ALBERTA LAW REFORM INSTITUTE

MORTGAGE REMEDIES IN ALBERTA

Report For Discussion No. 9

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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 for discussion has been produced in two stages. The preliminary work was done by Grant Hammond when he was with the Institute. A fairly broad consultative group was set up to discuss possible solutions and policy issues. The members of that committee are set out in chapter one. The second stage occurred after Mr. Hammond's return to New Zealand when the project was assigned to Janice Henderson-Lypkie, who has carried the project through to its current stage in the last 18 months.

Janice Henderson-Lypkie has updated the work which was done previously. Her organised research and presentation of policy issues has greatly assisted the Board in its consideration of this area. It has also been extremely helpful, both to counsel and the Board, to have had the benefit of the advice of the Project Committee, in particular, Michael J. Penny and H.J. Lyndon Irwin. In addition, we have benefitted from the comments of Eric Spink who joined the Institute as Counsel in the Fall of 1990.

There are many other people who have been consulted on an informal basis or whose views have been sought with respect to parts of the report. All of these people have improved the scope and quality of the report.

INVITATION TO COMMENT

This Report for Discussion sets out the Institute's tentative views for discussion and comment. The Institute will reconsider its views and prepare its final report and recommendations in light of comments received.

Comments should be in the Institute's hands by December 16, 1991. Comments in writing are preferred. Oral comments may be made to Janice Henderson-Lypkie. Her telephone number is (403) 492-1798.

MORTGAGE REMEDIES IN ALBERTA

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PART I — SUMMARY

Scope of This Report

This report is restricted to a consideration of mortgages over 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

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 is protected for a limited time. 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. 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. One thing is clear. Since 1939, Alberta has espoused a "hearth and home" philosophy by protecting home owners and farmers from deficiency judgments. This policy has been maintained through two depressions, war, economic boom and so on.

Recommendations for Reform

The General Direction of Reform

Alberta has three options to consider when designing mortgage remedies law. First, it could move to a privatized Ontario-style solution so that the private power of sale becomes the primary remedy. This option could also include allowing the lender to obtain a deficiency judgment, although the private power of sale and deficiency judgment provisions need not be congruent. Second, Alberta could simply retain the present law. Third, Alberta could retain the hearth and home philosophy, but do something to rationalize and improve the law.

We believe that the choice between these options is political. What clearly is at issue is preferring some interests over other competing interests. The values involved on both sides are legitimate: protection of borrowers on one hand and adequate supply of credit at a reasonable cost on the other. Given the traditional "hearth and home" philosophy followed in Alberta since 1939, we think the onus is on those who want a fundamental change to show that the existing philosophy harms essential Alberta interests. In our study we have not seen any evidence that this is the case. We are left with the view that the Institute's role in this study should be to show how things might be improved within the present broad policy of the day.

Recommendations — substance

1. Judicial Supervision of Foreclosure Actions: Alberta should 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. 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: Alberta should create deficiency judgment protection for each individual borrower who grants a mortgage charging residential land or farm land. The terms "residential land" and "farm land" would be defined by statute. Protection would not depend on the use made of the property. An individual borrower who grants a mortgage of residential land should be protected whether or not the individual resides on the property. An individual who grants a mortgage of farm land should be protected even if someone else carries on the farming operation. No individual borrower who grants a mortgage charging commercial or industrial land should be protected from an action on the covenant to pay given in the mortgage. Also, no corporate borrowers should be protected.

Lenders should be prohibited from suing transferees on any covenant of payment where the transferee is an individual and the mortgage charges residential land or farm land. As with individual borrowers, there would be no requirement that the transferee must reside on the residential land or personally carry on a farming operation on the farm land. No corporate transferee would be protected from deficiency judgment.

Even though a lender might be unable to sue the individual borrower on a covenant of payment, a lender would still be able to enforce collateral securities and guarantees.

We believe that the legislation creating deficiency judgment protection should apply to the Crown in right of Alberta and, if possible, the Crown in right of Canada. Also, there should be no exception for mortgages given to secure a loan made or insured under the *National Housing Act*. The individual borrowers who have high ratio mortgages that charge residential land are the individuals who need deficiency judgment protection the most.

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, all reasonable sums paid by the lender to maintain or preserve the property, and costs. These sums would be payable at the rate and at the time specified in the mortgage.

4. Attornment Clauses: Any attornment clause found in a mortgage charging residential land or farm land should be unenforceable against the individual borrower. 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: We believe that the existing law on the enforcement of due-on-sale clauses in Alberta is reasonable and should remain as it is at present.

Recommendations — procedure

We discuss the advantages and disadvantages of the Rice order procedure that was extensively used in Alberta in the 1980s. 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. Certain safeguards must be put in place to ensure that the lender purchases the mortgaged land for a fair price. Exposure to a wide market is one such safeguard. Therefore, we recommend that in most cases the court attempt to sell the land to the public before entertaining the lender's offer to purchase the land.

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 and discuss the matter of transition.

CHAPTER 1 — INTRODUCTION

A. Purpose and Scope of Report

1.1 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) and, in the event that repayment is not made or the terms of the loan are not otherwise adhered to, the lender may then have recourse to the land to recoup whatever monies are owing. Technically there can be, and are, mortgages of property other than land, but this report is restricted to a consideration of mortgages over land in Alberta, and the remedies that the law makes available to both lender and borrower in the event of a default under such a mortgage.

1.2 *Any* scheme of remedies for default under a mortgage raises formidable difficulties. The scheme should reflect sound social and economic policies within the particular jurisdiction, be even-handed as between borrower and lender, and, within the constraints imposed by such requirements, be expeditious and efficient. These objectives are easily stated, but historically their attainment has proved difficult in all the common law jurisdictions.

1.3 In this report we have undertaken two tasks. First, we review the existing Alberta law and practice in this subject area. Second, we then recommend certain changes which we think could usefully be made to that body of law to better attain the foregoing objectives.

1.4 In general, therefore, this report is concerned primarily with what lawyers term "adjectival" law rather than "substantive" law. Nevertheless, it is neither possible nor desirable that we should altogether avoid some matters of policy and substantive law. For instance, whether the lender is to be prevented, with respect to some or all classes of mortgage, from enforcing the borrower's personal covenant to pay if there is a deficiency on sale of the mortgaged property, is a question which raises fundamental issues of policy and substantive law which must necessarily be resolved in any report of this kind. Moreover, the terms "substance" and "procedure" are merely terms of classificatory convenience. There is no hard and fast line between these two categories.

1.5 There may be some members of the Bar, and perhaps the public, in Alberta who would have preferred a full scale review, and perhaps even a codification, of *all* mortgage law and practice in Alberta. Such a large scale exercise has not been undertaken for two reasons. First, the Institute has not the present resources to undertake an exercise of that character at this time (at least without diverting resources from other equally pressing subject areas). Second, there must, in light of developments in mortgage law in all jurisdictions in the last half century, be a real question as to whether codification in the true sense would be achievable in this subject area.

1.6 There may also be some concern that this report does not deal with the closely related subject of the use of agreements for sale as security devices. Our reasons for not dealing with this subject area *at this time* are these. First, as presently advised, it seems that the agreement for sale is used only infrequently as a financing device in Alberta. Mortgage default remedies and procedures, on the other hand, present a clear and present problem. Second, there is again a resource problem. The additional resources required to adequately research the large subject area of agreements for sale are not presently available. We do, however, at some later point of time propose to undertake a review of the law with respect to remedies for default on agreements. It may be that ultimately we will recommend that the remedies and procedure be the same in each case, or we may take the view that some aspects of the law relating to money defaults on agreements for sale should be treated in a different manner from that pertaining to mortgages.

B. The Form of the Report

1.7 This is not a final report. It is a tentative set of conclusions accompanied by certain recommendations. The Institute's purpose in issuing a Report for Discussion at this time is to allow interested persons the opportunity to consider these conclusions and proposals and make their views known to the Institute. Any comments sent to the Institute will be considered when the Institute determines what final recommendations, if any, it will make to the Attorney-General for Alberta.

1.8 It is just as important for interested persons to advise the Institute that they approve the proposals as it is to advise the Institute that they object to them, or that the proposals need to be revised in whole or in part. The Institute often substantially revises tentative conclusions as a result of comments it receives. The proposals have not been adopted, even provisionally, by the Alberta

Government.

C. Acknowledgements

1.9 In the development of this report we have had two stages of consultation with practising members of the bar. Grant Hammond was grateful to have the assistance of Mr. E. Mirth, Q.C., Ms. Marguerite Trussler (now Madame Justice Trussler), Mr. H.J.L. Irwin, Mr. J.D. Merrett, Mr. I. Karl Gurevitch, Mr. Francis Price, Mr. Clark Dalton, Mr. K.B. Payne, and Mr. W.E. Wilson, Q.C (now Mr. Justice Wilson). Janice Henderson-Lypkie was grateful to have the assistance of Mr. H.J.L. Irwin and Mr. Michael J. Penny. The assistance and input of each practitioner is greatly appreciated.

D. Terminology

1.10 In an effort to make this report understandable to individuals who do not have legal training, we have deviated from the traditional legal 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. In this report, the term "borrower" is interchangeable with mortgagor and the term "lender" is interchangeable with mortgagee. Most of the legal writings in this area use the terms mortgagor and mortgagee. Expect to see these terms used in the quotations referred to throughout the report.

1.11 We have also adopted the terms "transferor", "transferee", and "deficiency judgment". The transferor is the person who sells the land that is charged by the mortgage. The transferor can be the mortgagor or some subsequent owner. The transferee is the person who purchases the 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 this amount.

CHAPTER 2 — THE GENERAL NATURE OF THE PROBLEM

A. Introduction

2.1 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]

2.2 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.

B. The Pendulum Phenomenon

2.3 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,

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

apparently, that if a mortgage can be foreclosed promptly and efficiently without opportunities for borrowers to cause delays or become a nuisance value, then lenders will be even more fair and lenient, and the supply of credit will be less inhibited.

2.4 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 controlled conditions.

2.5 This tug of war between a viewpoint that sees a mortgage as a purely commercial transaction, on the one hand, and 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 some degree of self-interest, 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.

2.6 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 problem of finding a universal solution.

C. Second Level Problems

2.7 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 a mortgaged property? 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?

2.8 The answers given to these questions have also varied from jurisdiction to jurisdiction. This world wide 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

2.9 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

2.10 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

2.11 Throughout the history of mortgage law there has been a concern that there should not be unconscionable excess judgments against the borrower. The fundamental concern appears to be that careful lenders make an advance to be secured against real property on the footing of, first, a proper assessment of the present value of that property, and, second, a consideration of the likelihood that the particular borrower will honour an obligation to repay the advance (sometimes referred to as a review of the "general credit-worthiness" of the borrower).

2.12 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 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.

2.13 On what criteria should the choice between these alternatives turn? This is a question to which we will return in detail later in this report, but a preliminary indication of the issues may be useful here. The professional literature is strangely silent and unhelpful on this issue. Without attempting to resolve the matter at this time, we offer the following considerations which seem to us to be relevant. First, who is in a better position to pay? Most lenders are institutional lenders which are presumably the best available loss bearers in society (outside government) and can reallocate those losses on a society wide basis. Second, the civil law in general offers to a defaulting party a reasonable prospect of financial rehabilitation. Bankruptcy law enables a debtor, after reasonable efforts have been made for payment of accumulated debts, to secure a discharge from bankruptcy. One of the legal consequences of such a discharge is that the former debts of the discharged person are no longer enforceable. The bankrupt is made financially whole again. Thus, it may be argued, the law should be consistent and extend the same sort of opportunity for financial rehabilitation to the defaulting borrower as it does to other debtors. Is further protection necessary?

(3) The Importance of Adequate Transitional Arrangements

2.14 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

2.15 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. Also, the manner of sale should be such so as to realize the highest possible price for the land by whatever procedure is most likely to be effective in the particular case.

2.16 Thus, designers of systems of mortgage remedies have taken some pains to ensure that, whatever restrictions there may be on the exercise of a lenders right to sell, the sale itself should be legally protected and incontrovertible.

(5) The Reduction of Costs

2.17 Both when a mortgage document is drawn up, and in foreclosure proceedings, the costs of that "transaction" fall to the borrower or his 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 against 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

2.18 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.

2.19 Thus, 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.

E. Conclusion

2.20 Every jurisdiction has, in designing its mortgage laws, 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) that when a sale or foreclosure is required in the event of default there be adequate protection of the borrower and security of sales; and

(iv) that, in the interests of all parties, whatever default procedures are adopted should, consistent with the foregoing objectives, be as well understood and efficient a process as can be devised.

2.21 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. 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

3.1 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 North West 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 four.

B. Mortgages at Common Law

3.2 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 his 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.

3.3 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

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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.

left naked. Lenders' "remedies" attained the highest order of, but harshest, efficiency they were ever to enjoy.

3.4 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

3.5 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.

3.6 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 effected payment of 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".

3.7 This further reversal of the position of borrowers and lenders was not accomplished by equity judges without much of the rancour which still attends the attempted 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 favor owing to the rigid character of the common law and

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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.

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

> 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.

3.8 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).

3.9 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 lender. 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.

3.10 The fact that these two remedies came into being in and 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 amongst these remedies, which is to be exercised first? It is not necessary to outline the answers the courts gave to these questions here. 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 *inter se*.[8]

3.11 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.

3.12 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.

3.13 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.

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

3.15 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

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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.* [1984] 4 W.W.R. 587, 54 A.R. 172 (C.A.).

philosophy differ from jurisdiction to jurisdiction. Canadian jurisdictions have begun to evolve their own distinctive systems.

D. Legislation and Procedure in the Northwest Territories

3.16 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.

3.17 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.

3.18 One of the principle concerns in any newly settled jurisdiction is the establishment of a suitable system of title to land. In 1886 Canada enacted *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 not to operate as a transfer of the property.

3.19 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

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[10]R.S.C. (1886), c. 50, s. 11.
[11]S.C. 1872, c. 23.
[12]S.C. 1886, c. 26.
[13]S.C. 1894, c. 28.

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 public notice offering the land for sale again being given 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 personal covenant, thereby, leaving that matter to be governed by the general law.[20]

3.20 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, came legislation that made judicial supervision of the enforcement process mandatory. The lender could no longer sell the land.[21]

3.21 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

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[14] *Ibid.* s. 75.
[15] *Ibid*. s. 74.
[16] *Ibid.* s. 75.
[17] *Ibid*. s. 75.
[18] *Ibid.* ss 75 and 76.
[19] *Ibid.* s. 77.
[20] By virtue of ss 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.

rational legislator could refuse to enact it. The subsequent history of Alberta mortgage law has been one of piece-meal modification to the basic pattern established almost a century ago.

E. Alberta Legislation (To World War I)

3.22 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]

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

3.24 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]

3.25 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]

3.26 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

[22]S.C. 1905, c. 3, s. 16.
[23]McGregor, *A History of Alberta* (Edmonton: Hurtig, 1981), at 206.
[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 .
[28]See e.g. *Sun Life Assurance Co.* v. *Widmer* (1916) 9 W.W.R. 961, 963 per

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]

3.27 In 1914 Alberta passed a *Foreclosure and Sale Act*.[30] It is not now clear exactly what motivated this legislation, though to the extent that it purported to make foreclosures more expeditious it was perhaps the kind of legislation which might have been anticipated in the highly expansionary, "boom" economy which then prevailed in the province.

3.28 Under the Act, proceedings could be commenced by filing a notice of default in the Land 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 taste of what was to become a succession of constitutional set backs to Alberta mortgage legislation.

F. World War I to the Depression

3.29 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] (emphasis added). 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

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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.

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

[32]S.A. 1915, c. 3.

[33]*Ibid.* s. 2 – 62a(6).

thereto".[34]

3.30 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]

3.31 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]

3.32 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.

3.33 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.

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[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.
[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.

3.34 This left lending agencies in something of a quandary. They were faced with an election between 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.

3.35 This set the stage for the *Sayre* case 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 (2-1) and restored the Master's ruling.[43] In the Supreme Court of Canada the judges split 3-3, thereby, leaving the Court of Appeal ruling intact.[44] The judges who upheld the appeal appear to have done so in large part on the grounds of non-interference with provincial practice whereas the "dissenters" would, on the merits, have allowed the appeal. 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.

3.36 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 by confirming 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, and if the court approved the proposal, have both the property and subsequently, where so permitted, a deficiency judgment.[45] 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.

3.37 In fairness to those judges who arrived at this result—and who have also 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]*Trusts and Guarantee Company Limited* v. *Rice* [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

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.

3.38 During the economic difficulties caused by the post World War I deflation, the government also passed certain moratoria legislation, which also 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 repealed by the Legislature in the same year.

G. The Great Depression and World War II

3.39 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 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.

Wrong?" [1984] 22 Alta. L.R. 273. For a review of the general procedure adopted in Alberta 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).

3.40 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]

3.41 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.[56] The wheel had turned full circle from World War I.

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

3.42 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 and vendors. 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 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]

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

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[52]See Hogg, *supra*, note ; Mallory, *ibid*.
[53]*The Judicature Amendment Act, 1932*, S.A. 1932, c. 22.
[54]*The Judicature Amendment Act, 1942*, S.A. 1942, c. 37.
[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.
[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.

3.44 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 had much troubled the profession and set the stage for the well-known *Superstein* case.[62]

3.45 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 recourse 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 somehow destroy the borrower's covenant; it merely prevented action on it. That prohibition in turn did not extend to action against the guarantor.

3.46 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 home owner's protection was not going to be watered down: a waiver of the limitations in the 1939 statute 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?

3.47 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

[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.

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

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*.

3.48 Some other kinds of dealings, however, had the potential to give rise to some real difficulties. Many individual home owners assume corporate builders mortgages on "spec" houses, and those homebuyers potentially (and sometimes unwittingly) exposed themselves to personal liability in so doing. 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. In the first place, there were not many defaults and on a sharply rising market the owner could usually readily sell the property if financial difficulties did arise. In the second place, the real concern of lenders was with "spec" builders who defaulted *themselves* or where the sale by the builder was made to a purchaser who really should not have been approved, or who had exhibited some fraud or misrepresentation. Thus, the law under this head was selectively applied and rarely (if at all) against honest purchasers of "spec" 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.

3.49 One other feature of the post Second World War housing market 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.

3.50 In 1945, the Legislature enacted a *National Housing Loans Act* (Alta.),[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

[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

to determine. 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 the exemption was not granted, and Alberta put on a footing with the other Canadian jurisdictions (at least with respect to loans of this kind), National Housing Loans might not have been made available.

3.51 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] 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* (Alta.)[71] provides that an enactment is not binding on the Crown unless that enactment expressly states that it *shall* be binding.

3.52 It has been held, in the case of the Alberta Agricultural Development Corporation, that that corporation, insofar as it is an agent of the Crown by virtue of section 3(1) of the *Agricultural Development Act* is not bound by sections 41 and 42 of the *Law of Property Act*.[72] For many years, the profession accepted that this reasoning also applies to the Alberta Home Mortgage Corporation (now Alberta Mortgage and Housing Corporation), since that Corporation's enabling Act also treats it, for all purposes, as an agent of the Crown. However, in the late 1980s the Alberta Court of Appeal held that Alberta Mortgage and Housing Corporation is bound by sections 41 and 42 of the *Law of Property Act*.[73] As will be discussed in chapter four, a recent 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.[74]

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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.

[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]*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.

[74]See *Alberta Government Telephones* v. *Canadian Radio-Television and Telecommunications Commission* [1989] 2 S.C.R. 225 and the discussion at

3.53 It seems, therefore, that there is some emerging judicial reluctance to allow actions on the covenant even in the face of accepted practice, and that at least some Alberta judges and Masters are prepared to interpret the legislation in a way which will cut down what was generally thought to be the legislative intention.

3.54 The net result was, therefore, that by the 1970s Alberta law had reached the position where the personal covenant was enforceable against corporate mortgages, and more doubtfully,[75] against private home owners where the government sponsored lending and guarantee agencies were involved. Persons who assumed builders mortgages could also attract personal liability. Collateral guarantees were enforceable on any mortgage. The only situations where personal liability could not be enforced were with respect to non-corporate urban and farm mortgages.

3.55 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 and the Legislative Response

3.56 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)*[76] to section 43(2) of the *Law of Property Act*.

3.57 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

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paras. 4.15-4.27 of this report.

[75]See para. 3.52.

[76]R.S.A. 1970, c. 255.

moratoria legislation.

3.58 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 home owner 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) home owner attempted to preserve his 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 home owners found that their equity had, in many cases, disappeared, some became "walk-aways"—that is, persons who abandoned their homes, again secure in the knowledge that action could not be taken against them on the covenant.

3.59 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, any corporate mortgages assumed by individuals would have received the 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.

3.60 At the Fall 1983 Sitting of the Legislature Bill 109 was introduced. 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.

3.61 Essentially what the Legislature was concerned with in Bill 109 was to protect the person 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. Homes and farms, in other words, were to be seen as part of a general philosophy of protection of hearth and home. 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.

3.62 Bill 109 underwent considerable modifications during its gestation

and passage into law.[77] 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.

3.63 First, some terminological changes were introduced. For instance, the term "urban land" disappeared, and the terms "farm land" and "residential land" were introduced. Second, it was expressly provided that an individual transferee of land subject to a corporate mortgage would have the protection of section 41.[78] Third, in certain situations the Bill removed the legislative shield against an action on the covenant expressly or impliedly given by the individual transferee. In the case of residential land, the legislative shield 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".[79] In the case of farm land, the legislative shield 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".[80] Fourth, it was provided that where section 41 does protect the individual transferee who buys land charged by a corporate mortgage, then no action shall be brought against the individual on any covenant for payment, whether that covenant arises by virtue of section 62 of the *Land Titles Act*, or is a covenant referred to in section 41(1)(b). Also, the transferor was prohibited from seeking indemnity from the individual transferee. Guarantors were to remain liable, notwithstanding that they might become a transferee of the land. Fifth, 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

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

[78]S.A. 1983, c. 97, s. 2(4).

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

[80]*Ibid.* [43.4(3)].

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.

3.64 Two general observations might be made on this legislation at this point. First, at the operational level the amendments are extraordinarily complex. Practitioners have already 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 stand by a hearth and home philosophy.

3.65 In the spring of 1984 the Legislature also enacted the *Law of Property Amendment Act*,[81] which had two broad objectives.[82] First, it attempted to cure certain problems arising out of the Bill 109. Second, it sought to curtail the activities of dollar dealers.

3.66 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 his interest.

3.67 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 sale step in the whole remedial process could be avoided, thereby, substantially reducing the time-frame required to effect a foreclosure proper. The practical result, it was thought, would be to make the dollar dealers activities financially much less attractive to such entrepreneurs and yet leave 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

3.68 Throughout this period the Masters and Justices of the Court of Queen's Bench, and the Court of Appeal were called upon to rule upon literally

[81]S.A. 1984, c. 24.

[82]See *Alberta Hansard*, May 22, 1984, at 983.

thousands of court applications. Many of these applications involved practice points of some procedural nicety which ended up in the law reports. Others involved matters of real 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 is likely to set the framework for lenders' remedies for the foreseeable future, unless the Legislature deliberately intervenes.

3.69 This case is *Canada Permanent Trust Co.* v. *King Art Developments Ltd.*[83] 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.

3.70 Mr. Justice Laycraft, for the majority in the Court of Appeal, thought there were four issues, which he expressed thus:[84]

> 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 on the

[83][1984] 4 W.W.R. 587; 32 Alta. L.R. (2d) 1. All future page references will be to the Western Weekly Reports citation.
[84]*Ibid*. at 629.

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?

3.71 The majority appear to have answered these questions as follows:

(1) As a matter of 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) The lender who purchases at a court-conducted sale is not in the same position as a lender who forecloses. In the former case, the lender 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 this 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 Court noted that 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 bidding at a sale by tender. The Court was clearly minded to keep the procedures as flexible as possible. The object, as the Court saw it, 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 in issue, the court canvassed the difficult notions of "forced sale" and "forced sale on terms" which appraisers (and Masters) had been using in foreclosure actions. The court

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. As to whether a "sale" under a Rice order should be at market or some other value, the court appears to have treated that issue as one of discretion in the particular case.

(6) As to the relationship between remedies the Court held that a lender can take judgment and execute on the personal covenant (where he or she can lawfully do so) without first selling the land.

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

3.72 Justice Moir, in an extensive dissenting opinion, 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 *inter se*.

3.73 The majority judgment in *King Art* has resolved some matters but opened up others. First, the Court of Appeal clearly favoured a high degree of discretion in the conduct of sales. How the Masters, in the daily exercise of that discretion, will in fact exercise it seems still to be a relatively open question. 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?

K. Conclusion

3.74 Is it possible to draw any general conclusions or issues for law reform purposes from this attenuated survey of a very complex body of

[85] R.S.C. 1985, c. I-15.

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 all that 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 home owner 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, may be open to genuine debate, since some elements of all these factors can be found in the debates which have engaged legislators 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 to 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 home owner 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 need for clarity and simplicity. 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

4.1 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 five a consideration of the operational effectiveness of this body of law, and to chapter seven and eight our suggestions for law reform.

B. Remedies Available to the Lender

(1) General

4.2 When a mortgage goes into default, 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 his remedies concurrently in one action.[87] It should be noted at this point that the term "foreclosure action" is commonly used to describe such proceedings, notwithstanding 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]

(2) Action on the Covenant for Payment

(a) The general restriction

4.3 As discussed in chapter three 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

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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 at 393.

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 the remedy by way of a personal judgment against the borrower or a transferee. Thus, where a guarantee has been given as collateral security for a mortgage debt, the guarantor may still be liable under the guarantee, notwithstanding that 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)

4.4 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

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

[90]S. 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.

[92]*Credit Foncier Franco-Canadien* v. *Edmonton Airport Hotel Co. Ltd. and Superstein*, *supra*, note , as interpreted in *Telford* v. *Holt* [1987] 6 W.W.R. 385 (S.C.C.).

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]

4.5 For example, assume a borrower secures payment of the loan by giving his creditor 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]

4.6 Contrast this to the situation where a lender lends $100,000 to a borrower largely in reliance on his 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 the land mortgage was partial security only. It was a personal loan with land mortgage as partial security.[95]

4.7 In essence, the court must determine if 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

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[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.

[95]This is the hypothetical scenario discussed in *Clayborn Investments Ltd.* v. *Wiegert*, *supra*, note 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.).

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

for payment of that debt.[97]

4.8 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

4.9 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:

(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

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[97] *Clayborn Investments Ltd.* v. *Wiegert*, *supra*, note 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.

[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] *Wainright 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.

4.10 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 he or she 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 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

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[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 ; followed in *Merit Mtge. Group* v. *Sicoli, supra*, note ; *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.).

[104]*C.I.B.C.* V. *Andrejcsik, supra*, note , *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 , *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.).

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

[106]*Ibid.*

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

mortgages.[108]

(d) Exceptions to the general restriction

4.11 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*

4.12 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 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

4.13 These are specifically excluded from section 41 protection by section 43(1)(b) of the *Law of Property Act*[110] (which also removes section 42 protection from these mortgages). 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 three, recent amendments to the *Law of Property Act*[113] have, with certain limitations, restored

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[108]*Francois* v. *Vanderputt, supra*, note .

[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 s. 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 s. 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, s. 2(4) and (5) which enacted ss 43(1.1), (1.2) and (3) and 43.1 to 43.4 of the

protection to such individuals. Under the present legislation, where land has been transferred to an individual subject to a conventional mortgage granted by a corporation, and that individual or any member of his family has used the land as a *bona fide* residence or for carrying on *bona fide* farming operations at any time during which the individual was a registered owner of the land, section 41 applies to that individual to the same extent as if he or she had granted the mortgage.[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.

4.14 Individuals who renew mortgages granted by a corporation 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 of Renewals.

(iii) Mortgages granted to the Crown

4.15 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

Law of Property Act.

[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

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

4.16 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. *Murry*[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.

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

(a) expressly binding words

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and Conveyances. The other 7 parts of the Act do not contain a similar provision.

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

[119]*Supra*, note .

[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 at 286.

[123]*Supra*, note .

[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".

(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.

4.18 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.

4.19 The Court agreed that there was some ambiguity in the *R.* v. *Murry* case. 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.

4.20 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 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*.

4.21 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

[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 1012.

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.

4.22 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 of the *Law of Property Act* is not *wholly* frustrated if the Crown in not bound. Part 5 of the *Law of Property Act* 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.

4.23 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 of the *Law of Property Act*. 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 of the *Law of Property Act*. 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 his 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*.[127] 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).[128] 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).

4.24 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

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[127](15 & 16 Vict.) c. 86, s. 48.

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

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 sections was to protect the interests of the borrower. Subsection (1) protects against deficiency judgments and subsection (2) protects the borrowers equity in the property. The sections operate together to afford protection to borrowers. Therefore, if the lender relies on section 41(2) he or she 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.

4.25 If the Crown 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 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.

4.26 The Crown can also claim immunity from the operation of the *Interest Act*,[129] which limits the rate of post-judgment interest to 5% in the western provinces. 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.*[130] and *Provincial Treasurer of Alberta* v. *J. Woycenko & Sons Contracting Ltd.*[131] 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*.[132] Thus, these lenders should now be able to recover interest on deficiency judgments at the mortgage rate when the terms of the mortgage have so provided.

4.27 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

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[129]R.S.C. 1985, c. I-15, s. 12.

[130](1985) 36 Alta. L.R. (2d) 204 (Q.B.).

[131](1986) 73 A.R. 229 (M.C.).

[132]*J. Woyencko & Sons Contracting Ltd.* v. *Provincial Treasurer of Alberta* (1990) 105 A.R. 159 (C.A.).

pronouncement. As of 31 July 1990 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*. Recent 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*[133] 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*[134] 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*

[133](9 Nov. 1989) Appeal # 8903-0694-AC (Alta. C.A.).
[134](1990) 73 Alta. L.R. (2d) 293 (C.A.).

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 *Woyencko* case.

(e) Liability under the covenant when action not barred

4.28 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 he or she 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.[135] Further, the claim for the deficiency need not be brought in the judicial district in which the mortgaged land is located, as it is merely a claim in debt separate from the proceedings on the mortgage security itself.[136] The lender may pursue his claim on the covenant contemporaneously with the proceedings against the land; the lender is not required to wait until the land has been sold.[137] Until recently, the standard practice was for the lender to apply for judgment on the personal covenant (and/or against guarantors) at the same time as the lender applied for the order nisi/order for sale. Execution on the judgment would usually be stayed until after the sale, when the amount of any deficiency could be ascertained. In *Canada Perm. Trust Co.* v. *King Art Dev. Ltd. (No. 2)*,[138] however, it was held that in Alberta the *Interest Act* limited interest on judgments to 5%, even though that the mortgage itself called for post-judgment interest at a higher rate. Following this decision, the lender may well choose to postpone applying for judgment until the end of the foreclosure action.

4.29 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 him or her or if the terms of the mortgage are sufficiently altered by the

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

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

[137]*Humble Investments Ltd.* v. *Therevan Development Corp.* (1982) 21 Alta. L.R. (2d) 40 (M.C.).

[138]*Supra*, note .

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.[139]

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

4.30 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.

4.31 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.

4.32 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.[140] 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 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

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[139] *Killips* v. *Leroda Management Ltd.* (1985) 63 A.R. 352 (Q.B.).

[140] Manitoba, however, has a provision similar to Alberta's s. 62(1). See *Real Property Act*, R.S.M. 1980, c. R-30, s. 75. British Columbia has a provision which is differently worded, but which brings about the same implied covenant. See the *Property Law Act*, R.S.B.C. 1979, c. 340, s. 20.1(3) and (4).

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.[141]

4.33 To correctly interpret section 62, one must understand the law that existed before 1886.[142] 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".[143] 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, he or she had to obtain an assignment of the vendor's right to indemnity and pursue that cause of action.

4.34 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.[144] The section did not create new personal liability for the transferee; it created a more direct route for the lender to enforce existing liability.[145] 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.[146]

4.35 There are many situations in which the transferee is not bound in equity to indemnify the transferor against his personal liability to the lender and, therefore, no covenant arises under section 62 between the lender and the transferee.[147] This is so even though a literal interpretation of the section suggests

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[141]See Price and Trussler, *supra*, note at 157-58.

[142]*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. 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.

[143]*Short* v. *Graham* (1908) 7 W.L.R. 787 at 790 (Alta. T.D.).

[144]*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.).

[145]*AMIC Mortgage Investment Corporation* v. *Abacus Cities Ltd.*, *ibid.*

[146]*Guarantee Trust Company of Canada* v. *Bailey*, *supra*, note .

[147]For a list of these situations see L.Y. Cairns, *supra*, note at 204.

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 two such situations to illustrate this concept. First, no covenant arises under section 62 when the transferor transfers less than his entire interest in the land[148] or transfers only some of the land charged by the mortgage.[149] However, if the transferor transfers by one instrument of transfer his 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.[150] Second, if the transferor is not liable to begin with, section 62 would not raise a covenant and no subsequent transferee could be held liable.[151]

4.36 Two recent Court of Appeal decisions are examples of the second situation. In *Guaranty Trust Company of Canada* v. *Bailey*[152] the first mortgagee maintained that a final order of foreclosure obtained by a second mortgagee was an instrument transferring land and sought judgment against a subsequent transferee of the second lender on the basis of section 62(1). After discussing the authorities, the court concluded:[153]

> 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.

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[148]*In re Macdonald Estate* [1925] 1 W.W.R. 1031 (Alta. S.C.A.D.).
[149]*AMIC Mortgage Investment Corporation* v. *Abacus Cities Ltd, supra*, note and *Fidelity Trust Company* v. *Signature Finance Ltd. and Radostits Investment Ltd.* (April 3, 1990) Appeal # 10583 (Alta. C.A.).
[150]*Trust and Guarantee Company Limited* v. *Monk, supra*, note 144.
[151]*Guarantee Trust Company of Canada* v. *Bailey, supra*, note , and *Collingwood Invt. Ltd.* v. *Bank of Amer. Can. Mtge. Corp.* (1988) 58 Alta. L.R. (2d) 1 (C.A.).
[152]*Supra*, note .
[153]*Supra*, note at 301.

> The issue becomes: Is Argosy liable to pay on the express or implied covenant arising from the first Mortgage?

4.37 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.

4.38 In *Collingwood Invt. Ltd.* v. *Bank of Amer. Can. Mtge. Corp.*[154] Mr. and Mrs. Osterlee granted a mortgage charging certain property. They 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.

4.39 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.[155] 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.[156]

(g) Renewals

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[154]*Supra*, note .

[155]*Alberta Home Mortgage Corporation* v. *Fahlman*, *supra*, note .

[156]*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.).

(i) Section 43(1)(b)

4.40 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:[157]

> 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
>
> (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 s. 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 s. 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 s. 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 s. 43.4.
>
> 4. Section 43(2) removes the s. 41 protection in respect to *National Housing Act* mortgages.
>
> 5. Section 43(3) provides a transitional provision, to extend s. 43(1.1) to cases where action had been commenced but had not

[157](1988) 58 Alta. L.R. (2d) 13 at 17.

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 s. 43(1.1) in respect to potential liability on the basis of the s. 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 s. 62(1) of the *Land Titles Act*.

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).

8. Further evidence of legislative intent not to provide corporations with deficiency protection may be seen in s. 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 s. 43(1.1) or s. 43.1, but is deemed to be the transferee of the original corporate mortgagor.

9. As noted earlier, s. 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 s. 43.4.

(ii) <u>How should section 43(1) be interpreted?</u>

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

4.41 Originally, the application of section 43(1)(b) depended on the character of the person who granted the mortgage.[158] If the borrower was a corporation, section 43(1)(b) removed the protection of section 41(1). Therefore, any individuals who purchased commercial property (or residential property in

[158] *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 ; *First City Trust Company* v. *Mid-Continent Holdings Ltd.* (1982) 19 Alta. L.R. (2d) 21 (M.C.).

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.[159] This liability could arise in three different 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.[160] 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*.[161]

4.42 This was the approach adopted by the Alberta Court of Appeal in *Elmwood Holdings Ltd.* v. *Sinclair and Northside Electric Ltd*.[162] 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.

4.43 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 rejected the argument that the word "on any covenant" in section 41(1)(b) referred to the covenant contained in the assignment agreement. The literal interpretation of this decision suggests that section 41(1)(b) has no application to assignments of a purchaser's interest under an agreement for sale. It is unlikely the court meant to go that far for it contradicts the wording of section 41(1)(b). On this point the case is best explained on the basis that section

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[159]*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*, Edmonton No. 8303-03295 (M.C.).

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

[161]See *Collingwood*, *supra*, note at 7.

[162](1986) 44 Alta. L.R. (2d) 128.

41(1)(b) has no application because the purchaser was a corporation.

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

4.44 In *Royal Trust Company* v. *Potash*[163] 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.

4.45 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.

4.46 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 terms and long amortization periods. This does not preclude an interpretation of the section consonant with today's commercial realities if such an interpretation is

[163][1986] 2 S.C.R. 351.

compatible with the language of the section.

4.47 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 obtained. This would cause unnecessary expense.

4.48 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.

4.49 The Court construed section 10 as follows:[164]

> 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) 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

[164] *Ibid.* at 370-71.

> 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.

4.50 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".[165]

4.51 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*

4.52 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 the trilogy of cases composed of *Collingwood Invt. Ltd.* v. *Bank of Amer. Can. Mtge. Corp.*,[166] *Paramount Life Insurance Company* v. *Hilton*,[167] and *Pioneer Trust Company* v. *Patrick*.[168] These cases severely restrict the principles set out in *Elmwood Holdings Ltd.* v. *Sinclair* and may even overrule that decision.

4.53 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") was the assignee 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

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[165]*Ibid.* at 374.
[166]*Supra*, note .
[167]*Supra*, note .
[168](1988) 61 Alta. L.R. (2d) 312.

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.

4.54 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. There was no liability arising from the mortgage because Collingwood was not a borrower. Liability did not arise under section 62 of the *Land Titles Act* in these circumstances. A covenant arises under section 62 when equity would imply a right of indemnification in the transferor against the transferee. In this case, the transferor was an individual who was not personally liable on the mortgage. If the transferor was not personally liable there was no right of indemnification and, 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 cites *Elmwood Hldgs. 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 borrower was an individual, 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.

4.55 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 be 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 is a covenant that comes within the scope of section 41(1)(b). Therefore, the lender cannot 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.

4.56 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.

4.57 On the same day the Alberta Court of Appeal gave its decision in *Paramount Life Insurance Company* v. *Hilton*. In this case a corporation had granted a land mortgage to Paramount Life Insurance Company ("Paramount Life"). The corporation sold the land to another corporation which, in turn, sold it to Mr. Hilton. Paramount Life sought a deficiency judgment from Mr. Hilton.

4.58 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*.

4.59 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 Mr. 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 Mr. Hilton, section 43(1)(b) became inapplicable because the mortgage (as amended) was given by an individual not a corporation.

4.60 Applying the *Collingwood* analysis to the facts in *Paramount Life Insurance Company* v. *Hilton* raises some perplexing problems. Mr. 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*, Mr. Hilton would be liable on the covenant arising from the section 62. However, in *Paramount Life Insurance Company* 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?

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

4.62 A court composed of three different justices then attempted to summarize what the earlier two Court of Appeal decisions 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 *Paramount Life Insurance Company* v. *Hilton* held[169] "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".

4.63 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). The Court held that *Paramount Life Insurance Company* v. *Hilton* 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.

4.64 The Court distinguished the *Elmwood Holdings Ltd* decision on the

[169] *Supra*, note at 317.

basis that it did not deal with a subsequent extension agreement.

(iii) Conclusions

4.65 The effect of these three decisions of the Court of Appeal is unclear. However, they can be best rationalized as follows:

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

(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.[170]

(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.[171]

(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 parties understood that later there would be a renewal of the mortgage and if such a renewal agreement did come into existence, 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

[170] *Standard Trust Company* v. *100762 Canada Ltd.* (1990) 108 A.R. 336 (Q.B.).
[171] *Ibid*.

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 the covenant to pay it gives in a renewal agreement. Once the corporation executes the renewal, 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 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.

(c) It is unclear whether the expectation of a later renewal can be proven from the terms of the mortgage itself or whether more evidence is required. Query whether such an expectation always exists when the amortization period is longer than the term of the mortgage.

(d) 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 is keying on the maturity date of the mortgage. It is at that point 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.

(iv) <u>Potential future developments</u>

4.66 The approach taken by the Alberta Court of Appeal in the 1988 trilogy of cases on renewals finds support in the Supreme Court of Canada decision in *National Trust Company* v. *Mead*.[172] This case involved the interpretation of sections 2 and 40 of *The Limitation of Civil Rights Act*,[173] which is one of the statutes that creates deficiency judgment protection for certain persons who mortgage land situated in Saskatchewan. The Court summarized the relevant sections as follows:[174]

> Section 2 of the Act provides that when land is mortgaged for purposes of securing the purchase price of land, the mortgagee's recovery rights are restricted to foreclosure and sale of the mortgaged land. No action on the personal covenant lies against the mortgagor for any deficiency. Section 2(2)(d) extends that protection to subsequent purchasers by sweeping within its ambit "the personal covenant of a purchaser of lands subject to any such mortgage, to assume and pay the mortgage."
>
> On a plain reading of s. 2(2)(d) National Trust cannot recover from Mead on his personal covenant. This statutory intent is reinforced by s. 40(1) of the Act which provides that agreements purporting to waive the protection of the Act are "null, void and of no effect".
>
> Section 40(2), however, creates an exception to s. 2 and 40(1) of the Act by permitting corporate mortgagors to waive the protection.

4.67 Remai Construction (1981) Ltd. ("Remai") granted a mortgage to National Trust Company ("National Trust") as security for a loan used to construct a condominium unit. Remai waived the protection of section 2 of *The Limitation of Civil Rights Act*. Remai sold the condominium unit to Mead, who in turn executed an assumption agreement in favour of National Trust. In the assumption agreement, Mead covenanted to pay to National Trust the principle and interest owing under the mortgage. Section 2(2)(d) of the Act clearly protected Mead, unless Mead was a "successor or assign" of Remai and was thereby bound by Remai's waiver of protection.

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[172][1990] 5 W.W.R. 459 (S.C.C.).

[173]R.S.S. 1978, c. L-16 which is discussed in some detail in chapter 6.

[174]*National Trust Company* v. *Mead*, *supra*. note at 466-67.

4.68 In reaching its findings, the Court reviewed the purpose of sections 2 and 40(2) of the Act. Wilson J. held that the purpose behind section 2 is as follows:[175]

> . . . Section 2 protects individual mortgagors from being personally liable on a mortgage and restricts the mortgagee's remedy to the property. Individuals usually take out mortgages to secure residential houses or farms. Their home is typically the largest single asset they have. One can well imagine that once that is lost the individual in many instances has little else to seize and imposing the additional burden of personal liability would be onerous and perhaps futile. I note in passing that s. 2 was originally enacted by the Saskatchewan legislature in 1934 (S.S. 1934-35, c. 89, s. 4) at a time when many prairie farmers were "losing the farm" thanks to the notorious and disastrous effects of the "dustbowls" and the Depression.

The purpose of section 40(2) is to facilitate corporate financing that would not be available if lenders were not able to enforce their security upon default of the corporate borrower. Corporations are more sophisticated in the management of their affairs and require large amounts of capital.

4.69 The Court viewed the policy concerns behind the protection of individuals as inapplicable in the case of corporate borrowers. Section 2 should be interpreted to give effect to the purpose of the section: protection of individuals.

4.70 Although the Court acknowledged that it was possible for individuals to be assigns of corporate borrowers within the meaning of section 40(2), it interpreted the exception created by section 40(2) narrowly. The Court held:[176]

> . . . It is my view, however, that the purpose of this exception is to protect mortgagees who extend mortgages to corporations on condition that the latter provide a personal covenant and who then find that the corporation has unilaterally (and without the mortgagee's consent) assigned the mortgage to an individual on whom the personal covenant would not

[175] *Ibid*. at 468.
[176] *Ibid.* at 469-70.

> otherwise be binding under the Act. It is those "assigns" who must be bound by the personal covenant of the original corporate mortgagor if the mortgagee is to have the protection contemplated by the section. This situation would arise where there is an assignment of the mortgage from a corporate mortgagor to an individual without an assumption agreement between the individual mortgagor and the mortgagee.
>
> Where the mortgagee (in this case National Trust) has entered into an Assumption Agreement with the new mortgagor, however, the concern about the mortgagee's rights being unfairly defeated simply does not arise. National Trust was completely free in the present case to decide whether or not to let Mead assume the mortgage from Remai. If it saw itself as exposed to an undue risk if it could not sue on the personal covenant to recover a deficiency on the mortgage debt, it was at liberty to refuse to enter into the Assumption Agreement with Mead. It is noteworthy that while ss. 2(2)(a)—(d) extend the protection of the Act to circumstances of assignment, extension or assumption of a mortgage, s. 40(2) only binds successors and assigns to a waiver by a corporate body. This is no evidence on the record indicating whether Remai assigned its mortgage to Mead. Even if it had, however, the fact that Mead also assumed the mortgage by way of Assumption Agreement with National Trust entitles him to the benefit of s. 2(2)(d) which in turn is not subject to the waiver exception under s. 40(2). Remai's exercise of its waiver under s. 40 of the Act does not therefore bind Mead.

This was one of the grounds upon which the Court held that Mead was not personally liable for any deficiency.

4.71 The proposition that sections 41 and 43 of the *Law of Property Act* should be interpreted to give protection to individuals, but not corporations, is fully supported by *National Trust Company* v. *Mead*. It is possible that *National Trust Company* v. *Mead* will cause the Alberta Court of Appeal to overrule its decision in *Elmwood Holdings Ltd.* v. *Sinclair*. The argument, based on *National Trust Company* v. *Mead*, will be that any exception to the general protection of individual borrowers and transferees should be construed narrowly. Therefore, Sections 41 and 43 of the *Law of Property Act* should be interpreted so that an

individual who executes an assignment agreement in favour of the lender will be protected by section 41(1)(b) of Act. If this argument is successful, there would be much broader protection for individuals who assume mortgages granted by corporations than presently exists.

(h) Due-on-sale clauses

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

4.72 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.[177] A commonly found clause is the one that was interpreted in *Royal Bank of Canada* v. *Freeborn*[178] 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.

4.73 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.

(ii) Validity of due-on-sale clauses

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[177]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 and 33.

[178](1974) 32 A.R. 380 (S.C.T.D.).

4.74 In several Canadian cases such 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.[179]

4.75 In *Royal Bank of Canada* v. *Freeborn*[180] 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 does not approve of the purchaser of the land. The court did not decide if 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*.

4.76 In *Briar Building Holdings Ltd.* v. *Bow West Holdings Ltd.*[181] the mortgage contained a similar clause. The court held that this clause does not prevent transfer of the land and, therefore, it is 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. The right to relief under section 18(1) of the *Judicature Act* was dealt with later in the proceedings.

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[179]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.), and *Weeks* v. *Rosacha* (1983) 28 R.P.R. 126 (Ont. C.A.). 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.

[180]*Supra*, note .

[181](1981) 16 Alta. L.R. (2d) 42 (Q.B.)

4.77 Another decision of interest is *Weeks* v. *Rosacha*.[182] This case involved a dispute between a vendor and a purchaser. The agreement of sale provided that the purchaser would assume an existing mortgage. The agreement did not make reference to the due-on-sale clause forming part of the mortgage. The purchaser refused to close because the vendors did not obtain the lender's approval of the purchaser nor did they get a mortgage amending agreement which deleted the clause. The issue was whether these facts gave the purchaser the right to refuse to complete the deal. The Ontario Court of Appeal concluded that they did.

4.78 In reaching this decision, the court held that this clause was not so common to fall into the class of "usual mortgage clauses" that can be implied in the agreement of sale. The clause was for the exclusive benefit of the lender. Depending on the fluctuations of interest rates and other circumstances, the clause could be harmful to the owner's interest. It would interfere with the owner's ability to resell the property with an attractive existing mortgage without the lender's approval that may be withheld arbitrarily. It would be a factor a purchaser would consider if he or she contemplated reselling the property in the near future. As a result, land charged by a mortgage containing a due-on-sale clause[183] is of less value than a land charged by a mortgage without such a clause. Therefore, the potential detriment of a due-on-sale clause is not too speculative a ground upon which to permit the purchaser to avoid the contract.

4.79 Although this case does not deal specifically with the validity of due-on-sale clauses, the decision is premised on the fact that such clauses are valid. A purchaser would not be allowed to refuse to complete a deal if an invalid clause was not satisfied.

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

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

4.80 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. Such relief is available when there is no evidence that the purchasers will commit waste or cause the premises to fall in

[182](1983) 28 R.P.R. 126 (Ont. C.A.).

[183]The court called such a clause an optional maturity clause.

disrepair.[184] 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?[185]

4.81 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.[186] 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 transferee would pay the lender.[187] 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*

4.82 In *Royal Bank of Canada* v. *Freeborn*, the court queried whether it could grant relief under section 19 of the *Judicature Act*,[188] 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.*[189] The purchaser sought relief under section 44(8) of the Queen's Bench Act. This section is similar to section 39

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[184]*Royal Bank of Canada* v. *Freeborn, supra*, note .

[185]*Bigam* v. *Milne, supra*, note .

[186]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. How can this debt obligation be assigned by the mortgagor\debtor?

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

[188]R.S.A. 1970, c. 193.

[189]*Supra*, note .

of the Alberta *Law of Property Act*. When referring to section 44(8) the court held:[190]

> 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

4.83 In the United States the typical mortgage is a fixed rate mortgage of 15 to 30 years. The borrower is protected from fluctuating interest rates, but the lender is exposed 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 it out at a higher interest rate. 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.[191] 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.[192] 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

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[190]*Supra*, note at 244.

[191]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 at 36-39.

[192]*Wellenkamp* v. *Bank of America* (1978) 582 P. 2d 970 (Supreme Court of California).

lender.[193]

4.84 The restrictions on enforcement of due-on-sale clauses created by statute[194] 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.[195]

4.85 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.

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

1. A lender can enforce a due-on-sale clauses because otherwise he or she would be subject to a double risk. If interest rates increase, the lender is bound by his 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.[196]

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[193]Robertson, *supra*, note at 37.

[194]See the statutes cited in footnote 128 of Joseph Gibson III, *supra*, note .

[195]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.

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

2. The clause is not a restraint. 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.[197]

3. The clause is a restraint. 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.[198]

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."[199]

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 his loan.[200]

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.[201]

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

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[197]*Ibid*.
[198]*Ibid*. at 910.
[199]*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.
[200]"Enforcement of Due-on-Transfer Clauses", *supra*, note at 907.
[201]*Ibid.* at 908.

below market interest rate, the property will have a higher value. Automatic enforcement of due-on-sale clauses would prevent this result.[202]

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.[203] 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 average home is sold every 4 or 5 years. The average mortgage term exceeds 15 years.[204] 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.[205]

9. At the time the lender makes the mortgage loan, the borrower is concerned with the interest rate and the size of his 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.[206]

10. Due-on-sale clauses benefit only those who are lucky enough to find a low interest rate 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 downpayment. 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.[207]

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

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[202]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.
[203]"Enforcement of Due-on-Transfer Clauses", *supra*, note at 930.
[204]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.
[205]"Enforcement of Due-on-Transfer Clauses", *supra*, note at 930.
[206]Nelson, G.S., *Real Estate Finance Law* 2nd ed. (1985) at 318.
[207]*Ibid.* at 318-19.

1. Some authority reasons that a lender can enforce a due-on-sale clause because he or she 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 against loss due to prepayment when interest rates fall by insisting on a substantial prepayment penalty.[208]

2. Lenders undertake the risk of extended inflation and a competitive money market place. 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.[209]

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.[210]

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, the borrower should be deprived of the increased marketability of his property and the increased value of his property attributable to the low interest long-term mortgage.[211]

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

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[208]Cohen, *supra*, note .
[209]*Ibid*. at 117.
[210]Bonanno, *supra*, note at 290.
[211]"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.

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.[212]

6. Automatic enforcement of due-on-sale clauses interferes with the owners ability to freely sell and transfer property.[213]

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."[214] The legitimate interests of a lender do not include interest rate adjustment for the benefit 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 bargain.[215] This, in turn, may prevent the most efficient distribution of personnel throughout the United States. If the lender could protect its need to adjust to rising interest rates in other ways there was no need to allow automatic enforcement of due-on-sale clauses.

4.88 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

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[212]*Ibid*. at 121-22.
[213]*Ibid*. at 130.
[214]"Enforcement of Due-on-Transfer Clauses", *supra*, note at 909-10.
[215]Joseph Gibson, III, *supra*, note .

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 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.

4.89 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

4.90 A foreclosure action is usually undefended. Commonly a defendant will file a demand of notice.[216] Where sections 41 and 42 of the *Law of Property Act* apply,[217] 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:

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[216]R. 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.

[217]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 s. 43(1.1) and (3) of the *Law of Property Act* and there has been no renewal.

> 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 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.[218] 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.

4.91 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.

4.92 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*[219] 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

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

[219] S. 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).

default, or if the land is abandoned or is undeveloped land other than farm land.

4.93 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[220] 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.[221]

4.94 If the mortgage has not been redeemed 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.[222] Although the purpose of advertising would seem to be to attract a third-party purchaser, it has recently 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.[223] 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 value filed by the parties.[224] An offer or tender that is acceptable to the plaintiff lender (because it covers the

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[220]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.

[221]*Tessier* v. *Van Ed Block Dev. Ltd.* (1982) 48 A.R. 81 (M.C.).

[222]*Allen* v. *Greaves* (1982) 44 A.R. 300 (M.C.).

[223]*Canada Perm. Trust Co.* v. *King Art Dev. Ltd. (No. 2)*, *supra*, note .

[224]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.

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.

4.95 If an acceptable offer or tender is received, the plaintiff lender will apply for an order confirming sale. With effect from the date of pronouncement, the granting of such an order irrevocably terminates the borrower's equity of redemption.[225] It does not, however, extinguish the mortgage debt. Thus, if any balance of the debt 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 balance. This is true even where the purchaser of the mortgaged land is the lender himself.[226] 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

4.96 The lender is permitted to tender in a judicial sale. An alternative procedure, which culminates in the granting of the so called Rice order, was established in *Trusts & Guar. Co.* v. *Rice*[227] and confirmed in the *King Art* case.[228] 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). 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.[229] If it 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.[230] If it is worth less, the lender should abandon his

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[225]*Morguard Mortgage Investments Limited* v. *Faro Development Corporation Ltd.* [1975] 1 W.W.R. 737 (Alta. C.A.).
[226]*Canada Perm. Trust Co.* v. *King Art Dev. Ltd. (No. 2)*, *supra*, note .
[227]*Supra*, note .
[228]*Supra*, note .
[229]*Toronto Dominion Bank* v. *Olson* (6 October 1983) Edmonton No. 8203-26357 (Alta. Q.B.).
[230]*Co-operative Mortgage Fund Ltd.* v. *K. Mac C Investments Ltd. and*

claim against the land and pursue whatever remedies he or she may have on the covenant to pay or other security.

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

4.97 The court will not accept a lender's proposal to purchase at less than the fair value.[231] 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.[232] For a more detailed discussing of the Rice order procedure refer to chapter eight.

(c) Private sale by lender

4.98 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 his 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*,[233] 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

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MacCrimnon (1983) 43 A.R. 144 (M.C.).

[231]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.).

[232]*First Investors Corp. Ltd* v. *Golden Key Rental Co. Ltd.* (1982) 39 A.R. 592 (M.C.).

[233]*Supra*, note .

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.

4.99 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 his possession a transfer executed by the borrower.[234] 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.[235] 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 attorney will not extinguish subsequent encumbrances.

4.100 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.[236] 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

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[234] *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.).

[235] See s. 115 of the *Land Titles Act*, R.S.A. 1980 C. L-5.

[236] *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.

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.[237] In situations where the sale would appear to prejudice subsequence encumbrances, the order has been refused.[238]

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

4.102 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.

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[237] *First Investors Corporation Ltd.* v. *Regional Investments Ltd. and Pawluk*, *ibid.*
[238] *Femco Fin. Corp. Ltd. and Thorne Ridell Inc.* v. *Femco Ventures Ltd. et al.* (1983) 43 A.R. 100 (Q.B.).

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.*,[239] if the land cannot be sold or cannot be sold for its value, an order for foreclosure should be granted.

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

4.103 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

4.104 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

[239](1982) 45 A.R. 149 (M.C.) at 151.

it.

As indicated in chapter three, 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.*[240] 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 by the mortgage.[241] 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.[242] 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 he or she wishes to realize, the lender must first complete his realization on the guarantee, including execution on any judgment obtained against the guarantor.[243] 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.

4.105 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*,[244] 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

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[240]*Supra*, note , 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.

[241]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.).

[242]In the *King Art* case, *supra*, note , 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 s. 41).

[243]Price and Trussler, *supra*, note , at 233.

[244]*Supra*, note .

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 short-circuit foreclosure proceedings against the second lender.[245]

(ii) Foreclosure orders and guarantees

4.106 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.[246] To date, no guarantee has been sufficient to keep the guarantor liable.[247] For example, in *Style Properties Ltd.* v. *220293 Developments Ltd. and McKillop*[248] 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.

4.107 Of most interest was the obiter comments made by the majority of the court. The majority thought that, at the very least, the guarantee must bring to the guarantor's attention that he or she was waiving protection afforded under the *Law of Property Act*.[249] Even if this is done, the majority queried whether it is against public policy to allow a guarantor to waive the protection of section 44(1)

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

[246]*Canada Permanent Trust Co.* v. *King Art Development Ltd. (2), supra*, note at 644.

[247]*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.).

[248]*Ibid.*

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

of the *Law of Property Act*. Furthermore, even if the guarantor's obligation survives foreclosure, the lender cannot sue unless he or she is in a position to convey title.

(iii) Foreclosure orders and leases

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

4.109 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".[250] 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 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.[251] An assignment of rents does not create privity of estate.[252]

4.110 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 landlord's interest in the lease.[253] 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

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

[251] *Integrated Building Corp. Ltd.* v. *The Marcil Group Ltd.* (1989) 100 A.R. 318 (C.A.).

[252] *Lavalin Services Inc.* v. *National Life Ass'ce Co. of Canada* (10 April 1984) appeal #16008 (Alta. C.A.).

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

4.111 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 his right to redeem once a foreclosure order is granted because the debt is satisfied.[254] 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.[255] 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.[256]

4.112 As previously mentioned, the granting of an order approving and confirming a sale irrevocably extinguishes the borrower's equity of 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.[257]

(5) Taking Possession

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[254]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.

[255]*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.).

[256]*Mackie* v. *Standard Trusts Co., supra*, note and *Brattberg* v. *Royal Bank of Canada, ibid.*

[257]*Morguard Mtge. Inv. Ltd.* v. *Faro Dev. Corp. Ltd., supra*, note 225.

4.113 Where the common-law concept of mortgage remains (i.e. where a mortgage constitutes a conveyance of 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.[258] Under Alberta law, however, a mortgage constitutes a charge only[259] 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.

4.114 Such an order 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.[260] 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*[261] (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 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.[262]

4.115 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.[263] If, however, a lease 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

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

[259]*Land Titles Act*, R.S.A. 1980, c. L-5, s. 106.

[260]Price and Trussler, *supra*, note at 291-92.

[261]*Supra*, note .

[262]*Ferris* v. *Nowitskey, supra*, note .

[263]*Land Titles Act*, R.S.A. 1980, c. L-5, s. 65(1)(d).

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 he or she 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.

4.116 If a lender takes possession without a court order, he or she runs the risk of becoming a mortgagee in possession.[264] As such, he or she must account to the borrower for any rents or profits collected during his possession and is liable for negligent management of the property and for waste. The lender's liability to account does not cease if he or she abandons the property, as the lender has no right to give up possession whenever he or she chooses.

4.117 When the mortgaged property is rented to third parties, the question of what constitutes possession arises, as the lender does not take actual physical possession. In *Noyes* v. *Pollock*[265] 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*,[266] 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

4.118 Unlike the remedies previously discussed, 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.[267] In either case it is

[264]See *Snell's Principles of Equity*, *supra*, note at 405-06.
[265](1886) 32 Ch. D. 53.
[266](1984) 30 Alta. L.R. (2d) 66 (Q.B.).
[267]S. 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.*

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, appointment of a receiver can be undertaken solely on the basis of the lender's contractual rights, although he or she has the option of applying for a judicial appointment as prescribed 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.

(a) Private appointment

4.119 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. The powers of the receiver to collect rents and otherwise deal with the secured property are then enumerated. Should one of the specified events occur, upon notice to the borrower, the lender is entitled to appoint whomever he or she 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 duties, the privately-appointed receiver is discharged by the lender. There is no formal procedure for such discharge.

(b) Court appointment

4.120 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*.[268] The

[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.

[268]The court has a general power under s. 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

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 he or she is entitled to the appointment of a receiver as of right.[269] 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.[270] Further, when exercising the discretion to appoint a receiver under this section, the court considers the following factors:[271]

> A useful summary of the circumstances that ought to be considered is found in *Bennett on Receiverships* at p. 91, as follows:
>
> > . . . 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.[272]

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 s. 45. The section applies to all mortgage actions, including those in which s. 41 bars an action on the covenant.

[269]See Price and Trussler, *supra*, note at 307.

[270]*C.I.B.C.* v. *El Dorado Hldg. Ltd.* (1983) U.A.D. 396 (C.A.).

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

[272]*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.

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.[273]

4.121 If the order is granted, the court will usually appoint the applicant's nominee when it is satisfied that he or she is competent and disinterested. Once appointed, the receiver is not an agent but an officer of the court and he or she 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 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

4.122 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.[274]

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

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

Distress is the right to enforce payment of a debt directly by seizure and sale of certain goods.

4.123 Under the common law, the borrower transferred the fee simple to the lender. Therefore, it was possible for the borrower to become the tenant 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.[275] 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*

4.124 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*

4.125 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 decisions: *Tuxedo*

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

Savings & Credit Union Ltd. v. *Krusky*[276] and *Farm Credit Corporation* v. *Enns*.[277]

4.126 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*.[278]

4.127 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.

4.128 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 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

[276] *Supra*, note .
[277] *Supra*, note .
[278] *Supra*, note .

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".[279] The result is that, notwithstanding section 35(2), the Farm Credit Corporation cannot distrain under an attornment clause when the borrower is an individual.[280]

4.129 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 corporaion.

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

4.130 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.[281] By virtue of section 36 of the *Law of Property Act*, a

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[279]*Farm Credit Corporation* v. *Enns*, *supra*, note at 14.

[280]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.

[281]S. 35(2)(a) of the *Law of Property Act*.

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.[282] Section 41 does not apply to a mortgage given under the *National Housing Act*. As a result, the right to distrain under such a mortgage is not restricted by section 41.

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

4.131 The purpose of section 37 is to create an exception to section 35 by allowing the additional security 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 under an attornment clause in the mortgage.[283]

4.132 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 would 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.[284] Also, the 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

4.133 Even when the lender can distrain for rent under an attornment clause, section 20 of the *Seizures Act*[285] 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

[282]S. 36(2) of the *Law of Property Act*.
[283]*Re Tuxedo Savings & Credit Union Ltd. and Krusky*, *supra*, note .
[284]Price and Trussler, *supra*, note at 330.
[285]R.S.A. 1980, c. S-11.

> 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.

C. Relief Available to the Borrower

(1) General

4.134 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.[286] In the usual case, the borrower has in fact defaulted and the lender has not provided a defence by breaching any of his 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 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*

4.135 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

[286] *Canfran Invt. Ltd.* v. *Glivar* (1983) 42 O.R. (2d) 601 (H.C.J.).

> 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.[287] 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.[288] 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 second mortgagee, will be required to pay the whole accelerated balance unless the other person is an assignee of the borrower.[289]

(3) Section 41 of the *Law of Property Act*

4.136 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 *in personam* action.

(4) Right of Redemption

4.137 It has been held that a borrower's right to redeem arises as soon as

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[287] *Kolacz* v. *Munzel* [1971] 5 W.W.R. 757 (Alta. S.C.T.D.) at 760.
[288] *Country Holdings & Development Ltd.* v. *Roth* (1981) 16 Alta. L.R. (2d) 262 at 266 (Q.B.).
[289] *Ibid.* at 267 and Price and Trussler, *supra*, note at 194-95.

the lender commences proceedings to enforce his security. If one of the remedies the lender seeks is sale or foreclosure, the lender is enforcing his security.[290] 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.[291]

4.138 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 he or she 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 statutory redemption periods on any other grounds.[292] 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.[293] 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.

4.139 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

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[290]*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.).

[291]*Heritage Savings & Trust Co.* v. *Harke* (1978) 14 A.R. 86 (C.A.).

[292]*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 s. 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 s. 42(2) to include: "(11.1) whether the land has been abandoned".

[293]Price & Trussler text, *supra*, note at 189.

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.[294] 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 efforts to redeem.[295]

4.140 Even after the expiration of the redemption period and any extension allowed by the court, a borrower can redeem up until the land has been sold either to a third party or to the lender.[296] 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 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*

4.141 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*,[297] 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.

4.142 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 creditors, and assist the

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[294] *North West Trust Company* v. *247852 Alberta Ltd.* (1983) 45 A.R. 34.

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

[296] *Ibid.*; *First Investors Corp. Ltd.* v. *Golden Key Rental Co. Ltd.*, *supra*, note .

[297] R.S.C. 1985, c. 25 (2nd supplement).

farmer and his creditors to enter into an arrangement.[298] An application by a farmer in financial difficulty does not prevent a creditor from commencing or continuing any proceedings against the farmer.

4.143 Insolvent farmer is defined to include a farmer:[299]

(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

(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.[300] If the Board thinks extension of this time period is essential to the formation of an arrangement between the farmer and his creditors, it can extend the time period. There can be three extensions with up to a maximum of 30 days for each extension.[301] 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 his creditors for the purpose of facilitating an arrangement between them.[302]

4.144 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 intention to do so. The notice must advise the farmer of an insolvent

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[298] *Ibid.* s. 18.
[299] *Ibid.* s. 1.
[300] *Ibid.* s. 23.
[301] *Ibid.* s. 29.
[302] *Ibid.* s. 28.

farmer's right to apply to a Farm Debt Review Board.[303] The notice must be served 15 business days before action is commenced.[304]

4.145 This Act binds the provincial and federal Crown.

4.146 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. 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.[305]

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[303]*Ibid.* s. 22(1).

[304]*Ibid.* s. 22(2).

[305]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

5.1 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.

5.2 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 try and establish what is happening at the field or operational level.

B. The General Dimensions of the Mortgage Industry in Alberta

5.3 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 1989, the total outstanding sums secured by residential mortgages alone in Canada were: trust companies, $64,480,000,000; mortgage companies, $88,043,000,000; life insurance companies, $13,694,000,000 and chartered banks, $87,461,000,000.[306] At the end of 1989, the total outstanding sums secured by farm mortgages in Canada was $10,620,730,000.[307]

5.4 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 would appear that Alberta absorbs 6-10% of the total mortgage lending in Canada.

C. Particular Industry Subsets

5.5 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

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[306]Stats. Can. *Financial Institutions* (Financial Statistics, 4th quarter 1989) Table 93 at 155 and Table 1 at 2. The figures have been rounded off.

[307]Statistics Canada, unpublished data.

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 real day to day relevance, and not as mere abstractions.

D. Classification by Borrowing Categories

(1) Farm Mortgages

5.6 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 until the likelihood of repayment at a later date is minimal. 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.

5.7 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

5.8 Different considerations may apply when dealing with loans which are secured by residential properties. The usual situation is the home owner who grants a mortgage to facilitate the acquisition of a home in which to live. Public policy in Alberta has turned on a hearth and home philosophy and the result is that special protection is granted to the home owner borrower. But here again it would appear 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.

5.9 Statistics describing all aspects of the residential mortgage industry are readily available through sources such as Statistics Canada and the Canadian 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.

5.10 It would appear, on the statistics presently available to us,[308] that something over 60% (by value) of all mortgages in Alberta are residential mortgages. These mortgages fall within the hearth and home philosophy under which some mortgages get special legislative "consumer treatment" from lenders of money.[309]

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[308]That is, the published statistics of the various government agencies, and Statistics Canada.

[309]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

(3) Commercial Mortgages

5.11 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 for commercial mortgages.[310] Common banking practice would likely result in most of these mortgages having been given by corporations.

E. Classification by Priority of Mortgage

5.12 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

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financing.

[310]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.

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.

5.13 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 scale 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 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

5.14 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% 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.[311]

5.15 In Alberta there are three recognized insurers of mortgage debts. 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 will insure certain mortgages under the *Alberta Mortgage and Housing Corporation Act*, again only if certain criteria are met. Finally, the Mortgage Insurance Corporation of Canada ("MICC") makes a business out of insuring mortgages, and is a private corporation.

[311]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.

Virtually any mortgage will qualify for insurance from MICC, giving the company a special appeal. From annual reports filed by the government agencies it would appear that, nation wide, those agencies service an average of about 70% of all mortgage insurance borrowers, while the private sector agency services the remaining 30%. Also, by comparing total insured mortgage debts to total mortgage debts, it can be said that roughly one-third of all home owner 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.

5.16 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 home ownership properties. At the end of 1990, MICC had approximately $2.0 billion in insurance in Alberta.

5.17 There can be little doubt but 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

5.18 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 and perhaps the most dramatic ever. Unemployment rose to around 15%, land and housing prices dropped (by up to about 30%),[312] 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.

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[312]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.

5.19 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 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.

5.20 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, there was a lower debt\equity ratio in property and so it was less tempting for the borrower to just walk away from the property.

5.21 At this point in time, the overall economic picture appears to have at least stabilized, although the increase in interest rates that began in 1989 has many analysts worried about the future economic picture.

H. The Foreclosure Epidemic

5.22 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 home owners, who traditionally have much less equity in a home to act as a cushion.

5.23 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. The first caused outright defaults; the second 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.

5.24 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")[313] 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.[314] 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.

5.25 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.[315]

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

[314]*Ibid*. at 6-7.

[315]These statistics are reproduced from the Survey, mentioned in *supra*, note 156, 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

Number

Number

Number

Total 1980

3,669

not known

not knownTotal 1981

4,030

1,680

626Total 1982

6,874

3,373

1,143Total 1983

9,053

5,090

3,869Total 1984

11,669

5,639

8,023Total 1985

8,652

3,207

8,972Total 1986

5,280

1,339

3,871Total 1987

3,761

1,079

2,664Total 1988

2,552

1,283Total 1989 (up to November)

1,614

5.26 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.[316]

5.27 Dollar dealers attracted much public interest and legislative concern. Statistics again give the broad picture: these sales accounted for something like 1% of foreclosures in 1981, 8% in 1983, and 10% in 1984.[317]

5.28 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.

5.29 Farm and commercial mortgage foreclosures during the same period were as follows:

STATEMENTS OF CLAIM ORDERS NISI FINAL ORDERS

[316]Survey, *supra*, note at 8.
[317]Survey, *supra*, note at 8.

Farm

Commercial

Farm

Commercial

Farm

Commercial

1982

4851983

45721984

20211985

1965

23721986

9491987

10551988

4621989 (up to November)

I. The Disparate Impact of Foreclosures

5.30 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.

5.31 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.[318] 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.

5.32 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.[319] Eighty-eight per cent of the foreclosed properties were valued (on foreclosure) at less than $100,000 and indeed 64% of all residential foreclosures related to properties then valued at less than $80,000.[320] 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.

5.33 Of these younger home owners 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.

5.34 Third, these events had quite a dramatic impact on the only private

[318]Survey, *supra*, note at 5.
[319]Survey, *supra*, note at 8-9.
[320]Survey, *supra*, note at 9.

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.

5.35 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 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.

5.36 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

5.37 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 has raised its equity requirement from 10 to 15% in Alberta.)

5.38 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

5.39 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.

5.40 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

5.41 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 action is proceeded with only in the case of genuine impropriety: deliberate and reckless abandonment, entering into a dollar dealer transaction, deliberately vandalizing a property before quitting it.

5.42 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.[321] Canada Mortgage and Housing Corporation was also reported to be taking action in a number of cases.[322]

5.43 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 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 cases where judgments have been pursued.[323]

M. The Impact on the Judicial System of the Foreclosure Epidemic

5.44 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.

5.45 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.

5.46 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.[324] 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

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[321]See Edmonton Journal, Monday, March 25, 1985. The average deficiency was said to be $23,000.

[322]See Globe & Mail, Tuesday, February 5, 1985.

[323]Practitioners advise that recently Canada Mortgage and Housing Corporation changed its policy on this issue. It now routinely obtains a judgment for any deficiency.

[324]Survey, *supra*, note at 14.

dropped by between 10-15% in 1983 and 1984.[325]

5.47 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 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.

5.48 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.

5.49 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

5.50 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.

5.51 The protective provisions of that body of law, together with industry practices, have shielded the bulk of those persons affected by foreclosure of their homes and farms from personal liability. 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 a like situation. Given the statistics involved, it seems almost inevitable that had these provisions *not* existed, there would have been very real pressure for their

[325]See Globe and Mail, 25 October 1985, at B20.

enactment. Could any polity (or legislature) in contemporary circumstances really stand for a situation where, perhaps, 1 in 14 Alberta home owners 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 — MORTGAGE REMEDIES IN OTHER CANADIAN JURISDICTIONS

A. Introduction

6.1 Mortgage laws are, in many ways, mirror laws. That is, they reflect the social and economic realities of a given jurisdiction. This makes comparison with other jurisdictions difficult, and in some respects downright misleading. Nevertheless, there are some advantages to be gained by looking at the laws of other jurisdictions. First, and most obviously, comparisons in and of themselves highlight the distinctive characteristics and features of a given system and thereby aid analysis. Second, such an exercise often yields useful new ideas. Third, a review of the mortgage laws in other jurisdictions reinforces the notion, espoused throughout this report, that each jurisdiction must settle its own affairs according to its own lights.

6.2 In this chapter, therefore we review—though not in detail—the mortgage remedies of our neighbouring provinces, Saskatchewan and British Columbia. We also review certain features of the development of Ontario mortgage law and remedies. The Ontario law affords a distinct contrast to the development of the law in this area in the western provinces and therefore affords some kind of useful comparative yardstick.

6.3 Mortgage law and remedies in all of these jurisdictions have been almost continually under review in the last decade; each of the three jurisdictions mentioned above either has undertaken or is in the course of undertaking quite an extensive review of its laws. The final report on mortgage remedies has not yet been released by the Saskatchewan Law Reform Commission. The British Columbia Law Reform Commission has released a Report on Personal Liability under a Mortgage or Agreement for Sale. The Ontario Law Reform Commission has issued its final Report on The Law of Mortgages. The continual struggles of provincial law reform agencies with this topic should, in and of itself, indicate the difficulties in arriving at "final solutions". The learning may well be that mortgage law is not only local law but also provisional law.

B. Saskatchewan

(1) General

6.4 Saskatchewan's real property law is very similar to that in Alberta. This

is not surprising. Both became provinces virtually at the same time and both have used the Torrens system of title from the outset. There are essentially six pieces of legislation which provide the mortgage foreclosure remedies and procedure in that province. These are *The Land Titles Act*,[326] *The Limitation of Civil Rights Act*,[327] *The Land Contracts (Actions) Act*,[328] *The Saskatchewan Farm Security Act*,[329] *The Agreements of Sale Cancellation Act*,[330] and the Saskatchewan Queen's Bench Rules. We consider each of these pieces of legislation separately, but as in Alberta, these various pieces of legislation all interact to form "the system". These acts must be read in conjunction with the *Farm Debt Review Act*, which was discussed in chapter four.

(2) *The Land Titles Act*

6.5 In Saskatchewan, as in Alberta, a mortgage is treated as security for a debt but does not operate to transfer the mortgaged property.[331] A mortgage is defined as a charge on land for securing payment of money, and includes rent charges, annuities, and sums of money owing otherwise than by reason of a loan.[332] Hence, the basic "concept" of a mortgage within the Torrens land title system is the same in both Saskatchewan and Alberta.

6.6 There is no provision in the Saskatchewan statute allowing the assignment of a contract for sale and purchase of a mortgage without the consent of the lender, as is presently provided for in section 150 of the Alberta *Land Titles Act*.

6.7 Under section 133 of the Saskatchewan Act, proceedings to enforce the payment of monies secured by mortgages, or to enforce the observance of the covenants, agreements, stipulations or conditions contained in a mortgage, or for sale of the land mortgaged, or to foreclose any estate claim or interest may be taken in the Court of Queen's Bench. In addition, under this section that Court may authorize the lender to take rents and profits produced by the land during a foreclosure proceeding.

6.8 The section is interesting because although it provides a forum in

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[326]R.S.S. 1978, c. L-5.
[327]R.S.S. 1978, c. L-16.
[328]R.S.S. 1978, c. L-3.
[329]S.S. 1988-89, c. S-17.1.
[330]R.S.S. 1978, c. A-7.
[331]*Land Titles Act* (Saskatchewan), *supra*, note , s. 129.
[332]*Ibid.* s. 2.

which to bring these proceedings, the section is not stated as an imperative. At least on the face of that section, it is not clear whether there could exist, in Saskatchewan, a contractual power of sale of the mortgaged property. It was decided in *Industrial Development Bank v. Lees*[333] that the section required a lender seeking a sale to have recourse to the court. A contractual power of sale is unenforceable.

6.9 The provision which allows the court to authorize the lender to take the rents and profits from the land during the foreclosure proceedings would seem, on its face, to give that court a discretion to alleviate the undesirable consequences of one dollar sales.

(3) *The Limitation of Civil Rights Act*

6.10 This Act is designed to offer some protection to borrowers and purchasers under agreements for sale from unreasonable foreclosure procedures and determinations. This Act does not apply where *The Saskatchewan Farm Security Act* applies. *The Limitation of Civil Rights Act* does not distinguish between classes of borrowers as the Alberta legislation does but rather looks at what the borrower used the loan proceeds for. By virtue of section 40, a corporation can waive the protection of this Act.

6.11 Under section 2(1) of *The Limitation of Civil Rights Act*, the availability of an action on the personal covenant to pay the debt secured by the mortgage is restricted. Where the mortgage was granted to secure the purchase price of the land or part of the land, there can be no action on the covenant. Until 1982, the conventional wisdom was that this section applied to two types of situations. The first was where a purchaser gave a mortgage back to the seller to secure part of the purchase price. The second was where a third party lender lent money to a purchaser to buy land. This loan was secured by a mortgage charging the land purchased with the moneys. The conventional wisdom was upset by the decision in *Guaranty Trust Company* v. *Douglas*.[334] This case held that section 2 does not apply to a lender who loans the purchase money to buy the land, even when the lender knows the borrower will use the money to purchase the land. In response to this decision, the Saskatchewan Legislature added section 2(1.1) in 1984. That subsection provides that section 2(1) applies whether or not the lender was the vendor of that land. As a result, third party lenders are bound by the prohibition found in section 2(1).

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[333](1970) 75 W.W.R. 445 (Sask. C.A.).

[334](1982) 6 W.W.R. 178 (Sask. Q.B.).

6.12 Section 5 of the Act provides that the court is to set an upset price or to have a reserve bid when the land is sold. Further, in the absence of such an upset price or reserve bid, the court shall not allow a sale to be made. This of course, is a very effective way of ensuring that the mortgaged property does not sell at too low a price.

6.13 Section 6 of this statute is quite similar to section 44 of the Alberta *Law of Property Act*. It provides that a final order of foreclosure shall extinguish the debt owing to the lender. The result, in both provinces, is to prevent a lender from obtaining a deficiency judgment in a mortgage action after he has obtained a final foreclosure order.

(4) *The Land Contracts (Actions) Act*

6.14 This Act provides that no foreclosure action can be commenced without leave of the court. An action commenced without leave of the court is a nullity. Before obtaining leave, the lender must give notice to the Provincial Mediation Board of his intention to seek leave. Then, under *The Provincial Mediation Board Act*,[335] the Board may attempt to mediate a settlement between the parties. Mediation does not take place without the agreement of both parties. *The Land Contracts (Actions) Act* does not apply to farm land.

(5) *The Saskatchewan Farm Security Act*

6.15 In 1988, the Saskatchewan Legislature enacted the *Saskatchewan Farm Security Act*.[336] The purpose of Part II of this Act is to afford protection to farmers against loss of their farm land.[337] The Act requires that the lender give the farmer notice of his intention to seek leave to commence an action to enforce the lender's remedies.[338] This notice must be given to the farmer and the Farm Land Security Board 150 days before the application.[339] Upon receiving notice the Board prepares a report on the financial affairs of the farmer.[340] This report is sent to a mediator who attempts to mediate between the lender and farmer.[341] At

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[335]R.S.S. 1978, c. P-33.

[336]*The Saskatchewan Farm Security Act* replaced *The Farm Land Security Act*, S.S. 1984-85-86, c. F-8.01 which was in effect from 1984 to 1988.

[337]*The Saskatchewan Farm Security Act, supra*, note , s. 4.

[338]*Ibid.* s. 11(1).

[339]*Ibid*. s. 12(1).

[340]*Ibid*. s. 12(3).

[341]*Ibid*. s. 12(5).

the conclusion of this process, the Board prepares a further report outlining the outcome of the mediation and the financial affairs of the farmer. This report is filed with the court.[342] At the application for leave to commence action, the court must give primary consideration to this report.[343] The onus is on the lender to prove that the farmer has no reasonable possibility of meeting his obligations or the farmer is not making a sincere and reasonable effort to meet his obligations.[344]

6.16 Even if leave is granted, the lender's remedies are restricted when the mortgage secures or is given as collateral security for the purchase price of farm land.[345] In such situations, the lender's right to recover the unpaid balance due is restricted to the land and no action lies on a covenant for payment contained in the mortgage or covenant collateral to the mortgage agreement. This protection cannot be waived by an individual or a corporation.[346] A final order of foreclosure on farm land is deemed to operate in full satisfaction of the debt.[347] Even when the lender obtains a final order of foreclosure, the lender's right to obtain title and possession of the home quarter is severely restricted.[348]

6.17 The Act also creates a right of first refusal for the farmer who looses his farm land by foreclosure or transfers the farm land by quit claim to the lender.[349] In these situations, the lender must give the farmer notice that a third party has offered to purchase the farm land. The farmer then has fifteen days to exercise his right of first refusal by purchasing the land at the price set out in the offer.

(6) *The Agreements of Sale Cancellation Act*

6.18 This statute expressly prohibits a vendor under an agreement for sale from determining the sales contract upon default of payment without the approval of the court. By contrast, in Alberta extrajudicial determination of agreements for sale has become a significant practical problem. According to one authoritative commentator, the Alberta position is now riddled with loopholes and judge made quirks.[350]

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[342]*Ibid*. s. 12(12).
[343]*Ibid*. s. 13(b).
[344]*Ibid.* s. 18(1).
[345]*Ibid.* s. 25.
[346]*Ibid*. s. 105(2).
[347]*Ibid.* s. 26.
[348]*Ibid*. ss 43-44.
[349]*Ibid*. s. 27.
[350]Francis Price, "Agreements for Sale to Corporations—The Remedy of

(7) Saskatchewan Queen's Bench Rules

6.19 Rules 433 to 440 deal with foreclosure procedure. By Rule 433, foreclosure action is commenced by statement of claim. Where only an action on the personal covenant to pay is sought, the normal rules regarding personal actions govern. Although the Saskatchewan rules do not provide any guidance as to who should be made a party to the action, Rule 437 provides that the lender serve all interested parties with the order nisi of foreclosure. This again is a departure from Alberta law, where Rule 687 more clearly defines the parties to be included.

6.20 Under the Saskatchewan Rule 438, the court is responsible for determining the amount due under the mortgage, and in this amount is required to include the rents and profits forthcoming from the property during the foreclosure action. In addition, under that rule, the Court of Queen's Bench has a discretion to set the redemption period to be allowed to a borrower. In Alberta, there are statutory redemption periods provided for individual borrowers. The courts in Saskatchewan have a much freer hand in determining what the redemption period will be.

6.21 Another interesting distinction between Saskatchewan and Alberta law, is that concerning the recovery of possession of the mortgaged premises by the lender. Under Rule 439 of the Saskatchewan rules, the court can grant possession to the lender upon the granting of the order nisi if the lender requests such possession. At any time after the order nisi has been granted in Saskatchewan, the court can grant possession to the lender upon application by the lender. Practice in Alberta, on the other hand, with respect to possession of mortgaged premises is that possession is normally granted to the lender or the purchaser under the judicial sale only after the final order of foreclosure or the final order of sale. The Alberta courts are more reluctant to deprive a borrower of the mortgaged premises until the lender obtains a final order of some kind. Indeed some counsel in Alberta have indicated to us that it is customary for the courts to grant possession to the person entitled, only after thirty days has elapsed from the time of service of the final order upon those in possession. In Alberta, in contrast to Saskatchewan, the defaulting party has a long time in which to "live out their equity". The Saskatchewan rules are much more sympathetic to the lender in this regard.

Extra-Judicial Determination" (1981) 19 Alta. L. Rev. 192; and update (1983) 21 Alta. L. Rev. 281.

(8) Conclusion

6.22 The differences between Saskatchewan and Alberta mortgage remedies law are relatively obvious. Both jurisdictions proceed on the basis of requiring a judicial sale, but in Saskatchewan a "bottom" price is required. In situations where the action for any deficiency is barred, this bottom price has the effect of forcing a lender to a foreclosure if that price cannot be obtained. Action on the covenant is restricted in both jurisdictions. The basis of the restriction is fundamentally different in each province. Alberta attempts to protect individuals; Saskatchewan protects individuals and corporations which grant a mortgage on certain lands for the purpose of securing the purchase price of the lands. Alberta law is much more generous with respect to allowing a defaulting borrower to retain possession. For farm land, Saskatchewan has created mandatory mediation before a foreclosure action can be commenced. No similar system exists in Alberta. Until recent years, Saskatchewan did not make use of Rice orders.[351] Another difference is that a borrower who grants a mortgage to secure a loan made under the *National Housing Act* is not protected from deficiency judgment in Alberta. In contrast, protection exists for such a mortgage in Saskatchewan if the mortgage charges residential land.[352]

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[351]*First City Trust Company* v. *Tritec Developments Ltd.* (1986) 60 Sask. R. 161 (Q.B.).

[352]Compare s. 43(2) of the *Law of Property Act* and *HFC Trust Limited* v. *Gettle* (1990) 5 W.W.R. 727 (Sask. Q.B.).

(9) Law Reform in Saskatchewan

6.23 The Saskatchewan Law Reform Commission has on foot a project to review its mortgage remedies law. At the time of preparing this chapter, it is not known what (if any) reforms will be proposed.

C. British Columbia

(1) General

6.24 There has been a good deal of legislative and law reform activity in British Columbia in the real property and mortgage areas. British Columbia passed a new *Land Titles Act* in 1978 and in 1977 rewrote that portion of the Rules of Court which deal with mortgage foreclosure procedure. These 1977 Rules changes came about in large part as a result of recommendations made by the British Columbia Law Reform Commission in a 1975 report. That Commission has again recently visited the subject area in its Report 84 (*Personal Liability Under a Mortgage or Agreement for Sale*) and Report 85 (*Mortgages of Land: The Priority of Further Advances*).

(2) The *Land Titles Act*

6.25 Under the British Columbia *Land Titles Act*[353] mortgages again are merely charges. British Columbia has several provisions in that statute and the *Law of Property Act*[354] relating to priority of mortgages and the ability to give relief from acceleration clauses. A number of these provisions are not in the same terms as in Alberta, although they address similar functional problems.

(3) Foreclosure and Remedies Generally

6.26 British Columbia introduced through its Rule 50 a series of subrules relating specifically to foreclosure. In effect, Rule 50 and its sub-components is a mini code and an example of law reform through the Rules of Court.

6.27 In Alberta, the judicial sale is the predominant remedy of the lender and it is only after such a sale is attempted that a final order of foreclosure may

[353]R.S.B.C. 1979, c. 219, s. 1.
[354]R.S.B.C. 1979, c. 340.

be obtained. British Columbia, on the other hand, reverses this and treats foreclosure as being the predominant remedy, which can only be changed into a judicial sale upon application by interested parties (R. 50 (7)). It is clear that a lender must bring foreclosure proceedings to obtain sale of the property; judicial sale at common law or under other provisions of the British Columbia rules may not be used.[355] However, the courts in British Columbia have some discretion to order a sale rather than a foreclosure.[356]

6.28 Another major difference between British Columbia and Alberta is that in Alberta the statutory redemption periods are fixed by statute. In British Columbia no such fixed period exists. The length of the redemption period is entirely a matter of the discretion of the judge.[357]

6.29 British Columbia has given much greater attention to service and the interests of affected parties than is apparent under Alberta law. In Alberta, subsequent encumbrances are not parties to the action, whereas in British Columbia everyone who has an interest which may be cancelled by the action is made a party.[358] In addition, in British Columbia, there is provision in the rules of Court by which guarantors may be made parties to the action.[359]

6.30 In British Columbia, there is no distinction drawn between any type of mortgage; all mortgages are treated the same. All borrowers are subject to an action on the covenant.

6.31 A general review of the British Columbia rules suggests that with the complications that exist in Alberta as a result of sections 41 through 43 of the *Law of Property Act* removed, foreclosure procedure in Alberta is very similar to that employed in British Columbia. One difference is that judges in British Columbia have somewhat more discretion than judges in Alberta when dealing with foreclosure actions. In particular, Rule 50 (5) gives a judge a discretion over the redemption period and Rule 43 (5) gives a judge full control of the manner of sale of mortgaged property. In a very general way it could be said that the British Columbia Rules of Court anticipated to a large extent to position taken up by the

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[355]*Devaney et al* v. *Brackpool et al* (1981) 31 B.C.L.R. 256 (B.C.S.C.). See also J. Horn, "Foreclosure and Cancellation under the New Supreme Court Rules" (1976) 34 Adv. 419.
[356]Rule 50(5)(g).
[357]Rule 50(5)(a).
[358]Rule 50(2).
[359]Rule 50(3).

majority of the Alberta Court of Appeal in *King Art*.

(4) Law Reform in British Columbia

6.32 In its Report 84 the British Columbia Commission reviewed various problems arising under section 20 of the *Property Law Act*. At the time of publication of Report 84, this section provided:

> 20. In an instrument transferring an interest in land subject to a mortgage, there is implied, unless otherwise expressly provided, a covenant by the transferee with the transferor to pay the mortgage in accordance with its terms and to indemnify the transferor against liability to pay the principal sum, interest, any other money secured, and liability on the mortgagor's covenants expressed or implied.

Unlike section 62 of the *Land Titles Act* of Alberta, this section did not create a covenant between the transferee and the lender.

6.33 The Commission concluded:[360]

> . . . generally, the current holder of the property should be primarily responsible for personal liability under a mortgage or agreement for sale, and the original borrower responsible only for any deficiency that arises after proceedings have been taken against the current holder of the property. The recommendations we have made would permit a lender or a person entitled to an indemnity to proceed directly against the current holder of the property. In this way the original borrower is placed more nearly in the position of a guarantor of his purchasers credit worthiness than that of a person primarily liable for the debt.

The Commission also recommended that the borrower cease to be liable on the personal covenant in the mortgage 3 months after the term of the mortgage expires unless the lender demands payment before then. No proposals were made to restrict an action on the covenant, as has been done in Alberta. Indeed the British Columbia Commission referred to Alberta field experience with dollar dealers as being one reason for allowing an action on the personal covenant.

6.34 For the most part, the *Law Reform Amendment Act*[361] implemented

[360]B.C.L.R.C., W.P. #48, at 39.

[361]S.B.C. 1988, c. 42, ss 5-8.

the recommendations made in Report 84 by repealing section 20 discussed above and by enacting sections 19.1 to 20.3 of the *Property Law Act*. The only change was that the Commission's recommendation in respect of extinguishing liability on the personal covenant of the borrower was restricted to the case of residential mortgages.[362] Section 20.3 of the *Property Law Act* is not based upon a recommendation of the Commission. This section allows a borrower to seek the lender's approval of a new purchaser of land that is subject to a residential mortgage. If the lender grants the approval in writing, the borrower ceases to be liable on the covenant contained in the mortgage. The section also provides that the lender cannot unreasonably refuse to grant approval[363] and allows a borrower to bring a court challenge of a refusal.[364] As Report 84 did not discuss due-on-sale clauses, it is not known whether a lender could circumvent this consumer protection legislation by the exercise of such a clause.[365]

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[362]*Property Law Act*, s. 20.2.

[363]See 20.3(4).

[364]See 20.3(5).

[365]For an excellent analysis of the problems of continuing liability of vendors and due-on-sale clauses see J.T. Robertson "Neither a Borrower or Lender Be: The Problem With Sales of Real Property Subject to Existing Mortgages" *supra*, note .

D. Ontario

(1) General

6.35 Ontario has had for some years now a *Mortgages Act*.[366] There are also extensive provisions in the Ontario Rules of Court dealing with mortgage actions. Notwithstanding a considerable secondment of resources over the years in an effort to produce a coherent, centralized body of mortgage law in one statute, there was still sufficient dissatisfaction with the general position in Ontario to cause the Ontario Law Reform Commission ("the Ontario Commission") in October of 1981, to launch a major project. The general purpose of this project was to ascertain what problems were being encountered in practice and to determine what reform might be desirable in Ontario.

6.36 At the time of commencement of the study Professor Reiter of the University of Toronto Law School was appointed as Director of the Law of Mortgages Project. Five senior professors at Ontario law schools were commissioned to produce a large number of research papers. The general approach of the Ontario Commission was to isolate a general direction for reform, and then to get down to the nuts and bolts of reform. In 1987, the Ontario Commission issued its Report on The Law of Mortgages ("Ontario Report").

6.37 It is not necessary for the purposes of this report to go into Ontario mortgage law in extensive detail. For one thing, the system of land titles in Ontario is markedly different from that which prevails in Alberta and the western Canadian provinces. For another, there likely will be extensive changes to Ontario law as a result of the Ontario Commission's study. For our purposes, what is important about Ontario law is that it assumes the viability of a quite different remedial approach to mortgage defaults. In this section, therefore, we propose to deal with only four aspects of Ontario mortgage law and the proposals for reform thereof—the action on the covenant, the extrajudicial power of sale, foreclosure procedure, and the possession question.

[366]See R.S.O. 1980, c. 296.

(2) Power of Sale

6.38 The main difference between Ontario mortgage remedies and the regime in place elsewhere in Canada, lies in the emphasis in Ontario on the power of a lender to sell the mortgaged property extrajudicially. Under section 23 of the present statute:

> . . . the mortgagee, at any time after the expiration of three months from the time of default in the payment of any monies due under the mortgage or any omission to pay any premium of insurance that by the terms of the mortgage ought to be paid by the mortgagor, has the following powers to the like extent as if they had been in terms conferred by the mortgage:
>
> > 1. A power to *sell*, or to concur with any other person in selling, the whole or any part of the mortgaged property *by public auction or private contract*, subject to any reasonable conditions he may think fit to make, and *to buy in at an auction* and to rescind or vary contracts for sale, and to resell the land from time to time in like manner without being answerable for any loss occasioned thereby". (Emphasis added.)

6.39 Before the lender can sell the land, the lender must have given a statutory form of notice of default (which gives a borrower forty-five days to remedy the default).[367] The essential procedure therefore is to give such a notice of default, and if the borrower does not remedy the default a sale can take place three months after the default. The statute specifically provides in section 27 that the person exercising the power of sale has "power to convey or assign and to vest in the purchaser the property sold for all the estate and interest of the mortgagor and of which he had power to dispose". That is the *statutory* power of sale.

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[367] *Mortgages Act*, R.S.O. 1980, c. 296, s. 25(1).

6.40 Under the present Act the position is even more favourable to a lender where the mortgage *itself* contains a power of sale. Under section 31, notice of exercising the contractual power of sale "shall not be given until the default has continued for at least fifteen days, and the sale shall not be made for at least thirty-five days after the notice has been given".

6.41 The general approach of the Ontario Commission in the Ontario Report is to make a reformed power of sale the primary mortgage remedy. The remedy of judicial sale would be abolished and foreclosure would be available in restricted situations. A lender would be required to give clear notice of default under the mortgage and of the consequences of default[368] (ie., that the property might be sold and that the borrower might remain liable for an deficiency). The purpose of the notice is to bring home to borrowers the seriousness of default and to outline the avenues open for the relief of default pending the exercise of the power of sale.

6.42 After the delivery of a notice of sale, there would be a delay period during which no proceedings of any sort could be taken against the property. The period would be long enough to allow the borrower to refinance or to sell the property. The underlying philosophy of the Ontario Commissioners is that the best protection against a sale at an undervalue is sale by the borrower personally. The Ontario Commission recommended that the period end on the date that is the later of 4 months after the date of default and 2 months after the date that notice of sale was served on the borrower.[369]

6.43 The delay period procedure would not be applicable to all powers of sale. All borrowers (except protected borrowers) could waive the protection afforded by the delay period procedure. As the Ontario Report often gives protected borrowers special treatment it is useful to understand the meaning of this term. A protected borrower is defined to mean:[370]

> (a) a borrower who resides in secured property that is a single family residence or residential unit, such as a condominium, whether it is a primary residence or a secondary residence and regardless of the size or purpose of the loan;

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[368]S. 6.3(1) of the Draft Act appended to the Ontario Report.

[369]See 169 of the Ontario Report and s. 6.5 of the Draft Act appended to the Ontario Report.

[370]Ontario Report at 44.

(b) a borrower who resides in secured property that is either a farm, a commercial or manufacturing enterprise, or a multi-unit building of not more than five units, where such property secures a loan that does not exceed a specified amount, which should be prescribed by regulation and subject to adjustment on a regular basis to reflect inflation and market trends;

(c) a guarantor of a loan that is secured by exclusively or partially residential property, as described above, if the guarantor occupies the residence;

(d) a spouse of a borrower and a spouse of a guarantor of the loan as the term "spouse" is defined in section 1(1) of the *Family Law Act, 1986*, where the borrower or guarantor is a protected borrower, if the spouse occupies the premises as a residence; or

(e) a borrower who gives land as security for a loan in an amount less that an amount prescribed by regulation (150,000 may be an appropriate amount), irrespective of the purpose of the loan.

6.44 The Commission has also been concerned to try and introduce an express standard of care in exercising a power of sale. In its working documents, the Commission raised the possibilities of requiring only a good faith standard, or with imposing a trustee or fiduciary standard. However, it came to the conclusion that the best standard would be that of commercially reasonable care. The Ontario Commission believes this standard of care will require the lender to sell the property for the highest realizable price in the existing market on a forced sale.[371] The duty of care is owed by the lender to all persons who, in the reasonable contemplation of the lender, are likely to be injured by breach of the duty.

6.45 The Ontario Commission approved of the notion of allowing a lender to employ the use of agents in conducting a sale where it is commercially reasonable to do so. In its working papers the Ontario Commission considered whether a lender should be able to purchase at a sale of mortgaged property conducted by an agent provided there is no collusion between the lender and the agent conducting the sale. In the report it did not recommend that a lender be allowed to purchase from an agent.[372]

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[371]*Ibid.* at 173.

[372]S. 6.11(11) of the Draft Act appended to the Ontario Report.

6.46 The sale and distribution of the proceeds of sale would occur much as they do now in Ontario. At one time there was some discussion of reserving a "moving allowance" to a "consumer mortgagor" somewhat similar to that reserved in proposals in the Ontario Commission's Enforcement of Judgment Debts and Related Matters Report. (That report proposed that on any sale of land under execution, $2,000.00 of the proceeds be reserved on a priority basis for payment to a debtor who resided in the property sold.)

(3) Foreclosure

6.47 In many ways the most radical recommendation made by the Ontario Commission is that which would replace the present judicial concept of foreclosure by statutory foreclosure. The Ontario Commission seems to have had two different kinds of situations in mind whereby a lender might obtain title to the mortgaged property in satisfaction of the mortgage debt. The first situation would arise *before* the lender exercises or attempts to exercise any power of sale. If the value of the mortgaged land is less than the mortgage debt then the lender could send a notice to the borrower and all subsequent encumbrancers requesting consent to foreclosure. Within the waiting period the borrower and subsequent encumbrancers could refuse to consent without reason. After the waiting period expires, the borrower and subsequent encumbrancers could refuse only if they have reasonable grounds to believe the proceeds of sale would exceed the costs of sale, principal, interest and legal costs.[373] This procedure is labelled foreclosure by consent.[374]

6.48 The second manner in which the lender could obtain title to the mortgaged land would arise after the unsuccessful exercise of a power of sale. In this situation (referred to as judicial foreclosure),[375] upon proof by the lender that no sale is possible at a price greater than the value of the mortgage debt, the lender could apply to the court for an order of foreclosure.[376] If the lender were to take the property by virtue of either statutory foreclosure procedure, there would be no further liability of the borrower on the covenant.

6.49 In keeping with the spirit of the proposed reforms to the power of

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[373]Ontario Report at 180-83 and s. 16(4) of the Draft Act appended to the Ontario Report.

[374]S. 6.15 of the Draft Act appended to the Ontario Report.

[375]S. 6.16 of the Draft Act appended to the Ontario Report.

[376]Ontario Report at 183.

sale provisions, the Ontario Commission proposes an abolition of all conventional foreclosure and judicial sale procedures. Parallel with this, it advocates the abolition of the concept of the equity of redemption of the borrower. The net result would be that the power of sale would become the principal remedy available to the lender but would be supplemented by the modified foreclosure procedure.

(4) The Protection of the Borrower

6.50 To protect a borrower under this system, the Ontario Commission proposes to extend the operation of the "relief from acceleration clause provisions" in section 21 of the present Ontario statute (which is the equivalent of section 39 (1) of the *Alberta Law of Property Act*). Such a provision would allow a borrower to put his or her mortgage back in good standing by simply paying the arrears and interest due under the default or by performing any breached covenant. Arrears is defined as that which is actually owing and not the accelerated balance. The Ontario Commission believes that the availability of such relief should be extended until there is a successful sale under the lender's power of sale, vesting of the property in the lender by way of the modified foreclosure as outlined above, or when recovery of possession of the mortgaged premises is obtained by the lender. To put this more shortly, a borrower would no longer have an equity of redemption, but could rescue the mortgaged property by paying arrears and interest or by performing the covenant that he has breached. A non-protected borrower[377] would only be allowed such relief once in a twelve month period.[378]

(5) Possession of the Mortgaged Property

6.51 Section 6(1) of the *Land Registration Reform Act, 1984*[379] abolishes the requirement of transferring title to create a security interest and provides that notwithstanding the form of the agreement, a security interest constitutes a charge only against the property. Section 6(3) provides that, notwithstanding section 6(1), the borrower and lender are entitled to all legal and equitable rights that would be available if there had been a transfer of title. Therefore, in Ontario, the lender still has the right to possession before default. Notwithstanding his

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[377]We use the term non-protected borrower to include any borrower who is not a protected borrower. The definition of protected borrower is very extensive and is set out in paragraph 6.43.

[378]Ontario Report at 180.

[379]S.O. 1984, c. 32.

right to do so, a lender does not usually request possession before default. In Alberta, under section 105 of the *Land Titles Act*, a mortgage is to act only as a charge upon the property, and as a result a lender is not entitled to immediate possession of the mortgaged property. Furthermore, section 173 (1)(a) of the *Land Titles Act* provides that ejectment by the lender can only occur once the borrower is in default. The result is that in Alberta, an action must presently be brought by the lender before he can obtain possession of the mortgaged property.

6.52 The Ontario Commission recommends that the existing law be changed. To effect this purpose they made recommendations in respect of protected borrowers and non-protected borrowers. It recommended that non-protected borrowers should be entitled to possession until default. Upon default, the lender is entitled to take possession of the secured property. However, the parties can alter this general rule by agreement. When a protected borrower defaults, the lender is not entitled to possession until expiry of the delay period. The exception to this is that a lender is entitled to possession where the borrower abandons or destroys the property. A lender must obtain a writ of possession except in situations where extrajudicial possession of property is allowed.[380]

6.53 The Ontario Commission has also given extensive consideration to the protection of tenants.[381] Presently a lease executed subsequent to a mortgage is not binding upon a lender. The Ontario Commission thought that there should still be some protection extended to a tenant in such circumstances. The Commission has proposed, therefore, that there should be a class of protected tenants who could not be ejected from the property until the end of the lease term, but not less than 120 days and not more than 1 year from the date the lender takes possession of the property. Ejection is not possible because the lender becomes the landlord.[382] The class of protected tenants is made of those who rent residential premises as defined in the *Ontario Landlord and Tenant Act*. The present law in both Ontario and Alberta provides no such protection to lessees whose leases arise subsequent to the mortgage in question.

(6) Anachronisms and Anomalies

6.54 Ontario law has been curiously backward in dealing with the problem of the agreement for sale (though here again this may be a reflection of

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[380]Ontario Report at 216-21 and ss 6.22 and 6.23 of the Draft Act appended to that report.

[381]Ontario Report at 235-46.

[382]S. 6.27(3) of the Draft Act appended to the Ontario Report.

the fact that lenders may not extensively use agreements for sale as financing devices in that jurisdiction). At the present time, the agreement for sale in the province is dealt with by analogy to mortgages, there being no statutory provisions that specifically deal with agreements for sale. It will be recalled that in Alberta there is a somewhat wider definition of encumbrance in our *Land Titles Act* than the definitions in the Ontario legislation, and the *Alberta Law of Property Act* specifically treats the agreement for sale under its mortgage provisions. The Ontario Commission is proposing that mortgages be made equivalent to agreements for sale for the purpose of the remedies available to the lender or vendor upon default by the borrower or the purchaser under the agreement for sale.[383] It would appear that there is an urgent need for reform in Ontario because of the absence of the Alberta type provisions.

6.55 The Ontario Commission has also dealt with doctrine of clogs on the equity of redemption. It will be recalled that the present law is, in general terms, that a borrower must be entitled to redeem a mortgage; collateral advantages given to a lender are improper and illegal; and the lender cannot fetter the property of the borrower on redemption. The essential proposal by the Ontario Commission here is that the doctrine of the "clog on the equity of redemption" should be done away with, except in the case of protected borrowers. It was considered that unconscionable transactions legislation and the common law rules with respect to unconscionable transactions would adequately protect the borrower in such a situation. Where the mortgage involves a protected borrower, no provision that gives the lender a right to purchase the property on or before redemption, or on default, should be enforceable.[384]

(7) Action on the Covenant

6.56 At the present time in Ontario, a lender can bring an action on the covenant either concurrently with, or independently of, his action with respect to the land.[385] The Ontario legislation does not distinguish between various types of borrowers.

6.57 When the borrower transfers the land to someone else, the borrower remains liable for the debt unless the lender releases the borrower from this

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[383]S. 2.3 of the Draft Act appended to the Ontario Report.

[384]Ontario Report at 34.

[385]See generally, Marriott and Dunn, *Practice in Mortgage Actions in Ontario* (1982), c. 7.

obligation. It becomes a matter of construction of the transfer agreement whether or not the lender has the right to sue the transferee. Unless the transfer says otherwise, the court will imply a covenant that the transferee will indemnify the transferor for any liability incurred to the lender.[386] If the transferee is obliged to indemnify the transferor, the lender may then sue either the transferor or the transferee upon the personal covenant, but not both.[387]

6.58 The only relief presently given to borrowers in Ontario is that conferred by section 20 of the *Mortgages Act* in respect of building mortgages. This section provides that "no action may be brought by the mortgagee after the expiration of one year from the date of the maturity of the [building] mortgage . . . to recover payment from the person who executed the mortgage". There is the further qualification that the protection only arises if the grantee is by express covenant or otherwise obligated to indemnify the borrower in respect to the mortgage. A building mortgage for this purpose is defined as any mortgage for the purpose of financing the construction of the building.

6.59 The Ontario Commission finds it desirable to maintain the action on the covenant given by all borrowers as an additional remedy for the lender. It suggests that abolition of the action upon the covenant as a remedy would only create undue litigation as lenders attempt to circumvent such provisions. Like the British Columbia Law Reform Commission, it points to Alberta as an example of the difficulties which are created when a jurisdiction attempts to do away with such a remedy.

6.60 The Ontario Commission recommends that a lender have the statutory right to sue the purchaser of secured property for the mortgage debt if the purchaser is obligated to indemnify the borrower. The liability of the borrower and subsequent purchaser would be joint and several and the lender could sue both. Presently section 19(3) of the *Mortgages Act* requires a lender to make an election between the two.[388] This is further qualified by the recommendation that a protected borrower remain liable for the personal covenant only until such time as the lender has approved and consented to accept the transferee as the person solely responsible for the debt.[389] The lender must give its consent unless the assumption by the purchaser would on commercially reasonable grounds materially affect the lender's risk under the security

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[386]Ontario Report at 194.
[387]*Mortgages Act*, R.S.O. 1980, c. 296, s.19.
[388]Ontario Report at 194 and 200.
[389]S. 5.5(9) of the Draft Act appended to the Ontario Report.

agreement.[390] In the absence of such consent, both the transferor and the transferee would remain liable upon the personal covenant. Even if liability of the protected borrower continues after sale of the property, liability will cease 6 months after the term of the mortgage expires, unless the lender demands payment within that time period.[391]

6.61 The benefit of these provisions is somewhat tempered by the Ontario Commission's recommendation in respect of due-on-sale clauses. Although the form and extent of such a clause varies from mortgage to mortgage, the substance of such a clause allows the lender to call the loan upon sale of the property. The Ontario Commission recommends that lenders be able to exercise this type of clause for any reason, including the capitalization of interest rates.[392] However, there would also be a downside in placing a due-on-sale clause in a mortgage granted by a protected borrower. The downside is that the presence of such a clause would give the protected borrower the right to pay off the mortgage without penalty upon the *bona fide* sale of the property to an unrelated purchaser.[393] The result is that if the purchaser does not increase the lender's risk under the security agreement, the lender could still "disapprove" of the purchaser by exercising the due-on-sale clause. A lender could enforce a due-on-sale clause given by a non-protected borrower and require the non-protected borrower to pay a penalty upon pre-payment of the mortgage.

(8) Receiverships

6.62 In its working documents, the Ontario Commission indicated "The question of receiverships has caused us some difficulty. Ultimately, our view was that this is a matter than ought to be studied by the OLRC independently and that it cannot be viewed in isolation in the context of mortgage remedies. We recommend that the OLRC undertake a study of receivers' rights".[394]

(9) Law Reform in Ontario

6.63 Whatever the outcome of the present proposals for reform of

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[390]S. 5.5(4) of the Draft Act appended to the Ontario Report.
[391]S. 5.5(13) of the Draft Act appended to the Ontario Report.
[392]Lenders capitalize interest rates in two ways. They can call the loan and relend the money at a higher interest rate. Alternatively, they can request the purchaser to pay a higher interest rate as a condition of the lenders approval of the purchaser under a due-on-sale clause.
[393]S. 5.3 of the Draft Act appended to the Ontario Report.
[394]O.L.R.C., *Status Report*, January 4, 1983, at 8.

Ontario mortgage remedies and mortgage law may be, there likely will be some radical changes. Whatever the details of those changes may be, it is of more than passing interest to note that certain propositions that have been part of Alberta mortgage law for many years are fundamental to the Ontario Commission's considerations. First, the Ontario Commission accepts that there is something to be said for a fracturing of the old equity notion that every mortgage is the same mortgage. The Ontario Commission is working towards a position whereby protected borrowers are given more information and more protection from overreaching lenders that are non-protected borrowers. The realization of monies owed by a non-protected borrower is treated as being a relatively unhindered process. Some greater protection is afforded to protected mortgages. Second, a good deal of flexibility in remedies is proposed. Essentially, it is for the injured party to make elections as to various routes to be followed, and the various remedies are then structured accordingly.

6.64 Whatever the outcome of the Ontario Commission's proposals, a great deal of traditional property law wisdom is being challenged, and a good deal of the old underbrush swept away. The attempt is to provide a modern and fairly comprehensive scheme of statutory remedies.

E. Conclusion

6.65 Any review of the system of mortgage remedies enforced in the various Canadian jurisdictions reveals some considerable dissatisfaction with the present law. Attempts are being made by the law reform agencies of those various jurisdictions to propose new and better systems of mortgage remedies. No Canadian jurisdiction has yet succeeded in bringing down a completely reviewed and modernized system, though Ontario appears to have developed its comprehensive proposals more fully than, as yet, any other Canadian jurisdiction.

6.66 Everywhere there is concern that mortgage law is much too cumbrous and complicated. A desire exists to introduce (if it is at all possible) a remedial regime which is flexible and provides the lender with a range of alternatives to pursue, but which is not unduly oppressive of the borrower. Whether the current round of law reform activity will produce remedial schemes that are capable of surviving, let alone resolving, the historic tug of war adverted to in earlier chapters remains to be seen.

CHAPTER 7 — FRAMEWORK FOR REFORM

A. Introduction

7.1 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 eight will deal with recommended procedural changes.

B. The General Direction of Reform

7.2 In the preceding chapters, we have tried to give a sense of the on-going evolution of Alberta mortgage law. The survey suggested that there has been constant tinkering with the legislation and procedure over the last half century in a manner somewhat reminiscent of tax legislation. There has been constant fine tuning. The result, at the practical level, is an extraordinarily complicated body of law. At the policy level, historically Alberta governments (of all persuasions) have faced an on-going tug-of-war between lenders and borrowers. The Legislature, whether it has really appreciated it or not, has tried to see that neither sector really wins and has attempted to achieve some kind of balance between these contending forces.

7.3 If a mythical average Albertan was to look at the history of Alberta mortgage law and the present circumstances of the province and was asked to pass some kind of rounded judgment on the viability of that total body of law and practice, how might that person react? And how would such a person be likely to see the options that could be fairly said to be open to the province? It seems to us on all that we have read and heard to date that there would likely be three stances on these issues. The lines between these three positions are not hard and fast, but they give a realistic impression of where people would come out.

7.4 The first position is the school of thought in Alberta that says that the game (the existing body of law and practice) is not worth the candle. Persons in this category suggest, in one way or another, a move to a privatized Ontario style solution. Essentially this would involve realigning the law so that the private power of sale became the critical remedy. The courts would then fill a minimalist role, as a backstop of to which resort would be had only for foreclosure as such, or in cases of particular difficulty where for some reason the protection of a court order was thought necessary. Those contending for this approach would also

usually allow deficiency judgments on any shortfall, although the private power of sale and deficiency judgment provisions need not necessarily be congruent. In fact, there are those who are satisfied with the judicially supervised foreclosure system Alberta now has, but who take exception to the deficiency judgment protection.

7.5 Proponents of this broad approach appear to rest their case on one or both of two grounds. First, there are those who say that essentially a mortgage is nothing but a contract, and that failure to pay or failure to adhere to the terms of that contract ought to attract direct and powerful remedies. Absent such a regime, it is claimed, inevitably the extension of credit is threatened. The second ground routinely advanced for a reversion to something like the above system is more pragmatic and asserts that the present system, whatever its merits, cannot be made to work at anything like an acceptable cost. "Cost" here is used in an expansive sense and not just in a very narrow cost and benefit sense. To put this another way, the argument seems to be that all things considered, the system is grossly cumbersome for what it achieves.

7.6 The second position is to accept the burden of the present law (with all of its admitted present hiccups) as being worth something, and perhaps something significant, to Albertans and to be prepared to pay the price of the burden of the law as it stands. The grounds on which proponents of this position rest their case are usually based on an analysis of the historical position both of and in the province. The assertion is that in light of that history the general restrictions on enforceability of debts (not just in relation to mortgages but more generally in Alberta law) have proved to be, for Albertans, a good and proper thing. We have heard it suggested in some quarters and we have read suggestions in the history books that this could be viewed as the crudest kind of populist politics translated into legal doctrine. We are dubious about such an assertion. Nobody can read the harrowing accounts in the archives, the local history journals and in the academic texts of the suffering of many Albertans at the several unfortunate periods in the province's history where severe economic downturns have occurred without being moved (both intellectually and emotionally) to a view that, at least in the circumstances in which the legislation was enacted, that legislation has a genuine humanitarian bent. In those circumstances we have no difficulty in rejecting a more cynical view of the legislation and the law which has developed.

7.7 The third position a mythical Albertan might take is to accept, in principle, the burden of the present mortgage remedies system but claim that it

ought to be possible to do *something* about legal dyspepsia.

7.8 Before considering the choice between these positions, we shall focus on the issue of deficiency judgment protection. This is the area of most concern to lenders and mortgage insurance companies. In their view, the legislation creating such protection[395] causes two serious problems, namely, dollar dealers and walk-aways and is unnecessary to protect the home owner. Although they admit that the Alberta courts are able to deal satisfactorily with the problem of dollar dealers, they are dissatisfied with the protection afforded walk-aways. Lenders dislike walk-aways for two reasons. The first is obvious. The second reason is that the phenomena of walk-aways gluts the market and further depresses market prices. This erodes the equity of all home owners.

7.9 In arguing that deficiency judgment protection is unnecessary, they point to the fact that in provinces where lenders have recourse to the personal covenant, it is seldom enforced. Lenders do not normally pursue a personal covenant given in a residential mortgage when the borrower defaults as a result of unemployment or other situation of hardships which prevents him from meeting his obligation. This practice reflects economic realities. In jurisdictions where lenders have access to the personal covenant, most borrowers pay their mortgage payments until their wealth is depleted. Lenders recognize that there is little likelihood that they will recover on judgments obtained against such borrowers and experience has taught them than incurring legal fees to obtain such judgments is a waste.

7.10 Another fault found with deficiency judgment protection is that in certain circumstances it causes lenders to impose stricter lending criteria upon Albertans than those required of other Canadians. For example, in 1983 the Mortgage Insurance Company of Canada ("MICC") would not insure an Alberta land mortgage that had a high loan to value ratio unless the borrower had a downpayment of 15%. In other provinces MICC required a 10% downpayment.[396]

7.11 Let us now return to the consideration of the 3 positions outlined above. At the outset we reject the second position of leaving things as they are. There is sufficient discontent at the Bar and amongst the lending agencies to make this position untenable. The real question to be answered is whether the Institute should pursue the first position (a fundamental realignment of

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[395]Sections 41 to 43.4 of the *Law of Property Act*.

[396]As discussed in para. 5.35, MICC effectively withdrew from the Alberta market in 1984.

remedies) rather than the third position (making the present system better without disturbing its fundamental premises).

7.12 Such a choice would depend upon an assessment of complex social and economic factors. The Institute can try and comprehend those factors, and we have tried to do that, and we can perhaps even say something sensible about them. But to assume that we have all the information and public policy expertise which would be required to make that determination does seem to us—at least on a provisional view—to be going too far for us as a body. Moreover, such a choice is political. That is, what is at issue clearly involves a choice in preferring some interests over other competing interests. It involves a distinct realignment of the existing order of things. It involves taking some critical rights from debtors and conferring them on creditors.

7.13 In this connection, it is relevant to note that the Alberta Legislature, for more than half a century, has espoused a hearth and home philosophy and has not to date given even the slightest public indication that it might be prepared to contemplate change. This philosophy has been pursued through two depressions, war, economic boom, and so on. If this is not evidence of a *really* deep policy, what is? (On the other hand, we do not think that it has ever been said, and we should certainly not assume that the administration has a totally closed mind on the subject and that, if a proper case were made, it would not be prepared to change.)

7.14 Given the foregoing comments, it seems to us that the burden of proof on those who propose fundamental change in this area is even heavier than usual. On this argument, hard evidence would be required of almost irreparable damage to essential Alberta interests. That is, would the Institute not have to show that there is a significant chilling of the supply of credit or other genuinely significant, and detrimental, public policy effects arising out of the present law before we could seriously urge wholesale change?

7.15 On what we have gathered to date, we do not have any such evidence. It is always possible that our own research in this area has not been sufficiently in depth, and we may have missed things that have happened. We have talked to government and academic economists who have followed this problem and who seem to be responsible and impartial commentators. The sense we get of what they have told us is that lenders now more carefully manage the extension of credit, but the formal rules for credit really have not changed. In effect, many Albertans have received the benefit of a cross-subsidy from the major

lending institutions (which have a pan-Canadian base). Some institutions have got into financial trouble, and even spectacular financial trouble. But the rules of the game for the major Canadian players have not really changed as a result of that, and Albertans have had it demonstrated to them that there are at least *some* advantages to pan-Canadian financial institutions. Also, it does seem that on the figures thousands of Alberta home owners have been protected from the crushing burden of personal judgments. True, walk-aways have abused this protection, and some people have occasionally found some cracks in the system (here we are obviously thinking of the dollar dealers). There is universal condemnation of such activity, but clearly the ultimate question here is: Does concern about such activity in and of itself justify some fundamental realignment of the system? We think not.

7.16 We are not, in any event, convinced that there are no abuses under the Ontario regime. The Ontario Law Reform Commission did not get down to investigating field abuse under its private sale regime. Such abuse is more likely to happen in the private, secondary mortgage market (which is always a good test because it is where the shadier operators generally do business in Ontario). Assume that in such a case borrower A defaults. The second mortgage was from a small private mortgage company. The lender (B) wants his money. Down the road is another mortgage operator (C). The temptation for B occasionally to sell quickly at a fire sale price to C seems to be very real, particularly if C is likely to reciprocate on a suitable occasion. If A complains that the price was inadequate, and then sues, B and C can always settle with him out of court. What, after all, is one settlement when whatever loss is involved thereon can be treated as a tax loss and picked up on the next transaction? The potential for abuse was acknowledged by the Ontario Law Reform Commission which recommended that there be a statutory standard of behaviour to be observed by the lender in the case of default and on a sale. And we cannot see that this kind of abuse will disappear even *with* a statutory formula.

7.17 We believe that there are abuses both under court-supervised remedial regimes, and under regimes in which the private power of sale is the predominant remedy. (For instance a recent empirical study in up-state New York demonstrates very clearly that in that jurisdiction, under a traditional court-supervised regime in force in that state, some people were still able to buy far too cheaply and make handsome profits farther down the road.)[397] In short, under a

[397]S. Wechsler, "Through the Looking Glass: Foreclosure by Sale as *De Facto* Strict Foreclosure—an empirical study of mortgage foreclosure and subsequent resale" (1985) 70 Cornell Law Review 850.

private sale regime, there are opportunities for side dealing of a reprehensible character and sales at inadequate prices.[398] Under the court-supervised regime there are the very real difficulties of valuation and attracting bids, particularly when there is widespread economic dislocation. Perfection has not been attained anywhere.

7.18 If we wished to go back to fundamentals (as we clearly ought to in addressing this matter) we must ask: What is it that the law is trying to protect? In Alberta, whether by accident or by design the Legislature and the courts have assumed that they are trying to do at least two, and perhaps, three kinds of things. The first is to protect whatever equity the owner may actually have. The second is to protect certain classes of borrowers from any deficiency judgment. (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.) The third is to grant a sort of de facto licence to occupy for quite a period even after the equity is all done. It is quite possible that the first two policy considerations (the protection of equity and protection from deficiency judgments) are still valid in Alberta, but the third may have lost whatever validity or force it may once have had in this jurisdiction. This is reflected in more recent judicial practice. Alberta does not have a dreadful housing shortage.

7.19 If an advisory body is going to suggest a distinct change in the direction of the law, that body has to be able to say either that the values on which the law rests are demonstrably wrong or need modifying for some reason and (perhaps) that there is a consensus for change. Or, that body has to be able to say that there is distinct and compelling evidence that the law does not work properly for some reason or other, and hence change is required. As to the first matter, the values involved on both sides are legitimate: protection of borrowers, on one hand, and adequate supply of credit at reasonable cost, on the other. The choice between them seems to us to be truly political. As to the second matter, we can only repeat that we presently do not have the sort of evidence which would say that a wholesale change must be made. Furthermore we must ask ourselves whether such evidence is realistically procurable. The people we have spoken to seem to think that it is not. That is, even if we commissioned some kind of empirical investigation, the best advice people have been able to give us

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[398]See J.T. Robertson, "Foreclosure by Power of Sale: Securing a Proper Price in New Brunswick" (1983) 32 U.N.B. Law Journal 83 at 115 to 116. This article reveals that in New Brunswick lenders commonly exercise their statutory power of sale and buy the property at an inadequately advertised sheriff's sale for a nominal price of $100 to $1000.

to date is that it is distinctly unlikely that such an investigation would reveal different patterns than have already been suggested in the preceding chapters. In short, we know about as much as we are likely to know about the general state of things.

7.20 We are left with the view that, all things considered, the Institute's role in this study should be to analyze the existing law and policy and to show how things might be improved within the present broad policy of the day. That broad policy seems to be indubitably one of protection of hearth and home and, as a corollary, the elimination of demonstrated abuses that may arise as a result of that primary policy. It follows that what we should be doing in the way of recommendations is traditional hard grafting—curing as best we can legal dyspepsia, rather than remaking Alberta public policy in our own image.

RECOMMENDATION 1

As the values upon which the existing mortgage remedies law is based are not demonstrably wrong and as there is no evidence that this body of law damages essential Alberta interests, we recommend:

(a) Alberta retain judicial supervision of the foreclosure process;

(b) mortgage remedies law be improved within the parameters of the existing legislative policy of protecting any equity borrowers may have and, in the case of no equity, protecting certain borrowers from deficiency judgments.

C. Deficiency Judgment Limitations

(1) Introduction

7.21 In this section we discuss when Alberta should protect borrowers from deficiency judgments. The question of when this protection should be afforded to transferees who assume a mortgage will be dealt with later in this chapter under the heading "Chain of Liability".

(2) Public Policy Underlying Legislation That Protects Borrowers From Deficiency Judgments

7.22 The Canadian and American legislation[399] 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 and consequential mortgage defaults. 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 an overhanging deficiency judgment would make it more difficult for the borrowers to reestablish 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.[400]

7.23 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 debt secured by the mortgage on the land. It is only in times of economic depression that deficiencies become common.

(3) Comparison of Legislation That Protects Certain Borrowers From Deficiency Judgments

(a) The protection of individuals

7.24 As discussed in chapter four, 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 original borrower that determined for all time what type of mortgage it was. However, recent Court of Appeal cases have held that this approach is no longer applicable in situations where a transferee renews the mortgage.[401]

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[399]Alberta and Saskatchewan has such legislation. Several American states have statutes prohibiting deficiency judgments in certain situations. See R.M. Washburn, "The Judicial and Legislative Response to Price Inadequacy in Mortgage Foreclosure Sales" (1980) 53 South. Cal. Law Rev. 843 at 916-19.

[400]J.R. Hetland, "Deficiency Judgment Limitations in California—A New Judicial Approach" (1963) 51 Cal. Law Rev. 1 at 5-7.

[401]See discussion at paragraphs 4.40 to 4.65 of this Report For Discussion.

(b) The protection of purchase money mortgages

7.25 Saskatchewan[402] and several American states[403] prohibit action on the covenant found in a purchase money mortgage. A purchase money mortgage is given to the 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.[404] In Saskatchewan, such protection arises 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.

7.26 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, this 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.

7.27 An anomaly exists in situations where a borrower grants a mortgage on land he owns to secure a loan used to construct a residence on the land. In these circumstances the borrower does not use the moneys to purchase the land and, therefore, it is not a purchase money mortgage. This is illustrated by the decision in *Gravelbourg Savings* v. *Bissonnette*.[405] In that case the lower court held that even if section 2 of *The Limitations of Civil Rights Act* did apply, it would afford no protection to the borrower. The court came to this conclusion because

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[402]See s. 2 of the *Limitations of Civil Rights Act* and s. 25 of the Saskatchewan *Farm Security Act*.

[403]Washburn, *supra*, note at 916.

[404]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.

[405](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.).

the borrower used the loan proceeds to pay an existing debt and to construct an addition to the building located on the land charged by the mortgage. The mortgage did not secure the purchase price or part of the purchase price of the land.

7.28 It is most unfair 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[406] 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) Deficiency judgment protection if land sold by lender

7.29 Recognizing the potential of abuse of the lender's power of sale, several states prohibit deficiency judgments where the lender exercises a power of sale without judicial supervision.[407]

(d) Deficiency judgment protection if redemption period shortened

7.30 Several states also prohibit deficiency judgments where the lender seeks an order reducing the statutory redemption period.[408]

(e) Appraisal as restriction on deficiency judgments

7.31 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.[409] These type of statutes encourage sale of the land at fair price but do not protect borrowers when economic depression destroys the real estate market.

(4) Other Methods of Protecting Borrowers

7.32 Deficiency judgment protection is one method of protecting

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[406]*Punty* v. *Bank of America* (1974) 112 Cal. Rptr. 370, 37 C.A. 3d 430.
[407]Washburn, *supra*, note at 917
[408]*Ibid.* at 918.
[409]*Ibid.* at 904.

borrowers from overhanging deficiency judgments. A similar purpose can be 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.[410] This allows lenders to pursue borrowers who, at the time of the foreclosure, have assets other than the mortgaged land. Yet practically, it does not allow a lender to enforce the judgment against a borrower whose primary asset was the mortgaged land. It is unlikely such a borrower will accumulate assets of value within this two-year period.

7.33 Another method of protecting borrowers is to ensure that the land is sold at fair value. This is not a direct method of preventing deficiency judgments but in some situations this would eliminate any deficiency because the value of the land would exceed the amount of the debt. Many American states have fair market value statutes that provide 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. This is the case even when the lender sells the land for a price less that the fair market value of the land. It is recognized that 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.[411]

(5) Which Borrowers Should be Protected?

(a) The hearth and home philosophy for deficiency judgment protection

7.34 The general intention of successive Alberta Legislatures has been to create a hearth and home philosophy. That is, where a property is genuinely a home and occupied as such or where the property is farm land, deficiency judgment protection should arise. Although the legislation enacted in 1939 applied to all mortgages of land, it should be remembered that at that time Alberta had a rural economy.[412] Most Albertans were farmers, and the protection was designed with them and urban home owners in mind. As our economy

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[410]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.

[411]Washburn, *supra*, note at 907-916.

[412]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%.

started to diversify the Legislature tried to achieve the hearth and home philosophy by a factual test. In 1964, the line between protected and non-protected mortgages was drawn at a point where a mortgage was given by a corporation. As noted in chapter three, this caused difficulties in practice. The Legislature then attempted to shift, under the 1983 amendments to the *Law of Property Act*, to a more functional test: use of the property as a residence or a farm. This more functional test is used to determine the identity of transferees who will be protected from liability arising from the assumption of a mortgage given by a corporation.

7.35 As said in the beginning of this chapter, we believe that the law should continue to serve this hearth and home philosophy. Our task is to devise legislation that better serves this policy.

(b) Suggestions for reform

(i) No deficiency judgment protection for corporate borrowers

7.36 In keeping with the hearth and home philosophy, we see no reason to protect corporations from deficiency judgments. Corporations are themselves a vehicle used to protect the shareholders from personal liability. No additional protection is needed.

RECOMMENDATION 2

Corporate borrowers should not be afforded deficiency judgment protection.

(ii) Deficiency judgment protection for some, but not all, individual borrowers

7.37 The hearth and home philosophy envisions protection of certain individuals, but not all, from action for recovery of the deficiency.[413] We believe

[413]Section 15(1) of the Canadian Charter of Rights and Freedoms provides:

> 15(1) Every individual is equal before and under the law and has the right to the equal protection and equal benefit of the law without discrimination and, in particular, without discrimination based on race, national or ethnic origin, colour, religion, sex, age or mental or physical disability.

We do not believe that by creating deficiency judgment protection for

that this distinction is based on sound policy. The purpose of residential housing is to provide shelter and an environment in which to raise families. The purpose of commercial property is to generate income or capital gain. The former purpose is worthy of greater protection from economic swings than the latter. Also, the loss of a home through foreclosure has greater emotional and financial consequences than loss of a commercial property. When one loses one's home, one must reestablish a new residence. The home owner will be faced with moving expenses, legal fees, a new downpayment or at least rent and a damage deposit. A home owner must establish a new residence immediately. It is onerous on 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.

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certain individuals, but not others, the proposed legislation will offend s. 15(1) of the Charter. In *Andrews* v. *The Law Society of Alberta* [1989] 2 W.W.R. 289, the Supreme Court of Canada limited the scope of the possible grounds for discrimination dealt with in this section to the enumerated grounds and other analogous grounds. Fairly immutable personal characteristics are grounds analogous to those enumerated in the section. In *Andrews* citizenship was held to fall into the class of analogous grounds because non-citizens are a vulnerable group lacking in political power and, therefore, are a "discrete and insular minority" that section 15(1) seeks to protect. We do not believe that borrowers owning property other than residential land and farm land constitute a group that is either disadvantaged or deserving of the protection of s. 15 of the Charter. Even if this is the case, we believe that the proposed legislation would meet the tests established in *R.* v. *Oakes* [1986] 24 C.C.C. (3d) 321 (S.C.C.) and could be "demonstrably justified in a free and democratic society".

7.38 Some might argue 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. First, a farm is a commercial operation and commonly a residence as well.[414] Second, the loss of a farm is the loss of a home and a livelihood. When a farmer loses his farm, he must reestablish a residence and find a new occupation. Third, the production of food for our society is to be encouraged above that of many other commercial ventures. For these reasons, we recommend that the law treat farms the same as residences.

7.39 The public policy underlying legislation that creates deficiency judgment protection provides another reason for not protecting every individual borrower. This type of protection is *not* designed to allow people with means to escape payment of debt. It is designed to protect destitute borrowers from overhanging deficiency judgments. Borrowers in need of such protection are those individuals whose wealth is in their homes and farms. For those people (walk-aways excluded), the loss of their home or farm through foreclosure means they have come to the brink of financial ruin and must rebuild their fortunes. By providing deficiency judgment protection only to individuals who grant mortgages on residential land or farm land, Alberta will be protecting those most likely in need of protection. Those individuals who can afford to invest in commercial properties do not require protection from deficiency judgments. They are more likely to have other assets which can be used to satisfy the debt secured by the mortgage.

[414]We make the assumption that the large majority of farmers reside on their farm land.

(c) How should individuals who have mortgaged their home or farm be protected from deficiency judgments?

(i) Methods of protecting these individual borrowers

7.40 Having stated whom we wish to protect and why, we must now determine the simplest way of doing this. There are three possible methods that can be used to provide protection from deficiency judgments. The first is to restrict the lender's remedies to the land where an individual grants the mortgage. The second is to restrict the lender's remedies to the land where an individual grants a mortgage that charges residential land or farm land. The third is to restrict the lender's remedies to the land whenever an individual grants a purchase money mortgage that charges residential land or farm land. Let us evaluate and compare the three possibilities in respect of certainty and scope of protection.

7.41 The first method is to retain the distinction now made between individuals and corporations. At first glance this may seem to contradict our stated goal of raising protection from deficiency judgments in the case of mortgages of residential land or farm land but not commercial properties. 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 a corporate vehicle. This 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.

7.42 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.

7.43 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 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 of residential land or farm land is 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.

7.44 The hearth and home philosophy 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 a farming operation 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 borrower or any member of his family use the residential land as a *bona fide* residence or carry on a *bona fide* farming operation on the farm land. The difference between these concepts is illustrated by an example. Assume residential land is defined to include a single family detached unit—commonly known as a house. An individual purchases a house as an investment and rents it to strangers. If deficiency judgment protection arises because an individual mortgages residential land (defined to include a single family detached unit), the borrower is protected from a deficiency judgment. If deficiency judgment protection arises because an individual mortgages residential land upon which he resides, the borrower is not protected in these circumstances. We will deal with this issue in more detail later.

7.45 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?

7.46 The advantage of the second method is that it comes closest to protecting only those in need of deficiency judgment protection. The difficulties comes 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.

7.47 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 properties are the facts that trigger protection. Such legislation only protects 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.

7.48 The third method of protection has the advantage of certainty. At the time the loan is made the lender 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 very narrow deficiency judgment protection. Unless we expand the scope of the protection, a borrower who grants a mortgage to secure a loan for construction of a building on the mortgaged land will not be protected. 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?

(ii) Recommendations for reform

7.49 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 faced with this situation 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.

7.50 We are torn between these two methods. The certainty of application flowing from protecting all individuals is very attractive. However, the other method comes closest to protecting only those individual borrowers we believe should be protected. Therefore, it is our tentative 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.

RECOMMENDATION 3

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.

(6) What is the extent of the protection?

(a) Definition of residential land and farm land

7.51 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 hearth and home philosophy, 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 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.

7.52 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 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

(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 as a residence by one family,

(e) "residential land" means

(i) a parcel on which a single-family detached dwelling unit, single-family semi-detached dwelling unit, or duplex unit is located, or

(ii) a residential unit under the *Condominium Property Act*.

7.53 Please note that we have defined "unit" to mean living quarters intended for use as a residence. We have not defined it to be living quarters that are used as a residence. The importance of this will be discussed later when we consider whether a certain use must be made of the property before deficiency judgment will arise.

(i) Land development

7.54 One situation that requires special attention is the development of vacant land into residential land. In this context, we are concerned with default during the construction of the building and default after completion of the construction. Let us first deal with the situation in which default occurs at some time after the construction is complete. The hearth and home philosophy contemplates protection from deficiency judgment for the individual who has built a home, but not for the person who speculates in the price of vacant residential lots. Is it possible to create legislation which protects the first person, but not the second? This could be done if deficiency judgment protection arises because an individual granted a mortgage on land that at any time during the term of the mortgage became residential land. The individual who did not develop the lot before default would be liable for any deficiency. The individual that did construct a home on the lot would be protected from action on any covenant to pay given in a mortgage charging the land.

7.54 Default in payment can also occur during the construction process. This is particularly the case when the individual becomes embroiled in builders' lien disputes brought on by the insolvency of the building contractor. These individuals should also be protected. To ensure that individuals who are building a home are protected from deficiency judgment from the time construction begins, "residential land" as defined should include a parcel on which a single-family detached dwelling unit, single-family semi-detached dwelling unit, or duplex unit is being constructed.

7.56 The following examples demonstrate the protection we envision. Assume an individual purchases a lot that can be developed into a residential property. The individual borrows money to purchase the lot and grants a

mortgage on the lot as security for repayment of these moneys. Three years later, the individual places a construction mortgage and proceeds to build a house. From the moment construction begins, neither lender could sue the individual borrower for a deficiency judgment. This ensures that the individual who builds his or her own house is given the same protection as the individual who mortgages an existing house. In contrast, if the borrower defaulted before construction began, there would be no deficiency judgment protection since an undeveloped lot is not residential land.

(ii) Mobile homes

7.57 Many Albertans live in mobile homes located on land that they own. In Edmonton, for example, 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.

7.58 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.

(iii) Recommendations

7.59 We now take our original definition and revise it to deal with land development and mobile homes. This leads us to expand the definition of residential land and make the following recommendations:

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[415]R.S.A. 1980, c. M-18.5, s. 1(1)(d).

RECOMMENDATION 4

Residential land and farm land would 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 one family as a residence,

(e) "residential land" means

(i) a parcel on which a single-family detached unit, single-family semi-detached unit or duplex unit is located, or

(ii) a parcel on which a single-family detached unit, single-family semi-detached unit or duplex unit is being constructed,

(iii) a residential unit under the *Condominium Property Act*, or

(iv) a parcel on which no more than two mobile homes are located.

RECOMMENDATION 5

Deficiency judgment protection should arise if at any time during the term of the mortgage, as extended from time to time, vacant land was developed into residential land.

(b) Must the individual borrower reside on the residential land or carry on a farming operation on the farm land?

(i) Introduction

7.60 Asking this question is easy. Answering it is difficult. We begin by examining the purpose of a use requirement. Then we as ask: " When must the individual reside on the residential land or carry on a farming operation on the farm land?" After determining the use requirement that would best serve the hearth and home philosophy, we analyze whether the complexity created by such a use requirement outweighs the advantages of imposing it.

(ii) Rationale behind imposing a use requirement

7.61 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 situated in Edmonton. This individual can:

(a) live in the house,
(b) live in the house and carry on a business in the home,
(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 as a professional office.

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?

7.62 With farm land the task is not as difficult. The distinction between undeveloped land and farm land is that on the latter a farming operation is being carried out or has in the recent past been carried out. Without this activity the land is undeveloped land. So for farm land some one must be carrying on the farming operation. The issue is whether the borrower or a family member must carry on the farming operation.

7.63 The hearth and home philosophy does not seek to protect individuals who purchase residential properties or farm land as investment properties. Therefore, one would be serving this philosophy 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, he or she or a family member resides on the residential land or carries on a farming operation on the farm land. Nonetheless, it must be recognized that the imposition of certain uses as a condition of deficiency judgment protection greatly increases the complexity of the proposed reform.

(iii) Change of use

7.64 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 made of the property at the time the money was lent.

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.

7.65 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 this chart shows, however, different results are reached when use changes. "Yes" indicates there is deficiency judgment protection. "No" indicates there would be no protection.

Use Requirement

residence of borrower
(original use)

rental property
(original use)

rental property
(use at default)

residence of borrower
(use at default)

1. Original use as a residence

yes

no2. Use as residence at default

no

yes3. Use as residence at any time

yes

yes4. Exclusive use as residence

no

7.66 Two competing policies affect the choice between these alternatives. The first is our desire to implement the hearth and home philosophy and protect individuals who mortgage their home or farm, but not other types of property. The second is the need for the lender to know at the time he makes the loan whether he will be able to pursue the borrower for the deficiency judgment or not. If we give the first policy priority, options 2 and 3 are attractive. If the second policy is given priority, 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.

7.67 For example, assume a lender lends money to an individual for the purchase of residential land, which was 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, at some later date the individual borrower resides in the property. The borrower defaults in payment six months after taking possession of the property. If protection of all home owners from deficiency judgments is paramount, then the individual would be protected if he defaults in payment after he has chosen to live in the property. If certainty for lenders is paramount, the individual would not gain protection from a deficiency judgment by making the property his residence. The lender lent on the basis of recourse on the personal covenant. A subsequent event would not defeat this expectation.

7.68 The reverse situation must also be addressed. Should an individual borrower lose protection from a deficiency judgment if he stops using residential land as his 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 the lender in this situation because the loan was made on the basis that there would be no recourse to the personal covenant. If the desire to protect home owners 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.

7.69 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 a farming operation on the farm land. This is option 3 outlined above. Under this option, the law would protect an individual borrower of residential land or farm land if at any time during ownership of the land, the land is put to these uses. 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.

(iv) Multiple uses

7.70 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.

(v) Analysis

7.71 This issue generated lively debate amongst us. We have three serious concerns with the imposition of a use requirement. The first, and most serious concern, is 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 individuals who use the land as their residence or farm, the law would have to protect individuals who at any time during the term of the mortgage used the land as a residence or carried on a farming operation. At the time of making the loan, a lender would not know if an investment property would at a later date be used by the borrower as a residence or farm. 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. For example, assume an individual wished to borrow money to purchase a rental house. The individual wants to finance the purchase of the house through a mortgage charging the house. The individual does not plan to reside in the house. Nevertheless, the lender would know that he or she would lose the right to sue on the covenant to pay given in the mortgage if the borrower at any time resided in the house. With this knowledge, the lender might be forced to deal with the loan on the basis of no recourse on the personal covenant. This uncertainty is undesirable.

7.72 The second concern is an evidentiary one. Assume the law imposes a use requirement as a condition of deficiency judgment protection. Who will have the onus of proving the borrower resides or does not reside in the property? In 1984, the Alberta Legislature amended the *Law of Property Act* to place the onus of proving use of property upon the transferee seeking the protection of section 43(1.1). We speculate that this amendment came about because it is difficult for a lender to prove that the transferee did at no time reside in the property. Yet, we are uncomfortable in imposing such an onus on all borrowers. Most foreclosure actions are undefended. Many borrowers leave the province shortly after default or are too intimidated by the court process to appear. If a use requirement is imposed, some might be unaware that their protection hinges on their proving certain use of the property. In these cases the borrower will present no evidence as to whether he or she did or did not reside on the property or carry on a farming operation on the property. Will putting the onus on the borrower to prove protected use of the property defeat the protection afforded by the legislation? If we put the onus on lender to prove that borrower did not live in property, is this too difficult to prove?

7.73 Our third concern is complexity. All borrowers and lenders would agree that in the area of mortgage remedies law, simplicity is a virtue. We think that imposition of a use requirement would make the law unnecessarily complicated.

7.74 It was suggested to us that we could easily deal with these concerns. The proposed solution was that there be no deficiency judgment protection for an individual who at the time of the granting of the mortgage declares that he will never reside on the residential land or carry on a farming operation on the farm land. Once the declaration was given, the borrower's subsequent use of the residential land as a residence or the carrying on of a farming operation on the farm land would not raise protection. The effect would be certainty for the

lender from the time the loan is made. It was further suggested that the onus of proving use of the property should be on the person who has this information, namely, the borrower. This view took comfort from the fact that the evidence produced by most lenders would reveal whether the action dealt with residential land in which the borrower resided. The only time the lender might not know if the borrower resided in the property was when it was originally a revenue producing property. In such situations, it was fair to expect the borrower to prove he or she subsequently resided in the property. Finally, it was suggested that it was necessary to impose a use requirement to put into effect the hearth and home philosophy. We should not deviate from this guiding principle. Furthermore, imposing a use requirement would not unduly complicate the area. The introduction of sections 43(1.1) and 43.3 of the *Law of Property Act* has caused no problems.

7.75 The majority of the Board was not persuaded by these arguments. First, the technique of using the declaration is really a means of tying deficiency judgment protection to the original use. This was a narrow version of protection. The majority expected that the declaration would become a standard requirement to obtain loan proceeds used to purchase a revenue property, even when it was probable that the borrower might later reside in the property. There was also the concern that the declaration would be a device that raised its own problems. Would the declaration be abused by some lenders in an effort to circumvent the deficiency judgment protection that should arise? What if a lender took the declaration knowing it to be false? Second, and most importantly, the majority thought that the complexity created by the use requirement far outweighed any benefits that would flow from its adoption. The potential for abuse and the added complexity this declaration would create caused the majority not to adopt this device.

(vi) Recommendations

7.76 We do not recommend that deficiency judgment protection be tied to a specific use of residential land or farm land. Certainty is preferable to strict adherence to the principle of protecting only homes and farms.

7.77 The simplest way of providing deficiency judgment protection for individuals who mortgage their homes or farms is to protect all individuals who grant a mortgage that charges residential land or farm land. Protection arises independently of the use made of the property. This would protect all home owners and farmers, as well as some individuals who buy residential land or

farm land as an investment. It would not, however, stop a lender from insisting such investors use a corporate vehicle. This type of deficiency judgment protection would avoid the problem of change of use and multiple use. The law would not be concerned with whether or not protection would be lost if use changes from a protected use to a non-protected use. The law would not be concerned with whether protection could be acquired if use changes from non-protected use to a protected use. The law would not remove protection from an individual borrower who rented a suite located in the basement of his home. This scheme goes further than the protection of hearth and home, but may be justified on the basis of the certainty it creates.

RECOMMENDATION 6

Deficiency judgment protection should be triggered whenever an individual grants a mortgage of residential land or farm land. Such protection would not depend on the use made of the land by the borrower. Nonetheless, by definition, farm land would only include land that is being used for carrying on farming operations.

(c) Treatment of mortgages that charge different types of property

7.78 Another problem will arise if a mortgage charges residential land or farm land and other kinds of property. Should the borrower be protected in this situation? Our tentative recommendation is to protect the individual borrower if the mortgage charges different kinds of property, one of which is residential land or farm land. This would cause the prudent lender to make two loans secured by two mortgages: a mortgage secured by residential land or farm land and a mortgage secured by other kinds of land. The advantage is that it forces the parties to determine the amount that will be secured by a charge on the land only and the amount that will be secured by a charge on the land and recourse on the covenant to pay. This result is preferred to having a court determine this issue at some later date. The disadvantage is that it creates increased administrative costs for both the borrower and the lender. One can also imagine that it will lead to disputes as to whether the payment should be applied to the protected or non-protected mortgage.

RECOMMENDATION 7

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.

(d) Assignments of rent

7.79 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 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 rents property will also be given deficiency judgment protection. These situations will be limited to cases in which the property is residential land or farm land or to cases in which the mortgage charges these and other kinds of property.

RECOMMENDATION 8

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 deficiency judgment.

D. The Chain of Liability

(1) Introduction

7.80 It is common for a borrower to sell his property to the 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.

7.81 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, we believe it would be confusing to use terms that are different from those used in the section.

(2) **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.

(3) **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.

(4) **Renewal agreement**: A renewal is an agreement entered into upon the expiry of the mortgage term. The parties to the renewal are the lender and the person who is the owner at the time the term of the mortgage expires. 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 moneys 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?

7.82 Section 62 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 avoids the circuity of action formerly necessary by creating privity of contract between the transferee and the lender.[416] 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 any event.

7.83 We think section 62 should continue to serve these two purposes. Subject to our consideration of the scope of the covenants implied by the section, we recommend that section 62 be retained.

(b) What should be the scope of the covenant of indemnity and the scope of the covenant to pay?

7.84 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.[417] It is our recommendation 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

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[416]See paras. 4.30-4.39.

[417]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.) and *Bellman* v. *Big City Holdings Ltd.* 1984 A.U.D. 846 (M.C.).

created by the mortgage. These sums would be paid at the rate and at the time specified in the mortgage.

RECOMMENDATION 9

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, all reasonable sums paid by the lender to maintain or preserve the property, and costs. These sums would be payable at the rate and at the time specified in the mortgage.

(c) Should the lender be able to enforce the covenant to pay against each person in the chain of title?

7.85 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 him under the common law. If the purpose of the section is to allow the lender to sue the present owner, why is he 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 only the borrower and the person who was the registered owner at the time of default. 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. Upon transfer the shell company would default. This would leave the lender in the position of 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 borrower and the owner as of the date of default.

(d) Summary

7.86 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) Who should receive protection?

7.87 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[418] 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. As shown in chapter four, at present the law protects some individual transferees, but not others, and protects some corporate transferees, but not others. For example, a lender cannot sue an individual borrower on the covenant to pay given in a mortgage charging commercial property. However, if an individual assumes a mortgage on an identical property that was granted by a corporation, that individual is liable. The liability arises from the covenant to pay he gave in an assumption agreement or the covenant to pay implied by section 62 of the *Land Titles Act*. The liability ceases when the individual transferee renews the mortgage. Upon renewal the transferee is protected by section 41(1)(b). This unequal treatment of individual borrowers and individual transferees is not desirable.

7.88 The law should be designed to implement the hearth and home philosophy and, as far as possible, treat individuals equally and corporations equally. Therefore, individual transferees should be protected on the same basis as individual borrowers. That would mean that there should be protection for individuals who assume mortgages charging residential land or farm land, but there should be no protection for individuals who assume mortgages charging other kinds of land. The protection should arise no matter who originally granted the mortgage. Corporate transferees would be treated on the same basis as corporate borrowers. No corporation, be it the borrower or a transferee, would

[418]This covenant would be found in an assumption agreement or in a renewal agreement.

be afforded deficiency judgment protection.

RECOMMENDATION 10

A corporation that purchases land charged by a mortgage granted by an individual or a corporation should not be afforded deficiency judgment protection.

(b) When should individual transferees be protected?

(i) The existing method of protection

7.89 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.[419] 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 did not affect whether a transferee was protected from a deficiency judgment.

7.90 In 1988 the law changed and renewals now affect whether deficiency judgment protection is available to a transferee who has renewed the mortgage. As discussed in chapter four, this change came by way of three Court of Appeal cases: *Collingwood Invt. Ltd.* v. *Bank of Amer. Can. Mtge. Corp.*,[420] *Paramount Life Insurance Company* v. *Hilton*[421] and *Pioneer Trust Company* v. *Patrick*.[422] 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 he agrees to pay 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

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[419]The liability arose from the covenant implied by s. 62 of the *Land Titles Act* or from any covenant to pay the mortgage given by the transferee to the mortgagee.

[420]*Supra*, note .

[421]*Supra*, note .

[422]*Supra*, note .

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 his family did not reside in the property.[423]

7.91 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.[424] By itself, section 41(1)(b) is not adequate protection for the transferee because the section does not prevent the corporate borrower from suing on the covenant of indemnity implied by section 62.[425] 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.

7.92 Another problem with the present law is that it leaves some questions unanswered. Does a renewal affect the liability of previous owners including the borrower?[426] 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 assumed a mortgage granted by an individual or a corporation?

(ii) Suggestions for reform

7.93 The law should be improved by having legislation define the class of transferees that will be protected and the nature of that protection. We believe

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[423]See *Standard Trust Company* v. *100762 Canada Ltd. and Steel* (1990) 108 A.R. 336 (Q.B.). The facts were the same but the corporation did not transfer title to the individual.

[424]*Paramount Life Insurance Company* v. *Hilton and Torgerson Developments Ltd., supra*, note and *Pioneer Trust Company* v. *Patrick, supra*, note .

[425]*In re Forster Estate, supra*, note .

[426]See the discussion of this point by E. Mirth in an article entitled "Renewals in Alberta" (1985) 23 Alta. L.R. 405.

that the existence of deficiency judgment protection should depend on the identity of the transferee and the kind of land charged by the mortgage. Deficiency judgment protection should not be affected by the identity of the borrower or the existence or non-existence of a renewal. The scope of the protection should be broad and should protect against actions brought by the lender and transferor.

7.94 The legislation should prohibit a lender from bringing an action against a transferee on any covenant, express or implied, to pay any of the sums secured by the mortgage where:

(a) the transferee is an individual, and
(b) the mortgage charges residential land or farm land.

There would be no requirement that the transferee use the residential land as his or her residence or use the farm land for carrying on a farming operation. Yet, in the case of farm land, someone must carry on a farming operation. This would protect individuals who purchase homes from corporate home builders and who assume the mortgages granted by the corporation. It would protect any individual who is buying a property that will become his home or farm. It would also protect individuals who buy residential land or farm land as an investment. The protection would not depend on whether the previous owners were or were not personally liable for the deficiency.

7.95 It is important to realize that under the proposed regime, renewals would neither give rise to deficiency judgment protection or take it away. Renewals would be irrelevant vis a vis such protection. Nevertheless, a covenant to pay given in a renewal 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 on residential land granted by an individual. Under our proposed scheme, this individual would be protected from a deficiency judgment. In *Collingwood Invt. Ltd.* v. *Bank of Amer. Can. Mtge Corp.*,[427] the Alberta Court of Appeal held that in such a situation, section 62 of the *Land Titles Act* does not imply a covenant by the corporate transferee to 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.

[427] *Supra*, note .

RECOMMENDATION 11

A lender should be prohibited from suing a transferee on any implied or express covenant to pay any sums secured by the mortgage where:

(a) the transferee is an individual, and

(b) the mortgage charges residential land or farm land.

7.96 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 against a protected transferee by the transferor.

7.97 When the kind of land charged by the mortgage is residential or farm land, individual borrowers and individual transferees will be protected, but corporate borrowers and corporate transferees will not be protected. This will give rise to situations in which the chain of title includes protected individuals and non-protected corporations. Assume Corporation X builds a house and sells it to an individual. The individual assumes the mortgage granted by Corporation X. A few years later the individual sells the house to Corporation Y, which then enters into an assumption agreement with the lender. Upon the default of Corporation Y, the lender sues Corporation X on the covenant to pay given in the mortgage and Corporation Y on the covenant to pay given in the assumption agreement. 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 *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.

RECOMMENDATION 12

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:

(a) the transferee is an individual, and

(b) the mortgage charges residential land or farm land.

RECOMMENDATION 13

This recommendation applies to the special circumstances where the chain of title for residential land or farm land includes individuals and corporations. For the purpose of section 62 of the *Land Titles Act*, each corporation is deemed to be the transferee of the corporation that immediately preceded it in the chain of title. Individuals who intervene between corporations in a chain of title would, therefore, be transparent for the purpose of section 62. Whether section 62 of the *Land Titles Act* implies a covenant on behalf of the corporate transferee will depend on whether the corporate transferor is liable on any covenant, express or implied, that was given to the lender.

(4) Continuing Liability

7.98 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 the borrower who assumes that once he sells the property his 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. As discussed in chapter six, the Ontario Law Reform Commission has made similar proposals in respect of protected borrowers. The Ontario Commission's proposals will protect a broader class of borrowers and transferees.

7.99 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 non-protected individuals as well. 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?

7.100 As with most things in life, there are two sides to the issue. If you believe that the person who owns the property should be responsible for the mortgage debt, you 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, 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.

7.101 We favour the second view. As discussed throughout this report, we believe that individuals who mortgage residential land or farm land are deserving of deficiency judgment protection. Others are 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 14

Alberta should <u>not</u> 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.

E. Guarantors

(1) Should Protection Extend to Guarantors?

7.102 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. That is, individuals who grant a mortgage that charges residential land or farm land should be protected from action by the lender. Although the lender would be prohibited from suing such an individual on the covenant to pay given in the mortgage, this would not extinguish the debt. The lender 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 he or she cannot do directly. So if the promise to pay contained in the promissory note is the same as the promise to pay contained in the land mortgage, 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 for borrowers and transferees that we propose would not extend to guarantors. Also, the guarantor could not obtain such protection by becoming a transferee of the mortgaged land.

7.103 Having said that the protection afforded a borrower will not assist the guarantor, it must be noted that it is possible for a guarantor to be protected from action on the guarantee. The possibility arises where the guarantor gives a mortgage charging residential land or farm land that is collateral security for his or her obligations under the guarantee. The giving of the collateral land mortgage will raise the issue of whether the promise to pay in the guarantee is the same as the promise to pay in the collateral land mortgage. If the scope of the promises is the same, action on the guarantee will be prohibited. If the promise to pay given in the guarantee was intended to have broader scope than the promise to pay given in the collateral land mortgage, then the lender can enforce the guarantee.

RECOMMENDATION 15

Alberta should allow a lender to seek recovery of any deficiency from a guarantor 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 sue a guarantor 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

7.104 A guarantor who pays all or part of the debt secured by the 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.[428] Furthermore, there is nothing inequitable in obliging the borrower to indemnify the guarantor, even

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[428] *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.

where the lender cannot commence an action against the borrower or transferee.[429]

[429]*Taylor* v. *Glionna, ibid*.

7.105 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 to the borrower's obligation to the guarantor. The borrower's obligation to indemnify the guarantor is different than his or her obligation to pay the lender.[430]

7.106 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.[431] As transferee of the mortgage, the guarantor could, where not circumscribed by Part 5 of the *Law of Property Act,* exercise the *in rem* remedies and *in personam* 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

7.107 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.[432] 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.[433]

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[430]*Ibid.*

[431]*Land Titles Act*, R.S.A. 1980, c. L-5, s. 111.

[432]*Taylor* v. *Glionna*, *supra*, note (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).

[433]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

(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.

7.108 It is unclear whether equity gives the guarantor of the borrower's obligation an independent right to sue the transferee for indemnity. In his treatise on The Law of Guarantee,[434] 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.[435] By this view, the guarantor would have no greater rights against the transferee than would the lender.

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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.

[434]K.P McGuinness, *The Law of Guarantee* (Toronto: Carswell, 1986).

[435]*Ibid*. See chapters seven and eight, especially paras. 7.8 and 8.2.

7.109 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 extinguished was the debt owing by the borrower to the lender after the guarantor had paid the $8,000.

7.110 Query whether a guarantor who pays money to the lender may be able to argue that the transferee has, thereby, been unjustly enriched.[436]

(4) Should the Guarantor's Right to Seek Indemnity be Restricted?

7.111 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.

7.112 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

[436]See some interesting comments on unjust enrichment made by the Alberta Court of Appeal in *Guaranty Trust Company of Canada* v. *Bailey*, *supra*, note at 304.

why.

7.113 The guarantor will argue as follows:

(i) 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 court should be loathe to deviate from this principle.

(ii) 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 take the corresponding detriment, namely, he must save harmless the guarantor.

(iii) 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.

(iv) 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.

7.114 The borrower or transferee will argue:

(i) 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 his remaining exigible assets at a time when he is forced to find new living accommodations and, probably, new employment.

(ii) 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 gives the guarantee. Knowing this, the guarantor has no cause to complain when he is called on to perform his obligation under

the guarantee without recourse against the borrower.

7.115 We think it terribly 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 16

A guarantor's right to seek indemnity from the borrower or a transferee should remain as it is at present.

F. The Position of Crown Agencies

7.116 In the 1980s the Crown's ability 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. *Ciereszko and Craik*[437] and *Farm Credit Corporation* v. *Dunwoody Limited (Trustee) and Holowach*.[438] 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*.[439] 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*.[440]

7.117 Assume a property with an appraised value (new) of $80,000. The Crown's policy is to make housing available to more people. To implement this

[437]*Supra*, note .
[438]*Supra*, note .
[439]*Supra*, note .
[440]See paras. 4.15-4.27 of this report.

policy it lends money to first time home owners with little equity so that they can purchase a home. A young couple puts in several thousand dollars and the Crown advances the rest. The Crown's loan is secured by a mortgage charging the home. The bottom falls out of the market, and the equity is quickly lost. Should the Crown have recourse to the personal covenant given in the mortgage?

7.118 The Crown can support its immunity by arguing recourse is necessary when public funds are lent. A debt due to the Crown is in fact a debt due to the taxpayers and should, on this account, be recoverable, even when recovery by individuals is barred. In addition, it is necessary to protect the reserves of the Crown and thereby ensure the financial stability of the Crown. Furthermore, this *is* a special function of lending to first time home owners with little equity. The purpose is to make housing available to more people. This would not be undertaken if there was no possibility of recourse. On the other hand, there are many things to be said on behalf of the young couple. First, it seems somewhat anomalous (to say the least) that the millionaire who gets into trouble escapes personal liability of perhaps many thousands of dollars on his house whilst the young couple do not. We are assuming here that the millionaire borrowed money from a private lender. Second, will the inability on the part of the state to have recourse really cause "drying up" of this source of funding? Third, 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. Finally, there is much to be said for symmetry of the law in this area. That is, if we are going to state general principles of liability, carving out exceptions to those principles is undesirable save in truly compelling circumstances.

7.119 The arguments in favour of the Crown's position are not convincing. In this day and age it is bizarre when the Crown places itself above the law. If the Crown is acting like a commercial lender, it should be governed by the same laws. If the Crown is lending to low income individuals or other persons likely to suffer in times of economic dislocation, it should not be allowed to enforce the covenant to pay. These are the persons most deserving of deficiency judgment protection and the Crown, as the representative of society as a whole, is the best loss absorber in times of serious economic dislocation.

7.120 There is some debate as to whether provincial legislation can bind the federal Crown. We do not choose to enter this debate. Our position is that certain individuals require deficiency judgment protection and it matters not who lends the money. Alberta should make the provincial Crown, and if possible, the federal Crown subject to the general laws creating deficiency

judgment protection for certain individuals. We note that in Saskatchewan, the Farm Credit Corporation is not able to obtain deficiency judgments against a farmer who granted a purchase price mortgage on farm land.[441] To our knowledge, Farm Credit Corporation has not challenged the Saskatchewan legislation on the basis that it does not bind the federal Crown. More important, Farm Credit Corporation continues to do business in Saskatchewan.

7.121 After balancing these considerations, we recommend that everyone, Crown or not, should be bound by the protective principles stated in the preceding sections and upon the terms there stated.

RECOMMENDATION 17

The Crown should be bound by all the legislation which governs mortgage remedies. In particular, the Crown should be bound by Alberta legislation that limits lenders' remedies to the land in certain situations.

7.122 When discussing the position of Crown agencies, one must also address the 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 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.[442] 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, the Corporation also takes this position. Section 43(2) of the *Law of Property Act* and its predecessors were enacted for the benefit of Canada Mortgage and Housing Corporation. This section expands the remedies of the approved lenders so that these lenders are in the same position that the Crown

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[441] *The Saskatchewan Farm Security Act*, S.A. 1988-89, C. s-17.1, ss 25 and 104.
[442] *National Housing Act*, R.S.C. 1985, C. N-11, s. 9(1)(a).

would be in if it had made the loan directly.[443] This allows the insurer, Canada Mortgage and Housing Corporation, 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.

7.123 Typically, Canada Mortgage and Housing Corporation 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 downpayment is less that 25% of the value of the house. Most borrowers who have a high ratio mortgage are young individuals who have been able to save a small downpayment towards the purchase of their first home. These are the persons most needing protection from deficiency judgments in a time 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. The counter argument is that Canada Mortgage and Housing Corporation instructs the approved lenders to seek judgment only in deserving cases.[444] Yet, it strikes us that the Alberta Legislature should determine who is deserving of protection and not the policy of a Crown corporation.

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[443]See K.R. Laycock, "Foreclosure Action on Mortgages under the NHA" LESA 1985 Banff Refresher Course 256 at 262.

[444]At one time Canada Mortgage and Housing Corporation ("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.

7.124 Our major concern is the possibility that Canada Mortgage and Housing Corporation would stop insuring high ratio mortgages given to Albertans if section 43(2) was repealed. The likelihood of this happening is difficult to gauge. Saskatchewan must believe that the Corporation will continue to insure Saskatchewan land mortgages even where the remedies of an approved lender are restricted. We draw this conclusion from the fact that Saskatchewan recently passed legislation that provides that its deficiency judgment protection legislation for purchase money mortgages applies to all loans insured by the Corporation under the various National Housing Acts. To this general protection, there is an exception for rental housing projects, co-operative housing projects and dormitories.[445] We leave the political realities to the Alberta Legislature. On principle, we cannot recommend that Alberta retain this exception for mortgages given to secure a loan made under the *National Housing Act*. The individual borrowers who have high ratio mortgages on residential land are the ones most in need of deficiency judgment protection and should be protected.

RECOMMENDATION 18

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*.

G. Due-on-Sale Clauses

7.125 In Alberta due-on-sale clauses are valid and enforceable clauses 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.[446] 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.

7.126 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

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[445] *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.).

[446] Due-on-sale clauses are discussed in more detail in chapter four, paras. 4.72-4.85.

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.[447] 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.

7.127 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:[448]

> 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.

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[447]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 1113-1116.

[448]Ontario Law Reform Commission, Report on the Law of Mortgages (1987) at 85.

7.128 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*.[449] 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, if it had, the clause could be enforced and the court would not stay the foreclosure action.

7.129 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?[450] 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.

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[449] *Supra*, note .

[450] 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 . 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.

7.130 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."[451]

7.131 The Ontario Law Reform Commission recognized that due-on-sale clauses are of significant benefit to lenders and that this fact is not generally understood by borrowers. While recognizing this imbalance in the position of the parties, the Commission did not go so far as to prohibit enforcement of due-on-sale clauses agreed to by protected borrowers.[452] It was afraid that a general prohibition would have the effect of forcing lenders to opt for shorter terms or to raise interest rates. Therefore, the Commission recommended that lenders be allowed to enforce due-on-sale clauses for any reason. To restore the balance in the position of the parties, it also recommended that the presence of a due-on-sale clause would allow the protected borrower to pay out the mortgage upon sale to a third party, even when there was no right of prepayment in the mortgage.

7.132 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 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.

RECOMMENDATION 19

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[451] *Ibid*. at 52.

[452] The definition of "protected borrower" is set out at para. 6.43.

The existing law relating to the enforcement of due-on-sale clauses is adequate.

H. Enforcement of Attornment Clauses

7.133 In Alberta, sections 35(2)(a)-(c) and 37 of the *Law of Property Act* validate attornment clauses given in certain types of mortgages. 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* is enforceable.[453] With one large exception, being the National Housing Act mortgage, the law is designed to allow the additional security of distress only against goods that are not residential belongings or farm equipment.

7.134 The goal of protecting residences and farms is laudable and should be continued. This goal can best be accomplished by tying enforceability of the attornment clause with deficiency judgment protection. If the lender cannot sue the borrower for a deficiency judgment, then the attornment clause is void. If the borrower is liable for any deficiency, then the clause is valid. With one exception, this would ensure that there would be no distraint if the property was the residence or farm of the borrower. The exception would be when 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 his business from the first floor of mortgaged commercial property and resides on the second floor.

7.135 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

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[453]The enforceability of attornment clauses in Alberta is discussed in more detail at paras. 4.122-4.133 of this report.

from seizure under execution. These exemptions would protect some, but not all, residential goods. Allowing enforcement of an attornment clause in these situations merely allows seizure before judgment, rather than after judgment. The same exemptions apply.

7.136 We would recommend that all lenders be subject to the same restrictions on the validity of attornment clauses. No exception should be 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 20

Any attornment clause found in a mortgage charging residential land or farm land is unenforceable against an individual borrower. 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.

I. Waiver

7.137 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 21

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

8.01 In this chapter we shall 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 of how to accomplish the transition between the existing law and the proposed law.

B. Extrajudicial Sale by a Lender

8.02 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*.[454] 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. Where the lender wishes to extinguish subsequent encumbrances, the lender must bring a foreclosure action and seek an order that will extinguish them.[455]

8.03 We favour judicial supervision of foreclosure proceedings because it is the system that goes the furthest to ensure fair treatment of the borrower, the lender, and holders of subsequent encumbrances. Of particular concern is the need for sale of the land at a fair price. We believe that judicial supervision does a far better job in ensuring sale of land at a fair price than does a system of extrajudicial sale. For this reason we dislike extrajudicial sale.

8.04 We make one exception in the case of a lender (or his duly appointed receiver) who exercises a power of sale granted by a corporation. In this case we believe the lender (or his duly appointed receiver) should be able to

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[454] 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.

[455] See the discussion at paras. 4.98–4.101 of this report.

exercise the power of sale, but only when there are no subsequent encumbrances. This will allow a business, including the land, to be sold as a going concern where no subsequent encumbrances exist. We do not recommend that the law enable the lender to transfer the land free and clear of subsequent encumbrances and interests.

8.05 We think this restriction upon the exercise of a power of sale given by a corporation is necessary to protect persons who have registered subsequent encumbrances. The perceived difficulty with allowing the lender to sell the land under a power of sale is that there is little incentive for the lender to sell the land for more than what is owing to the lender. In some situations, admittedly not the majority of situations, the land will be worth more than the debt owed to the lender. Where there are subsequent encumbrances, the court should supervise the sale process to ensure that the land is sold for a fair price. This will ensure that any surplus money goes to the holders of subsequent encumbrances. It also gives the holders of subsequent encumbrances the chance to redeem the land if they so choose. For these reasons we think that the lender (or his duly appointed receiver) should not be able to sell the land free and clear of subsequent encumbrances without pursuing foreclosure proceedings.

8.06 Our proposals will not bring about a change in result. However, the result will have to be accomplished in a different way. At present, the lender can exercise a power of sale if two conditions exist. First, the borrower must be a person who is not protected from deficiency judgment. Second, no subsequent encumbrances must be in existence. Under the new regime, some individual borrowers will not receive deficiency judgment protection. If the new regime does not specifically deal with powers of sale, then a lender could enforce powers of sale given by these individuals if there are no subsequent encumbrances registered against the land. To ensure that this does not happen, we recommend that all powers of sale granted by individuals be void. No exception would be made for mortgages given or insured under the *National Housing Act* and its predecessors. No other change will be needed to protect the position of corporations.

RECOMMENDATION 22

(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?

8.07 The Rice order takes its name from the order upheld by the Alberta Supreme Court, Appellate Division in *Trusts and Guarantee Company* v. *Rice*.[456] As the first step, the court offers the land for sale by tender. For whatever reason, the lender does not submit a tender. If no successful tender 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. If the court finds the proposal satisfactory, it accepts it and stays the order for a period—usually two months. Within this time the borrower has the opportunity to locate someone who is willing to pay more for the land. If no better offer is received, the land is sold to the lender.[457] Judgment is entered against the mortgagor for the amount of the deficiency.

(2) The Development of the Rice Order

8.08 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.[458] Under a Torrens system, the lender can obtain title by purchasing at a judicial sale or by foreclosing. At one point 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 who is asserting exclusive ownership of the land after foreclosure cannot sue on the covenant to pay.[459] It has been decided, however, that purchase at a judicial sale is not the

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[456]*Supra*, note .

[457]*Canada Permanent Trust Company* v. *King Art Developments Ltd.*, *supra*, note at 645-48.

[458]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.

[459]The common law is set out in *Lockhart* v. *Hardy* (1846) 50 E.R. 378 (Ch.),

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."[460]

8.09 In Alberta this view was first expressed in *The Security Trust Company Limited* v. *Sayre*[461] and *Trusts and Guarantee Company Ltd.* v. *Rice*.[462] A short time later the Privy Council reached the same conclusion in *Gordon Grant & Company Ltd.* v. *Boos*.[463] These principles were most recently affirmed by the majority of the Alberta Court of Appeal in *Canada Permanent Trust Company* v. *King Art Developments Ltd.* and the British Columbia Court of Appeal in *Re Bank of Montreal and Butler et al; Canada Mortgage & Housing Corporation, Intervenor*.[464] Strong dissenting opinions were given in the two most recent decisions.

8.10 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.[465]

8.11 The Rice order procedure is not mandatory; it is an alternative to allowing the lender to submit a tender. Allowing the lender to tender at a court conducted sale or to submit a proposal after an unsuccessful judicial sale gives the same result. The successful lender will still be able to sue for the deficiency.

(3) Must an Attempt to Sell the Land Precede a Rice Order?

Fink v. *Robertson* (1907) 4 C.L.R. 864 (Aust. H.C.), *Mutual Life Assurance Company of Canada* v. *Douglas, supra*, note , *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 Permanent Trust Company* v. *King Art Developments Ltd., supra*, note at 633-36.

[460]*Canada Permanent Trust Company* v. *King Art Developments Ltd.*, *supra*, note at 642.

[461]*Supra*, note . 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.

[462]*Supra*, note .

[463][1926] A.C. 781.

[464](1990) 66 D.L.R. (4th) 664.

[465]See *Man. Dev. Corp.* v. *Berkowits* [1979] 5 W.W.R. 138 (Man. C.A.).

8.12 In *Trusts and Guarantee Company, Limited* v. *Rice*,[466] the Alberta Supreme Court, Appellate Division expressed its views on when the court should give what is now known as a Rice order. The majority gave the following directions:

(i) The lender should not be able to bid at the first instance in mortgage proceedings, no matter who has conduct of the sale.[467]

(ii) In the economic conditions then existing, there should be an upset price fixed and announced in advance.

(iii) If after that procedure there is an abortive sale, the lender can propose to the Master that it purchase the property.

(iv) Instead of attempting to adjudge whether the lender's price is fair and reasonable, the court should protect the borrower by giving the borrower time to bring in a better offer.

(v) The time given to the borrower will vary depending on the nature of the property and the period of the year.

8.13 Until the 1980s 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.*[468]

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[466]*Supra*, note .

[467]In *Canada Permanent Trust Company* v. *King Art Developments Ltd.*, *supra*, note at 651 the Alberta Court of Appeal reversed its position on this point. It concluded:

> ". . . that in a court-conducted sale there is no reason to prevent a mortgagee from bidding. Whether the sale will be by tender, by a proposal by the mortgagee, by some combination of the two procedures, or by some other mode, is in my opinion, a matter for the exercise of discretion dependent upon the facts of each case."

[468](1984) 32 Alta. L.R. (2d) 75 (C.A.)—At the time this case was decided the Alberta real estate market was severely depressed. The chambers judge granted a foreclosure order 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 other legal rights without good reason. Even though an order directing sale would harm the borrower by increasing the size of the debt and

the Court of Appeal suggested that there could be an immediate Rice order. As a result, it is now possible for a lender who has a National Housing Act mortgage to seek immediate sale to the lender. The court grants this order when the lender is willing to pay fair market value.

8.14 This quick and efficient procedure for National Housing Act mortgages has been the subject of criticism. This criticism serves to highlight the issues that must be addressed when deciding if the Rice order procedure is desirable. The criticism is as follows. The fair market value is usually established by appraisal evidence produced by the lender. Are we confident all appraisal evidence is objective? Why is it that appraisers need to know whether their client is the borrower or lender? Should the appraisal be tested by an attempt at sale? These issues will be addressed later in this chapter.

(4) Availability of Rice Orders

(a) Mortgages granted to Alberta Mortgage and Housing Corporation

8.15 The Chambers Judge in *Alberta Mortgage and Housing Corporation* v. *Ciereszko*[469] held that the regulations governing the operation of this corporation did not allow sale to the corporation. In time, the Alberta Court of Appeal overruled this decision.[470] Before the appeal was heard, however, the regulations were amended to make it clear that when the corporation has commenced a foreclosure action, a sale to the corporation is possible.[471]

(b) Where the value of prior encumbrances exceeds the value of the land

8.16 In *Co-operative Mortgage Fund Ltd.* v. *K. Mac C Investments Ltd. and MacCrimmon*[472] Master Funduk refused to grant a Rice order to a second mortgagee because the value of the land was less than the debt owing on the first mortgage. In his view, a Rice order realized something out of the land for both the borrower and the lender. It produces a sale at a fair price which is of benefit

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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.

[469](1986) 2 W.W.R. 57, 41 Alta. L.R. (2d) 242 (Alta. S.C.).

[470]*Supra*, note .

[471]*Alberta Mortgage and Housing Corporation* v. *Kesef Investment Company Ltd., Ng and Ng* (1986) 78 A.R. 212 (M.C.).

[472](1983) 43 A.R. 144 (M.C.).

to the borrower and lender. Where there is no realization for the benefit of the borrower, a Rice order is inequitable. The sale to the lender is of no benefit to the borrower when the land is worth less that the debt owing on prior encumbrances. In this situation, the lender seeks to have the land and claim for the entire debt. This it could not do at common law and, therefore, any such proposal is unacceptable.

8.17 The practical effect of this decision is to force a second lender to rely exclusively on his *in personam* remedies where the land is worth less than the first mortgage.

(5) At What Price Will the Land be Sold to the Lender?

(a) Valuation in general

8.18 "Value is always a question of fact, and is therefore always a matter of evidence."[473] A court determines value on the basis of expert opinion evidence. In a foreclosure action the parties introduce this evidence by way of an affidavit of value sworn by an individual qualified to give evidence on the value of land. The individual can be an appraiser or, in some situations, a realtor. The affidavit sets out the individual's qualifications and attaches an appraisal report as an exhibit to the affidavit.

8.19 Rule 686(7) requires the lender to file an affidavit of value before he or she 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.[474] 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.

8.20 The value of land is not something that can be measured scientifically. It is common for equally qualified appraisers to have 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 may be small. Large divergences of opinion arise in volatile markets or at times when no market presently exists for the property in question. Volatile markets and no market in the near future were

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[473] *Nova, An Alberta Corporation* v. *Will Farms Ltd.* (1981) 31 A.R. 378 (Alta. C.A.) at 383.

[474] *Yorkshire Trust Company* v. *H.B. Nielson Management Corp. Ltd. et al* (1984) 34 Alta. L.R. (2d) 174 (Q.B.).

both common occurrences in Alberta in the recession of the 1980s. During such times valuation of land is a difficult task.

(b) Confirmation of sale to the lender

8.21 The question of how much a lender must pay for the land has been a subject of much contention. Should the lender pay fair market value,[475] forced sale value for cash,[476] or forced sale value on terms,[477] or some other value? The difference of opinion of various Court of Appeal justices is reflected in the case law.

8.22 In *Canada Permanent Trust Company* v. *King Art Developments Ltd.*[478] 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[479] 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.

8.23 This practice came into doubt after the Court of Appeal decision in *Yorkshire Trust Company* v. *Armwest Development Ltd #1*.[480] In that case the lender

[475]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.

[476]In *Canada Permanent Trust Company* v. *King Art Developments Ltd. #2, supra*, note , 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.

[477]"Forced sale on terms" is incapable of definition unless one knows what terms are being offered.

[478]*Supra*, note at 649-51.

[479]See *Fuhr* v. *Madison Dev. Corp.* 30 Alta. L.R. (2d) 206 (Q.B. -McDonald).

[480](1986) 66 A.R. 93.

offered to purchase the land for the forced sale value. The Court rejected the offer because 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. 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".[481] The Court held that as between borrower and lender the fair value is the market value and not the forced sale value.

8.24 The confusion was resolved in *Manufacturer's Life Insurance Company* v. *Daon Dev. Corp. and Price Waterhouse Limited*.[482] 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 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".[483]

8.25 The Court 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. 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."[484] With the assistance of such expert opinions, the court must establish the fair value which reflects the different circumstances. Of course, fair

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[481]*Ibid.* at 94.
[482](1989) 65 Alta. L.R. (2d) 40.
[483]*Ibid*. at 41.
[484]*Ibid*. at 46.

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.

8.26 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.

8.27 The Court did not expound on why the other anticipated expenses are improper. Its only comment was:[485]

> . . . 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 Company* v. *King Art Developments Ltd.*[486] 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.

8.28 Lawyers specializing in foreclosure law find this approach unrealistic.[487] They argue that a lender wants repayment of the loan in cash, not in land. Lenders are in the business of lending money, not in the business of managing properties. Some lawyers propose that 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

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[485]*Ibid.* at 48.

[486]*Supra*, note at 642.

[487]See F. Price, "Mfr. Life Ins. Co. v. Daon Dev. Corp.: Rice Orders—A Missed Opportunity" 65 Alta. L.R. (2d) 50.

fees.[488] 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.

8.29 It is difficult to determine value in a fluctuating market. It is even more difficult when a lender attempts to ride the market for his or her 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".[489]

(6) Rice Order — Fair or Foul?

(a) Rice order — fair

8.30 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 him and not just restricted to foreclosure of land worth less than the debt owing.

8.31 The Rice order procedure also allows the 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.

8.32 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

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[488] *Ibid*.

[489] *Yorkshire Trust Company Ltd.* v. *Armwest Developments Ltd. #1, supra*, note at 94.

gets this benefit? It will be lost in any event.[490]

8.33 In *Lennie* v. *LDM Holdings Ltd.*,[491] Master Funduk held that a vendor who had sold his land by agreement for sale could purchase land when the vendor's lien was being enforced by sale of 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:

(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 time to bring in a better offer than made by the vendor [lender].

(b) <u>Rice Order — foul</u>

8.34 The Rice order procedure is criticized as one which creates a windfall for lenders. Justice Wood voiced this criticism in his dissenting opinion in *Re Bank of Montreal and Butler; Canada Mortgage & Housing Corporation, Intervener*.[492] His concerns with the use of the Rice order in British Columbia, where there is no deficiency judgment protection for individuals, were as follows:[493]

> 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,

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[490]*Re Bank of Montreal and Butler*, *supra*, note at 666-67.

[491](1982) 40 A.R. 87 (M.C.).

[492]*Supra*, note .

[493]*Ibid.* at 678-79.

> 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, 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.

8.35 The *Boos* decision 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 he sold the land for a large profit. He 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 emphasizes that the court prevents 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 he was unable to have? Referring to this

result, the Court merely 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.

8.36 When explaining why he chose not to follow this decision, Justice Wood said:[494]

> 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.

8.37 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:[495]

> 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.

8.38 Under this heading the last word belongs to Justice Moir, who was the dissenting judge in *Canada Permanent Trust Company* v. *King Art Developments Ltd.* 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

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[494] *Re Bank of Montreal and Butler; Canada Mortgage and Housing Corporation, Intervenor*, *supra*, note at 687.

[495] *Supra*, note at 119.

Rules of Court contemplate sale by tender to 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.[496] Furthermore, the Rice order procedure results in sale at an inadequate price and for this reason has become an instrument of oppression.[497] Sale is supposed to benefit the borrower, not harm him.

8.39 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.[498] In voicing this view he said:[499]

> 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 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

[496] *Canada Permanent Trust Company* v. *King Art Developments Ltd.*, *supra*, note at 599.

[497] *Ibid*. at 600.

[498] See *Canada Permanent Trust Company* v. *King Art Developments Ltd., supra*, note at 15-17. 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.

[499] *Ibid.* at 601-02.

> 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.

8.40 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 t o the Rice order, he disliked both. He thought the lender must choose between the land and the action on the covenant.

(7) Recommendations

8.41 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 him. Without this procedure, the lender's remedies would be restricted to foreclosure whenever sale to a third party does not materialize. Since most foreclosure actions do not result in sales to third parties, the lender's remedies would be unduly restricted. Furthermore, the court has the tools to determine the value of land and thereby ensure that the mortgagee pays fair value for the land. This task becomes more difficult in a fluctuating market, but this difficulty arises from the prevalent economic conditions and not the procedure itself. The same problems exist when the court is asked to confirm a sale to a third party at a certain price.

8.42 Our concern lies with the availability of the order. We think that

the Rice order should be granted only when there is no ready market for the land, and then only when the lender pays fair value. Whether or not a ready market exists will only be known for sure if the court attempts to sell it. An attempt at sale will also serve as a test of the appraised value of the land. Also, exposure to a wide market is still the best method of attracting an acceptable offer. The only time an immediate Rice order is justified is when the real estate prices are dropping quickly and the court is satisfied with the quality of the appraisal evidence before it. In all other situations, an attempt at sale should precede the Rice order.

8.43 One situation is particularly disturbing. We have been told that routinely the court grants an immediate Rice order to a *National Housing Act* lender who is willing to pay the fair market value of the property as established in the lender's appraisal evidence. This order is only given when the borrower **does not** oppose the application. Yet, it is in this very situation where the appraisal evidence goes unchallenged. We do not think that justice is served by this efficient but potentially unfair procedure. Our hope is that deficiency judgment protection will be given to all individuals who have granted a mortgage charging residential land. Whether or not a mortgage is insured or given under the *National Housing Act* should not determine if deficiency judgment protection arises. This will mean that the lender's remedies will be limited to sale of the property to a third party or foreclosure, but will not include a Rice order. If the Legislature does not accept this recommendation, then an attempt at sale should precede the Rice order in these situations.

8.44 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 than he or she paid for it, the lender can collect the larger deficiency amount.

8.45 The difficult issue is how fair value should be determined. We think that this is a matter best left to the courts to determine. Fair value is not something that can be determined by a mathematical formula. The method of

determining value 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 he or she receives at the time of sale. The benefit would arise if the lender happens to sell the property for more than the appraised fair market value, or sooner, or at a lesser cost than was anticipated. Yet, the law does not require the lender to do this. Once the lender becomes the owner of the land, he or she 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.

RECOMMENDATION 23

(a) The Rice order procedure is a justifiable method of ensuring that the lender is paid what is owing to him or her.

(b) The court should attempt to sell the land to members of the public before it accepts the lender's offer to purchase the land. An immediate Rice order would be available only when land prices are falling and the court is satisfied with the quality of the appraisal evidence before it.

(c) The courts should be left to their own devices in determining fair value.

D. Protection of Tenants

8.46 At present, the fundamental principles of the *Land Titles Act* determine if the lender's interest has priority over the interest of any tenant. If the lender's interest has priority, he or she is entitled to sale of the property free and clear of the tenant's interest or foreclosure which will extinguish the tenant's interest.[500] We recommend that this continue. We do not favour giving

[500]In certain situations a mortgagee can enforce subsequent leases even

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 24

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.

E. Appointment of a Receiver of Rents

8.47 In our review we did not discover any serious problems with section 45 of the *Law of Property Act*. This section deals with the appointment of a receiver or receiver-manager for a property that is the subject of a foreclosure proceeding. Therefore, we recommend that this section remain as is.

RECOMMENDATION 25

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 should continue to be the law of Alberta.

F. Procedure

(1) General Comments

8.48 It is important to reiterate that the typical foreclosure proceeding is triggered by the borrower's failure to pay money due under the mortgage. The general objective of both procedure and remedies in this area should be to procure the best possible price for the property, and **how that is to be achieved does depend upon the particular case**. The remedies law and procedure should be flexible so that the court can achieve a proper resolution of the particular dispute.

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after a foreclosure order is granted. See the discussion at paras. 4.99-4.101.

8.49 Another point worth noting is that it is naive to think that in any system of judicially supervised remedies simplicity **per se** is possible. However, this does not prevent one from simplifying procedure as much as is possible.

(2) Existing Procedure

8.50 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 like 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.[501] This is the source of the court's jurisdiction in respect of mortgages.

8.51 Before the enactment in 1939 of the borrower protection legislation now found in sections 41 to 44 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:[502]

(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.

8.52 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 could award and by specifying the redemption period. When the 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

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[501] *Judicature Act*, R.S.A. 1980, C. J-1, s. 5(3)(b).
[502] *Scotia Mortgage Corporation* v. *Goss* (1987) A.R. 15 (M.C.) and L.Y. Cairns, *supra*, note .

variation of the statutory redemption period.[503] 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).[504]

8.53 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 or has a cause of action against an insurer on a first loss payee clause.[505] The court orders sale to the lender in these 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.[506]

8.54 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 his or her 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 land titles. For the majority of cases, the section will prevent a more valuable property being transferred to the lender in satisfaction of the debt.[507]

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[503]*Scotia Mortgage Corporation* v. *Goss*, *ibid*.

[504]*Law of Property Act*, R.S.A. 1980, c. L-8, s. 41(2)(b).

[505]*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).

[506]*Ibid*.

[507]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.

8.55 Until 1984, the court could not dispense with the requirement of sale where section 41(2) of the *Law of Property Act* applied. Where the circumstances warranted, the court would grant an order nisi with no redemption period or a one day redemption period.[508] 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).[509]

8.56 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

(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.

8.57 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

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[508] *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.).

[509] *First Investors Corporation Ltd.* v. *64675 Alberta Ltd.* (1984) 38 Alta. L.R. (2d) 45 (M.C.).

three months. Where the lender is well secured, the statutory redemption period will apply. 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 in which 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 statutory redemption period is what the Legislature sees as a reasonable time to give to the borrower to find funds to pay the lender. 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 for his money.

8.58 In 1983 Alberta enacted sections 43(1.1)[510] 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.[511] The result was that when such an individual defaulted, the court would not grant an immediate foreclosure order unless the facts in section 42.1 exist.[512]

8.59 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.[513] 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 in paragraph 8.51 above.[514] Also, the statutory redemption periods no longer apply to mortgages granted by corporations. For such mortgages the court must set a redemption period reasonable in the circumstances.[515]

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[510]This section was amended in 1984 to correct the omission of the word "and 42".

[511]*Canada Trustco Mortgage Company* v. *Coleman, supra*, note .

[512]*Ibid.*

[513]*Scotia Mortgage Corp.* v. *Goss, supra*, note .

[514]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.

[515]Price and Trussler, *supra*, note at 190-91.

(2) Mortgages Charging Residential Land or Farm Land

8.60 In chapter seven, we recommended that Alberta protect individuals who grant or assume mortgages charging residential land and farm land. 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 individuals

8.61 Assume that an individual grants a mortgage charging residential land or farm land. Several years later the borrower sells the land to another individual. At all relevant times the land is owned by individuals. The proposed procedure in this case is the same as that which presently exists for mortgages granted by an individual.

8.62 As discussed earlier, the protection of hearth and home is our guiding philosophy. Not only should home owners 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 value will protect any equity in the property. A sale at fair value 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.[516] 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.

8.63 To this general regime of judicial sale, we would make three exceptions. 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 home owner 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

[516]The wording of 41(2) should be changed to show clearly that the Court must grant the order nisi.

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.

8.64 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.

8.65 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 there is a deficiency and there will be little risk that the borrower's equity will be extinguished before the land is offered for sale. The same result is not achieved if the appraisal evidence is not consistently reliable or if the court is unable to detect suspect appraisals. 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.

8.66 We invite comment from lawyers as to their experience with the reliability of appraisal evidence and the court's ability to detect suspect appraisal evidence.

(b) Chain of title consisting exclusively of corporations

8.67 The procedure that will be used when neither borrower or transferee is protected from deficiency judgment will be discussed later.

(c) Chain of title including individuals and corporations

8.68 It is common in the building industry for a corporate builder to grant a mortgage on land to raise money to pay for the construction of a residence. Upon completion of the construction, the property is sold to an individual who assumes the mortgage. What rights should the lender have if the individual defaults in payment? Under the proposed regime, the lender could sue the corporate builder on its covenant to pay given in the mortgage. In contrast, the lender could not sue the individual on any covenant to pay implied by section 62 of the *Land Titles Act* or on a covenant to pay given in an assumption agreement or renewal.

8.69 Any equity the individual has in the property should also be protected. This can be done if the court is required to grant an order nisi that directs sale of the land if the individual fails to redeem the property. The order will also establish the redemption period, which 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 it for sale, or make a vesting order, or accept the lender's offer to purchase. The court must have the ability to sell the land to the lender in order to preserve the lender's right to sue the corporate borrower on the covenant to pay it gave in the mortgage. The necessity arises from the fact that the foreclosure order operates as full satisfaction of the debt. After a foreclosure order is given, the lender could not pursue the corporate borrower. The court's ability to sell the land to the lender would not prejudice the individual transferee because the lender could not obtain judgment against the individual transferee.

8.70 We do not think that the law should protect corporations to the

same degree as individuals. If it is a corporation that defaults and there were previous owners in the chain of title who were individuals, the lender could not sue the individuals on any covenant to pay the mortgage. Nonetheless, the existence of these individuals should not prevent the lender from suing on any covenant to pay the mortgage debt given by the corporation and from exercising any of the traditional *in rem* rights.[517] It is unnecessary to insist that the court grant an order nisi that provides that if the land is not redeemed, the land will be offered for sale. The court should be able to exercise its traditional powers to give any *in rem* remedy that a Court of Chancery could have given, subject to the need to attempt to sell the land before granting a Rice order.

RECOMMENDATION 26

(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 borrower and all subsequent owners are individuals and facts do not exist that justify the granting of an immediate foreclosure order, the court must grant an order nisi that provides 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.

> **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**

[517]See para. 8.51 for a list of the traditional *in rem* remedies.

(iii) the value of the land is less than the debt secured by the mortgage.

(c) Where the chain of owners of the residential land or farm land includes individuals and corporations, the procedure will be determined by the identity of the owner at the time of default.

If an individual is the owner of the mortgaged land at the time of default 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 individual for the deficiency.

If a corporation is the owner of the land at the time of default, 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 individual for the deficiency.

(d) The redemption period for any individual who grants a mortgage on residential land or farm land and the redemption period for any 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 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 individual**

(ii) when the action is in respect of a security on residential land,

- **the ability of the individual to pay**
- **the value of the land including the improvements made thereon,**
- **whether the land has been abandoned**

- the nature, extend and value of the security held by the lender

- the earning capacity of the individual and

- whether the individual's failure to pay was due to temporary or permanent unemployment or other conditions beyond the control of the individual.

The redemption period for a corporation will be within the court's discretion.

The redemption period for an individual who has mortgaged land other than residential land or farm land will be within the court's discretion.

(3) Mortgages Charging Other Kinds of Land

8.71 Under the hearth and home philosophy, Alberta will not protect corporations and certain individuals from deficiency judgments. We do not propose to limit the traditional jurisdiction of courts to govern the rights of unprotected borrowers and transferees and the corresponding lenders. The lenders should be able to seek enforcement of any covenant to pay given by the borrower or a transferee and should be able to seek enforcement of the mortgage security by foreclosure or sale. The court should, with one exception, be able to give any of the six *in rem* remedies listed above. The exception would be that in specified situations a Rice order must be preceded by an attempted sale. Also, the redemption period will be that which the court considers appropriate in the circumstances.

8.72 At one time Alberta law required the lender to sell the land before enforcing a judgment on the personal covenant contained in the mortgage.[518] In special circumstances, the lender could seek leave to enforce the judgment before selling the land. This restriction exists presently for agreements for sale. At present, a lender can simultaneously seek to enforce his charge on the land and to sue on the covenant to pay found in the mortgage and to enforce that judgment. We see no reason to impose the previous restriction on the lender's right to exercise his or her equitable remedies. The hearth and home philosophy 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,

[518] *The Judicature Act*, R.S.A. 1922, c. 72, s. 37(o).

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, junior mortgages often did not pursue the land because it's value was insufficient to satisfy prior mortgages. It seems pointless to make the lender apply for leave to sue in these circumstances.

RECOMMENDATION 27

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 borrower and all subsequent owners are corporations.

The length of the redemption period will be within the discretion of the court.

(4) The Sale Process

8.73 Once the court decides to offer the land for sale, it should direct sale of the land in the fashion which 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 that the Court considers proper".[519] It should not be restricted to a certain method of sale or a certain manner of advertisement. It certainly should not be restricted to sale by tender and advertising in the newspaper. Therefore, it would be our recommendation that Rule 689 be removed. 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.

RECOMMENDATION 28

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.

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[519]This is the wording now used in s. 41(2)(a) of the *Law of Property Act*.

Rule 689 should be repealed.

(5) The Originating Document

8.74 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 originating document, proper parties, 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.

8.75 During our review of this matter, we have had some arguments presented to us concerning the document that should be used to commence a foreclosure action. As a result, we have looked briefly at this point. In the hope that our research will be of benefit to the Foreclosure Rules Committee, we summarize the arguments and our brief review of the topic.

8.76 As far as we are able to determine, foreclosure actions in Alberta have generally been commenced by way of statement of claim. From 1914 to 1943, Rule 432(b) allowed proceedings for foreclosure to be brought by originating notice. Nonetheless, during this time foreclosure actions were often commenced by way of statement of claim. This was the procedure outlined by L.Y. Cairns in his article entitled "Foreclosure of Land Mortgages in Alberta by Way of Court Procedure", which was published in the late 1930s.[520] In *Rose* v. *Wait*,[521] the Alberta Supreme Court held that a vendor under an agreement for sale could not seek possession by originating notice. At that time there was a rule (as there is now) that allowed proceedings to be commenced by originating notice to recover possession of land. The court held that this rule is limited to situations in which the order for possession will substantially determine the rights of the parties. At that time there was the right to specific performance and, by virtue of what is now section 41(2) of the *Law of Property Act*, the court had to offer the land for sale. As a result, an order for possession would not have substantially determined the rights of the parties. In 1959 the first rules applying specifically to foreclosure actions on mortgages were enacted.[522] Since that time, there has been a rule directing that foreclosure actions be commenced by statement of

[520]L.Y. Cairns, *supra*, note at 198-200.
[521][1941] 1 W.W.R. 634.
[522]Alberta Regulation 438/59.

claim.[523]

8.77 The foreclosure procedure leaves a trail lined with paper. The number of documents generated in a typical action is truly remarkable. If you doubt this, refer to the charts found at pages 17 to 20 in Mortgage Actions in Alberta.[524] Where the borrower is an individual who has equity in the property, the lender will make a minimum of two court applications. The first application is for an order nisi and the second application is for an order confirming sale or an order of foreclosure. If service is a problem or the action is defended, there will be many more applications.

8.78 Some lawyers believe that the procedure could be simplified if a foreclosure action was commenced by originating notice. This view recognizes that in most foreclosure actions there is no defence. Default in payment has occurred and the lender is enforcing his remedies. They argue that the lender should not commence proceedings by way of a statement of claim when there is no real dispute between the parties. Issues such as length of redemption period, value of land, and date of possession could all be dealt with in a proceeding commenced by originating notice. They also see the originating notice procedure as a means of shortening the paper trail. Instead of serving a statement of claim, noting the defendant in default, and making application for an order nisi, the lender would serve the originating notice and supporting affidavits.

8.79 Other lawyers see the originating notice procedure as too restrictive. In their view, the originating notice procedure is designed for cases in which the rights of the parties will flow from the court's decision on one issue. Foreclosure does not fit this mold.

8.80 The use of the originating notice as the commencing document will eliminate the need to file certain documents. However, it will not reduce the number of court applications necessary to complete the action.

RECOMMENDATION 29

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

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[523]See Rule 685.

[524]*Supra*, note .

advertise, taxation of costs, and forms.

(6) Cleaning up Title at the Land Title's Office

8.81 The use of the word "encumbrance" in court orders creates problems for the Land Titles Offices. Kenneth B. Payne, Inspector of Land Titles Offices discussed these problems in a memorandum sent to real estate practitioners on June 28, 1984. He described the problems as follows:

> 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 work "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

8.82 Some people propose that these problems be solved by amending section 44 to provide that easements, utility rights, 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 its 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 30

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 subsequently to the mortgage. The order will also operate as full satisfaction of the debt secured by the mortgage.

G. Costs

8.83 From 1938 to 1965, *The Vendors' and Mortgagees' Costs Exaction Act*[525] restricted the lender's ability to recover certain costs from the borrower. This statute prohibited collection of costs **other** than:[526]

(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.[527] 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".[528]

8.84 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 these costs. However, if 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 costs can be paid from the sale proceeds. Where a lender can sue on the covenant to pay solicitor and client costs, he or she can obtain a judgment for solicitor and client 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

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[525]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.

[526]*Ibid.* s. 2.

[527]*Ibid.* s. 3.

[528]*Ibid.* s. 4.

Law of Property Act.[529]

8.85 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 hearth and home philosophy. They also are concerned for the individual borrowers who are able to come up with sufficient money to pay the arrears of principal and interest and some costs, but are unable to find the money to pay the total solicitor and client costs. 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.

8.86 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 not be able to recover all the costs he or she incurs in enforcing the mortgage. Why should a lender be restricted to recovering the artificially low party and party costs? Moreover, many other contracts, such as leases, loan agreements and guarantees, contain a covenant where one party agrees to pay solicitor and client costs. Such covenants in these agreements are enforceable. 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 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.

8.87 We agree that where the mortgage so provides, the lender should be able to collect solicitor and client costs against any corporation and against any individual who is not protected from a deficiency judgment. We have more doubts about the lender's ability to do this when the defendant is an individual who is protected from deficiency judgment. Before making any recommendation

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[529]*Central Housing and Mortgage Corporation* v. *Conaty* (1967) 59 W.W.R. 11 (Alta. S.C.A.D.).

on this issue, we invite comments from both lenders and borrowers.

H. Transition

(1) Introduction

8.88 Whenever the lender's right to enforce his *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? Should it not? What will be the formula used to bring about transition? These and other questions will be addressed under the topic of transition.

(2) Statutory Construction

(a) Retrospective operation of legislation

8.89 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 was first enunciated in *Phillips* v. *Eyre*[530] as follows:

> 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*,[531] 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

[530](1870) 6 Q.B. 1 at 23.
[531][1977] 1 S.C.R. 271.

> 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.

8.90 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.

8.91 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.

(b) Historical precedent

8.92 Whenever the Alberta Legislature has introduced legislation that restricts remedies of the lender, it has specified in the legislation the mortgages that were to be affected. For example, when the Legislature enacted section 37(p) of the *Judicature Act*[532] in 1939, the section was given retrospective effect. It read:

> In any action brought upon any mortgage of land . . . *made at any time before or after this section comes into force*, the right of the mortgagee . . . shall be restricted to the land to which the mortgage or agreement relates . . .

Even in the face of this wording, the Supreme Court of Canada held that the Legislature had not expressed the intention that the section apply to actions pending at the time the section came into force.[533] Since this decision, whenever the Legislature has enacted amendments that extend deficiency judgment protection, it has also enacted detailed transition provisions. These provisions will indicate whether the change is to apply to actions that are proceeding. Section 43(3) of the *Law of Property Act* is such a provision.

8.93 In 1964 the Legislature restricted deficiency judgment protection,

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[532]R.S.A. 1922, c. 72.

[533]*Minchau* v. *Busse* [1940] 2 D.L.R. 282 (S.C.C.).

but did not enact transitional provisions.

(3) Methods of Transition

(a) Effect of proposed recommendations

8.94 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.

8.95 The recommendations that will have the greatest impact on Albertans are those relating to deficiency judgment protection. The impact will be different for mortgages given or insured under the *National Housing Act* as compared to those that are not. 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. Home owners 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. Individuals who have purchased residential property subject to a

mortgage granted by a corporation will be protected before they renew the mortgage. This is so, even if they do not reside in the property.

8.96 For mortgages insured under the *National Housing Act*, the recommendations will create protection that does not exist at present. All individuals who grant a mortgage charging residential land will be protected. Corporate borrowers and individuals who grant a mortgage charging land other than residential land will not be protected. The remedies of Crown lenders will also be restricted in this way.

(b) Policy considerations

8.97 Consider the retired individual who buys an apartment building (4 units) as a hedge on inflation. The individual does so knowing that at most he or she can lose the equity in the property. This individual is unwilling to be exposed to the risk of a deficiency judgment because of the recognition that he or she is unable to work to replace this loss. If the proposed changes are retrospective, this individual will lose his or her protection as of the effective date of the legislation. Should this be the case?

8.98 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.

(c) Transition

8.99 The transition between the old and new regimes can be accomplished in several different ways. Methods that come to mind 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.

8.100 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.

8.101 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 with 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.

8.102 Our preference is 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 he or she 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.

8.103 Of course, all procedural reform will apply immediately. Even ongoing actions would be affected by the procedural reform.

RECOMMENDATION 31

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.

PART III — LIST OF RECOMMENDATIONS

RECOMMENDATION 1

As the values upon which the existing mortgage remedies law is based are not demonstrably wrong and as there is no evidence that this body of law damages essential Alberta interests, we recommend:

(a) Alberta retain judicial supervision of the foreclosure process;

(b) mortgage remedies law be improved within the parameters of the existing legislative policy of protecting any equity borrowers may have and, in the case of no equity, protecting certain borrowers from deficiency judgments.

RECOMMENDATION 2

Corporate borrowers should not be afforded deficiency judgment protection.

RECOMMENDATION 3

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.

RECOMMENDATION 4

Residential land and farm land would 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 one family as a residence,

(e) "residential land" means

(i) a parcel on which a single-family detached unit, single-family semi-detached unit or duplex unit is located, or

(ii) a parcel on which a single-family detached unit, single-family semi-detached unit or duplex unit is being constructed,

(iii) a residential unit under the *Condominium Property Act*, or

(iv) a parcel on which no more than two mobile homes are located.

RECOMMENDATION 5

Deficiency judgment protection should arise if at any time during the term of the mortgage, as extended from time to time, vacant land was developed into residential land.

RECOMMENDATION 6

Deficiency judgment protection should be triggered whenever an individual grants a mortgage of residential land or farm land. Such protection would not depend on the use made of the land by the borrower. Nonetheless, by definition, farm land would only include land that is being used for carrying on farming operations.

RECOMMENDATION 7

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.

RECOMMENDATION 8

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 deficiency judgment.

RECOMMENDATION 9

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, all reasonable sums paid by the lender to maintain or preserve the property, and costs. These sums would be payable at the rate and at the time specified in the mortgage.

RECOMMENDATION 10

A corporation that purchases land charged by a mortgage granted by an individual or a corporation should not be afforded deficiency judgment protection.

RECOMMENDATION 11

A lender should be prohibited from suing a transferee on any implied or express covenant to pay any sums secured by the mortgage where:

(a) the transferee is an individual, and

(b) the mortgage charges residential land or farm land.

RECOMMENDATION 12

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:

(a) the transferee is an individual, and

(b) the mortgage charges residential land or farm land.

RECOMMENDATION 13

This recommendation applies to the special circumstances where the chain of title for residential land or farm land includes individuals and corporations. For the purpose of section 62 of the *Land Titles Act*, each corporation is deemed to be the transferee of the corporation that immediately preceded it in the chain of title. Individuals who intervene between corporations in a chain of title would, therefore, be transparent for the purpose of section 62. Whether section 62 of the *Land Titles Act* implies a covenant on behalf of the corporate transferee will depend on whether the corporate transferor is liable on any covenant, express or implied, that was given to the lender.

RECOMMENDATION 14

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.

RECOMMENDATION 15

Alberta should allow a lender to seek recovery of any deficiency from a guarantor 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 sue a guarantor 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.

RECOMMENDATION 16

A guarantor's right to seek indemnity from the borrower or a transferee should remain as it is at present.

RECOMMENDATION 17

The Crown should be bound by all the legislation which governs mortgage remedies. In particular, the Crown should be bound by Alberta legislation that limits lenders' remedies to the land in certain situations.

RECOMMENDATION 18

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*.

RECOMMENDATION 19

The existing law relating to the enforcement of due-on-sale clauses is adequate.

RECOMMENDATION 20

Any attornment clause found in a mortgage charging residential land or farm land is unenforceable against an individual borrower. 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.

RECOMMENDATION 21

Any waiver or release of the rights, benefits or protection given by the proposed regime should be against public policy and void.

RECOMMENDATION 22

(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.

RECOMMENDATION 23

(a) The Rice order procedure is a justifiable method of ensuring that the lender is paid what is owing to him or her.

(b) The court should attempt to sell the land to members of the public before it accepts the lender's offer to purchase the land. An immediate Rice order would be available only when land prices are falling and the court is satisfied with the quality of the appraisal evidence before it.

(c) The courts should be left to their own devices in determining fair value.

RECOMMENDATION 24

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.

RECOMMENDATION 25

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 should continue to be the law of Alberta.

RECOMMENDATION 26

(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 borrower and all subsequent owners are individuals and facts do not exist that justify the granting of an immediate foreclosure order, the court must grant an order nisi that provides 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.

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 4 months before the mortgage goes into default, or

(iii) the value of the land is less than the debt secured by the mortgage.

(c) Where the chain of owners of the residential land or farm land include individuals and corporations, the procedure will be determined by the identity of the owner at the time of default.

If an individual is the owner of the mortgaged land at the time of default 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 individual for the deficiency.

If a corporation is the owner of the land at the time of default, 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 individual for the deficiency.

(d) The redemption period for any individual who grants a mortgage on residential land or farm land and the redemption period for any 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) 6 months from the date of the granting of the order in the case of land other than farm 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 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 individual

(ii) when the action is in respect of a security on residential land,

- the ability of the individual to pay
- the value of the land including the improvements made thereon,
- whether the land has been abandoned
- the nature, extend and value of the security held by the lender
- the earning capacity of the individual and
- whether the individual's failure to pay was due to temporary or permanent unemployment or other conditions beyond the control of the individual.

The redemption period for a corporation will be within the court's discretion.

The redemption period for an individual who has mortgaged land other than residential land or farm land will be within the court's discretion.

RECOMMENDATION 27

The court can exercise its traditional equitable jurisdiction and grant the appropriate *in rem* remedy where:

(i) the mortgage charges land other than residential land or farm land, or

(ii) the mortgage charges residential land or farm land and the borrower and all subsequent owners are corporations.

The length of the redemption period will be within the discretion of the court.

RECOMMENDATION 28

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.

Rule 689 should be repealed.

RECOMMENDATION 29

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.

RECOMMENDATION 30

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 subsequently to the mortgage. The order will also operate as full satisfaction of the debt secured by the mortgage.

RECOMMENDATION 31

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.

PART IV — APPENDICES

APPENDIX A — PART 4 OF THE *LAW OF PROPERTY ACT* — SECTIONS 35-37

PART 4
ATTORNMENT CLAUSES

Attornment clauses

35(1) Every covenant, agreement, condition or stipulation that is contained in a mortgage or agreement for sale, or in any other instrument of any kind that is supplementary or collateral to a mortgage or agreement and whereby the mortgagor agrees or has agreed to become the tenant of the mortgagee or whereby the purchase agrees or has agreed to become the tenant of the vendor, as the case may be, is void.

(2) Nothing in this section applies to

(a) a mortgage on land in favour of The Canadian Farm Loan Board or the Farm Credit Corporation or an agreement for the sale of land entered into by The Canadian Farm Loan Board or the Farm Credit Corporation,

(b) a mortgage 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, or

(c) a mortgage given to secure loans for the purpose of building a house or houses when the form of the mortgage, including its terms and conditions, has been approved by the Lieutenant Governor in Council

Mortgagor tenant of mortgagee

36(1) A mortgage to which section 35(2)(b) refers and under which the mortgage money is to be paid by instalments 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.

(2) The rent payable under such an 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.

(3) No such agreement of itself operates as, or shall be considered as, a taking of possession of the mortgaged premises or land by the mortgagee.

Relationship of landlord and tenant

37(1) Notwithstanding section 35, when the mortgage money or purchase money, as the case may be, is to be paid by instalments, a mortgage or agreement for sale of business premises may contain a covenant or provision that the mortgagee or vendor, and in that case the relationship of landlord and tenant is validly constituted between those persons but is so constituted only so long as no part of the land or premises is occupied by the mortgagor or purchaser as a residence.

(2) 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.

(3) 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.

(4) In this section "business premises" means land and premises from which revenue is derived, other than land and premises for farming purposes.

APPENDIX B — PART 5 OF THE *LAW OF PROPERTY ACT* — SECTIONS 38-46

PART 5
ENFORCEMENT OF MORTGAGES AND AGREEMENTS FOR SALE OF LAND

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 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.

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.

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.

Action on covenant

41(1) In an action brought on a mortgage of land, whether legal or equitable, or on an agreement for the sale of 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.

(2) In an action brought on a mortgage of land or on an agreement for sale of land

(a) the order nisi in the case of a mortgage, or the order for specific performance in the case of an agreement for sale, 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.

Redemption time

42(1) The time to be fixed for redemption by the order nisi in an action for foreclosure of a mortgage and the time to be fixed for redemption by the order for specific performance in an action on an agreement for sale 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 land other than farm 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,

(ii.1) whether the land has been abandoned,

(iii) the nature, extent and value of the security held by the creditor, and

(iv) 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 land other than farm land,

(i) the ability of the debtor to pay,

(ii) the value of the land including the improvements made thereon,

(ii.1) whether the land has been abandoned,

(iii) the nature, extent and value of the security held by the creditor,

(iv) the earning capacity of the debtor, and

(v) 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.

(4) In this section "farm land" means farm land as defined in section 43.4(3).

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 land or on an agreement for sale of 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,

or

(c) the land

(i) is abandoned, or

(ii) is undeveloped land other than farm land as defined in section 43.4(3),

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.

Application of sections 41 and 42

43(1) Sections 41 and 42 do not apply to a proceeding for the enforcement of any provision

(a) of an agreement for sale of land to a corporation, or

(b) of a mortgage given by a corporation.

(1.1) Notwithstanding subsection (1), sections 41 and 42 apply to an action brought against an individual, as it relates to that individual, where

(a) the action is on

(i) a mortgage of land, whether legal or equitable, given by a corporation, or

(ii) an agreement for sale of land to a corporation,

made before or after the coming into force of this subsection, and

(b) the individual is

(i) a transferee of land that is subject to that mortgage, or

(ii) an assignee of a purchaser's interest under that agreement for sale of land,

whether the transfer or assignment was made before or after the coming into force of this subsection.

(1.2) Any waiver or release of the rights, benefits or protection given by subsections (1.1) and (3) is against public policy and void.

(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.

(3) Notwithstanding subsection (1), where

(a) an individual is

(i) a transferee of land that is subject to a mortgage, whether legal or equitable, given by a corporation, or

(ii) an assignee of a purchaser's interest under an agreement for sale of land to a corporation,

and

(b) before the coming into force of this subsection

(i) an action was brought against that individual on that mortgage or agreement for sale, and

(ii) in respect of that action no order nisi, in the case of the mortgage, or no order for specific performance, in the case of the agreement for sale, has been granted,

then after the coming into force of this subsection no judgment or order shall be granted against that individual in respect of any of the covenants or damages referred to in section 41(1)(a) to (c), and sections 41 and 42 apply to the action as it relates to that individual.

Covenant for payment

43.1(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 individual who is a transferee of land that is subject to a mortgage, whether the transfer was made before or after the coming into force of this section, 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 waiver or release of the rights, benefits or protection given by subsections (2) and (5) is against public policy and void.

(4) This section does not apply in respect of 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.

(5) Where

(a) an individual is a transferee of land that is subject to a mortgage, and

(b) before the coming into force of this section

(i) an action was brought against that individual 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,

and

(ii) in respect of that action no judgment has been granted,

then after the coming into force of this section no judgment shall be granted against the individual in respect of any covenant or obligation referred to in clause (b).

Remedy against corporation, guarantor or surety

43.2 Nothing in section 43(1.1) or (3) or 43.1 limits or derogates from any remedy that a person has against

(a) a corporation, or

(b) a guarantor or other surety of

(i) a mortgage of land, or

(ii) an agreement for sale of land,

notwithstanding that the guarantor or other surety may become a transferee of that land or assignee of the agreement for sale.

Corporation deemed to be transferee

43.3 For the purposes of section 62 of the *Land Titles Act*, when

(a) an individual is a transferee of land that is subject to a mortgage given by a corporation, and

(b) a corporation becomes a transferee of that land from that individual,

the corporation referred to in clause (b) is deemed to be the transferee of the land from the last corporation to which that land was transferred prior to that individual's becoming the transferee of that land.

Limitation on individual's rights

43.4(1) Sections 43(1.1) and (3), 43.1 and 43.3 apply only in respect of residential land and farm land.

(2) Sections 43(1.1) and (3), 43.1 and 43.3 do not apply to an individual that is or was a registered owner of residential land or farm land if

(a) in the case of residential land, neither that 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 that land, or

(b) in the case of farm land, 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 that land.

(2.1) In order for an individual to be given the benefit of sections 43(1.1) and (3), 43.1 and 43.3, the onus of proof is on that individual to establish that he is not excluded from those benefits by reason of subsection (2).

(3) In this section,

(a) "farm land" means land that is or was 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, or

(iv) beekeeping;

(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;

(d) "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;

(e) "registered owner" includes an individual purchasing the land under an agreement for sale;

(f) "residential land" means

(i) a parcel on which a single-family detached unit or duplex unit is located, or

(ii) a residential unit under the *Condominium Property Act*,

that is or was used as a residence.

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.

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.

(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) does not apply when the mortgagor or purchaser is a corporation.

(10) In this section "farm land" means farm land as defined in section 43.4(3).

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.