

Table of Contents

COMPENSATION FOR SECURITY INTERESTS IN EXPROPRIATED LAND 1

MEMORANDUM FOR DISCUSSION 1

UNIVERSITY OF ALBERTA

GOV'T DOCS.

APR 21 1982

1.	INTRODUCTION	1
a.	Purpose of Memorandum for Discussion	1
b.	Recent developments in expropriation law	2
c.	"Payment of outstanding balance" theory	3
d.	"Market value" theory	5
e.	Reasons for review	7
2.	COMPENSATION FOR EXPROPRIATED SECURITY INTERESTS:	
	GENERAL CONSIDERATIONS	11
a.	Object of compensation	11
b.	Nature of security interest	12
c.	Effect of expropriation	14
3.	COMPENSATION FOR EXPROPRIATED SECURITY INTERESTS:	
	ALTERNATIVE APPROACHES	15
a.	Proposals to be considered	15
b.	"Payment of outstanding balance" theory	16
c.	Compensation according to market value	18
4.	CHOICE OF COMPENSATION THEORY	23
5.	PROVISIONS TO MEET SPECIFIC PROBLEMS	24
a.	"Payment of outstanding balance" theory	24
b.	"Market value" theory	38
6.	CONCLUSION	44
	APPENDIX A	45
	APPENDIX B	46

COMPENSATION FOR SECURITY INTERESTS IN EXPROPRIATED LAND

MEMORANDUM FOR DISCUSSION

1. INTRODUCTION

a. Purpose of Memorandum for Discussion

1.1 The purpose of this Memorandum for Discussion is to ask for comment on the present law relating to the compensation to be paid for expropriated security interests in land and for views as to whether or not it should be changed. In the memorandum we will review the present law, describe the formulas for the determination of compensation which appear to us to be within the range of practicality, and set out the considerations which appear to us to be relevant to the choice of formula. We hope that the memorandum will be a satisfactory foundation for discussion and comment. We would prefer that comments be made in writing to:

Institute of Law Research and Reform
402 Law Centre
The University of Alberta
Edmonton, Alberta
T6G 2H5

However, comments may be made orally to W.H. Hurlburt at (403) 432-591. Comments should be in our hands by June 1, 1982.

Anyone who wishes to comment but needs further time should tell us by that date.

1.2 The governing legislation at the date of this memorandum is ss. 48, 49 and 52 of the Expropriation Act, R.S.A. 1980, c. E16, which we will sometimes call "the 1980 Act." We

attach a copy of these sections as Appendix A, and we will refer to them rather than to their predecessors, ss. 46, 47 and 50 of the Expropriation Act S.A. 1974, c. 27 (which we will call "the 1974 Act"). The sections in the 1980 Act are in substance the same as their counterparts in the 1974 Act.

b. Recent developments in expropriation law

1.3 The 1974 Act was a thorough revision of the Alberta law of expropriation, both as to the principles upon which compensation is based and as to procedure. Similar legislation had been enacted in Ontario in 1968 following upon a 1967 report of the Ontario Law Reform Commission on Compensation and also following upon the Report of the Ontario Royal Commission, Inquiry into Civil Rights. Similar legislation had also been adopted in 1970 as the Canada Expropriation Act. The movement for reform of expropriation law had also resulted in the 1971 report and recommendations of the Law Reform Commission of British Columbia and it later resulted in the 1976 report and recommendations of the Law Reform Commission of Canada, though neither of these reports has as yet led to legislation. The 1974 Act itself was based upon this Institute's Report No. 12, with some variations.

1.4 The Institute's report recommended that compensation should be paid to the holder of a security interest in expropriated land in accordance with what we shall describe as the "market value" theory instead of the "payment of outstanding balance" theory upon which the previous law of Alberta was based. The 1974 Act adopted the recommendation. We will now describe

the two theories.

c. "Payment of outstanding balance" theory

1.5 We will describe the "payment of outstanding balance" theory in relation to one kind of security interest, the mortgage. Under this theory

- (a) the total compensation for the expropriated land which is subject to a mortgage is determined by valuing the expropriated land as if it were unencumbered;
- (b) the balance outstanding under the mortgage is determined;
- (c) the balance outstanding under the mortgage is paid to the mortgagee; and
- (d) the remaining balance of the compensation for the land is paid to the land-owner or to the owner of interests which take priority over the land-owner's interest.

If, however, the outstanding balance under the mortgage exceeds the compensation payable for the land, the whole of the compensation is paid to the mortgagee and the mortgagee retains any other rights and remedies which he may have for payment of the deficiency, including any claim which he may have under a personal covenant of the land-owner, the original mortgagor, and any intervening owners of the land. The balance outstanding under the mortgage includes the unpaid balance of principal, any accrued interest, and any other amount secured by the mortgage, whether or not the amount is due and without any discount to

bring it to present value.

1.6 The "payment of outstanding balance" theory prevails in all Canadian jurisdictions in which the law continues to be based upon the England Lands Consolidation Clauses Act, 1845. It also applies in Ontario and in federal expropriation legislation. The Ontario legislation as it appeared in ss. 16, 17 and 20 of RSO 1970, c. 54, (a copy of which sections is attached as Appendix B) qualifies the application of the theory to mortgages (though not to other security interests) in the following ways:

- (a) If the mortgage is a purchase money mortgage and the amount of the mortgage debt exceeds the value of the mortgaged land, the mortgage is deemed to be fully paid and discharged (Ontario s. 17(4)(a)).
- (b) If the mortgage is not a purchase money mortgage but includes a bonus, and if the amount of the mortgage debt exceeds the value of the mortgaged land, the amount of the deficiency, up to the amount of the bonus is deemed to be fully paid and satisfied (Ontario s. 17(4)(b)).
- (c) If only part of the land held as security is expropriated, the mortgagee receives a sum that bears the same ratio to the compensation (and damages for injurious affection) as the balance outstanding on the mortgage at the date of expropriation bears to the market value of the entire land (Ontario s. 17(6)).
- (d) Additional compensation is paid as follows:
 - (i) To the mortgagee, three months' interest at a prescribed rate (or the amount provided by the mortgage if it is less) plus any stipulated prepayment notice or bonus (Ontario s. 20(a)).
 - (ii) If there is no prepayment right in the mortgage, compensation to the mortgagee if prevailing interest rates at expropriation are lower than the interest rate in the mortgage, though this can be awarded only for a maximum of five years (Ontario s. 20(b)).
 - (iii) To the mortgagor, compensation for loss incurred by reason of a difference in interest rates (Ontario s. 20(c)).

1.7 We have described the "payment of outstanding balance" theory as it applies to the compensation of mortgagees. The Ontario legislation (though not the qualifications we have mentioned) applies to the compensation of holders of other security interests as well. Ontario s. 17(3) so provides. We will later refer to difficulties in the application of the theory to security interests other than mortgages.

d. "Market value" theory

1.8 Under the "market value" theory, the owner of each interest in an expropriated parcel of land should receive the market value of his interest. Because of that and because the "market value" of an interest is the price which the interest may be expected to realize if sold in the open market by a willing seller to a willing buyer (1980 Act s. 41), the land-owner's interest and the security-holder's interest must be valued separately (1980 Act s. 48, 49(1)); and compensation for one does not vary directly or inversely with compensation for another except to the extent that the market would take one into account in arriving at the other. In arriving at the "market value" of a security interest the tribunal must therefore take into account all the circumstances which a willing seller and a willing buyer would take into account, e.g., any difference between interest rates prevailing at the time of expropriation and the interest rate under the security instrument, the length of the term over which the money secured by the security interest is to be paid, and the strength of the security (including covenants and collateral securities).

1.9 Some consequential points must be dealt with. The 1980 Act goes on to provide that when the security holder is paid his compensation based on the market value of his interest, the debt secured by the interest is extinguished unless there is collateral security other than the covenant of purchaser or borrower (1980 Act s. 47(2)). If there is collateral security other than a covenant the debt is not extinguished and the tribunal must determine the balance remaining and the manner in which it is to be repaid (1980 Act s. 49(3)). If only part of the land is expropriated the tribunal must determine the market value of the expropriated part and distribute the compensation between the land-owner and the security holder as it considers just in the circumstances (1980 Act s. 49(4)). In addition, a security holder has a right to be paid three months' interest at the contract rate or at the normal rate applicable (1980 Act s. 52).

1.10 Application of the "market value" theory under the 1980 Act involves the following steps:

- (a) the market value of the security interest is determined by itself and in isolation from the land-owner's interest and the holder of the security interest is paid an amount equal to the amount so determined.
- (b) the market value of the land-owner's interest is determined in isolation from the interest of the security holder (though with allowance for its effect) and the land-owner is paid an amount equal to the amount so determined.
- (c) if there is a covenant which can be sued upon and no collateral security, the land-owner is discharged from liability under it (and, presumably, also, the original mortgagor and any intervening owners of the land who are liable on the covenant are discharged from it).
- (d) if there is collateral security, the balance remaining and the manner in which it is to be repaid are determined by the tribunal.

- (e) if only a part of the land which is subject to a security interest is expropriated, the market value of the expropriated part is determined by the tribunal and the compensation is distributed by the tribunal as it considers just in the circumstances.

The "market value" theory applies not only to mortgages but to all other interests which can be called "security interests", a term which is not defined in either the 1980 Act or the 1974 Act (1980 Act s. 49).

1.11 The "market value" theory applies only in Alberta, although the Law Reform Commission of British Columbia and the Law Reform Commission of Canada, in the reports mentioned above (para 1.3), recommended that it be adopted in British Columbia legislation and federal legislation respectively.

e. Reasons for review

1.12 There are three reasons the cumulative effect of which has caused us to undertake a review of the provisions of the Expropriation Act relating to compensation for security interests in expropriated lands. They are as follows:

- (a) Since the introduction of the bill which became the 1974 Act the Mortgage Loans Association of Alberta has made continuous representations against the "market value" theory and in favour of the "payment of outstanding balance" theory. The law must of course have regard to all the interests involved and not only to the interest of one group, but the Association has put forward a carefully argued case which we think deserves either rebuttal or some degree of recognition.
- (b) The results of the application of the "market value" theory in the 1980 decision of the Land Compensation Board in Forster Mah Enterprises Ltd. v. The City of Calgary (which we will discuss at some length below) raise questions about the "market value" theory and about the relevant provisions in the Expropriation Act. Although the Board made it clear that its decision

followed from the unusual facts and from the way in which the case was put before it, we think that the results suggest that a review of the law should be undertaken, whether or not the review results in change.

- (c) Our own continuing analysis of the relevant provisions has indicated that there are worrying problems in the application of the "market value" theory.

1.13 We will now describe the Forster Mah case and the problems which it raises. The facts were as follows:

- (a) the expropriated land was raw unimproved land which Forster Mah Enterprises Ltd. had acquired in October of 1977 for a purchase price of \$60,000.
- (b) in February of 1978, Forster Mah sold the land to Last Mountain Developments Ltd. for \$120,000, being \$10,000 paid in cash and \$110,000 by mortgage in favour of Forster Mah.
- (c) at the time of its purchase Last Mountain sold a one-half interest in the land to Sentry Mortgage and Investments Ltd.
- (d) the City of Calgary expropriated the land in June 1978, at which time the outstanding balance under the mortgage appears to have been slightly in excess of the original \$110,000.
- (e) the Board found the market value of the land at the time of expropriation to be \$100,000.
- (f) there being no collateral security, and the whole of the land having been expropriated, s. 47(2) of the 1974 Act (s. 49(2) of the 1980 Act) applied and s. 47(3) and s. 47(4) of the 1974 Act (s. 49(3) and s. 49(4) of the 1980 Act) did not.

1.14 The only evidence about the market value of the Forster Mah mortgage was adduced by Forster Mah. It was the evidence of a mortgage broker. The broker decided that a purchaser of the mortgage would have looked for a yield of 16% and would have discounted at that rate the payments provided for in the mortgage. The actual interest rate under the mortgage was only 11%. The market value of the mortgage (before the final deduction which will be mentioned later) was therefore only

\$101,000. In arriving at the 16% discount rate the witness took into account a number of risk factors such as the following: the land was undeveloped; the covenant behind the mortgage was not strong; the land could not be developed without planning approval; the "loan to value ratio" was high; the amortization period of 25 years was long; the site was small; and the term of the mortgage was only two years. The Board accepted the mortgage broker's evidence on these points, including his discount rate of 16%. All this appears to be in accordance with the "market value" theory.

1.15 The mortgage broker went one step farther. Although he had already considered the "loan to value" ratio in determining that the prospective proceeds of the mortgage should be discounted at 16%, he went on to say that the market value of the mortgage would not exceed the "prudent lending ratio", that is, that a prudent mortgagee would not on the security of the land lend a sum greater than a certain percentage of the land value and that a prudent purchaser of the mortgage therefore would not pay more than the same sum for the mortgage. He appears to have concluded that the "prudent lending ratio" in the Forster Mah case was 85%. He applied that 85% to a valuation of \$120,000 for the land itself put in by another witness. Since he had, as stated above, arrived at a discounted value of the cash stream (\$101,000) which was slightly less than the prudent lending value of \$102,000 (being 85% of \$120,000) the witness did not find it necessary to reduce the market value of the mortgage below the \$101,000 figure. However, the Land Compensation Board found that the land value was not \$120,000, but \$100,000, and it

found that the prudent lending ratio was not 85% but 75%. It then applied the 75% figure to the \$100,000 land value and concluded that the market value of the mortgage could not exceed \$75,000, and it awarded that amount to the mortgagee. The Board expressed reservations about the propriety of applying the prudent lending ratio as a limiting factor on the value of the mortgage; and its reasons for judgment indicate that it did so only because the evidence of the mortgage broker was the only evidence which it had.

1.16 Having valued the Forster Mah mortgage at \$75,000, the Board then held that the value of the interests of the two land-owners, Last Mountain and Sentry Mortgage, was the amount by which the market value of the land exceeded the market value of the mortgage. It therefore awarded the two land-owners a total of \$25,000 although the market value of the land (\$100,000) was less than the amount secured by the mortgage (\$110,000) and was even less than the market value of the mortgage as ascertained before the application of the "prudent lending ratio" (\$101,000). Again, the Board's reasons for judgment indicate that the Board considered itself bound by the evidence before it and by the positions taken by the parties to make the award on that basis.

1.17 For two reasons we do not think that the Forster Mah case is a precedent which will be applied in later cases. First, the facts involved a purchase money mortgage for almost the whole of the price for the last of a series of sales in a speculative market of a parcel of land which was undeveloped in fact and for which there was no development plan in short-term prospect. Second, as we have said (paras. 1.15 and 1.16) the Board was

careful to point out that it was restricted in making its awards by the evidence before it and by the positions taken by the parties; the language of its judgment has left the Board quite free to take a different view if a later case is put before it differently.

1.18 Nevertheless, as we have already said (para. 1.12(b)) we think that the results of the case raise questions about the "market value" theory and its embodiment in the Expropriation Act which should be answered. If the law now justifies the restriction of the mortgagee's compensation to the "prudent lending value" of the land, and if it justifies the payment to the owner of fully mortgaged land of the difference between the "prudent lending value" and the market value of the land, we think that it should be reviewed in order to see whether it should be retained or changed. If the law does not justify these results we think that the case suggests that it should be reviewed in order to see whether there is in it any complexity or lack of intelligibility which should be rectified for the benefit of those who are affected by it and whether its benefits are substantial enough to justify the costs incurred by the parties in order to litigate the questions which it raises.

2. COMPENSATION FOR EXPROPRIATED SECURITY INTERESTS: GENERAL CONSIDERATIONS

a. Object of compensation

2.1 The compensation paid to the owner of an interest in expropriated land should make good the loss which the owner has suffered from the expropriation. The counsel of perfection is

that the compensation for such an interest should be the cash equivalent of the interest, no more and no less.

b. Nature of security interest

2.2 The essential characteristics of a security interest in land are, first, that the security holder has a right to receive money and, second, that if the money is not paid the security holder will have a remedial claim to realize it from the land, whether by taking the rents and profits, or by requiring the sale of the land, or by acquiring ownership of the land, or by a combination of these. There is however a great diversity of security interests in land.

2.3 The most common kind of security interest in land is the mortgage. Mortgages themselves have a great diversity of characteristics. Some examples are as follows:

- (1) A simple mortgage which affects one parcel of land and which does not include an enforceable obligation to pay.
- (2) A simple mortgage which affects one parcel of land and which includes an enforceable obligation to pay.
- (3) A mortgage which is the prime security but is supported by other collateral securities.
- (4) A mortgage which is merely one security among many.
- (5) A mortgage which is itself only secondary collateral security, e.g., a mortgage given to secure a guarantee, a mortgage incidental to a demand line of credit at a bank, or a mortgage on a service station which is really incidental to a loan to a multi-national corporation for the construction of the service station.
- (6) A mortgage under which the mortgagee shares in the profits realized from the mortgaged property or from a business carried on upon the mortgaged property.
- (7) A mortgage containing another kind of special advantage (e.g., a right to have only the mortgagee's products

sold from the mortgaged property, or a right to purchase the mortgaged property).

- (8) A mortgage given to secure the purchase price of the mortgaged property.
- (9) A "bonus" mortgage, under which the mortgagor pays a "bonus" to the mortgagee, or a "discount" mortgage which secures an amount larger than the amount advanced by the mortgagee.
- (10) A floating charge on the assets of a corporation, which upon crystallization becomes a specific charge.

2.4 There are in addition many other kinds of security interests. One is the agreement for sale of land under which the seller holds title as security for the balance of the purchase price; for expropriation purposes the seller's security interest under the agreement for sale is very similar to a mortgagee's security interest under a purchase money mortgage. Liens are another important class of security interest affecting land; these include such different security interests as the builder's lien of one who has supplied goods or services for an improvement on the land and the lien of the Workers' Compensation Board for levies not paid by the owner. Writs of execution appear to be another class of security interest; when a writ of execution is registered at the Land Titles Office it binds the execution debtor's land and interests in land in the land registration district. Annuities are another class; for example, a testator may leave land to one child subject to payment of a periodic sum to another. Some security interests are difficult to classify; for example, an old couple may transfer the family farm to a son subject to the right of the old couple to live in a room in the house and to receive utilities and food, an arrangement which may confer both a right to occupy land and a right to receive money or money's worth.

c. Effect of expropriation

1. Expectations of land-owner and security holder

2.5 The holder of any one of the great diversity of security interests we have mentioned has a legally protected claim against land. He also has a legally protected degree of priority for his claim. His expectation is that the money to which he is entitled will be paid in accordance with the instrument which creates it and that if the money is not paid his claim against the land will be enforceable in accordance with its degree of priority.

2.6 A land-owner must necessarily recognize that his ownership of his land is subject to prior secured claims and that he can enjoy the benefits of ownership only if the amounts secured are paid as they fall due. Often, however, he will expect that the returns from the land, whether in the form of current rents or current profits of a business, or in the form of a sale price, will provide for mortgage payments and leave something over. Sometimes he will undertake a secured obligation which is large in relation to the capital or income value of the land in the expectation that his management of the land or its appreciation in market value over time will enable him to pay the secured obligation and realize substantial gains for himself.

2.7 An expropriation will often frustrate the expectations of both parties. It substitutes money for the land and brings to an end the income stream and the capital appreciation of the land. Its effect is much like that of a casualty, such as a fire, which substitutes insurance money for a building.

Expropriation law must recognize that the frustration has occurred and it must address itself to the problem of dealing with the consequences of the frustration to those whose property interests are taken.

2. Expectations of expropriator

2.8 An expropriator's objective is to acquire unencumbered the fee simple or lesser interest which it needs. Whether interests in the land are valued separately under "market value" theory or together under the "payment of outstanding balance" theory is irrelevant to the expropriator except as the choice of theory affects what it must pay. The general theory of the Expropriation Acts is that individual owners should not suffer because the public interest requires the taking or use of their land and that they should receive adequate compensation for it and for losses associated with the taking; and the expropriator must therefore expect to pay fair compensation, whatever that is.

3. COMPENSATION FOR EXPROPRIATED SECURITY INTERESTS: ALTERNATIVE APPROACHES

a. Proposals to be considered

3.1 We have referred only to the two theories which we have called the "payment of outstanding balance" theory and the "market value" theory. Other solutions to the problem of compensation for the holders of security interests are possible. For example, the expropriating authority could be required to step into the shoes of the land-owner and to make payments to the security holder as they fall due; or the land-owner could be

allowed to invest the money awarded and required to make the payments; or the whole award could be held by a court or other agency or by a trustee in order to make the payments. We think however, that upon expropriation of the land the law should leave the parties free to plan and manage their affairs; that it should terminate the relationship among the parties; that it should not impose continuing obligations; that it should not tie up money so that it cannot be used; and that it should not require any party to rely upon the financial stability and responsibility of any other party. It is only the two solutions which we have mentioned that will allow the law to achieve these objectives and we therefore do not propose to consider any other solution.

b. "Payment of outstanding balance" theory

3.2 We have already described the "payment of outstanding balance" theory (paras. 1.5 to 1.7). We will now set out the arguments which we think should be borne in mind by anyone considering whether or not to adopt it.

1. Arguments favouring adoption

3.3 The "payment of outstanding balance" theory has the following advantages:

- (a) Certainty. The outstanding balance secured by a security interest is usually established by available documents and records and the parties will usually have a fairly clear understanding of what is owing.
- (b) Simplicity. The amount of the outstanding balance can usually be calculated by reference to existing documents and records in the possession of the parties.
- (c) Suitability. This theory recognizes that the security transaction has been frustrated and that the land security has been converted into money. It effects rough justice by requiring payment of the compensation

for the land in accordance with the legal priorities between the parties. Payment of the outstanding balance is probably what the parties would have expected if they had directed their minds to the possibility of expropriation, and, indeed, they often make similar arrangements by contract.

2. Arguments against adoption

3.4 The "payment of outstanding balance" theory gives rise to some difficulties which we will now set out:

- (a) Departure from the compensation principle. The compensation paid to a security holder should approximate as closely as possible the value in cash of his interest at the time of expropriation (para. 2.1). The outstanding balance will approximate the value in cash of the expropriated security interest only if it would have been payable at or shortly after the time of the expropriation or if the security holder was entitled to receive interest at a rate which approximates the then prevailing rate for a similar investment. If the security holder was not entitled to interest, or if he was entitled under the security to interest at a rate below the prevailing rate, early payment of the outstanding balance will over-compensate him; he will be able to re-invest his compensation and earn more than he would have received under the security. On the other hand, if he was entitled under the security to receive interest at a rate greater than the prevailing rate for a similar investment, early payment will under-compensate him because he cannot re-invest the money and earn as much as he would have received under the security. Therefore the acceleration of payments which may be brought about by the "payment of outstanding balance" theory will in most cases over-compensate or under-compensate the security holder, and only rarely will it compensate him properly.

The land-owner will receive what is left of the compensation for the land after deduction of the balance outstanding under the security interest. Therefore, he will be charged improperly with any amount by which the compensation paid to the security holder exceeds the cash equivalent of the security holder's interest, and he will be improperly left to enjoy the benefit of any amount by which that compensation is less than the cash equivalent.

- (b) Expropriation of means of repayment. In some cases the land-owner will have relied for payment of a very high amount of debt on the income or capital appreciation which he expected to realize from the land (para. 2.6). Expropriation followed by the accelerated payment of

the balance owing will in such a case deprive him of the chance to realize from the land the gains which would have enabled him to pay the mortgage debt, so that a solution which will leave him liable to pay an outstanding balance will be unfair to him.

- (c) Purchase money securities. A purchase money mortgage or agreement for sale may secure a very high amount because the dealings in the land were speculative or the cash payment low; part of the amount may really be a payment for the extension of credit. Expropriation in such a case takes away the purchaser's chance of having the income or capital appreciation of the land to help him to discharge the obligation and a solution which will leave him immediately liable for the whole amount will be unfair to him. It may also be thought unfair that he should be made to pay for the seller's benefit a purchase price which is demonstrated by the award to have been excessive.
- (d) "Bonus" or "discount" mortgages. If the mortgagor executes a mortgage (a "bonus" or "discount" mortgage), for a larger amount than is actually advanced for the mortgagor's benefit, the difference may be intended as an advantage to the lender, to be spread out throughout the life of the mortgage. Acceleration of payment upon expropriation will unfairly result in giving the lender, at the land-owner's expense, the whole of the advantage without requiring him to have his money out for the agreed time.
- (e) No outstanding balance. There are some cases in which it cannot be said that there is an outstanding balance secured by a security interest, e.g., the case of a life annuity charged on land. A "payment of outstanding balance" theory does not cope with these cases.
- (f) Partial taking. If only a small part of the land is taken, and if the award goes to the security holder, the land-owner gets nothing at the time, though if it is applied against the principal he will ultimately get the benefit. This may be seen as a disadvantage by a land-owner.

c. Compensation according to market value

(1) Arguments favouring adoption

3.5 We have already described the "market value" theory (paras. 1.8 to 1.11). It should be first noted that application of the theory has the following effects:

- (a) The market value of a security interest which secures future payments is likely to be less than the outstanding balance if its interest rate is lower than prevailing rates of interest, and its value is likely to be greater than the outstanding balance if its interest rate is higher than prevailing interest rates.
- (b) If the security is weak, the market value of the security interest is likely to be lower than the value of an equivalent but less risky security which secures the same outstanding balance. In the absence of other security a prudent investor is unlikely to purchase a mortgage at a cost to him which is greater than the value of the property which is the security behind the mortgage, and he may not be willing to pay that much.

We will now set out the arguments which we think should be borne in mind when the retention of the theory is under consideration.

(2) Advantages of compensation according to market value

3.6 If the "market value" theory can be properly applied, it has the following advantages:

- (a) Application of compensation principle to security holder. Market value is the test of compensation for other interests in land; and there are particularly strong arguments for applying that test to the compensation to be paid for an interest which can have no value except the value of the money which it will yield. If the security holder receives the market value of his security interest he should be able to replace the interest with a similar security at a similar cost, and compensation based on market value will therefore compensate him for what was taken from him, no more and no less.
- (b) Application of compensation principle to land-owner. For the purpose of compensating the land-owner the "market value" theory focusses attention on what the market would pay for what he has in fact got (an encumbered property). The "payment of outstanding balance" theory however focusses attention on what the market would pay for something which does not exist (an unencumbered property) and then deducts from that

hypothetical sum an amount measured by the outstanding balance under the security (which amount is not likely to measure accurately the detriment which the security interest imposes upon the land-owner's interest).

(3) Arguments against adoption

3.7 The "market value" theory has, or may be argued to have, the following disadvantages:

- (a) Personal liability. A security holder's rights include a claim to have the land held as security for the money payable under it. They may also include a personal claim against the land-owner for payment of the debt. In such a case the market value of all the security holder's rights (the security interest plus the land-owner's personal liability) may be greater than the market value of the security interest alone. This situation will arise if the land-owner is solvent and the land is less than adequate security for the amount secured by the security interest. In order to see whether the "market value" theory can deal adequately with such a case it is necessary to consider whether or not the value of the land-owner's personal liability is to be taken into account in determining the market value of the security holder's rights and to consider, in either event, whether or not the land-owner's personal liability will be discharged. (This will, we think, exhaust the possible cases.)

The expropriator wants only the land. If it pays additional compensation based on the value of rights which include something other than rights against the land (i.e., the land-owner's personal liability) it will in effect pay for something which it does not want and from which it cannot benefit, and it will therefore pay excessive compensation. If the effect of the payment is to extinguish the land-owner's liability the land-owner will receive a windfall because he will escape personal liability without giving up anything for his release. If the land-owner's liability is not extinguished, the security holder will have received the market value of all his rights and will still have part of them, so that he will receive a windfall. In the latter event there is the further difficulty that there is nothing in the "market value" theory to say what balance remains outstanding after an apple (compensation based upon the market value of the security holder's rights) is applied against an

orange (the balance outstanding under the security interest). In order to determine the balance it will be necessary to abandon "market value" theory and to proceed on some principle which is inconsistent with it (e.g., the equitable apportionment of a burden between two innocent parties); it is at best of doubtful utility to legislate upon the basis of a theory which must be jettisoned part way through in a class of case which is by no means uncommon.

On the other hand, if the expropriator pays compensation based only on the market value of the security interest in the land (excluding the value of the land-owner's personal liability) it will pay only for what it gets and will be treated fairly. If the effect of the payment is to extinguish the land-owner's personal liability, however, the security holder will be under-compensated because he will lose both the security interest and the land-owner's personal liability but will be compensated for the value of the security interest alone. If the land-owner's liability is not extinguished the difficulty of determining the outstanding balance again arises, and the remarks we made in the preceding paragraph will apply.

For these reasons it may be argued that the market value theory cannot cope adequately with a case in which a security interest secures the payment money for which the land-owner is personally liable and in which the land security is not clearly adequate. The same reasoning would also apply if someone other than the land-owner, for example, a guarantor or a prior owner of the land, is personally liable.

- (b) Collateral securities. The "market value" theory creates a similar but even more difficult problem if there is other security for payment of the money secured by the expropriated security interest. In many cases the security interest in land (e.g., a mortgage given in support of a guarantee of a loan which is itself secured by other security as well and is in good standing) could not be sold by itself, and if there is no market there cannot be a market value. Further, if the award to the security holder is based upon the market value of the security interest and has no relation to the amount secured, and if the amount secured exceeds the value of the land, the difficulty would again arise that the "market value" theory does not explain how compensation based upon market value can be applied against the balance outstanding under the mortgage: see our remarks under heading (a) above. S. 49(2) of the 1980 Act recognizes the problem by leaving it to

the tribunal to decide the balance owing, but neither the subsection nor the "market value" theory provides any principle upon which the tribunal could decide what is owing.

- (c) Partial takings. The "market value" theory creates a similar difficulty with partial takings, and s. 49(3) of the 1980 Act again leaves the solution to the tribunal. Obviously there is no market for a security interest in part of a parcel so that the "market value" theory does not provide any principle upon which the tribunal can decide what the security interest is worth, nor does the theory explain how compensation for the security interest can be applied against the outstanding balance.
- (d) Purchase money securities and "bonus" or "discount" mortgages. The "market value" theory does not avoid the problems with purchase money and bonus mortgages which are discussed above in connection with the "payment of outstanding balance" theory (see para. 3.4(c) and (d)). A holder of either may receive in the guise of capital, and receive early, what was really intended as a charge for credit recoverable over the life of the loan.
- (e) Complexity. The "market value" theory is complex and difficult of application. The Forster Mah case is an example of the difficulties which parties may encounter in applying it.
- (f) Cost. Application of the market value theory requires expensive valuations and litigation in order to determine the market value of security interests. The outstanding balance can usually, however, be determined by the parties themselves from records which are in their possession. Even if the "market value" theory would lead to greater abstract justice, it is necessary to consider whether or not the benefit to the parties fully off-sets the additional costs which it imposes.
- (g) Existence of market. The "market value" theory depends upon the existence of a satisfactory market for security interests, but the existence of a satisfactory market is not demonstrated. Mortgages are bought and sold but it is by no means clear that there is a market of sufficient strength even for fairly common kinds of mortgages, and for some security interests (e.g., collateral mortgages, annuities charged on land, builders' and other liens, and writs of execution) it is unlikely that there is any market at all.
- (h) Avoidance. Some mortgage lenders avoid the application of the "market value" theory by

drawing mortgages with provisions that make the outstanding balances immediately due and payable upon expropriation (sometimes with an assignment of the land-owner's prospective award for further security). We have not investigated to see how widespread this practice is, but we understand that it is quite common. Legislation could, of course, invalidate such provisions, but legislation of that kind should be avoided unless an overriding public interest or overriding considerations of fairness require it. To the extent that the practice is followed it nullifies the "market value" theory and constitutes a contractual adoption of the "payment of outstanding balance" theory.

- (i) Attribution of value without grounds. The requirement of separate valuation may lead to attaching a value to that which clearly has no value. In the Forster Mah case, for example, the owners of land which was mortgaged in excess of its value received \$25,000 for their interest.

4. CHOICE OF COMPENSATION THEORY

4.1 The principal question to be addressed is this: should the Expropriation Act be amended to reflect a "payment of outstanding balance" theory of compensation for security interests or should it continue to reflect a "market value" theory?

4.2 We think that the relevant considerations are as follows:

- (a) The arguments in favour of adoption of the "payment of outstanding balance" theory as set out in para. 3.3;
- (b) The arguments against adoption of the "payment of outstanding balance" theory as set out in para. 3.4;
- (c) The advantages of the "market value" theory as set out in para. 3.6;
- (d) The arguments against adoption of the "market value" theory as set out in para. 3.7;
- (e) The questions raised by the Forster Mah case as set out in para. 1.18.

4.3 There is a further consideration. Successive reversals of legislative policy are likely to be confusing and unsettling to those who are affected by a piece of legislation; and adoption of the "payment of outstanding balance" theory would reverse an innovative legislative policy which was adopted only some eight years ago. However, it appears likely that business affairs have not been arranged on the strength of the "market value" theory which was adopted by the 1974 Act, but have rather been arranged to circumvent its application, and it appears that those who consider the question when making their contracts tend to adopt the "payment of outstanding balance" theory. These countervailing considerations suggest that the importance of the maintenance of consistency of legislative policy should not be the decisive consideration.

4.4 We invite comment and argument on the question whether or not the Expropriation Act should be amended to reflect a "payment of outstanding balance" theory instead of a "market value" theory. If there are answers to the problems with the "market value" theory which we have raised, we would like to hear them and consider them, and we will consider them carefully.

Question No. 1

Should the Expropriation Act be amended to reflect a "payment of outstanding balance" theory instead of a "market value" theory?

5. PROVISIONS TO MEET SPECIFIC PROBLEMS

a. "Payment of outstanding balance" theory

5.1 If the ultimate decision is that a form of the "payment of outstanding balance" theory should be adopted, we think that

some of the problems which arise from it should be considered.

(1) Change in interest rates

5.2 The first problem is that if prevailing interest rates are not the same as the interest rate applicable to the secured debt (which will often be the case), and if the expropriation accelerates payment, the application of the "payment of outstanding balance" theory will result in over-compensation for the holder of the security interest and under-compensation for the land-owner, or vice-versa, (see para. 3.4(a)). Can a solution for this problem be found?

5.3 We see only three practicable solutions to the problem posed by a discrepancy in interest rates:

- (a) To pay the security holder the outstanding balance and to accept the over-compensation of one party and the under-compensation of the other. This solution would give the owner of one interest an undeserved advantage and impose upon the owner of another an undeserved loss (para. 3.4). It would be fair to the expropriator.
- (b) To deduct from the compensation payable to the "winner" (the party who would otherwise be over-compensated) and to add to the compensation for the "loser" (the party who would otherwise be under-compensated) the amount by which the one would be over-compensated and the other would be under-compensated. This solution, if practicable, would be fair to all parties. It appears likely, however, to cause difficulties like those caused by the "market value" theory, some of the elements of which it includes. In particular, it could not cope adequately with the balance owing if the compensation for the expropriated land is less than the balance outstanding. (See, by way of analogy, our remarks in para. 3.7(a)).
- (c) To require the expropriator to pay additional compensation to the owner of the security interest if prevailing interest rates are lower than the rate payable under the security interest and to pay additional compensation to the land-owner if they are higher. Ontario has adopted this solution (Ontario s. 20(b) and s. 20(c)) with the following qualifications:

- (i) it applies only to mortgages and not to other security interests.
- (ii) the mortgagee will be compensated under Ontario s. 20(b) only if there is no prepayment privilege in the mortgage, and he will be compensated for no more than 5 years' loss.
- (iii) the land-owner will be compensated under Ontario s. 20(c) only if he can demonstrate "loss" by reason of difference.

This solution is fair as between land-owner and mortgagee as it does not penalize either. It would also be fair as between the "loser" and the expropriator as it would require the expropriator to compensate the "loser" for his actual loss. It would however require the expropriator to over-compensate the "winner". As previously stated, the Ontario legislation applies it only to a case in which the security interest is a mortgage and not to a case in which another kind of security interest is involved.

5.4 Presumably a mortgagee should be compensated for a decline in interest rates only if he has been deprived of a legal right to keep the money out at the high contract rate. If at the time of the expropriation a mortgagor has the right to pay off the mortgage, the mortgagee does not have the right to have the money kept out at the higher rate and should not receive compensation under this head. Ontario's s. 20(b)(ii) so provided. We invite comment.

5.5 The last paragraph refers to a case in which the mortgagor was entitled to prepay the mortgage debt. But what if the mortgagee is entitled to demand payment of the outstanding balance upon expropriation? It may be said that at the time of expropriation the mortgagee nevertheless has the right to have the money kept out at the higher interest and should be compensated for the loss of that right. It might, however, be

said in reply that a mortgagee who has taken steps to guard himself against the effects of expropriation should be left to the rights for which he has stipulated and should not receive additional compensation. We invite comment on that proposition also.

Question No. 2

We invite comment on the following questions:

Under the "payment of outstanding balance" theory:

- (1) (a) should the compensation which is paid to a mortgagee be the outstanding balance under the mortgage even though prevailing interest rates are greater or less than the rate to which the mortgagee would have been entitled if there had been no expropriation; or
- (b) should the compensation of the party who gains from the difference be reduced and the compensation of the party who loses from it be increased by the amount of the gain and the loss respectively; or
- (c) should the "loser" be compensated for the loss while the compensation of the "winner" remains unaffected by the change in the interest rates; or
- (d) should some other solution be adopted?
- (2) if the mortgagee is to be compensated because interest rates go down, should an exception be made
 - (a) if at the time of the expropriation the mortgagor has the right to pay off the mortgage? or
 - (b) if the mortgagee has the right upon expropriation to declare the whole outstanding balance due and owing?
- (3) should the same solution be applied to compensation for security interests other than mortgages?

(2) Purchase-money mortgages and agreements for sale

5.6 In para 3.4(c) we set out arguments which may support the proposition that it is unfair upon expropriation to charge the purchaser of the subsequently expropriated land with the full amount of a purchase-money security. If there is unfairness and if something should be done to rectify it, we think that the following are the choices:

- (a) to provide that where the compensation for expropriated land is not sufficient to pay the balance outstanding upon a mortgage or other security which is retained by the seller of the same land, the balance outstanding is to be treated as paid in full and all remedies for the debt and all securities are discharged. This is the substance of the Ontario solution (see Ontario s. 17(4)(a)).
- (b) to adopt the same solution but only in restricted circumstances, e.g., where the sale is recent, or where it can be demonstrated that the excess of the outstanding balance over the market value of the land is primarily a premium for a credit risk (see, e.g., Dunham, Do "Hard Cases" make Bad Economics? (1958) 4 Harvard L.J. 50).

Upon considering Ontario s. 17(4)(a), however, we doubt that it should apply if the land expropriated does not include all of the land which is subject to the purchase-money security; payment to the security holder of the compensation for part of the land should not satisfy the obligation of the land-owner to pay the purchase price of the whole. We expect that an Ontario tribunal would find that it is the provision relating to partial takings (Ontario s. 17(6)) which would apply, and not Ontario s. 17(4)(a). We raise for discussion, however, the question whether or not, if one of the solutions described above is adopted, it should apply only if all the land subject to the security interest is taken. It might be possible to work out a special

formula for cases of partial takings of land subject to purchase-money securities, but we suspect that such a formula would be too complex for practical application.

5.7 If the argument set out in para. 5.6 is valid its logic might in a particular case say that the compensation of the security holder should be reduced by whatever part of the outstanding balance is attributable to the cost of credit or by any amount by which the total compensation for the land proves to be less than the sale price which the land-owner agreed to pay even if the security holder's compensation would be reduced below the market value of the expropriated land. We do not raise such a proposition for consideration.

Question No. 3

We invite comment on the following questions:

Under the "payment of outstanding balance" theory:

- (a) If a seller of land retains an interest in the land to secure payment of the balance of the purchase price, and the amount of the compensation for the land is not sufficient to pay off the balance outstanding under the security, should the debt be satisfied and other securities discharged?
- (b) If the solution in (a) is adopted, should it be restricted to cases in which the sale is recent and the amount of the deficiency is primarily a premium for credit risk, or both?
- (c) If the solution in (a) or (b) is adopted, should it be restricted to cases in which all the land subject to the security interest is taken?

(3) Bonus or discount mortgages

5.8 In para 3.4(d) we set out an argument which may support the proposition that it is unfair to the land-owner to accelerate the payment of the money secured by a "bonus" or "discount" mortgage. The Ontario solution (Ont. s. 17(4)(b)) is to discharge the land-owner from liability for any amount by which the outstanding balance exceeds the compensation for the land, apparently by analogy to the purchase money mortgage. Somewhat different considerations apply, however, especially if the parties regard the "bonus" or "discount" as a cost spread over the prospective term of the mortgage. In such a case it might be argued that it would be better to apportion the cost rather than to have its incidence automatically determined by the relationship between the amount of the outstanding balance of the mortgage (plus the amounts secured by the prior securities often associated with "bonus" or discount mortgages) and the compensation awarded for the expropriated land. Even in a case in which the compensation for the land exceeds the balance outstanding under the mortgage it may be unfair to the land-owner if the expropriation accelerates payment of the amount of the discount or bonus. On the other hand, if a discount or a bonus is a reasonable inducement to a seller to accept a risky security and a dubious purchaser it may be unfair to the seller, if the security is proved by the expropriation award to be inadequate, to deprive him of the right to recover the whole discount from the land-owner. It should also be noted that if only part of the mortgaged land is taken it is not likely to be appropriate to discharge the whole amount of the bonus or discount.

Question No. 4

We invite comment on the following questions:

Under the "payment of outstanding balance" theory, in the case of a "bonus" or "discount" mortgage:

- (a) If the market value of the land is less than the balance outstanding under the mortgage, should the amount of the bonus, up to the amount of the deficiency, be treated as paid; or
- (b) Should the tribunal have power to deduct from the mortgagee's compensation all or part of the "bonus" or "discount," and, if so, what criteria should it apply; or
- (c) Should the "bonus" or "discount" be dealt with in some other way; or
- (d) Should the "bonus" or "discount" mortgage be treated like an ordinary mortgage; and
- (e) If special provision is made for "bonus" or "discount" mortgages, should it apply if only part of the mortgaged land is expropriated?

(4) No "outstanding balance"

5.9 In para 3.4(2) we referred briefly to cases in which there is no "outstanding balance" under a security interest. We will now describe the problem at somewhat greater length. Occasionally, an annuity may be charged on land, e.g., a testator may leave land to one of his children subject to the making by that child of annual payments to another child. In such a case, there is no "principal" and no "interest". If the annuity is to be paid for a specific number of years there might be said to be an "outstanding balance" which is the total of the annuity payments to be made in the future, but it may well be argued that it would not be appropriate merely to accelerate payment upon

expropriation, as present payment of interest-free amounts due in the future would confer a windfall benefit upon the annuitant. If the annuity is for an indeterminate period, such as the annuitant's life, it would be possible to estimate the term by life expectancy tables or otherwise and then to characterize either the total of the amounts which would be payable during the estimated term, or the present value of those deferred payments, as the "outstanding balance", but that balance would be a fiction; the chances are very great that the annuitant would not live for that precise term. On the whole, it is difficult to see how the "payment of outstanding balance" theory can be applied to the case of an annuity.

5.10 Annuities charged on land are rare in our experience, but the law should be framed so that an interest in expropriated land securing payment of one can be dealt with if such a case arises. The alternatives which occur to us are (a) to empower the tribunal to fix a "fair value" (which, assuming that the land was adequate security, will probably turn out to be the present value of a similar annuity) or (b) to empower the tribunal to require the expropriator to purchase a similar annuity for the annuitant. The term "fair value" obviously leaves the tribunal with a broad area of discretion and may therefore create uncertainty, but we think that it might be a suitable formula for cases which are likely to be infrequent and the nature of which cannot be accurately foreseen. The term "fair value" has been adopted by the Business Corporations Act (e.g. s. 184) and the courts will have occasion to become familiar with it in that context.

5.11 There is also a question as to the value of the land-owner's interest if it is subject to the payment of the annuity. The test could be either the market value of his interest (which would probably be the market value of the land, valued as if unencumbered, less the present cost of an equivalent annuity) or the "fair value" of his interest. We invite comment.

Question No. 5

We invite comment on the following questions:

Under the "payment of outstanding balance" theory:

- (a) Should the holder of an annuity which is charged on expropriated land receive
 - (i) the fair value of the annuity; or
 - (ii) a similar annuity in replacement; or
 - (iii) something else?
- (b) Should a land-holder whose interest is security for the payment of an annuity receive
 - (i) the market value of his interest, or
 - (ii) the fair value of his interest, or
 - (iii) something else?

5.12 The ingenuity of the human race may well devise other arrangements which charge land with money payments which cannot be firmly quantified or with the provision of other things having money's worth. An example is the encumbrance already mentioned under which the old people transferring the family farm to their children reserve the right to live in a room of the house and to be supplied with food and fuel. Such arrangements cannot be dealt with by the "payment of outstanding balance" theory because

there is nothing which can be called an "outstanding balance", but the interest of the holder may be, in whole or in part, a security interest. We are inclined to the view that provision should be made for all such arrangements under which there is nothing that can really be called an "outstanding balance" and that it should be a determination by the tribunal of compensation based upon "fair value," but we would welcome comment. Again, the land-owner's compensation could be determined by a "market value" or "fair value" test.

Question No. 6

We invite comment on the following questions:

Under the "payment of outstanding balance" theory:

- (a) Should the holder of a security interest which secures any other amounts which cannot be quantified receive
 - (i) the "fair value" of the right to receive the money, or
 - (ii) something else?
- (b) Should a landowner whose interest is security for the payment of an amount referred to in (a) receive
 - (i) the "fair" value of his interest, or
 - (ii) the market value of his interest, or
 - (iii) something else?

(5) Small partial takings

5.13 We referred briefly in para. 3.4(f) to the special problem of distribution of compensation which may be created by the expropriation of a small part of the land which is subject to a security interest. If a comparatively small part of the

security is taken, the land-owner may well feel that he should receive the compensation and that it should not go to the security holder, even though the payment will presumably apply for his benefit upon the amount secured. If the security holder continues to be amply secured by the remaining land or other security his interests have not been adversely affected by the expropriation, and it can be argued that a mortgagee whose interests have not been adversely affected should not be compensated. These considerations would suggest that the compensation in such a case should go to the land-owner.

5.14 However, it is not always easy to decide whether the expropriation has had a significant effect on the security, and the security holder may reasonably take the view in any event that part of his security has gone and that he should receive the compensation for its taking, or at least part of the compensation, for application upon the money secured by his interest.

5.15 One solution would be to allow the tribunal to decide whether the expropriation has impaired the security to such an extent that the security holder should receive all or part of the compensation, and to make its award accordingly. Another (the Ontario solution) would be to provide that the security holder is to be paid a sum that is in the same ratio to the compensation as the balance outstanding is to the market value of the entire land (Ontario s. 17(6); e.g., if the market value of the parcel of land of which part has been expropriated is \$100,000, the balance outstanding under the the mortgage is \$50,000, and the compensation for the part taken is \$10,000, the mortgagee would

get half of the \$10,000, leaving him with a \$45,000 mortgage against a \$90,000 property rather than a \$50,000 mortgage against a \$100,000 property. The reasons given by the Ontario Law Reform Commission for recommending this solution, are as follows: "The application of the ratio method is both simple and fair. It can be applied where only part of a parcel is taken and also where a mortgage covers several or many parcels of land, contiguous or otherwise." We do not, however, see how the ratio method could be applied to cases involving security interests such as those mentioned in paragraphs 5.9 and 5.12 where there is really no outstanding balance. It will be noted also that the Ontario provision would require valuation of all the land covered by the mortgage, which may be quite expensive if only a small part, or only one of many parcels, is taken. Further, if the amount involved is comparatively trivial it may be unduly doctrinaire to insist upon maintaining the existing ratio of debt to land value, and if the security is shaky, it may be that the mortgagee should get the entire benefit, as upon a sale of the part he would be entitled to stipulate for payment of all or part of the sale price as a condition of giving a partial discharge of his security. On the other hand, if the amount involved is indeed small, it may be that the Ontario formula would work quite well simply because the parties will settle rather than litigate.

Question No. 7

We invite comment on the following questions:

Under the "payment of outstanding balance" theory, if only part of the land subject to the security interest is expropriated and the parties do not agree who should receive the compensation

- (a) should the whole amount of the compensation (up to the balance outstanding under the security) be paid to the security holder for application to the secured claim; or
- (b) should the security holder be paid, for application to the secured claim, a sum bearing the same ratio to total of the compensation for the expropriated land and for injurious affection of the remainder as the balance outstanding on the security bears to market value of the entire land; or
- (c) should the security holder be paid, for application to the secured claim, such amount as the tribunal finds necessary to avoid prejudice to the security holder's security; or
- (d) should some other method of apportionment of the compensation be adopted?

(6) Application of partial payment

5.16 Under the "payment of outstanding balance" theory, money paid to a security holder will apply against the outstanding balance. If the payment is less than the outstanding balance, and if the outstanding balance was payable by instalments, there may be a question as to whether the payment should be credited against the instalments in the order in which they fall due (so that the land-owner would not make payments under the security until the credit is used up) or whether it should be credited in the reverse order (so the land-owner would continue to pay the instalments called for by the security and would get his credit at the end). In the case of a mortgage we think that the latter course is customary, but in the case of a security interest such as those mentioned in paras. 5.9 and 5.12 (except for the fixed term annuity) the amounts of the last payments will not be known until after they are paid, a circumstance which makes it difficult to apply compensation for expropriation to them. We are not aware that the silence of

expropriation statutes on the point has given rise to problems in the past, and it may be that the Alberta Expropriation Act should not provide a solution in the apparent absence of a problem. The solution, if one is required, could be to require that the compensation be applied as payments would fall due, or that the compensation be applied against payments in the reverse order, and one solution could be applied to cases where outstanding balances can be ascertained and another to cases in which outstanding balances cannot be ascertained. There may be other possible solutions. We invite comment.

Question No. 8

We invite comment on the following question:

Under the "payment of outstanding balance" theory, should the statute prescribe the way in which any compensation payable to the security holder will be applied to future instalments, and, if so, what way or ways should it prescribe?

b. "Market value" theory

(1) Personal obligations and collateral securities

5.17 In para. 3.7(a) and (b) we set out some theoretical difficulties in the application of the "market value" theory to cases in which the security holder holds as security for money not only a security interest in the expropriated land but also the personal liability of the land-owner or someone else and to cases in which the security holder has other collateral security. We refer the reader back to those remarks and we invite comment on them.

Question No. 9

We invite comment on the following questions:

- (1) Does s. 49 of the Expropriation Act cope adequately with cases in which
 - (a) the land-owner or some other person is liable to pay money secured by the security interest, or
 - (b) there is other security for payment?
- (2) If not, can the "market value" theory cope adequately with such cases, and, if so, how?

(2) Partial taking

5.18 In para 3.7(c) we set out a theoretical difficulty in the application of the "market value" theory to cases of partial taking.

Question No. 10

We invite comment on the following questions:

- (1) Does s. 49(4) of the Expropriation Act cope adequately with a case in which only part of the land that is subject to a security interest is expropriated?
- (2) If not, can the "market value" theory cope adequately with cases of partial taking, and, if so, how?

(3) Purchase money and "bonus" or "discount" mortgages

5.19 In para. 3.7(d) we referred to the problems of purchase money securities and "bonus" or "discount" mortgages.

Question No. 11

We invite comment on the following questions:

- (1) Does s. 49 of the Expropriation Act cope adequately with cases in which there is a purchase money security or a "bonus" or "discount" mortgage in which part of the money secured as principal is really a charge for credit or risk?
- (2) If not, what changes should be made?

(4) Existence of market

5.20 In para. 3.7(g) we pointed out that the "market value" theory depends upon the existence of a satisfactory "market". We raised a question whether there is a market of sufficient strength even for fairly common kinds of mortgages. In the same sub-paragraph and in para. 3.4(c) we suggested that it is unlikely that there is a market for some security interests (e.g., collateral mortgages, annuities charged on land, builders' liens and writs of execution) or for security interests in only part of the land affected by the security. We invite comment on the existence of markets for these various kinds of interests. If the theory depends upon the existence of a "market", and there is not a satisfactory "market", we would be interested in proposals which would provide for the valuation of security interests upon the basis of their separate value.

Question No. 12

We invite comment upon the following questions:

- (1) For the purposes of the market value theory is there an adequate market for
 - (a) mortgages (a mortgage for this purpose being defined as an entire right to receive a sum or

sums of money under a land mortgage instrument together with all securities and liabilities for payment)?

- (b) agreements for sale of land (being the entire right to receive a sum or sums of money under an instrument under which title to land is retained as security, together with all securities and liabilities for payment)?
 - (c) security interests under mortgages or agreements for sale securing money for which there is other security or for which someone is liable, but without the other security or the benefit of the personal liability being included in the sale?
 - (d) annuities and other unascertained amounts charged upon land, builders' and other liens?
- (2) If there is an adequate market for some of these security interests but not for others
- (a) should the "market value" theory apply
 - (i) to those security interests for which there is an adequate market,
 - (ii) to those security interests for which there is not an adequate market?
 - (b) what theory or formula for compensation should apply to those security interests for which there is not an adequate market?

(5) Problems arising from application of the "prudent lending value"

5.21 It will be remembered that in the Forster Mah case, the Land Compensation Board felt compelled by the evidence and arguments before it to take two steps.

5.22 The first step (para. 1.15) was to hold that on the evidence and arguments before it the market value of the mortgage could not exceed the "prudent lending value" of the mortgaged land, which the Board found in the particular case to be 75% of the market value of the mortgaged land. Although it may be

possible to find some support for the making of such a finding in the "market value" theory and in the Expropriation Act, our tentative view is that the law should be altered or clarified so that such a finding would not be made in another case. So far as "market value" goes, it is by no means sure that the mortgage market would make the same decision as the tribunal about the market value of the mortgaged land and then apply the "prudent lending ratio" to it. Even if the "market value" theory would permit a scaling down of the market value of the mortgage to the "prudent lending value" of the land, we do not think that theory should compel a tribunal which establishes a market value for the land to close its eyes to the fact that its award fully secures the outstanding balance up to the amount of the award.

5.23 The second step which the Board thought the positions of the parties compelled it to take (para. 1.16) was to deduct the market value of the mortgage from the market value of the land and to pay to the land-owners an amount equal to the difference. We think that the payment clearly constituted a windfall to the land-owners. We would have thought that the requirement in s. 48 and s. 49(1) of the 1980 Act that the interests be valued separately would have precluded the deduction of the value of one (the market value of the security interest) from a third amount (the market value of the land itself) to obtain the other (the market value of the land-owner's interest), but the position of the parties appears to have been that it did not, and we think that the law should be clarified to put it beyond doubt that it does.

5.24 The question then arises as to how the Expropriation Act should deal with these two points (avoiding the reduction of the market value of the security interest to the "prudent lending value" of the land and avoiding the deduction of the market value of the security interest from the market value of the land to arrive at the amount of compensation for the land-owner's interest).

5.25 One solution would be to provide that the market value of the security interest shall not be reduced below the market value of the land-owner's interest in the mortgaged land (subject to all charges or encumbrances which are entitled to priority over the security interest) by reason only that the value of the land and any other security for the secured amount is less than the market value of the security interest. In the Forster Mah case, such a provision would have resulted in payment to the mortgagee of \$100,000, being the market value of the land. It would also have meant that there could be no justification for any payment to the land-owners because there would have been no excess of the market value of the land over the market value of the mortgage.

5.26 An alternative solution would be to provide that the market values of all the separate interests in the land should be aggregated and that payment of compensation should be made in order of priority so that the land-owner would be paid only if the secured obligations are less than the aggregate sum; in the Forster Mah case, of course, the secured obligation was greater than the aggregate sum and the entire amount would have been paid to the mortgagee.

Question No. 13

We invite comments on the following question:

(a) Should the Expropriation Act

- (i) provide that the market value of a security interest shall not be reduced below the market value of the land-owner's interest upon which it is secured by reason only that the market would have regarded the security as weak; or
- (ii) provide that the market values of the separate interests in expropriated land shall be aggregated and then compensated for in order of priority, so that the land-owner would be paid only if the secured obligations are less than the aggregate sum; or
- (iii) deal in some other way or not at all with the problem which arises because application of the "prudent lending value" test reduces the market value of the mortgage below the market value of the land?

6. CONCLUSION

6.1 We again solicit comments and opinions on the subject of compensation to holders of security interests in expropriated lands and related questions about the compensation to be paid to the owners of land subject to security interests. We will consider all such comments carefully in arriving at our final conclusions.

J.W. BEAMES

W.F. BOWKER

C.R.B. DUNLOP

G.C. FIELD

E.F. GAMACHE

W.H. HURLBURT

J.C. LEVY

T.W. MAPP

D.B. MASON

W.E. WILSON

March, 1982

APPENDIX A

Expropriation Act, RSA 1980, c. E-16

48. When there is more than one separate interest in land, the market value of each separate interest shall, where practical, be established separately.

49.(1) When the expropriated land is subject to a security interest, the market value of each person having an interest in the land shall be established separately.

(2) When the amount owing to the security holder is greater than the market value of his interest and there is no collateral security other than the covenant of the purchaser or borrower to pay the amount of the debt, the security interest shall be deemed to be fully paid, discharged and satisfied on payment to the security holder of the market value of the security.

(3) When the amount owing to the security holder is greater than the market value of his interest and there is collateral security other than the covenant of the purchaser or borrower to pay the amount of the debt, and whether that collateral is by way of security on other property or a guarantee of a third party or otherwise, the compensation shall not fully discharge the debt and the Board shall determine the balance remaining and the manner in which it is to be repaid.

(4) When the expropriation is of a part of land that is subject to a security interest, the Board shall determine the market value of the expropriated part and shall distribute the compensation between the parties as it considers just in the circumstances.

52.(1) When the expropriated land is subject to a security interest, the expropriating authority shall pay to the security holder 3 months' interest at the rate prescribed in the security document or, if no rate is prescribed, at the rate that would normally be payable in respect of the security, on the amount of the outstanding principal.

(2) When the Board makes a determination under section 48, the amount payable in respect of interest under this section to the security holder shall be in the same proportion in relation to the total payment made on account of interest that the land being expropriated and subject to the security interest bears to the entire amount of land subject to the security interest.

APPENDIX B

Expropriation Act, RSO, 1970, c. 54

16. Where there are more separate interests than one in land, other than the interest of a security holder or a vendor under an agreement for sale, the market value of each such separate interest shall be valued separately. 1968-69, c. 36, s. 16.

17.(1) In this section, "bonus" means the amount by which the amount secured under a mortgage exceeds the amount actually advanced.

(2) Where land is subject to a security interest,

- (a) the value of the interest of the security holder shall be determined in accordance with this section and section 20 and not otherwise; and
- (b) the market value of the land shall be determined without regard to the interest of the security holder and the amount of such market value plus any damages for injurious affection shall stand in place of the land for the purposes of the security.

(3) Security holders shall be paid the amount of principal and interest outstanding against the security out of the market value of the land and any damages for injurious affection payable in respect of the land subject to the security, in accordance with their priorities, whether or not such principal and interest is due, and subject to subsections 4 and 5.

(4) Where the land is subject to a mortgage and the amount payable to the mortgagee under subsection 3 is insufficient to satisfy the mortgage in full,

- (a) where the mortgage is a purchase-money mortgage, the mortgage shall be deemed to be fully paid, satisfied and discharged for all purposes; and
- (b) where the mortgage is not a purchase-money mortgage and includes a bonus,
 - (i) the amount by which the amount payable to the mortgagee under subsection 3 is insufficient to pay the amount remaining unpaid under the mortgage, or
 - (ii) the amount of the bonus,

whichever is the lesser, shall be deemed to be fully paid and satisfied for all purposes.

(5) No amount shall be paid in respect of a bonus until all security holders have been paid all amounts payable other than any bonus.

(6) Where land held as security is expropriated in part or is injuriously affected, a security holder is entitled to be paid to the extent possible in accordance with his priority, out of the market value portion of the compensation and any damages for injurious affection therefor, as the case may be, a sum that is in the same ratio to such portion of the compensation and damages as the balance outstanding on the security at the date of the expropriation or injurious affection is to the market value of the entire land, provided however that the sum so determined shall be reduced by the amount of any payments made to the security holder by the owner after the date of expropriation or injurious affection.
1968-69, c. 36, s. 17.

20. Where a statutory authority prepays a mortgage in whole or in part, the statutory authority,

(a) shall pay to the mortgagee a bonus in respect of the prepayment amounting to,

(i) three months interest on the amount of principal prepaid at the rate of 6 per cent a year or at such other rate as is prescribed by the Lieutenant Governor in Council by regulation, or

(ii) the value of any notice or bonus for prepayment provided for in the mortgage,

whichever is the lesser;

(b) shall pay to the mortgagee where,

(i) the prevailing interest rate for an equivalent investment is lower than the rate under the mortgage, and

(ii) there is no provision in the mortgage permitting prepayment at the date of the expropriation,

an amount to compensate for the difference in the interest rates for the period for which the amount of principal prepaid has been advanced, not to exceed five years; and

(c) shall pay to the mortgagor whose interest is

expropriated an amount to compensate for any loss incurred by reason of a difference in the interest rates during the period for which the payment of principal provided for in the mortgage has been advanced, but such difference shall not be calculated on a new interest rate any greater than the prevailing interest rate for an equivalent mortgage, 1968-69, c. 36, s. 20.