LAW REFORM COMMISSION OF BRITISH COLUMBIA

REPORT ON

THE CALCULATION OF INTEREST ON FORECLOSURE

LRC 47

September 1980

The Law Reform Commission of British Columbia was established by the *Law Reform Commission Act* in 1969 and began functioning in 1970.

The Commissioners are:

Hon. Mr. Justice J. S. Aikins, Chairman
Peter Fraser
Kenneth C. Mackenzie
Bryan Williams
Anthony F. Sheppard
Arthur L. Close

Anthony J. Spence is Counsel to the Commission.
Frederick W Hansford and Thomas G. Anderson are Legal Research Officers to the Commission.
Sharon St. Michael is Secretary to the Commission.

The Commission offices are located on the 10th Floor, 1055 West Hastings Street, Vancouver, B.C. V6E 2E9.

Canadian Cataloguing in Publication Data
Main entry under title:
Report on the calculation of interest on foreclosure.

LRC 47.
ISBN 0-7718-8220-3

1. Foreclosure - British Columbia.
I. Law Reform Commission of British Columbia.

KEB235.5.F6A74 346.71104'364 C81-092001-8

TABLE OF CONTENTS

TO THE HONOURABLE L. ALLAN WILLIAMS, Q.C.
ATTORNEYGENERAL FOR BRITISH COLUMBIA

The Law Reform Commission of British Columbia has the honour to present the following:

REPORT ON
THE CALCULATION OF INTEREST ON FORECLOSURE

In two recent decisions, the courts have arrived at divergent views concerning the calculation of interest payable in a foreclosure proceeding by a mortgagor who wishes to redeem his property. One view is that interest should be payable only to the date of redemption. The other view is that interest should be payable for the entire redemption period, usually six months, irrespective of the actual time of redemption. At the request of your predecessor, this matter was added to our programme. In this Report, we analyse the issues and interests at stake and conclude that the former view should prevail subject to a discretion in the court to order that additional interest be paid in appropriate circumstances.

CHAPTER I INTRODUCTION

A number of remedies are available to a mortgage lender on a default by the mortgagor. They include an action on the mortgagor's personal covenant, the exercise of a contractual power of sale, a sale under a court order and an action for foreclosure. These remedies were described and considered in a Report issued by this Commission in 1975. That Report focussed on the divergence between the remedies available on the foreclosure of a mortgage and under an agreement for sale. In view of the functional similarity of these security devices, recommendations are made to introduce a measure of uniformity. This Report is concerned with the calculation of interest in an accounting upon foreclosure.

The events leading to this accounting usually start with the mortgagor defaulting in the payment of one or more of the instalments due under the mortgage. As one writer colourfully puts it, "Thus, out of this maelstrom of business failure and human frailty are cast the flotsam which, somewhat coldly, become known as mortgage defaults." Faced with this default, which may be of a continuing or chronic nature, the mortgagee will commence legal proceedings to realize on his security. The proceedings normally take the form of a petition under Rule 50 of the Rules of Court, asking, among other things that:

> unless the Respondents pay into Court, on or before the date for redemption the amount required to redeem the said lands, then the Respondents shall be foreclosed of all right, title, interest and equity of redemption in or to the said lands.

Assuming that all the supporting materials are in order, all persons whose interest may be affected have been served and the facts in the action warrant foreclosure, a judge of the court sitting in chambers will grant an order *nisi*.

It has long been the practice of the courts to grant the mortgagor a period of time, usually six months, in which to redeem his property by paying the amount of principal and interest that is due and owing. This period of redemption is granted as part of the usual order *nisi* along with a reference to the Registrar to take an accounting of what "will be due the petitioner (mortgagee) or to any person on the expiration of the period of redemption."

It has been the settled practice of the court until recently, that the usual order should call for payment of interest for the whole six month period irrespective of when, if at all, the mortgagor redeems his interest. This amount of interest has been said to be in lieu of notice to the mortgagee. It is, however, in the discretion of the court to abridge or extend the time for redemption and "order at what times, on what terms, and in what order of priority respondents may redeem the mortgaged property." Traditionally, this discretion, codified now in the Rules of Court has been exercised as part of the court's equitable jurisdiction to relieve from forfeiture.

The settled practice was questioned recently by Catliff, L.J.S.C. in *Avco Financial Services* v. *Gustafson*. Reasoning that present high interest rates remove the justification for the practice and that Rule 50(5)(e), Rules of Court, permits a chambers judge to exercise a discretion in this instance, he awarded interest calculated to the date when, if at all, the mortgagor paid the amount due and owing. This decision favours the mortgagor (or subsequent encumbrancer, such as a second mortgagee) who redeems earlier than six months after the order *nisi*.

The British Columbia Court of Appeal did not agree with this exercise of discretion in framing the usual order *nisi*. In *North West Trust Co. v. Paramount Management Corp*. two of the three judges agreed that the settled practice of awarding interest to the date set for redemption should be continued in:

> ... the usual order, the order that will be made without reasons in the usual case and will only be departed from in the discretion of the chambers judge in the appropriate case.

This form of the usual order favours the mortgagee since, if the mortgage is redeemed before the lapse of the redemption period, he is still entitled to the full six months' interest. The dissent, however, suggests that whether the settled practice should be adhered to remains a matter of some dispute.

The following chapter will explore the historical background to the settled practice and examine the practice in other jurisdictions. That provides the background against which the issues raised by the *Avco* and *North West Trust* decisions will be examined.

CHAPTER II THE SETTLED PRACTICE

A. Historical Background

Generally, a mortgagor is not entitled to redeem his property before the day fixed in his mortgage contract. In *Brown* v. *Cole*, for example, the ViceChancellor held that there was no equity to grant early redemption of a mortgage even though the mortgagor had tendered the full sum payable, including interest to the date of redemption. On the other hand, if the mortgagee has taken some action to obtain payment, such as by suing on the covenant in the mortgage or taking action to foreclose, then the mortgagor can redeem by payment of the principal and any outstanding interest without giving any notice to the mortgagee.

Default by the mortgagor has different consequences. The general principle was stated by Romer, J. in *Smith* v. *Smith*:

> It seems to be a settled rule of practice that, after default has been made by a mortgagor in payment of the principal and interest in accordance with the proviso for redemption contained in the mortgage deed, he must either give the mortgagee six calendar months' notice of his intention to pay off the mortgage, or must pay the mortgagee six months' interest in lieu of notice. This is the well settled general rule.

The interest payable under the "usual order" is a particular application of this general rule. This emerged four years later in *Hill* v. *Rowlands* where Romer, J. reaffirmed the rule and added a slight gloss to it. At trial in that case, there was a foreclosure order followed by the usual accounting (of costs, principal and interest to be paid) by the Chief Clerk who set a place and a date for redemption six months hence. The mortgagor sought to tender a lower sum earlier than the redemption date. To this Romer J. replied:

> ... In accordance with the longestablished and invariable practice, which it is far too late now to challenge, he [Chief Clerk] calculated the interest up to the day fixed for redemption. That certificate binds the parties, being made in their presence, and there being no summons or application to vary it. Under these circumstances it appears to me that the applicant cannot now disregard the judgment and certificate, and move to redeem at a time different from that fixed by the certificate, and in payment of a sum different from that certified. The defendants Rowlands and Bullock took advantage at the trial of the time allowed them for redemption, though they might have shortened the time then if they had thought fit, and had asked for it.

The added gloss to the "settled rule of practice" seems to be that when there is a foreclosure judgment with a Chief Clerk's certificate issued (the equivalent of the "usual order" in B.C.) the parties are bound by the strict terms of that certificate not only as to amount required to redeem the mortgage but also as to the time at which the payment is to be made. It is, however, difficult to reconcile the finality of the certificate with the undoubted jurisdiction of the court to extend the time for redemption.

The English Court of Appeal agreed unanimously with this position and Chitty L.J. said:

> In my opinion, also, this appeal fails. In substance it is an application to vary the certificate. The sum which the chief clerk finds due is the principal with interest up to the date of the certificate, to which, according to the invariable practice, he adds interest for six months from the date of the certificate, and *redemption is to take place on payment of that sum with costs at the expiration of the six months*. The reason is plain. The mortgagor has six months allowed him to find the money, and the mortgagee has six months to find out how to place it. It is a fixed rule of the Court, and not a matter of bargain, and there is no precedent for allowing the mortgagor to redeem within the six months on payment of a less sum. *The practice is so well settled that it is not surprising that no authority is to be found on the subject*.

While it is true that there is no authority to be found on the subject, there is some indication that the rule of practice was an accepted one.

In Seton's Forms of Judgments published in 1893 a draft order provides that the plaintiff should recover against the defendant the total of the principal sum:

> And it appearing that there will be due to the Plt on &c, being the expiration of six months from the date of this order, the further sum of for interest (less property tax), at the rate aforesaid, on the sum of and that the said sums make together

This draft order in a foreclosure action was used to avoid the necessity of an accounting being carried out by the Chief Clerk. It would seem that the award of six months' interest was accepted at that time and such an accounting would not change the award.

The arguments advanced in *Gules* v. *Hall*, suggest that in the early 1700's the Court of Chancery was strictly enforcing agreements as to time and place of tendering payment for the purpose of stopping the running of interest. Also, six months' notice of tender of payment seems to have been adequate notice in the view of the Lord Chancellor, although it is not clear whether a specific redemption date had been provided for in the mortgage. While not direct evidence of a settled practice in foreclosure actions, the strictness of enforcement and six months' notice are consistent with the settled practice enunciated in *Hill* v. *Rowlands*.

In 1921, the British Columbia Court of Appeal considered the effect of the decision in *Hill* v. *Rowlands*. The facts in *Western Imperial Company* v. *Nicola Land Company* diverge from *Hill* v. *Rowlands* in that the mortgagors sought and received in the order *nisi* for foreclosure, a redemption period of twelve months. Shortly after the accounting by the registrar they found a buyer for the property and sought to redeem immediately, thus avoiding some part of the interest. To do this, they applied unsuccessfully to vary the order nisi to reduce the redemption period to six months. In the Court of Appeal, McDonald C.J. stated that *Hill* v. *Rowlands* "is an authority against the appellants" and indicated that the order nisi of the Supreme Court could not be varied, especially when it was the appellant who asked for the original order. Martin J.A., while not questioning the authority of *Hill* v. *Rowlands*, held that since these were extraordinary circumstances with the mortgagors willing to pay the "well settled" six months' interest, the order *nisi* should be varied. In the event the court was evenly divided and the appeal failed.

In *Western Imperial*, Martin J.A. also said:

> I am unable to take the view that the court is powerless and must close its eyes to new conditions created by extraordinary times and circumstances.

An echo of this spirit is sounded in *Avco Financial Services* v. *Gustafson* by Catliff L.J.S.C. when he said:

> I see little merit in the argument in these days of high interest rates that the mortgagee should require six months to arrange to reinvest his money. It also seems illogical to me that a mortgagee, who is not entitled to six months' notice (or interest in lieu) once he has issued his writ, should then become entitled to six months' interest after foreclosure nisi. The equity of the situation would appear to favour the mortgagor if he is able to redeem within the redemption period. If there are special circumstances which the court should consider they can be raised by the mortgagee at the time the application for foreclosure nisi is made.

Catliff L.J.S.C. ordered that interest should accrue daily at a specified rate until the date of payment so that the interest payable on redemption would be less if the mortgagor redeemed early.

Whether this form of order was universally adopted is uncertain. There is, however, some evidence that it was in regular use. For example, Hutcheon J., in his Practice Notes cites the order as a form of redemption clause to be used under Rule 50(5) of the Rules of Court, in the case of a summary judgment in foreclosure proceedings. Also, in *North West Trust* v. *Paramount Management*, it was alleged that after *Avco* Catliff L.J.S.C. made all his orders in that form, citing as an example the order given in *CMHC* v. *Callaghan*.

In October 1979, a majority decision of the Court of Appeal, reestablished the old "settled practice" as stated in *Hill* v. *Rowlands* as the law in British Columbia, but, as noted earlier, Craig J.A. dissented preferring the *Avco* position. Clearly the issue concerns the exercise of the discretion granted the court by Rule 50(5)(e). It states that the Court may:

> order at what times, on what terms and in what order of priority respondents may redeem the mortgaged property and that in default they shall be foreclosed of any interest, right or claim in or to the mortgaged property.

This clause of Rule 50 which grants the discretion as to times, terms and orders of priority for redemption, gives no guidance as to the circumstances which invite a specific form of order. The Court of Appeal, clearly contemplating the situation where no one appears in chambers to dispute the request for the "usual order," has opted for the settled practice as stated in *Hill v. Rowlands*. Discretion to depart from the usual order should, according to this view, only be exercised in the unusual case where there is some dispute as to the terms of the order.

The opposite view, represented by *Avco* and Craig J.A.'s dissent, is that Rule 50(5)(e), should be interpreted so as to give the chambers judge the power to exercise discretion as to the terms of the order, even in the usual case. This discretion can be invoked to change and adapt the usual order to shifting commercial realities. It is not necessary to prove injustice or exceptional circumstances in each individual case to trigger the exercise of this discretion.

B. The Practice in Other Jurisdictions

1. *Ontario*

In Ontario, this aspect of the law has a curious history. A starting point is *Archbold* v. *The Building and Loan Ass'n*, an 1888 decision of three judges of the Queen's Bench Division. At issue was the applicability of the larger rule of the mortgagee's entitlement of 6 month's notice of an intention to redeem or 6 month's interest in lieu of that notice.

After a review of the authorities, Street J. concluded that the rule was in force in Ontario. An opposite conclusion by Armour C.J. was set out in most outspoken terms:

> The rule that after default in the payment of the principal money secured by a mortgage the mortgagee is not bound to receive it unless after six months' notice, or upon payment of six months' interest, is, no doubt, of great antiquity, but that is its only merit. It is an unjust rule, for it does not bind both parties alike. It permits the mortgagee to call for payment at any time without any notice, and it compels the mortgagor to give six months' notice, or be mulcted in six months' interest, before he can compel the mortgagee to receive. It puts another instrument in the hands of the extortioner with which to vex his unfortunate debtor, and in my experience, it is never invoked except by those who do not aim to be of good repute. It will, however, like every other node of oppression, have its defenders, and will be chiefly and most stoutly defended by those who use the maxim: "Thou shalt love thy neighbour as thyself" only for the purpose of devotion. It was formulated at a time when redemption was regarded only, in the light of an indulgence to the mortgagor and before it had come to be looked upon as a right. It was adopted and has continued to exist in England under circumstances and modes of dealing wholly different from those which prevail in this province, and it is wholly unsuited to the circumstances and modes of dealing in this province, ought never to have been introduced here, and ought not now to be followed or recognized.

Falconbridge J. concurred with Street J. but he did so "reluctantly" and added that "I shall not be sorry hereafter to find that I am wrong in my opinion.

The dissenting views of Armour C.J. provoked a quick reaction by the provincial legislature and in little over a month an Act was passed to modify the rule. It provided that arrears of principal secured by a mortgage could b)e paid at any time after default without notice or interest in lieu. This was subject to any express agreement in the mortgage covering notice or interest and it did not extend to principal that became due through the operation of an acceleration clause.

In 1903 that provision was repealed and replaced by a section that provided for 3 months notice or interest in lieu by the mortgagor intending to redeem. One new section operated notwithstanding any contrary stipulation in the mortgage. This provision, in slightly modified form, is now section 16(1) of *The Mortgages Act:*

> Notwithstanding any agreement to the contrary, where default has been made in the payment of any principal money secured by a mortgage of freehold or leasehold property, the mortgagor or person entitled to make such payment may at any time, upon payment of three months interest on the principal money so in arrear, pay the same, or he may give the mortgagee at least three months notice, in writing, of his intention to make such payment at a time named in the notice, and in the event of his making such payment on the day so named he is entitled to make the same without any further payment of interest except to the date of payment.

This section and its predecessor are silent on its application to accelerated arrears of principal but there is no reason why it should not apply.

One would expect the statutory modification of the common law exile to be reflected in the form of the usual foreclosure order in Ontario so as to limit the interest payable on a redemption which occurs early in the period allowed. This does not appear to have happened and in a recent case it was affirmed that the rule in *Hill* v. *Rowlands* applies with full vigour in Ontario.

2. ___*Manitoba*

In Manitoba the broader rule on which *Hill* v. *Rowlands* is based appears to have been abrogated by statute. *The Mortgage Act* provides in section 20(1) that:

> The rule or law under which a mortgagee is entitled to demand and receive notice or a bonus of six months' interest, in case the principal of his mortgage is not paid on the day it falls due, is not in force in the Province of Manitoba.

3. ___*Alberta*

The issue of the more general rule concerning the mortgagee's entitlement to six month's additional interest came before the Alberta Supreme Court in 1914 in the case of Re *Pambrun* v. Short. Beck J. adopted the reasoning of Armour C.J. in Archbold and quoted at length from that decision in holding that the rule was not in force in Alberta.

Another ground for the decision in *Re Pambrun* is the effect of the Torrens system on the character of a mortgage. As Beck J. stated:

> Mortgages, with us, do not grant the mortgagor's estate, subject to a right of redemption; they constitute merely a charge upon his estate.

This reasoning nay have some application in British Columbia. As a matter of strict legal theory a mortgage in this province is not simply a charge. It acts to convey the legal estate to the mortgagee leaving the equity of redemption with the mortgagor. The practical effect of the land title system in this Province, however, is that the mortgagor remains the true owner of the land and the mortgagee is the holder of a registrable security interest only.

4. ___*England*

Practice Directions issued by the Chancery Division concerning redemption and foreclosure of mortgaged property indicate that the strict rule is still being enforced although the mortgagor must now give seven days' notice of his intention to redeem at the appointed time and place.

> REDEMPTION AND FORECLOSURE OF MORTGAGED PROPERTY
>
> In order to make it unnecessary to go to the expense of preparing deeds, powers of attorney and form of receipt to hand over in case a mortgagor should attend to redeem at the time and place appointed by the master's certificate for redemption; all orders for foreclosure or redemption unless the court otherwise directs will provide (1) that the mortgagor shall given seven days' notice of his intention to attend and redeem

and (2) if no such notice is given but the mortgagor in fact attends at the appointed time and place then at the option of the mortgagee the time for redemption shall be extended for one week. This will give the mortgagee's solicitor time to prepare the necessary documents.

The master's certificate pursuant to an order *nisi* (or the order itself if thereby a certificate is avoided) shall nominate as the place of redemption the office of the mortgagee's solicitors if it be within five miles of the Royal Courts of Justice, Strand, or such other place as may be agreed between the parties and recorded in the order or certificate. In all other cases the place of redemption shall be recorded as Room 138 of the Royal Courts of Justice, Strand, W.C.2. The rule, however, has not escaped criticism in England. In 1933, Maugham, J. observed that:

> In these days ... you can get suitable investments in for less than six months' time, and, although I do not intend to interfere with what I believe to be the strict rule in equity ... I would express the opinion that the term is a harsh one, and it would not be surprising if the Legislature thought fit to alter that rule.

CHAPTER III ISSUES RAISED IN THE COURT OF APPEAL

A. The Majority Judgment

A number of threads are visible in the majority judgment of Seaton J.A. in *North West Trust*. An underlying, if somewhat muted, theme is that default by a mortgagor is a sufficiently reprehensible course of conduct that a rule of law that calls for the payment of additional interest is not unjust:

> If the mortgagor redeems when onehalf of the period has elapsed he will pay interest for a further three months. That does not seem an excessive burden to put on a mortgagor who has not observed his obligations under the mortgage and is being permitted to redeem ...

A similar observation is made later in the judgment:

> Indeed I think that when one considers the position of both the mortgagee and the mortgagor the former practice is the fairer. It gives some attention to the agreement that the parties made. It pays some regard to the party that has not breached his bargain.

His conclusion seems to be that the potential detriment to the mortgagor arising from the 6 month interest rule may be partially justified by the fact of default.

The counterpart of the potential detriment to the mortgagor is the potential benefit to the mortgagee of the 6 month interest rule. Seaton J.A. justifies this in the traditional terms: "It permits the mortgagee some room to reinvest moneys that have been repaid other than in the manner agreed upon," "It allows the mortgagee to foresee what will be repaid if the mortgagor chooses to repay at all."

In *Avco* this basis for the 6 month interest rule had been doubted:

> I see little merit in the argument in these days of high interest rates that the mortgagee should require six months to arrange to reinvest his money.

The response of Seaton J.A. was as follows:

> If a rule has been applied in many jurisdictions over long periods it is probable that it is based on good sense. In those circumstances I would look for good reasons before rejecting it. The *Avco* judgment does not, in my respectful opinion, offer good reasons. [Expressions such as] "I see little merit in" are conclusions. The reasoning that led to them is not expressed ...
>
> If the reason is a general sympathy for persons caught by high interest rates then I suggest that the new practice is not of real help. Most mortgagees are either commercial lenders, individuals with savings to invest or persons who have sold their homes and taken a mortgage back. The cost of mortgage foreclosures is one of the

> costs a commercial lender will have to take into account when fixing interest rates. A new cost to such mortgagees ultimately is borne by mortgagors. Thus the result of the new practice would not be to benefit mortgagors at the expense of commercial lenders but to benefit. defaulting mortgagors at the expense of nondefaulting mortgagors. The reasoning will not apply to all mortgagees. Persons who have invested their savings or sold their property and taken a mortgage back will not have a group of mortgagors and will have to absorb the cost. I see no reason to prefer defaulting mortgagors over such mortgagees.

He added that if mortgagors as a class need assistance at the expense of mortgagees, "that is a matter for legislation."

A final concern raised in the majority decision is that the *Avco* form of order would effectively emasculate any prepayment clause the mortgagor may have agreed to:

> In order to fully consider *Avco*, I have obtained from the registry a copy of the mortgage there in question. Prepayment was anticipated ... :
>
> "PROVIDED that the Mortgagor when not in default shall have the privilege of prepaying the whole of the outstanding principal balance hereby secured at any time during the first five years of the term of this mortgage upon payment of a bonus equal to twelve months interest ..."
>
> It will be apparent that, if the mortgagor in *Avco* redeemed, his default allowed him to escape from the prepayment clause to which he had agreed. If he had made all the payments in the time and manner agreed upon in the mortgage and had sought to pay out the mortgage in April 1977, he would have had to pay a full 12 months' interest. But he had not made the payments. The mortgagee had been forced to institute foreclosure proceedings. The chambers judge then seems to have thought that to require the mortgagor to pay interest to the final date for redemption would be too harsh. I am unable to agree.

Such prepayment clauses are a common feature of mortgages in this province.

B. The Dissent

In his dissenting judgment Craig J.A. took the position that the award of six months' interest to the date of redemption was a matter of practice and procedure rather than substantive law. This was in response to the argument advanced by the appellant that:

> the principle established by cases such as *Smith* v. *Smith* and *Hill* v. *Rowlands, supra*, is a principle of substantive law, not of practice, that the Supreme Court Rules relate only to practice and procedure and that, therefore, Rule 50(5)(e) cannot be construed to give a judge the power to make the direction which is the subject of this appeal.

Inherent in this submission is the contention that the chambers judge is fettered in the exercise of his discretion by this principle of substantive law. Although disagreeing as to the circumstances that would allow the exercise of this discretion, the majority also clearly rejected this idea by speaking of "the order that will be made without reasons in the usual case and will only be departed from in the discretion of the chambers judge in an appropriate case." There is no disagreement as to the existence of that discretion; only the perception of what is an "appropriate case" is in issue.

Craig J.A. also considered the existence of the noticefree period for redemption between the issue of the writ (or petition) and the order nisi. It had been argued that it would be anomalous to allow interestfree prepayment via default while holding the nondefaulting mortgagor to the terms of his bargain. Craig, J.A. said:

> This may be anomalous but it is no more anomalous than the established law that the mortgagee who demands payment of debt or takes steps to enforce a mortgage...disentitles himself to interest in lieu of notice yet becomes entitled to interest in lieu of notice once the order *nisi* has been made.

As in *Avco*, the principle that the six month interest period is in lieu of notice to allow the mortgagee to arrange alternate placement of his monies was doubted. Craig J.A. pointed out that the mortgagee may not know until the final day for redemption whether his money will be returned. Thus he is uncertain as to whether to arrange alternate investment or not.

CHAPTER IV OUR ANALYSIS

A. Is the Conduct of the Mortgagor Relevant?

As we pointed out in the previous chapter, an underlying theme of the majority judgment is that, in seeking to balance the equities between mortgagee and mortgagor, the law should not lose sight of the fact that it is the mortgagor that has breached his bargain. Hence, a rule that favours the mortgagee is said to be not unfair.

As an abstract statement of policy this view has much to commend it. When, however, it is considered in the context of specific fact patterns its application is less clearcut. First, a mortgagor's breach may arise through circumstances beyond his control. Breach is not always synonymous with blameworthy conduct. It must also be remembered that the mortgagor may not be the only person that has a right to, and may wish to redeem the property. A subsequent encumbrancer such as a second or third mortgagee may wish to redeem. So might other creditors who have acquired an interest in the land. Such a creditor could be a builders' lien claimant, a judgment creditor who has registered a notice of his judgment under the Court *Order Enforcement Act,* or a spouse who has registered a maintenance order under the *Family Relations Act*.

It cannot be said that these parties have breached any agreement with the mortgagee. They are blameless, unless one is prepared to go so far as to regard them as tainted by the mortgagor's conduct. They are, however, bound by the redemption provisions of the usual order. If one function of the 6 month interest rule is to express society's disapproval of those who breach their contracts then it operates in a haphazard way and is as likely to "punish" an innocent party as a "guilty" mortgagor. It appears to be an unsatisfactory basis for the rule.

B. Is the Rule Anomalous?

Consider the situation if A lends money to B, repayable on a specified day with interest payable at periodic intervals before and after maturity. The loan is unsecured. If B fails to live up to his bargain A may take legal proceedings to enforce the agreement and if he does he will obtain a judgment for the principal and interest accrued to the date of judgment. Interest then accrues on that judgment until it is satisfied. There is no rule of law that says A is entitled to additional interest on the theory that he should have "room to reinvest" the proceeds of the judgment. However, if A's debt were secured by a mortgage on land, and the mortgagee has obtained an order *nisi* for foreclosure, he is entitled to such interest.

What magic is there in the fact that a debt is secured that invites this extraordinary departure from the general position? In the Commission's Report on Limitations this issue was confronted in a different context. In considering the longer limitation period that historically governed actions on mortgages of land it asked,"is there any logical reason 0ny there should be a longer limitation period merely because security is given"; and concluded that the security and the remedies attached to it are merely ancillary to the debt and the general limitation period for debt actions should govern.

A consistent approach would suggest that in determining the mortgagee's actual monetary recovery in foreclosure proceedings, one should look to the general law governing the debt and regard the existence of the security as irrelevant for this purpose.

C. Is the Rule Archaic?

The most frequently cited basis of the more general 6 month interest rule is that it allows the mortgagee time to arrange for the reinvestment of his money. The rule dates back at least to the 19th century and its applicability to Canada in the 20th century is an issue on which the courts are divided.

In *Avco* Catliff L.J.S.C. referred to present high interest rates and dismissed a suggestion that 6 months to reinvest was necessary. In the Court of Appeal in *North West Trust* Seaton J.A. characterized this as a conclusion, and added that the reasoning that led to it was not expressed. He did not, however, identify any factors that made 6 months a particularly appropriate period.

How difficult is it to reinvest the money that may be yielded by a redemption in a foreclosure action? This may not be a matter on which any universal conclusions are possible. For example, a foreclosure on a large commercial enterprise might, on redemption, yield a sum of money that would pose significant reinvestment problems while that yielded in the case of a residential mortgage might be amenable to a variety of immediate investment opportunities.

Also relevant may be the existence of a shortterm money market in Canada. In the 19th century, the mortgagee may have been compelled to let his money sit idle while a new investment was sought. This is no longer the case and contemporary mortgagees are much better able to mitigate this aspect of loss arising out of the mortgagor's default.

In summary, the issue under this heading is whether or not investment opportunities are still sufficiently limited that the ostensible basis of the rule, to give the mortgagee an opportunity to reinvest, retains its force in this province. Or is the rule archaic?

D. Is the Rule Effective?

If one assumes the soundness of the "opportunity for reinvestment" policy that is said to underlie the rule, there remains a question of whether the rule is effective in realizing this policy. Two aspects of its operation suggest that the efficacy is questionable.

The first was pointed out by Craig J.A. in his dissenting judgment:

> A mortgagee may not know right up until the final day of the redemption period whether the mortgagor intends to redeem. That being so how can he possibly make arrangements to reinvest his money?

This observation leads to the second difficulty. The mortgagee may wait until the end of the redemption period before producing the necessary funds. An eleventh-hour redemption will deprive the mortgagee of any benefit he might otherwise have derived from an order in the form approved by *North West Trust*. Hence the policy is defeated.

This form of order would, in fact, appear to encourage late redemption. No rational man (in the economic sense) will pay money earlier rather than later to achieve the same benefit. Not every person who seeks to redeem

will have the financial flexibility to arrange for a late redemption, particularly the mortgagor whose default led to the foreclosure. A subsequent mortgagee, however, might easily be able to do so.

E. Is the Character of the Mortgagee Relevant?

In the previous chapter we set out at length the remarks of Seaton J.A. on what might be called the "economics of foreclosure." He pointed out that mortgagees may be large institutions in a position to spread the losses arising out of a foreclosure among a broad base of borrowers and that this is a factor they take into account when fixing interest rates, but that individual lenders, without that base, must absorb the loss. This view calls for close examination.

First, it should be noted that mortgages, almost universally, provide for costs on a solicitor and client basis if there is a default and enforcement proceedings are necessary. Hence the lender, whether individual or institutional, should recover all outofpocket expenses incurred in the proceedings if there is a redemption. What then are the "costs" referred to by Seaton J.A. that turn on the form of the order?

It would seem that neither "cost" nor "loss" is a totally apt term to describe the impact on the mortgagee of an order in the *Avco* form. Rather, it is the case of a potential benefit denied. Where there is an early redemption, the mortgagee will receive less money under an order in the *Avco* form than in the *North West Trust* form, but this is not an added cost of foreclosure that must be absorbed or passed on.

It is arguable, however, that the potential benefit (or absence of benefit) to the mortgagee that is dependent on the form of the usual order has some marginal impact on the interest rates set by institutional lenders. Even if this is the case, interest rates sought by individual lenders usually follow the lead set by the larger institutions. Thus, to the extent that the form of the order is reflected in institutional interest rates, it will also modify individual rates.

This suggests that the character of the mortgagee should be irrelevant to the form of the usual order. In this context we use "character" in the sense of small individual lenders as contrasted with large institutional lenders.

F. Does the Rule Reinforce Prepayment Clauses?

A factor that emerged in the majority decision in *North West Trust* concerned the position of prepayment clauses. Seaton J.A. noted that the mortgage in the *Avco* case provided that the mortgagor could prepay the principal during the first 5 years of its term upon the payment of a bonus of 12 months' interest. He suggested that an order in the *Avco* form would allow the mortgagor entirely to avoid this provision through a voluntary default on the mortgage and immediate redemption after the order nisi, thus avoiding any interest penalty for prepayment.

The reason why the prepayment clause is not given effect according to its terms in foreclosure proceedings seems to rest on section 8 (1) of the *Interest Act* (Can). It provides:

> No fine or penalty or rate of interest shall be stipulated for, taken, reserved or exacted on any arrears of principal or interest secured by mortgage of real estate, that has the effect of increasing the charge on any such arrears beyond the rate of interest payable on principal money not in arrears.

That provision was recently considered by the Supreme Court of Canada in *East Marstock Lands* v. *Tommel Investments* where it was held to void a clause calling for the payment of a "bonus" of three month's interest on outstanding principal upon the default of the mortgagor.

In this province we understand that a prepayment clause is regarded in much the same light as such a "bonus" clause and that the practice of Registrars has been to disallow operation of prepayment clauses on the authority of *East Marstock* when carrying out an accounting upon foreclosure. If the foreclosing mortgagee questions the applicability of that decision to the clause in his mortgage, the Registrar will invite argument on the point by both sides before making a ruling.

With prepayment clauses rendered ineffective in foreclosure proceedings, the concern of Seaton J.A. is understandable. There are two difficulties, however, which suggest that the *North West Trust* form of order is not an effective vehicle to preserve the rights conferred on the mortgagee by the prepayment clause. The first, as we pointed out earlier, is that it may be open to the mortgagor to redeem very late in the period. He would thus pay only interest that had actually accrued and no money that would be identifiable as a bonus to the mortgagee.

The second difficulty is inherent in an anomaly mentioned earlier. There is a hiatus between issue of legal process and the order *nisi*. During this hiatus, the mortgagee who has started to realize on his security is not entitled to six months' notice of an intention to redeem or interest in lieu thereof. In principle, then, an alert mortgagor being foreclosed might tender an amount sufficient to redeem during that hiatus and so avoid the six months' interest.

This possibility is qualified by a clause commonly found in many mortgage documents. It reads as follows:

> PROVIDED that upon default in the payment of the principal hereby secured, the Mortgagee shall not be obliged to accept payment of such *overdue principal* unless the Mortgagor shall pay interest thereon to the date of payment and in *addition thereto three months'* interest *thereon by way of* bonus ...

Assuming that upon default the whole principal sum has become due (and thereafter overdue) owing to the operation of an acceleration clause, the mortgagor attempting to take advantage of the hiatus between the issue of a petition and an order *nisi* could be met by a demand for the interest provided by such a clause. Whether a court would enforce that demand, in view of section 8(1) of the *Interest Act*, is an issue which must await judicial consideration.

There may be much to be said for allowing a prepayment clause to be as effective in the context of a foreclosure proceeding as it was before default. It seems apparent, however, that this aim is not realized through the adoption of a usual order in the *North West Trust* form. The payment of additional interest can be avoided by the mortgagor. If extra interest is paid as the result of a redemption early in the permitted period, its amount may bear no relationship to the amount stipulated in the prepayment clause.

G. Sale of the Mortgaged Property.

In the context of mortgage law "redemption" is a term of art that identifies a precise course of conduct by the mortgagor or other person having a similar right. It contemplates a tender of money to the mortgagee at a specified time and place. In a foreclosure proceeding the amount of money to be tendered depends on the form of the order *nisi* and the accounting carried out pursuant to the order.

But not every foreclosure proceeding ends either with a redemption, in the sense described above, or with a final order that extinguishes the mortgagor's interest. A middle course is available that is commonly taken sale of the mortgaged property. A sale might be arranged as a matter of private agreement among the interested parties, but often it is made under the terms of a court order. Any interested party, including the mortgagee, may apply to the Court for such an order. 15. *See Law and Equity Act*, R.S.B.C. 1979, c. 224, s. 16 !c); Rules of Court, Subnotes 7 to 9 of Rule 50.

The proceeds of such a sale are distributed among the interested parties according to their respective priorities. The extent of the foreclosing mortgagee's interest in the proceeds is determined by the amount found due on the accounting, and this, in turn, depends on the form of the order. In the result, the mortgagee's position is the same

whether he is paid in the context of a formal redemption or whether he participates in the proceeds of a sale under a court order (assuming the proceeds are sufficient to satisfy the amount due).

This consistency is generally satisfactory but when it is considered in the context of the 6 month interest rule one concern emerges. The mortgagee is a person who has status to apply to a court for an order under which the property may be sold. Thus he has it within his power to bring about what, from his point of view, is an early redemption. It might be argued that a mortgagee who seeks an early sale ought not to receive interest for a period beyond the date on which he is paid.

This argument is superficially attractive but it is difficult to justify the creation of an anomaly for that reason only. The entitlement of the mortgagee should not vary with, or depend upon, the way in which the funds were generated. In particular one should be cautious about adopting a rule that might inhibit the sale of property in foreclosure proceedings. Very often a sale constitutes the best and fairest solution for all concerned.

H. Carriage of the Proceedings

It is common ground that the court has a discretion to depart from the terms of the *usual order* when the circumstances of a specific case demand it. This is true whether the usual order is of the type used in *Avco* or the one approved in *North West Trust*. In other words, if the usual order were in the *Avco* form the court would have a discretion to award interest to the end of the redemption period irrespective of the actual date of redemption. Conversely, *if* the usual order were in the *North West Trust* form the court would have a discretion to award interest to the date of redemption only. In either case, the party seeking a departure from the usual order would be obliged to demonstrate that the circumstances of the particular case justify such a departure.

If one were starting afresh and, on an *a priori* basis, attempting to choose one form of the usual order in preference to the other, how relevant should be the fact that when application is made for the order nisi the mortgagee has carriage of the proceedings and is usually represented by counsel and that such an application is frequently unopposed. It can be argued that this pattern should lead to the adoption of the form of order that is less favourable to the mortgagee the *Avco* form of usual order.

The basis of this argument is that the mortgagee is best situated to know the kinds of circumstances that are likely to trigger the exercise of the discretion, to know when such circumstances exist, and to bring them to the attention of the court. The mortgagor is not so favourably situated. He is frequently unrepresented; he may not know the discretion exists or how it is exercised. He may be illequipped to communicate special circumstances to the court in a persuasive fashion. The argument concludes that over a wide range of cases justice will be better served by a rule that places on the mortgagee an onus to demonstrate special circumstances that warrant a departure from a usual order favourable to the mortgagor.

An example of this approach is that aspect of the usual order setting a redemption period of 6 months. This period of time is relatively generous to the mortgagor. It is, however, open to the mortgagee to demonstrate that a shorter (or no) period is called for. This might be done, for example, where the mortgagor has abandoned the property and it is physically deteriorating at a rapid rate. Orders in which the time is abridged are made fairly frequently. If, however, the usual order specified a short redemption period, with an onus on the mortgagor to demonstrate that a longer period was appropriate, it is arguable the departures from the usual order would be much rarer.

CHAPTER V THE WORKING PAPER

A. The Options

Earlier this year we circulated a Working Paper which called for comment and submissions on the issues raised in this study. The Working Paper set out the history, exposition and analysis of the issues but adopted no firm proposals for reform. We stated that:

> It is customary when circulating a Working Paper for comment that we set out our tentative conclusions and specific proposals for reform to provide a focal point for discussion. In this paper we depart from that practice. It is fair to say that a majority of the Commission would prefer to see the *Avco* form of the usual order restored to use. That preference, however, does not represent a strongly held Commission view and we are not, at this stage, prepared to characterize it as a tentative conclusion or proposal for reform. To do so would be misleading. The proper approach to the issue addressed in this paper should be regarded as totally open, in the sense that there is no Commission position which calls for rebuttal or support, and comment is sought on that basis. For present purposes we have therefore identified a number of options for possible changes in the law and set them out in a general way for discussion.

Three options were identified in the Working Paper. The first was the adoption of the view in *Avco* as to the form of the usual order. In that regard, we stated:

> Adoption of the *Avco* form as the usual order involves a conclusion that the 6 months interest rule should be abrogated in whole or in part. Arguments that support such a conclusion are that the rule is anomalous and archaic and that as a matter of policy the usual form of order should favour the party that normally does not have conduct of the proceedings.

The second option raised was the retention of the form approved in *North West Trust* as the usual order. We said:

> A retention of the present form of usual order implies two conclusions that the policy that underlies the 6 month interest rule remains sound and that way satisfactorily realizes that policy. The basic policy was discussed earlier in the context of whether the rule is archaic and the realization of the policy was considered under the heading "Is the Rule Effective." In the latter discussion it was suggested that the efficacy of the rule leaves much to be desired assuming the underlying policy to be sound.

The third option raised was the development of a new form of usual order. The Working Paper set out a number of possible approaches to devising a new form of order that might effect a compromise between, or partially reconcile, the competing views.

B. Response to the Options

Although the Working Paper was widely circulated among the financial community, the legal profession and persons or agencies that might be identified as speaking on behalf of the debtors' interest, the response was small. The responses we did receive, however, were detailed and, on the whole, well reasoned. We found them exceedingly helpful.

Among those who responded, opinion was fairly evenly divided as to a preference among the three options. Those who indicated a preference for the *North West Trust* form of order tended to defend it on pragmatic grounds rather than in terms of principle and policy. One respondent stated:

> Your statement ... that a lender will recover all of its costs on taxation would rarely seem to be true, and of course, a taxation of legal costs does not take into account the internal costs of staff time, etc. which are incurred when a loan goes into default. Arguably, if under the existing law the lender collects too much interest, then some

> form of rough justice has been dispensed as the surplus of interest will offset to some extent the other costs imposed on the lender by the default of the mortgagor.

He went on to point out that, similarly, additional interest would provide some compensation with respect to bonus clauses that are rendered ineffective in foreclosure proceedings.

Support for the *Avco* form of usual order seemed to rest mainly on a view that it was the most likely to achieve a fair result in a majority of cases. In this regard, one respondent wrote:

> The most difficult task ... in this area is to try to identify and protect the interests of house purchasers, who represent 90% of the respondents to foreclosure actions and of whom 90% are neither represented nor present in person. In granting Orders Nisi against such persons a judge is, of course, aware that, under the present law, he must thereby impose on them a further six months interest, which it is probable that they would not have had to pay had they been able to refinance (or sell prior to the hearing of the motion. The granting of the Order Nisi increases the cost of redemption to a mortgagor with a 12% $50,000 mortgage by an immediatm $3,000. mortgagor will also be charged solicitor and client costs of between $1,200 and $1,500. One cost of redemption for such a mortgagor after the chambers judge gives the Order Nisi may be as much as $4,000 nare than it was the day before. For the unadvised and unrepresented mortgagor this may be the most significant result, under the present law, of the exercise of the equitable jurisdiction of the Court.
>
> If a mortgagor appears in chambers on the motion for Order Nisi and says he has an imminent sale, the judge can adjourn the application for a couple of weeks in the hope of sparing him the practical consequence of the application of the present interest rule. I think a sophisticated or welladvised mortgagor would avoid the penalty involved by enjoying or renting the property through the redemption period and selling at the end of it. In that way the mortgagor pays for nothing that he does not get and the mortgagee gets nothing which he has not earned. But a judge with an average Chambers List before him cannot possibly discover whether or not this is a practical option for a particular mortgagor. The 6-month interest rule tends, I think, to fall as a penalty only on unsophisticated and unadvised mortgagors. These are the very people for whom the resulting substantial addition to the mortgage debt at time of Order Nisi must, I think, increase the probablity that the Order Absolute will have to be granted in six months time. If that happens, then it might be said that the exercise of the court's jurisdiction has tended to defeat the first principle of mortgage law, that a mortgage is to be treated as a security only, and not the means by which the lender may obtain title if that result can fairly be avoided by the Courts.

He then endorsed the *Avco* form of usual order as meeting these concerns.

Others were attracted by the third option, some "intermediate" form of usual order. One respondent recognized that "the historical rule ... can work a substantial hardship where redemption must occur ... early in the redemption period" but viewed the *Avco* rule as the "least desirable alternative." This person suggested that the usual order should call for the payment of "interest to the actual date of redemption plus interest for an additional three months." A similar suggestion was made in another submission for a rule that would call for:

> Interest to be calculated to the earlier of:
>
> (a) the date of actual redemption, plus one month, or
>
> (b) the date of the expiration of the period of redemption.

The respondent stated:

> This suggestion would recognize in clause (a) a period of 30 days within which the mortgagee could seek and obtain a new mortgage to reinvest the proceeds of the redeemed mortgage, and clause (b) would recognize the right of the mortgagee to receive interest to the date set for redemption.

A different form of intermediate order was raised in the Working Paper:

Interest calculated to the later of:

(a) the date of actual redemption, or

(b) a date 3 months from the order nisi

One respondent indicated a preference for this suggestion.

C. Discretion to Vary the Usual Order

Our discussion of the responses to the options in the previous section itends to emphasize the diversity of views expressed to us so it is important to note a unifying proposition that was common to almost all the submissions received. This is that the court should have a wide discretion to vary the terms of the usual order, whatever its form may be, so as to achieve a just result in individual cases.

It is common ground that a discretion presently exists under the Rules of Court but the principles on which it is exercised are not clear. An examination of the reported decisions yields very little guidance. Only one case, a very recent one decided after *North West Trust*, appears to have considered this issue. In *Haven Investment* v. *Crossie*, the mortgagor sought an order that provided for interest to be calculated and paid only to the date of redemption. Catliff L.J.S.C. stated:

> From the material filed it appears that the land is adequate security for the amount owing, that a sale of all or part of it is anticipated in order to redeem the mortgage and that the respondents represented by Mr. Chertkow are prepared to consent to an order that they pay interest monthly on the redemption amount until it is paid. It seems to me, nevertheless, that these are not circumstances which justify me from departing from the terms of the usual order deemed appropriate by the Court of Appeal in *North West Trust*.

The mortgagor's request was accordingly denied.

The Working Paper called for submissions relating to the exercise of this discretion:

> The exercise of such a discretion or a failure to exercise it, will not always be reflected in written reasons and there may be a number of such instances that have not come to our attention. We are therefore anxious to hear from persons experienced in this area of other instances in which such a departure from the usual order has been sought, the circumstances thought to justify that departure, and the result.
>
> If it appears that there is no well established body of law a further question arises whether it would be desirable or possible to set out in legislation appropriate guidelines for the court as opposed to allowing the judicial development of the law to take its course. If guide lines are desirable what should be their content? In what circumstances should the court depart from an *Avco* type of usual order, or from a *North West Trust* form of order? Comment on these issues is also welcome.

The response did not illuminate the present exercise of the discretion, but suggestions were received as to the principles that ought to apply.

One respondent (who favoured the *Avco* form of usual order) suggested:

> The onus should, I think, be on the mortgagee who claims interest beyond date of repayment to show that the terms of the mortgage and the facts of the case make it unjust that he should be required to discharge the borrower on payment only of principal, interest to date and solicitorclient costs. He should show that he will suffer some loss or detriment and should be compensated by additional interest only to the extent that he does so.

Another respondent offered more detailed suggestions:

I don't accept the theory the lender will lose interest (or at least substantial interest) if he doesn't get time to reinvest his money. The short term money market is flexible and wellorganized. He can reinvest at a rate not much lower than the mortgage rate the same day as he's repaid, by a simple visit to his bank to purchase a term deposit receipt.

If you can accept that "interest" on money no longer owing isn't really interest, but more in the nature of a bonus or liquidated damages, then the form of foreclosure order ought to:

(a) set the redemption period

(b) require payment of the full principal sum within that period, setting the principal sum

(c) require payment of interest up to the date of payment of principal (the computation is simple and shouldn't need a Registrar to work it out)

(d) provide for foreclosure at the expiry of the redemption period (this is Judge Catliff's form of order in the *Avco* case)

It follows further that any other benefit the lender seeks should be :

(a) stipulated in the mortgage document, and

(b) presented to the Judge on the hearing of the Petition (i.e. at the Order Nisi stage) so that the Judge may:

(i) see whether it's legal (e.g. does it infringe Section 8(1) of the *Interest Act*)?

(ii) consider relief against forfeiture and penalties

(iii) generally exercise his discretion as to whether the benefit is fair and appropriate in the circumstances

In the exercise of his discretion, I suggest the Judge should consider whether the penalty stipulated in the mortgage document was really a matter of bargain between the Mortgagee (lender) and the party doing the payment out ...

(a) Often the actual payer was a subsequent encumbrancer, or even a judgment holder, who had no part in the negotiation of the mortgage. Maybe a subsequent encumbrancer would be fixed with notice of the terms of the prior mortgage, however onerous, and deemed to have chosen to go on the title subject to them. But a judgment holder?

(b) The vast bulk of mortgages are on standardized, lengthy, and highly complex forms, which are presented to the vast bulk of borrowers on a "take it or leave it" basis. Most borrowers couldn't understand the small print even if it were explained to them, which it usually isn't.

My feeling is that a mortgage freely negotiated between two businessmen or companies should be enforced quite strictly, but in either of the two cases above (i.e. payer not a party to the mortgage, (or unsophisticated borrower) I personally don't think any bonuses or other benefits are appropriate.

None of the respondents that favoured the *North West Trust* or an intermediate form of order offered any specific suggestions as to the exercise of the court's discretion.

D.___Other Issues Raised

Although the focus of the Working Paper was a relatively narrow aspect of mortgage law, a number of persons took the opportunity to discuss or suggest changes in other aspects of the law and practice concerning mortgage foreclosure that were of concern to them. Others pursued issues that were raised in the Working Paper but which fell outside the scope of the options for reform that were set out.

Comprehensive Reform

One submission contained the following comments:

> *In 1975 the Commission made a report entitled Report on Security Interests in Real Property; Remedies on Default*. I have heard that report praised many times, both by members of the Bench and members of the bar. It contains a number of recommendations. Some of those recommendations have been implemented but a number of very worthwhile and significant recommendations have not been implemented. There are a number of persistent unsatisfactory aspects of this field of law that remain uncorrected. Some of those areas are mentioned in the specific recommendations to that report. One of those areas has since been discussed in *Emerald Christmas Tree Co*. v. *Boel & Sons* (1979) 13 B.C.L.R. 122. I think that it would be unfortunate to pick away at this subject on a piecemeal basis. I would much prefer to see the Commission make a proposal for legislation that would provide a coherent and systematic amendment in this area so that the amendment could take place and then the law could remain settled for a while, known and understood by mortgagees, the legal profession and every mortgagor who cares to find out what it is.

2. *Prepayment Clauses and the Interest Act (Can.)*

The concern expressed by the majority in *North West Trust* concerning prepayment clauses also emerged in some of the submissions received. The fear is that a mortgagor may deliberately default to rid himself of his mortgage obligation and, through provoking foreclosure proceedings, avoid the effect of a prepayment clause that he has agreed to. However, no information was provided on the extent to which this is, or might become, a problem. One respondent doubted that it would arise often:

> The penalty in solicitorclient costs would, I think, generally be an adequate disincentive to mortgagors who might otherwise seek to take unfair advantage of an opportunity to avoid notice or bonus on early repayment by provoking foreclosure proceedings. I understand these costs are being taxed today at between $1,000 and $1,500 on mortgage debts between $25,000 and $50,000.

Whatever the merit of giving effect to prepayment clauses in the context of foreclosure proceedings, an effective change in this regard can emerge only from changes in the *Interest Act*. This is a matter solely within the jurisdiction of the Parliament of Canada. We note that the Law Reform Commission of Canada in its First Annual Report identified the *Interest Act* as a matter suitable for study as part of their project on the modernization of statutes.

3. *Compensation for Loss of Bargain*

In the Working Paper, we expressed our view that the six month interest rule was never intended to compensate the mortgagee for his loss of bargain. No proposal was made in the Working Paper directed to the recovery of such compensation. This prompted one person to comment:

> I do not think that the paper deals adequately with the possible problem caused by mortgagors who may find it cheaper at a time of declining interest rates to borrow money on a five year term and then, after one year, to cease making payments so that they can get out of the f ive year term by foreclosure and redemption and refinancing, more cheaply than by carrying out their contractual obligation. This is another aspect, in a time of declining interest rates, of the problem that faces mortgagees, who may borrow money at 12%, lend it at 13%, foreclose, receive the monies payable on redemption, and find that they have to lay them out at 11%, even though they are still paying 12% interest on the same money.

The same concern was raised by another respondent as follows:

> While with present market conditions and sophisticated money management techniques, reinvestment of foreclosure proceeds should not present a problem, the fact is that most mortgagees segregate and match those funds loaned to mortgagors to funds borrowed from investors. The latter are guaranteed a certain yield for a specific period of time and if a mortgagor defaults and foreclosure proceedings result there is always a lost yield due to the shortened investment term.

The loss of a bargain through the effect of declining interest rates raises a number of difficult issues.

A starting point is to ask whether compensation for such a loss of bargain would be recoverable at common law if the loan had not been secured. It seems clear that the failure of a lender to advance money on terms he has agreed to may attract liability. The general position concerning the measure of damages is set out in McGregor:

> In contracts for the loan of money the normal measure of damages for the lender's failure to provide the money is the amount required by the borrower to go into the market and effect a substitute loan for himself less the amount that the contractual loan had required.

With respect to a breach by the borrower, McGregor states:

> Conversely, the normal measure of damages for the borrower's failure to accept the money contracted to be lent is the profit the lender would have made on the loan less the profit he can make on a substitute loan made by him in the market. There *appear to be no cases dealing with the question*.

The borrower's breach referred to in that passage is a failure to accept the money, but the failure of the borrower to pay an instalment and thus provoke an acceleration would seem to involve a similar point of principle.

If the loan is secured by a mortgage of land, a further question arises. Are the damages or compensation for loss of bargain (if recoverable at all) secured by the mortgage or is it a mere unsecured personal claim. The answer to this question may turn on the specific terms of the mortgage agreement. Arguably, the standard forms of mortgage agreement commonly used in the province would not secure such compensation. Whether a properly drawn mortgage clause could achieve this, avoid being characterized as a penalty and avoid co)ffending the *Interest Act*. (Can.) is a matter on which opinions may vary.

All that seems clear at this point is that the concern raised is on the untested fringes of the law of damages and of mortgages. It has not been demonstrated that either is deficient. If the recovery of damages for loss of bargain in such cases is a matter of high concern to lenders, we believe they should first test the limits of their rights under the general law through contractual provisions. It is in the light of experience developed in this context that the desirability of legislative intervention should be assessed.

E. Reinstatement

One development since the circulation of our Working Paper has been the enactment of legislation aimed at providing relief from the effect of an acceleration clause. Section 15 of the *AttorneyGeneral Statutes Amendment Act*, *1980* adds to the *Law and Equity Act* a provision in the following terms:

> 21.1 (1) Notwithstanding an agreement to the contrary, where by reason of a default in payment of any money due under, or in the observance of a covenant contained in
>
> (a) a chattel mortgage as defined in the *Chattel Mortgage Act*,
>
> (b) a conditional sale as defined in the *Sale of Goods on Condition Act*,

(c) a mortgage of land, or

(d) an agreement for sale of land,

the payment of money or the doing of anything is or may be required at an earlier time than would be the case if the default had not occurred, then, in a proceeding for the enforcement of rights under the instrument, the court may, before a final disposition of the proceeding, relieve any person from the consequence of the default.

(2) In granting relief under subsection (1), the court may impose any terms as to costs, expenses, damages, compensations and all other matters it considers appropriate.

(3) This section applies to an instrument referred to in subsection (1) (a) to (d) made before or after the coming into force of this section, and to proceedings commenced before or after the coming into force of this section.

(4) Section 24 does not apply in an application for relief under this section.

"Reinstatement" is a compendious expression we adopt for relief of this kind.

Section 21.1 generally reflects recommendations made in two earlier Reports of this Commission, but its enactment at this time seems to be a response to the decision of the British Columbia Court of Appeal in *Emerald Christmas Tree Co*. v. *Boel & Sons*. In that case it was held that section 21 of the *Law and Equity Act*, which sets out the right of a court to relieve against penalties and forfeitures, does not extend to relief from the effect of an acceleration clause.

We have considered whether this Report should make any recommendations which relate specifically to this new provision. Certainly redemption and reinstatement have something in common. Both provide a form of relief to the mortgagor and both would involve an order that provides for the payment of interest calculated to some particular time as a condition of that relief. On the other hand different considerations may arise with respect to reinstatement. For example, if a mortgage was reinstated, there would be no large amount of principal paid to the mortgagee hence the "room to reinvest" rationale said to underlie the historical rule adopted in North West Trust would have no application.

Section 21.1(2) gives the court a very wide discretion in imposing terms in an order giving relief. We believe it would be undesirable to make any recommendations concerning the way this discretion should be exercised until there is some experience in its operation. We will, of course, monitor the application of this provision with keen interest.

CHAPTER VI CONCLUSIONS

A. The Scope of Our Recommendations

While we appreciate the concerns that led those who responded to the Working Paper to raise issues that were beyond the scope of possible changes contemplated by it, we do not feel justified in modifying our terms of reference to accommodate those concerns.

One such concern was that our recommendations that the reform of mortgage law should be more comprehensive rather than "Piecemeal." We have a great deal of sympathy with this view, however, there are factors which

suggest that undertaking a more comprehensive study should be approached with caution. First we are somewhat reluctant to devote substantial resources to further studies in an area where prior Commission recommendations remain unimplemented. Secondly, while it may be fair to characterize the scope of this study "piecemeal" reform, we point out that it was added to our programme at the request of the Attorney General and, it was clear that a limited study was contemplated.

Certain respondents have also indicated their dissatisfaction with the law in that it fails to give effect, in foreclosure proceedings, to clauses which call for a bonus on prepayment under mortgage. This result seems to flow from the application of the *Interest Act* (Can.) and we repeat that legislative change in this regard is a matter for the Parliament of Canada.

Finally, with regard to the issue of compensation for the mortgagee's loss of bargain (if any), we believe, for reasons set out earlier, that legislative intervention is premature and therefore make no recommendation.

B. The Form of the Order

In arriving at a conclusion on the principal issue raised in this Report, it is important to remember that the concern is with the form of the usual order *nisi*. This is the order that will be granted when no unusual circumstances or facts are before the court and which often will be made when the mortgagor is unrepresented or absent from court.

What is fairness or justice in this context? One proposition urged on us by a spokesman for secured lenders is that they "should not be in any worse a situation as a result of a default than if that default had not occurred." In the context of the present discussion, we agree but believe that a corresponding proposition also deserves recognition. A mortgagee should be in no better a situation as a result of the default.

The fact patterns that can arise in practice are so varied that it seems evident that no form of usual order is capable of achieving a just result in all cases. This observation suggests two principles that have guided us in reaching our conclusions. First, the form of the usual order should be such that it achieves a just result in as many cases as possible. Secondly, the courts should have a wide discretion to vary the terms of the usual order so as to achieve a just result where the facts and circumstances are such that the usual order is not appropriate.

We believe the following factors are relevant in determining where the "balance of justice" lies. First, the responses suggest that the majority of mortgage foreclosures arise with respect to residential property and that in large numbers of cases the respondents are neither present or represented. Where redemption occurs, the money received is normally in an amount that is easily re-invested on short notice. Where the mortgagee is a large institutional lender, (as many are) it can be directly placed in a further mortgage and short term bank deposits and the like are available to other lenders. Only in rare cases will reinvestment opportunities be so limited that significant additional compensation is called for. This suggests that the basis for the "historic" rule endorsed in *North West Trust* should not be adopted.

The arguments in favour of the *North West Trust* are based on, in our view, factors that should be irrelevant in determining the form of the usual order. It was urged that while the historic basis of the six month interest rule may not be totally supportable, it may, in some cases, provide compensation for losses arising out of other perceived deficiencies in foreclosure law such as those relating to inadequate costs, loss of bargain and ineffective prepayment clauses. Whatever the merits of the complaints in this regard, we do not believe that the perpetuation of an otherwise unsupportable rule is an acceptable approach to their mitigation.

The rejection of the historic form of usual order (*North West Trust*) leaves the form endorsed in *Avco* or some "intermediate" form of order as possible choices. While a new intermediate form of order received some support in the responses to the Working Paper, there was no substantial agreement as to the form it might take. In any event, having regard to the principles that we believe should be observed in assessing or developing a form of usual order, any new form that we could endorse would be so close to the *Avco* form as to be indistinguishable. We, therefore, adopt the form of usual order endorsed in *Avco* as that recommended for use in foreclosure proceedings in British Columbia. In determining the amount necessary to redeem, interest should be calculated only to the actual date of redemption.

The courts would continue to have a discretion to vary the terms of the usual order and in the Working Paper, we called for submissions as to whether it would be appropriate to legislate guidelines as to the exercise of that discretion and what the contents of such guidelines might be. Only two submissions provided detailed comment on the criteria that should guide the courts. These comments were set out in the previous chapter. Other submissions simply endorsed a wide discretion.

On the whole, we do not believe specific guidelines should be enacted at this time. The development of guidelines with respect to departures from a new form of order would involve a number of assumptions about the circumstances in which it might be sought and there is little experience to guide us in such an exercise. We do, however, believe that the discretion should be expressly conferred in an enactment. At present, this discretion is conferred only by implication in Rule 50(5)(e) of the Rules of Court.

C. The Mechanics of Reform

How should the general conclusions set out in the previous part be implemented? There appear to be two possible approaches. In the Working Paper we asked:

> If this course [*Avco*] is adopted, ... should a modification of the law in this regard be limited to specifying that the *Avco* form of order prevail or should the wider 6 months interest rule itself be abolished, the *North West Trust* form of usual order being a particular application of the wider rule? We note that in Alberta and Manitoba it was the wider rule that was abrogated by the courts and legislature respectively.

We did not receive any comments on this issue.

We have considered this issue and concluded that the approach adopted in Manitoba, abolition of the wider six month rule, is to be preferred. Although the rule is seldom invoked outside of foreclosure proceedings, this is only because lenders do not choose to do so or perhaps because they are unaware of the rule. In theory, it could be invoked, and six months additional *interest* demanded, every time a short term mortgage is to be paid out at the end of the term and inadequate notice is given to the mortgagee. Now that residential mortgages seldom have a term longer than five years (although payments may be amortized over a much longer period) the potential detriment to borrowers is obvious.

Our specific conclusion is that the *Law and Equity Act* be amended by adding a provision similar to section 20(1) of The *Mortgage Act* of Manitoba and which expressly confers on the courts a discretion with respect to the calculation of interest.

The Commission recommends that a provision be added to the *Law and Equity Act* comparable to the following:

(1) The rule or law under which a mortgagee is entitled to demand and receive notice or a bonus of six months' interest, in case the principal of his mortgage is not paid on the day it falls due, is not in force in the province.

(2) Notwithstanding subsection (1), in a proceeding for the foreclosure of the equity of redemption in mortgaged property the court, in its discretion, may, as a condition of redemption, order the payment of interest calculated to a date other than the actual date payment is made to redeem the property.

D. Acknowledgments

The Commission wishes to thank all those who took time to respond to the Working Paper that preceded this Report. As we said earlier, they were few in number, but their contribution was substantial and we derived very real assistance from their submissions.

We also wish to thank Mr. George Copley, formerly of the Commission's research staff, for his contribution to the preparation of the Working Paper.

J. S. AIKINS
P. FRASER
K. C. MACKENZIE
B. WILLIAMS
A. F. SHEPPARD
A. L. CLOSE

September 26, 1980.