298]

After this decision, it was still unclear whether the right to distrain fell within the "additional security" exception. This issue came before the Alberta Court of Appeal in *Farm Credit Corporation* v. *Enns*. That case involved a mortgage given by Mr. Enns ("Enns") to the Farm Credit Corporation. The mortgage contained a clause whereby the borrower agreed to attorn as tenant to the lender from year to year during the term of the mortgage at the yearly rent equivalent to monthly payments of principal and interest under the mortgage. The Farm Credit Corporation served notice on Enns that it intended to rely on the attornment clause and distrain for rent. It then distrained by causing the goods of Enns to be seized. Enns filed a notice of objection to seizure and the Master granted an order for removal and sale. The court was asked to decide if an order for removal and sale should be granted in these circumstances.

The court refused to affirm the order for the following reasons. First, the Notice of Motion seeking an order for removal and sale was an action within the meaning of section 41(1) of the Law of Property Act. Second, the

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296 *Supra*, note 294.

297 *Supra*, note 138.

298 *Supra*, note 105.

prohibition against an action on the covenant to pay contained in the mortgage is engaged because the attornment clause is tied by contractual terms to the covenant to pay the mortgage debt. The rent was equal to the principal and interest owing under the mortgage. Third, the removal and sale of the goods under a power of distress flowing from the creation of the rent debt is an indirect method of enforcing the covenant to pay in the mortgage. *Krook* v. *Yewchuk* made it clear that this is not permissable. The attornment clause is not an "additional security" of the type allowed in the *Krook* v. *Yewchuk*. The borrower has not given additional security. He has simply "agreed to an attornment clause which created an additional remedy for the mortgagee which would take effect if and when there should be a default".[299] The result is that, notwithstanding section 35(2), the Farm Credit Corporation cannot distrain under an attornment clause when the borrower is an individual.[300]

In the *Enns* decision, the Farm Credit Corporation argued that section 37 did not affect Farm Credit Corporation mortgages. Section 37 begins with the phrase "Notwithstanding section 35". This phrase can be interpreted as meaning "notwithstanding section 35(1)". The lower courts adopted this interpretation because to do otherwise would render meaningless the exception for Farm Credit Corporation found in section 35(2)(a). The Court of Appeal did not decide this issue because of the conclusion it reached on section 41(1). Under the interpretation adopted by the lower courts, Farm Credit Corporation can distrain against the goods of a corporate borrower when rent is due under an attornment clause. The restrictions in section 37 relating to farm land would not apply. If later cases decide that the Crown is not bound by section 41(1), Farm Credit Corporation could distrain for rent owing under an attornment clause which was given by either an individual or a corporation.

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299 *Farm Credit Corporation* v. *Enns*, *supra*, note 138 at 14.

300 The curious thing about this decision is that the Farm Credit Corporation did not challenge the validity of the *Farm Credit Corporation* v. *Dunwoody Limited* decision which held that the Crown is bound by section 41 of the Law of Property Act. In view of the *Alberta Government Telephones* v. *Canadian Radio-television and Telecommunications Commission* decision, the authority of the *Dunwoody* decision is now doubtful. If section 41 of the LPA does not apply to the Crown, then the Farm Credit Corporation would be able to enforce the attornment clause in this situation. However, until the Alberta Court of Appeal readdresses the issue of crown immunity, the *Enns* case is determinative on the issue of enforcement of attornment clauses.

(B) National Housing Act mortgages: sections 35(2)(b) and 36 Law of Property Act

An attornment clause given in a mortgage that secures a loan under the National Housing Act, R.S.C. 1952, c. 188 or the National Housing Act, R.S.C. 1970, c. N-10 is valid.[301] By virtue of section 36 of the Law of Property Act, a National Housing Act mortgage may contain "a covenant or provision that the mortgagor agrees to become the tenant of the mortgagee, and in that case the relationship of landlord and tenant is validly constituted between those persons". The rent payable under such a clause cannot exceed the fair annual rent at which the premises might reasonable be expected to rent on a tenancy from year to year with the landlord paying the taxes.[302] Section 41 does not apply to a mortgage given under the National Housing Act. As a result, a lender under a National Housing Act mortgage can distrain for rent made payable by an attornment clause.

(C) Mortgage of business premises: section 37 of the Law of Property Act

The purpose of section 37 is to create an exception to section 35 by allowing the additional remedy of distress against goods other than residential belongings. However, section 37 is not an exception to section 41. When section 41(1) of the Law of Property Act protects a borrower from suit on the covenant to pay, it also protects the borrower from suit or distress under an attornment clause in the mortgage.[303]

By virtue of section 37, where the mortgage calls for payment by instalments and charges **business premises**, the attornment clause is valid. The section defines "business premises" to mean land and premises from which revenue is derived other than land and premises for farming purposes. Business premises include such properties as apartments, single family rental properties, and warehouses. However, a lender could not distrain in respect of farm land which is rented out.[304] Also, the

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301 Section 35(2)(a) of the Law of Property Act.

302 Section 36(2) of the Law of Property Act.

303 *Re Tuxedo Savings & Credit Union Ltd. and Krusky*, *supra*, note 294.

304 Price and Trussler, *supra*, note 101 at 330.

attornment clause is not valid if any part of the land is occupied by the borrower as a residence. Therefore, if the borrower charges an apartment building and resides in one apartment, the lender could not distrain under section 37.

(b) Restrictions on enforcing valid attornment clause

Even when the lender can distrain for rent under an attornment clause, section 20 of the Seizures Act[305] restricts this right. This section provides:

> 20 The right of a mortgagee of land or his assigns to distrain for interest in arrears or principal due on a mortgage is, notwithstanding anything stated to the contrary in the mortgage or in any agreement relating to the mortgage, limited
>
> (a) to the goods and chattels of the mortgagor or his assigns, and
>
> (b) to only those goods and chattels that are not exempt from seizure under execution.

Query whether section 20 of the Seizures Act binds the Crown or its agents.

C. Relief Available to the Borrower

(1) General

As stated above, most foreclosure actions are undefended. Default under the mortgage is all that is required to give the lender a cause of action, as long as the default continues at the date the action is commenced.[306] In the usual case, the borrower has in fact defaulted and the lender has not provided a defence by breaching any of its covenants. As the foregoing discussion has indicated, however, the lender is not permitted under Alberta law to pursue unchecked all the remedies the mortgage contract purports to give the lender, notwithstanding the borrower's lack of defences. Instead, the lender's remedies are significantly restricted by

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305 R.S.A. 1980, c. S-11.

306 *Canfran Invt. Ltd.* v. *Glivar* (1983), 42 O.R. (2d) 601 (H.C.J.).

various statutory and equitable forms of relief extended to the borrower. Most of these have already been considered in the context of the lender's remedies and will therefore be dealt with only briefly below.

(2) Section 39(1) of the Law of Property Act

Section 39(1) of the Law of Property Act, with the references to agreements for sale deleted, states that:

> The Court has jurisdiction and shall grant relief from the consequences of the breach of a covenant or the non-payment of principal or interest by a mortgagor in any case in which the mortgagor remedies the breach of covenant or pays all the arrears due under the mortgage with lawful costs and charges in that behalf
>
> (a) at any time before a judgment is recovered, or
>
> (b) within a time that by the practice of the Court relief therein could be obtained.

The use of the mandatory word "shall" in section 39(1) requires the court to grant relief if the borrower's default is remedied prior to judgment or within a time that by the practice of the court relief could be obtained. An order nisi is a judgment, but it is the practice of the court to grant relief if a mortgage is placed in good standing at any time before a vesting order is made or the land is sold.[307] In cases involving mortgages with acceleration clauses (whereby the full amount outstanding becomes due upon default), there was at one time some uncertainty whether "all the arrears due" in section 39(1) meant the accelerated balance or only the payments in default. It has since been settled, however, that section 39(1) allows the court to relieve against the consequences of an acceleration clause, so that the borrower will be entitled to relief under the section if he or she pays the arrears and costs and remedies any other breaches of covenant.[308] It has also been held that this relief is available only to the borrower and subsequent transferees. Any other person wishing to redeem, such as a

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307 *Kolacz* v. *Munzel*, [1971] 5 W.W.R. 757 (Alta. S.C.T.D.) at 760.

308 *Country Holdings & Development Ltd.* v. *Roth* (1981), 16 Alta. L.R. (2d) 262 at 266 (Q.B.).

second mortgagee, will be required to pay the whole accelerated balance unless the other person is an assignee of the borrower.[309]

(3) Section 41 of the Law of Property Act

As already discussed, section 41(1) of the Law of Property Act represents an important form of relief to individual borrowers and transferees by barring action on the covenant to pay and restricting lenders to an action for the land itself. Thus, the most the borrower or transferee can lose is the mortgaged property; he or she cannot be subjected to a deficiency judgment. As also discussed, however, section 41 is inapplicable to several significant categories of mortgages and many individual borrowers and transferees are, in fact, vulnerable to an action on the covenant.

(4) Right of redemption

It has been held that a borrower's right to redeem arises as soon as the lender commences proceedings to enforce its security. If one of the remedies the lender seeks is sale or foreclosure, the lender is enforcing its security.[310] Thus, if the borrower then tenders the whole balance owing, the lender must accept it, notwithstanding that the mortgage has not yet matured and even if the borrower deliberately defaulted after the lender refused to allow prepayment of the mortgage.[311]

Usually, however, the borrower's concern is how long he or she has to redeem rather than how soon he or she can do so. The lender, on the other hand, is concerned to obtain the shortest redemption period it can. As mentioned above, section 42 of the Law of Property Act prescribes a redemption period of one year for farm land and six months for other land. It then authorizes the court to decrease or extend the statutory period on the grounds listed in section 42(a) and (b). It has been held that this listing is exhaustive and that the court does not have jurisdiction to vary the

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309 *Ibid.* at 267 and Price and Trussler, *supra*, note 101 at 194-95.

310 *Great West Permanent Loan Co.* v. *Jones* (1918), 8 Alta. L.R. 45; *Beck* v. *Investors Group Trust Co. Ltd.* (1977), 4 Alta. L.R. (2d) 1 (S.C.T.D.); *Heritage Savings & Trust Co.* v. *Harke* (1978), 14 A.R. 86 (C.A.); *North American Life Assurance Company* v. *Beckhuson*, [1981] 2 W.W.R. 446 (Q.B.).

311 *Heritage Savings & Trust Co.* v. *Harke* (1978), 14 A.R. 86 (C.A.).

statutory redemption periods on any other grounds.[312] Up until 1984, the court still had to order sale of the property and establish a redemption period where the debt greatly exceeded the value of land. The courts generally reduced the redemption period in such circumstances.[313] In 1984, section 42.1 was enacted. Now, notwithstanding section 42(1) the court may grant an immediate vesting order in some situations without the land first being offered for sale.

Upon expiration of the redemption period set in the order nisi, the borrower may apply for an extension under section 44(3) of the Law of Property Act, which reads:

> An order nisi may at any time prior to the sale of the mortgaged land under an order for sale or to the granting of a final order for foreclosure, whichever first happens, be relieved against by a postponement of the day fixed for redemption.

An extension will not be granted unless there is ample security and the borrower has a reasonable probability of obtaining the money required for redemption within a short time.[314] If both these conditions are met, however, and no disadvantage accrues to the lender, the borrower will likely be granted more time to pursue his or her efforts to redeem.[315]

Even after the expiration of the redemption period and any extension allowed by the court, a borrower can redeem until the land has been sold either to a third party or to the lender.[316] As previously stated, the granting of an order approving and confirming sale, unless stayed, immediately extinguishes the right of redemption. Where the lender has taken title under a final order for foreclosure, however, redemption may yet

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312 *Stady* v. *Patel* (1982), 48 A.R. 27 (M.C.). At the time of this decision abandonment of land was not a factor listed in section 42. Therefore the Master held that he could not consider abandonment when varying the statutory redemption period. This was changed by S.A. 1983, c. 7, s. 2(3) which amended section 42(2) to include: "(11.1) whether the land has been abandoned".

313 Price & Trussler text, *supra*, note 101 at 189.

314 *North West Trust Company* v. *247852 Alberta Ltd.* (1983), 45 A.R. 34.

315 *Northguard Acceptance Corp. Ltd.* v. *Kurtz* (1977), 3 Alta. L.R. (2d) 172 (S.C.A.D.).

316 *Ibid.*; *First Investors Corp. Ltd.* v. *Golden Key Rental Co. Ltd.*, *supra*, note 252.

be allowed in proper circumstances, as long as no subsequent rights have intervened. Section 44(5) of the Law of Property Act, quoted above at paragraph 4.111, confirms the court's discretion to grant such relief.

(5) The Farm Debt Review Act

Depressed grain prices and the drought that affected much of the prairies during the 1980s created economic hardship for many Canadian farmers. By 1985, the problem was endemic. As a result, the federal government enacted the Farm Debt Review Act,[317] which came into force on August 5, 1986. This Act is designed to "facilitate arrangements between farmers and their creditors". The Act establishes a Farm Debt Review Board for each province, or for such regions of Canada as may be designated by the Governor in Council. A farmer in financial difficulty or an insolvent farmer may apply to the Board established for the area in which the farmer resides.

Upon application by a farmer in financial difficulty, the Chairman of the Board appoints a review panel made of one Board member and two other persons. The review panel examines the financial affairs of the farmer and may offer advice to the farmer, meet with the farmer and his or her creditors, and assist the farmer and creditors to enter into an arrangement.[318] An application by a farmer in financial difficulty does not prevent a creditor from commencing or continuing any proceedings against the farmer.

Insolvent farmer is defined to include a farmer:[319]

> (a) who is for any reason unable to meet his obligations as they generally become due
>
> (b) who has ceased paying his current obligations in the ordinary course of business as they generally become due, or

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317 R.S.C. 1985, c. 25 (2nd supplement).

318 *Ibid.* s. 18.

319 *Ibid.* s. 1.

> (c) the aggregate of whose property is not, as a fair valuation, sufficient, or if disposed of at a fairly conducted sale under legal process would not be sufficient, to enable payment of all his obligations, due and accruing due.

An insolvent farmer may apply to the Board which is established for the area in which he or she resides. The application is to be in a prescribed form and includes the names and addresses of all creditors of the farmer. The Board gives each creditor notice that the application has been received. The effect of the application is to stay any proceedings for 30 days after receipt of the application and to prevent the bringing of any proceedings during the same period.[320] If the Board thinks extension of this time period is essential to the formation of an arrangement between the farmer and the creditors, it can extend the time period. There can be three extensions with up to a maximum of 30 days for each extension.[321] The Board must give the farmer's creditors notice of any extension of this time period. Upon receipt of the application, the Board appoints a review panel. The panel must review the financial affairs of the farmer and must meet with the farmer and the creditors for the purpose of facilitating an arrangement between them.[322]

Any secured creditor who wishes to take proceedings to realize on any security of a farmer must give the farmer written notice (in the prescribed form) of his or her intention to do so. The notice must advise the farmer of an insolvent farmer's right to apply to a Farm Debt Review Board.[323] The notice must be served 15 business days before action is commenced.[324]

This Act binds the provincial and federal Crown.

The annual reports of the Farm Debt Review Boards indicate that between August 5, 1986 and December 31, 1989 creditors across the nation served the Boards with 29,798 Notices of Intent to Realize on Security.

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320 *Ibid.* s. 23.

321 *Ibid.* s. 29.

322 *Ibid.* s. 28.

323 *Ibid.* s. 22(1).

324 *Ibid.* s. 22(2).

Farmers made a total of 10,981 applications to the Boards, of which 9914 have been dealt with by the Boards or withdrawn. The Boards have assisted 5485 farmers in making arrangements with their creditors. Of the 29,798 Notices of Intent to Realize on Security received, 4786 arose from Alberta. Alberta farmers made 1685 applications to the Alberta Farm Debt Review Boards, and 985 arrangements were signed. It is also useful to note that there were approximately 52,500 farms in Alberta in 1986 and a total of 262,000 in Canada for the same year.[325]

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[325] These figures are found at p. 57 of the Farm Survey 1988 prepared by the Farm Credit Corporation. The tally does not include farms with reported agricultural sales of less than $2000, institutional farms, farms on Indian reserves, community pastures, farms in areas having little or no agricultural activity, and farms which were part of large multiple farm operations owned by large corporations.

CHAPTER 5
THE MORTGAGE INDUSTRY IN ALBERTA

A. Introduction

Law reform cannot be undertaken in the abstract. There must be an adequate appreciation of the real life circumstances out of which contemporary, and, so far as they can reasonably be anticipated, projected, legal problems are said to arise.

In this chapter, therefore, we outline, in a broad way, the nature and dimensions of the mortgage industry in Alberta, and the difficult practical problems that industry—and consumers of its "products"—have encountered in the last several years. Our purpose here is to establish what is happening at the operational level.

B. The General Dimensions of the Mortgage Industry in Alberta

The yearly values for total approved mortgages in Canada (expressed in dollars for all mortgages regardless of type) have fluctuated somewhat over the past decade. But on any view, the sums involved are enormous. For instance, as at the end of 1993, the total outstanding sums secured by residential mortgages alone in Canada for the following institutions were: chartered banks, $159,638,000,000; trust companies $45,405,000,000; local credit unions $42,323,000,000; and life insurance companies, $19,786,000,000.[326] At the end of 1992, the total outstanding sums secured by farm mortgages in Canada was $11,145,647,000.[327]

Although it is difficult to establish the precise figures (partly because they do not appear to be conveniently consolidated, and partly because the relevant accounting dates and classification systems do not conveniently cross-match) it appears that Alberta absorbs 6-10% of the total mortgage lending in Canada.

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326 Statistics Canada, unpublished data.

327 Statistics Canada, unpublished data.

C. Particular Industry Subsets

Historically, as we have seen, the fundamental premise of the common law was that all mortgages are the same. Today, in Alberta, this does not reflect industry or even legal practice. Mortgages could be classified in several different ways, and the incidents which attach to each kind of mortgage differ both in practice and in law. For the sake of convenience, we think mortgages could most usefully be classified and described under three functional heads:

1) borrowing category;

2) the source of the funds (that is, whether the mortgage issues from the primary or a secondary mortgage market); and

3) whether a mortgage is insured or not.

None of these categories is exclusive: it is quite possible to have, for instance, a second, insured, residential mortgage, or some other combination of these categories. Generally speaking, however, the categories do reflect real life factors which are seen as being of day to day relevance, and not as mere abstractions.

D. Classification by Borrowing Categories

(1) Farm mortgages

Mortgages granted in the farming sector of any economy are almost always taken out in order to finance the acquisition of either the land (and sometimes machinery) without which the business of farming could not be carried on. Due to the inherently seasonal nature of the farming industry, banks and other lenders are often more lenient when dealing with a farm loan default. Lenders are less likely to take immediate legal action upon default, and will often voluntarily renegotiate the loan agreement in order to facilitate repayment at a later date by the borrower. Thus, lenders appear to recognize that although crops can and do sometimes fail, it is often advantageous for everyone concerned to avoid realization of the security while there is a reasonable likelihood of repayment at a later date. While accurate statistics concerning the number of farm mortgages in

Canada or Alberta do not seem to have been compiled, it would appear that they represent a fairly small percentage of the total mortgage advances (probably less than 5% in terms of dollar value) in Alberta.

Nevertheless, farm loans enjoy high political visibility and practical importance, particularly in the West. If farm loans fail and are foreclosed, there is a potential disruption of the production of food for both domestic and export consumption. And "farming" cannot be turned on and off like a tap. It represents a way of life, and lean and difficult years marked by many foreclosures may bring about a disastrous de-population of farming areas and talent that may take many years to recover. Thus, of all the categories of borrowers, farmers have traditionally attracted the greatest leniency towards repayment, both in operational, and strictly legal terms.

(2) Residential mortgages

Different considerations may apply when dealing with loans which are secured by residential properties. The usual situation is the homeowner who grants a mortgage to finance the purchase of a home in which to live. Public policy in Alberta has focused on support of homeowners and farmers and the result is that special protection is granted to the homeowner borrower. But here again it appears that, in general, lenders are cautious about taking legal action upon default unless the chances for future payment are minimal. While such commendable action can be explained by a genuine feeling of compassion for the borrower, there can be little doubt that the adverse publicity that would accompany ruthless lending practices is also a factor encouraging lenders to exercise discretion in enforcing their rights. Lenders have an interest in their reputation and goodwill with consumers of financial services. There is little doubt, however, that lenders became more aggressive in pursuing defaults in the mid-1980s as the recession took hold.

Statistics describing all aspects of the residential mortgage industry are readily available through sources such as Statistics Canada and the Canada Mortgage and Housing Corporation, but these statistics themselves raise the question as to exactly what properties should constitute "residential property" and should, thus, fall within the scope of the policy consideration outlined above. The sources mentioned above tend not to distinguish between multi-unit residential rental properties (which are in

one sense business properties), and owner occupied residential properties. In Alberta, the former category is generally owned by a corporation and a corporate borrower is not entitled to the protective provisions of the mortgage legislation.

It would appear, on the statistics presently available to us,[328] that something over 60% (by value) of all mortgages in Alberta are residential mortgages. These mortgages fall within the legislative policy under which some mortgages get special legislative "consumer treatment" from lenders of money.[329]

(3) Commercial mortgages

Commercial mortgages are those mortgages that charge multi-unit residential rental properties and non-residential properties such as hotels, stores, office buildings, garages, theatres, warehouses, industrial plants and vacant land. Alberta lenders classify loans secured by these mortgages as business loans. Their practice is to usually insist that the borrower be a corporation. Where a mortgage is granted by a corporation, both the law and business practice treat the mortgage with far less leniency. After all, shareholders are usually limited in their liability, and present Alberta public policy (as reflected in the law) recognizes that the necessity for a business to pay its debts punctually is greater than the necessity for an individual, whether as a householder or a farmer, to pay debts punctually. The result of this is that defaults on mortgages by corporations are much more quickly acted upon, and legal action against corporations for outstanding debts is much more a fact of life than it is as against individuals. In the commercial sphere, as in the farm mortgage sphere, there is a shortage of compiled statistics, but it seems to be the case that something like one third (by value) of all mortgages granted in Alberta are

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328 That is, the published statistics of the various government agencies, and Statistics Canada.

329 In 1988 mortgages placed in Canada on Single Detached Dwellings constituted 63.82% of total mortgage lending. See Canada Housing Statistics, 1988, Tables 38, 40 and 42. These tables include all loan commitments made by lending institutions on the security of a mortgage. Excepted from the statistics are mortgages taken as collateral security on loans for other purposes, or mortgages taken as security for interim financing.

for commercial mortgages.[330] Common banking practice would likely result in most of these mortgages having been given by corporations.

E. Classification by Priority of Mortgage

A distinction which is potentially very important is that which could be drawn between what are commonly called first mortgages and second (and later) mortgages. With a first mortgage the full value of the mortgaged property is available as security, while with a second or later mortgage only that portion of the value of the property remaining after the first mortgage has been satisfied is available as security. The consequences of this are that second or later (sometimes called "junior") mortgages carry a somewhat higher risk than do first (or "senior") mortgages, and also that such mortgages as a result tend to be used to secure substantially smaller loans than do first mortgages. It may well be that these distinctions warrant special consideration. However, due to a lack of statistical information concerning the relative numbers of first and second mortgages, the impact of the second mortgage market in Alberta is difficult to assess. In the economic climate that existed in the early 1980s, where even first lenders have found it difficult to obtain full satisfaction of debts owing to them due to falling land prices, it is possible that the secondary mortgage market was a small one, due to the unusually high risk involved.

Not only is this distinction important in relation to strict legal priorities to the secured land, it is important in terms of markets. There is a first mortgage market, predominantly, but not exclusively, occupied by large financial institutions. The secondary market is occupied principally, though again not exclusively, by smaller institutions or individuals, who advance (relatively) smaller sums of money at greater (and often significantly greater) interest rates than the primary market offers. The encouragement of an adequate secondary market appears to be an important public policy consideration because it allows individuals or entities who would not otherwise qualify for a loan to procure one and thus participate in any

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330 The ratio between the sum of mortgages on non-residential property and multiple dwelling structures to total mortgage lending in Canada in 1988 was 36.18%. This results from analysis of statistics found in Canada Housing Statistics, 1988 Tables 38 and 42. In these tables all conventional loans granted by approved lenders on the security of farm land mortgages fall within the category of mortgages on non-residential property. As discussed in relation to residential mortgages, these statistics do not include collateral mortgages.

general economic growth. Some Canadians would not get a "start in life" if they were restricted entirely to the institutional primary market, not, it should be noted, for any reasons of prejudice based on non-economic factors, but simply because they could not meet the institutional norms of the primary market.

F. Classification by Insurance

Mortgage insurance is a means by which lenders are guaranteed repayment of their loan. A fee is paid to the insurers based on the value of the debt secured (the usual fee is in the neighbourhood of 1-2% of the mortgage debt) and if the borrower subsequently defaults and must lose the secured property, the mortgage insurance policy will pay any loss arising due to the inadequacy of the security.[331]

In Alberta there are three recognized insurers of mortgage debts, but only one insurer continues to be actively involved in the insurance of Alberta mortgages. The federal government will insure a mortgage under the National Housing Act, provided that the mortgage meets certain criteria that qualify it for the programme. Along similar lines, the provincial government has insured certain mortgages under the Alberta Mortgage and Housing Corporation Act, again only if certain criteria were met. Finally, the Mortgage Insurance Corporation of Canada ("MICC") makes a business out of insuring mortgages, and is a private corporation. Virtually any mortgage will qualify for insurance from MICC, giving the company a special appeal. Alberta Mortgage and Housing Corporation is no longer in the business of insuring mortgages, and MICC has temporarily stopped insuring mortgages in Canada.

From annual reports filed by the government agencies it would appear that, nation wide, the government agencies service an average of about 70% of all mortgage insurance borrowers, while the private sector agency services the remaining 30%.[332] Also, by comparing total insured mortgage debts to total mortgage debts, it can be said that roughly one-

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331 The fee is paid by the borrower, but the insurance is for the benefit of the lender. In the event of default the insurer will seek, where possible, to recover its loss from the borrower.

332 Of course, this ratio will change if MICC does not continue with its business of insuring mortgages.

third of all homeowner mortgages granted are insured in some manner. From these figures, it is apparent that the mortgage insurance industry is a significant one and is worthy of some attention.

The sums involved are impressive. For instance, MICC has indicated to us that at the end of 1983, that Company had approximately $3.5 billion in insurance in force in Alberta. This included $3 billion of insurance on more than 50,000 homeownership properties. At the end of 1990, MICC had approximately $2.0 billion in insurance in Alberta.

There can be little doubt that mortgage insurance has played a significant role in the industry. It makes loans easier to get, and easier to enforce. But the guarantee agencies—particularly in the private sector—are in a very vulnerable position in the event of a major economic downturn. They become, in effect, the borrower of first resort, with only qualified recourse, either through legal or self-imposed constraints, against the defaulting "owner".

G. The Economic Downturn of the 1980s

Reference has already been made, at several points, to the economic downturn which occurred in Alberta in the years from (about) 1980 on. It is not necessary that we establish the precise reasons for this downturn for the purposes of this study. Suffice it to say that a combination of world and domestic events (inflation, high interest rates, the National Energy Program, a reaction to a possibly overheated Alberta economy during the "boom" years of the 1960s and 70s) all conspired to produce the deepest recession experienced in Alberta since the 1930s. Unemployment rose to around 15%, land and housing prices dropped (by up to about 30%),[333] and, for about three years, the province suffered a net population loss as workers moved off in search of jobs in other parts of Canada. Bankruptcies rose sharply, and some trust companies, lending institutions, and even chartered banks failed.

In 1984, the mortgage industry began to turn around. Interest rates declined from 1984 to 1989 and the economy in general improved. As a result, the number of mortgages approved in Canada each year skyrocketed

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[333] Based on a comparison prepared by the Alberta Department of Housing of the average sale prices of houses in Calgary and Edmonton from 1981 to 1984.

from 24 billion dollars in 1984 to 54 billion in 1988. Housing prices also improved between 1984 and 1989. This turn around in the fortunes of the country had a dramatic effect on the number of foreclosure actions initiated in Alberta since 1984. The number of residential and commercial foreclosures has decreased significantly each year since 1984. Farm foreclosures have seemed to remain at fairly steady levels with the exception of a few upswings.

The dramatic drop in the number of residential and commercial foreclosure actions has been caused by several factors, including an improving economy and lower interest rates than there were previously. With the increase in housing prices since 1984, the debt to equity ratios have tended to be lowers and so it has been less tempting for the borrower to just walk away from the property.

By the end of the 1980s, the overall economic picture appeared to have at least stabilized, although as we now know it never seems to stabilize for long.

H. The Foreclosure Epidemic

The general economic malaise of the early 1980s was reflected in the foreclosure statistics. Alberta, for some years, had experienced a young, "boom" economy. Real estate values had risen constantly, even dramatically. It was thought to be "safe" to lend on the security of Alberta real estate, and many transactions were financed at debt/equity ratios which might otherwise have been considered marginal, or have been rejected altogether. Moreover a statistically "young" population had produced a large number of first-time homeowners, who traditionally have much less equity in a home to act as a cushion.

In this overall climate, two general effects became apparent as the recession took hold. First, in point of time, as unemployment rose, so too did loan defaults as people exhausted savings or other resources. Second, at some later point in time real estate values began to fall. These two problems gave rise to two discrete phenomena. Unemployment and the exhaustion of resources caused outright defaults; the fall in real estate values exacerbated that problem, but also, coupled with the no-deficiency claim rule, led to what has become known as "walk-aways". These are

people who **could** meet loan obligations but who chose not to. Walk-aways either had no equity to protect and were, in economic terms, better off in the long run purchasing a new property at a lesser price and with a correspondingly smaller mortgage. Others, conversely, were "trading up" to a qualitatively better property with the same total loan obligations. This phenomenon was itself exacerbated by the time the whole foreclosure process took to complete. It was quite possible for a potential walk-away to accumulate during a drawn-out legal process the $5-10,000 necessary for the deposit, legal fees and related expenses on another home. In the classic manner of a severe recession, these various problems thus fed on each other.

Some studies of the relative importance of various factors which contributed to this unhealthy situation were undertaken, and tend to confirm the field experience suggested to us by individual lending agencies and officers. The Survey on Residential Mortgages ("Survey")[334] found that the most significant source of all "foreclosures" was "income and unemployment" problems, but that "declining real estate values" was the second greatest reason. This Survey (of all major lenders in the province) showed that, at one time (December 31, 1983), current payments on 16,800 residential mortgages (amounting to 7% of total mortgages held by those lenders) were between one and three months overdue.[335] Given that the Survey did not take in **all** lenders in the province, it seems quite likely that through the later part of 1983 and 1984 **more** than 1 in 14 residential mortgages in Alberta were in arrears.

Not all of those mortgages which were in arrears resulted in foreclosure proceedings, but some indication of how prolonged and real the difficulties were can be gleaned from the following "raw" statistics for the years 1981-88 and the first eleven months of 1989.[336]

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334 *Survey on Residential Mortgage Defaults* (Alberta Department of Housing, April 1984).

335 *Ibid.* at 6-7.

336 These statistics are reproduced from the Survey, *supra*, note 334 at 3 and from similar data collected by Municipal Affairs, Housing Planning Secretariat for the years 1984 and later. They were, in turn, extracted from the Court of Queen's Bench.

	STATEMENTS OF CLAIM	ORDERS NISI	FINAL ORDERS
	Number	Number	Number
Total 1980	3,669	not known	not known
Total 1981	4,030	1,680	626
Total 1982	6,874	3,373	1,143
Total 1983	9,053	5,090	3,869
Total 1984	11,669	5,639	8,023
Total 1985	8,652	3,207	8,972
Total 1986	5,280	1,339	3,871
Total 1987	3,761	1,079	2,664
Total 1988	2,552	779	1,283
Total 1989	1,724	605	669
Total 1990	1,820	518	479
Total 1991	2,341	754	753
Total 1992	2,493	840	909
Total 1993	2,515	868	967

Historically, marriage breakups have been a major factor in residential foreclosure actions in Alberta. In the 1980s, however, it was a minor cause, accounting for only 5% of the foreclosure actions. This figure remained relatively constant through the five-year period 1980-85. Hence marriage breakups did not have much effect on the relative statistics.[337]

Dollar dealers attracted much public interest and legislative concern. Statistics again give the broad picture: these sales were present in something like 1% of foreclosures in 1981, 8% in 1983, and 10% in 1984.[338]

The general pattern seems clear enough. Beginning in 1981 and rising to a peak in 1984/85, residential foreclosure actions rose steadily to a peak of about 1000 new statements of claim per month. The root cause of these actions (in something like 75% of cases) was economic hardship, either in the form of income problems or falling property values.

Farm and commercial mortgage foreclosures during the same period were as follows:[339]

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337 Survey, *supra*, note 334 at 8.

338 Survey, *supra*, note 334 at 8.

339 Statistics provided by Municipal Affairs, Housing Planning Secretariat.

	STATEMENTS OF CLAIM		ORDERS NISI		FINAL ORDERS	
	Farm	Commercial	Farm	Commercial	Farm	Commercial
1982	196	1799	88	1086	40	485
1983	369	4956	224	2743	202	4572
1984	416	3891	213	2236	117	2021
1985	392	1965	151	771	275	2372
1986	313	1542	107	267	176	949
1987	300	863	92	170	169	1055
1988	508	750	148	154	239	462
1989	209	438	111	96	151	313
1990	190	421	77	94	94	161
1991	194	466	59	118	93	202
1992	92	514	48	149	86	218
1993	70	713	39	195	54	381

I. The Disparate Impact of Foreclosures

A question of some moment is whether the burden of these events has fallen unevenly on discrete groups of lenders or consumers in Alberta. If there is such evidence, it may have real implications for legislators and for law reform purposes. Several concerns appear from the available statistics.

First, the geographical distribution of residential foreclosure actions showed a clear pattern—over 50% of the proceedings were in Calgary, 25% in Edmonton, and the rest scattered throughout the province.[340] The explanation given by most analysts for this pattern relates to the relative characteristics of the two "big" cities. Calgary, it is said, had a bigger "boom" and less in the way of governmental and institutional personnel to fall back upon when the recession affected the oil and gas industry. These factors do not appear to be in any way related to the present law relating to mortgages.

Second, of the residential mortgage foreclosures, it seems clear that the majority affected younger persons (25-40 years of age) who had purchased homes within 1 to 3 years before the foreclosure occurred.[341] Eighty-eight per cent of the foreclosed properties were valued (on

340 Survey, *supra*, note 334 at 5.

341 Survey, *supra*, note 334 at 8-9.

foreclosure) at less than $100,000 and indeed 64% of all residential foreclosures related to properties then valued at less than $80,000.[342] This clearly suggests that in the residential sector, foreclosures fell most heavily on younger, first-time buyers, with a high debt/equity ratio and who were "squeezed" by the recession. Those first-time buyers who entered the market after the recession began, were of course, able to take advantage of rapidly falling prices if they so wished. Where more mature individuals were affected, it was often because a business failure of some kind occurred and a home mortgaged as collateral for business purposes became at issue.

Of these younger homeowners who were thus affected, many were at risk of being pursued for deficiency judgments if their mortgages were advanced or guaranteed by the government agencies; all others were not.

Third, these events had quite a dramatic impact on the only private guarantee company operating in Alberta, Mortgage Insurance Company of Canada ("MICC"). For instance, that company in 1983 and 1984 had total mortgage losses of $170 million in Alberta. (The bulk of this loss was suffered on mortgages insured between 1979 and 1982, before the recession began to "bite" severely). During this period, monthly losses were running at around $1.6 million per week. There was a serious question as to how long, if at all, the company could continue to service Alberta mortgages, but a capital infusion, and other factors had returned the company as a whole, by 1986, to profitability for the first time since 1981. Quite apart from the huge financial losses to date, MICC has suffered a significant loss of business goodwill. That company, in its contracts, has an option which requires lenders to accept 25% of the loss on foreclosures and leave them with the property. MICC has invoked this clause and has suggested that had it not done so, the company's losses would have amounted to more than $800 million in Alberta alone.

MICC has consistently maintained that it is (legally) disadvantaged as compared with the public sector agencies, and that it is thus subject to a form of "unfair competition". In 1984, MICC decided to withdraw from the Alberta market. In its opinion, "the withdrawal was necessary because it was impossible to underwrite mortgage loans in a market where borrowers were under no obligation to pay their mortgages and could deliberately

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342 Survey, *supra*, note 334 at 9.

default anytime they felt it was in their financial interest to do so". From 1984 to present, MICC has only insured loans totalling $99 million. This represents an insignificant percentage of the business it does nation-wide.

Fourth, a number of "smaller" lending institutions (including some small trust and mortgage companies and some regionally based banks) that were heavily involved in real estate loans have failed. It is claimed that depressed real estate prices "caused" these failures. Large national institutions have been able to "spread" their losses, or take other action, and have, to date, survived.

J. The Effect of the 1980s Experience on the Supply of Credit

In theory, most economists would probably have expected figures such as those recited above to have had a substantial and overt effect on the supply of credit in Alberta. At least at the formal level, this does not appear to have happened to any marked extent. According to conversations we have had with some banks, the large lending institutions did not apply differential interest rates to Alberta loans. In effect, if not in name, a pan-Canadian insurance scheme has operated. Losses have been absorbed by large institutional borrowers and "spread" on a national basis. Equity ratios have not altered significantly. (MICC did raise its equity requirement from 10 to 15% in Alberta.)

At a less formal level, it has been suggested to us that lending practices in the field have become much more careful, and "tighter". Whatever the formal requirements for a loan, in cases of doubt, borrowers are rejected where once they would have been accepted. The burden of proof has, in effect, been reversed in practice.

K. The "Management" Issue

As might be expected, there has been considerable debate as to the "causes" of this complicated economic picture. One school of thought amongst analysts has painted a picture of external events pressing upon Alberta, and it is said those events were quite beyond the province's control. On the other hand, there also appears to be a school of thought that says that "management" was throughout much less careful than it ought to have

been. Thus, some commentators have said, at least if matters were gauged by traditional lending practices, lenders dug themselves an open grave.

We have not investigated this large and complex allegation. Intuitively we sense there were a number of factors at work (including management), all of which conspired in an unhappy way to the events that occurred. At least based upon our consultations to date, lending agencies seem quite frank that their practices were in some respects generous in the "good" years. We have seen nothing, however, in the way of published material, nor have such interviews as we have conducted to date suggested that the events were simply a "management" phenomenon.

L. The Enforcement of the Covenant

There has been much public concern and press comment with respect to the enforcement of deficiency judgments (where it is legally permissible to do so). Those lending agencies which were permitted to proceed on the covenant have insisted that this phenomenon has been overstated in the press. These agencies assert that they sought deficiency judgments only in the case of genuine impropriety: deliberate and reckless abandonment, entering into a dollar dealer transaction, deliberately vandalizing a property before quitting it.

Alberta Mortgage and Housing Corporation, for instance, apparently commenced something over 800 law suits for deficiencies with the intention of "weeding out" those who were deliberately avoiding their loan obligations.[343] Canada Mortgage and Housing Corporation was also reported to be taking action in a number of cases.[344]

Whatever final statistics emerge from this exercise—and that is subject to the current debate as to whether these agencies can now legally pursue a judgment—it seems clear on any view of the matter that for most of the 1980s the Crown agencies adopted a policy of **selective** enforcement. In the mid-1980s, wholesale enforcement of deficiency judgments did not in fact occur, and the government agencies claim they can justify individual

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[343] See *Edmonton Journal* (March 25, 1985). The average deficiency was said to be $23,000.

[344] See *Globe & Mail* (February 5, 1985).

cases where judgments have been pursued.[345] At the end of the 1980s this policy was changed and Canada Mortgage and Housing Corporation now instructs its lenders to take deficiency judgment whenever a deficiency exists.

M. The Impact on the Judicial System of the Foreclosure Epidemic

It may be thought that the term "epidemic" is too strong a word for the above statistics. However, any event which generates more than 100 superior court statements of claim per day for a lengthy period of time is clearly very significant and has itself, a pronounced effect on the day to day administration of the law.

In this case, the effects have been felt at two levels. First, substantial legal work has been generated for the legal profession. Even a cursory review of the average legal file shows that the amount of paperwork under the present regime is formidable. What concerns us greatly here is that **the system itself** appears to give rise to a situation whereby substantial legal costs are necessarily generated, irrespective of the efficiency of individual practitioners.

It has been suggested that the average loss (to a lender) on a residential foreclosure is well above $10,000 and a significant proportion of that figure represents costs. The average loss in the Survey (27 lenders) was $16,000.[346] The average farm loss is harder to estimate, but one study done by the Farm Credit Corporation showed that the value of farms and buildings in Alberta dropped by between 10-15% in 1983 and 1984.[347]

Moreover, the amount of case law generated by the spate of foreclosures has been staggering. Our own research staff have been hard pressed to assimilate the flood of literally hundreds of cases. The position of individual practitioners, with a myriad of other matters pressing on their

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345 Practitioners advise that recently Canada Mortgage and Housing Corporation changed its policy on this issue. It now routinely obtains a judgment for any deficiency.

346 Survey, *supra*, note 334 at 14.

347 See *Globe & Mail* (25 October 1985) at B20.

time, is unfortunate, to use a neutral term. The law in this area, as many practitioners suggested to us, has become close to "unknowable" and a number of practitioners have, independently of each other, employed an analogy to Dickens' "Bleak House" and the conditions then existing in the Court of Chancery.

At the judicial level, the Court of Queen's Bench has faced a considerable burden. The Masters of that court have had to deal with the heaviest volume of mortgage related applications (literally thousands), and many cases have also occupied judges of that court for extended periods of time. The Court of Appeal has delivered extensive judgments in a number of important cases, which must have required a great deal of painstaking work. In the result, there has been a very significant secondment of judicial time and a consequential impact on already crowded civil lists.

It is not possible to state with any degree of accuracy what total secondment of legal resources this exercise has attracted in dollar terms in the years 1980-85. On any view, the cost of legal services in this area has been extraordinarily high.

N. Conclusion

There was widespread and severe dislocation in the Alberta mortgage industry in the 1980s. It seems that this dislocation cannot be attributed solely to the state of the law as such, although some aspects of Alberta mortgage law have contributed particular wrinkles.

The protective provisions of that body of law, together with industry practices, have shielded from deficiency judgment liability the bulk of those persons affected by foreclosure of their homes and farms. Those provisions have also, however, created anomalies which are difficult to justify as between crown and private agencies, and between borrowers who are situated in like situations. Given the statistics involved, it seems almost inevitable that had these provisions **not** existed, there would have been very real pressure for their enactment. Could any polity (or legislature) in contemporary circumstances really stand for a situation where, perhaps, 1 in 14 Alberta homeowners faced personal liability in an average amount of over $10,000? Borrowers are a diffuse group and do not have the benefit of collective organizations to which most lenders belong, but it seems likely

that public reaction would have been much fiercer without the protective provisions. In short, despite all the technical hiccups and frustrations of the "system", it appears to have performed as it was designed to perform in the overall Alberta context in the event of genuinely severe economic dislocation. That does not, however, mean that there are not matters deserving of law reform. Even if the "Alberta thesis" is to stand, there is clearly a good deal of room for simplification of that system and a resolution of the more obvious discrepancies.

CHAPTER 6
THE GENERAL DIRECTION FOR REFORM

A. Introduction

The defining characteristics of a mortgage remedies system are: (1) the degree of court involvement in the enforcement of the lender's remedies, and (2) the extent that the system interferes with the lender's right to enforce the borrower's covenant to pay. The prominent features of the existing Alberta law are judicial supervision of the foreclosure process and deficiency judgment protection for individuals. In this chapter, we examine whether the new regime should continue along these lines or whether other models should be adopted.

B. Should a Power of Sale Regime Replace Court Supervision of the Foreclosure Process?

When there is a default under the mortgage, the lender usually looks to the land to satisfy the debt secured by the mortgage. In Canada, mortgaged land is sold in these circumstances in only two ways: judicial sale or sale by lenders acting under a power of sale.[348] British Columbia, Alberta, Saskatchewan, Manitoba, Quebec and Nova Scotia have chosen judicial sale as either the primary or the only permitted method of selling mortgaged land. Under this model, the land is sold by the court or under the supervision of the court.[349] In Ontario, New Brunswick, Prince Edward Island and Newfoundland, sale of land under a statutory or contractual power of sale is the primary remedy of the lender.[350] In these provinces, the sale usually takes place without court supervision.

The marketing techniques and methods of sale vary from province to province. Success in obtaining adequate prices depends more on the marketing techniques and methods of sale employed than on the particular

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348 For an excellent summary and critique of mortgage remedies law in the Canadian provinces see: Joseph T Robertson, "The Problem of Price Adequacy in Foreclosure Sales" (1987) 66 Can. Bar Rev. 671.

349 *Ibid.* at 677.

350 *Ibid.* at 681.

model of law. British Columbia, a judicial sale regime, and Ontario, a power of sale regime, have the most success in obtaining price adequacy in foreclosure sales. New Brunswick, a power of sale regime, is the least successful in obtaining price adequacy.[351]

In the report for discussion, we took the view that the choice between court supervision of the foreclosure process and a power of sale regime was a political one. Each regime has its advantages and disadvantages. Yet, since we did not see the existing regime as harming essential Alberta interests, we recommended retention of court supervision of the foreclosure process.

Some commentators have suggested that we go further and examine the benefits and cost of a court-supervised regime and the policy alternatives. This analysis will look at the policy considerations underlying the choice between judicial supervision of the foreclosure process and a power of sale regime. We will examine the advantages and disadvantages of each regime and then analyze which is best for Alberta. Of course, there are many variations between power of sale regimes. When a particular variation gives rise to certain advantages or disadvantages, this will be noted.

(1) The advantages and disadvantages of a power of sale regime

The advantages of a power of sale regime are:

- ***Speed***. In this context, speed refers to the time it takes for the lender to realize on its mortgage security. Three factors affect speed: (1) the steps involved in enforcing the remedy, (2) availability of redemption period, and (3) the time it takes to sell the land. In those jurisdictions which have both a power of sale and a judicially supervised procedure, there are generally fewer steps to be completed under the power of sale procedure and there is usually no need to attend court. Also, the redemption period given to the borrower under the power of sale procedure is usually shorter than under the judicially supervised procedure.[352]

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351 *Ibid.* at 717.

352 In Ontario, the time given to the borrower to redeem the property after service of the notice of intention to sell property under power of sale varies from 35 to 45

(continued...)

Where a lender sells the land to a third party, the time taken to realize the sale will depend largely upon the type of property and the prevailing market. The ability to exercise a power of sale does not ensure that the land will be sold quickly. For example, in Ontario, most lenders sell residential land under a power of sale by listing the land with a realtor.[353] In 1991 the average period between default and the time the land was sold in Ontario under a power of sale was 438 days.[354] Speed can be increased where the law allows the lender to exercise a power of sale through auction at which the lender can bid.[355]

- ***Reduced legal costs***. Legal fees are often lower in power of sale regimes, particularly in situations where the lender does not seek judgment and where the borrowers vacate the property when requested by the lender.

- ***Convenience to lenders***. It is always easier to do things without someone supervising your actions.

- ***Reduced consumption of court resources***.

The disadvantages of a power of sale regime are:

- ***Sales at inadequate prices***. In a power of sale regime, sales at an inadequate price can result for several reasons. Use of inappropriate marketing techniques is the primary cause of inadequate sale prices in a power of sale regime.[356] Marketing techniques are directly influenced by

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[352](...continued)
days. In foreclosure proceeding or judicial sale proceedings, the defendant can file a request to redeem and then the period is 60 days. See:
· Ontario Bar Course Materials (1992) Chapter 7, Mortgage Remedies, pp. 92-93, and
· Paul M. Perell, "Remedies for the Mortgage Lender in Ontario" [1991] 13 Advocates' Quarterly 195 at 200.

[353] *Ibid.*, Ontario Bar Course Materials at 95.

[354] Letter of March 4, 1992 from Canada Mortgage and Housing Corporation giving average period between time of default and sale in Ontario claims for the year 1991.

[355] This occurs in New Brunswick and Nova Scotia.

[356] This result is not unique to a power of sale regime because both judicial sale and power of sale can result in an inadequate sale price if the seller fails to employ the appropriate marketing techniques.

the standard of care imposed by law on the lender who exercises the power of sale. The standard of care varies from jurisdiction to jurisdiction.[357] In some provinces there is a duty to act in good faith when exercising the power of sale. In Ontario, there is some uncertainty over what the duty of care is.[358] The less onerous standard applied by Ontario courts is that the lender must exercise the power of sale in good faith. This means the mortgagee "must not fraudulently, wilfully or recklessly sacrifice the property".[359] The more onerous standard applied by the Ontario courts is that the mortgagee owes a duty to the mortgagor to take reasonable precautions to obtain the true market value at the date the land is sold. Effective protection exists only if the lender is held accountable for the use of inadequate marketing techniques and sale methods that result in inadequate sale prices.

The standard has been even further diluted by the judicial interpretation that the duty of care, whatever it be, is met by complying with the legislative requirements of enforcing the power of sale even though such requirements are universally admitted to be totally ineffective.[360] For example, New Brunswick has legislation allowing the lender to exercise a statutory power of sale by selling the land at an auction conducted by the Sheriff. With the rare exception, the only party that attends such sales is the lender. In *Bank of Montreal* v. *Allender Investments Ltd.*,[361] the court held that as long as the lender follows the statutory and contractual provisions relating to exercise of the power of sale, the lender has satisfied

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357 See Robertson, "The Problem of Price Adequacy in Foreclosure Sales", *supra*, note 348 at 693-707 for a discussion on the standard of care imposed on lenders in England and the Canadian provinces where a lender sells land pursuant to a power of sale.

358 See Perell, *supra*, note 352 at 203-04 and Ontario Bar Course Materials, *supra*, note 352 at 95.

359 *Ibid.*, Perell at 203.

360 See *Bank of Montreal* v. *Allender Investments Ltd.* (1983), 53 N.B.R. (2d) 143 (N.B. Q.B.) discussed by Robertson, "The Problem of Price Adequacy in Foreclosure Sales", *supra*, note 348 at 715-16.

361 *Ibid.*

the duty of care. The result is sale of land at inadequate prices with no recourse for the borrower.[362]

The problem of price adequacy is further aggravated in a power of sale regime where the lender is able to buy at its "own" sale. In some provinces the lender can purchase the land when it exercises the power of sale by selling the land at a public auction. It goes without saying that if the lender has the ability to buy the land and obtain a deficiency judgment, the lender bids the lowest price possible. Since the auctions usually draw no bidders except the lender, the lender is not forced to bid competitively. One author advises that such a system exists in New Brunswick where the lender typically buys land worth $60,000 for less than $1,000.[363]

The problem of price adequacy also arises in situations in which the land is worth more than the debt secured by the mortgage. In these circumstances there often is little incentive for lenders to seek a price higher than the debt, especially when courts are reluctant to set aside sales to *bona fide* purchasers on the basis of price only and many borrowers cannot afford to sue the lender for breach of the duty of care in exercising the power of sale. In this situation, it may be expedient for the lender to sacrifice the equity of the borrower.[364]

One author concluded that of the four provinces in which power of sale is the primary remedy of the lender, only Ontario is successful in

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362 In *Bank of Montreal* v. *Allender Inv. Ltd.*, *ibid.*, the lender bought land appraised at $46,000 for a price of $100. The borrower owed $47,000. The lender sued for a deficiency of $46,900, being ($47,000 - $100). The court held that the lender had not breached the duty of care when exercising the power of sale.

363 J.T. Robertson, "Foreclosure by Power of Sale: Securing a Proper Price in New Brunswick" (1983) 32 U.N.B. Law Journal 83.

364 There have been a number of cases in the United States in which the federal Bankruptcy Court has determined that a sale of land pursuant to a power of sale is a fraudulent transfer under the bankruptcy legislation. In each case the sale price was sufficient to satisfy the mortgage debt, but was substantially less than the actual value of the land. The notable fact in each case was that the sale was lawful under the state mortgage law. See Robert E. Richards Jr., "Mortgage Foreclosure & Bankruptcy in Massachusetts: Is a Lawful State Foreclosure a Fraudulent Federal Transfer" (1990) New England Law Rev. 325. There are numerous articles on this topic.

obtaining price adequacy. He attributed Ontario's success to use of reasonable marketing techniques.[365]

• ***No effective safeguard for the borrower***. How does a borrower who does not have the money to make his mortgage payment finance a law suit against the lender? The importance of this factor is suggested by the fact that, in Ontario, an improvident sale is not often the subject of a claim for damages brought by a mortgagor, but it is more often raised as a claim for set-off when the lender sues the mortgagor to recover a deficiency judgment. If there has been an improvident sale, the court will credit the mortgagor with what the lender should have recovered on the sale.[366] Also, in New Brunswick and Newfoundland, the right to sue the lender for breach of duty in sale of the land pursuant to the power of sale is seldom exercised. This is so even though one author reports that lenders in those provinces routinely sell the mortgaged land at a public auction, which is inadequately advertised, and where the lenders purchase the land for nominal amounts.[367]

It is also more costly to pursue a claim for breach of duty of care in selling land under a power of sale than it is to argue in front of a court as to whether the offer is acceptable. The issues are different, although adequacy of price is relevant to both actions.

Though many mortgagors may be unable to finance such law suits, the existence of the duty of care is still of some benefit. In those jurisdiction in which the court insists that a lender use commercially reasonable marketing techniques in order to satisfy the duty of care, conscientious lenders act accordingly. Of course, not all lenders will use such techniques, but most will.

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365 Robertson, "The Problem of Price Adequacy in Foreclosure Sales", *supra*, note 348 at 707.

366 Perell, *supra*, note 352 at 203.

367 See three articles written by Robertson: (1) "Foreclosure by Power of Sale: Securing a Proper Price in New Brunswick", *supra*, note 363 at 118; (2) "Foreclosure by Power of Sale: Securing a Proper Price in New Brunswick, 1983-87" (1987) 36 U.N.B. L.J. 115; and (3) "The Problem of Price Adequacy in Foreclosure Sales", *supra*, note 348 at 681-83 and 711-17.

(2) The advantages and disadvantages of a judicial sale regime

In a judicial sale regime, the court supervises all aspects of the foreclosure process and the primary remedy of the lender is judicial sale. The advantages of a judicial sale are:

- ***Review of every sale***. There is judicial supervision in every foreclosure action, not just those in which the borrower has the money to litigate over whether the lender breached his duty when selling the land under a power of sale.

- ***Appraisal evidence required***. The court will base its decision to approve a sale on independent appraisal evidence. This appraisal evidence is obtained in every action. Accredited appraisers are generally used where the value of the land justifies the additional cost. Such evidence is not required in the exercise of a power of sale, although cautious lenders will use it to ensure that they meet the standard of care.

- ***Protection against sales at inadequate prices***. The sale of the land is subject to judicial review and the court will not knowingly approve sales at grossly inadequate prices. That does not always ensure sale at fair value, but it generally ensures that the land is not sold at grossly inadequate values. Of course, this assumes that the court employs effective marketing techniques in the sale of the land.

- ***Immediate foreclosure order if no sale***. If the judicial sale proves abortive, it is possible to apply to the court for a final order of foreclosure immediately. If the lender's attempts to sell the land under the power of sale are unsuccessful, the lender will have to keep trying to sell the land or commence court proceedings for foreclosure or judicial sale.[368]

- ***Protection for lender***. The lender is protected against any allegation of improvident sale of land that could arise if the land were sold under a power of sale. This is the major advantage, from the lender's view, of judicial sale.

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[368] See Perell, *supra*, note 352 at 204.

The disadvantages of judicial sale are:

- ***Increased costs***. Court proceedings increase the costs of enforcing the lender's remedies.

- ***Quality of appraisal evidence affects fairness of result***. The fairness of the system is directly related to the quality of appraisal evidence before the court.

- ***Redemption periods may be longer***. Sometimes legislation will give standard redemption periods that cannot be varied even when there is no equity. This delays the exercise of the lender's remedies.

- ***Difficulty in attracting bids***. If the marketing techniques and method of sale adopted by the court are not commercially reasonable for the type of property being sold, no bids may be forthcoming. Achieving price adequacy in a judicial sale becomes impossible if there are no bids. Also, some people shy away from buying property that is being sold by a court in a mortgage action. They see purchase of such a property, especially if they have no ability to view the inside of the property, as very risky.

Until the mid-1980s, Alberta courts tried to sell land by tender, with little success. In most actions there were no tenders for the property. The marketing technique and method of sale were inadequate. To remedy this, Alberta courts went from sale by tender to sale by listing with a realtor.

(3) Which is better for Alberta?

Comparing the advantages and disadvantages of a power of sale regime and a judicial supervision regime is meaningless unless done in the context of the economy in which it is going to operate. A power of sale regime is best suited for an economy which is stable and where land prices do not fluctuate with frequency. Judicial sale seems to be the preference for the western Canadian provinces, which have economies that experience wide fluctuations in land values.

Alberta has an economy largely based on natural resources. The province's economic strength varies with the price of the commodities Albertans sell. As these prices fluctuate so does the economy. A healthy

economy brings an influx of workers to Alberta and a corresponding demand for land and housing. A recession reverses the process. There is migration of individuals from Alberta, decreased demand for housing and falling land prices. The result is that our land values pattern themselves after the strength of the economy. This is why our land values fluctuate more than land values in Ontario. The price of land in Edmonton was more than twice as volatile as the price of land in Toronto for the period of 1976 to 1987.[369]

With such a fluctuation in land prices comes the need for judicial supervision because in times of fluctuating land prices, a judicial supervision regime is of benefit to both the lender and the borrower. It ensures that some attempt is made to sell the land at a fair price and it gives lenders protection from actions alleging improvident sale of land under the power of sale. Judicial supervision can be an effective tool in ensuring price adequacy in foreclosure sales because it ensures a tangible review of land values based on independent appraisal evidence. This benefits borrowers who could not afford to sue a lender who when exercising the power of sale did not take the necessary steps to sell the land for a reasonable price.

Although the cost of exercising the lender's remedies in a judicial supervision regime is greater than under a power of sale regime, the difference in costs is not very great. Canada Mortgage and Housing Corporation ("CMHC"), Mortgage Insurance Company of Canada ("MICC"), CIBC Mortgage Corporation, Bank of Montreal and Scotiabank provided information in respect of the fees and costs related to legal process in the Canadian provinces. This information is summarized in Appendix B. With the exception of the Scotiabank, these lenders indicated that the "fees and costs related to the legal process [in Alberta] are similar to other provinces".[370]

Only Scotiabank reported that there was a significant difference between fees paid for a foreclosure action in Alberta and fees paid in respect

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369 E.J. Chambers and Michael B. Percy, *Western Canada in the International Economy* (Edmonton: University of Alberta Press, 1992) at 32-34. Note Table 4.2.

370 Letter of November 12, 1993 from MICC to Mortgage Loans Association of Alberta, which was provided to us by the Association. This information confirms oral representations provided by officers of MICC to Institute Counsel.

of the exercise of a power of sale in Ontario. Nonetheless, Scotiabank sees no need to go to a power of sale regime in Alberta.[371]

One must also remember that the mere exercise of a power of sale does not give judgment to the lender. Action must be started to obtain judgment and this adds to the lender's cost. This may account for the difference between the fees quoted by Scotiabank and the other lenders. Also, in power of sale jurisdictions, lenders must defend actions or counterclaims where the borrower alleges that the lender has breached its duty of care in exercising the power of sale. These costs, which do not arise in Alberta, must also be considered when comparing the two regimes.

It is fair criticism to say that in Alberta judicial sale by tender during the 1980s attracted few bidders. The solution to this problem does not have to be an adoption of a power of sale regime; the solution can be a more responsive sale method. Clearly, the more bidders the judicial sale process can attract, the better. This is a function of the economy, marketing techniques and the method of sale. Alberta courts did not use effective marketing techniques or sale methods in the early 1980s, but this problem has been addressed by the court through the introduction of judicial listings. Since 1987 lenders have become more keen to sell land through judicial sale. Before then, lenders sought title by way of foreclosure or Rice order as quickly as possible; now, they seek judicial sale. This change has occurred because lenders have reduced holding costs for properties occupied by the borrower and there is greater chance of successful sale when a judicial listing is the method of sale. Mortgages insured by CMHC are the exception to this trend. Since lenders do not get paid by CMHC until CMHC obtains title, lenders seek title and then quickly convey it to CMHC.

The best argument in favour of court supervision is the acceptance of the system by those who are affected by it. Most people who responded to the report for discussion acknowledged that the existing system is adequate. The Mortgage Loans Association of Alberta sees court supervision of foreclosure actions as a fair balance between the rights of the lender, borrower and other interested parties. Moreover, many loans officers acknowledge that the speed of exercising mortgage remedies dramatically

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[371] Letter of March 1, 1993 from R.A. Connolly, Vice-President, Credit, Scotiabank to Canadian Bankers' Association.

increased in the 1980's in response to the flood of foreclosure actions commenced in those years. R.J. Dubask of the Bank of Montreal wrote:[372]

> As a general statement, current provincial foreclosure procedures provide no major concerns or exposures to the bank in its ability to administer a file and protect against losses on a timely basis within the residential mortgage portfolio.

R.A. Connolly, Vice-President, Credit, of Scotiabank wrote:[373]

> We do not believe an Ontario-style power of sale regime would necessarily be of benefit in Alberta. The present powers of foreclosure are considered sufficient to sell property within a reasonable time frame.

In contrast, the Canadian Bankers' Association favours a power of sale for the following reasons:[374]

> Recommendation 22(a) states that "A power of sale granted by an individual borrower should be void." This recommendation endorses the policy underlying present Alberta law which prohibits a lender from exercising any form of private sale process where the borrower is an individual. The lender, faced with a default under a mortgage granted by an individual, must resort to the remedies of foreclosure and judicial sale. These remedies are generally regarded as cumbersome and costly from the lender's point of view. These costs are then passed on, where possible, to the debtor. Presumably, the Institute favours judicial supervision of foreclosure and sale proceedings as a means to ensure fair treatment of the borrower and a fair price for the land. However, power of sale should be an option for a lender as it can reduce costs for the debtor, and works very well in other provinces. We believe that sufficient

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372 Letter of November 19, 1991.

373 Letter dated March 1, 1993.

374 Letter of December 16, 1991.

safeguards can be built into the system to ensure that the lender sells at market value.

We remain of the view that judicial sale is the best system for Alberta. Judicial supervision is needed to ensure price adequacy in foreclosure sales in times of fluctuating land prices that are frequently experienced in Alberta. Procedural reform, which is discussed in Chapter 8, will address the concerns of the Canadian Bankers' Association as to the speed and cost of enforcing mortgage remedies.

RECOMMENDATION 1

Alberta should retain judicial supervision of the foreclosure process.

C. Should there be Deficiency Judgment Protection in Alberta?

Under this heading, we compare the various legislative models of deficiency judgment protection, describe the policy that is served by such legislation and examine the consequences that this policy has in Alberta. We then consider whether reform should proceed within the existing legislative policy or proceed along a different course.

(1) Comparison of legislation that protects certain borrowers from deficiency judgments

(a) Protection of individuals

As discussed in Chapter 4, Alberta has legislation which prohibits a lender from suing on the personal covenant to pay given by a borrower. This prohibition does not apply when a corporation grants the mortgage. Originally, it was the identity of the borrower that determined for all time whether the lender's remedies were restricted. However, recent Court of Appeal cases have held that this approach is no longer applicable in situations where a transferee renews the mortgage.[375]

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375 See Chapter 4 at 61-76.

(b) Protection in respect of purchase money mortgages

Saskatchewan[376] and several American states[377] prohibit action on the covenant found in a purchase money mortgage. A purchase money mortgage is given to a vendor to secure payment of the unpaid balance of the purchase price or to a lender to secure payment of a loan used to purchase the land charged by the mortgage.[378] In Saskatchewan, actions on the covenant are prohibited in respect of all purchase money mortgages regardless of the type of property. This protection can be waived by corporations, except where the corporation has granted a purchase money mortgage that charges farm land. Unlike Saskatchewan, many American states limit the protection to purchase money mortgages charging single or two-family houses or homesteads.

This regime does not protect borrowers who charge their homes as security for other purposes. For example, if parents borrow money to finance their child's university education and secure the loan by a mortgage on their home, the mortgage is not a purchase money mortgage. If they default in their payments, the lender can foreclose on the home and sue the parents for a deficiency judgment.

An odd situation arises where a borrower grants a mortgage on land he or she owns to secure a loan used to construct a residence on the land. In these circumstances the borrower does not use the money to purchase the land and, therefore, it is not a purchase money mortgage.[379]

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376 See section 2 of the Limitations of Civil Rights Act, R.S.S. 1978, c. L-16 and section 25 of the Saskatchewan Farm Security Act, S.S. 1988-89, c. S-17.1, as am.

377 R.M. Washburn, "The Judicial and Legislative Response to Price Inadequacy in Mortgage Foreclosure Sales" (1980) 53 South. Cal. Law Rev. 843 at 916.

378 Section 2(1.1) of The Limitations of Civil Rights Act, R.S.S. 1978, c. L-16 provides that the protection of the section applies to mortgages given to secure purchase of the land, whether or not the lender is the vendor of that land. In contrast, some American statutes apply only to mortgages given by the purchaser to the vendor to secure payment of the balance of the purchase price. Other American statutes apply to these mortgages and to mortgages granted to lenders who loan money so that the mortgagee can purchase land charged by the mortgage.

379 *Gravelbourg Savings* v. *Bissonnette* (1986), 43 Sask. R. 241 (Q.B.), aff'd (1988) 66 Sask. R. 81 (C.A.) though the Court of Appeal did not deal with this issue. See also *First City Trust Company* v. *Woodlawn Properties Ltd.* (1990), 80 Sask. R. 299 (Q.B.).

It seems inconsistent that a borrower who purchases a home is protected, but a borrower who builds a home is not protected. This problem was been overcome in one American state with a result oriented decision[380] which held that "purchase" included the term construction. The result was that the lender could not obtain a deficiency judgment on a covenant to pay given in a deed of trust charging a lot to secure payment of the construction loan used to build a residence on the lot.

(c) Protection if land sold by lender

Recognizing the potential for abuse of the lender's power of sale, several states prohibit deficiency judgments where the lender exercises a power of sale without judicial supervision.[381]

(d) Protection if redemption period shortened

Several states also prohibit deficiency judgments where the lender seeks an order reducing the statutory redemption period.[382]

(e) Appraised value as restriction on deficiency judgment

Some state legislation provides that the mortgaged land shall not be sold for less than two-thirds of the appraised value. Three of these states also provide there shall be no deficiency judgment where two-thirds of the appraised value is larger than the debt owed plus costs.[383] Such provisions encourage sale of the land at fair price but do not protect borrowers when economic depression destroys the real estate market.

(f) Other methods of protecting the borrower

Deficiency judgment protection is but one method of protecting borrowers from overhanging deficiency judgments. A similar purpose can be

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380 *Punty* v. *Bank of America* (1974), 112 Cal. Rptr. 370, 37 C.A. 3d 430.

381 Washburn, *supra*, note 377 at 917

382 *Ibid.* at 918.

383 *Ibid.* at 904.

achieved by reducing the time in which a lender can enforce any such deficiency judgment. For example, in Iowa, a lender can obtain a deficiency judgment but must enforce it within two years of the date of judgment.[384] This restriction allows lenders to pursue borrowers who, at the time of the foreclosure, have assets other than the mortgaged land. But it generally will not allow a lender to enforce the judgment against a borrower whose primary asset was the mortgaged land because it is unlikely that the borrower will accumulate significant assets within this two-year period.

Another method of protecting borrowers is to ensure that the land is sold at fair value. This does not always prevent deficiency judgments but in some situations it does because the fair value of the land exceeds the amount of the debt. Nova Scotia[385] and Quebec[386] and many American

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384 Patrick B. Bauer, "Judicial Foreclosure and Statutory Redemption: The Soundness of Iowa's Traditional Preference for Protection over Credit" (1985) 71 Iowa Law Rev. 1 at 47-48.

385 In Nova Scotia, the relevant section is found in Civil Procedure Rule 47,10(2), which reads as follows:

> 47(2) Where a plaintiff or a party related in interest is the purchaser at a sale pursuant to Rule 47.08, and it appears that the price paid was less that the fair market value of the property at the time of sale, the court, in determining the amount of the deficiency, may deem the sale price to have been
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> (a) the fair market value of the property at the time of the sale as established by independent appraisal;
>
> (b) the amount realized upon a resale of the property if the court is satisfied that the price obtained was reasonable, but in that event any income derived from the property before resale shall be added to the price obtained and there shall be deducted therefrom the costs of resale (including real estate commission paid to a third party), expenses reasonably incurred to derive income from the property and other costs reasonable and necessarily incurred to protect or conserve it.

[Subsection 3 of this rule requires that the application for deficiency judgment be made within six months of the Sheriff's sale.]

386 Article 1695 of the Civil Code of Quebec, S.Q. 1991, c. 64 reads as follows:

> 1695. Where a prior or hypothecary creditor acquires the property on which he has a claim, as a result of a judicial sale, a sale by the creditor or a sale by judicial authority, the debtor is released from his debt to the creditor up to the market value of property at the time of acquisition, less any claims ranking ahead of the acquirer's claim.
>
> The debtor is also released where, within three years from the sale, the creditor who acquired the property receives, by resale of all or part of the property or by any other transaction in respect of it, value equal to or greater than the amount of his claim, including capital, interest and costs, the amount of the disbursements he has made on the property, with interest, and the amount of the other prior or hypothecary claims ranking ahead of its own.

This article came into force on January 1, 1994 and restricts the protection formerly available to borrowers in Quebec. For a discussion of the predecessor to

(continued...)

states have fair market value legislation, which provides that a deficiency judgment cannot be for an amount greater than the difference between the debt owed and the fair market value of the land. The legislation applies when the lender sells to itself but can also apply when the lender sells to a third party. Fair market value statutes do not provide any protection to the borrower when the real estate market collapses. Consequently, such statutes are of little benefit to the borrower in times of severe economic depression.[387]

(2) Public policy underlying legislation that protects borrowers from deficiency judgments

The Canadian and American legislation[388] that protects certain borrowers from deficiency judgments was enacted in response to the Depression. At that time severe economic recession had resulted in widespread unemployment, consequential mortgage defaults, and market failure. The governments of the day wished to ensure that the borrowers who lost their land would not be saddled with the future obligation to pay for it. They recognized that the existence of overhanging deficiency judgments would make it more difficult for the borrowers to re-establish themselves and this would, in turn, worsen the recession. The governments saw the borrowers as the ones least able to absorb the loss and, conversely, saw the lenders as the ones most able to absorb the loss. Lenders, at least, had the land as a buffer to bankruptcy.[389]

We believe that this is still the public policy behind legislation which limits deficiency judgments (also known as antideficiency legislation). In times of economic growth and stable or increasing land prices, antideficiency legislation does not greatly affect lenders. During such times deficiencies are rare because the borrower generally can sell the land and repay the

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[386](...continued)
this article and the unjust enrichment of lenders it was designed to eliminate, see *Garcia Transport Ltee.* v. *Royal Trust Company*, [1992] 2 S.C.R. 499.

[387] Washburn, *supra*, note 377 at 907-16.

[388] Alberta and Saskatchewan has such legislation. Several American states have statutes prohibiting deficiency judgments in certain situations. See Washburn, *supra*, note 377 at 916-19.

[389] J.R. Hetland, "Deficiency Judgment Limitations in California—A New Judicial Approach" (1963) 51 Cal. Law Rev. 1 at 5-7.

debt secured by the mortgage on the land. It is only in times of economic depression that deficiencies become common.

(3) Existing legislative policy: protection of homeowners and farmers

Since the introduction of antideficiency legislation in Alberta in 1939, the general intention of successive Alberta governments has been to provide protection to homeowners and farmers. The 1939 legislation applied to all mortgages of land. At that time Alberta had a rural economy,[390] and the protection was designed with farmers and urban homeowners in mind. As our economy began to diversify, the Legislature tried to achieve the selective protection of homeowners and farmers by a factual test. In 1964, the line between protected and non-protected mortgagors was drawn at the point where a mortgage was given by a corporation. As noted in Chapter 3, this caused some difficulties in practice. In 1983, the Legislature then attempted to shift[391] to a more functional test: use of the property as a residence or farm. This functional test is used to determine those transferees who will be protected from liability arising from the assumption of a mortgage given by a corporation.

(4) Taking a closer look at deficiency judgment protection in Alberta

In the report for discussion, we took the position that in the area of mortgage remedies there were legitimate values on both sides of the debate: protection of borrowers, on one hand, and adequate supply of credit at reasonable cost, on the other. The choice between them seemed to us to be truly political. Since we could not conclude that the values on which the law rested were demonstrably wrong or that there was evidence that the law harmed fundamental Alberta interests, we saw no reason to go away from the existing policy of deficiency judgment protection.

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390 Statistics published by the Alberta Bureau of Statistics (Edmonton, 1950) reveal that in 1936 62.93% of the Alberta population was rural. By 1941 there had been a slight decline to 61.49%.

391 See the 1983 amendments to Part 5 of the Law of Property Act.

Several commentators asked us to examine in more detail the policy underlying deficiency judgment protection. One commentator suggested that we answer these questions:

- Who benefits from deficiency judgment protection?
- By how much?
- Who pays the costs of this protection?
- What are the costs?
- Are there more economical ways of achieving the same results?
- Why do homeowners deserve protection more than others?
- Did deficiency judgment protection in some manner affect land prices in the 1980s?

These are valid questions. Although we cannot respond to these questions with exact dollar figures, it is useful to address them in some detail.

Who benefits from the existing deficiency judgment protection?

Deficiency judgment protection benefits individuals (but not corporations) who grant mortgages. The position of individuals who assume mortgages is more complicated, but again many such individuals receive deficiency judgment protection. Presently, it matters not what type of land the individual mortgages.

- ***Certain individuals***

The people who benefit directly are those who default at a time when the value of their home or land realizable in foreclosure proceedings is less than the debt owed to the lender. Information provided by lenders for the years 1982 and 1983 shows that the majority of residential foreclosures affected younger persons (25-40) who had purchased the home within 1 to 3 years before default occurred. About 88% of the foreclosed properties were valued (at foreclosure) at less than $100,000 and 64% of all residential foreclosures related to properties worth less than $80,000. Residential foreclosure fell most heavily on younger, first-time buyers with a high debt/equity ratio who were squeezed by the recession. Of those younger homeowners who were affected, many were at risk of being pursued for

deficiency judgment protection if their mortgages were advanced or guaranteed by government agencies, all others were not.[392]

An indirect benefit may be felt by those who take comfort in the fact that if the recession deepens and they lose their jobs and their homes, they will not have to face deficiency judgments on their mortgages.

We do not know how many individuals were protected from deficiencies that arose on mortgages charging commercial or industrial land.[393]

- ***Alberta's economy***

The economy itself benefits by the existence of deficiency judgment protection. Borrowers will extinguish overwhelming personal liability by personal bankruptcy. Yet, widespread bankruptcies worsen a recession by shaking public confidence and by eliminating all debts of bankrupts, not just the mortgage deficiency. If lenders are allowed to recovery on deficiency judgments against large numbers of former residential mortgagors, the recovery of the economy may be delayed.

By how much?

Individuals who are protected from deficiency judgments benefit by not having judgments registered against them and not having assets seized to satisfy the judgments at times when they have to find new places to reside. This creates both an emotional and financial benefit, but the financial benefit is what we will concentrate on at this time. For those people who are destitute at the time they lose their home, the financial benefit accrues later. If and when they rebuild their fortunes, the lender will not be able to pursue them at that time for the judgment debt and interest. For people who could pay the deficiency (i.e. walk-aways), the immediate benefit is the full amount of the deficiency.

Care must be taken to distinguish between the benefit received by protected individuals and the actual loss experienced by lenders. The two are not the same. The size of deficiencies on residential mortgages in the

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[392] See Chapter 5 at 131-32.

[393] Under the recommendations made in this report, such individuals would be liable on their covenant to pay.

1980s was large. Some lenders indicated that the average loss on a residential foreclosure in the mid 1980s was $10,000. In one survey, the average loss for the 27 of 45 lenders who responded to the question was $16,000. The actual losses are huge if you consider the number of foreclosures and quitclaims that occurred during that period. Yet, even if all of this loss had been reduced to judgment, the losses suffered by lenders would still be huge because many judgments would not be recoverable. A judgment is worthless if the debtor has no assets or attachable income to satisfy it.

What are the costs of this protection?

- ***Loss of revenue for lenders***

Whether or not you have deficiency judgment protection, certain borrowers will default on their covenant to pay. In most provinces where lenders have access on the covenant, the actual amount collected on deficiency judgments is a small proportion of the sum of such judgments.[394] The major criticism of deficiency judgment protection in Alberta is not that it stops recovery and enforcement of deficiency judgments (since collection on such judgments is relatively insignificant in other provinces), but that in Alberta (1) borrowers stop paying their mortgage loans before they stop paying other debts, and (2) dollar dealers and walk-aways take advantage of deficiency judgment protection laws.

The actual loss to the lenders **caused by deficiency judgment protection** (and not the economy) is:

(a) the money walk-aways would have paid had they stayed in their homes,

(b) the money that would have been collected on deficiency judgments, which would have been relatively small,[395]

(c) the money that was diverted into the hands of dollar dealers.

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394 CMHC indicated that in the 1980s it collected very little on deficiency judgments. Also, AHMC and AMHC had access on the covenant up until 1986, and yet this did not prevent the massive losses those corporations suffered. (See the discussion in Chapter 7 with respect to CMHC.)

395 CMHC indicated that from 1987 to 1992 it collected in excess of $4.5 million on Alberta judgments. Yet, for the years 1983-1992, CMHC has paid claims nationally which total, on average, $257.8 million per year. See the discussion in Chapter 7.

Walk-aways and dollar dealers, although only a temporary phenomena, were large in number from 1982 until 1984. As land prices plummeted, the number of walk-aways and the activity of dollar dealers increased. Lending officers advise that dollar dealers and walk-aways were not a large problem in 1985. It is difficult to estimate the actual losses attributable to these mortgage defaults, but there is no doubt the losses were significant.

The only information we have concerning the number of walk-aways and dollar dealers comes from *Survey of Residential Mortgage Defaults* prepared by Alberta Housing.[396] In that Survey, lenders were asked to specify the cause of defaults that led to foreclosure actions and quitclaims concluded in 1982 and 1983. The categories were: (1) marriage break-up, (2) income/unemployment related, (3) decline in property values, (4) high debt load, (5) abandonment, (6) dollar deal and (7) other. The results of the survey do not address the issue of walk-aways unless we assume that decline in property values refers to walk-aways. This seems fair since a distinction is made between defaults that are income/unemployment related and those that relate to decline in property values. We also have no way of knowing how accurately the lenders were able to judge the reasons for the foreclosures and quitclaims. We include this information to give some idea of the nature of the problem, but we caution readers to recognize our assumption that decline in property values refers to walk-aways and the possibility of errors in the data provided by lenders.

The Survey dealt with residential mortgage defaults that occurred during 1982 and 1983 and also provided an estimate for reasons for default in 1984, but no estimates for 1985.[397] The information, updated to include the actual number of foreclosures in 1984, is as follows.

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396 (a) Survey, *supra*, note 334 at 7 and 8 and Appendix, Number of Residential Foreclosures in Alberta. We also used updated statistics on the number of residential foreclosures in Alberta for the year 1984.
(b) For an interesting yet debateable approach to this issue see also Lawrence D. Jones, "Deficiency Judgments and The Exercise of the Default Option in Home Mortgage Loans" (1993) 36 J. Law and Econ. 115. Query whether conclusions made on the basis of the experience of MICC can be extrapolated to the residential mortgage industry as a whole.

397 The Survey suggests that dollar dealers were involved in 8% or 390 final orders in 1983. We have used the 8% as the benchmark even though 8% of 3869 is 310, not 390. If the 390 is correct, the percentage for 1983 re dollar dealers is about 10%.

Year	Total number of final orders in Alberta for residential foreclosures	Dollar deals %	Dollar deals #	Decline in property value % of defaults	Decline in property value - #
1982	1143	1%	12	12%	137
1983	3869	8%	310	27%	1044
1984	8023	10% (est.)	802 (est.)	29% (est.)	2327 (est.)

The lenders surveyed held a total of 240,620 single family mortgages in their portfolios as of the end of 1983. The foreclosures and quitclaims for 1983 represent 2.0% of the reported single-family portfolios.[398]

Dollar dealers were definitely a thorn in the side of the lenders, but it is difficult to gauge the amount of loss they caused. Dollar dealers diverted rental income to themselves that might have gone to the lender. They also often took the refrigerators and stoves when they vacated the properties. The lenders then had to replace these appliances so that they could sell the houses. We have no way of estimating how much lenders actually lost as a result of dollar dealers, but no doubt it was large. Lenders advise that the procedural changes of 1984 helped reduce the number of dollar dealers.

- ***Other real or alleged consequences of deficiency judgment protection***

The existence of deficiency judgment protection in Alberta does give rise to tighter lending criteria. Yet, this makes sense in a province in which the economy is tied to the value of resources that depends on events beyond the province's control.

Another consequence of deficiency judgment protection is that MICC effectively left the Alberta market at the end of 1982 because of the losses it incurred on residential mortgages insured during 1979 to 1982.[399] CMHC has filled this gap in the market so there is no lack of mortgage insurance

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398 Survey, *supra*, note 334 at 7.

399 See Chapter 5 at 132.

for residential mortgages. Until recently, MICC continued to insure mortgages of commercial property.

Some of the traditional arguments against deficiency judgment protection are that it will cause interest rates to rise or it will reduce the amount of money lent in the jurisdiction that creates it. These did not transpire in Alberta. The major banks charge the same interest rate on residential mortgages in every province, and lenders agree that there has always been an adequate supply of credit granted in Alberta on land mortgages.

One commentator believes that deficiency judgment protection conveys to Albertans the idea that the payment of debt is not important. Another commentator suggested such protection should increase the demand for homes and farms and cause Albertans to borrow more than they can afford because they will not have to face the consequences of their choices.

We cannot find support for these two views. If these views were correct, there would be a constant demand for housing in Alberta unaffected by the prevailing interest rate or state of the economy and Albertans would believe that paying their mortgages is not important. Yet, any realtor or house builder knows that the demand for homes is directly related to the prevailing interest rate and how secure people feel in their jobs, both of which indicate that people are concerned about their ability to pay their debts. No reasonable person wants to put a significant down payment into a house he or she cannot afford only to lose that money when the bank forecloses and takes title. Taking out a residential mortgage is one of the most important decisions people make in their lives and most Albertans recognize this and treat it accordingly.

Who pays these costs?

It goes without saying that the financial losses experienced by lending institutions as a result of deficiency judgment protection are passed on to mortgage insurers or on to the customers and shareholders of the institution. Mortgage insurers pay for these losses out of insurance premiums. Individual lenders suffer the loss personally. The spreading of loss by institutional lenders and mortgage insurers is seen by some commentators as desirable, because it places the risk of massive economic

decline upon lending institutions and mortgage insurers which are the institutions in our society most able to deal with the loss. Lenders and mortgage insurers, obviously, disagree. They see deficiency judgment protection as unfairly placing the risk of economic downturn on lenders who do not get the corresponding benefit from increasing land values. Individual lenders must be especially careful that they have adequate security for the mortgage loans they make or suffer the losses.

It must be again emphasized that even if lenders had access to all personal covenants in the 1980s, they would still have suffered significant losses because of the economic decline experienced in Alberta during those years.

Another consequence of deficiency judgment protection is that borrowers must meet the stricter lending requirements that are imposed in Alberta during certain economic conditions. For example, MICC insisted on 15% equity in residential properties for an insured mortgage in Alberta as compared with 10% equity in other provinces.[400] Also, with the withdrawal of MICC from the residential mortgage insurance market, borrowers are left with only CMHC. When both were doing business in Alberta, borrowers had more success in obtaining less strict lending conditions.

Are there more economical ways of achieving the same result?

Lenders suggest that there is no need for deficiency judgment protection of truly impecunious borrowers because:

- a lender is unlikely to pursue such a borrower for a deficiency where there is little hope of collecting on the judgment, and

- if a judgment is obtained, the borrower can declare bankruptcy.

It must be recognized that in the 1980s many lenders sued for deficiency judgment whenever it was available, with no regard to the financial circumstances of the borrower. Many lenders were obtaining judgments against individuals who had assumed mortgages granted by the builder Nu-West Homes Ltd. This precipitated the 1983 amendments that

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400 See Chapter 5 at 133.

protected individuals who assumed corporate mortgages on residential properties in which the individuals or their families lived. History shows that in times of deep recession, lenders often abandon the policies that guided them in stable economic times and seek deficiency judgment whenever it is available.

Bankruptcy is one method of protecting destitute borrowers from overhanging deficiency judgments. But is it a more economical way of achieving the same result as deficiency judgment protection? We are not convinced that it is. In a time of severe economic decline, borrowers will extinguish overwhelming personal liability by personal bankruptcy. The bankruptcy will eliminate not only the mortgage deficiency but all the other debts of the bankrupt. Large numbers of bankruptcies shake public confidence and reduce consumer spending. This will hurt the local economy and prolong the recession.[401]

One must also consider the social cost of forcing large numbers of Albertans into bankruptcy because of deficiencies on land mortgages brought on by falling land values caused by things outside their control. The same argument could be made for other business failures brought on by unexpected market factors, but the percentage of Albertans who are homeowners is larger than those who are businessmen. Moreover, society views business people as more sophisticated and able to deal with economic conditions than the population as a whole.

Why do homeowners deserve protection more than others?

This is an important question. It raises two separate issues:

- Why do Albertan homeowners deserve protection over other Canadian homeowners who do not receive protection in their province?

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401 Many of these arguments are made in recent American articles examining the need for deficiency judgment protection. These articles were prompted by recessions that hit Texas and the mid-west in the 1980s that were similar to that experienced in Alberta. See:

1. John Mixon, "Deficiency Judgments Following Home Mortgage Foreclosure: An Anachronism that Increases Personal Tragedy, Impedes Regional Economic Recovery and Means Little to Lenders" (1991) Texas Tech. Law Rev. 1.
2. John Mixon and Ira Shepard, "Antideficiency Relief for Foreclosed Homeowners: ULSIA Section 511(b)", (1992) 27 Wake Forest L. Rev. 455.
3. Michael H. Schill, "An Economic Analysis of Mortgagor Protection Laws", (1991) 77 Virginia Law Rev. 485.

- Why do Albertans who mortgage their home or farm deserve more protection than Albertans who mortgage other types of property?

To understand why Albertan homeowners receive protection that is not provided in some of the other provinces, we must first recognize that all provinces have different economies. Our land values fluctuate twice as much as do land values in Ontario.[402] There may be no need for deficiency judgment protection in provinces that have more diversified economies and relatively stable land prices. There may be a great need for such protection where land values fluctuate dramatically. The provinces and states that have some form of deficiency judgment protection usually have more resource-based economies and a history of boom and bust land values. Alberta is typical.

Alberta deficiency judgment protection has always favoured homeowners and farmers over other mortgagors. This reflects a policy based on the social purpose of the different types of property. The general purpose of residential housing is to provide shelter and an environment in which to raise families. The general purpose of commercial property is to generate income or capital gain. Alberta legislation clearly implies that the former purpose is worthy of greater protection from economic swings than the latter. The loss of a home through foreclosure may be expected to have greater emotional and financial consequences than loss of a commercial property. When homeowners lose their home, a new residence must be found immediately. The homeowner will be faced with moving expenses, legal fees, a new down payment or a least rent and a damage deposit. It is onerous for an individual to have his or her home taken away and then have the lender seize the remaining exigible assets at a time when the individual is scrambling to find new shelter. When commercial property is lost through foreclosure, there is no necessity to obtain an alternative commercial property. The commercial investor loses nothing but money, and the feeling is not so strongly in favour of protecting such an individual.

Some might suggest that farms are commercial properties and the law should treat them as such. There is no doubt that farms are commercial operations. However, the unique features of a farm make it more akin to a residence. A farm is usually a residence as well as a commercial operation,

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[402] Chambers and Percy, *supra*, note 369.

so the loss of a farm is often the loss of a home and a livelihood. Also, the production of food for our society is to be encouraged above that of many other commercial ventures.

The public policy underlying legislation that creates deficiency judgment protection provides another reason for not protecting every individual borrower. The policy is NOT to allow people with means to escape payment of debt. Deficiency judgment protection is intended to protect destitute borrowers from overhanging deficiency judgments. Borrowers in need of such protection are those individuals whose major asset is their homes or farms. For those people (walk-aways excluded), the loss of their home or farm through foreclosure means that they have come to the brink of financial ruin and must rebuild their assets. By providing deficiency judgment protection only to individuals who grant mortgages on residential land or farm land, Alberta law will protect those most likely in need of protection. Individuals who can afford to invest in commercial properties do not require protection from deficiency judgments because they are more likely to have other assets which can be used to satisfy the debt secured by the mortgage.

Did deficiency judgment protection in some manner affect falling land prices in the 1980s?

MICC suggest that the phenomena of walk-aways increased the number of homes on the market and thereby deflated land values during the 1980s. This, in its opinion, caused a loss of equity for all Albertan homeowners. One economist we interviewed thought that the phenomena of walk-aways had little effect on land values. In his opinion, the land devaluation that occurred in the 1980s was caused by the inflated land prices of the late 1970s and migration of people from Alberta in the 1980s. The phenomena of walk-aways probably had some effect on land prices, but it certainly was not the primary cause of falling land values experienced in Alberta in the 1980s. Land values must drop significantly over a short period before walk-aways emerge.

(5) Conclusion

Our review shows that while deficiency judgment protection has some negative effects, it generally protects thousands of homeowners who, through no fault of their own, lose their jobs and homes at a time when land values are substantially reduced by recessionary forces. Whether one

finds this desirable or not depends on one's philosophical views, but the political choice and policy of providing deficiency judgment protection has prevailed in Alberta continuously since 1939. Protection of homeowners and farmers is legitimate public policy. We have found no compelling evidence showing a need to change that policy.

On what we have gathered to date, we conclude that the existing policy does not harm essential Alberta interests. The recession experienced in the 1980s caused lenders to more carefully manage the extension of credit, but the formal rules for credit have not changed.

Does abuse of the system by walk-aways and dollar dealers justify some fundamental realignment of the system? We think not. Procedural changes have largely solved the problem of dollar dealers and the vast majority of homeowners who defaulted on their mortgages in the 1980s did so because of unemployment or falling income. The relatively small number of walk-aways does not, in our view, justify repeal of deficiency judgment protection for all homeowners.

In the final analysis, whether a government chooses to create deficiency judgment protection is really a political decision. So it is fair to say that this decision is best left to the politicians. Our recommendations are intended to reform the law within the present policy of protecting homeowners and farmers and, in the process, to eliminate demonstrated abuses that may arise as a result of that primary policy.[403]

RECOMMENDATION 2

As the values upon which the existing mortgage remedies law is based are longstanding and as there is no evidence that this body of law damages essential Alberta interests, we recommend that mortgage remedies law be reformed within the existing legislative policy of protecting homeowners and farmers from deficiency judgments.

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403 In Chapter 8, we will discuss procedural changes that were successful in discouraging purchase of homes by dollar dealers.

CHAPTER 7
FRAMEWORK FOR REFORM

The purpose of this chapter is to suggest a framework for reform of substantive mortgage remedies law and to outline particular issues for determination within that framework. Chapter 8 will deal with recommended procedural changes.

A. No Deficiency Judgment Protection for Corporate Borrowers

As discussed in Chapter 6, the existing legislative policy contemplates deficiency judgment protection for homeowners and farmers, but not others. Corporations are themselves a vehicle used to protect the shareholders from personal liability. No additional protection is needed. Corporations should not receive deficiency judgment protection.

RECOMMENDATION 3

Corporate borrowers should not be afforded deficiency judgment protection.

B. Deficiency Judgment Protection for Some Individual Borrowers

Under this heading we discuss means of creating deficiency judgment protection for individual borrowers who mortgage their homes or farms. The question of deficiency judgment protection for transferees, who assume mortgages, will be dealt with later in this chapter.

(1) Methods of protecting homeowners and farmers

Having stated in Chapter 6 who should be protected and why, we must now determine the simplest way of doing this. There are three methods that can be used to protect homeowners and farmers from deficiency judgments. The first method is to restrict the lender's remedies to the land where an individual grants a mortgage of land. The second method is to restrict the lender's remedies to the land where an individual grants a mortgage of residential land or farm land. The third method is to restrict

the lender's remedies to the land whenever an individual grants a mortgage of residential land or farm land that is a purchase money mortgage.[404] Let us evaluate and compare the three possibilities in respect of certainty and scope of protection.

The first method retains the distinction now made between individuals and corporations. At first glance, this may seem to contradict our stated goal of creating deficiency judgment protection for homeowners and farmers, but not other individuals. Practical realities, however, must not be forgotten. Lenders do not have to lend to individuals. In commercial matters, the general practice of lenders is to require individuals to create corporate vehicles. The corporation will be the borrower and the lender will insist that the individual guarantee the loan. In contrast, when individuals borrow money to purchase a home, lenders do not require that the individual create a corporate vehicle. It is also our understanding that the general practice of lenders is not to require farmers to create a corporation in order to obtain the loan.

The obvious strength of this method is certainty of application. There can be no confusion between an individual and a corporation. One cannot change into the other, ever. Accordingly, lenders know with certainty that deficiency judgment protection is afforded to the individual borrower but not to the corporate borrower. Confusion has arisen in respect of liability of transferees. The confusion stems from renewals and the uncertainty of interpretation of sections 41 and 43 of the Law of Property Act. Suffice it to say that these problems can and will be dealt with later in this chapter. The solution to those problems, however, is directly related to the nature of the deficiency judgment protection afforded borrowers.

The second method is to limit the lender's remedies to the land when an individual grants a mortgage that charges residential land or farm land. This is a limited version of the existing protection created by section 41 of the Law of Property Act. The law would restrict enforcement of the debt; it would not extinguish the debt (except in the case of an order of foreclosure). Collateral securities such as guarantees and personal property security interests would be enforceable. As is the case now, there would be situations which are outside the scope of the protection. The court would still have to

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404 A purchase money mortgage is a land mortgage taken as security for a loan where the loan proceeds are used to buy the land charged by the mortgage.

determine whether the substance of the transaction was a mortgage of residential land or farm land or whether the substance of the transaction was a debt to which the mortgage was collateral. As now, if a borrower granted a mortgage of residential land or farm land to secure repayment of an existing debt, the lender could seek a judgment for any deficiency.

The existing legislative policy envisions deficiency judgment protection for individuals who mortgage their homes and farms. That is, it contemplates deficiency judgment protection of individuals who live on the residential land or who carry on farming operations on the farm land. The law could protect such individuals by restricting the lender's remedies to the land whenever a mortgage granted by an individual charges residential land or farm land. It could go further and require that the individual or any member of his or her family use the residential land as a *bona fide* residence or carry on *bona fide* farming operations on the farm land. The difference between these concepts is illustrated by an example. Assume Jane Smith purchases a house as an investment and rents it to strangers. If deficiency judgment protection arises because an individual mortgages residential land, Jane Smith is protected from a deficiency judgment. If deficiency judgment protection arises because an individual mortgages residential land upon which he or she resides, Jane Smith is not protected in these circumstances. We will deal with this issue in more detail later.

The disadvantage of imposing a specific use as a condition of protection is that the use of the land can change from time to time. For example, the borrower can occupy the residential land for many years and later rent it to a non-family member. Farm lands may be farmed by the owner for many years, and when the farmer retires, it can be rented to neighbours. One can buy a property as an investment property and later occupy it as a residence. If a specific use of the property was a precondition to deficiency judgment protection for the borrower, the legislation would have to answer the following questions. Will this protection be lost if the property is no longer used for a protected use? What if a borrower establishes a protected use after the loan is made on the understanding the property will be put to a non-protected use? What if a mortgage charges different types of property, some having a protected use and others not?

The advantage of the second method is that it comes closest to protecting only those in need of deficiency judgment protection. The

difficulties come in defining precisely the types of properties that would trigger such protection and deciding whether Alberta should further limit such protection by requiring certain use be made of the property at some specified time.

The third method is to protect individuals who grant purchase money mortgages that charge residential land or farm land. With this method the purpose of the loan and the nature of the property are the facts that trigger protection. Such legislation only gives protection in situations where the borrower uses the loan proceeds to purchase the land charged as security for payment of the loan. An example illustrates this difference. Assume an individual borrows money to start a business. The individual grants a land mortgage as security for repayment of the loan. The value of the land charged exceeds the amount of the loan. Under the existing Alberta legislation the individual would not be liable on the covenant to pay given in the mortgage. There would be liability in the same situation under legislation that only raises protection for purchase money mortgages.

The third method of protection has the advantage of certainty. At the time the loan is made the lender usually will know what use the money is to be put and this will not change over time. In contrast, the use made of residential land or farm land can change over time and this adds complexity. The disadvantage of the third method is that it provides narrower protection. Unless the scope of the protection is expanded, a borrower will not be protected if the borrower grants a mortgage to secure a construction loan. This means individuals who build a residence on land they own would not be protected, but individuals who purchase a residence would be protected. Another problem arises in the case of refinancing. Assume that a purchase money mortgage comes up for renewal, and the individual wishes to refinance with another lender. Would the borrower lose the deficiency judgment protection?

(2) Recommendations

Although deficiency judgment protection in the case of a specified class of purchase money mortgage has the advantage of certainty, we do not believe it provides the necessary scope of protection. For most Albertans who grant a mortgage of their residence or farm, their wealth is in their residence or farm. Except for walk-aways, the loss of a residence or farm

through foreclosure means the borrower has come to the brink of financial ruin. Whatever the reason for the financial ruin, the borrower requires protection from an overhanging deficiency judgment. Therefore, the choice comes down to deficiency judgment protection for all individuals or deficiency judgment protection for individuals who mortgage residential land or farm land.

We are torn between these two methods. The certainty of application flowing from protecting all individuals is very attractive. However, the other method comes closer to protecting only homeowners and farmers. Therefore, it is our recommendation that in an action brought on a mortgage of residential land or farm land granted by an individual, the right of the lender should be restricted to the land to which the mortgage relates and to foreclosure of the mortgage. Under the next heading, we consider whether the protection should also depend upon the use made of the property.

RECOMMENDATION 4

Deficiency judgment protection for all individuals is an unnecessarily broad method of protecting homeowners and farmers. The present law should be replaced with a system that creates protection for certain individuals who mortgage residential land or farm land.

(3) What is the extent of the protection?

(a) Must the individual reside on the residential land or carry on farming operations on the farm land?

Asking this question is easy. Answering it is difficult. We begin by examining the purpose of a use requirement. Then we ask, if there is a use requirement, when must the individual reside on the residential land or carry on farming operations on the farm land. After determining the use requirement that would provide adequate protection to homeowners and farmers, we analyze whether the complexity created by such a use requirement outweighs the advantages of imposing it.

(i) Rationale behind imposing a use requirement

As alluded to earlier, the individual who mortgages residential land can use the land in several different ways. Consider the case of an individual who owns a house. This individual can:

(a) live in the house,
(b) live in the house and carry on a business in it,
(c) use the house exclusively as office space,
(d) rent the house to tenants who reside in the house, or
(e) rent the house to tenants who use the house to carry on a business.

Will deficiency judgment protection arise from the fact that the individual grants a mortgage on a parcel on which a single-family detached unit is located (be it used as a residence or not) or will such protection only arise if it is used as a residence? If the property must be used as a residence, must it be the borrower's residence?

With farm land the task is not as difficult. The distinction between undeveloped land and farm land is that on the latter farming operations are being carried out or has in the recent past been carried out. Without this activity the land is undeveloped land. So for farm land someone must be carrying on farming operations. The issue is whether the borrower or a family member must carry on farming operations or whether it can be carried on by someone else.

The existing legislative policy does not seek to protect individuals who purchase residential properties or farm land as investment properties. Therefore, one would be serving this policy by making certain uses a precondition to deficiency judgment protection. That is, such protection would arise for an individual borrower where, at some specified time, the borrower or a family member resides on the residential land or carries on farming operations on the farm land. Nonetheless, it must be recognized that the imposition of certain uses as a condition of deficiency judgment protection increases the complexity of the proposed reform.

(ii) Change of use

Whenever deficiency judgment protection is afforded on the basis of use of the property, one has to deal with changing use. The use of property can vary from time to time. As a result, the law must establish at what time the borrower must be using the property in the required manner in order to obtain protection from deficiency judgment. There are four different ways of creating protection for borrowers based on use. These are as follows:

1. Original use: protection will arise from the use the borrower intends to make of the property.[405]

2. Use at default: protection will arise from use made of the property at the time of default.

3. Use at any time: protection will arise if at any time during the term of the mortgage, as extended from time to time, the borrower puts the property to a protected use.

4. Exclusive use: protection will be extended if during the term of the mortgage, as extended from time to time, the borrower always puts the property to a protected use.

The scope of the deficiency judgment protection depends on the time at which the borrower must be using the property in the required manner. If the borrower always uses the property as a home or a farm, each alternative protects the borrower from a deficiency judgment. If the borrower never uses the property as a home or a farm, none of the alternatives afford protection. As the following chart shows, however, different results are reached when use changes. "Yes" indicates there is deficiency judgment protection. "No" indicates there would be no protection.

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405 Before approving the loan application, the lender will determine what use the borrower plans to make of the land. We will assume that the borrower does use the land in the fashion contemplated at the time the loan is made.

requirement	residence of borrower (original use) ↓ rental property (use at default)	rental property (original use) ↓ residence of borrower (use at default)
1. Original use as a residence	yes	no
2. Use as residence at default	no	yes
3. Use as residence at any time	yes	yes
4. Exclusive use as residence	no	no

Two competing policies affect the choice among these options. The first is the desirability of protecting individuals who mortgage their home or farm, but not individuals who mortgage other types of property. The second is the need for the lender to know at the time it makes the loan whether it will be able to pursue the borrower for the deficiency judgment or not. If priority is given to the first policy, options 2 and 3 are attractive. If priority is given to the second policy, option 1 would be chosen. The use contemplated at the time the lender makes the loan would determine for all time if the borrower would be protected.

For example, assume a lender makes a loan to an individual for the purchase of residential land, which is to be an investment property rented to non-family members. The loan is secured by a mortgage charging the property. Due to unexpected change in circumstances, the individual borrower resides in the property at some later date and defaults in payment six months after taking possession of the property. If protection of all homeowners from deficiency judgments is paramount, then the individual would be protected if the default occurred after he or she has used the property as a residence. If certainty for lenders is paramount, the individual would not gain protection from a deficiency judgment by making the property his or her residence. The lender lent on the basis of recourse on the personal covenant. A subsequent event would not defeat this expectation.

The reverse situation must also be addressed. Should individual borrowers lose protection from a deficiency judgment if they stop using

residential land as their home? If certainty for lenders is the primary goal, then protection would not be lost upon change from protected to non-protected use. The change in use does not affect lenders in this situation because the loans were made on the basis that there would be no recourse to the personal covenant. If the desire to protect homeowners is the primary goal, is it use at the time of default or use throughout the term of the mortgage which governs? Assume the default on the mortgage occurs ten years after the loan is made. The borrower used the residential property as a home for the first 3 years and as a rental property for the last 7 years. It would seem fair in that situation to remove deficiency judgment protection for the borrower. Now, assume that the borrower resided in the property for 6 years, rented the property for 1 year, and then resided in it for three years. On these facts it is unfair that the borrower loses deficiency judgment protection because of a short term change of use. In order to provide protection in the latter situation, we think protection should be based on any protected use throughout the term of the mortgage, as extended from time to time. Deficiency judgment protection based on original use or use at the date of default does not protect everyone deserving of protection.

This option provides the greatest scope of deficiency judgment protection, but it is not a perfect solution. There will be situations in which the borrower will use the land for a non-protected use much longer than for a protected use. However, this will not be the majority of cases.

We conclude that if a use requirement is imposed, it must be broad enough to protect all individuals who at some time during the term of the mortgage occupy the residential land as a residence or carry on farming operations on the farm land. This is option 3 outlined above and is the use requirement set out in sections 43(1.1) and 43.4 of the Law of Property Act. These sections create deficiency judgment protection for certain individuals who purchase residential land and farm land charged by a mortgage granted by a corporation.[406]

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[406] Section 43(1.1) of the Law of Property Act creates deficiency judgment protection for all individuals who assume corporate mortgages. Section 43.4 then creates a large exception to the protection of individual transferees. First, the protection only arises in respect of residential land and farm land. Second, there is no protection where neither the individual or any member of his or her family has at any time used the residential land as a *bona fide* residence or has carried on *bona fide* farming operations on the farm land. A key element of the existing scheme is the

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We would borrow two refinements from the use test employed by sections 43(1.1) and 43.4 of the Law of Property Act. The first is the requirement of *bona fides* and the second is use by family members. We propose that protection not arise unless the individual or a family member establish a *bona fide* residence on the residential land or carry on *bona fide* farming operations on the farm land. The element of *bona fides* will prevent an individual from moving into the house near the time of default just for the purpose of obtaining deficiency judgment protection. It allows the court to examine when and why the residency was established or farming operations commenced. We would also allow use by family members to trigger the protection. Family members would include those now falling within the definition of "member of his family" as set out in section 43.4(3)(c).[407] Although this goes technically beyond protection of homeowners and farmers, we think this broader protection of the family serves the policy behind deficiency judgment protection. It is particularly important in the farming community, where it is common for a family member to be farming land on behalf of the borrower.

(iii) Multiple uses

There will be situations in which the borrower lives in the home but uses it for other purposes as well. The borrower may have a suite in the basement or run a business from the home. We believe that such borrowers should be protected from deficiency judgments. It is very likely that for those people who rent the suite in the basement or who run their business out of their home, their wealth is in the home. Loss of the home means loss of their wealth. These borrowers fall within the category of those who require protection from deficiency judgments.

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[406](...continued)
requirement of *bona fides*. NOTE: By virtue of judicial interpretation,these sections govern until the time of renewal. After a renewal is executed, broader protection is extended to individual transferees. See the discussion in Chapter 4.

[407] Section 43.4(3)(c) reads as follows:
(c) "member of his family" means
(i) an individual's grandparent, parent, sibling, child, niece, nephew or spouse, and
(ii) a grandparent, parent, sibling, child, niece or nephew of the individual's spouse.

(iv) Analysis

In the report for discussion, we tentatively recommended that deficiency judgment protection be created for all individuals who mortgage residential land or farm land, no matter what use is made of the property. At that time, we had three serious concerns with the imposition of a use requirement. The first, and most serious concern, was the difficulty the use requirement would create for lenders. If Alberta did impose a use requirement, the legislation would have to specify the use as of a certain time. In order to protect all homeowners and farmers, the law would have to protect individuals who at any time used the residential land as a residence or carried on farming operations on the farm land. At the time of making the loan, a lender would not know if an individual buying the residential land or farm land as investment property would later establish a residence or carry on farming operations. This uncertainty might force a prudent lender to make the loan on the basis that there would be no access to the personal covenant given in the mortgage. This would be so even if the original use contemplated by the parties was a non-protected use.

Our second concern was an evidentiary one. Since knowledge of how the property was used would lie with the borrower, the onus of proof would have to be with the borrower. If a use requirement is imposed, some borrowers might be unaware that their protection hinges on their proving certain use of the property or might be too embarrassed or intimidated to come to court to present their evidence. In these cases, the court may be unaware that the borrower is a homeowner or farmer and may grant a deficiency judgment against that borrower. Will putting the onus on the borrower to prove protected use of the property defeat the protection afforded by the legislation in some cases?

Our third concern was complexity. All borrowers and lenders would agree that in the area of mortgage remedies law, simplicity is a virtue. We were concerned that imposition of a use requirement would make the law unnecessarily complicated.

Most commentators argued that if there is to be deficiency judgment protection,[408] it should be tied to use of the property as a residence or farm. In their view, protection should be restricted to homeowners and farmers even if this increases the complexity of the legislation. Investors should be liable on their covenants to pay. A difference of opinion exists on when the borrower must be using the property in the required fashion to obtain protection. Two commentators would tie protection to use made of the property within six months before default. One would tie protection to the use made of the land at the time proceedings are commenced. One would tie protection to the use the borrower plans to make of the property as disclosed at the time the loan is approved. Others do not specify a time but wish to protect the principal residence only and not investment properties.

This response has caused us to reconsider our recommendation. The primary reasons for tentatively rejecting deficiency judgment protection tied to use of the property as a residence or farm was the uncertainty it would create for lenders and the resulting complexity this would cause. If these are not the obstacles we thought they were, then protection could be tied to use as long as some solution to the evidentiary problems can be found.

As we mentioned earlier, most foreclosure actions are undefended. It is possible that borrowers who are entitled to protection may not come to court to establish the use they made of the property. This may strike one as odd. One would expect borrowers to come to court to present their side of the case. Unfortunately, human nature works against logic in this situation. We received strong indication, although anecdotal, that many borrowers fail to come to court because they are embarrassed, intimidated or naive, not because they would not benefit from presenting their case before the court. How can a system be designed that protects borrowers from their own inaction but does not put the impossible task of proving a negative upon the lender? The law can address this problem with a two pronged approach. First, the defendant must have the onus of proving that he or she or a family member used the residential land or farm land as required in order to receive deficiency judgment protection. Second, the lender must be obliged to make full and fair disclosure of all material information known to

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408 As indicated earlier, most lenders argued for repeal of deficiency judgment protection. Failing this, they favour deficiency judgment protection for homeowners and farmers only.

the lender as to whether the individual or family member resided on the residential land or carried on farming operations on the farm land.

We do not feel that this is going too far in the protection of homeowners and farmers. It must be remembered that a lawyer is an officer of the court and as such cannot mislead the court. A lawyer who had information that the borrower had resided on the property or carried on farming operations on the land must disclose this to the court if the defendant did not appear. Failure to do this would mislead the court. Yet, clients may not advise the lawyer of the information they have on their file about the use made of the property. This can be avoided by requiring the lender to disclose this information.

We have discussed this proposal with the executive of the Mortgage Loans Association of Alberta. They indicated that the loan application will almost always indicate whether the borrower intends to establish a residence on the residential land or use it as a rental property. They may not have information on the use made of the property by transferees, but they usually have such information for borrowers. They had no objection to disclosing the information they have to the court.

Before concluding this topic, we wish to consider the issue of waiver. It is possible to allow investors to waive the proposed deficiency judgment protection. Any investor who had granted a waiver of protection would be liable on the covenant to pay even if at a later time the investor or family member uses the residential land as a *bona fide* residence or carries on *bona fide* farming operations on the farm land. We have not adopted this position for the following reasons. First, waiver can lead to abuse. If waiver is allowed, it is likely to become a standard term in every mortgage. Through inadvertence or design, such a clause may lead to judgment against a homeowner or farmer. People desperate for the loan may, on their own accord or under pressure from a loans officer, misstate how they truly intend to use the property. Second, it really is a means of tying protection to the intended use at the time the loan is made. This, in our opinion, creates inadequate protection because some homeowners will not receive protection. Third, there are other means of dealing with the risk of lending to individual investors granting mortgages on residential land or farm land. Lenders are very familiar with these means because they presently employ

them when making loans to individual investors mortgaging residential land or farm land.

(v) Recommendations

Deficiency judgment protection should be extended to all individuals who mortgage residential land and farm land where the land is used in the required fashion. To gain protection, the individual or a family member must use the residential land as a *bona fide* residence or carry on *bona fide* farming operations at any time during which that individual is or was the registered owner of the land. An individual seeking deficiency judgment protection should have the onus of proving that he or she is entitled to the protection. The lender must disclose to the court all information it has concerning the use the borrower has made of the land.

RECOMMENDATION 5

(a) In an action brought on a mortgage of residential land or farm land granted by an individual, the right of the lender should be restricted to the land to which the mortgage relates and to foreclosure of the mortgage. No action should be brought on a covenant for payment contained in the mortgage and no action should be brought for damages based on the sale or forfeiture for taxes of land included in the mortgage, no matter who was responsible for sale or forfeiture of the land.

(b) This protection should only extend to protected individuals. An individual is a "protected individual" if that individual or any family member of that individual has in good faith

> **(i) in the case of residential land, used that land as a residence, or**
>
> **(ii) in the case of farm land, used that land for carrying on farming operations**

at any time during which that individual is or was a registered owner of the mortgaged land.

"Family member" means

(i) an individual's grandparent, parent, sibling, child, niece, nephew or spouse, and

(ii) a grandparent, parent, sibling, child, niece or nephew of the individual's spouse.

(c) An individual seeking deficiency judgment protection has the onus of proving that he or she is a protected individual.

(d) In an action concerning a mortgage of residential land or farm land, every affidavit filed in support of an application for an *in rem* judgment or *in personam* judgment against an individual shall make full and fair disclosure of all material information known to the mortgagee as to whether the individual is or is not a protected individual.

(b) Default during construction

In the existing Alberta market, there are two commonly used arrangements for financing the construction of new homes. Under the first arrangement, a home builder (which is almost always a corporation) pre-sells the home. The corporation then obtains mortgage financing to build the home. Upon completion, the individual purchases the home and either assumes the existing mortgage or places new mortgage financing. If the individual assumes the corporate mortgage, the individual executes an assumption agreement that changes the terms of the mortgage to reflect the new deal made with the individual. Under the second commonly used

arrangement, an individual places a residential construction mortgage[409] on the land to finance construction of the home. The individual may hire a builder to supervise construction or act as his or her own contractor.

Lending officers advise that almost all individuals who place a residential construction mortgage intend to reside in the property upon completion. There is a practical reason for this. The rental income that can be earned by leasing a new home does not support the mortgage financing usually sought to construct it, so lenders rarely finance the construction of a single-family unit that is to be a rental property.

Default by an individual during construction of a residence is infrequent, although it does happen.[410] It is most likely to occur when the individual becomes embroiled in builders' lien disputes brought on by the insolvency of the building contractor or in a situation of marriage breakdown.[411]

We must ask whether individuals who default under a residential construction mortgage should be protected from deficiency judgments and, if so, how this can be accomplished in the proposed system. In our opinion, an individual who is constructing a home that he or she intends to reside in should receive deficiency judgment protection. Such individuals are not

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409 Residential construction mortgages are short term financing instruments designed to accommodate construction of a house. Typically, they are due on demand during the construction period, but the borrower pays periodically (typically monthly) the interest that has accrued on the mortgage draws. At the end of construction, a new agreement is reached creating a monthly payment of blended principal and interest. The construction mortgage can be discharged and replaced with a conventional mortgage or it can remain on title and the parties can enter into an amending agreement specifying the interest rate, term, amortization period, frequency of payment and corresponding mortgage payment.

410 Lending officers advise that cost overrun, not default, is the problem most experienced with individuals who grant residential construction mortgages.

411 In Alberta, builders registered under the Alberta New Home Warranty Program build approximately 80-85% of the new homes each year. On February 1, 1991 the program was extended to provide a Builder Performance Indemnity. This indemnity applies when a builder fails to complete the home. Under the indemnity, the Program undertakes the completion of the home and will contribute up to $25,000 to resolve builders lien disputes or pay for additional costs of completion or both. The indemnity extends to an individual who has obtained his or her own mortgage financing and has hired a member of the Program to construct the home. This indemnity should reduce the incidences of default by an individual under a residential construction mortgage brought on by the builder's insolvency.

investors and should be treated like homeowners who have resided in the property. Many individuals who are constructing a home will have put their savings into payment of the land and will need deficiency judgment protection as much as other homeowners.

Protection designed for individuals who have established a *bona fide* residence on residential land will be of no benefit to an individual who defaults before the home is completed. Protection designed for this particular scenario must be introduced. We propose to extend deficiency judgment protection to an individual who defaults under a mortgage placed to finance construction of a residential unit if that individual or a family member intended to reside in the residential unit upon completion of construction. The individual would have the onus of proving that the individual or family member had such an intention. Nevertheless, the lender will have an obligation to disclose any information it has on this issue. Lending officers have indicated that this will not be a problem. Since the lending criteria applicable to homeownership loans and investment loans differ, lenders will know at the time the loan is made whether the borrower or a family member intends to reside in the property upon completion.

RECOMMENDATION 6

Deficiency judgment protection should also be extended to an individual who defaults under a mortgage granted to finance construction of a residential unit if that individual or a family member intended to reside in the residential unit upon completion of construction. The onus of proving that the individual or family member intended to reside in the unit lies with the individual. The lender must disclose any information it has concerning the intended use of the property.

(c) Definition of residential land and farm land

In defining "residential land" and "farm land" it is helpful to begin by discussing the types of property that would and would not trigger deficiency

judgment protection. To serve the existing legislative policy, protection must arise for individuals who mortgage their home or farm. A home could be a single-family detached dwelling unit, a single-family semi-detached dwelling unit, a unit in a duplex, a unit in a row housing development,[412] a unit described in a strata title,[413] a mobile home, a condominium unit, or an acreage. A farm would include a grain farm, a ranch, a poultry farm, a beekeeping operation, a tree farm, a vegetable and small produce farm and other similar operations. Individuals who grant mortgages on commercial properties or industrial properties should not be protected. Commercial properties include such properties as apartment buildings, hotels, motels, restaurants, service stations, movie theatres, business premises, veterinarian clinics and so on. Industrial property would include manufacturing plants, storage areas for pipeline equipment or heavy machinery and other such properties.

To create a definition of residential land and farm land, one must begin by listing the types of properties that would trigger deficiency judgment protection if the borrower resided on the property or farmed the property throughout the term of the mortgage. Later, we shall revise the definition to reflect decisions made in respect of new home construction, land development and mobile homes. We begin by including in the definition of farm land and residential land properties that individuals typically occupy as homes or farms. These terms should be defined to include the following:

> (a) farm land" means land that is used for carrying on farming operations,
>
> (b) "farming operations" means
>
> (i) the planting, growing and sale of trees, shrubs or sod

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412 In the Report for Discussion, we had assumed that all multi-unit developments in which there was a separate certificate of title for each unit would be condominiums. We have been advised that this is not always the case. For example, in some of the older row housing developments, there is a separate certificate of title for each unit, but there is no condominium plan registered. In addition, some high rise apartment complexes in Edmonton have strata titles for each unit. We have revised our definition of residential land to accommodate these units.

413 *Ibid.*

(ii) the raising or production of crops, livestock, fish, pheasants or poultry,

(iii) fur production, or

(iv) beekeeping

(c) "parcel" means the aggregate of the one or more areas of land described in a certificate of title or described in a certificate of title by reference to a plan filed or registered in a land titles office,

(d) "unit" means a unit provided with living, sleeping and cooking facilities, intended for use by an individual or group of individuals as a residence,

(e) "residential land" means

(i) a parcel or parcels on which a single-family detached dwelling unit or a single-family semi-detached dwelling unit is located,

(ii) a unit in a duplex that has a separate certificate of title for each unit,

(iii) a unit in a row housing development that has a separate certificate of title for each unit

(iv) a unit described in a strata title, or

(v) a residential unit under the *Condominium Property Act*.

Note particularly that residential land is **not** defined to include both units in a duplex where the duplex is built on one parcel of land. This is so even if one of the units is occupied by the borrower. Residential land only includes a unit in a duplex where there is one certificate of title for each of the duplex units.

(i) New home construction

The definition of residential land must include a parcel on which a single-family detached dwelling unit, single family semi-detached dwelling unit, or duplex unit is being constructed. This will ensure that individuals who are building a home they intend to reside in are protected from deficiency judgment from the time construction begins. Land upon which multi-residential units are being constructed would not fall within the definition.

(ii) Land development

When one defines residential land and farm land, one is really visualizing developed land. Yet, the nature of land can change over time. Land can go from undeveloped land to developed land and back again. This can cause some mental gymnastics in a system of deficiency judgment protection tied to the nature of land. Therefore, it is important to establish rules that govern how developing land is to be treated.

Is this a mortgage of residential land or farm land or a mortgage of some other type of land? To answer this question, the court will as a general rule look to the type of land charged by the mortgage at the time the mortgage is registered. Subsequent changes in the nature of the land will be irrelevant in respect of that mortgage except in two situations. The first situation involves mortgages of land placed to finance construction of a building ("construction mortgages"). In these situations, the mortgage will be seen as a mortgage of whatever is to be built under the mortgage financing. For example, assume that a builder wishes to build an apartment block on three lots upon which three dilapidated houses presently stand. The builder seeks mortgage financing to assist in the purchase of the land and the construction of the apartment. The houses are demolished and construction begins. This mortgage must be treated as a mortgage of commercial land, not a mortgage of residential land.

The second situation involves mortgages charging vacant lots or undeveloped land that become at a later time residential land or farm land. Once construction of the dwelling begins, the mortgage placed upon the vacant land must be treated as a mortgage of residential land. If this is not the case, then deficiency judgment protection would arise in respect of the mortgage placed to finance construction of the residence, but it would not arise in respect of the mortgage placed to finance purchase of the lot. This is not logical or politically attractive.

The consequence of these recommendations can be illustrated through a series of examples. Assume Mr. and Mrs. Jones buy a vacant lot upon which they wish to build a home in the future. They borrow money to purchase the lot and grant a mortgage on the lot as security for repayment of these moneys. Three years later, they place a construction mortgage and proceed to build the home. They move into the home and default on both

mortgages two years after taking possession. From the moment construction begins, both mortgages will be treated as mortgages of residential land. This ensures that individuals who build their own home are give the same protection as individuals who mortgage existing homes. In contrast, if they do not develop the land but default on the mortgage charging vacant land, deficiency judgment protection does not arise. This is not a mortgage of residential land.

Another example shows how these recommendations will work in a chain of title involving more that one owner. Assume Mr. and Mrs. Jones grant a mortgage on a vacant lot. Later they sell the lot to Mr. and Mrs. Smith, who assume the mortgage. The Smiths place a construction mortgage and build a home that they then reside in. Two years after they take possession of the home, the Smiths run into financial difficulty and fail to make the mortgage payments owing under both mortgages. Once construction begins, both mortgages would become mortgages of residential land. Nevertheless, deficiency judgment protection would only extend to the Smiths because the Jones did not use the land as a residence. This is a fact the Jones would have to consider when deciding if they would allow the Smiths to assume the mortgage charging the vacant lot. In practice, this scenario may be of little consequence to the Jones. The lender who lent the money to the Jones is well secured because the property is now worth much more than the value of the undeveloped lot.

With these recommendations come two disadvantages: (1) uncertainty for the lender and (2) potential for abuse. As the Mortgage Loans Association of Alberta noted a "lender who makes a mortgage loan secured by vacant land will be uncertain as to whether or not it will be able to pursue a deficiency judgment since the lender will have no control over development of lands".[414] Although this uncertainty exists, we submit that several factors help to minimize the problem. First, at the time the loans is made, the lender will know the zoning classification for the land. If a lender makes a loan to assist in the purchase of a lot zoned exclusively for residential housing and takes a mortgage on that lot, it must assume that it will not have access on the covenant given in the mortgage once construction begins. Second, development will increase the value of the land and improve the position of the first mortgagee. It is really only during

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[414] Submission dated December 13, 1991.

construction that the first mortgagee is at risk. Default during this time would be of more concern to the lender financing the construction (i.e. second mortgagee).

The second disadvantage is the potential for abuse. One commentator is concerned that borrowers will abuse this recommendation by trying to change the nature of the land just to avoid paying a deficiency. We do not anticipate that this will be a large problem. The cost of digging a basement and pouring foundations is large enough to discourage this practice. Anyone with the money to begin construction would probably use it to pay the mortgage debt.

Notwithstanding these disadvantages, these recommendations are a necessary part of the proposed scheme. Without them, protection would arise only in respect of mortgages granted on developed land or mortgages placed to finance construction of a residence, but not on mortgages placed on a lot that at a later stage becomes a home. As already stated, this is not logical or politically attractive.

(iii) Mobile homes

Many Albertans live in mobile homes located on land that they own. In cities, such properties are located in mobile home subdivisions. Residential land must be defined to include such properties. Care must be taken to ensure that commercial properties, such as mobile home parks, do not fall within this definition. A mobile home park is defined in the Mobile Home Sites Tenancies Act[415] as a "parcel of land that includes not less than 3 mobile home sites rented or held out for rent". A mobile home site is defined to mean "a site where the owner of the mobile home is not the same as the owner of the site on which the mobile home is to be located". By defining residential land to include a parcel on which no more than two mobile homes are located, we will exclude commercial properties—such as mobile home parks. By allowing two mobile homes on the parcel, the borrower can still let a daughter or son place a mobile home on the parcel and reside there, without the borrower losing deficiency judgment protection.

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415 R.S.A. 1980, c. M-18.5, s. 1(1)(d).

Occasionally, a mobile home will be placed near an industrial plant and will be used as a surveillance unit. This is a unit occupied by a watchman who is employed to protect the industrial plant from theft or vandalism. As this clearly is not residential land, there is no need to exclude it from the definition of residential land.

(iv) Recommendations

We now take our original definition and revise it to deal with new home construction, land development and mobile homes. This leads us to expand the definition of residential land and make the following recommendations:

RECOMMENDATION 7

Residential land and farm land should be defined as follows:

(a) "farm land" means land that is used for carrying on farming operations,

(b) "farming operations" means

(i) the planting, growing and sale of trees, shrubs or sod,

(ii) the raising or production of crops, livestock, fish, pheasants or poultry,

(iii) fur production,

(iv) beekeeping

(c) "parcel" means the aggregate of the one or more areas of land described in a certificate of title or described in a certificate of title by reference to a plan filed or registered in a land titles office,

(d) "unit" means a unit provided with living, sleeping and cooking facilities intended for use by an individual or group of individuals as a residence,

(e) "residential land" means

(i) a parcel or parcels on which a single-family detached unit or single-family semi-detached unit is located,

(ii) a parcel or parcels on which a single-family detached unit or single-family semi-detached unit is being constructed,

(iii) a unit in a duplex that has a separate title for each unit,

(iv) a unit in a duplex that has a separate title for each unit and that is being constructed,

(v) a unit in a row housing development that has a separate title for each unit,

(vi) a unit described in a strata title,

(vii) a residential unit under the *Condominium Property Act*, or

(viii) a parcel on which no more than two mobile homes are located.

RECOMMENDATION 8

A mortgage that charges undeveloped land that becomes residential land or farm land at some time before default under the mortgage shall be considered a mortgage of residential land or farm land.

A mortgage placed to finance the construction or development of land will be considered a mortgage of residential land or farm land if the construction or development creates residential land or farm land.

(d) Treatment of mortgages that charge different types of land

A mortgage that charges two or more parcels of land, one of which is residential land or farm land needs special consideration. We refer to such mortgages as mixed land mortgages.[416] Assume that one mortgage secures the debt and that this mortgage charges the borrower's home and a fourplex (or a rental house). Should the borrower receive deficiency judgment protection? Should the mixed land mortgage be treated as a residential mortgage or as something else?

In the report for discussion, we tentatively recommended that deficiency judgment protection in respect of the entire debt should arise when the mortgage charges residential land or farm land and other kinds of property. Our choice of wording led to confusion. The recommendation related to mixed land mortgages. Our intention was to treat mixed land mortgages in the same fashion as mortgages of residential land or farm land. This does not mean that there will be deficiency judgment protection for every mixed land mortgage (or mortgages of residential land or farm land, for that matter). It does mean that the same rules would apply to such mortgages. The court would still have to determine if the substance of the transaction is a mixed land mortgage with certain collateral securities or whether the substance of the transaction is a debt to which the mixed land mortgage is collateral. If the mixed land mortgage was not co-extensive with the personal covenant contained in other documents and security, the personal covenant in the other documents could be enforced.

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[416] A mixed land mortgage must charge two parcels of land. It does not include a mortgage that charges a single parcel of land where the land is put to a variety of uses. For example, a mortgage charging an apartment building is not a mixed land mortgage even though the owner resides in one of the units. It is a mortgage of commercial land. An apartment building does not fall within the proposed definition of residential land.

The Mortgage Loans Association of Alberta finds this recommendation acceptable if the recommendation concerns mortgage charging several parcels of land (which was our intention). It does not favour a change in the current law relating to a lender's right to enforce personal judgment where the land mortgage is only one of several pieces of security and is not co-extensive with the personal covenant contained in the other documents and security. Philip Matkin argued strenuously against the recommendation for the reasons set out below.

Let us re-examine the policy arguments surrounding this issue. The arguments in support of having the term "residential land mortgage" include mixed land mortgages are:

(1) certainty, and

(2) the need to prevent lenders from using mixed land mortgages as a device to circumvent protection,

(3) the desirability of uniform treatment of every mortgage charging residential land or farm land.

The counter arguments are:

(1) certainty is also created by providing that mixed land mortgages are not mortgages of residential land, and

(2) since mixed land mortgages would usually arise in the context of loans for commercial purposes they should not be treated as a residential land mortgage, and

(3) forcing lenders to make and administer two loans needlessly increases costs and administrative difficulties

(4) it is unlikely that lenders will use a mixed land mortgage to circumvent protection in case of loan given to purchase home. They do not seek such security now, and, in any event, few first-time homebuyers have any additional security.

In one sense, it does not matter what the law is on the point as long as it is clear. If mixed land mortgages are treated in the same fashion as mortgages of commercial land, the borrower who charges his or her home under a mixed land mortgage will not have deficiency judgment protection in respect of the home. An individual borrower who seeks such protection must negotiate for two separate loans, one secured by the mortgage of residential land, the other secured by the mortgage of commercial property. If mixed land mortgages are treated as mortgages of residential land or farm land, then the lender must act accordingly and lend on the basis that it does not have access on the covenant to pay or make two loans and take the security it needs.

We recommend that mixed land mortgages be treated in the same fashion as mortgages of residential land or farm land. This will create certainty and prevent easy circumvention of deficiency judgment protection for homeowners and farmers. We recognize this may increase the costs and administrative difficulties for lenders, but we do not find this sufficient reason to change our recommendation. There are often good reasons to have several mortgages securing one debt as opposed to one mortgage charging several parcels of land securing the debt. Those reasons include increased efficiencies in exercising remedies.

RECOMMENDATION 9

This recommendation applies to a mixed land mortgage, which we define as a mortgage that charges two or more parcels of land, one of which is residential land or farm land. A mixed land mortgage should be treated in the same manner as a mortgage of residential land or farm land.

Having made this recommendation, we wish to discuss land development in the context of mixed land mortgages. Land mortgages that charge land that can be developed into residential land or farm land should be analyzed closely. Assume an individual wishes to obtain financing to purchase an apartment building. As security for the loan, the individual grants a mortgage charging the apartment building and a vacant lot he or she owns. Two years later, the individual constructs a home upon the lot.

The mortgage then becomes a mixed land mortgage. A lender who is not content to lend without recourse on the covenant to pay must pay special attention to the possibility of land development and how this would affect its other security.

(e) Assignments of rent

At present, section 46 of the Law of Property Act provides (again with the references to agreements for sale deleted):

> An assignment in writing for a lease or rent given by a mortgagor . . . in favour of a mortgagee . . . and not being an assignment of the mortgage . . . itself may be enforced notwithstanding the restrictions contained in section 41.

This section makes it clear that a lender can enforce an assignment of rents even though the borrower is protected from a deficiency judgment. We recommend that this continue. When making this recommendation, we realize that under the new regime there will be few situations in which an individual, who leases residential land or farm land to tenants, will also be given deficiency judgment protection. These situations will involve previous use of the property as a home or farm by the individual or a family member.

RECOMMENDATION 10

An assignment of a lease or an assignment of rents given by a borrower to a lender should be enforceable even though the borrower is protected from a deficiency judgment.

C. Chain of Liability

(1) Introduction

It is common for a borrower to sell mortgaged property to a purchaser on the basis that the purchaser will assume the borrower's obligations under the mortgage. The purchaser in turn can resell to someone else on the same basis. This process can go on indefinitely. Under this heading, we

consider when the purchaser is personally liable to repay the mortgage debt. We begin by examining section 62 of the Land Titles Act. Then, we consider whether purchasers should be protected from personal liability and, if so, on what basis. Finally, we will consider whether previous owners should be released from liability and if so, at what point in time.

In an effort to be clear and concise, we have adopted certain terminology. The key terms are:

(1) *Transferor and Transferee*: The transferor is the seller who transfers title of the land to the purchaser. The transferee is the person to whom the land was transferred, commonly known as the purchaser. We have adopted these terms because they are used in section 62 of the Land Titles Act. Since this section plays such a key role in this area, it would be confusing to use terms that are different from those used in the section.

(2) *Assumption agreement*: An assumption agreement is an agreement entered into by the transferee and the lender in which the transferee promises to the lender that the transferee will make the payments owing under mortgage.

(3) *Assuming a mortgage*: A transferee who assumes a mortgage is a person who agrees with the transferor (who can be the borrower or someone else in the chain of title) that the transferee will pay the sums owing under the mortgage. By merely assuming the mortgage, the transferee has given no promise to the lender that the transferee will pay the moneys secured by the mortgage. As will be discussed later, such a promise to pay may be implied by statute in certain circumstances.

(4) *Renewal agreement*: This is an agreement entered into upon the expiry of the mortgage term by the lender and the person who is the owner at that time. The renewal agreement extends the term of the mortgage for a specified period and may also change the interest rate and payment schedule. It is also usual for the person renewing the mortgage to covenant to pay the money secured by the mortgage as it becomes due under the mortgage.

(2) Implied covenant in the transfer: section 62 of the Land Titles Act

(a) Should there be a covenant implied in the transfer of land that the transferee will indemnify the transferor and pay the lender the moneys secured by the mortgage?

Section 62 of the Land Titles Act serves two useful purposes. First, it codifies the covenant of indemnity which arises in equity between a transferor and his or her transferee. Second, it creates privity of contract between the transferee and the lender and thus avoids the circuity of action formerly necessary.[417] The interpretation of the section reflects its equitable lineage. As a result, if the transferee is not bound in equity to indemnify the transferor, no covenant arises under section 62. This is so even though the literal interpretation of the section suggests the covenant should arise.

In the report for discussion, we recommended that section 62 continue to serve these two purposes. The Mortgage Loans Association of Alberta, the Canadian Bankers' Association and several other commentators support this recommendation. In contrast, three lawyers seek fundamental change of section 62, namely, that regardless of equitable principles, the section should imply in every transfer of land a covenant by the transferee with the transferor and lender. They argue that such a covenant is necessary for several reasons. First, it would create an enforceable covenant against all dollar dealers.[418] Second, it would make second mortgagees who obtain title through a foreclosure order liable to pay the first mortgage. Third, it would eliminate the need for the complicated deeming provisions found in section 43.3 of the Law of Property Act.

We begin our analysis by considering the fundamental issue raised by section 62. When, if ever, should the law give lenders the right to sue transferees, a right that arises by virtue of statute and not contract? Most

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417 See Chapter 4 at 56-61.

418 If a covenant to pay was implied in every transfer of land and if every transferee who did not reside on the residential land was liable on the covenant to pay, then lenders could seek deficiency judgments against dollar dealers. Of course, the ability of a dollar dealer to negative the covenant under section 63 would also have to be eliminated.

provinces have legislation that implies a covenant between the transferee and the transferor, but few create a covenant between the transferee and the lender. Alberta, on the other hand, does both. This is justified if the purpose of the implied covenant in favour of the lender is to create a more direct method of enforcing existing liability on the part of the transferee. But it is not justified if the only purpose of the section is to give the lender more people to pursue. Removal of the section from its equitable roots will create real hardship in many situations[419] and would ignore entirely the doctrine of privity of contract and basic property law.

Under property law, the burden of a positive covenant does not run with the land, in equity or at common law. This means a transferee is not obliged to perform the promise to pay principal and interest given by the borrower in the mortgage or any other positive covenant given in the mortgage.[420] The policy served by this body of the law is the need for free alienation of land. Nineteenth century judges feared that by allowing a positive covenant to run with the land, title to land would become heavily encumbered and, as a result, the transfer of land would be impeded. This is undesirable and, therefore, the law developed so that positive covenants do not run with the land. We believe this is still the policy the law should serve.

Now we will address the three specific arguments made in favour of fundamental revision of section 62. We begin with the first argument. Although we agree that the law should discourage the existence of dollar dealers, we reject fundamental revision of section 62 as the means to accomplish this. As we will discuss in Chapter 8, the 1984 amendment to Part 5 of the Law of Property Act was sufficient to discourage dollar

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419 See Chapter 4 at 58-59 for a list of situations in which an implied covenant does not arise under section 62 of the Land Titles Act.

420 Some mortgages contain covenants that do not relate to payment of principal. Examples include:

- covenant not to buy beer from elsewhere: *John Brothers Abergarw Brewery Co.* v. *Holmes*, [1900] 1 Ch. 188
- covenant not to buy petroleum products from anyone but the mortgagee: *Regent Oil Company* v. *J.A. Gregory Ltd.*, [1965] 3 All E.R. 673 (C.A.), *Esso Petroleum Co. Ltd.* v. *Harper's Garage (Stourport) Ltd.*, [1967] 1 All E.R. 699 (H.L.), *Cities Service Oil Co. Ltd.* v. *Pauley*, [1931] O.R. 685 (H.C.J.); *Canadian Petrofina Ltd.* v. *Rogers* (1962), 35 D.L.R. (2d) 552
- covenant to keep an apartment as a low rental project for 40 years: *CMHC* v. *Hongkong Bank of Canada* (1993), 6 Alta. L.R. (3d) (S.C.C.)
- covenant to share profits with the mortgagee.

dealers. Implying a covenant in every transfer, no matter what the circumstances, is too drastic a solution to this problem. Furthermore, dollar dealers would only respond to such an amendment by operating through a corporation.[421] As discussed, some seek reform of section 62 in order to impose liability on junior mortgagees and to avoid the complexity of section 43.3 of the Law of Property Act. We do not view these concerns as sufficient reason to imply a covenant of payment by the transferee in favour of the lender in every land transfer. Although fundamental realignment of section 62 would eliminate the two criticisms, it would create even more serious injustices. The equitable principles presently governing section 62 allow for flexibility that a literal interpretation of section 62 would not provide.

Section 62 is defensible and logical when it operates as a codification of the covenant of indemnity implied by equity between the transferee and the transferor. In such situations, it is reasonable to give the lender the right to enforce that liability without having to get an assignment of the right to sue. The section, as it now operates, creates a good balance between the need for free alienation of land and the need for transferees to pay the encumbrances that charge the land. The section works well and should not be divorced from its equitable roots.

(b) Should the lender be able to enforce the covenant to pay against each person in the chain of title?

Some may see section 62 as creating a windfall for the lender because, when a covenant is implied under the section, the lender can sue the borrower and each transferee. This gives the lender access to more "pockets" than would be available to it under the common law. If the purpose of the section is to allow the lender to sue the defaulting owner, why is it given access to the previous owners also? Perhaps the section should be limited (as it now is in Ontario) to allow the lender to sue the borrower or the person who was the registered owner at the time of default, but not both. The problem with this approach is that it invites easy circumvention of the section. For example, a knowledgeable owner knowing he or she was soon going to default on the mortgage, could transfer the property to a shell company with no assets. Shortly thereafter, the shell company would default. This would leave the lender in the position of

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421 Again, we are assuming the dollar dealer's ability to negative the covenant would be removed.

obtaining an assignment of the borrower's right to seek indemnity from the knowledgeable owner. This is what the section is designed to prevent. For this reason, we do not recommend that the scope of the section be limited to the owner as of the date of default.

(c) What should be the scope of the covenant of indemnity and the scope of the covenant to pay?

The section implies a covenant by the transferee with the transferor and the lender. The covenant has two branches to it. The transferee covenants to pay "the principal money, interest, annuity or rent charge secured by the mortgage after the rate and at the time specified in the instrument creating it". The transferee also covenants to indemnify the transferor "from and against the principal sum or other money secured by the instrument and from and against the liability in respect of any of the covenants therein contained or under the Act implied on the part of the transferor". The first branch of the covenant is much narrower in scope. For example, the lender cannot recover from the transferee taxes, insurance premiums and sums paid to maintain the property. In the absence of some clause in the mortgage saying so, these sums are not principal, interest, annuity or rent charge. Many mortgages provide that insurance, taxes and other charges paid by the lender shall become principal. There is conflicting case law on whether such a clause can make these expenditures part of the principal moneys for the purposes of section 62.[422]

In our report for discussion, we recommended that section 62 be amended to allow a lender the right to recover from a transferee the additional sums of taxes, insurance premiums, sums paid by the lender to maintain the property, and costs, where such sums are secured by the charge created by the mortgage. These sums would be paid at the rate and at the time specified in the mortgage.

The Mortgage Loans Association of Alberta and the Canadian Bankers' Association support this recommendation, but the Mortgage Loans Association of Alberta and another commentator suggest the implied

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[422] Compare *Trusts & Guarantee Company, Limited* v. *Monk*, [1923] 1 W.W.R. 1217 (Alta. S.C.T.D. aff'd on other grounds, [1925] 1 W.W.R. 5 (Alta. S.C.A.D.); *Canada Mortgage and Housing Corporation* v. *Ward* (1957), 23 W.W.R. 319 (Alta. S.C.); *Bellman* v. *Big City Holdings Ltd.* 1984 A.U.D. 846 (M.C.); and *Scotia Mtg. Corp.* v. *Dunlop and Freeman* (1992), 6 Alta. L.R. (3d) 203 (M.C.).

covenant be expanded to include all moneys secured by the mortgage.[423] We will now examine this suggestion in more detail.

Section 62 creates a more direct route for the lender to enforce liability that arose from the obligation of indemnity imposed by equity upon a transferee.[424] It can, therefore, be argued that the scope of that covenant in favour of the lender should be as broad as the covenant of indemnity and relate to any sums that might be a charge upon the land. This would also allow the lender to sue the defaulting owner for such sums because it is usually the defaulting owner who fails to pay taxes and insurance or fails to maintain the property. This seems to be the impetus for enacting sections of this type in the first place.[425] The only problem with this approach is that it may expose intervening transferees to liability they may not contemplate or foresee at the time of sale. For example, land development by a subsequent owner may give rise to rural electrification liens or rates that

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423 It is common for the mortgagor to covenant to pay various sums, including:

- costs of placing the mortgage and examining title
- principal and interest
- insurance premiums, taxes and rates (Taxes are defined in include municipal taxes, school taxes and local improvement rates.)
- condominium fees or levies
- payment of prior liens, charges, encumbrances or claims charged or to be charged against the land
- cost to maintain, repair, restore or complete the mortgaged premises
- legal costs, as between solicitor and client
- an allowance for the time, work and expenses of the mortgagee.

There is usually a clause that says if the mortgagor fails to perform these covenants, the mortgagee may do so and such expenses become a charge on the land.

424 In *Waring* v. *Ward* (1802), 7 *Ves. Jun.* 333, 32 E.R. 136 (Ch.), the Court of Chancery held at 137-38:

> . . . yet this court, if [the purchaser of the equity of redemption] receives possession, and has the profits, would, independent of contract, raise upon his conscience an obligation to indemnify the vendor against the personal obligation to pay the money due upon the vendor's transaction of mortgage; for being become owner of the estate, he must be supposed to intend to indemnify the vendor against the mortgage.

425 The purpose behind section 62 and similar sections is to allow the lender to seek a deficiency judgment against the defaulting owner. It is a commonly held view that the lender should look first to the owner at the time of default, because it is this person who has the benefit of the land and who should take the corresponding burden. This is mentioned in some of the earlier decisions and was the basis for the recommendations of the Law Reform Commission of British Columbia recommendations that gave rise to Law of Property Act, R.S.B.C. 1979, c. 340, s. 20.1. See LRCBC, Report 84, *Report on Personal Liability Under a Mortgage or Agreement for Sale*.

have priority to the mortgage. Should transferees who come between the borrower and the defaulting owner be personally liable for these moneys?

If the section created privity of contract between the lender and the defaulting owner (and not transferees who come between the borrower and the defaulting owner), a covenant to pay all sums secured by the mortgage would be appropriate.[426] Section 62, however, creates privity contract between the lender and every transferee. In our opinion, a balance must be struck between allowing a lender to sue the defaulting owner for sums secured by the mortgage and limiting the exposure of intervening transferees. This balance is established if the covenants in the mortgage that run with the land relate to payment of principal, interest, and expenditures normally associated with ownership of land.

We therefore recommend that section 62 of the Land Titles Act be amended so that covenant to pay is expanded to include taxes, insurance and all reasonable sums paid by the lender to maintain or preserve the property. We are no longer of the view that costs should be included in this covenant. The payment of costs under the terms of a mortgage is a personal agreement between the mortgagor and the lender and does not relate to the land.

RECOMMENDATION 11

Section 62 of the Land Titles Act should be amended so that the transferee covenants with the lender to pay certain sums secured by the mortgage, namely: principal money, interest, annuity, rent charge, taxes, insurance premiums, and all reasonable sums paid by the lender to maintain or preserve the property. These sums would be payable at the rate and at the time specified in the mortgage.

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[426] See Law of Property Act, R.S.B.C. 1979, c. 340, s. 20.1 and Mortgages Act, R.S.O. 1990, c. M-40, s. 20.

(d) Summary

The importance of section 62 has fluctuated over time. Between 1906 and 1939 it was significant because it created a direct cause of action for the lender against the transferee at a time when there was no deficiency judgment protection in Alberta. It had no practical application when there was a blanket prohibition on deficiency judgments between 1939 and 1945. Since 1945 the scope of the deficiency judgment protection has been limited and the importance of section 62 has increased. The section was rediscovered in the 1980s when economic pressures forced lenders to look to all available avenues for the recovery of the debt. If the deficiency judgment protection afforded individuals is further restricted, it will become very important in respect of commercial property.

(3) Deficiency judgment protection for transferees

(a) The existing law

When the transferee agrees with the transferor that the transferee will assume payments under the mortgage, the transferee does not become personally liable to repay the mortgage debt. Personal liability arises when the transferee covenants with the lender to pay the mortgage according to its terms[427] or if such a covenant to pay is implied by section 62 of the Land Titles Act. Whether or not a lender can enforce these covenants depends on the factual situation.

Before 1988 the identity of the borrower determined whether the transferee was protected from deficiency judgment. If the borrower was an individual, then any transferee who assumed the mortgage was protected. If the borrower was a corporation, then any transferee who assumed that mortgage was liable.[428] In 1983 the Alberta Legislature gave deficiency judgment protection to certain individual transferees who assumed a mortgage granted by a corporation. Sections 43(1.1) and 43.4 of the Law of Property Act create this protection. Until 1988 a renewal agreement did not affect whether a transferee was protected from a deficiency judgment.

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427 This covenant would be found in an assumption agreement or in a renewal agreement.

428 The liability arose from the covenant implied by section 62 of the Land Titles Act or from any covenant to pay the mortgage given by the transferee to the mortgagee.

In 1988 the law changed and a renewal agreement now affects whether deficiency judgment protection is available to a transferee who has renewed the mortgage. As discussed in Chapter 4, this change came by way of four Court of Appeal cases: *Collingwood Invt. Ltd.* v. *Bank of Amer. Can. Mtge. Corp.*,[429] *Paramount Life Insurance Company* v. *Hilton*,[430] *Pioneer Trust Company* v. *Patrick*,[431] and *Standard Trust Company* v. *100762 Canada Ltd. and Steel*.[432] These cases have complicated the law in this area and provide incomplete protection to certain transferees. This is illustrated by the following fact scenarios. Assume that a corporation grants a mortgage on a condominium unit. The unit is sold to an individual who executes an assumption agreement wherein the individual agrees to pay to the lender all sums owing under the terms of the mortgage. At no time does the individual reside in the property. Before the term of the mortgage matures, the individual defaults. The lender could enforce the covenant to pay the individual gave in the assumption agreement and could enforce the covenant implied by section 62 of the Land Titles Act. This is a mortgage given by a corporation and, therefore, section 41(1)(b) does not protect the individual. Also, section 43(1.1) does not provide protection because the individual or a member of his or her family did not reside in the property.[433]

If default occurred after the individual transferee renewed the mortgage, it would then be a mortgage, as amended, given by an individual; section 41(1)(b) would protect the individual from an action by the lender.[434] By itself, section 41(1)(b) is not adequate protection for the transferee because the section does not prevent the corporate borrower from

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429 *Supra*, note 158.

430 *Supra*, note 169.

431 *Supra*, note 181.

432 *Supra*, note 182.

433 See *Standard Trust Company* v. *100762 Canada Ltd. and Steel, ibid.* The facts were the same but the corporation did not transfer title to the individual.

434 *Paramount Life Insurance Company* v. *Hilton and Torgerson Developments Ltd., supra*, note 169 and *Pioneer Trust Company* v. *Patrick, supra*, note 181.

suing on the covenant of indemnity implied by section 62.[435] It only prevents the lender from suing on the covenant to pay implied in section 62 or similar covenant given in an assumption agreement. Therefore, if the lender pursued the corporate borrower, the borrower could seek indemnity from the individual transferee. The protection afforded the individual who renews is incomplete. If section 43(1.1) applied, section 43.1 would prohibit an action by the transferor seeking indemnity. However, as sections 43(1.1) and 43.1 have no application, the claim for indemnity can proceed.

Another problem with the present law is that it leaves some questions unanswered. Does a renewal agreement affect the liability of previous owners including the borrower?[436] More puzzling is how the fact of renewal affects the liability of those who purchase the property subject to the renewed mortgage. Assume that an individual mortgages residential land. The individual sells the land to a corporation that assumes the mortgage. The corporation renews the mortgage and in turn sells to an individual. How is the last owner's liability determined? Has he or she assumed a mortgage granted by an individual or a corporation?

(b) Which transferees should receive deficiency judgment protection?

This unequal treatment of individuals and unequal treatment of corporations resulting from protection tied to the identity of the borrower is undesirable. Deficiency judgment protection for transferees should depend on the identity of the transferee, the kind of land charged by the mortgage, and the use made of the land.[437] It should not depend upon the identity of the borrower or the existence or non-existence of a renewal agreement. All homeowners and farmers, be they borrowers or transferees, should receive deficiency judgment protection. No other borrowers or transferees should be protected. The scope of the protection for homeowners and farmers should

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435 *In re Forster Estate, supra*, note 90. The Saskatchewan courts have interpreted a similar section differently. See *Buena Vista Developments Ltd., Crenian, Machula* v. *First City Trust Company and Tilford*, [1993] 3 W.W.R. 714 (Sask. C.A.).

436 See the discussion of this point by E. Mirth in an article entitled "Renewals in Alberta" (1985) 23 Alta. L.R. 405.

437 The use requirement that would determine whether a transferee is deserving of protection would be the same as that used in determining whether a borrower is deserving of protection.

be broad and should give protection against actions brought by the lender and transferor.

To implement this reform, the legislation must create deficiency judgment protection for transferees who purchase residential land or farm land and who are protected individuals. Corporate transferees and other individual transferees should be liable on any express or implied covenant to pay. Under this scheme, there would be protection for individuals who assume mortgages charging residential land or farm land where the use test is satisfied (ex. homeowners assuming corporate builder's mortgage). There would be no protection for individuals who assume mortgages charging other kinds of land or for individuals who assume mortgages charging residential land or farm land, but where the use requirement is not met. Transferees that are corporations would not receive deficiency judgment protection.

It is important to realize that under the proposed regime, renewal agreements would neither give rise to deficiency judgment protection or take it away. They would be irrelevant vis a vis such protection. Nevertheless, a covenant to pay given in a renewal agreement would be critical to the issue of liability because it may form the basis of the lender's claim in certain situations. For example, consider the situation where a corporation assumes a mortgage charging residential land granted by an individual who established a residence upon the land. Under our proposed scheme, the individual borrower would be protected from a deficiency judgment. In *Collingwood Invt. Ltd.* v. *Bank of Amer. Can. Mtge. Corp.*,[438] the Alberta Court of Appeal held that in such a situation, section 62 of the Land Titles Act does not imply a covenant to pay by the corporate transferee in favour of the lender. Until the corporation executes a renewal agreement or an assumption agreement wherein it covenants to pay all sums owing under the mortgage, the lender would have no cause of action against the corporation.

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[438] *Supra*, note 158.

RECOMMENDATION 12

A corporation that purchases land charged by a mortgage granted by an individual or a corporation should not be afforded deficiency judgment protection.

RECOMMENDATION 13

A lender should be prohibited from suing a transferee on any implied or express covenant to pay any sums secured by the mortgage where the mortgage charges residential land or farm land and the transferee is a protected individual.

(c) Additional protection

As discussed above, the transferee's protection is incomplete if only the lender's remedies are restricted. The law must go further, as it does in section 43.1 of the Law of Property Act, and prohibit a transferor (which could be the borrower or some subsequent owner) from seeking indemnity from the protected transferee. The prohibition must extend to actions based on the covenant of indemnity implied by section 62 of the Land Titles Act or any other such agreement of indemnity entered into between the parties. Therefore, we recommend there be a bar on any actions for indemnity brought by a transferor against a transferee where the mortgage charges residential land or farm land and the transferee is a protected individual.

When the type of land charged by the mortgage is residential or farm land, the chain of title may include protected individuals and others. Assume Corporation X builds a house and sells it to an individual. The individual assumes the mortgage granted by Corporation X and establishes a residence in the house. A few years later the individual sells the house to Corporation Y. Upon the default of Corporation Y, the lender sues Corporation X on the covenant to pay given in the mortgage and enforces its remedies against the land now owned by Corporation Y. In this situation, Corporation X should have the right to seek indemnity from Corporation Y.

This right will not exist unless legislation provides that, for the purposes of section 62 of the Land Titles Act, Corporation Y is deemed to be the transferee of Corporation X. This will allow Corporation X to sue Corporation Y on the covenant of indemnity that would be implied by section 62. The result would be the same if the protected individual sells to an individual who does not receive deficiency judgment protection.

One commentator views these recommendations as very harsh, particularly in this scenario. Assume a corporate borrower sells land to a protected individual, who later defaults. The mortgagee could sue the corporate borrower on the covenant to pay, but the corporate borrower could not seek indemnity from the protected individual. This, in his opinion, is harsh treatment of a corporate borrower who did not default on the mortgage.

This is a situation every corporate builder presently finds itself in when it sells a new home to a homeowner who assumes the mortgage granted by the corporate builder.[439] The risk inherent in the situation causes most builders to seek a release from the lender once the lender has approved the homeowner. If the corporate builder does not seek a release, it remains liable on the covenant to pay given in the mortgage and has no claim for indemnity against the homeowner.[440] One may consider the result harsh, but it is necessary if deficiency judgment protection is to extend to the individual transferee who resides in the home. Without section 43.1 of the Law of Property Act, the corporate borrower could assign its right to seek indemnity from the homeowner to the lender. The lender could then bring action on the claim for indemnity and by a different route obtain a judgment for the deficiency.

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439 See sections 43(1.1), 43.1 and 43.4 of the Law of Property Act.

440 *Ibid.*

RECOMMENDATION 14

A transferor should not be able to seek indemnity from his or her transferee on the basis of an express or implied covenant of indemnity where the mortgage charges residential land or farm land and the transferee is a protected individual.

RECOMMENDATION 15

This recommendation applies to the special circumstances where the chain of title for residential land or farm land includes protected individuals and others. For the purpose of section 62 of the Land Titles Act, each corporation or individual who does not receive deficiency judgment protection is deemed to be the transferee of the corporation or unprotected individual who immediately preceded it in the chain of title. Protected individuals would be transparent for the purpose of section 62.

(4) Continuing liability

In British Columbia and Ontario there is no deficiency judgment protection. Each borrower is liable on the covenant to pay given in the mortgage. This liability does not end upon sale of the land to a purchaser who agrees to assume the mortgage. Often this is not understood by borrowers who assume that once they sell the property their liability is at an end. This misconception is exposed after the purchaser defaults on the mortgage and the lender brings an action against the borrower and purchaser. To bring the law into line with this common expectation, British Columbia enacted legislation that releases the liability of previous owners at the time of sale or upon renewal of the mortgage. At the time of sale, the vendor can seek the lender's approval of the purchaser. The granting of such approval releases the vendor. When the lender refuses to give its

approval or when no application is made, the vendor is released from liability three months after the term of the mortgage expires unless the lender demands payment within that time. These provisions only apply to residential land.

In Alberta there is presently deficiency judgment protection for every individual borrower and, therefore, continuing liability is not a concern for them. It is of concern for corporations which sell land subject to a mortgage. If the deficiency judgment protection afforded individuals is reduced, continuing liability will become an issue for individuals who are not protected individuals. Should there be a mechanism which terminates continuing liability at the time of sale or at the time of renewal? Should it apply to individuals only or to individuals and corporations?

As one might expect, there are two sides to the issue. One who believes that the person who owns the property should be responsible for the mortgage debt will probably favour a mechanism which terminates liability at some time. Why should a lender be able to sue the borrower, when it has had an opportunity to assess the new purchaser and found him or her credit-worthy? The lender will not lose its cause of action against the borrower until it has established that the purchaser is an acceptable credit risk. This proposal will also avoid the arguments of novation that often arise on renewal of a mortgage. On the other hand, one can argue that Alberta provides deficiency judgment protection for certain individuals on the basis that they are deserving of protection. A broader basis of protection is unnecessary. Furthermore, a borrower who wishes to avoid continuing liability can bargain for a right to prepay the mortgage or can sell the property upon maturity of the mortgage term. Also, there are situations in which the lender approves the sale to the purchaser only on the basis of continuing liability of the vendor. The release of the vendor's liability upon renewal would force the lender to call the loan.

We received only one comment on this issue. One commentator favoured the first view and supports a system that would, generally speaking, impose liability only upon the party who is owner at the time of default.

We favour the second view. As discussed throughout this report, we believe that homeowners and farmers should receive deficiency judgment

protection. Others should not. There is no need to provide further protection. British Columbia has limited continuing liability for borrowers of residential land because it does not have deficiency judgment protection.

RECOMMENDATION 16

Alberta should not enact legislation that extinguishes the liability of a transferor (be it the borrower or some subsequent owner) upon the sale of the land charged by the mortgage to a transferee approved by the lender.

D. Guarantors

(1) Should protection extend to guarantors?

Earlier on in this chapter, we considered three possible means of creating deficiency judgment protection for borrowers. For the reasons discussed previously, we recommend that Alberta adopt a limited version of the existing protection. The general rule would be that in an action brought on a mortgage of residential land or farm land, the lender's remedies would be limited to the land. No action would lie on a covenant to pay found in the mortgage, an assumption agreement, or renewal agreement. No action would lie on the covenant to pay implied by section 62 of the Land Titles Act. From this general scheme of protection is excepted corporations and individuals who are not protected individuals. The lender could enforce any covenant given by corporations and such individuals.

The deficiency judgment protection we propose is a procedural bar to recovery by the lender. It does not extinguish the debt. The lender, therefore, could still enforce collateral security. This right to enforce collateral security would be tempered, as it now is, by the lender's inability to do indirectly what it cannot do directly. So if the promise to pay contained in the promissory note is the same as the unenforceable promise to pay contained in the mortgage of residential land or farm land, the promissory note would be unenforceable. Furthermore, the fact that the lender cannot enforce the borrower's covenant to pay does not protect the guarantor from his or her obligation as guarantor. The deficiency judgment protection that we propose would not extend to guarantors. Also, the

guarantor could not obtain such protection by becoming a transferee of the mortgaged land.

RECOMMENDATION 17

Alberta should allow a lender to enforce a guarantee of a borrower's obligation. This should be the case even when the lender is prohibited from suing the borrower on the covenant to pay given in the mortgage. The lender's right to enforce a guarantee would not be defeated if the guarantor at some time later became a transferee of the land charged by the mortgage granted by the borrower.

(2) Guarantor's rights against the borrower

A guarantor who pays all or part of the debt secured by a land mortgage can seek indemnity from the borrower. This is so even though section 41 of the Law of Property Act prevents the lender from commencing action to enforce the borrower's covenant to pay. Section 41 circumscribes the equitable remedies available to the lender against the borrower. It does not apply to the right of the guarantor to seek indemnity from the borrower.[441] Furthermore, there is nothing inequitable in obliging the borrower to indemnify the guarantor, even where the lender cannot commence an action against the borrower or transferee.[442]

A foreclosure order does not extinguish any liability of the borrower to the guarantor. The borrower's obligation to indemnify the guarantor is not the same as the borrower's obligation to pay the lender. Section 44 of the Law of Property Act deals with the borrower's obligation to the lender, not with the borrower's obligation to the guarantor. The borrower's

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441 *Taylor* v. *Glionna* (1986), 46 Alta. L.R. (2d) 140 (M.C.) and *First Investors Corporation Ltd.* v. *Mehra* (1986), 71 A.R. 140 (M.C.) aff'd (1987), 56 Alta. L.R. (2d) 380 (C.A.). In the *Mehra* case, Master Funduk held that section 41(1)(a) of the Law of Property Act prohibits an *in personam* claim by a creditor against his debtor. It does not prohibit a claim for indemnity by a surety against the debtor. This part of the decision was not considered by the Court of Appeal.

442 *Taylor* v. *Glionna, ibid.*

obligation to indemnify the guarantor is different than his or her obligation to pay the lender.[443]

Section 64 of the Law of Property Act codifies the guarantor's equitable right to have the lender transfer the land mortgage to the guarantor if the guarantor pays the mortgage debt. By virtue of section 64(2), a guarantor who pays the mortgage debt when due can demand that the lender transfer the mortgage to the guarantor. Upon transfer of the mortgage, the guarantor becomes vested with all the rights, powers and privileges of the lender.[444] As transferee of the mortgage, the guarantor could, where not circumscribed by Part 5 of the Law of Property Act, exercise the remedies of the lender. Upon payment of the mortgage debt, the guarantor would also be entitled to an assignment of any judgment the lender may have against the borrower.

(3) Guarantor's rights against a transferee

The right of the guarantor of the borrower's obligation to seek indemnity from a transferee exists in the following situations:

(i) Where the transferee has covenanted to indemnify the guarantor, Part 5 of the Law of Property Act does not bar this type of action.[445] As a result, a guarantor who, prior to foreclosure, pays the lender $8,000 can recover this sum from the transferee who has agreed to indemnify the guarantor for any moneys paid under the guarantee.[446]

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443 *Ibid.*

444 Land Titles Act, R.S.A. 1980, c. L-5, s. 111.

445 *Taylor* v. *Glionna*, *supra*, note 441 (borrower,transferee, and guarantor were all individuals); *Canada Trustco* v. *Donegal Homes Ltd.* (1984), 55 A.R. 38 (M.C.) (borrower was corporation; transferee and guarantor were individuals).

446 A foreclosure order operates as full satisfaction of the debt. Therefore, if the lender forecloses and then seeks to recover on the guarantee, it will be unsuccessful. However, the lender can first sue the guarantor and collect whatever it can and then obtain a foreclosure order. If this procedure is followed, the guarantor is entitled to enforce his or her contractual right to indemnity from the transferee for any money it paid the lender. Part 5 of the Law of Property Act does not interfere with the guarantor's rights to seek indemnity from the borrower or, where available, from the transferee.

(ii) When the guarantor pays the entire debt and seeks a transfer of the mortgage, the guarantor can exercise all the rights of the lender. In such a case, the guarantor could seek sale of the land and sue on any covenant implied by section 62 of the Land Titles Act. In this situation, the guarantor has no better remedies than the lender has, and Part 5 of the Law of Property Act and the case law prohibit action against certain transferees.

(iii) Where the lender assigns its right of action against the transferee to the guarantor, the guarantor can pursue the action against the transferee.

It is unclear whether equity gives the guarantor of a borrower's obligation an independent right to sue the transferee for indemnity. In his treatise on *The Law of Guarantee*,[447] K.P McGuinness suggests that this right exists against the borrower, but not others. Any right to sue others in respect of the guaranteed debt arises through subrogation to the lender's rights.[448] By this view, the guarantor would have no greater rights against the transferee than would the lender.

Contrary to this is the obiter statement made by Master Funduk in *Taylor* v. *Glionna*. In that case Taylor was the guarantor of an individual borrower who had sold the mortgaged land to Mr. and Mrs. Glionna. At the time of sale, the Glionnas agreed to indemnify the borrower and Taylor for any loss they might suffer should the Glionnas fail to pay the mortgage debt as due. Upon default by the Glionnas, the lender sued Taylor and the Glionnas. The action against Taylor was settled after Taylor paid $8,000 to the lender. After discontinuing the action against Taylor, the lender obtained a foreclosure order. Later, Taylor commenced this action against the Glionnas to recover the sum plus interest and costs. The court held that Part 5 of the Law of Property Act did not bar the action. Part 5 applies to lenders and vendors; it does not apply to a guarantor. In an obiter comment, Master Funduk noted that the right of indemnity probably exists independently of contract. He gives no authority for this statement. He also held that section 44 of the Law of Property Act did not extinguish the liability of the borrower or transferee to the guarantor. The debt that was

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447 K.P McGuinness, *The Law of Guarantee* (Toronto: Carswell, 1986).

448 *Ibid*. See Chapters 7 and 8, especially paras. 7.8 and 8.2.

extinguished was the debt owing by the borrower to the lender after the guarantor had paid the $8,000.

Query whether a guarantor who pays money to the lender may be able to argue that the transferee has, thereby, been unjustly enriched.[449]

(4) Should the guarantor's right to seek indemnity be restricted?

Legislation creating deficiency judgment protection exists to save destitute borrowers from overhanging deficiency judgments. The legislation is designed to ensure that the borrower who loses his or her land will not be saddled with the future obligation to pay for it. The policy behind such legislation is that an overhanging deficiency judgment would make it more difficult for the borrower to reestablish himself or herself. The borrower is seen as the one least able to absorb the loss, and conversely, the lender is seen as the one most able to absorb the loss. The lender has at least the land as a buffer to bankruptcy.

By allowing the guarantor to seek indemnity from the borrower who cannot be sued by the lender on the covenant to pay, the law creates a means of circumventing the deficiency judgment protection. Is this justified or should the guarantor's right to seek indemnity be restricted? We will address this issue by setting out the arguments to be made on behalf of the guarantor and borrower. Then we will explain which view point we find most persuasive and why.

The guarantor will argue as follows:

- As between the guarantor and the person primarily liable for the debt, the person primarily liable for the debt should bear the whole burden of that debt. This is a legal principle of ancient heritage based on common sense. The law should be loathe to deviate from this principle.

- The loan would not have been made except for the existence of the guarantee. The borrower has had the benefit of the guarantee and should

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[449] See some interesting comments on unjust enrichment made by the Alberta Court of Appeal in *Guaranty Trust Company of Canada* v. *Bailey, supra*, note 151 at 304.

take the corresponding detriment, namely, the borrower must save harmless the guarantor.

- The policy arguments behind restricting the lender's remedies to the land vis a vis the borrower who charges residential land and farm land are inapplicable to the case of the guarantor. An underlying assumption behind the policy of deficiency judgment protection is that most lenders are institutional lenders, who are better able to absorb the loss. This is not true in the case of guarantors. In the proposed regime, it will only be mortgages of residential land and farm land granted by individuals that attract deficiency judgment protection. A large percentage of such mortgages will be placed to assist the financing of the purchase of a home or family farm. Most guarantors will likely be relatives or close friends.

- Most protected mortgages will not be guaranteed. Allowing a guarantor to seek indemnity from the protected borrower will not severely diminish the scope of deficiency judgment protection. And it is justified, especially where the guarantor is himself or herself an individual.

The borrower or transferee will argue:

- If the law allows the guarantor to seek indemnity from the borrower or transferee, the deficiency judgment protection is circumvented. The destitute borrower will have the guarantor seizing any remaining exigible assets at a time when the borrower is forced to find new living accommodations and, probably, new employment.

- Once it is known that a guarantor of a protected borrower's obligation to pay is unable to seek indemnity from the borrower, the guarantor will understand this when he or she gives the guarantee. Knowing this, the guarantor has no cause to complain that he or she has no recourse against the borrower.

We think it unfair that a guarantor called upon to pay the borrower's obligations should not be able to seek indemnity from the borrower. One can assume that institutional lenders are in a position to absorb the loss occasioned when their remedies are restricted to the land and the value of the land falls below the debt secured by the land mortgage. One cannot assume that a guarantor is in such a position if his right to seek indemnity

is barred. Furthermore, the existing money market is very competitive. This fact ensures that the number of guarantees of protected individuals will not be so large as to create a significant inroad into deficiency judgment protection. If this does occur in the future, the problem can be dealt with at that time.

RECOMMENDATION 18

A guarantor's right to seek indemnity from the borrower or a transferee should remain as it is at present.

E. The Position of Crown Agencies

Many agencies of the Crown lend money to Albertans. Such agencies include: Farm Credit Corporation, Alberta Agricultural Development Corporation,[450] Alberta Opportunity Company and Alberta Treasury Branches. Agencies that have lent money in the past, but no longer do so, are Alberta Home Mortgage Corporation and Alberta Mortgage and Housing Corporation. Each agency serves or did serve policy established by the government. The policies vary from encouraging economic diversification to assisting low and modest-income Albertans in the purchase of housing. In the course of serving government policy, the crown agencies may compete with private-sector lenders or they may be making loans private-sector lenders consider too risky to make. These agencies are either part of the Crown itself or declared by statute to be agents of the Crown, and thus are treated as the Crown. In the following discussion, we use the term Crown to refer to both the Crown and its agents.

In the 1980s, the ability of the Crown to enforce covenants to pay found in mortgages granted to it became a contentious issue. In the early 1980s the conventional wisdom was that the Crown was not bound by Part 5 of the Law of Property Act and, therefore, section 41 and 42 did not bind the Crown. This conventional wisdom was upset in 1987 by two Alberta Court of Appeal decisions: *Alberta Mortgage and Housing Corporation* v.

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450 On April 1, 1994, Alberta Agricultural Development Corporation will amalgamate with Alberta Hail and Crop Insurance to become the Agricultural Financial Services Corporation.

Ciereszko and Craik[451] and *Farm Credit Corporation* v. *Dunwoody Limited (Trustee) and Holowach.*[452] The authority of these two decisions, however, has been undermined by the Supreme Court of Canada decision in *Alberta Government Telephones* v. *Canadian Radio-television and Telecommunications Commission.*[453] It can be argued that the law is back to the position where the Crown is not bound by Part 5 of the Law of Property Act.[454] When the Crown is not bound by legislation it is said to be immune.

In our report for discussion, we tentatively recommended that the Crown be bound by all the legislation that governs mortgage remedies, including the legislation that creates deficiency judgment protection. Although this recommendation has widespread consequences, we received only three comments on it. Alberta Treasury Branches indicated that it did not utilize its crown immunity and, therefore, loss of this immunity would have little effect on it. Two lawyers argued in favour of crown immunity. We shall incorporate their arguments in the policy analysis that follows and then make our final recommendation on this issue.

We must consider whether the legislation that will govern mortgage remedies should bind the Crown, including the legislation that creates deficiency judgment protection for homeowners and farmers. Those who favour crown immunity make these arguments. First, money lent by the Crown comes from public funds. Repayment of such funds must be protected for the benefit of all taxpayers. Second, loans made by the Crown are, more often than not, made to individuals who would not qualify for a loan from a private-sector lender.[455] They represent a high risk of default. As this is the case, they must be willing to stand behind their covenant to pay in

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451 *Supra*, note 73.

452 *Supra*, note 120.

453 *Supra*, note 73.

454 See Chapter 4 at 48-54.

455 For example, see page 13 of the 1983-84 joint annual report of Alberta Housing Corporation and Alberta Home Mortgage Corporation, where the profile of the typical mortgagor is described as follows:

> Not surprisingly, the majority of AHMC's mortgagors are married, between the ages of 25 and 35, earning approximately $25,000 a year and have one dependant child. Many of these families receive a monthly mortgage subsidy as well.

return for the opportunity of borrowing the money. One commentator, Ian Logan, expressed this argument best when he wrote:[456]

> The same general considerations apply to mortgages given by Alberta Mortgage and Housing Corporation, Alberta Agricultural Development Corporation, and Farm Credit Corporation. Anyone who can qualify for a loan from a non-governmental institution is not compelled to deal with these institutions. In essence, such loans are only extended as a special social privilege, and they carry, at public expenses and risk:
>
> (a) Direct subsidies
> (b) Reduced interest rates;
> (c) Extended fixed terms;
> (d) Specially correlated payment terms such as frequency;
>
> and/or other special advantages, for which some special consideration must be given. They are given with a much higher average risk factor than standard loans and enforced at a much less vigorous level, and, in the end, they amount to a taxpayer subsidization for the relevant industries. No only should the deficiency judgement protection and attornment clause voiding protection not be applied to them, it should be expressly stated not to apply in an way to them, and this should be demanded by the public.

Third, the threat of deficiency judgment is needed to prevent borrowers from walking away from high-ratio mortgages of residential land. Ian Logan indicated that threat of deficiency judgment was an effective tool in preventing borrowers from walking away from high-ratio residential mortgages given to Alberta Home Mortgage Corporation and Alberta Mortgage and Housing Corporation. These mortgages financed up to 90-95% of the purchase price of the home.

Those who oppose crown immunity make these arguments. First, there is much to be said for symmetry of the law in this area. If we are going to state general principles of liability, carving out exceptions to those principles is undesirable save in truly compelling circumstances. Second, it

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456 Letter dated August 26, 1991.

is incongruent to allow deficiency judgments against the poorest of borrowers, but not those who are of sufficient wealth to borrow from private-sector lenders. If anybody is going to have to absorb this kind of loss in the event of truly serious economic dislocation, the best loss absorber in society is society itself, not the poorest people in that society. Third, even if the Crown is allowed to obtain deficiency judgments against low and modest-income borrowers, the judgments will be of little value to the Crown. Having a judgment is one thing; collecting money to satisfy the judgment is another. Although Alberta Mortgage and Housing Corporation suffered losses in the hundred of millions because of mortgage defaults and falling land prices, it recovered relatively insignificant amounts on the deficiency judgments it obtained.[457] The only practical value is the threat of deficiency judgment against potential walk-aways. The question then becomes whether the number of walk-ways that might occur justifies imposing deficiency judgments against all borrowers.

The broad scope of lending activities of the Crown complicates this issue. On one side of the spectrum operates the Alberta Treasury Branches, which is managed very much like other private-sector lending institutions. On the other side of the spectrum were Alberta Home Mortgage Corporation and Alberta Mortgage and Housing Corporation, which lent money to low and modest-income Albertans for purchase of a home.[458] We remain of the view that if the Crown is acting like a private-sector lender, it should be governed by the same laws. The mere fact that taxpayers' money is being

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457 We examined the annual returns of Alberta Home Mortgage Corporation (1981-1983) and Alberta Mortgage and Housing Corporation (1984-1992). Each annual return filed for the years 1981 to 1987 contained a Statement of Receipts and Expenses for the Mortgage Insurance Fund. Beginning in 1984 that statement showed a source of revenue entitled "interest on writs". We assume this is the money AMHC collected on the writs of execution filed to enforce deficiency judgments. These statements show that during the years 1984-87 a total of $809,000 was collected under this head of revenue. Yet, the losses suffered because of falling land prices were in the hundreds of millions of dollars.

458 These Crown agencies would not lend to purchasers unless the established income and value requirements were met. Loans would NOT be made to purchasers who earned above a certain income level or where the value of the home exceeded a stated value. For example, in 1980 families with an adjusted gross income of up to $31,000 per year were eligible. The value of the new home could not exceed $70,000. The adjusted gross income was calculated by adding 100% of the principle wage earners income and 100% of the other spouse's income and subtracting (1) the working spouse's income or up to $4,000, whichever is less; and (2) $300 per dependent child up to $1500. By 1984 the maximum adjusted gross income was raised to $34,000 and the maximum value of a new home was raised to $78,000.

lent is insufficient reason in modern times to place the Crown in a better position than private-sector lenders. Consultation has caused us, however, to reconsider the scope of our original recommendation. There will be situations in which the social policy being served results in loans to high-risk homeowners and farmers who would not be serviced by private-sector lenders. In these situations, the Crown may be justified in excepting itself from legislation that creates deficiency judgment protection for homeowners and farmers. In evaluating whether an exception must be made, the Crown should balance two competing factors. First, the consequences of suing low and modest-income individuals for a deficiency judgment caused by falling land prices brought on by a recession. Second, the likelihood that some of the low and modest-income borrowers will become walk-aways[459] in deep recessionary times. Clearly the concern over walk-aways grows stronger as the size of the down payment grows smaller.[460]

Our final recommendation is that the Crown should be bound by all the legislation which governs mortgage remedies, subject to specific exceptions that the Crown may wish to include in respect of certain agents of the Crown. This recommendation would apply both the Crown in right of Alberta and the Crown in right of Canada.

There is debate as to whether provincial legislation can bind the federal Crown. There is, at best, marginal authority that provincial legislation can bind the federal Crown.[461] The weight of authority is that, subject to certain exceptions, provincial legislation cannot bind the federal

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459 As mentioned in Chapter 3, walk-aways are borrowers who have the ability to repay the mortgage debt but who choose not to because the value of the land is less than the debt secured by the mortgage.

460 In his letter of August 26, 1991, Ian Logan wrote:

> You discuss the phenomenon of "walk-aways" in a vacuum if you do not canvas the mortgagees and the foreclosure solicitors as t the actual experience. AMHC (with its 5 per cent down-payment) is the best example, but NHA (10 per cent) is not far behind. The fact is that the lower the original investment and, more importantly, commitment to the purchase, the easier it is for people to walk away from it, and the ability to pay has far less bearing on this than voluntary choice to cease payment.

461 See *Dominion Building Corp.* v. *R.*, [1933] A.C. 533 (P.C.) and *Reid* v. *Canadian Farm Loan Board*, [1937] 4 D.L.R. 248.

Crown.[462] Those exceptions include incorporation of provincial legislation by the federal legislation,[463] voluntary submission, and the benefit-burden exception. Where the federal Crown takes advantage of a provincial statute, it will be bound by the burdens of the statute if the benefit and burdens created by the statute are so interrelated that the benefit must have been intended to be conditional upon compliance with the burden.[464]

Having noted the uncertainty in the law, we suggest that Alberta adopt the pragmatic position taken by Saskatchewan in respect of farm mortgages. In 1988, Saskatchewan enacted The Saskatchewan Farm Security Act.[465] This is a comprehensive piece of legislation that governs how farm mortgages given to secure the purchase price of farm land can be enforced. Section 25 creates deficiency judgment protection for farmers who grant such mortgages. The Act applies to recognized financial institutions, which are defined to include Farm Credit Corporation and The Agricultural Credit Corporation of Saskatchewan. To our knowledge, Farm Credit Corporation has not challenged the Saskatchewan legislation in its entirety on the basis that provincial legislation cannot bind the federal Crown.[466] More important, Farm Credit Corporation continues to do business in Saskatchewan.

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462 Provincial legislation cannot bind the federal Crown:
- *Gauthier* v. *R.* (1918), 56 S.C.R. 176
- *The Queen* v. *Breton* (1968), 65 D.L.R. (2d) 76 at 79
- *Re Pac. West. Airlines Ltd; R.* v. *Can. Tpt. Comm.*, [1978] 1 S.C.R. 61 at 72-73
- *Eldorado Nuclear Ltd.* v. *Uranium Canada Ltd.*, [1983] 2 S.C.R. 551 at 565-66
- *FBDB* v. *Hillcrest Motor Inn Inc.*, [1988] 5 W.W.R. 466 (B.C.C.A.).

463 An example of this is found in the Crown Liability and Proceedings Act, 1985, R.S.C. 1985, c. C-50, ss 3 & 4.

464 See *A.G. Canada* v. *Tombs* (1946), 4 D.L.R. 519 (Ont. C.A.) at 523; *Toronto Transportation Commission* v. *The King* (1949), S.C.R. 510; *AGT* v. *CRTC*, *supra* note 73. The *AGT* v. *CRTC* deals with this principle, although it does so in a slightly different context.

465 S.S. 1989, c. S-17.1.

466 In 1993, Farm Credit Corporation successfully argued that the mandatory lease-back provisions of the Act, which were created by amendments enacted in 1992, did not bind the federal Crown. This was so even though Act states that it applies to Farm Credit Corporation. Farm Credit Corporation made it clear that it was just objecting to the operation of the lease-back provisions, and not the other provisions in the Act, which included deficiency judgment protection for certain farmers. See *Carbert* v. *Farm Credit Corporation*, [1993] 5 W.W.R. 58 (Sask. Q.B.).

We are of the opinion that Alberta should make the provincial Crown, and, if possible, the federal Crown subject to the general laws creating deficiency judgment protection for homeowners and farmers, unless there are compelling reasons for excepting certain crown agencies.

RECOMMENDATION 19

The Crown should be bound by all the legislation that governs mortgage remedies, subject to any exception the Crown may wish to make for specific crown agencies.

When discussing the position of Crown agencies, one must also address section 43(2) of the Law of Property Act. This section provides:

> (2) Sections 41 and 42 and subsections (1.1) and (3) of this section do not apply to a mortgage given to secure a loan under the National Housing Act, R.S.C. 1952, c. 188 or the National Housing Act, R.S.C. 1970, c. N-10.

Since 1954, the various National Housing Acts have enabled Canada Mortgage and Housing Corporation ("CMHC") to insure certain loans made by approved lenders. These loans must be for the purposes authorized by the Acts. The authorized purposes include loans made for the construction of a house or the purchase of an existing house.[467] As the insurer, the Corporation is subrogated to the rights of the lender. This means that if the lender cannot sue for judgment for the deficiency amount, CMHC also takes this position. Section 43(2) of the Law of Property Act and its predecessors were enacted for the benefit of CMHC. This section expands the remedies of the approved lenders so that these lenders are in the same position that the Crown would be in if it had made the loan directly.[468] This allows the insurer, CMHC, to take an assignment of any deficiency judgment obtained by an approved lender. As assignee of the judgment, the Corporation can take steps to enforce the judgment.

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[467] National Housing Act, R.S.C. 1985, c. N-11, s. 9(1)(a).

[468] See K.R. Laycock, "Foreclosure Action on Mortgages under the NHA" (LESA 1985) Banff Refresher Course 256 at 262.

At one time CMHC did not require the insured lender to seek judgment for any deficiency in every case. Action for the deficiency was reserved for situations involving dollar dealers. In the late 1980s, this policy changed. Now, CMHC requires the insured lender to obtain judgment for every deficiency. CMHC does not take steps to collect on these judgments. However, for various reasons the debtors often must deal with these judgments at some later date. At that stage, CMHC insists on some settlement of the judgment. The amount required for discharge of the judgment depends on the ability of the debtor to pay the judgment. CMHC indicates that its rate of recovery on deficiency judgments obtained throughout Canada has improved. In the 1980s, the rate of recovery was very low; in the 1990s, CMHC has collected about 25¢ on each dollar of deficiency judgment.[469]

The sums recovered on Alberta deficiency judgments is large in actual dollars, but not significant when compared to the total claims paid by CMHC on insured mortgages. CMHC has collected a total of $4.5 million on Alberta deficiency judgments during the years 1987 until 1992.[470] For the years 1983 through 1992, CMHC has paid claims nationally which total, on average, $257,800,000 per year.[471]

Typically, CMHC insures mortgages that have a high loan-to-value ratio. These are commonly referred to as high-ratio mortgages. A high-ratio mortgage is one where the loan amount is more that 75% of the value of the house being bought. Put another way, it is a mortgage securing a loan for the purchase of a house when the down payment is less that 25% of the value of the house. Each borrower pays an insurance premium of 2% of the loan amount.

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469 Information provided by Doug Dennis, Director, MIF/MBS Policy Development, CMHC.

470 Letter of April 23, 1993. This sum represents collections on deficiency judgment which were, for the most part, obtained in the 1980s.

471 Information provided by Doug Dennis, Director, MIF/MBS Policy Development, CMHC. Note that the average actual loss would be less than this. The actual loss is calculated by taking the claims paid and subtracting the proceeds from sales of real estate earned that year. The proceeds equals the price recovered on sales less holding costs and costs of sale.

The profile of Alberta homeowners seeking loans insured by CMHC is as follows:[472]

Year	Item	New Home Owner/FLHI (Alberta)	Existing Home Owner/FLHI (Alberta)
1988	Income	46,134	45,820
	GDS	22.77%	22.84%
1989	Income	49,926	49,659
	GDS	23.58%	23.86%
1990	Income	54,078	54,208
	GDS	24.14%	24.55%
1991	Income	53,912	53,376
	GDS	23.21%	23.24%
1992	Income	52,096	51,304
	GDS	22.90	22.92%

FLHI is the Family First Program under which CMHC provides 95% financing.
GDS is the gross debt service ratio. This is the ratio of principle, interest, taxes and heat to gross income, multiplied by one hundred. The maximum GDS ratio allowed by CMHC is 32%.
Income is family income, but if one income is sufficient to qualify the other income may not be included in this sum.[473]

In the report for discussion, we tentatively recommended that the general laws creating deficiency judgment protection for specified individuals should apply to mortgages given to secure a loan made or insured under the National Housing Act. The reasoning behind this recommendation was as follows:[474]

> Most borrowers who have a high-ratio mortgage are young individuals who have been able to save a small down payment towards the purchase of their first home. These are the persons most needing protection from deficiency judgments in a

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472 Letter of April 23, 1993.

473 Information provided by CMHC.

474 Report for Discussion at para. 7.123.

> times of economic depression. Why should approved lenders be allowed to sue these borrowers? In most cases these borrowers will have no assets to satisfy the judgment entered against them.

This tentative recommendation generated responses that ranged from total support to total opposition. Those that support the recommendation do so for various reasons. Some argue that mortgages insured under the National Housing Act create economic stimulus and, therefore, are for the general good. The insurance premiums collected by CMHC fund this program, and there is no need for access on the covenant. CMHC recovers very little on deficiency judgments, in any event. Others argue that if deficiency judgment protection is going to exist for homeowners and farmers, it should exist for them all. Each borrower pays an insurance premium and should receive the benefit of the insurance.

Lenders were concerned that removal of the National Housing Act exception would negatively impact the availability of high-ratio financing. They suggested that the recommendation would cause CMHC to reduce the maximum loan-to-value ratios it is prepared to insure or increase mortgage insurance premiums or establish other lending restrictions. This, they argue, would result in fewer high-ratio loans being made and would result in lost opportunity for borrowers and lost profit for lenders.

One commentator, Ian Logan, argues that our recommendation is based on the false assumption that high-ratio mortgages are a vehicle for assisting lower income groups to purchase housing. In his experience, there is no correlation between income level and the likelihood someone will seek high-ratio financing. He believes that anyone who can qualify for a mortgage can save 25% down. Those who choose high-ratio financing make this decision to accommodate choices as to personal spending and planning. In his view:[475]

> . . . a mortgage insured under the National Housing Act is a special privilege extended by government policy, utilizing (or at least risking) public funds as a matter of economic social policy. Anyone not wishing to give this consideration is

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[475] Letter of August 26, 1991.

> not being forced to do so, as they have the alternatives of renting shelter or saving for a sufficient down payment . . . . The exception for NHA mortgages is not only just and reasonable, it should be demanded by the public.

CMHC opposes the recommendation and argues that we have shown no need for change. In its view, the current law does not do irreparable harm to Alberta interests and as such should be left intact. CMHC argues for retention of the existing law on the following bases. First, borrowers who grant high-ratio mortgages DO NOT have significantly lower incomes that borrowers who grant conventional mortgages. "In 1990 the characteristics of the average borrower with a mortgage loan insured through CMHC for a single detached dwelling in Calgary were as follows: 34 years of age with a family income of $67,000 purchasing a house valued at $140,000. In Edmonton that borrower was 36 years old with an income of $65,800 purchasing a house valued at $133,800."[476] Second, CMHC insured borrowers are high-risk individuals; they do not have the equity in their real estate to cushion any downturn in housing values. These borrowers would not be able to obtain the loan without the assistance of the National Housing Act. Finally, CMHC must have all available remedies against a defaulting borrower so that it can control the size of the potential losses to the Mortgage Insurance Fund operated by CMHC.

CMHC officials were unable to estimate the insurance premium increase that would be necessary to offset loss of recovery on Alberta deficiency judgments. They did indicate that over the long term CMHC did not see insuring Alberta mortgages as a greater risk than insuring mortgages granted in other provinces. This is the case because although the percentage of defaults in every province is always low, these defaults can still lead to large losses.[477]

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476 Letter of January 14, 1992. Please note that the average family income for Alberta borrowers who granted a CMHC insured mortgage in 1990 is slightly above $54,000. This is significantly lower that the $67,000 average family income for borrowers who in 1990 granted a CMHC mortgage charging a single detached dwellings located in Calgary. The other borrowers insured by CMHC must earn significantly less to bring the average family income down by $12,000.

477 Meeting with Bill Lusk and Wayne Wywrot. This information is confirmed by statistics provided to us by the Canadian Bankers Association which show the percentage of residential housing loans in arrears three months or more for the years 1982 to 1993.

This difference of opinion is reflected among Institute Board members and, as a result, we recommend that the legislature consider whether an exception should be made for mortgages insured under the National Housing Act. Some of us are uncomfortable with the assumption made in the report for discussion that high-ratio mortgages are a vehicle for assisting low and modest-income borrowers in purchasing housing. Clearly, the mortgages insured under the National Housing Act in the last 5 years have been granted by individuals of middle income, not low or modest income. Also, some of us are concerned that access on the covenant in the case of high-ratio mortgages is necessary to discourage walk-aways.

Other board members disagree. They point to the fact that little is collected on deficiency judgments obtained in Alberta. The fact remains that the end result is judgment against those who did not have sufficient money to pay the 25% down payment necessary for conventional mortgages. These are first-time homebuyers. CMHC must look to future income to satisfy these judgments and this is what deficiency judgment protection is designed to prevent. Furthermore, these borrowers have already paid an insurance premium for such losses. CMHC should look to the premiums to cover the cost of the programs served by the National Housing Act. In their opinion, the number of walk-aways that may occur in the future is not sufficient reason to allow judgment against all borrowers who have CMHC insured mortgages. The phenomenon of walk-aways has not been seen since 1985. Most people who default on their mortgages do so because they have no money to pay and are deserving of deficiency judgment protection in a province where cyclical land prices lead to large crippling deficiency judgments. These board members also note that the rate of default on residential mortgages is always low and, in 1990, Saskatchewan extended deficiency judgment protection to include purchase money mortgages insured under the various National Housing Acts.[478]

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[478] Saskatchewan Housing Corporation Act, R.S.S. 1978, c. S-24, s. 46 (Am. 1990, c. 6, s. 2) and *HFC Trust Limited* v. *Gettle* (1990), 5 W.W.R. 727 (Sask. Q.B.).

RECOMMENDATION 20

The Legislature should examine whether the general laws creating deficiency judgment protection for specified individuals should apply to mortgages given to secure a loan made or insured under the National Housing Act.

F. Due-on-Sale Clauses

In Alberta due-on-sale clauses are valid and enforceable and are not considered to be a restraint on the power of alienation. Nevertheless, the courts are willing to give relief against the enforcement of such clauses when sale of the property does not increase the risk of default, waste or disrepair.[479] We believe that the validity of such clauses is a matter to be determined by the common law. The issue of whether the courts should, if ever, relieve against the enforcement of such clauses is of concern to us.

We recognize that a lender has a legitimate concern in the identity of the purchaser. Sale to an indigent purchaser greatly increases the likelihood of default and the costs and delay that come with a foreclosure. Also, a mortgaged property may only be viable if properly managed. Sale to persons without the necessary expertise can greatly increase the risk of default. For these reasons lenders wish to prevent sales to such purchasers. They also dislike sales to purchasers who have little equity in the property. Experience teaches that such purchasers have little incentive to keep the property in good repair. This is very important in a falling real estate market, especially if the lender's remedies are restricted to the land. This failure to keep the property in repair can result in an unrecoverable loss for the lender.[480] Therefore, a lender should be allowed to enforce a due-on-sale clause when the borrower has sold the land to a high-risk purchaser. Such a purchaser is one who increases the risk of default, waste or disrepair. The law presently allows this.

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479 Due-on-sale clauses are discussed in more detail in Chapter 4 at 77-90.

480 R.L. Cohen, "Judicial Treatment of the Due-on-Sale Clause: The Case for Adopting Standards of Reasonableness and Unconscionability" (1975) Stanford Law Rev. 1109 at 1113-16.

The difficult question is whether the lender should be allowed to enforce the due-on-sale clause for any reason, including the wish to take advantage of a rise in interest rates. The problem was described by the Ontario Law Reform Commission as follows:[481]

> The central policy issue with respect to due-on-sale clauses is the question of who should be entitled to obtain the benefit of a rise in interest rates during the term of the agreement. It has been suggested that, as a matter of social policy, it is preferable that borrowers, rather than lenders, should obtain the benefit of a rise in interest rates. Where interest rates have been increased, a borrower ordinarily will want to offer to the purchaser the valuable lower interest rate for the balance of the term of the agreement as part of the sale package, since the property obviously will be more attractive if the purchaser can finance the purchase at the lower interest rate. In selling the lower interest rate to the purchaser, the borrower is, in effect realizing the capital value representing the difference between the rate of interest being charged on the existing agreement and the increased rate at which the purchaser would otherwise have to arrange financing. If the lender is able to call the loan and relend the money at the increased rate, it is the lender, and not the borrower, who will obtain the capital value.

Alberta is the only province in which the courts have interfered with enforcement of due-on-sale clauses. The two cases in which this was done relieved against the operation of the clause because the purchaser did not represent an increased risk of default, waste or disrepair. Neither of the cases specifically dealt with the lender's right to enforce the due-on-sale clause in order to take advantage of an increase in interest rates. Nonetheless, if the lender has such a right in Alberta, the court should not have relieved against the enforcement of the due-on-sale clause interpreted in *Bigam* v. *Milne*.[482] In that case the court merely held that the positive difference between the existing interest rate and the mortgage rate did not make the terms of the mortgage unconscionable. The implication was that,

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481 Ontario Law Reform Commission, *Report on the Law of Mortgages* (1987) at 85.

482 *Supra*, note 196.

if it had, the clause could be enforced and the court would not stay the foreclosure action.

Should the Alberta law be changed to allow the lender to enforce the due-on-sale clause for any reason, including the wish to take advantage of an increase in the interest rates?[483] Those that support the existing law argue that in Canada lenders have no economic need to update their mortgage portfolios through the enforcement of due-on-sale clauses. Canada's market is dominated by short-term mortgages, which are renewed at the market rate at the end of the term. The short terms of mortgages ensure that a lender's mortgage portfolio is kept up-to-date. The economic necessity for enforcement of due-on-sale clauses that is recognized in the United States does not exist in Canada. Furthermore, lenders undertake the risk of extended inflation and a competitive money market. Lenders set their interest rates on the basis of their long-term projections on future economic conditions. It is fair to hold lenders to their projections over a short mortgage term. The due-on-sale clause should not be used to provide further insurance against these foreseeable hazards.

Those that seek the right to enforce a due-on-sale clause for any reason insist that lenders have no desire to take advantage of an increase in interest rates. They fear a system which allows a court to second guess a business decision made in a responsible manner. Court supervision of lenders' exercise of due-on-sale clauses is both time consuming and expensive. In some types of mortgages, such as participation mortgages, the lender should have the right to insist the borrower retain ownership of the property. At the very least, the lender should have the unfettered discretion to determine the suitability of the purchaser. "Finally it can be argued that no lender should be subjected to risks imposed by courts which do not have to answer for their errors other than by appellate review."[484]

We agree that there is no need to go so far as to prohibit enforcement of due-on-sale clauses. They serve a useful purpose when the borrower sells

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483 The arguments on both sides of this debate are more fully developed by Professor Robertson in his article entitled "Neither a Borrower Nor a Lender Be: The Problem with Sales of Real Property Subject to Existing Mortgages", *supra*, note 194. His analysis deals with the interconnection of continuing liability of the seller and enforcement of due-on-sale clauses in provinces that do not have deficiency judgment protection.

484 *Ibid.* at 52.

the land to a high-risk purchaser. Yet, we see no need to allow lenders to enforce due-on-sale clauses for any reason. In Canada, lenders bring their loan portfolios up-to-date by having short-term mortgages. There is no need for lenders to enforce due-on-sale clauses to bring about this result. The present Alberta law allows the court to relieve against the enforcement of due-on-sale clauses when the sale does not increase the risk of default, waste, or disrepair. This strikes the proper balance between the interests of borrowers and lenders and should be retained.

In the report for discussion, we made no recommendation for change. We merely affirmed that the existing law relating to enforcement of due-on-sale clauses is adequate. This met with approval, but the Mortgage Loans Association of Alberta would like to see legislation which guides a court in giving relief from a due-on-sale clause. We agree with this suggestion and so recommend.

RECOMMENDATION 21

The existing law relating to the enforcement of due-on-sale clauses is adequate. The legislation governing mortgage remedies should list the factors the court can consider when giving relief against the operation of a due-on-sale clause.

G. Attornment Clauses

In Alberta, attornment clauses are void except for those found in mortgages described in sections 35(2)(a)-(c) and 37 of the Law of Property Act. Those mortgages are: (1) mortgages granted to Farm Credit Corporation, (2) mortgages of business premises, and (3) mortgages given to secure a loan under the National Housing Act. Nonetheless, lenders cannot enforce attornment clauses given in these mortgages where section 41(1) of the Law of Property Act protects the borrower from action on the covenant to pay given in the mortgage. The result is that Farm Credit Corporation cannot sue or distrain for rent owing under an attornment clause if the borrower is an individual. It can only do so if the borrower is a corporation. Where the mortgage charges business premises in which the borrower does not reside, the lender can enforce the attornment clause only if the borrower

is a corporation. In this context, "business premises" does not include farm land. An attornment clause in a mortgage given to secure a loan made under the National Housing Act, however, is enforceable because section 41(1) does not apply to such mortgages.[485]

Most protected individuals will not know that an attornment clause gives the lender the right to distrain goods to satisfy the fictional rent established by such a clause. As it applies to a protected individual, an attornment clause is an indirect means of enforcing the covenant to pay given in the mortgage. This should not be allowed where deficiency judgment protection is extended to such an individual. We recommend that the enforceability of attornment clauses be tied to the existence of deficiency judgment protection. If the lender cannot enforce the covenant to pay given by the borrower, then the attornment clause should be void. If the lender can enforce the covenant to pay given by the borrower, then the attornment clause should be enforceable.

With one exception, this recommendation would ensure that there would be no distraint if the property was the residence or farm of the borrower. The exception would arise where the property is not residential land, as defined, but is occupied by the borrower. This might happen where the borrower resides in an apartment building which is charged by the mortgage. It also might happen when the borrower carries on business from the first floor of mortgaged commercial property and resides on the second floor.

We have puzzled over whether in these situations the law should restrict the lender's right to distrain to non-residential goods. We have concluded it should not. By virtue of section 20 of the Seizures Act, the lender cannot distrain under an attornment clause on those goods and chattels that are exempt from seizure under execution. These exemptions would protect some, but not all, residential goods. Enforcement of an attornment clause in these situations merely allows seizure before judgment, rather than after judgment. The same exemptions apply.

We would recommend that all lenders be subject to the same restrictions on the validity of attornment clauses. No exception should be

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485 The enforceability of attornment clauses in Alberta is discussed in more detail in Chapter 4 at 108-13.

made for mortgages given to the Farm Credit Corporation, or mortgages insured under the National Housing Act, or mortgages given to the Crown or any of its agents.

RECOMMENDATION 22

Any attornment clause given by a protected individual in a mortgage charging residential land or farm land should be void. No exceptions should be made for mortgages granted to the Farm Credit Corporation, mortgages securing loans given or insured under the National Housing Act, or mortgages granted to the Crown or any of its agents.

H. Waiver

The protection of specified individuals that is created by our proposals could be easily eliminated by a simple technique. That technique is the use of a standard clause in every mortgage waiving the protection created by statute. This is undesirable and should be prohibited.

RECOMMENDATION 23

Any waiver or release of the rights, benefits or protection given by the proposed regime should be against public policy and void.

CHAPTER 8
RECOMMENDATIONS FOR REFORM OF FORECLOSURE PROCEDURE

A. Introduction

In this chapter, we suggest changes to the existing foreclosure procedure. We begin by discussing the specific issues of extrajudicial sale by the lender, Rice orders, the sale process, and the appointment of receivers. We then deal with procedure and how it could be improved. We conclude with suggestions as to how accomplish the transition between the existing and the proposed law.

B. Extrajudicial Sale by a Lender

At present, a lender cannot exercise any form of extrajudicial sale process where the borrower is an individual who is protected by section 41 of the Law of Property Act.[486] A lender can exercise a power of sale granted by a corporate borrower if the lender is able to register a transfer (executed by the borrower or the borrower's attorney) or makes application under section 180 of Land Titles Act. The transfer of title through these means will not extinguish subsequent encumbrances.[487] Sale of land under a power of sale usually occurs in the context of receiverships that arise under a debenture. Even in these situations, it is infrequent, because the exercise of a power of sale in Alberta does not allow the Receiver to transfer title free and clear of subsequent encumbrances.

In our report for discussion, we suggested that a lender's ability to exercise a power of sale be restricted as it now is, and we made recommendations to bring about this result in the new regime. We tentatively recommended that all powers of sale granted by individuals be

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[486] Although most mortgages insured under the National Housing Act contain powers of sale, the approved lenders do not exercise these powers of sale. Foreclosure proceedings are commenced. If an approved lender did exercise a power of sale given in a mortgage, the lender would face the same limitations the lender would face if a corporation had given the power of sale.

[487] In order to extinguish subsequent encumbrances, the lender must bring a foreclosure action and seek an appropriate order. See the discussion in Chapter 4 at 95-97.

void. No exception would be made for mortgages given or insured under the National Housing Act and its predecessors. Powers of sale granted by a corporation would remain enforceable.

The Mortgage Loans Association of Alberta suggests that a lender be able to enforce a power of sale whenever the borrower is not protected from deficiency judgment. We do not agree with this suggestion. For the reasons set out in Chapter 6, we believe that a system of judicial supervision goes the furthest to ensure fair treatment of borrowers, lenders and subsequent encumbrancers. Although we wish to ensure that receivers appointed under a debenture may sell land pursuant to a power of sale, judicial supervision is preferable in other situations.

We have considered whether all powers of sale should be void except those granted by a corporation in a debenture. We have rejected this approach because such a narrow exception could easily be circumvented by putting a corporate land mortgage into the form of a debenture charging land. We do not wish to invite strategies based on form as opposed to substance of the document.

As discussed in Chapter 6, several commentators thought Alberta's system of judicial sale should be replaced with a power of sale regime. As explained in that chapter, we do not hold that view. That discussion is not repeated in this section.

We affirm our tentative recommendation made in respect of extra-judicial sale.

RECOMMENDATION 24

(a) A power of sale granted by an individual borrower should be void.

(b) A lender's right to exercise a power of sale granted by a corporation should remain unchanged. As is the case at present, the lender who exercises a power of sale granted by a corporation will be unable to transfer title free and clear of subsequent encumbrances.

C. Rice Orders

(1) What is a Rice order?

The Rice order takes its name from the order upheld by the Alberta Supreme Court, Appellate Division in *Trusts and Guarantee Company* v. *Rice*.[488] As the first step, the court may offer the land for sale.[489] If no successful offer is received, the lender proposes to the court that the lender buy the land for a certain price. The court judges the adequacy of this proposal on the basis of appraisal evidence submitted by the lender and appraisal evidence, if any, submitted by the defendants. If the court finds the proposal satisfactory, it accepts it and grants a Rice order directing sale of the land to the lender for the approved price. The order may be effective immediately or it may be stayed for a period, usually two months, to give the borrower an opportunity to locate someone who is willing to pay more for the land. If the order is stayed and no better offer is received during this period, the land is sold to the lender.[490] The Rice order also contains an *in personam* judgment against the borrower (or others where available) for the amount of the deficiency plus costs.[491]

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488 *Supra*, note 45.

489 Until 1984 it was thought that a Rice order could not be given unless there had been an attempt at sale. However, in *Central Trust Company* v. *Stewart Brown Real Estate Ltd. and Michael's Flooring and Home Furnishings Ltd.* (1984), 32 Alta. L.R. (2d) 75, the Court of Appeal suggested that there could be an immediate Rice order. At the time this case was decided the Alberta real estate market was severely depressed. The chambers judge granted a foreclosure order over the lender's opposition, even though the debt owed exceeded the value of the land by $1500. The Court of Appeal held that this was an improper exercise of the Chamber Judge's discretion since it deprived the lender of its right to a deficiency judgment. Even though an order directing sale would harm the borrower by increasing the size of the debt and would not likely result in a sale to a third party, the foreclosure order was not the answer. The Court suggested the use of an immediate Rice order as a means of avoiding the consequence of delay. This overruled the earlier direction in *Trust and Guarantee Company, Limited* v. *Rice*, *supra*, note 45, that a Rice order must always be preceded by an attempt at sale.

490 *Canada Perm. Trust Co.* v. *King Art Dev. Ltd. et al.*, *supra*, note 82 at 645-48.

491 A Rice order is commonly understood to be a order directing sale to the lender and an order granting judgment against the defendants for the amount of the deficiency plus costs. Occasionally, however, the lender may first seek sale to the lender and at a later application seek judgment for the deficiency and costs.

(2) The development of the Rice order procedure

At common law, a lender had the legal title and the borrower had the equitable interest in land known as the equity of redemption. The lender could extinguish the borrower's equity of redemption by obtaining a foreclosure order and, in some special circumstances, by purchasing at a judicial sale.[492] Under a Torrens system, the lender can obtain title by purchasing at a judicial sale or by foreclosing. Before 1920 it was unclear whether a lender who bought at a judicial sale could sue the borrower for any deficiency. The ability to do this seemed to conflict with the common law principle that a lender which asserts exclusive ownership of the land after foreclosure cannot sue on the covenant to pay.[493] It has been decided, however, that purchase at a judicial sale is not the same as foreclosure and the common law principle does not apply. "[W]here the sale to the mortgagee is truly independent and so fairly establishes a value for land nothing prevents a deficiency judgment."[494]

In Alberta this view was first expressed in *The Security Trust Company Limited* v. *Sayre*[495] and *Trusts and Guarantee Company Ltd.* v. *Rice*.[496] A short time later the Privy Council reached the same conclusion in *Gordon Grant & Company Ltd.* v. *Boos*.[497] These principles were most recently affirmed by the majority of the Alberta Court of Appeal in *Canada*

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492 For a discussion of the circumstances in which the lender was given leave under the English law to purchase at a judicial sale, see *Re Bank of Montreal and Butler et al; Canada Mortgage & Housing Corporation, Intervener* (1990), 66 D.L.R. (4th) 664 at 682-84.

493 The common law is set out in *Lockhart* v. *Hardy* (1846), 50 E.R. 378 (Ch.), *Fink* v. *Robertson* (1907), 4 C.L.R. 864 (Aust. H.C.), *Mutual Life Assurance Company of Canada* v. *Douglas, supra*, note 38, *Gordon Grant & Co.* v. *Boos*, [1926] A.C. 781 (P.C.) at 784-85, *Rushton* v. *Industrial Dev. Bank*, [1973] 34 D.L.R. (3d) 582 (S.C.C.) at 589, and *Canada Perm. Trust Co.* v. *King Art Dev. Ltd. et al., supra*, note 82 at 633-36.

494 *Canada Perm. Trust Co.* v. *King Art Dev. Ltd. et al., supra*, note 82 at 642.

495 *Supra*, note 44. The appeal was heard by six justices of the Supreme Court. Three justices would have allowed the appeal on the basis that equity will not allow the lender to have both the mortgaged property and the mortgage money. Three justices would dismiss the appeal on the basis that the Court should not interfere with matters of procedure. The appeal, therefore, failed on equal division.

496 *Supra*, note 45.

497 [1926] A.C. 781.

Permanent Trust Co. v. *King Art Developments Ltd. et al.* and the British Columbia Court of Appeal in *Re Bank of Montreal and Butler et al; Canada Mortgage & Housing Corporation, Intervenor.*[498] Strong dissenting opinions were given in the two most recent decisions.

In response to the *Boos* decision, Manitoba enacted legislation which provides that, when the lender acquires title by way of foreclosure **or otherwise**, the debt is satisfied. By virtue of the words "or otherwise", a lender who buys at a judicial sale is not able to sue for any deficiency.[499]

(3) Existing chambers practice in Edmonton and Calgary

When deficiency judgment protection does not arise, lenders seek Rice orders when the appraisal evidence suggests that the amount of the debt exceeds the fair value of the land.[500] If the value of the land exceeds the debt, lenders seek foreclosure or judicial sale. The larger the equity in the property, the more likely the court will insist on attempted judicial sale before granting a foreclosure order.

In the past, chambers practice in Edmonton and Calgary differed significantly. Over time, these differences have been eliminated and now the practice is very similar.[501]

On an application for a Rice order, the onus is on the defendant to protect his or her interests. If the application for a Rice order is unopposed, the Masters usually grant a Rice order without first attempting to sell the land through judicial sale. The order is not automatically stayed so as to give the borrower time to find a better offer. In the existing economic

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498 (1990), 66 D.L.R. (4th) 664.

499 See *Man. Dev. Corp.* v. *Berkowits*, [1979] 5 W.W.R. 138 (Man. C.A.); *Toronto Dominion Bank* v. *Ilyniak*, [1993] 1 W.W.R. 653 (Man. C.A.).

500 If the lender wishes to pass the cost of sale on to the debtor, it may seek judicial sale to a third party even when a deficiency will exist.

501 If there is no equity, the Court will not insist on an attempt at sale before a Rice order and deficiency judgment is granted. Nevertheless, Calgary Masters more frequently direct an attempt at sale before hearing a Rice order application.

climate, the lender must offer to pay fair market value for the land before the court will grant an immediate Rice order.

If the defendant introduces appraisal evidence that conflicts with that of the lender, the result may be different. In the face of the conflicting evidence, the defendant can seek one of several orders:

- an attempt at sale before the Rice order is granted

- stay on the Rice order for a period, usually two months, in which the borrower has the opportunity to attract a higher offer. In this situation, the order will allow the lender to purchase the land after the stay period for fair market value as shown in the lender's appraisal evidence if no higher offer materializes.

- trial on the issue as to value, or a decision that the lender must buy the land for the fair market value shown in the borrower's appraisal or some other value determined by the court

The ultimate decision depends on facts, the existing market, the quality of the appraisal evidence[502] and the equity position of the borrower as shown by the evidence.

When faced with conflicting appraisal evidence that cannot be explained on any basis other than difference of opinion, the Masters usually insist on an attempt at sale before the Rice order is given. The order will direct sale by judicial listing with a listing price at the higher value. Sometimes, the Master will grant the Rice order at the lower value but stay the order for a period of several months.[503] During this period the defendant still has possession of the property and can attempt to market it. Direction of trial of an issue as to value is infrequent.

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502 The difference in opinions as to value can often be explained by such factors as: (a) time when the appraisal was done, (b) opportunity to view the inside of the premises, (c) improper assumptions (e.g. price would be $130,000 if landscaping was completed, or feasibility of re-zoning for development), and (d) poor comparables.

503 One lawyer suggested that the Masters give this order when they sense that the defendant is merely trying to delay the action.

At present, the most common circumstance in which an immediate Rice order is granted involves a National Housing Act mortgage where the borrower does not appear in Chambers to oppose the application. These mortgages usually secure loans that financed 90 to 95% of the purchase price of a home. At the time of the application, the borrower owes several months arrears plus legal costs. This quickly eats up any equity in the property and the result is often a deficiency. The lender seeks an immediate Rice order because this is the quickest way of obtaining vacant possession of the property. The incentive for doing this lies in the fact that CMHC will not pay out the claim until the lender obtains vacant possession. Immediate Rice orders are less common in foreclosure actions involving commercial properties because in those situations the defendants usually appear in court with appraisal evidence to support their cause.

(4) At what price will the land be sold to the lender?

(a) Valuation in general

"Value is always a question of fact, and is therefore always a matter of evidence."[504] The court determines value on the basis of expert opinion evidence given by a professional appraiser or, in some situations, a realtor. In a foreclosure action the parties introduce this evidence by way of an affidavit of value, which sets out the individual's qualifications and attaches an appraisal report as an exhibit to the affidavit.

Rule 686(7) requires the lender to file an affidavit of value before it applies for an order nisi/order for sale. If the value of the land falls after the lender applies for an order nisi/order for sale, the lender may file a further affidavit of value in support of the application for a Rice order.[505] The lender will not be bound by the first affidavit. The borrower may also file an affidavit of value sworn by a person qualified to give evidence concerning the value of land.

The value of land is not something that can be measured scientifically. It is common for equally qualified appraisers to have

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504 *Nova, An Alberta Corporation* v. *Will Farms Ltd.* (1981), 31 A.R. 378 (Alta. C.A.) at 383.

505 *Yorkshire Trust Company* v. *H.B. Nielson Management Corp. Ltd. et al* (1984), 34 Alta. L.R. (2d) 174 (Q.B.).

differences of opinion on the value of land. When the real estate market is stable and there is a substantial volume of sales, these differences tend to be small. Large divergences of opinion arise in volatile markets or at times when there is virtually no market for the property in question. In the recession of the 1980s, Alberta experienced both a volatile market and, for some properties, no market in the near future. During such times valuation of land is a difficult task.

It is difficult to determine value in a fluctuating market. It is even more difficult when a lender attempts to ride the market for its benefit. To prevent this, the Court of Appeal has established that, in the absence of special circumstances, the lender should make only one application for a Rice order. The court should determine the value of the land "on the day when the mortgagee was first entitled to apply for such an order, or the day when such an order is indeed obtained, whichever is higher".[506]

(b) Confirmation of sale to lender

The question of how much a lender must pay for the land has been a contentious subject. Should the lender pay fair market value,[507] forced sale value for cash,[508] or forced sale value on terms,[509] or some other value? Until the mid-1980s, the Masters usually sold the land to the lender under a Rice order at the forced sale value on terms. This practice changed in light of several Court of Appeal decisions considering this issue.

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506 *Yorkshire Trust Company Ltd.* v. *Armwest Developments Ltd. #1, supra*, note 512 at 94. See also *Royal Trust Corporation of Canada* v. *371980 Alberta Ltd., Alberta Caterplan Ltd., Oshry and Wilman* (1993), 15 Alta. L.R. (3d) 325 (Q.B., M.C.).

507 Black's Law Dictionary, 4th ed., defines this terms to mean the price at which a willing seller under no compulsion to sell and a willing buyer under no compulsion to buy will trade. Numerous other sources define "fair market value" in a similar manner.

508 In *Canada Perm. Trust Co.* v. *King Art Dev. Ltd. et al., supra*, note 82 at 650, the Court of Appeal discussed the meaning of "forced sale" as follows:

> "Forced Sale" implies that there is available less that the normal time within which to find a purchaser. What is a normal time, however, may well depend on the type of real estate and the market in which it is to be offered. Then what shortening of time is envisaged may greatly affect the answer. . . . All that one can suggest is that the person using the term state the sense in which it is used, for example: the price which the property will bring when the market knows it must be sold within four to six months.

509 "Forced sale on terms" is incapable of definition unless one knows what terms are being offered.

In *Canada Permanent Trust Co.* v. *King Art Developments Ltd. et al.*[510] the majority held that the lender could purchase the land for a fair value. The determination of fair value is always a question of fact. The court pointed out that previous judicial statements that the lender should pay fair market value in a Rice order[511] did not create a binding general proposition. It also stated that appraisers must define the terms "forced sale for cash" and "forced sale on terms". Without definition these terms have no meaning. After this decision the Masters and Judges in Chambers continued their practice of allowing the lender to purchase for less than fair market value.

This practice came into doubt after the Court of Appeal decision in *Yorkshire Trust Company* v. *Armwest Development Ltd #1.*[512] In this case, the chambers judge accepted the lender's offer to purchase the land for the forced sale value. To arrive at the forced sale value, the appraiser discounted the fair market value to reflect the fact that "the process of judicial sale limits the ability to get the market price".[513] The appraiser had taken all the market factors into consideration when establishing the fair market value, including the factor that at the time Alberta land values were falling. The Court of Appeal held that, as between borrower and lender, the fair value is the market value and not the forced sale value, unless there are special considerations. On the facts of this case, the fair market value was the fair value for the purposes of the Rice order.

The confusion was resolved in *Manufacturer's Life Insurance Company* v. *Daon Dev. Corp. and Price Waterhouse Limited.*[514] In this case there were conflicting appraisals. The borrower's appraisal declared that the fair market value was $833,000 and the forced sale value was $755,000. This appraiser thought it would take six months to sell the land. Therefore, he determined the forced sale value by taking the fair market value and subtracting the operating costs for 6 months, the cost of sale, and taxes outstanding. The lender's appraisal declared that the fair market

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510 *Supra*, note 82 at 649-51.

511 See *Fuhr* v. *Madison Dev. Corp.* (1984), 30 Alta. L.R. (2d) 206 (Q.B.).

512 (1986), 66 A.R. 93.

513 *Ibid.* at 94.

514 (1989), 65 Alta. L.R. (2d) 40 (C.A.).

value on terms was $730,000 and the forced sale value on terms was $650,000. The Master accepted the lender's appraisal evidence and allowed the lender to purchase the land for $730,000. On appeal, the Chambers Judge accepted the borrower's appraisal evidence and substituted $833,000 as the fair market value that the lender must pay. On further appeal to the Court of Appeal, the issue was whether "the chambers judge in establishing the fair value . . . erred by restricting his consideration to market value alone".[515]

The Court of Appeal explained that the *Yorkshire Trust Company* decision did not conflict with the *King Art* decision. Both recognized that the lender must purchase the land for the "fair value" that is established by the court, which may or may not be fair market value. Appraisers use various techniques to estimate the fair market value of the property: replacement cost approach, income analysis and comparisons of sales of similar properties. When the appraiser establishes fair market value by comparisons of sales, he or she must also evaluate if a market for the property actually exists. If there is little available market within a reasonable time, the fair market value determined by using this method should reflect "the time-worth of money and abnormal costs incurred because sale may not be accomplished reasonably promptly."[516] With the assistance of such expert opinions, the court must establish the fair value which reflects the different circumstances. Of course, fair market value will be one of the most important factors the court considers when establishing fair value. Yet, fair value may be something other than fair market value.

The court rejected the argument that the value should be the fair market value to the lender. This was the sum of $755,000 calculated by taking fair market value and subtracting taxes owing for 1985, the anticipated operating costs for the six month period (including the taxes for 1986), and the anticipated costs of sale. The court concluded that, except for 1985 taxes, the trial judge did not err by restricting his consideration to fair market value when he established the fair value.

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515 *Ibid.* at 41.

516 *Ibid.* at 46.

The court did not expound on why the other anticipated expenses are improper. Its only comment was:[517]

> . . . Similarly, if the appraiser expects that market conditions would not facilitate sale within a reasonable period then no doubt the appraiser would discount market value to reflect the abnormal fixed and operating costs and taxes beyond those which would normally be incurred if sale resulted within a reasonable period.

One possible explanation of the result in this decision and certain comments made by the same court in *Canada Permanent Trust Co.* v. *King Art Developments Ltd. et al.*[518] is that the Court of Appeal views a Rice order as payment of the mortgage debt partly by way of land and partly by way of money.

Some lawyers criticize this approach to determining what the lender must pay for the land.[519] They argue that lenders are in the business of lending money, not in the business of managing properties, and, therefore, they want repayment of the loan in cash, not land. In their opinion, where there is evidence that the lender intends to sell the property after obtaining title, the lender should pay the sum that the lender will recoup upon sale of the property. This value could be determined by taking the fair market value and discounting it by the cost required to carry the property until such time as the fair market value will be attained and by the costs of sale, including real estate commissions and legal fees.[520] Fair value would be fair market value where the income from the property will cover these costs or where the lender plans to hold on to the property.

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517 *Ibid.* at 48.

518 *Supra*, note 82 at 642.

519 See F. Price, "Mfr. Life Ins. Co. v. Daon Dev. Corp.: Rice Orders—A Missed Opportunity" (1989), 65 Alta. L.R. (2d) 50.

520 *Ibid.*

(5) Rice order — fair or foul?

(a) Rice order — fair

In jurisdictions where there is no Rice order procedure, an unsuccessful judicial sale is usually followed by a foreclosure order. As foreclosure satisfies the debt, no deficiency judgment can be pursued. In times of economic depression, the majority of judicial sales are unsuccessful. It follows that the Rice order procedure increases the availability of an action on the covenant, especially in times of economic depression. It helps to ensure that the lender is paid the debt owed to it and not just restricted to foreclosure of land worth less than the debt owing.

The Rice order procedure also allows a court to deal with the difficult problem of establishing the value of land in the face of conflicting opinion evidence. This problem is intensified when there exists a volatile market or depressed market. During such times it is easy for the borrower to decry the lender's offer as being grossly inadequate. Nonetheless, the market is the true test of value. If the lender's offer is grossly inadequate, the borrower should be able to entice someone to bid more during the stay period.

Another argument made in support of Rice orders is that once the borrower loses title, be it to a third party or a lender, the borrower loses the future increase in value of the land. Should the borrower care whether the lender gets this benefit? It will be lost in any event.[521]

In *Lennie* v. *LDM Holdings Ltd.*,[522] Master Funduk held that a vendor who had sold his land by agreement for sale could purchase the land when the vendor's lien was being enforced by sale of the land. This is akin to a Rice order in a foreclosure proceeding because it gives the vendor the land and the ability to sue on the covenant to pay. Earlier cases had disallowed this on the basis that the vendor was purchasing at a low price or was purchasing from himself or herself. Master Funduk listed the safeguards that exist today. We submit that these are the same safeguards which ensure that the lender purchases for fair value and the Rice order procedure is not abused. The safeguards are:

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521 *Re Bank of Montreal and Butler*, *supra*, note 492 at 666-67.

522 (1982), 40 A.R. 87 (M.C.).

(a) The court conducts the sale.

(b) The sale is a public sale, by tender [or otherwise].

(c) The vendor [lender] must provide evidence of the value of the land.

(d) The appraisals are by persons who are independent of the vendor [lender].

(e) The court has the jurisdiction to order the property to be again put up for sale if the first sale does not produce satisfactory tenders.

(f) The vendor [lender] merely makes a proposal to the court and this does not bind the court to accept the proposal.

(g) The court can give the purchaser [borrower] time to bring in a better offer than made by the vendor [lender].

(b) Rice order — foul

The Rice order procedure is criticized as one which creates a windfall for lenders. Justice Wood of the British Columbia Court of Appeal voiced this criticism in his dissenting opinion in *Re Bank of Montreal and Butler; Canada Mortgage & Housing Corporation, Intervener*.[523] His concerns with the use of the Rice order in British Columbia, where there is no deficiency judgment protection for individuals, were as follows:[524]

> The practical result of the decision by the majority in this case is that a mortgagee in this jurisdiction need never again take an absolute order of foreclosure where the value of the mortgaged lands is, or is likely to be, less than the debt owing. Instead, whenever an offer to purchase is presented to the court for approval, following an order for sale, the mortgagee can simply counter with a marginally higher offer and take clear title to the property, all the while preserving the right to pursue the mortgagor for any deficiency between the sale price and the debt owing. In the volatile real estate market which we have experienced in this province over the last decade,

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523 *Supra*, note 492.

524 *Ibid.* at 678-79.

> there is a better than even chance that, if held onto for a short while, the property can be sold for a handsome profit which, when combined with a successful collection of the deficiency judgment, will result in a windfall to the mortgagee which was never contemplated by the terms of the original lending agreement.
>
> I believe that most people would see such a result as manifestly unfair to the mortgagor . . . .
>
> In argument before us counsel acknowledged that the intervener has a substantial number of similar applications to bring on should this one succeed. All, like this one, are said to relate to properties which cannot otherwise be sold. One must ask the question, "why would the intervener want to buy a property that nobody else apparently wants to buy?" The answer is obvious. It is because the intervener expects that the property will increase substantially in value in the near future (if, indeed, it has not already increased by the same 25% to 30% by which the value of most other properties in the lower mainland have jumped in the 18 months since the intervener's application was first launched) and that, as a consequence, it will reap the benefit of the very sort of windfall described above.

Gordon Grant & Company Ltd. v. *Boos*[525] is the classic case of abuse of the Rice order. In that case the lender purchased a plantation in Trinidad at a judicial sale for a nominal price. A short time later it sold the land for a large profit. It then brought action on the covenant to pay seeking the difference between the mortgage debt and the nominal purchase price. Throughout the decision Lord Phillimore emphasized that the court should prevent the lender from having both the land and judgment for the entire mortgage debt. Yet the end result was that the lender bought a valuable property for a nominal price and procured judgment for the difference between the mortgage debt and the nominal sum. Did not the lender get what Lord Phillimore said it was unable to have? Referring to this result, the Court said that the mortgagor was to blame because he did not appeal the issue of value. No one likes this decision, but they hold their noses and apply it anyway.

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[525] *Supra*, note 497.

When explaining why he chose not to follow this decision, Justice Wood said:[526]

> With great respect to Lord Phillimore, I say that the result in the *Boos* case was unconscionable. I can well understand that it continues to bind the courts in the West Indies, unless its effect has been overcome by legislation. But I do not believe that the principles of *stare decisis* require this court to accept as binding upon it a decision of the Judicial Committee, which was rendered over 60 years ago in a case from another jurisdiction, which was reached without the benefit of any argument from the party who had the most to lose and lost it, and which no court now seems able to apply without first apologizing.

Justice Wood agreed that in very special circumstances the court will allow a lender to purchase the mortgaged land at a judicial sale. In his opinion, sale at an adequate price was not such a special circumstance. He thought the British Columbia court should have applied the general equitable rule described by Anglin J. in his decision in *Sayre* v. *Security Trust Company*. Anglin J. held:[527]

> In my opinion the doctrines of equity in regard to mortgages preclude the making of an order which purports *uno flatu* to vest the mortgaged property in the mortgagee as purchaser free from all equity of redemption and to enforce the personal liability of the mortgagor for some part of the mortgage debt. A mortgagee cannot have both the mortgaged property and the mortgage money.

Under this heading the last word belongs to Justice Moir, who was the dissenting judge in *Canada Permanent Trust Co.* v. *King Art Developments Ltd. et al.* He deplored the Edmonton procedure of attempted sale by tender followed by a Rice order if the borrower is a corporation. In his view, this procedure was not allowed under existing Alberta law because the legislation and the Alberta Rules of Court contemplate sale by tender to

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526 *Re Bank of Montreal and Butler; Canada Mortgage and Housing Corporation, Intervenor*, *supra*, note 492 at 687.

527 *Supra*, note 44 at 119.

a third party. The court does not have the power to accept the lender's proposal made on the basis of the lender's appraisals.[528] Furthermore, the Rice order procedure results in sale at an inadequate price and for this reason has become an instrument of oppression.[529] Sale is supposed to benefit borrowers, not harm them.

Justice Moir was critical of the court's practice of sale by tender. He recognized that in depressed economic times sale by tender is completely ineffective.[530] In voicing this view he said:[531]

> We still persist in the inefficient sale by tender following advertisement and then followed in Edmonton by a Rice order if it is a corporate mortgage. This is triggered by the mortgagee commencing an action for foreclosure. The mortgagee obtains an appraisal or appraisals. The appraisal or appraisals are designed to demonstrate that the amount owing on the mortgage vastly exceeds the sale value of the property. The property is then advertised for sale. No bids are received for numerous reasons. One reason may very well be that the mortgagee does not want to sell as he wants to have both the money and the mud; that is a Rice order. Secondly, the advertisement contains very little about the particulars of the property. No one knows, if it is a rental property, to whom the property is presently rented. Often the property is in receivership. The ad directs the would-be-purchaser to the solicitor for the mortgagee. That individual usually would only provide the amount owing on the mortgage and the daily interest. He knows nothing about the percentage of occupation, the terms of the leases, the amounts of vacant space, whether or not any of the existing tenants

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528 *Canada Perm. Trust Co.* v. *King Art Dev. Ltd. et al.*, *supra*, note 82 at 599.

529 *Ibid.* at 600.

530 See *Canada Perm. Trust Co.* v. *King Art Dev. Ltd. et al.*, *supra*, note 82 at 604. Before the Alberta Court of Appeal's decision in this case, the lower courts typically directed sale by tender. In *King Art* the Court of Appeal criticized this practice and, as a result, the lower courts began using other methods of sale, such as sale by judicial listing. Now sale by judicial tender is rarely used.

531 *Ibid.* at 601-02.

> are in arrears, the operating costs and so on. Often the property cannot be inspected, particularly if the mortgagor is in possession or if the property is leased. Far more importantly, the knowledgeable person who may be interested in purchasing the property knows that he is going through an exercise in futility; unless he bids more than the mortgage debt, the mortgagee will, if forced, take foreclosure rather than allow a third party to acquire the property for less than the mortgage debt. The terms of sale are onerous. Ten percent has to be put down with the bid. The balance is payable within 30 days. If the cash is not produced the ten per cent deposit may very well be forfeit. The deposit may be outstanding for weeks or months and would bear no interest. When all of these things are considered, no serious prospective purchaser can afford to take the risk of bidding at a judicial sale where valuable properties are advertised for sale. No prudent bidder will bid at all. Unless he bids more than the liability of the mortgagor to the mortgagee he cannot obtain the property.

In Justice Moir's opinion, staying the Rice order for a period so that the borrower has an opportunity to sell the land was also of little benefit to the borrower. The borrower who no longer possesses the property will not have the information necessary to inform would-be-purchasers. Even with the necessary information, the court does not give the borrower adequate time to sell properties of substantial value. Although Justice Moir viewed tender by lender as preferable to the Rice order, he disliked both. He thought the lender must choose between the land and the action on the covenant.

(6) Response to tentative recommendations

In our report for discussion, we recommended that, with one exception, the existing Rice order procedure should be retained. The exception involved restricting the availability of immediate Rice orders. We recommended that an attempt at sale precede a Rice order except when land prices are falling and the court is satisfied with the quality of the appraisal evidence.

In the view of most of the commentators, the Rice order procedure is working well and is better left alone. The arguments they make supporting this position will be discussed in the next section. Only one commentator would prohibit Rice orders. He thought the procedure created an incentive for lenders to pay as little as possible for the land. He also expressed little faith in appraisal evidence, although his concern was that the appraisal evidence was often too high and lenders were unable to sell the land for the appraised value.

(7) Analysis

Although we recognize that the Rice order procedure is not perfect, we see it as a justifiable method of ensuring that the lender is paid what is owed to it. Without this procedure, the lender's remedies would be restricted to foreclosure or sale to a third party. Since many foreclosure actions do not result in sales to third parties, the effect would be to unfairly force the lender to foreclose and extinguish the debt.[532] Furthermore, the court has the tools to determine the value of land and, thereby, ensure that the lender pays fair value for the land. This task becomes more difficult in a fluctuating market, but this difficulty arises from the economic conditions and not from the procedure itself. The same problem exists when the court is asked to confirm a sale to a third party at a certain price.

The law requires the lender to pay fair value for the land. This should be retained. The lender should not be able to pay less than fair value just because it is a judicial sale, even if a third party is able to do so. At first glance, it might seem illogical to allow a third party to purchase land at a judicial sale for less than what the lender must pay for it. There is, however, a reason why the lender cannot be treated in the same manner as the third party. The law must ensure that the lender does not receive a windfall. Allowing the lender to collect a deficiency judgment which is the difference between the debt and some value less than the fair value results in a windfall for the lender. Not only can the lender sell the land for more

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[532] In theory, where the land cannot be sold to a third party, the lender can:
(1) obtain a deficiency judgment,
(2) exhaust all steps to enforce the judgment, and
(3) then obtain a foreclosure order.
This means the land cannot be resorted to for this period. Since little is collected on the vast majority of deficiency judgments, lenders choose to proceed against the land as quickly as possible.

than it paid for the land, the lender can collect the larger deficiency amount.

How should fair value be determined? We think it is better to leave this matter to the courts. Fair value is not something that can be determined by a mathematical formula. It will depend on the type of property, the current economic conditions and other factors. Nor do we think that fair value should be defined as the fair market value less the anticipated cost of sale and the anticipated cost of maintaining the property until such times as fair market value will be attained. This would be acceptable if the lender had to account for any benefit it receives when it resells the property for more than the appraised fair market value, or sooner, or at a lesser cost than was anticipated. The law, however, does not require the lender to do this. Once the lender becomes the owner of the land, it receives the benefit and burden of ownership. The lender can retain any benefit created by a rising real estate market. With this right goes the obligation of maintaining the property until the lender sells it to a third party and the obligation of paying for the costs of sale to the third party. Also, to define fair value in this way is inapplicable where the income from the property exceeds the operating costs and costs of sale or where the lender intends to retain the property and sell when the market improves.

The more difficult question is whether an attempt at sale must precede a Rice order in every case? As already discussed, if the lender pays less than fair value for the land, a windfall will accrue to the lender. Reliable appraisal evidence is the key to ensuring these windfalls do not materialize. Presently, a number of factors serve as checks on the quality of appraisal evidence. They are as follows:

- Most appraisals are given by people who are qualified to give such evidence. The level of accreditation varies but, generally, the more valuable the land, the more skilled the appraiser.

- The defendant always has the opportunity to introduce additional appraisal evidence or examine the appraiser on the affidavit of value.

- The Masters are experienced with land values[533] and will question appraisals that fall outside the normal range.[534]

- The Masters are able to direct an attempt at sale when there is a legitimate difference of opinion as to value or when they suspect the appraisal is unreliable.

- The Masters can stay the Rice order for a period in which the defendant has an opportunity to come up with a better offer.

Those who support an attempt at sale before every Rice order insist that this is the only true test of appraisal evidence. They are not convinced that appraisers are always independent professionals. In their experience, appraisers' opinions are too frequently influenced by who they are providing the appraisal for. They also recognize that many defendants will not come to court to present evidence because they are embarrassed, intimidated or naive, so the lender's appraisal evidence often goes unchallenged.

Many practitioners view a mandatory attempt at sale before every Rice order as unnecessary and in some situations as futile. They support this position as follows:

- Most appraisal evidence is given by persons qualified to give the opinion as to value on properties of that type. The more difficult a property is to appraise, the more likely an accredited appraiser will be used.

- It seems counter-productive to insist on sale in every case just to rout out a small percentage of inadequate appraisals.

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533 Unless it is a special chambers application, the Masters in chambers will not have read the appraisal evidence before they come to chambers. They rely on information presented by counsel. Yet, they always have the discretion to order an attempt at sale before granting a Rice order where they suspect the appraised value is too low. Some Masters rely on the defendant to point out the inadequacy of the appraisal evidence. Others, like Master Brietkreuz, go further and insists on knowing these facts: the type of land, location and date the mortgage was granted. He assumes that the loan amount is an indication of value at the time of the loan. So he may be suspicious of appraisal evidence that shows that the land is worth much less the debt owing when the loan was made a year or so before the chambers application.

534 One lawyer says that Masters use the smell test. If the appraisal does not pass the smell test, they will treat it accordingly.

- The obligation should be on the borrower to protect his own interest by producing an appraisal. It is all too easy to say the lender's appraisal evidence is low. Borrowers often do this with nothing to support their position.

- Often the economic conditions of the day make an attempt at sale futile. In such economic times an attempt at sale only increases costs and may result in the old "advertising at Sheriff's office", a method used to avoid such costs.

- In many situations, an attempt at sale will generate offers at something less than fair value. The end result is a Rice order to the lender at fair value, but the deficiency is higher because of increased interest charges and costs.

After considering these comments, we now are of the view that the court should decide whether an attempt at sale should precede an application for a Rice order. The fact that caused us to change our position was that, in some situations, the borrower is better off if the lender takes an immediate Rice order at fair market value as opposed to taking a Rice order at a later date after an unsuccessful attempt at sale.

Let us look at this in more detail. Assume that the lender's appraisal evidence accurately states the value of the property. If land is sold by judicial listing, a third party will likely offer to pay 10-20% less than the fair market value. If the offer is accepted, then the deficiency will be the difference between the debt (calculated at the date the court accepts the third party's offer to purchase the land) and legal costs minus the purchase price and the cost of sale (which is usually a 6% real estate commission on the first $100,000 and 3% on anything above that). If the lender takes an immediate Rice order, the deficiency will be significantly less. The bare purchase price is higher, no costs of sale are deducted, and the interest stops running sooner. In a scenario where the lender's appraisal evidence is accurate, the borrower is better off if the lender purchases the land by Rice order.

The same cannot be said where the appraised value is too low. In such situations, sale to a third party may result in a higher purchase price.

The borrower, however, is not better off unless the increase in the price offsets the accrued interest over the listing period and the costs of sale.

The following examples illustrate these points. Assume that the house has a fair market value of $100,000 and on Day 1 the debt owing under the mortgage is $110,000 for principal and interest plus $2,000 for legal costs. The per diem interest is $22. If the lender purchases the land by way of Rice order on Day 1, the deficiency judgment is calculated as follows:

DEBT:	112,000 = 110,000 + 2,000
RECOVERY ON SALE:	100,000
DEFICIENCY:	12,000

Now assume the land is offered for sale by judicial listing. A third party offers to purchase the land for $90,000 and the offer is accepted by the court on Day 90. The real estate commission is $5400. In these circumstances, the deficiency judgment would be calculated as follows:

DEBT:	113,980 = $110,000 + (90 * $22) + $2,000
RECOVERY ON SALE:	84,600 = $90,000 - $5400
DEFICIENCY:	29,380

The difference between the two deficiencies is caused by accrued interest over the 90 days it takes to obtain and accept the offer, the cost of sale and the lower purchase price offered by the third party.

Of course, the scenario changes if, in fact, the house is worth $120,000. In that situation, sale to a third party might result in an offer at 10% below market value (i.e. $108,000). The deficiency would then be calculated as follows:

DEBT:	113,980 = $110,000 + (90 * $22) + $2,000
RECOVERY ON SALE:	101,760 = $108,000 - $6,240
DEFICIENCY:	12,220

There would still be a deficiency even if the purchaser paid the fair market value of $120,000 and a realtor received a commission of $6,600, calculated as follows:

DEBT:	113,980 = $110,000 + (90 * $22) + $2,000
RECOVERY ON SALE:	113,400 = $120,000 - $6,600
DEFICIENCY:	580

These examples illustrate two things. Clearly, the law should encourage sale of the land in a commercially reasonable manner so that bids approaching fair market value will be made. This is very important to any borrower. Second, these examples show that an immediate Rice order may be of benefit to the borrower. Clearly, the better the appraisal evidence of the lender, the better the result for the borrower.

Although the need for an attempt at sale should be left to the court's discretion, we think it would be useful if the Rules of Court set out the factors the court should consider in making this decision. Practice should not evolve to the point where the court routinely gives immediate Rice orders without thought to whether it is appropriate to the situation. The list should not be exhaustive but should include the following factors: nature of property; value of property; existing market for the property; quality of the appraisal evidence before the court; and difference in opinion as to value of land.

We recommend that the existing Rice order procedure continue and that the Rules of Court establish a list of factors the court should consider when deciding if the land should be offered for sale before the lender is allowed to bring a Rice order application.

RECOMMENDATION 25

(a) The Rice order procedure is a justifiable method of ensuring that the lender is paid what is owing to it.

(b) It should be left to the court's discretion as to whether an attempt at public sale should precede an application for a Rice order. The Rules of Court should list the factors a court should consider when exercising this discretion. Those factors should not be exhaustive but should include:

- **nature of property**
- **value of property**
- **existing market for the property**
- **quality of the appraisal evidence before the court**
- **difference in opinion as to value of land**

(c) The court should continue to determine the value the lender must pay for the land.

D. Protection of Tenants

At present, the fundamental principles of the Land Titles Act determine whether the lender's interest has priority over the interest of any tenant. If the lender's interest has priority, the judicial sale or foreclosure will extinguish the tenant's interest.[535] We recommend that this continue. We do not favour giving residential tenants security of tenure at the expense of the lender. The court gives those in possession adequate time to vacate the premises. Those tenants who wish not to be disturbed by the lender must negotiate for this right.

RECOMMENDATION 26

Residential tenants should not receive security of tenure at the expense of the lender. The Land Titles Act should determine if the lender's interest has priority over the interest of any tenant.

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535 In certain situations a mortgagee can enforce subsequent leases even after a foreclosure order is granted. See the discussion in Chapter 4 at 101.

One commentator suggested that we codify and clarify the law as to when a lender who obtains a foreclosure order can enforce a lease entered into by the borrower after the mortgage was registered.[536] This would involve codifying when privity of estate exists between the tenant and the mortgagee. We think that this is not necessary or desirable.

E. Appointment of Receiver or Receiver-Manager

The court has a general power under section 13(2) of the Judicature Act[537] to appoint a receiver "in all cases in which it appears to the Court to be just or convenient" to do so. Section 45 of the Law of Property Act, however, applies specifically to mortgage actions and amendments in 1984 have rectified several of its previous inadequacies. It is, therefore, most likely now that mortgagees seeking a receivership order in a foreclosure action will apply under section 45. The section applies to all mortgage actions (except those involving farm land), including those in which section 41 bars an action on the covenant.[538]

The 1984 amendments to section 45 make it clear that the court has the ability to appoint a receiver or receiver-manager in actions brought to enforce the mortgage security or to protect that security.[539] They also allow the court to appoint a receiver *ex parte* in the circumstances set out in subsection 45(1.2), namely, where land is sold or transferred while the mortgage is in default or within four months before the mortgage goes into default.

The Legislature enacted subsection 45(1.2) at the same time as section 42.1 of the Law of Property Act.[540] These sections are designed to

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536 The rule is "where a lease takes effect as an interest in land subsequent to a mortgage of that property, an order for foreclosure will render the lease unenforceable unless it is expressly preserved in the order and privity between the mortgagee and lessee has been established": *Re Manufacturer's Life Insurance Co. and J.K.P. Holding Co. Ltd.* (1986), 26 D.L.R. (4th) 461 at 466 (Alta. C.A.).

537 R.S.A. 1980, c. J-1.

538 See Chapter 4 at 105-08.

539 See section 45(a) and Price and Trussler, *supra*, note 101 at 312.

540 Section 42.1 allows the court to grant a vesting order in the case of a mortgage without the land being offered for sale under section 41(2). The ability to do this

(continued...)

discourage the activity of dollar dealers by giving title to the lender quickly and appointing a receiver to collect rents for the short period during which the dollar dealer is the owner of the land. Most lenders attribute the decline in the number of dollar deals to the introduction of these amendments.[541]

In our review, we did not discover any serious problems with section 45 of the Law of Property Act, and we found that section 45 together with section 42.1 was an effective method of discouraging the operation of dollar dealers. Therefore, we tentatively recommended that section 45 remain as is.

The Mortgage Loans Association of Alberta made two suggestions in respect of this section. First, that the section should apply to farm land as well as other types of land. Second, that the section should make it clear that the court must appoint a receiver of rents when the mortgage is in default and the land is producing rents, irrespective of the borrower's equity in the land. The second suggestion was also put forth by another commentator.

We have considered these suggestions but are concerned that they would have some undesirable consequences. As to the first suggestion, a farmer would be effectively dispossessed from the farm if the court could appoint a receiver-manager to run the farming operation. We think that this should only happen when the lender acquires title. For this reason, we do not support expanding the scope of section 45 to cover a farming operation.

Our main concern with the suggestion of an automatic appointment of a receiver is its inflexibility. There are situations where appointing a receiver of rents would negatively affect the owner of the land and the tenants with little gain for the lender, other than payment sooner rather than later. These situations, although they do not occur frequently, are characterized by these facts:

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[540](...continued)
exists where the mortgaged land is transferred or sold while the mortgage is in default or within four months before the mortgage goes into default.

[541] Price and Trussler, *supra*, note 101 at 306 and information provided by members of the Canadian Bankers' Association and members of the Mortgage Loans Association of Alberta.

- the owner has substantial equity in property, and the value of the property depends upon the number and quality of the tenants,

- appointment of a receiver of rents would mean the owner no longer has funds to pay for necessary maintenance and repairs,

- if the property is not maintained, tenants may leave and this would dramatically reduce the value of the property.

In this situation, it may be unreasonable to sacrifice the equity of the owner just to give the lender immediate access to the rental payments. This is not to say that an appointment cannot be made when the owner has equity in the property. Sometimes, it is reasonable to do so. We feel that the court should have flexibility , as opposed to a mandatory obligation, to appoint a receiver.

For this reason, we prefer the existing law, which requires the court to consider a number of factors in determining whether it is just and equitable to appoint a receiver.[542]

RECOMMENDATION 27

Section 45 of the Law of Property Act empowers the court to appoint a receiver to collect rents arising from land that is the subject of foreclosure proceedings or to appoint a receiver-manager for such land. This section serves a useful purpose and is effective in discouraging the operation of dollar dealers. It should continue to be the law of Alberta.

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542 See *Citibank Canada* v. *Calgary Auto Centre Ltd.* (1989), 98 A.R. 250 (Q.B.) for a useful discussion on how the court should exercise its discretion under section 45 of the Law of Property Act.

F. Procedure

(1) Existing procedure

Historically, it was the Court of Chancery which in England gave equitable relief in respect of mortgages. The Alberta Court of Queen's Bench has the same jurisdiction and powers possessed and exercised by the Court of Chancery in England as of July 15, 1870 in respect of all matters relating to mortgages.[543] This is the source of the court's jurisdiction in respect of mortgages.

Before the enactment in 1939 of the borrower protection legislation now found in sections 41 and 42 of the Law of Property Act, the predecessor of the Alberta Court of Queen's Bench could grant the following types of relief in a foreclosure action:[544]

(i) an immediate order for foreclosure

(ii) an immediate order for sale of land

(iii) an immediate order for selling land to the lender or to someone else

(iv) an order nisi with sale to follow if land is not redeemed

(v) an order nisi with foreclosure to follow if land is not redeemed

(vi) an order nisi with a reservation to lender as to relief to follow if land not redeemed.

These were the types of remedies the Court of Chancery had traditionally given when the lender brought an *in rem* action seeking enforcement of the mortgage security. The length of the redemption period, if any, was within the discretion of the court.

Sections 41(2) and 42 of the Law of Property Act restrict the court's exercise of its equitable jurisdiction by restricting the type of *in rem* remedy the court can award and by specifying the redemption period. When the

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543 Judicature Act, R.S.A. 1980, c. J-1, s. 5(3)(b).

544 *Scotia Mortgage Corporation* v. *Goss* (1987), A.R. 15 (M.C.) and L.Y. Cairns, *supra*, note 46.

mortgage is one to which these sections apply and none of the facts listed in section 42.1 exist, the court can only give the *in rem* remedy listed in (iv) above. In addition, the statutory redemption period applies unless specified circumstances justify variation of the statutory redemption period.[545] If the land is not sold, the court can order either that the land be again offered for sale or make a foreclosure order (also known as a vesting order).[546]

Typically, the court will refuse to order sale to the lender where the mortgage is caught by section 41(1) of the Law of Property Act. An exception is made if the lender holds additional security[547] or has a cause of action against an insurer on a first loss payee clause.[548] The court orders sale to the lender in these exceptional situations, but it cannot grant a deficiency judgment against the individual mortgagor. The court grants such an order because it does not want to discourage the lender from proceeding against the land first. If the court did not grant the order of sale to the lender, the lender would not seek a foreclosure order. Instead, the lender would enforce the collateral security, first, and then seek a foreclosure order. Since the court does not wish to postpone the lender's ability to enforce the land mortgage, which is usually the most valuable security, it gives the order of sale to the lender. Furthermore, the order does not prejudice the borrower because the lender must pay fair value for the land and the lender is not obtaining judgment against the borrower.[549]

Where the land is worth more than the mortgage debt, the land should be sold so that anything left after satisfaction of the mortgage debt can be paid to the borrower or the borrower's creditors. Section 41(2) is designed to ensure this. Although the section does not state that there must be an order nisi, that is the result because Alberta has a Torrens system of

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545 *Scotia Mortgage Corporation* v. *Goss*, *ibid.*

546 Law of Property Act, R.S.A. 1980, c. L-8, s. 41(2)(b).

547 For example, personal property security or a guarantee given by a third party.

548 *The Toronto-Dominion Bank* v. *June B. Olson* (6 October 1983), Edmonton No. 8203-26357 (M.C.). A first loss payee clause is a clause in an insurance policy that states that in the event of loss, the insurance moneys will be paid to the lender first. If the moneys paid by the insurance company exceed the amount owed to the lender, the surplus is paid to the borrower (who is the named insured in the policy).

549 *Ibid.*

land titles. In the majority of cases, this subsection will prevent a more valuable property being transferred to the lender in satisfaction of the debt.[550]

Until 1984, the court could not dispense with the requirement of sale where section 41(2) of the Law of Property Act applied. If there was clearly no equity, the court would grant an order nisi with no redemption period or a one day redemption period.[551] In 1984, the Alberta Legislature enacted section 42.1 of the Law of Property Act. This section enables the court to order immediate foreclosure, notwithstanding that sections 41(2) and 42 apply to the mortgage. The court's ability to order immediate foreclosure is limited to abandoned land, undeveloped land other than farm land, and situations designed to catch sale to a dollar dealer. When section 41 applies to the mortgage and the circumstances referred to in section 42.1 do not exist, the lender is still restricted to the kind of judgment mandated by section 41(2)(a).[552]

The statutory redemption period for farm land is one year. For land other than farm land the statutory redemption period is 6 months. On application the court can extend or reduce these periods having regard to certain circumstances outlined in section 42(2) of the Law of Property Act, which are as follows:

(i) the ability of the debtor to pay

(ii) the value of the land including the improvements made thereon

(iii) whether the land has been abandoned

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550 Of course this can still happen when it is impossible to sell the land at its fair value. See for example, *Ball and Ball* v. *Group 77 Investments Ltd. and Silver Bell Investments* (1982), 45 A.R. 149 (M.C.) and *North West Trust Company* v. *247852 Alberta Ltd.* (1983), 45 A.R. 34 (M.C.). These were actions involving mortgages granted by a corporation. In each case the land was offered for sale, but due to the depressed real estate market no offers were forthcoming. In time the Master granted a foreclosure order even though the value of the land exceeded the debt owing under the mortgage.

551 *First Investors Corporation Ltd.* v. *64675 Alberta Ltd.* (1984), 38 Alta. L.R. (2d) 45 (M.C.) and *Canada Trustco Mortgage Company* v. *Coleman* (1985), 36 Alta. L.R. (2d) 316 (M.C.).

552 *First Investors Corporation Ltd.* v. *64675 Alberta Ltd.* (1984), 38 Alta. L.R. (2d) 45 (M.C.).

(iv) the nature, extent and value of the security held by the creditor

(v) in the case of farm land, whether the failure to pay was due to hail, frost, drought, agricultural pests or other conditions beyond the control of the debtor, and

(vi) in the case of land other than farm land, whether the debtor's failure to pay was due to temporary or permanent unemployment or other conditions beyond the control of the debtor.

The most common reason for reducing the redemption period is that by the time the statutory period expires, the mortgage debt will exceed the value of the land. For example, assume that within three months time the debt plus accrued interest and costs will just exceed the value of the residential land. In these circumstances, the court will usually reduce the redemption period to three months. Where the lender is well secured, the statutory redemption period will apply. The statutory redemption period is what the Legislature sees as a reasonable time to give to the borrower to find funds to pay the lender. At the end of this period, the borrower can apply to extend the redemption period. The extension of the redemption period happens infrequently and only in situations where the borrower can show that he or she will be soon in a position to redeem the property or to bring all the mortgage arrears into good standing. The lender should be able to seek judicial sale of the property if the borrower is unsuccessful in finding the necessary funds within this period. This is so even though the land is worth more than the debt; the lender does not have to wait indefinitely to be paid.

In 1983 Alberta enacted sections 43(1.1)[553] and 43.4 of the Law of Property Act. Together these sections provide that sections 41 and 42 apply to certain individual transferees who buy land that is subject to a mortgage granted by corporation. Those individual transferees fall into two categories: (1) individuals who assume a mortgage charging land that the individual or family member uses as a *bona fide* residence and (2) individuals who assume a mortgage charging farm land that the individual or family member uses for carrying on farming operations. These sections were interpreted as putting individuals in the same position they would have been had they granted the mortgage originally.[554] The result was that

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553 This section was amended in 1984 to correct the omission of the words "and 42".

554 *Canada Trustco Mortgage Company* v. *Coleman, supra*, note 114.

when such an individual defaulted, the court would not grant an immediate foreclosure order unless the facts in section 42.1 exist.[555]

When sections 41 and 42 of the Law of Property Act do not apply to the mortgage, the lender can sue on any covenant to pay the mortgage debt and can enforce the mortgage security . The lender does not have to rely on the Law of Property Act for any relief that might be granted by the court.[556] When sections 41 and 42 have no application, the court can exercise its full equitable jurisdiction. This means that it can give any of the six *in rem* remedies listed above.[557] Also, the statutory redemption periods do not apply. For such mortgages the court must set a redemption period reasonable in the circumstances.[558]

(2) Mortgages charging residential land or farm land

In Chapter 7, we recommended that Alberta protect individuals who grant or assume mortgages charging residential land and farm land where the individual or family member has used the property for the relevant purpose. This discussion will focus on the procedure that will be followed by the lender when the mortgage in default charges residential land or farm land.

(a) Chain of title consisting exclusively of protected individuals

Assume that an individual grants a mortgage charging residential land or farm land. Several years later the borrower sells the land to another individual who at some time fails to make the mortgage payments. Both individuals are protected individuals. The proposed procedure in this case is the same as that which presently exists for mortgages granted by an individual.

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555 *Ibid.*

556 *Scotia Mortgage Corp.* v. *Goss, supra*, note 544.

557 See *North West Trust Company* v. *Modest Investments Ltd.* (1987), 77 A.R. 282 where Master Funduk gave an immediate order for sale in respect of a mortgage granted by a corporation. As the land was worth less than the mortgage debt, he thought there was no point in granting an order nisi.

558 Price and Trussler, *supra*, note 101 at 190-91.

As discussed earlier, the existing legislative policy is protection of homeowners and farmers. Not only should homeowners and farmers be protected from deficiency judgments, but any equity they have in the property should also be preserved. Sale of the land at a fair price will protect any equity in the property. A sale at fair price will most likely occur if the land is offered for sale to a wide market. In an effort to bring about sale of the land at a fair price, Alberta should continue to require that the court grant an order nisi in a foreclosure action that directs sale of the land if the defendant fails to redeem the property.[559] The order will establish the time fixed for redemption. The statutory redemption period will apply unless the court decreases or extends the time having regard to the circumstances outlined in section 42(2) of the Law of Property Act. As will be discussed later, the time, place, form of advertisement and manner of the sale shall be that which the court considers proper. If the sale is unsuccessful, the court will have the authority to again offer it for sale or grant a foreclosure order. The effect of a foreclosure order would remain as it is now.

To this general regime of judicial sale, we would make three exceptions where the court would have the discretion to grant an immediate foreclosure order. Two of these presently exist by virtue of section 42.1 of the Law of Property Act: abandonment and sale to a dollar dealer. If the homeowner or farmer abandons the land, this is usually an indication that there is no equity in the property. More important, abandonment puts the lender's security at great risk. Therefore, in this circumstance a court should have the ability to grant an immediate foreclosure order. When choosing between ordering sale and ordering immediate foreclosure, the court will have to balance the risk of deterioration of the lender's security against any equity a borrower might have. We would also allow an immediate foreclosure order when a dollar dealer has bought the property. This usually occurs when the borrower or transferee sells the residential land or farm land while the mortgage is in default or within 4 months before the mortgage goes into default. This exception will allow the court to deal adequately with the dollar dealer. There would be no need to have an exception for undeveloped land other than farm land because no protection would arise for such land. It would not fall within the definition of residential land or farm land.

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559 The wording of section 41(2) should be changed to show clearly that the court must grant the order nisi.

The third exception would be for situations in which the land is worth much less than the mortgage debt. Assume that the borrower owes $100,000, which is secured by a mortgage charging a home worth $80,000, and that the real estate market is depressed. The court, typically, sets a redemption period of one day and directs sale. The sale is advertised by a posting at the Sheriff's office for 5 days. The order nisi may even provide that a foreclosure order will follow, without further order, if there is no sale of the property. The court uses this procedure because it recognizes that the borrower will not wish to redeem a $80,000 property for $100,000 and sale by tender is unlikely to attract a purchaser. Advertising in local papers would just increase costs and any delay gives rise to higher interest charges. Currently, the court does not have the jurisdiction to give an immediate foreclosure order in these circumstances.

It seems unreasonable to apply a procedure designed to protect the borrower's equity to a situation in which the borrower has no equity. All that this accomplishes is that the lender has to incur the further cost of advertising the land for sale. Should the court have the discretion to direct an immediate foreclosure order in this situation? The answer to the question depends on the reliability of the appraisal evidence placed before the court. If appraisal evidence is consistently reliable, then it will establish whether the borrower has any equity to be protected by offering the land for sale. If the appraisal evidence is not consistently reliable or if the court is unable to detect suspect appraisals, then some borrowers may lose their equity. It comes down to a question of whether it is better to insist that the land be offered for sale in every case in order to catch the situations in which the appraisal evidence is wrong. We believe that the discretionary nature of the remedy will serve as a check on unreliable evidence. The court can refuse to give an order of immediate foreclosure where it is unsatisfied with the appraisal evidence before it. We recommend that the court have the discretion to order immediate foreclosure when there is no equity in the property and there is no other security.

The third exception will significantly speed up the process in times of recession. Falling land prices quickly erode any equity the borrower may have had at the time the loan was made. The lender will receive vacant possession sooner because the borrower without equity in the land will not be allowed to live in the property while the court goes through the motions

of sale. It will also eliminate the need to resort to nominal attempts at sale, such as posting at the Sheriff's office.

RECOMMENDATION 28

(a) Where the mortgage charges residential land or farm land, Alberta law should continue to restrict the nature of relief the court can grant in a foreclosure action and restrict the court's discretion to establish a redemption period.

(b) Where the chain of title for residential land or farm land includes only protected individuals and facts do not exist that justify the granting of an immediate foreclosure order, the court must grant an order nisi. The order nisi must direct that if the land is not redeemed by the end of the redemption period, the land will be offered for sale. If no satisfactory offers to purchase are received, the court can again offer the land for sale or grant a foreclosure order. Sale to the lender will be possible only when the lender has additional securities or has a claim against an insurer on a first loss payee clause.

(c) A court shall not grant an immediate order of foreclosure unless:

(i) the land is abandoned,

(ii) the land is transferred or sold while the mortgage is in default or within four months before the mortgage goes into default, or

(iii) the value of the land is less than the debt secured by the mortgage.

RECOMMENDATION 29

(a) The redemption period for any protected individual who grants a mortgage on residential land or farm land and the redemption period for any protected individual who assumes a mortgage charging residential land or farm land shall be:

(i) one year from the date of the granting of the order in the case of farm land, and

(ii) six months from the date of the granting of the order in the case of residential land.

The court on application may decrease or extend the period of redemption having regard to the following circumstances:

(i) when the action is in respect of a security on farm land,

- **the ability of the protected individual to pay**
- **the value of the land including the improvements made thereon,**
- **whether the land has been abandoned,**
- **the nature, extent and value of the security held by the lender**
- **whether the failure to pay was due to hail, frost, drought, agricultural pests or other conditions beyond the control of the protected individual**

(ii) when the action is in respect of a security on residential land,

- **the ability of the protected individual to pay**
- **the value of the land including the improvements made thereon,**

• whether the land has been abandoned
• the nature, extent and value of the security held by the lender
• the earning capacity of the protected individual and
• whether the protected individual's failure to pay was due to temporary or permanent unemployment or other conditions beyond the control of the protected individual.

(b) Chain of title that does not include protected individuals

If the residential land or farm land is never owned by a protected individual, the procedure will be the same as that which now exists for mortgages granted by a corporation. The court will be able to award any of the six *in rem* remedies historically available and to grant judgment for any deficiency. The redemption period, if any, will be within the discretion of the court.

(c) Chain of title consisting of protected individuals and others

In a chain of title that includes protected individuals and others, the procedure will depend upon whether or not the owner at the time the lender makes application for an *in rem* remedy is a protected individual.[560]

If the owner at the time of the application is a protected individual, then the court's discretion will be limited as described for chains of title that include only protected individuals. The court would have to grant an order nisi that directs that if the mortgage is not redeemed upon the expiry of the redemption period, the land will be offered for sale in the manner the court considers proper. The redemption period will be the statutory redemption period unless it is a proper case to extend or reduce this period. If the sale is unsuccessful, the court should have the authority to again offer

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[560] Unless title is transferred after default, this owner will be the owner who first defaults under the mortgage.

it for sale, or make a foreclosure order, or accept the lender's offer to purchase.

The practical difference in a chain of title of this nature is that the lender will usually not seek a foreclosure order. If the sale attempt is unsuccessful, the lender will make an offer to purchase the land. This will preserve its right to enforce any covenant to pay given by previous owners who are not protected individuals.[561]

If the owner at the time of the application is someone who is not a protected individual, then the court could grant any one of the traditional *in rem* remedies and could exercise its discretion in setting the redemption period, if any. The statutory redemption periods would not apply. The existence of previous owners who were protected individuals would not affect the procedure. Of course, previous owners who were protected individuals would receive deficiency judgment protection.

RECOMMENDATION 30

(a) Where the chain of title for residential land or farm land includes protected individuals and others, the procedure will be determined by the identity of the owner at the time of application for an *in rem* remedy.

(b) If a protected individual is the owner of the mortgaged land at the time of the application and facts do not exist that justify the granting of an immediate foreclosure order, the court must grant an order nisi. The order nisi will direct that if the land is not redeemed by the end of the redemption period, the land will be offered for sale. If no satisfactory offers to purchase are received, the court can order the land to be again offered for sale, grant an order of foreclosure,

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561 Presently, the court will usually refuse to order sale to the lender where the mortgage is caught by sections 41 and 42 of the Law of Property Act. An exception is made if the lender holds additional security or has a cause of action against an insurer on a first loss payee clause. The court directs sale to the lender, but it cannot grant a deficiency judgment against the individual mortgagor.

or sell the land to the lender. No judgment can be entered against any protected individual for the deficiency.

(c) If a corporation or individual who is not a protected individual is the owner of the land at the time of application, the court can grant any of the traditional *in rem* remedies that a Court of Chancery could grant. There is no need for the court to offer the land for sale. Also, the redemption period will be in the discretion of the court. No judgment can be entered against any protected individual for the deficiency.

(d) In actions involving mortgages of residential land or farm land, the redemption period for an owner who is not a protected individual will be within the court's discretion.

(3) Mortgages charging other types of land

Where the mortgage charges land other than residential land or farm land there should be no limits on the court's traditional jurisdiction to govern the rights of borrowers, transferees and lenders. In an action brought on a mortgage of commercial, industrial or undeveloped land, the court will be able to give any of the six *in rem* remedies. The redemption period, if any, will be that which the court considers appropriate in the circumstances. No deficiency judgment protection will arise. This is the same procedure as now exists for mortgages granted by corporations.

At one time Alberta law required the lender to sell the land before enforcing a judgment on the personal covenant contained in the mortgage.[562] In special circumstances, the lender could seek leave to enforce the judgment before selling the land. This restriction still exists for agreements for sale, but a lender can simultaneously enforce its charge on the land, sue on the covenant to pay found in the mortgage, and then enforce that judgment. We see no reason to resurrect the previous

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562 The Judicature Act, R.S.A. 1922, c. 72, s. 37(o).

restriction on the lender's right to exercise his or her equitable remedies. The existing legislative policy does not envision protection for borrowers who grant mortgages that charge land other than residential land or farm land. Moreover, in times of depressed land values, it is common for the value of the land to be less than the total debt secured by charges on the land. In the last recession, the holders of junior mortgages often did not pursue the land because its value was insufficient to satisfy prior mortgages. It seems pointless to make the lender apply for leave to sue in these circumstances.

RECOMMENDATION 31

The court can exercise its traditional equitable jurisdiction and grant the appropriate *in rem* remedy where:

(a) the mortgage charges land other than residential land or farm land, or

(b) the mortgage charges residential land or farm land and the chain of title does not include protected individuals.

The length of the redemption period, if any, will be within the discretion of the court.

(4) The sale process

No matter whether the lender sells the land under a power of sale or whether the land is sold in judicial proceedings, there is little chance of selling the land for fair value unless an effective marketing and sale method is employed.[563] This fact makes the sale process of key importance. The appropriate marketing technique and sale method will depend upon the type of property being sold and the existing economic conditions.[564] One does not sell a bungalow located in Calgary in the same fashion as a downtown office tower.

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563 Robertson, "The Problem of Price Adequacy in Foreclosure Sales", *supra*, note 348.

564 See *Canada Perm. Trust Co. v. King Art Dev. Ltd. et al.*, *supra*, note 82 at 648-49.

For many years, Alberta courts operated on the premise that, in foreclosure actions, Rule 689 required any judicial sale to be a sale by tender. Rule 689 provides as follows:

> 689. (1) Except as otherwise stated all judicial sales of land shall be by tender in the form of a certified cheque to be submitted to the clerk.
>
> (2) Notice of the judicial sale shall be published once a week for two consecutive weeks in a newspaper having a general circulation in the area in which the land is located.
>
> (3) Unless otherwise ordered the advertisement need not set out an upset price.

The notice described in Rule 689(2) discloses the date on which tenders will close. In Calgary this is 10 days after the last day of publication in the newspaper (3 weeks in Edmonton).[565] Tenders must be accompanied by a certified cheque or cash for 10% of the amount of the tender. No interest is paid on the deposit. The balance of the purchase price must be paid into court within 30 days after acceptance of the tender. It is often a term of the notice that the tenders are irrevocable.

Sale by tender worked well in the 1960s and the 1970s but was totally ineffective in the surge of foreclosures experienced in the 1980s. Very few tenders were received during the 1980s, and these tended to be extremely low. Acceptable tenders were rare. The Masters began looking for more flexible methods of sale because sale by tender was costly, ineffective and drew the criticism of members of the Court of Appeal[566]. To come up with a more flexible method of sale, the Masters concluded that Rule 689 could not restrict the power granted to the court by section 41(2) of the Law of Property Act.[567] The reinterpretation of the rule gave rise to different methods of sale: (1) sale by tender with advertising by posting at the

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565 Bar Course Materials, Creditors Rights, p. III-18.

566 See Justice Moir's dissent in *Canada Perm. Trust Co.* v. *King Art Dev. Ltd. et al.*, *supra*, note 82 at 601-02 and the majority's call for more inventive methods of sale at 648-49.

567 Section 41(2) of the Law of Property Act provides that if the defendant does not pay the debt, the land is to "be offered for sale at a time and place, in a manner, after any advertisement of sale, and at any price that the Court considers proper".

Sheriff's office, and (2) judicial listing. Posting of the advertisement of judicial sale at the Sheriff's office is a technique designed to comply with section 41(2) and save the cost of newspaper advertising. It is used when the cost of redemption exceeds the value of the land (ie there is no equity in the land). The judicial listing method is used to sell land where there is sufficient equity to cover the real estate commission.

Judicial listing has been the method of choice in Edmonton for many years now but has only recently been used widely in Calgary. Edmonton continues to use the sale by posting method when there is no equity in the property and the lender cannot enforce the covenant to pay given by the borrower or transferee. Calgary practitioners and Masters dislike the sale by posting method and instead use the procedure described in Rule 689 (ie. sale by tender). Both are normally ineffective methods of selling land. Calgary practice continues to use sale by tender to sell homes with equity, although in the last year the Masters have been encouraging use of judicial listings.

Once the court decides to offer the land for sale, it should direct sale of the land in the fashion that will bring the best price. To accomplish this goal, the court must have the ability to offer the land for sale " at a time and place, in a manner, after any advertisement of sale, and at any price the Court considers proper". The method of sale should not be restricted to sale by tender and advertising in the newspaper. Therefore, in the report for discussion, we recommended that Rule 689 be repealed. The rules could still deal with how the court should treat tenders that are received, but sale by tender would only be one of the available methods of sale.

This recommendation met with general approval. No one disputes that selling land by tender in the 1980s was a totally ineffective method of sale and that other methods should be chosen. "[C]are should be taken to make the proposed sale as attractive as possible to the advantage of lender and debtor alike."[568]

One commentator, who supported a power of sale regime, had serious concerns with the practice of judicial listings. First, in his opinion, involving lawyers and judges in negotiating an offer to purchase is not a very efficient

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568 *Canada Perm. Trust Co.* v. *King Art Dev. Ltd. et al.*, *supra*, note 82 at 649.

way to sell property. Second, if the borrower does not want the property sold, then it will be difficult to sell the property, even if the order directs the borrower to cooperate with the realtor. Third, the commentator is concerned that the fact the land is sold by the court without warranties of any kind makes it more difficult to sell certain types of property through the courts.

We respond to these concerns as follows. The first concern ignores the key role played by the realtor appointed by the judicial listing. Moreover, a judicial listing does not cause the judge to negotiate the offer. The judge's role is to evaluate whether the offer is acceptable. While the lawyer may have to do more work in respect of a judicial listing, we think the increased success of selling land by this method more than compensates for this. As to the second concern, no system can prevent people from acting irrationally. As to the third concern, we note that no warranties of any kind are given by a lender who sells land pursuant to a power of sale or by a court which sells land in a foreclosure action. This is the nature of a forced sale.

We remain of the view that the court should have the discretion to choose the marketing techniques and methods of sale that will "encourage as many persons as possible to be bidders and to bid as high as possible".[569]

RECOMMENDATION 32

The court should have the ability to offer land for sale at a time and place, in a manner, after any advertisement of sale, and at any price that the court considers proper.

(5) Rules of Court governing general matters of foreclosure procedure

Foreclosure practice, like other areas of the law, changes over time. This allows practice to adapt to practical realities. The end result can be outdated Rules of Court which do not reflect the existing practice. Today several of the Rules governing foreclosure procedure are not followed, and

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569 *Ibid.*

sensibly so. Such rules include those dealing with sale by tender and service of documents on tenants. The existing rules need to be updated to reflect current practice.

The Foreclosure Rules Committee chaired by Master Funduk is reviewing the Alberta Rules of Court dealing with foreclosure procedure. We think that this Committee is best able to deal with the general matters of procedure now dealt with by the Alberta Rules of Court. These matters include the originating document, the proper parties to the action, service of documents, notice of applications, notice of intention to advertise, taxation of costs, and forms. We make no recommendations on these matters knowing that the Committee will deal with them in due course.

RECOMMENDATION 33

The Foreclosure Rules Committee should deal with matters involving the type of document to be used to commence the action, proper parties, service of documents, notice of applications, notice of intention to advertise, taxation of costs, and forms.

(6) Cleaning up title at the Land Titles Office

A foreclosure order vests title in the lender free from "all right and equity of redemption on the part of the owner, mortgagor or encumbrancer or any person claiming through or under him subsequently to the mortgage or encumbrance".[570] Foreclosure orders of the 1980s did not always reflect this reality and when they did, they extinguished easements, utility rights of way, party wall agreements and restrictive covenants. This often created inconvenience for pipeline companies and utility companies who have rights of ways on parcels of land that run for hundreds of miles.

In a memorandum of June 28, 1984, Kenneth B. Payne (then Inspector of Land Titles Offices) described the problem as follows:

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[570] Section 44(1) of the Law of Property Act.

The significant increase in court proceedings resulting from the default of mortgagors has accentuated a problem which the Land Titles Offices have had with respect to the interpretation of the word "encumbrances" in court orders. An encumbrance is defined by the Land Titles Act to mean any charge on land and does not include a variety of other interests such as leases, easements, utility rights of way and caveats. However, in many court orders which vest titles in another person, the word "encumbrance" seems to be intended to encompass more interests than just charges. It would greatly assist Land Titles staff if court orders stated either that title is to issue free and clear of "encumbrances and interests" where this is intended or that title is to issue subject only to specified instruments and caveats.

With respect to foreclosure orders and orders confirming sale granted in foreclosure proceedings, the forms in the Rules of Court use the phrases "free from . . . all subsequent encumbrances" and "free and clear of all encumbrances" respectively. The restricted definition of encumbrance in the Land Titles Act has not been applied to these types of orders as the statute law [section 44 of the Law of Property Act] relating to foreclosure indicates that a mortgagee is entitled to foreclose the interests of all persons claiming through or under the owner subsequently to the mortgage. Therefore, certain interests which are not in the nature of encumbrances are not carried forward to the new certificate of title. However, it is established practice to carry forward easements, utility rights of way, party wall agreements, restrictive covenants and caveats concerning these interests unless the owner of the interest is named as a defendant in the action or there is a specific direction to the contrary in the order. Due either to a statutory provision which is expressed to be applicable notwithstanding any statute or to the fact that the interest arises by virtue of a statute rather than through or under the owner, the following instruments are also carried forward unless there is a specific direction to the contrary in the order:

— Tax Recovery Notification
— Rural Electrification Lien
— Gas Co-op Lien
— Order under the Surface Rights Board Act
— Certificate under the Water Resources Act
— Order or Notice under the Historical Resources Act
— Notice of Intention to Expropriate, Extension Order of Certificate of Approval

Some people propose that these problems be solved by amending section 44 to provide that easements, utility rights of way, party wall agreements, restrictive covenants and caveats concerning these interests survive the foreclosure order. We cannot recommend this even in the case of pipeline easements and utility rights of way which are of public benefit. The problem is not of sufficient importance to justify departure from the principles of the Torrens system of title. Pipeline companies, utility companies and others who have subsequent interests must convince the lender to postpone the mortgage to the subsequent interest. In the alternative, they can rely on the practice of the Land Titles Office to carry forward easements and utility rights of way unless the foreclosure order directs otherwise. If the easement or utility right of way is lost through foreclosure, the holder of the interest can seek the same interest from the new registered owner, the lender.

RECOMMENDATION 34

The effect of an order of foreclosure should remain as it is. The effect will be to vest the title of the land in the lender free from all right and equity of redemption on the part of the owner, borrower or any person claiming through or under him or her subsequently to the mortgage. The order will also operate as full satisfaction of the debt secured by the mortgage.

G. Costs

From 1938 to 1965, The Vendors' and Mortgagees' Costs Exaction Act[571] restricted the lender's ability to recover certain costs from the borrower. This statute prohibited collection of costs **other** than:[572]

(i) the costs payable in respect of and by virtue of a judgment or order of a court of competent jurisdiction

(ii) the costs and disbursements in respect of the issuing and serving of a statement of claim, or

(iii) the costs of a mortgage of land, the costs incidental to the making of a loan and the taking of the security, and the costs of supervising the construction or improvement of any building erected upon the mortgaged premises.

In fact, it was an offence to demand payment of any other fees, charges, or sums.[573] The Act did not prevent the lender from recovering sums paid by it for the "protection, maintenance, repair or improvement of the property to which the mortgage . . . relates".[574]

Today most mortgages provide that the borrower must pay any solicitor-and-client costs incurred by the lender in the enforcement of the mortgage. Since the repeal of The Vendors' and Mortgagees' Cost Exaction Act, lenders have been, where possible, enforcing these clauses and collecting solicitor-and-client costs. When section 41(1) of the Law of Property Act bars an action on the covenant to pay given in a mortgage, the lender cannot sue the borrower for solicitor-and-client costs.[575] However, if

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571 S.A. 1938, c. 30; R.S.A. 1942, c. 149; R.S.A. 1955, c. 357, which was repealed by S.A. 1965, c. 98.

572 *Ibid.* s. 2.

573 *Ibid.* s. 3.

574 *Ibid.* s. 4.

575 But one case does suggest that the lender can sue an individual for party-and-party costs notwithstanding section 41 of the Law of Property Act. See *Canwest Trust Co.* v. *Brady, McEwan and Peat Marwicke Thorne Inc.*, [1994] 4 W.W.R. 348 (Alta. Q.B.).

in such a situation the mortgage provides that such costs are to become part of the principal, the costs become a charge on the land. Upon sale of the property the solicitor-and-client costs can be paid from the sale proceeds. Where a lender can sue on the covenant to pay solicitor-and-client costs, it can obtain a judgment for those costs. These costs are substantial. In the face of such a clause in the mortgage, payment of solicitor-and-client costs is a precondition to redemption of the mortgage and to relief under section 39 of the Law of Property Act.[576]

Some lawyers advocate a return to the era where the lender could only recover party-and-party costs in a foreclosure action brought against individuals who are protected from deficiency judgment. They argue that this is a logical extension of the existing legislative policy of protecting homeowners and farmers. They also are concerned for the homeowner or farmer who is able to come up with sufficient money to pay the arrears of principal and interest and some costs but is unable to find the money to pay the total solicitor-and-client costs. In their view, it is unfair that someone loses the property just because of the inability to pay legal fees. These lawyers also worry that legal fees are not scrutinized by the lender who does not have to pay them. This may lead to unduly high legal fees.

Other lawyers abhor a return to the era where the lender could only recover party-and-party costs in a foreclosure action. They see no reason why a lender should be unable to recover all the costs it incurs in enforcing the mortgage. Why should a lender be restricted to recovering the artificially low party-and-party costs when many other contracts, such as leases, loan agreements and guarantees, contain an enforceable covenant by one party to pay the solicitor-and-client costs of another party. A mortgage contract should not be treated any differently. These lawyers do not believe that solicitor-and-client costs charged by lawyers are unduly high. In any case in which the costs are to be paid by the borrower, the taxing officer taxes the bill of costs. This process ensures that the solicitor-and-client costs are reasonable. Furthermore, it is not correct to assume that the borrower or transferee always pays the account of the lender's lawyer. In many cases, this is paid by the lender and never recovered from the borrower or transferee. Lenders are very concerned that the legal fees they pay are fair and reasonable. Another argument in support of the existing situation is

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576 *Central Housing and Mortgage Corporation* v. *Conaty* (1967), 59 W.W.R. 11 (Alta. S.C.A.D.).

that payment of the solicitor-and-client costs by the borrower causes the borrower to act reasonably in the event of default. The borrower knows he or she will pay for the cost of enforcing the mortgage and will not raise bogus defences.

Only one commentator responded to this issue. He thinks lenders should be able to recover solicitor-and-client costs if the mortgage so provides.

After further consideration, we are of the view that the lender's right to recover solicitor-and-client costs should not be limited by statute. Deficiency judgment protection is designed to ensure that the lender looks to the land only, and not to the personal covenant. It does not concern itself with the agreement giving rise to the debt secured by the mortgage. If a defendant believes the costs are unreasonably high, this is a matter for the taxing officer. The procedure of taxation of costs is designed to deal with these problems. We do not think further protection is necessary.

H. Transition

(1) Introduction

Whenever the lender's right to enforce its *in personam* remedies is altered, problems of transition arise. Should the legislation affect the rights of a borrower and lender who entered into their relationship before the legislation comes into effect? What will be the formula used to bring about transition? These and other questions will be addressed under the topic of transition.

(2) Presumption against retrospective legislation

Retrospective legislation alters the character of a legal relationship or transaction so that after the legislation is passed, the character is different than what it was at the time is was entered into. The presumption against interpreting legislation as operating retrospectively was first enunciated in *Phillips* v. *Eyre*[577] as follows:

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[577] (1870), L.R. 6 Q.B. 1 at 23.

> Retrospective laws are, no doubt, prima facie of questionable policy, and contrary to the general principle that legislation by which the conduct of mankind is to be regulated ought, when introduced for the first time, to deal with future acts, and ought not to change the character of past transactions carried on upon the faith of the then existing law . . . . Accordingly, the Court will not ascribe retrospective force to new laws affecting rights, unless by express words or necessary implication it appears that such was the intention of the legislature.

This presumption was more recently restated by Dickson, J. in *Gustavson Drilling (1964) Limited and The Minister of National Revenue*,[578] as follows:

> The general rule is that statutes are not to be construed as having retrospective operation unless such a construction is expressly or by necessary implication required by the language of the Act. An amending enactment may provide that it shall be deemed to have come into force on a date prior to its enactment or it may provide that it is to be operative with respect to transactions occurring prior to its enactment. In those instances the statute operates retrospectively.

An exception to this presumption arises in the case of legislation relating only to procedure. Such statutes are interpreted as applying to all actions, even those commenced before the legislation came into force. Procedure governs the method of enforcing a right; it does not take away any cause of action.

There are many cases in which litigants argued that certain amendments operated retrospectively or prospectively. We do not propose to review these cases. We refer to them only as a reminder of the need to define clearly those mortgages that will be governed by the new legislation.

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[578] [1977] 1 S.C.R. 271.

(3) Effect of proposed recommendations

In this report we have made recommendations that touch on the following subjects:

1. Deficiency judgment protection for borrowers
2. Section 62 of the Land Titles Act
3. Deficiency judgment protection for transferees
4. Mortgages insured under the National Housing Act
5. Whether Part 5 of the Law of Property Act will apply to the Crown
6. Due-on-Sale clauses
7. Attornment clauses
8. Exercise of power of sale granted to mortgage
9. Rice orders
10. Protection of tenants
11. Procedure: method of sale, when sale must be attempted, immediate foreclosure

These recommendations fall into two categories: procedure and substance. Many of the recommendations affect matters of substance. A few deal with procedural change only.

The recommendations that will have the greatest impact on Albertans are those relating to deficiency judgment protection. For mortgages that are **not** given or insured under the National Housing Act, the recommendations generally restrict the deficiency judgment protection that now exists for individuals. Homeowners and farmers will remain protected. Individuals who have granted mortgages on commercial property will not be protected. Corporations which assume mortgages granted by individuals will be liable on any covenant to pay they give to the lender. This will apply to covenants to pay given before renewal of the mortgage, as well as the covenants given in the renewal agreement itself. Individuals who have purchased commercial property subject to a mortgage granted by a corporation will not receive protection once they renew the mortgage.

The recommendations will also restrict the remedies of Crown lenders by making the Crown (subject to any exceptions the Legislature creates) bound by Part 5 of the Law of Property Act.

We do not know at this time how the Legislature will deal with mortgages insured under the National Housing Act. We made no recommendation on whether the exception for such mortgages should continue, but suggested the Legislature re-examine this issue.

(4) Analysis

The transition between the old and new regimes can be accomplished in several different ways. Some alternatives are:

1. The new legislation will apply immediately to every mortgage, no matter when the mortgage was granted and no matter when the action was started.

2. The new legislation can apply only to mortgages granted after the date the legislation comes into force ("effective date").

3. The new legislation can apply to mortgages granted or renewed after the effective date.

4. The new legislation can apply when the cause of action (i.e. default) arose after the effective date.

The presumption against retrospective legislation is based on common sense. Parties should be able to structure their affairs in light of existing law. Retrospective legislation removes their ability to do so. Nonetheless, the need to give individuals the ability to structure their affairs in light of existing law must be weighed against the need for uniform application of mortgage law. Prospective legislation will result in delayed implementation and might produce mortgage remedies law that lacks uniformity for many years. A balance must be struck between these two opposing considerations.

Many factors influence a lender's decision to lend money and a customer's decision to borrow money. Not the least of these factors is whether the lender can have recourse on the customer's promise to repay the debt. We dislike changing the rules in the middle of the game. For this reason we reject options 1 and 4.

Bringing existing mortgages under the new regime at the time of renewal is attractive in so far as it affects the lender and the owner at the time of the renewal. The existing owners (be they borrowers or transferees) who will lose protection can take steps to sell the land if they find the new risk unacceptable. Those lenders who are losing remedies can decide whether they wish to renew under the new legislation. If the risk is unacceptable, the lender can refuse to renew or can request the owner to pay down a portion of the debt. The result will be a staged implementation that gives these parties the opportunity to re-evaluate their position at the time of renewal. The serious objection we have to this method is the retroactive affect it would have on previous owners. If a mortgage comes under the new regime as of the time of renewal, previous owners will have deficiency judgment protection removed at the time of renewal. They will have made decisions on the basis of this protection and at some later date will find their position altered, and they will be unable to prevent this.

In the report for discussion, we recommended that the new regime apply only to mortgages that are granted after the new regime becomes the law of Alberta. Any mortgage granted before this day and renewed after this day would be governed by the old regime. Theoretically, this can lead to a long transition period that could extend until all existing mortgages are paid in full. Our concern over a lengthy transition period is mitigated by several factors. First, the parties entered into the transactions on the basis of the old law and it may be preferable from their point of view to let the relationship stay the same. Second, the marketplace will determine how fast the transition will occur between the old and the new regime. If a lender or borrower has a better position under the new regime, at the time of renewal they can take steps to achieve this better position. The lender does this by refusing to renew the mortgage. The present owner does this by obtaining new financing. The parties may choose to continue the existing relationship if it is to their mutual benefit. Recourse on the covenant will be an important factor, but not the only factor, to be considered when deciding what action should be taken at the time of renewal. Third, it will easy to determine whether the mortgage is governed by the new law or the old law. When was the mortgaged signed? The old regime will govern if the mortgage was signed on or before a certain day. The new regime will govern all mortgages signed after that day. All mortgages, including mortgages granted to the Crown and those insured under the National Housing Act, would be subject to the same rules of transition.

Of course, all procedural reform will apply immediately. Even ongoing actions would be affected by the procedural reform.

Only one commentator responded on the issue of transition. He was concerned that our tentative recommendation regarding transition "would leave too much uncertainty and confusion as it could be many years before all the mortgages were give the same status." In his view, the new legislation should apply to a mortgage granted or renewed after the effective date of the legislation. He is also concerned that the courts will treat a renewed mortgage as a new mortgage, no matter what the legislation provides.

We acknowledge that the transition we propose could lead to the application of the old and new regimes for several years. Yet, the market will determine the speed at which the transition takes place. In our view, it is unfair to impose liability on previous owners because of a renewal entered into by the current owner.

RECOMMENDATION 35

The transition between the existing substantive law and the proposed substantive law should be accomplished by having the new regime apply only to mortgages granted after the new regime becomes the law of Alberta. Procedural reform would apply immediately to all mortgages, including those that are the subject of ongoing litigation.

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_____
CHAIRMAN

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DIRECTOR

June 1994

PART III — LIST OF RECOMMENDATIONS

Alberta should retain judicial supervision of the foreclosure process.

As the values upon which the existing mortgage remedies law is based are longstanding and as there is no evidence that this body of law damages essential Alberta interests, we recommend that mortgage remedies law be reformed within the existing legislative policy of protecting homeowners and farmers from deficiency judgments.

Corporate borrowers should not be afforded deficiency judgment protection.

Deficiency judgment protection for all individuals is an unnecessarily broad method of protecting homeowners and farmers. The present law should be replaced with a system that creates protection for certain individuals who mortgage residential land or farm land.

(a) In an action brought on a mortgage of residential land or farm land granted by an individual, the right of the lender should be restricted to the land to which the mortgage relates and to foreclosure of the mortgage. No action should be brought on a covenant for payment contained in the mortgage and no action should be brought for damages based on the sale or forfeiture for taxes of land included in the mortgage, no matter who was responsible for sale or forfeiture of the land.

(b) This protection should only extend to protected individuals. An individual is a "protected individual" if that individual or any family member of that individual has in good faith

(i) in the case of residential land, used that land as a residence, or

(ii) in the case of farm land, used that land for carrying on farming operations

at any time during which that individual is or was a registered owner of the mortgaged land.

"Family member" means

(i) an individual's grandparent, parent, sibling, child, niece, nephew or spouse, and

(ii) a grandparent, parent, sibling, child, niece or nephew of the individual's spouse.

(c) An individual seeking deficiency judgment protection has the onus of proving that he or she is a protected individual.

(d) In an action concerning a mortgage of residential land or farm land, every affidavit filed in support of an application for an *in rem* judgment or *in personam* judgment against an individual shall make full and fair disclosure of all material information known to the mortgagee as to whether the individual is or is not a protected individual.

RECOMMENDATION 6 183

Deficiency judgment protection should also be extended to an individual who defaults under a mortgage granted to finance construction of a residential unit if that individual or a family member intended to reside in the residential unit upon completion of construction. The onus of proving that the individual or family member intended to reside in the unit lies with the individual. The lender must disclose any information it has concerning the intended use of the property.

RECOMMENDATION 7 189-90

Residential land and farm land should be defined as follows:

(a) "farm land" means land that is used for carrying on farming operations,

(b) "farming operations" means

(i) the planting, growing and sale of trees, shrubs or sod,

(ii) the raising or production of crops, livestock, fish, pheasants or poultry,

(iii) fur production,

(iv) beekeeping

(c) "parcel" means the aggregate of the one or more areas of land described in a certificate of title or described in a certificate of title by reference to a plan filed or registered in a land titles office,

(d) "unit" means a unit provided with living, sleeping and cooking facilities intended for use by an individual or group of individuals as a residence,

(e) "residential land" means

(i) a parcel or parcels on which a single-family detached unit or single-family semi-detached unit is located,

(ii) a parcel or parcels on which a single-family detached unit or single-family semi-detached unit is being constructed,

(iii) a unit in a duplex that has a separate title for each unit,

(iv) a unit in a duplex that has a separate title for each unit and that is being constructed,

(v) a unit in a row housing development that has a separate title for each unit,

(vi) a unit described in a strata title,

(vii) a residential unit under the *Condominium Property Act*, or

(viii) a parcel on which no more than two mobile homes are located.

RECOMMENDATION 8 190-91

A mortgage that charges undeveloped land that becomes residential land or farm land at some time before default under the mortgage shall be considered a mortgage of residential land or farm land.

A mortgage placed to finance the construction or development of land will be considered a mortgage of residential land or farm land if the construction or development creates residential land or farm land.

RECOMMENDATION 9 193

This recommendation applies to a mixed land mortgage, which we define as a mortgage that charges two or more parcels of land, one of which is residential land or farm land. A mixed land mortgage should be treated in the same manner as a mortgage of residential land or farm land.

Any attornment clause given by a protected individual in a mortgage charging residential land or farm land should be void. No exceptions should be made for mortgages granted to the Farm Credit Corporation, mortgages securing loans given or insured under the National Housing Act, or mortgages granted to the Crown or any of its agents.

Any waiver or release of the rights, benefits or protection given by the proposed regime should be against public policy and void.

(a) A power of sale granted by an individual borrower should be void.

(b) A lender's right to exercise a power of sale granted by a corporation should remain unchanged. As is the case at present, the lender who exercises a power of sale granted by a corporation will be unable to transfer title free and clear of subsequent encumbrances.

(a) The Rice order procedure is a justifiable method of ensuring that the lender is paid what is owing to it.

(b) It should be left to the court's discretion as to whether an attempt at public sale should precede an application for a Rice order. The Rules of Court should list the factors a court should consider when exercising this discretion. Those factors should not be exhaustive but should include:

- nature of property
- value of property
- existing market for the property
- quality of the appraisal evidence before the court
- difference in opinion as to value of land

(c) The court should continue to determine the value the lender must pay for the land.

Residential tenants should not receive security of tenure at the expense of the lender. The Land Titles Act should determine if the lender's interest has priority over the interest of any tenant.

Section 45 of the Law of Property Act empowers the court to appoint a receiver to collect rents arising from land that is the subject of foreclosure proceedings or to appoint a receiver-manager for such land. This section serves a useful purpose and is effective in discouraging the operation of dollar dealers. It should continue to be the law of Alberta.

(a) Where the mortgage charges residential land or farm land, Alberta law should continue to restrict the nature of relief the court can grant in a foreclosure action and restrict the court's discretion to establish a redemption period.

(b) Where the chain of title for residential land or farm land includes only protected individuals and facts do not exist that justify the granting of an immediate foreclosure order, the court must grant an order nisi. The order nisi must direct that if the land is not redeemed by the end of the redemption period, the land will be offered for sale. If no satisfactory offers to purchase are received, the court can again offer the land for sale or grant a foreclosure order. Sale to the lender will be possible only when the lender has additional securities or has a claim against an insurer on a first loss payee clause.

(c) A court shall not grant an immediate order of foreclosure unless:

(i) the land is abandoned,

(ii) the land is transferred or sold while the mortgage is in default or within four months before the mortgage goes into default, or

(iii) the value of the land is less than the debt secured by the mortgage.

RECOMMENDATION 29 270-71

(a) The redemption period for any protected individual who grants a mortgage on residential land or farm land and the redemption period for any protected individual who assumes a mortgage charging residential land or farm land shall be:

(i) one year from the date of the granting of the order in the case of farm land, and

(ii) six months from the date of the granting of the order in the case of residential land.

The court on application may decrease or extend the period of redemption having regard to the following circumstances:

(i) when the action is in respect of a security on farm land,

- the ability of the protected individual to pay
- the value of the land including the improvements made thereon,
- whether the land has been abandoned,
- the nature, extent and value of the security held by the lender
- whether the failure to pay was due to hail, frost, drought, agricultural pests or other conditions beyond the control of the protected individual

(ii) when the action is in respect of a security on residential land,

- the ability of the protected individual to pay
- the value of the land including the improvements made thereon,
- whether the land has been abandoned
- the nature, extent and value of the security held by the lender
- the earning capacity of the protected individual and
- whether the protected individual's failure to pay was due to temporary or permanent unemployment or other conditions beyond the control of the protected individual.

RECOMMENDATION 30 272-73

(a) Where the chain of title for residential land or farm land includes protected individuals and others, the procedure will be determined by the identity of the owner at the time of application for an *in rem* remedy.

(b) If a protected individual is the owner of the mortgaged land at the time of the application and facts do not exist that justify the granting of an immediate foreclosure order, the court must grant an order nisi. The order nisi will direct that if the land is not redeemed by the end of the redemption period, the land will be offered for sale. If no satisfactory offers to purchase are received, the court can order the land to be again offered for sale, grant an order of foreclosure, or sell the land to the lender. No judgment can be entered against any protected individual for the deficiency.

(c) If a corporation or individual who is not a protected individual is the owner of the land at the time of application, the court can grant any of the traditional *in rem* remedies that a Court of Chancery could grant. There is no need for the court to offer the land for sale. Also, the redemption period will be in the discretion of the court. No judgment can be entered against any protected individual for the deficiency.

(d) In actions involving mortgages of residential land or farm land, the redemption period for an owner who is not a protected individual will be within the court's discretion.

RECOMMENDATION 31 274

The court can exercise its traditional equitable jurisdiction and grant the appropriate *in rem* remedy where:

(a) the mortgage charges land other than residential land or farm land, or

(b) the mortgage charges residential land or farm land and the chain of title does not include protected individuals.

The length of the redemption period, if any, will be within the discretion of the court.

RECOMMENDATION 32 277

The court should have the ability to offer land for sale at a time and place, in a manner, after any advertisement of sale, and at any price that the court considers proper.

General comment on scope of legislation

There are two methods of securing a debt against property: a mortgage and an agreement for sale. Both serve a similar function and, historically, have been treated similarly. Although this report only considers mortgage law, we have drafted the legislation to deal with mortgages and agreements for sale. In our opinion, the proposed protection, especially deficiency judgment protection, should be the same whether the debt is secured by a mortgage or an agreement for sale.

Section 35, 35.1 and 35.2: Attornment clauses

1. See Recommendation 22.

2. If an attornment clause given by a protected individual was enforceable, it would become an indirect way of enforcing the covenant to pay given in the mortgage. This follows from the fact that many attornment clauses make the "rent" equal to the payments owing under the mortgage. This defeats the protection we propose. For this reason such clauses must be void.

Section 36 — Crown bound

1. We do not recommend that provincial or federal Crown agencies be able to enforce attornment clause given by protected individuals. Our concern with attornment clauses is that most protected individuals will have no idea of the effect of such a clause. How many farmers will realize that such a clause, if enforceable, allows the lender to seize machinery and equipment to satisfy outstanding "rent" (which is the mortgage arrears)? They will know that this is the result of giving security that charges the machinery and equipment, but it is unlikely they will understand that an attornment clause has a similar effect. If a Crown lender wishes to obtain security on personal property from the protected individual it must do so in a more direct way at the time the loan is made.

PART IV — ANNOTATED LEGISLATION

PART 4 OF THE *LAW OF PROPERTY ACT*
Attornment Clauses

35(1) Every covenant, agreement, condition or stipulation that is contained in a mortgage of residential land or farm land or an agreement for sale of residential land or farm land, or in any other instrument of any kind that is supplementary or collateral to such a mortgage or agreement and whereby the mortgagor agrees or has agreed to become the tenant of the mortgagee or whereby the purchaser agrees or has agreed to become the tenant of the vendor, as the case may be is void.

(2) Subsection (1) does not apply where a corporation or an individual who is not a protected individual grants the mortgage or purchases the land under the agreement for sale.

35.1(1) This section applies to:

(a) a mortgage of land other than residential land or farm land or an agreement for sale of land other than residential land or farm land,

(b) a mortgage of residential land or farm land that was granted by a corporation or an individual who was not a protected individual

(c) an agreement for sale of residential land or farm land where the purchaser under the agreement is a corporation or an individual who is not a protected individual.

(2) Where a mortgage or agreement described in subsection (1) is to be paid by instalments, the mortgage or agreement may contain a covenant or provision that the mortgagor or purchaser agrees to become the tenant of the mortgagee or vendor, and in that case the relationship of landlord and tenant is validly constituted between those persons.

(3) The rent payable under any such agreement shall not exceed the fair annual rent at which the premises might reasonably be expected to rent on a tenancy from year to year with the landlord paying the taxes.

(4) No such agreement of itself operates as, nor shall it be considered as, a taking of possession of the premises or land mortgaged or sold by the mortgagee or the vendor.

35.2 In this part, "residential land", "farm land" and "protected individual" will have the meanings as defined in section 37.

36 The Crown is bound by this part.

Comments

General comment on scope of legislation

There are two methods of securing a debt against property: a mortgage and an agreement for sale. Both serve a similar function and, historically, have been treated similarly. Although this report only considers mortgage law, we have drafted the legislation to deal with mortgages and agreements for sale. In our opinion, the proposed protection, especially deficiency judgment protection, should be the same whether the debt is secured by a mortgage or an agreement for sale.

Section 37 — Definitions

1. See Recommendations 5, 6 and 7.

2. The definitions of family member, farm land, farming operation, and parcel are taken, with minor modifications, from section 43.4(3) of the Law of Property Act.

3. Residential land has been redefined. The definition is more detailed than the definition of residential land now found in 43.4(3) of the Law of Property Act. We have attempted to define residential land narrowly to include only properties typically occupied as a home.

4. The word "parcels" was added to 37(1)(f)(i) and (iii) to ensure that a house built upon two lots would fall within the definition of residential land.

5. A duplex built on one lot would not fall within the definition. But if each duplex unit is built on a separate lot, a mortgage of one of the units would fall within the definition of residential land. A fourplex does not fall within the definition of residential land even if the owner resides in one of the apartments.

6. "Protected individual" is a new term. This term plays a key role in the proposed regime because it defines those individuals who will receive deficiency judgment protection in respect of mortgages of residential land or farm land. The term is intended to cover all homeowners and farmers. The individual must establish that during the time he or she owned the property, the individual or a family member at any time in good faith used the residential land as a residence or used the farm land for carrying on farming operations.

7. The "good faith" requirement ensures that a borrower cannot move into the residential land near the time of default just to obtain deficiency judgment protection.

8. "Protected individual" includes both borrowers and transferees.

PART 5 OF THE *LAW OF PROPERTY ACT*
Enforcement of Mortgages and Agreements for sale of land

Definitions
37(1) In this Part,

(a) "family member" means

(i) an individual's grandparent, parent, sibling, child, niece, nephew or spouse, and

(ii) a grandparent, parent, sibling, child, niece or nephew of the individual's spouse;

(b) "farm land" means land that is or was used for carrying on farming operations;

(c) "farming operations" means

(i) the planting, growing and sale of trees, shrubs or sod,

(ii) the raising or production of crops, livestock, fish, pheasants or poultry,

(iii) fur production, or

(iv) beekeeping;

(d) "parcel" means the aggregate of the one or more areas of land described in a certificate of title whether or not it is described by reference to a plan filed or registered in a land titles office;

(e) "protected individual" means an individual, who

(i) has granted a mortgage charging land,

(ii) has purchased land subject to a mortgage,

(iii) has purchased land by way of agreement for sale, or

(iv) is an assignee of a purchaser's interest in an agreement for sale of land,

where that land is or before default on the mortgage or agreement for sale becomes residential land or farm land and that individual or any family member of that individual has in good faith

(i) in the case of residential land, used that land as a residence, or

(ii) in the case of farm land, used that land for carrying on farming operations

at any time during which that individual is or was a registered owner of the mortgaged land or an equitable owner of the land subject to an agreement for sale.

(f) "residential land" means

(i) a parcel or parcels on which a single-family detached unit, single-family semi-detached unit is located,

(ii) a unit in a duplex that has a separate title for each unit,

(iii) a parcel on which a single-family detached unit or single-family semi-detached unit is being constructed,

(iv) a unit in a duplex that has a separate title for each unit and that is being constructed,

(v) a unit described in a strata title,

(vi) a residential unit under the Condominium Property Act,

(vii) a parcel on which no more than two mobile homes are located, or

(viii) a unit in a row housing development that has a separate title for each unit.

(g) "unit" means a place that provides living, sleeping and cooking facilities intended for use by an individual or group of individuals as a residence.

Section 37.1 — Land Development

1. See Recommendation 8

2. For many mortgages, land development is not an issue because the nature of the land does not change during the lifetime of the mortgage. There are, however, situations in which the nature of the land will change after the mortgage charges the land.

3. Section 37.1(a) is designed to ensure that a mortgage loan placed to purchase the lot falls within the scope of section 41 if a house is later built upon that lot. This ensures that all mortgages placed to finance acquisition of a home fall within the scope of section 41. Section 37.1(b) ensures that a construction mortgage is categorized on the basis of the land after completion of the construction and not on the basis of the land at the time the mortgage is placed.

Section 37.2 — Mortgage charging different kinds of land

1. See Recommendation 9

2. The purpose of this section is to ensure that deficiency judgment protection for homeowners and farmers is not avoided by the inclusion in the mortgage of another parcel of land. Every mortgage that charges residential land or farm land will be treated as a mortgage of residential land or farm land and not a mortgage of land falling outside the scope of section 41.

3. The following would be treated as a mortgage of residential land:

   - a mortgage charging a home and a house rented to tenants.
   - a mortgage charging two condominium units.
   - a mortgage charging a home and a fourplex.
   - a mortgage charging two parcels of land where a duplex unit is build upon each parcel.

4. A individual who granted such a mortgage would be treated as a protected individual if in the case of one parcel of residential land, he or she or a family member in good faith established a residence. So if the mortgage charges the home and a rental house, deficiency judgment protection would arise for the entire loan unless the mortgage is a collateral mortgage so as to fall outside the scope of section 41.

Land development

37.1(1) In this Part, the Court shall determine whether the mortgage is a mortgage of residential land or farm land by examining the nature of the land at the time the mortgage is granted except that

(a) a mortgage that charges undeveloped land that becomes residential land or farm land at some time before default under the mortgage is deemed to be a mortgage of residential land or farm land; and

(b) a mortgage placed to finance construction on the mortgaged land will be characterized according to the type of land that will exist upon completion of construction.

(2) In this Part, the Court shall determine whether the agreement for sale is an agreement for sale of residential land or farm land by examining the nature of the land at the time the agreement is executed except that an agreement for sale of undeveloped land that is developed into residential land or farm land at some time before default under the agreement for sale is an agreement for sale of residential land or farm land.

Mortgage charging different kinds of land

37.2(1) In this Part,

(a) a mortgage of residential land or farm land includes a mortgage that charges two or more parcels of land, one of which is a parcel of residential land or farm land;

(b) an agreement for sale of residential land or farm land includes an agreement for sale of two or more parcels of land, one of which is a parcel of residential land or farm land.

(2) In the case of a mortgage or agreement described in subsection (1), an individual is a protected individual if that individual or any family member of that individual has in good faith

(a) in the case of one parcel of residential land, used that parcel as a residence, or

(b) in the case of one parcel of farm land, used that parcel for carrying on farming operations

at any time during which that individual is or was a registered owner of the mortgaged land or the equitable owner of the land subject to an agreement for sale.

Section 38 — Mortgagor's Right to Sue (unchanged)

Section 39 — Granting Relief to the Mortgagor (unchanged)

Mortgagor's right to sue

38 A mortgagor entitled for the time being to the possession or receipt of the rents and profits of any land as to which no notice of his intention to take possession or to enter into receipt of the rents and profits thereof has been given by the mortgagee, may in his own name only,

(a) sue for possession of the land,

(b) sue or distrain for the recovery of the rents or profits, or

(c) sue to prevent or recover damages in respect of a trespass or other wrong relative thereto,

unless the cause of action arises on a lease or other contract made by him jointly with any other person and in that case he may sue or distrain jointly with the other person.

RSA 1980 cL-8 s38

Granting relief to mortgagor

39(1) The Court has jurisdiction and shall grant relief from the consequences of the breach of a covenant or the non-payment of principal or interest by a mortgagor or purchaser in any case in which the mortgagor or purchaser remedies the breach of covenant or pays all the arrears due under the mortgage or agreement for sale with lawful costs and charges in that behalf

(a) at any time before a judgment is recovered, or

(b) within a time that by the practice of the Court relief therein could be obtained.

(2) The mortgagor or purchaser may, by notice in writing, require the mortgagee or vendor to furnish him with a statement in writing

(a) of the nature of the breach of any covenant, or

(b) of the amount of principal or interest with respect to which the mortgagor or purchaser is in default,

and of the amount of any expenses necessarily incurred by the mortgagee or the vendor.

(3) A mortgagor or purchaser may, not more than twice a year by notice in writing to the mortgagee or vendor, require the mortgagee or vendor, as the case may be, to furnish, to him or a person designated by him, without charging any fee or expense or accepting any amount for so doing, a statement in writing setting out with respect to the mortgage or agreement for sale

(a) the amount of principal, interest and any other charges owing, and

(b) the balance in the tax account.

(4) The mortgagee or vendor shall answer a notice given under subsection (2) or (3) within 30 days after he receives it and if, without reasonable excuse, he fails to do so or his answer is incomplete or incorrect, any rights that he may have for the enforcement of the mortgage or for the cancellation or specific performance of the agreement for sale are suspended until he has complied with the notice.

(5) Notice by a mortgagor or purchaser to the mortgagee or vendor may be given personally or may be sent to the mortgagee or vendor by ordinary mail to the address where money owing under the mortgage or agreement for sale is payable.

(6) A mortgagee or vendor who

(a) fails to answer, as required by subsection (4), a notice given by a mortgagor or purchaser under subsection (2) or (3), or

(b) charges or attempts to charge any fee or expense or accepts any amount for providing a statement referred to in subsection (3),

is guilty of an offence and liable to a fine of not more than $500.

RSA 1980 cL-8 s39;1982 c24 s2;1983 c97 s2

Section 39.1 — Relief against the operation of a Due-on-sale Clause

1. See Recommendation 21.

2. This section deals with actions brought when a debt is accelerated by the terms of a due-on-sale clause.

3. The court has the jurisdiction, under s. 18 of the Judicature Act, to stay an action brought to enforce a mortgage of land or an agreement for sale of land where a due-on-sale clause has accelerated payment of the debt. Subsection (2) attempts to codify the factors the courts now consider when exercising the discretion to stay such an action. See *Royal Bank of Canada* v. *Freeborn* (1974) 32 A.R. 380 (S.C.T.D.) and *Bigam* v. *Milne* (1983) 25 Alta. L.R. (2d) 179 (Q.B.)

Relief against the operation of a due-on-sale clause

39.1(1) The Court may grant a stay in an action brought on a mortgage of land or an agreement for sale of sale to enforce payment of the debt, which by the terms of the mortgage or agreement, has been accelerated because of:

(a) a sale of the land or sale of the purchaser's interest under the agreement, or

(b) a change in the control of a corporation, where the corporation is the mortgagor or purchaser under the agreement for sale.

(2) When exercising its jurisdiction to grant a stay of an action described in subsection (1), the court shall have regard to all the relevant circumstances, including:

(a) the likelihood that the buyer of the land or the purchaser's interest under the agreement will default with respect to future payments,

(b) the likelihood that the buyer of the land or the purchaser's interest under the agreement will commit waste or cause the premised to fall into disrepair,

(c) the value of the security held by the mortgagee or vendor, and

(d) the likelihood that the mortgagee or vendor will suffer hardship if the stay is granted.

Section 40 — Foreclosure Proceedings (unchanged)

Section 40.1 — Power of Sale

1. See Recommendations 1 and 24.

2. This section ensures that a lender can exercise a power of sale only when it is given by a corporation, and even then it is subject to the limitations imposed by a Torrens system of title.

Foreclosure proceedings

40(1) Proceedings for recovery of money secured by a mortgage or encumbrance, or to enforce any provision thereof, or sale, redemption or foreclosure proceedings with respect to mortgaged or encumbranced land, may be taken in any court of competent jurisdiction in accordance with the existing practice and procedure thereof.

(2) No execution to enforce a judgment on the personal covenant contained in an agreement for sale of land shall issue or be proceeded with until the sale of the land, and levy shall then only be made for the amount of money remaining unpaid after the due application of the purchase money received at the sale.

(3) As long as execution cannot issue or be proceeded with under this section, the payment of the money secured by an agreement for sale of land shall not be enforced by attachment or garnishment or by the appointment of a receiver or by any other process of a similar nature.

(4) The Court in any case where it is fair and equitable to do so and on application by notice of motion may order that subsections (2) and (3) are no longer to apply wholly or partly to the agreement for sale that is the subject matter of the application.

(5) No order shall be made under subsection (4) unless the Court is satisfied

(a) of the inadequacy of the land as a security for the amount agreed to be paid for the land,

(b) of the possession by the purchaser of liquid assets sufficient to discharge the debt, and

(c) of the existence of a grave danger of disposal of the assets of the purchaser to defeat the claim of the vendor.

(6) An order under subsection (4) may be at any time varied or set aside by the same or any other judge.

RSA 1980 cL-8 s40

Power of sale

40.1 A power of sale granted by an individual in a mortgage of land is void.

Section 41(1) — Action on Covenant

1. See Recommendations 4, 5, 12 and 14.

2. Section 41(1) creates deficiency judgment protection for borrowers who mortgage residential land or farm land and for every transferee who assumes such a mortgage. It also prohibits the lender from suing on a covenant to pay the mortgage given by a transferee in an assumption agreement or a renewal agreement, or such covenant implied by section 62 of the Land Titles Act. This is the general rule, to which section 43 makes exception for corporations and individuals who are not protected individuals.

3. Section 41(1) applies only to mortgages of residential land or farm land. The result is that deficiency judgment protection will not exist for anyone (be it a corporation or individual) who mortgages commercial land or industrial land or other land that does not fall within the definition of residential land or farm land.

4. Section 41(1) is deliberately patterned after the existing section 41 so that the interpretation of that section will apply, but to a smaller class of land mortgages. The result will be that section 41(1) as amended will prevent the direct or indirect enforcement of the covenant to pay contained in a mortgage of residential land or farm land. Yet, it will not prevent a lender from taking and enforcing additional security (ex. guarantees, security in personal property, and other land mortgages). Also, there will be mortgages of residential land or farm land that do not trigger deficiency judgment protection. The test will be whether the transaction is a mortgage of residential land or farm land with certain collateral securities (so the proposed section 41(1) applies) or whether the substance of the transaction is a debt to which the land mortgage is collateral (so the section does not apply).

Action on covenant

41(1) In an action brought on a mortgage of residential land or farm land, whether legal or equitable, or on an agreement for the sale of residential land or farm land, the right of the mortgagee or vendor is restricted to the land to which the mortgage or agreement relates and to foreclosure of the mortgage or cancellation of the agreement for sale, as the case may be, and no action lies

(a) on a covenant for payment contained in the mortgage or agreement for sale,

(b) on any covenant, whether express or implied, by or on the part of a person to whom the land comprised in the mortgage or agreement for sale has been transferred or assigned subject to the mortgage or agreement for the payment of the principal money or purchase money payable under the mortgage or agreement or part thereof, as the case may be, or

(c) for damages based on the sale or forfeiture for taxes of land included in the mortgage or agreement for sale, whether or not the sale or forfeiture was due to, or the result of, the default of the mortgagor or purchaser of the land or of the transferee or assignee from the mortgagor or purchaser.

Section 41(2) — Order Nisi, Order for Sale

1. See recommendation 28.

2. This section is a modified version of section 41(2) of the Law of Property Act. The section has been modified in two material aspects. First, the section applies only in respect of mortgages of residential land or farm land. Second, the section is now mandatory. This reflects the interpretation put on the existing section by the Alberta Court of Appeal in *Co-op Credit Union* v. *Greba* (1984) 32 Alta. L.R. (2d) 389 (C.A.).

3. The section will in certain circumstances limit the courts traditional jurisdiction to give an *in rem* remedy. Instead of having broad discretion, the court must grant an order nisi with sale to follow if the mortgage is not redeemed. The court can direct sale to the lender (but not give judgment on any covenant) where such an order is necessary to preserve a cause of action against a party that does not receive deficiency judgment protection or to preserve the right to enforce other security. If no such cause of action exists, the court will only give a foreclosure order after an unsuccessful attempt at sale. This is the existing practice under section 41(2).

Section 41(3)-(5) (unchanged)

1. See Recommendation 23.

41(2) In an action brought on a mortgage of residential land or farm land or on an agreement for sale of residential land or farm land

(a) the court shall grant an order nisi in the case of a mortgage, or an order for specific performance in the case of an agreement for sale, and the order shall direct that if the defendant fails to comply with the terms of the order, the land that is subject to the mortgage or agreement for sale is to be offered for sale at a time and place, in a manner, after any advertisement of sale, and at any price that the Court considers proper, and

(b) if the land is not sold at the time and place so appointed, the Court may either order the land to be again offered for sale or make a vesting order in the case of a mortgage or an order of cancellation in the case of an agreement for sale, and on the making of a vesting order or cancellation order, every right of the mortgagee or vendor for the recovery of any money whatsoever under and by virtue of the mortgage or agreement for sale in either case ceases and determines.

(3) Nothing in subsection (2) applies to an order nisi or order for specific performance to which the consent of the debtor has been obtained.

(4) Notwithstanding the provisions of any order nisi or order for specific performance, it is not necessary for the land to be advertised or offered for sale when, subsequent to the making of the order, the debtor consents

(a) to a vesting order in the case of a mortgage, or

(b) to an order of cancellation in the case of an agreement for sale,

without that advertising or offering for sale.

(5) Any waiver or release hereafter given of the rights, benefits or protection given by subsections (1) and (2) is against public policy and void.

RSA 1980 cL-8 s41;1982 c24 s3

Comments

Section 42 — Redemption

1. See Recommendation 29.

2. This section is the same as section 42 of the Law of Property Act, but the scope has been limited to residential land and farm land. The redemption period for farm land is 1 year and for residential land is 6 months. The factors that the court can take into account in reducing or extending the statutory redemption period have not been changed.

3. The redemption period, if any, in respect of a corporation or individual who is not a protected individual will be within the discretion of the court. The statutory redemption period will not apply. (See comments on section 43.)

Redemption time

42(1) The time to be fixed for redemption by the order nisi in an action for foreclosure of a mortgage of residential land or farm land and the time to be fixed for redemption by the order for specific performance in an action on an agreement for sale of residential land or farm land shall

(a) in the case of farm land be one year from the date of the granting of the order, and

(b) in the case of residential land be 6 months from the date of the granting of the order.

(2) In an action coming under subsection (1), the Court on application may decrease or extend the period of redemption having regard to the following circumstances:

(a) when the action is in respect of a security on farm land,

(i) the ability of the debtor to pay,

(ii) the value of the land including the improvements made thereon,

(iii) whether the land has been abandoned,

(iv) the nature, extent and value of the security held by the creditor, and

(v) whether the failure to pay was due to hail, frost, drought, agricultural pests or other conditions beyond the control of the debtor;

(b) when the action is in respect of a security on residential land,

(i) the ability of the debtor to pay,

(ii) the value of the land including the improvements made thereon,

(iii) whether the land has been abandoned,

(iv) the nature, extent and value of the security held by the creditor,

(v) the earning capacity of the debtor, and

(vi) whether the debtor's failure to pay was due to temporary or permanent unemployment or other conditions beyond the control of the debtor.

(3) Nothing in this section applies to an order to which the consent of the debtor has been obtained.

Section 42.1 — Vesting Order, etc, without land being offered for sale

1. See Recommendation 28.

2. This section is based on section 42.1 of the Law of Property Act, with two key changes. First, the section applies only in respect of mortgages of residential land and farm land. Second, the section allows the court to award a foreclosure order without the land being offered for sale under section 41(2) were:

   - there has been a sale to a dollar dealer,
   - the owner has abandoned the property, or
   - the value of the land is less than the debt owing under the mortgage.

   The third category is new. It should significantly speed up the process in recessionary time and will also eliminate the posting at the Sheriff's office formerly used in such circumstances. The new section no longer needs to include undeveloped land other than farm land because such land is not residential land or farm land.

Vesting order etc. without land being offered for sale

42.1 Notwithstanding sections 41(2) and 42, in an action brought on a mortgage of residential land or farm land or an agreement for sale of residential land or farm land where

(a) the land is transferred or sold, in the case of a mortgage,

(i) while the mortgage is in default, or

(ii) within 4 months before the mortgage goes into default,

(b) the purchaser's interest in the land is assigned or sold, in the case of an agreement for sale,

(i) while the agreement for sale is in default, or

(ii) within 4 months before the agreement for sale goes into default,

(c) the land is abandoned, or

(d) the value of the land is less than the debt owing under the mortgage or agreement for sale,

the Court may, without the land being first offered for sale under section 41(2), make a vesting order in the case of a mortgage or an order of cancellation in the case of an agreement for sale.

Comments

Section 43(1) — Application of sections 41 and 42

1. See recommendations 3, 4, 5, 11, 13, 30 and 31.

2. This section creates exceptions to the general rule of deficiency judgment protection in respect of mortgages of residential land or farm land that was created by section 41(1). Protection does not arise for anyone in the chain of title that is a corporation or an individual who is not a protected individual.

3. The section also makes section 41(2), 42 and 42.1 inapplicable if the owner of the mortgaged land at the time of default is a corporation or an individual who is not a protected individual. If those sections do not apply, then the court can award any *in rem* remedy it considers appropriate and establish the redemption period, if any, without being bound by section 42.

4. This section critically differs from section 43(1) of the Law of Property Act.

   The existing legislation
   The existing legislation creates deficiency judgment protection in respect of all land mortgages, and then removes that protection in respect of mortgages granted by a corporation. Generally speaking, the protection of a transferee depends upon the identity of the mortgagor.

   The proposed legislation
   Under the new section, there is protection for every owner in the chain of title for the residential land or farm land, but certain owners are excepted. This means that the protection of a transferee does NOT depend upon the identity of the mortgagor.

   Section 43(1.1) emphasizes that the protection provided to a transferee does not depend upon the identity of the mortgagor.

5. A corporation which assumes a mortgage of residential land granted by an individual will be liable on the covenant to pay it gives in an assumption agreement or renewal. An individual who assumes a mortgage of residential land granted by a corporation will be protected by virtue of section 41 as long as that individual is a protected individual.

6. Section 43(1)(c) makes it clear that a lender can enforce any remedy it has against a guarantor of a mortgage of residential land or farm land, even if the guarantor should become a transferee of the mortgaged land.

Application of sections 41 and 42

43(1) Notwithstanding sections 41, 42 and 42.1, nothing limits or derogates from any remedy that a mortgagee or vendor has against

(a) a corporation,

(b) an individual who is not a protected individual

(c) a guarantor or other surety notwithstanding that the guarantor or other surety may become a transferee of the residential land or farm land or an assignee of a purchaser's interest under an agreement for sale of residential land or farm land.

(1.1) The protection provided by sections 41, 42 and 42.1 for:

(a) a transferee of land subject to a mortgage, and

(b) an assignee of a purchaser's interest under an agreement for sale of land

does not depend upon the identity of the mortgagor or the purchaser.

Section 43(2) — National Housing Act exception

1. See Recommendation 20.

2. As discussed in the report, we were divided in opinion as to whether the National Housing Act exception should exist. This issue is left to the Legislature. If the Legislature wishes to retain the section, this subsection must be included. If the Legislature does not wish to retain the section, this subsection should be deleted.

Section 43.1 — Burden of proof

1. See Recommendations 5(c) and (d).

2. Proving a negative is extremely difficult. This is the reason we do not recommend placing the onus on the lender to prove that an individual borrower or transferee is not a protected individual. The onus of proof lies on the borrower or transferee to prove that the residential land was used as a residence or that the farm land was used to carry on farming operations. Yet, the lender must disclose any information it has as to how the land was used. This will prevent a lender from obtaining deficiency judgment where it knows the borrower or transferee is a protected individual, but the protected individual does not come to court to prove this fact.

[**43(2)** Sections 41, 42 and 42.1 do not apply to a mortgage given to secure a loan under the *National Housing Act*, R.S.C. 1952, c. 188, the *National Housing Act*, R.S.C. 1970, c. N-10, or the *National Housing Act*, R.S.C. 1985, c. ....]

Burden of proof

43.1(1) In order for an individual to be given the benefit of sections 41, 42 and 42.1, the onus of proof is on that individual to establish that he or she is not excluded from those benefits by reason of subsection 43(1)(b).

(2) Notwithstanding subsection (1), in an action concerning a mortgage of residential land or farm land or an agreement for sale of residential land or farm land, every affidavit filed in support of an application for an *in personam* judgment or an *in rem* judgment against an individual shall make full and fair disclosure of all material information known to the mortgagee or vendor as to whether the individual is or is not a protected individual.

Section 43.2 — Default during construction

1. See Recommendation 6

2. This section will create deficiency judgment protection for individuals who are building their own home and default prior to completion of construction.

3. This section only applies to a default that occurs during construction. Once construction is complete, sections 41 and 43 govern the situation.

Default during construction

43.2(1) This section applies only in the event of default during construction under a mortgage placed to finance construction of a single-family detached unit, single-family semi-detached unit, or a duplex unit.

(2) An individual shall be deemed to be a protected individual if:

(a) the purpose of a mortgage loan is to provide funds for construction of single-family detached unit, single-family semi-detached unit, or duplex unit for occupancy by the individual or a family member upon completion of construction, and

(b) default under a mortgage occurs during construction of the said unit.

(3) In order for an individual to be given the benefit of subsection (2), the onus of proof is on that individual to establish that he or she or a family member intended to occupy the unit upon completion of construction.

(4) Notwithstanding subsection (3), every affidavit filed in support of an application for an *in personam* judgment or *in rem* judgment against an individual who has defaulted under a mortgage during construction of a single-family detached unit, single-family semi-detached unit or a duplex unit shall make full and fair disclosure of all material information known to the mortgagee as to whether the individual or a family member intended to occupy the unit upon completion of construction.

Comments

Section 43.3 — Protection of transferee from actions for indemnity brought by transferor

1. See Recommendation 14

2. Alberta case law has interpreted section 41 of the Law of Property Act as restricting the rights of lenders only. The section does not prevent a transferor from seeking indemnity from a transferee, even when that transferee is protected by section 41. Assume that a corporate builder grants a mortgage charging residential land. The corporation sells the house to individuals who assume the mortgage and use the land as a residence. Under the proposed legislation, the lender could enforce the covenant to pay given by the corporation in the mortgage, but could not enforce the covenant to pay implied by section 62 of the Land Titles Act on behalf of the transferee. Yet, section 41 and 43 will not affect the corporations ability to seek indemnity from the transferee. Section 43.3 completes the protection for the transferee by prohibiting any action for indemnity the corporate builder could bring in equity or law against the transferee who is a protected individual.

3. If section 43.3 did not exist, the corporation could assign its claim for indemnity to the lender. This would effectively circumvent the protection created by section 41.

Section 43.4 — Section 62 Land Titles Covenant

1. See Recommendation 15

2. This section is designed to create a "jumping section 62 Land Titles Act covenant" in respect of residential land or farm land where the chain of title includes both protected individuals and others. For the purposes of section 62 of the Land Titles Act, protected individuals would be invisible in the chain of title. The result will be that a corporation or individual who is not a protected individual will be deemed, for the purposes of section 62, to transfer the property to the next corporation or individual who is not a protected individual who appears in the chain of title.

Protection of transferee from actions for indemnity brought by transferor

43.3(1) In this section, "covenant for payment" means that portion of the covenant referred to in section 62(1) of the Land Titles Act that comprises one or more of the following:

(a) the covenants referred to in section 41(1)(a) and (b) of this Act;

(b) the obligation that relates to the damages referred to in section 41(1)(c) of this Act;

(c) the indemnification of the transferor from and against the principal sum or other money secured by a mortgage.

(2) No action shall be brought against any protected individual who is a transferee of residential land or farm land that is subject to a mortgage on the basis of

(a) the covenant for payment, or

(b) any obligation that exists at law, in equity or by agreement that is in substance the same as the covenant for payment.

(3) Any purported waiver or release of the rights, benefits or protection under subsections (2) given by a protected individual is against public policy and void.

1984 c24 s2

Section 62 *Land Titles Act* covenant

43.4 For the purposes of section 62 of the Land Titles Act, when

(a) a protected individual is a transferee of residential land or farm land that is subject to a mortgage, and

(b) a corporation or an individual who is not a protected individual becomes a transferee of that land from the protected individual,

the transferee referred to in clause (b) is deemed to be the transferee of the land from the last corporation or individual who is not a protected individual to which that land was transferred prior to the protected individual becoming the transferee of that land.

Section 44 — Order of foreclosure

1. See Recommendation 34

2. This section is the same as section 44 of the Law of Property Act.

Order of foreclosure

44(1) The effect of an order of foreclosure of a mortgage or encumbrance is to vest the title of the land affected thereby in the mortgagee or encumbrancee free from all right and equity of redemption on the part of the owner, mortgagor or encumbrancer or any person claiming through or under him subsequently to the mortgage or encumbrance, and

(a) the order operates as full satisfaction of the debt secured by the mortgage or encumbrance, and

(b) the mortgagee or encumbrancee shall be deemed a transferee of the land and becomes the owner thereof and is entitled to receive a certificate of title for it.

(2) Repealed 1982 c23 s31.

(3) An order nisi may at any time prior to the sale of the mortgaged land under an order for sale or to the granting of a final order for foreclosure, whichever first happens, be relieved against by a postponement of the day fixed for redemption.

(4) When a judge has postponed the day fixed for redemption no appeal lies except on the ground that the discretion of the judge was not exercised judicially.

(5) No order of absolute foreclosure made in an action shall be deemed to deprive any court of any power that the court had immediately before May 17, 1919, to reopen the foreclosure.

RSA 1980 cL-8 s44;1982 c23 s31

Section 45 — Appointment of receiver

1. See Recommendation 27.

2. This section is the same as the existing section 45, with a minor amendment to subsection (9) and the deletion of subsection (10). Subsection 10 becomes unnecessary because "farm land" is defined in section 37.

3. Subsection (8) provides that when an order appointing a receiver is made under the section, then, unless the Court otherwise provides, the proceedings in the action on the mortgage or on the agreement for sale shall be stayed until the receiver is discharged. Subsection 9 now provides that subsection (8) only applies when an action is brought on a mortgage of residential land or farm land or an agreement for sale of residential land or farm land.

Appointment of receiver

45(1) Notwithstanding section 41, after the commencement of an action on

(a) a mortgage of land other than farm land, or

(b) an agreement for sale of land other than farm land,

to enforce or protect the security or rights under the mortgage or the agreement for sale the Court may do one or both of the following:

(c) appoint, with or without security, a receiver to collect rents or profits arising from the land;

(d) empower the receiver to exercise the powers of a receiver and manager.

(1.1) If

(a) a mortgage of land or an agreement for sale referred to in subsection (1) is in default, and

(b) rents or profits are arising out of the land that is subject to that mortgage or agreement for sale,

the Court shall, on application by the mortgagee or vendor, appoint a receiver where the Court considers it just and equitable to do so.

(1.2) Notwithstanding subsections (1) and (1.1), an application to appoint a receiver may be made ex parte if

(a) in the case of a mortgage, the land is transferred or sold

(i) while the mortgage is in default, or

(ii) within 4 months before the mortgage goes into default,

or

(b) in the case of an agreement for sale, the purchaser's interest in the land is assigned or sold

(i) while the agreement for sale is in default, or

(ii) within 4 months before the agreement for sale goes into default.

45(2) The proceeds of rents or profits collected by the receiver, less any fee or disbursements, which may be allowed by the Court to the receiver by way of remuneration, shall be applied

(a) in payment of taxes accruing due or owing on the land in receivership, and

(b) in reduction of the claims of the mortgagee or vendor against the land in receivership.

(3) A receiver appointed pursuant to this section may distrain for rent in arrears in the same manner and with the same right of recovery as a landlord.

(4) On default of the mortgagor or purchaser of the land other than farm land that is in receivership to pay the rents or profits therefrom, the Court may order possession of the land to be delivered up to the receiver and leased by him, on any terms and conditions that the Court considers fit.

(5) The Court may, on application by the receiver, give the receiver further directions from time to time as the circumstances require.

(6) An order appointing a receiver may be discharged by the Court at any time, but the order shall only be discharged on application after notice.

(7) When and so often as the circumstances require, the Court may, without discharging the order appointing the receiver, substitute another person for the person originally appointed by the order appointing a receiver, and the substituted receiver shall perform all the duties and has all the powers given by the order or this section to the person originally appointed.

(8) When an order appointing a receiver is made under this section, then, unless the Court otherwise directs in that order or in a subsequent order, proceedings in the action on the mortgage or on the agreement for sale shall be stayed until the time that the order appointing a receiver is discharged.

(9) Subsection (8) only applies in an action brought on a mortgage of residential land or farm land or an agreement for sale of residential land or farm land.

RSA 1980 cL-8 s45;1983 c97 s2;1984 c24 s5

Comments

Section 46 — Assignments

1. See Recommendation 10

Section 46.1 — Crown Bound

1. See Recommendation 19

2. Our recommendation is that the proposed Part 5 of the Law of Property Act bind the Crown, subject to such exceptions as the Legislature wishes to make. The exceptions, if any, can be made in the acts creating the lending agents of the government or in this section.

Assignments

46 An assignment in writing for a lease or rent given by a mortgagor or by a purchaser under an agreement for sale in favour of a mortgagee or vendor thereof and not being an assignment of the mortgage or agreement for sale itself may be enforced notwithstanding the restrictions contained in section 41.

RSA 1980 cL-8 s46

Crown bound

46.1 The Crown is bound by this Part.

Comments

Section 62 of the Land Titles Act

1. See Recommendation 11

2. This section expands the existing implied covenant between the transferee and the lender to include taxes, insurance premiums and all reasonable sums paid by the mortgagee to maintain or preserve the property.

3. Section 62 must not be read literally because it is a codification of a rule of equity. No covenant arises under subsection (1) unless the transferee would be held in equity bound to indemnify the transferor against the transferor's liability to the mortgagee.

Implied covenants in transfer

62(1) In every instrument transferring land for which a certificate of title has been granted, subject to mortgage or encumbrance, there shall be implied the following covenant by the transferee both with the transferor and the mortgagee: That the transferee will pay the

(a) principal money,

(b) interest,

(c) taxes,

(d) insurance premiums,

(e) all reasonable sums paid by the mortgagee to maintain or preserve the property,

(f) annuity, and

(g) rent charge

if secured by the mortgage or encumbrance, after the rate and at the time specified in the instrument creating it, and will indemnify and keep harmless the transferor from and against the principal sum or other money secured by the instrument and from and against the liability in respect of any of the covenants therein contained or under this Act implied on the part of the transferor.

(2) If a transferee declines to register any such transfer, the transferor or the mortgagee may by notice call on the transferee or such other person or persons as a judge may direct to show cause why it should not be registered, and on the return thereof the judge may order the registration of the transfer within a time named or make any further or other order and on any terms as to costs and otherwise that to him seem proper.

RSA 1980 cL-5 s62

Rule: Rice order procedure

R. 688.1 When considering whether an attempt at public sale should precede sale of land to the lender, the court shall consider all relevant circumstances, including:

(a) the nature of the property,

(b) existence and strength of market for the property and the likelihood that sale to a third party would take place within a reasonable period,

(c) the value of the property,

(d) the quality of the appraisal evidence before the court, and

(e) the difference, if any, in opinion as to value of the land.

Appendix A

List of Commentators

Individuals

Mr. Robert Bishop
Ms. Roberta Black
Mr. Paul Caron
Ms. Peggy Hartman
Mr. Paul Kader
Mr. Ian Logan
Mr. Philip Matkin
Mr. Fred Mitchell
Mr. Dennis Pawlowski
Mr. Frank Shane
Mr. Lorne Smart
Mr. Grant Sprague

Organizations and Groups

Alberta Treasury Branches
Canada Mortgage and Housing Corporation (Alberta)
Various Members of the Creditors' Rights Subsection (Canadian Bar Association—Northern Alberta)
Group of Individuals consisting of Robert Curtis, E. Mirth, Q.C., Dennis Pawlowski, and Cheryl Sanford
Mortgage Loans Association of Alberta
The Canadian Bankers' Association

Note: Most commentators made written submissions, but a few gave their comments verbally.

Appendix B

Comparison of Legal Fees

The information we have obtained in respect of fee comparisons is as follows:

1. CMHC was unable to provide a comparison of legal fees but did report as follows:[1]

> An analysis and comparison of the costs of existing mortgage remedies, by jurisdiction, has not been undertaken by CMHC. However, it is believed that the costs in Alberta are generally comparable with other provinces. This appears to be evident by the NHA Approved Lenders' acceptance of the maximum legal costs agreed to for various actions in common law provinces, for single account claims, under a new claim settlement method recently introduced by CMHC.

2. CIBC Mortgage Corporation advises that the fees charged in Ontario and Alberta in respect of residential properties were typically in the 2000 to 2500 range.[2] It also gave a historical picture of cost comparisons. In 1983, CMHC became concerned by the increasing fees charged by Alberta lawyers and took steps to reverse this trend. In time the difference between Ontario fees and Alberta fees charged for simple residential property situation became small. Yet, recently Alberta fees have begun to increase.

3. The Bank of Montreal reported:[3]

> Generally speaking, the costs of a foreclosure action in Alberta can range from $2,500 - $4,000, including disbursements. The occasional account has exceeded $5,000 in unusual circumstances. We are advised that a foreclosure action in Ontario would average $5,000 - $6,000 and a Power of Sale auction would average approximately $3,500, including disbursements.

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1 Letter dated April 23, 1993.

2 Conversation with Bill Burns, June 14, 1993.

3 Letter from D.E. Gidlow, Vice-President, Credit, Western Canada dated July 26, 1993.

4. Scotiabank provided a detailed comparison of fees paid in respect of foreclosures.[4] The following table summarizes the fees paid for the base fee and subsequent attendances. The fees do not include disbursements.

Province	Quit Claim	Foreclosure	Power of sale (without auction)	Power of sale (with auction)
Alberta	525	2925		
Manitoba	525	2400		
Ontario	525		1200	1300
Saskatchewan	525	2600		

It is interesting to note that the Scotiabank saw no need to go to a power of sale regime in Alberta. "The present powers of foreclosure are considered sufficient to sell property within a reasonable time frame."[5] Query whether the fees for power of sale include an action for deficiency judgment?

5. Mortgage Insurance Company of Canada ("MICC") advises as follows:[6]

> Generally, the cost of exercising mortgage remedies is not the main issue in determining the acceptability of a market to do business in. Most jurisdictions recognize the need for quick recourse where defaults occur and there is clearly no equity remaining. In this regard, we feel Alberta is in the middle of a spectrum which ranges from nine to eighteen months from the date of default to claims settlement. Fees and costs related to the legal process are similar to other provinces.

MICC does not keep records of average fees paid in each province, but Patti Stapleton, Manager of Residential Claims for MICC did provide details of 24 claim settlements. These accounts were randomly selected out of a list of 1989\1990 settlements involving residential properties. In most

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4 Letter of March 1, 1993 from R.A. Connolly, Vice-President, Credit, Scotiabank to Canadian Bankers' Association.

5 Letter of March 1, 1993 from R.A. Connolly to Esther Anderson of Canadian Banker's Association.

6 Letter of November 12, 1993 from MICC to Mortgage Loans Association of Alberta, which was provided to us by the Association. This information confirms oral presentations made by officers of MICC to Institute counsel.

of these accounts, MICC obtained sale to a third party and, where available, judgment for costs. The fees vary depending upon the complexity of the file. The redemption period varies in each case with the exception of Ontario where it is always 42-45 days. The fees quoted include lawyers time and disbursements, but do not include realtors commissions or the Ontario land transfer tax.

The results of this comparison are summarized in the following table.

Province	**Average fees and disbursements**	**Average Redemption period**
Alberta	2,259.00	3.2 months
B.C.	2,471.49	2.86 months
Manitoba	2,262.41	30 days
Ontario	2,696.00 (power of sale)	42 to 45 days
Saskatchewan	2,649.93	2.6 months