LAW REFORM COMMISSION OF BRITISH COLUMBIA

REPORT ON
PERSONAL LIABILITY UNDER A MORTGAGE OR AGREEMENT FOR SALE

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

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TO THE HONOURABLE BRIAN R.D. SMITH, Q.C.,
ATTORNEY GENERAL OF THE PROVINCE OF BRITISH COLUMBIA:

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

REPORT ON
PERSONAL LIABILITY UNDER A MORTGAGE OR AGREEMENT FOR SALE

The recent drastic increase in the volume of foreclosure applications being heard in our courts has brought to light certain difficulties and deficiencies in the law relating to foreclosure practice. Questions relating to the judgment on the borrower's covenant have proved to be particularly troublesome.

In this Report, recommendations for reform are set out which focus primarily on three separate issues. The first is the rule that the lack of privity of contract between the mortgagee and a transferee of the mortgagor's interest prevents the mortgagee from maintaining an action against the transferee with respect to liability on the covenant, even though the transferee may ultimately be liable to pay through the effect of one or more proceedings for indemnity. It has been recommended that the mortgagee should be permitted to proceed directly against the transferee.

A second issue concerns the duration of the mortgagor's personal liability to the mortgagee. Currently, the original mortgagor will often remain liable under a mortgage even after there has been a transfer of the property and the mortgagee has engaged in direct dealings with the transferee up to and including the modification of the mortgage in a manner which amounts to its renewal. Recommendations are made concerning the termination of the original mortgagor's personal liability.

This Report also examines the statutory indemnity provided by section 20 of the *Property Law Act* when there has been a transfer of the mortgagor's interest. There are circumstances in which that statutory right of indemnity can operate unfairly and recommendations are made to clarify its proper sphere of operation.

Finally, recommendations are made concerning agreements for sale, to ensure that, so far as possible, the law governing that form of security interest parallels the law governing mortgages.

CHAPTER I INTRODUCTION

A. Generally

Traditional wisdom has it that debt is a bad thing. It is wisdom that is usually ignored. Most people at one time or another will borrow money.

Commercial lenders may lend money on no more than the borrower's creditworthiness and his promise to pay. Frequently, particularly if large sums of money are involved, a commercial lender will require security for the loan.

A loan can be secured in many ways. Perhaps the most familiar method is a mortgage of real property. A mortgage represents a promise to repay borrowed money together with interest on that money. It also constitutes security for repayment. If the borrower is unable to keep the mortgage in good standing, the lender may look to the mortgaged property to recover his money. He will petition for foreclosure. Order absolute of foreclosure will bring to an end all of the borrower's interest in the property.

The lender (mortgagee) may also seek judgment against the borrower (mortgagor) for breach of his promise to repay the borrowed money plus interest, just as if no mortgage were involved. The borrower's promise is referred to as the personal covenant. Judgment on the personal covenant permits the mortgagee to look to assets of the mortgagor other than the mortgaged property to recover his money.

The Commission has looked at issues of law arising from mortgages (and agreements for sale, a similar form of security) in other projects. In an earlier Report, *Security Interests in Real Property: Remedies on Default*, the Commission, as then constituted, made the following observations respecting mortgages and agreements for sale:

> In British Columbia there are two principal devices used for the creation of consensual security interests in real property the mortgage and the agreement for sale. The law and practice surrounding them diverge on a number of points of detail, and in view of the fact that the two devices are functionally identical, that divergence seems difficult to justify.

Both a mortgage and an agreement for sale are security instruments which involve the taking or retaining of an interest in land for the purpose of securing payment of a debt. Functionally, they are identical. In a vendor financed purchase of real property, the choice between an agreement for sale and a deed and mortgage back is often no more than a matter of chance.

In its earlier Report, the Commission made a number of recommendations designed to resolve inconsistencies in law and practice governing mortgages and agreements for sale. In this Report, we examine the law and practice governing personal liability under mortgages and agreements for sale. One aspect of that examination is to determine whether inconsistencies arise depending upon the nature of the security instrument involved, and whether those inconsistencies are justifiable.

B. The Working Paper

In January 1985, the Commission published a Working Paper on "Personal Liability under a Mortgage or Agreement for Sale."

The subject matter of the Working Paper generated a significant amount of interest. A number of events occurred after its publication. These included:

(i) The Law Society issued an Alert Bulletin reminding lawyers of issues addressed in the Working Paper.
(ii) The Vancouver Real Estate Board published a "Hot Sheet" advising realtors of the Commission's work in this area. This generated numerous requests for copies of the Working Paper from real estate agents.
(iii) Community newspapers in North Vancouver and New Westminster/Surrey published articles on the Commission's Working Paper.

(iv) The issue of liability on the personal convenant was raised in the legislature by Mr. MacWilliam, member of the opposition.

The Commission received submissions from members of the judiciary and government, lawyers, real estate agents and members of the public. These submissions will be referred to in the balance of this Report.

C. A Note on Terminology

In this Report, frequent reference is made to the "term" of a mortgage or agreement for sale. The "term" of an agreement is commonly understood to mean the period during which the agreement is in force. When used with respect to mortgages or agreements for sale, the "term" of the agreement has a slightly different meaning.

A mortgage or agreement for sale will be in force until the debt obligation secured is satisfied. Commonly, the parties to a mortgage or agreement for sale will calculate repayment of the debt obligation secured over a period of years. Many people think of this as the "term" of the mortgage or agreement for sale but, strictly speaking, it is not. This is usually referred to as the amortization period.

The term of a mortgage or agreement for sale defines the period of time over which particular provisions of the agreement are in force. Most commonly, the term defines the period during which the interest rate on the debt obligation applies. On the expiration of the term, it is usually contemplated that the parties will enter into a modification agreement which provides for a new interest rate and the further term during which it is in force.

To avoid confusion, it is important to keep in mind that the term of a mortgage or agreement for sale refers to the period during which certain provisions of the arrangement are in force as opposed to the period over which repayment of a secured debt obligation is amortized.

CHAPTER II REMEDIES ON DEFAULT

A. An Example

In 1980, Mr. and Mrs. A bought a home. The purchase price was $125,000. Mr. and Mrs. A paid $25,000 and borrowed the rest from a bank. The bank took back a mortgage for $100,000 which was registered against the property in the Land Title Office. In 1982, Mr. and Mrs. A sold their home to Mr. and Mrs. B. Property values had fallen. Mr. and Mrs. B paid Mr. and Mrs. A $5,000 and assumed the mortgage against the property. All was well until 1984, when Mr. B lost his job and was unable to keep up the mortgage payments. Mr. and Mrs. B tried to sell their home. It is now worth about $60,000, less than the mortgage. No one is interested in buying it.

The bank consults its lawyers. Mr. and Mrs. B are about to be involved in legal process, and may lose a great deal of money. Mr. and Mrs. A probably do not know it, but they will be involved as well.

B. The Mortgagee's Remedies

When a mortgagor (the borrower) defaults on his mortgage the mortgagee (the lender) has a number of legal remedies open to it but may not immediately realize on the security. An application must be made to the court.

1. Petition for Foreclosure

The mortgagee may commence a petition for foreclosure. This asks the court to terminate the mortgagor's interest in the property (together with all other interests subordinate to the mortgage). The court will make an order *nisi*. Unless the mortgagor or any subsequent encumbrancer redeems the mortgage within a certain period (usually six months), the mortgagee may apply for an order absolute, which will terminate the mortgagor's interest in the property together with those of subencumbrancers. In that case, the mortgagee, by legislation, is required to accept the property in full satisfaction of the mortgage debt. Section 28 of the *Property Law Act* provides as follows:

> After the making of an order absolute for foreclosure or for cancellation of an agreement for sale, a mortgagee or vendor has no right to enforce the personal covenant of the mortgagor or the purchaser to pay. He may not issue execution on a judgment taken on the covenant to pay unless by process of law the order absolute is set aside or reopened.

If the value of the property is less than the mortgage debt, the mortgagee may not wish to take order absolute.

2. Personal Covenant

The mortgage lender may also commence an action on the personal covenant. Usually that will be brought with the petition for foreclosure. Judgment on the personal covenant may be granted with the order *nisi*. There is some question whether the mortgage lender may defer taking personal judgment until some later time.

A mortgage lender may be reluctant to apply for judgment on the personal covenant with the order *nisi* because it limits his entitlement to interest. Before judgment, interest is dictated by the mortgage. After judgment, interest is determined by the Canada *Interest Act*. Section 13 of that Act limits interest on judgments to 5 per cent. That is so even if there is a term of the mortgage which specifically provides that judgment does not affect the mortgage lender's right to interest at the contract rate on the personal covenant. Consequently, it is to the mortgage lender's advantage to delay taking personal judgment.

Judgment on the covenant affects only entitlement to interest on the personal claim. It does not affect the mortgage lender's entitlement to interest at the contract rate if the mortgagor redeems.

3. Order for Sale

Often it is in the best interests of both the mortgage lender and the mortgagor to sell the property and apply the proceeds to the mortgage debt. Either party may apply for an order for sale, but restrictions have recently been placed upon when a mortgage lender may apply.

In *Pope* v. *Roberts*, the British Columbia Court of Appeal held that a mortgage lender was not entitled to an order for sale until the expiry of the redemption period. Sale before that time would be inconsistent with the mortgagor's equitable right to redeem the mortgage. After expiration of the redemption period, the mortgage lender may apply for either order absolute of foreclosure or an order for sale. After order absolute, the mortgage lender is no longer entitled to an order for sale. It is open to subsequent mortgage lenders to apply for and obtain orders for sale during the redemption period.

Exceptions may be found to the general rule that a mortgage lender is not entitled to an order for sale until the expiration of the redemption period. In *Bank of Montreal* v. *Martina Enterprises Ltd*., the mortgage lender was granted an order for a receivermanager to conduct the sale of the mortgaged property before order *nisi*. The court found that the mortgagor would not be prejudiced in the circumstances. The mortgaged land was the site of an incomplete development project. It was in everyone's interests that the property be sold to someone who could complete the project.

The mortgage lender will usually be entitled to an immediate order for sale in circumstances which would justify an immediate order absolute; namely, where the mortgagor has no equity in the property and there is no reasonable possibility of redemption.

4. Liability on the Personal Covenant

Historically, a mortgage of property conveyed legal title to it from the borrower to the lender. The borrower retained no legal interest in the property. Courts of equity recognized that the borrower retained a beneficial interest in the property, the equity of redemption.

If a mortgagor sells his property to another, technically all he is capable of conveying is the equity of redemption. In British Columbia, however, as in other Torrens jurisdictions, for the purposes of the land title system, ownership of the property is registered in the mortgagor's name and the mortgage is registered against the title as a charge. If the mortgagor sells his property, a new certificate of title is issued in the purchaser's name.

Sale of property which is subject to a mortgage does not release the original mortgagor of his liability on the personal covenant to repay the borrowed money. He remains the primary debtor unless the mortgage lender releases him from the covenant, or until the mortgagee and purchaser of the property substantially alter the mortgage. Moreover, the purchaser of the property is not liable to the mortgage lender on the personal covenant until he agrees with the mortgage lender to assume that obligation. Until then, there is no privity of contract between the mortgage lender and the purchaser of the property. Unless there is privity the mortgage lender cannot proceed directly against the purchaser of the property.

Usually the original mortgagor is not at risk. The purchaser may be able to keep the mortgage in good standing. If the purchaser defaults, the original mortgagor is entitled to redeem. Moreover, he will have a remedy against the purchaser. Section 20 of the *Property Law Act* provides as follows:

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

5. Substantial Alteration of the Mortgage

What constitutes substantial alteration of a mortgage, sufficient to release the original mortgagor of liability on the covenant, is an issue which is currently unsettled. A guarantor of someone else's liability may be released if the loan agreement is modified without notice to the guarantor. The original mortgagor, however, is not regarded as a guarantor of his purchaser's creditworthiness. He is regarded as the primary debtor. The traditional view is that only material alteration which amounts to novation (a new contract replacing the old) will release the original mortgagor.

1. the new debtor must assume complete liability;
2. the creditor must accept the new debtor as the principal debtor and not merely an agent or guarantor; and
3. the creditor must accept the new contract in full satisfaction and substitution for the old contract.

To these factors, the British Columbia Court of Appeal has recently added a fourth: the new contract must be made with the consent of the old debtors: *Bank of British Columbia* v. *Firm Holdings Ltd*., (1984) 57 B.C.L.R. 1, relying on *Herold* v. *Br. Amer. Oil Co.*, (1954) 12 W.W.R. 333 (Alta. S.C.); *see also Roylease Ltd.* v. *Modern Tool Ltd.*, [1985] B.C.D. Civ. 97901 (B.C.S.C.). Literally construed, this qualification might prevent novation occurring in most circumstances involving an assigned mortgage, since the original mortgagor often is unaware of the contractual relations between his transferee and the mortgagee. The requirement for consent, however, is designed to protect a person from unwillingly losing the benefit of an agreement. Whether consent is necessary for that purpose, where the original mortgagor retains only the burden of the mortgage, is doubtful.

At the end of the term of the mortgage, the mortgage lender and the purchaser may enter into a modification agreement which specifies a further term and the interest rate over the term. It is difficult to view such a modification agreement as constituting a novation of the original agreement. In *Credit Fon-*

cier Trust Co. v. *Sharp*, the mortgage lender extended the mortgage three times after it had been conveyed subject to the mortgage. Each extension provided for different interest rates and payments. The mortgage specifically provided for such extensions and the court found that the mortgage lender had no intention to substitute the liability of the purchaser for that of the original mortgagor. There was no novation. Nevertheless, in several recent cases, the court has held that an agreement modifying the terms of the mortgage made between the mortgagee and the purchaser of the property releases the original mortgagor of his liability on the personal covenant.

6. Stays of Execution

The mortgage lender, theoretically, may pursue all of his remedies concurrently. In practice, it is considered inappropriate to permit execution on the judgment on the personal covenant where the mortgage lender's security is not in jeopardy. The mortgagor will usually be granted a stay of execution until the expiry of the redemption period, and may obtain further extensions pending, for example, appeal. That is so even if the merits of the appeal appear to be dubious, provided the mortgagor has shown a genuine desire to proceed expeditiously. A stay will not be granted if it will prejudice the mortgage lender. For example, where the mortgagor has little or no equity in the mortgaged property, or where the mortgagor has no practical use for a stay, it is unlikely that one will be granted.

The result of the current practice of granting stays of execution appears to be that, unless the mortgage lender would be prejudiced, the mortgage lender is required first to look to the mortgaged property to recover. If sale of the mortgaged property results in a deficiency, the mortgage lender may then seek his remedies on the personal covenant.

C. Agreements for Sale

1. What is an Agreement for Sale?

In British Columbia an agreement for sale is regarded as a common and effective security device which may be used as an alternative to a sale of real property with a mortgage back to the vendor. It is a contract between a vendor and purchaser under which the vendor agrees to sell, and the purchaser agrees to buy, the vendor's interest in the property for a certain sum payable over a specified period of time. Under an agreement for sale, legal title remains with the vendor until the full purchase price is paid and the conveyance is effected. Until then, all the purchaser has is a right to obtain the legal title by fulfilling the terms of the agreement. In British Columbia this right is noted on the vendor's certificate of title as a charge or encumbrance in favour of the purchaser, in the same manner as the interest of a mortgage lender is registered.

2. The Basic Remedies

A purchaser's default under an agreement for sale leaves the vendor with two basic courses of action. He may *affirm* the contract, treat it as subsisting, and sue for specific performance, or he may *disaffirm* the contract, treat it as at an end, and seek an order for cancellation. The current market value of the property involved will often determine which course of action is followed, but once the vendor has made his election he cannot re elect. If he chooses to seek cancellation of the purchaser's interest in his land, he is precluded from enforcing a personal judgment for any part of the amount found owing on the agreement. The vendor's election need not be made in the petition and, in fact, he may seek two inconsistent remedies and postpone his irrevocable election until he asks for his judgment or order *nisi*. If the vendor receives an order *nisi* of cancellation, in which is included personal judgment, no election has been made. The vendor may elect at the end of the redemption period.

Often an agreement for sale will contain an express term allowing the vendor, upon default, to determine the agreement by giving an appropriate notice to the purchaser, and to retain any purchase mo-

nies paid to date. When a vendor purports to determine the agreement pursuant to that clause, he may seek a declaratory judgment affirming that he has validly determined the agreement and that his title to the land is no longer affected by it. Determination, as opposed to cancellation, indicates an affirmation of the contract by the vendor and an election to hold the purchaser to its express or implied terms.

The action based on a default under an agreement for sale is brought by petition. The petitioner will apply for an order *nisi* by notice of motion. The time fixed for payment in the order *nisi* is six months, calculated from the Registrar's certificate of account. This period of time is commonly referred to as the "redemption period."

3. Liability on the Covenant

Principles similar to those which govern liability on a mortgage covenant apply to personal liability under an agreement for sale. An order for cancellation of an agreement for sale terminates the purchaser's liability to pay the purchase price. If the purchaser assigns his right to purchase, he remains liable under the agreement for sale until released by the vendor or until there is a novation of the agreement.

Unless the purchaser's assignee enters into an agreement with the vendor, there is no privity and the vendor may not proceed directly against the purchaser's assignee in the event of default. Unless the purchaser and his assignee agree, the purchaser has no right to indemnification from his assignee for personal liability under the agreement for sale.

D. Summary

Provided the value of the mortgaged property exceeds the mortgage and is not likely to diminish, generally the mortgage lender will be required to look first to the mortgaged property for recovery. Notwithstanding that principle, the mortgage lender will usually not be able to take any steps toward recovering its money until the expiry of the redemption period.

Several aspects of the personal covenant have been noted:

(i) there is some doubt as to the time when the mortgagee may take judgment on the personal covenant;

(ii) unless a purchaser of property subject to a mortgage assumes the mortgage, or enters into a direct contractual relationship with the mortgagee, he is not liable to the mortgagee on the personal covenant;

(iii) unless the mortgagee releases the original mortgagor, he remains liable on the personal covenant even after sale of the equity of redemption, until the purchaser and mortgagee so alter the mortgage that it amounts to novation.

The position with respect to agreements for sale is similar.

We will examine these aspects of the personal covenant in greater detail in the next chapter.

CHAPTER III LIABILITY ON THE COVENANT

A. Need for the Personal Covenant

The manner in which the mortgage lender is permitted to seek his remedies has, in many respects, diminished the importance of the personal covenant. Except when the property market is volatile and values drop drastically, the mortgage lender will usually recover his money from the proceeds of sale of the property. If the value of the property falls below the mortgage debt, the mortgage lender may look to the mortgagor to recover the deficiency. If the deficiency is large, rarely will the mortgagee recover all of it. For most people their wealth consists of their home. Execution on a judgment for the deficiency will frequently force the mortgagor into bankruptcy.

In British Columbia, erosion of the importance of the personal covenant is due to foreclosure practice that has developed with respect to execution on the covenant. In other provinces, similar results have been obtained through legislation. In Alberta, for example, legislation has been enacted which prevents the mortgage lender from maintaining an action on the personal covenant except against a corporation. The thrust of Saskatchewan legislation, it has been held, is to discourage sale of the mortgaged property and confine the mortgage lender's remedy to taking it back in satisfaction of the mortgage.

One author observes that in Canada the rights of mortgage lenders to recover on the personal covenant have been gradually diluted. While that trend suggests that the personal covenant is practically valueless, this author argues that the personal covenant has an importance in lending transactions that is often overlooked:

> Those who contend that the personal covenant is relatively valueless base their case on these legal impediments and also point out that even where judgment against the debtor is allowed, it is of little practical value, and final recourse must be taken against the property. Thus, they question, "Why should lenders at the loan inception incur the expense of detailed investigation of the applicant's assets? Why not rely solely on the real property security value?" It is unquestionably true that Canadian lenders have had little success in collecting judgment claims in cash. Nevertheless, Canadian lenders have voluminous records of loans made and repaid without involving the lender in any difficulty whatsoever. Such loans were repaid because of the strength of the covenants obtained.

Protecting mortgagors from liability on the covenant, consequently, is not desirable. The recent experience in Alberta demonstrates that point dramatically. Homeowners, unable to meet mortgage payments on mortgages significantly higher than the value of their property, sell to a third party for a nominal sum. The purchaser allows the mortgage to go into default and, during the redemption period, rents out the premises (often to the original mortgagor) or sells off items of value, such as refrigerators and stoves. The mortgage lender has no recourse against the original mortgagor or his purchaser. Moreover, the purchaser's actions have further diminished the value of the mortgagee's security.

B. Judgment on the Covenant

As mentioned earlier, the effect of the Canada *Interest Act* makes it desirable to postpone taking judgment on the personal covenant.

In those cases in which the court has held that personal judgment should be taken with the order *nisi*, the reason often given is that delayed judgment is to the prejudice of the mortgagor. In many cases the mortgagor in default is deserving of sympathy. Economic setbacks have placed him in a financial disaster from which he may never recover. Nevertheless, we are not wholly convinced that there is merit in the argument that postponed judgment prejudices the mortgagor.

First, the Canada *Interest Act* rate of 5% on judgments was not intended to provide an artificially low level of interest. When it was originally set, 5% was a fair, perhaps even generous, rate of interest. The Act has not been reconsidered in the light of current interest rates.

Second, in order to redeem, the mortgagor must pay interest at the mortgage rate. The discrepancy between interest calculations on the personal judgment and on the amount necessary to redeem is

illogical. If mortgagors were, for policy reasons, to be protected on default by artificially lowering interest, that policy should also apply to calculating interest on the sum necessary to redeem.

Third, interest is payable on a judgment to compensate the wronged party (in this case, the mortgage lender) for having been kept from the use of his money. An interest rate on judgments below prevailing rates does not adequately compensate the judgment holder. However deserving of sympathy the mortgagor may be, we can see no policy reason for prejudicing the mortgage lender in these circumstances.

Lastly, one of our correspondents observed, in many cases it is the mortgagor who requests a postponement of the application for judgment on the personal covenant:

> In some cases, notably that of barristers and solicitors, a judgment must be reported to a governing body. In other situations, a mortgagor's employment may be jeopardized by a judgment. Postponement of these applications for judgment are considered appropriate by many mortgagees. The conclusion is that a postponement or adjournment of the application for judgment on the personal covenant is often of benefit to the mortgagor notwithstanding the issue of interest.

Another submission suggested that a mortgagor may anticipate that he will be able to redeem and may not want personal judgment registered against him in the interim.

Nevertheless, the current practice which requires the mortgagee to seek personal judgment with the order *nisi* is, in at least one respect, desirable. Historically, a mortgage was regarded as a separate matter from the personal debt. In fact, proceedings on the mortgage could only be brought in a court of equity, while proceedings on the personal covenant could only be brought in a court of common law. The modern view of a mortgage is quite different. A mortgage is usually security for repayment of a debt. The court should be satisfied that the money is owing before granting remedies on the security. Postponement of the taking of personal judgment defers full consideration of that issue. Logically the mortgage lender should take judgment with the order *nisi*.

The question of when personal judgment may be taken arises because 5 per cent per annum has proved to be an unrealistically low level of interest on judgments. Recent developments suggest that those provinces currently subject to the provisions of the Canada *Interest Act* will be permitted to decide upon a fair rate of postjudgment interest, which may permit interest on a judgment on the personal covenant at a more realistic commercial rate. For example, the British Columbia *Court Order Interest Act* has recently been amended to provide for postjudgment interest. That section is not yet in force, but it is in place and will become operative when Parliament leaves the field open to the Provinces. The calculation of postjudgment interest is an issue which the Commission addressed in Working Paper No. 49, *The Court Order Interest Act*.

The Chief Justice of the Supreme Court has urged that the conflicting authority on when judgment on the personal covenant may be taken be resolved. The need for consistent foreclosure practice is obvious.

It is our conclusion that mortgage lenders should take personal judgment with the order *nisi*. Special circumstances may justify delay in taking personal judgment. Perhaps only part of the personal debt is secured, and there is doubt whether the unsecured portion of the debt is due and owing. The court should be able to postpone giving personal judgment. That issue can be addressed at the time the order *nisi* is sought.

This is the practice that has emerged since the Chief Justice suggested legislation be enacted to resolve the issue of when judgment on the covenant should be sought. In the Working Paper we stated a tentative conclusion that there is no longer a need for legislative intervention, and invited comment on this issue.

A majority of our correspondents agreed that judgment on the personal covenant should be taken at the time of the order *nisi* or leave should be requested at that time to apply subsequently for judgment. Some of these correspondents, however, thought that legislative intervention was desirable. Although a consistent practice may be emerging, there are advantages to having that practice endorsed or recorded by legislation. At the very least, it would permit unrepresented persons involved in foreclosure proceedings some opportunity to discover their rights.

Upon reconsideration, the Commission agrees that legislation on this issue would be desirable. We are reluctant, however, to recommend that an application for judgment or leave to apply at a later date take place with the order *nisi* of foreclosure. That would not really accomplish very much unless legislation were also to prohibit taking judgment at a later date. The real issue is not the time judgment on the personal convenant should be taken. The real issue is the proper calculation of interest on the judgment. Legislation should provide that interest on a judgment for money secured by a mortgage should be calculated at the appropriate postjudgment rates from the date of the order *nisi*. Adopting that approach removes any advantage from postponing an application for personal judgment.

The Commission recommends that:

1. *Unless the court otherwise orders, interest on a judgment for an amount owing under a mortgage shall be calculated as if judgment had been granted with the order* nisi *of foreclosure.*

The recommendation is framed to provide the courts with discretion to depart from the general rule in appropriate circumstances. An example of circumstances which might justify calculating interest on a different basis is to be found in *Bancorp Financial Limited* v. *Darwai Investment Corporation*. The respondent insisted that the application for personal judgment be placed on the trial list, causing delay in taking judgment on the personal covenant. The court ordered that interest from the date of the order *nisi* to the date of judgment should be calculated at the mortgage rate.

The mortgage lender may decide to proceed on the personal covenant before looking to his security. Judgment on the personal covenant may predate the making of the order *nisi*. Recommendation 1 would allow the court to order that postjudgment interest be calculated from the date of the judgment on the personal covenant.

C. Liability on the Covenant

When the mortgagor sells an interest in property which is subject to a mortgage, the purchaser will be liable on the personal covenant only if he enters into an agreement with the mortgage lender assuming that liability. If property is only purchased subject to a mortgage, the purchaser is not liable on the covenant. On the other hand, the original mortgagor is liable on the covenant until he is released by the mortgage lender or there has been a novation of the mortgage.

A mortgage usually secures money borrowed which made purchase of the mortgaged property possible. In that sense, the mortgage represents a benefit. It seems strange, consequently, that a person who owns property for the time being, and who has the benefit of the mortgage, may not be liable to repay the money secured by it.

A sale of mortgaged property usually represents the conveyance of two things: the equity of redemption and the mortgage debt. The *money* received by the vendor for the purchase is calculated by deducting from the purchase price the amount secured by the mortgage together with other debts and obligations associated with the property.

Why, then, does the mortgagor remain the primary debtor under the mortgage after he sells the land and the mortgage debt? There are two reasons, unassociated with the issue of who has the benefit of the mortgage. First, the mortgagor contracted for the loan of money and is liable until the contract is terminated. Second, the original mortgagor cannot force a new debtor on the mortgage lender in his place. The new debtor may not be creditworthy.

These reasons explain why the original mortgagor remains liable on the personal covenant, but do not shed light on why the person who now has the benefit of the mortgage may not be liable personally for its repayment. Another principle of contract law governs that issue. A person is not personally liable on a contract unless he is a party to the contract. Unless the purchaser contracts personally with the mortgage lender, he will not be liable on the personal covenant. There is no privity.

These principles of contract have been developed over several hundred years of common law and in most commercial situations they operate sensibly. However, with respect to mortgages, the result they dictate is often unreasonable.

That is not to say the purchaser of the property is free from liability. Section 20 of the *Property Law Act* provides that the owner of the mortgaged property, subject to a contrary agreement, is required to indemnify the vendor of the property (usually the original mortgagor) for any liability under the mortgage. That section confirms the position at common law. The courts of equity were prepared to find that a purchaser of property subject to a mortgage was under an implied obligation to indemnify the original mortgagor.

Several practical problems arise where the original mortgagor is liable on the covenant and the purchaser is not. First, as noted earlier, the purchaser is under less pressure to keep the mortgage in good standing. Second, if the mortgage goes into default, and a deficiency remains after sale of the property, the mortgage lender must proceed against the original mortgagor. The original mortgagor has a right to indemnification from his purchaser and usually he will add his purchaser as a third party to the proceedings. If, however, the original mortgagor is insolvent, he may not care whether the mortgagee obtains judgment against him or he may be unable to afford to pursue his remedy against the purchaser. In either case, the mortgage lender is unable to recover his monies, even if the purchaser of the property is solvent.

If the original mortgagor is solvent and does claim over against the purchaser, then the mortgage lender recovers from the mortgagor and the mortgagor recovers from the purchaser. This approach lends complexity to the proceedings.

This issue has been resolved in other jurisdictions by permitting the mortgage lender to proceed directly against the purchaser where the purchaser is under an obligation to indemnify the original mortgagor. Legislation has found a way around the problem of lack of privity. The Ontario *Mortgages Act*, for example, provides as follows:

> s. 19(2) Notwithstanding any stipulation to the contrary in a mortgage, where a mortgagor has conveyed and transferred the equity of redemption to a grantee under such circumstances that the grantee is by express covenant or otherwise obligated to indemnify the mortgagor with respect to the mortgage, the mortgagee has the right to recover from the grantee the amount of the mortgage debt in respect of which the grantee is obligated to indemnify the mortgagor; provided that the right of the mortgagee to recover the amount of the mortgage debt under this section from the grantee of the equity of redemption shall as against such grantee terminate on the registration of a grant or transfer of the equity of redemption by such grantee to another person unless prior to such registration an action has been commenced to enforce the right of the mortgagee.

There are several aspects to this section.

(i) a mortgage lender may proceed directly against the grantee of the original mortgagor (the purchaser of the equity of redemption);

(ii) that right is limited to the extent the grantee is required to indemnify the original mortgagor under the mortgage;

(iii) that right persists until the grantee transfers the equity of redemption to another person;

(iv) the mortgage lender may not proceed against subsequent grantees of the property.

The grantee's liability to the mortgage lender on the personal covenant, under the Ontario legislation, ends when he transfers the equity of redemption to another person. The grantee, however, would still be liable to indemnify the grantor for liability under the mortgage. Moreover, termination of the statutory indemnity does not affect the obligation to indemnify that may arise in equity.

Permitting the mortgage lender to proceed directly against the mortgagor's grantee does not alter the fact that the original mortgagor is the principal debtor on the covenant. It does go some distance, however, in encouraging the mortgage lender to look first to the current holder of the property, and to the original mortgagor only for any deficiency existing after that. In effect, if not in law, the original mortgagor becomes more nearly a guarantor of his purchaser's creditworthiness.

Limiting the direct right of action to the mortgagor's grantee reduces the value of this procedure, however. We think that it is desirable for the mortgage lender to be able to proceed directly against the person who currently owns the mortgaged property, notwithstanding a number of transfers of the property. Limiting that right to the extent that the current owner of the property is obliged to indemnify his grantor is also sensible. In British Columbia, by legislation, in the absence of any contrary provision, the purchaser of the equity of redemption is required to indemnify the original mortgagor for any liability under the mortgage. The issue of whether a mortgage lender should have a direct right of action against a subsequent purchaser of the property is closely linked to the issue of what rights the original covenantor should have against subsequent transferees of his interest in the property. That subject is discussed in greater detail in the next section. Our recommendation on mortgage lender's rights against subsequent purchasers of mortgaged property is to be found in the next section of this Report.

It is also our conclusion that a vendor who has conveyed property by agreement for sale should be able to proceed directly against the assignee of his purchaser in the event of default. Our recommendation on this point is also to be found in the next section of this Report.

In British Columbia, the assignee of a purchaser under an agreement for sale is not required to indemnify the purchaser for personal liability under the agreement for sale. It is our conclusion that there should, in the absence of contrary agreement, be such an obligation to indemnify.

The parties may expressly exclude the obligation to indemnify, although that would be unusual. Section 20 of the *Property Law Act* was enacted because mortgagor and purchaser often overlook the legal position with respect to liability on the covenant, and there is no reason to suspect that a purchaser under an agreement for sale and his assignee will be any more diligent in addressing this issue.

The Commission recommends that:

2. The transfer of a purchaser's rights under an agreement for sale should give rise to the obligations to pay and indemnify contained in section 20 of the Property Law Act *in the same way as does a conveyance of property subject to a mortgage.*

D. Section 20 of the Property Law Act

1. The Chain of Indemnity

In British Columbia, the implied mortgage covenant to indemnify is framed so that if the equity of redemption is transferred several times, the obligation to indemnify becomes a chain between the original mortgagor and each subsequent purchaser of the equity of redemption. For convenience, we reproduce section 20 of the *Property Law Ac*t:

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

If A buys property, borrows money secured by a mortgage and sells the property to B, B is under an obligation to indemnify A for liability under the mortgage. If B sells the property, subject to the mortgage, to C, C is under a similar obligation to indemnify B.

This approach does not ensure that the original mortgagor or a subsequent purchaser who sold the property subject to the mortgage will be indemnified. The chain may break at any point; perhaps one purchaser has become insolvent or cannot be located.

We have considered providing a right of action against any person in the chain, and against the person who holds the property irrespective of whether there had been a break in the chain of indemnity. One of our correspondents favoured this position and suggested that the mortgagor and all transferees of his interest should be regarded as jointly and severally liable on the personal covenant. This approach, however, becomes complex if several persons are involved (rights of contribution present various problems). Moreover, if there has been a break in the chain, it is not clear that policy favours giving the original mortgagor a direct right of action against the person who holds the property.

We have concluded that a person entitled to indemnification under section 20 of the *Property Law Act* should be able to proceed directly against the current holder of the property provided he is under an obligation to indemnify and the chain of indemnity is unbroken. The responsibility for establishing a break in the chain of indemnity, however, should be on the person against whom the direct right of action is asserted.

A similar approach should also be adopted with respect to rights of indemnity arising under conveyance of property by agreement for sale.

This parallels our earlier conclusion that the mortgage lender should be able to proceed against the current owner of the property, provided the chain of indemnity is unbroken. Usually the mortgage lender will have required a subsequent purchaser of property to enter into an assumption agreement. The approach described above with respect to mortgage lenders' rights will only be necessary where assumption agreements have not been entered into.

In summary, it is our conclusion that, in the usual case, the person who currently "owns" property should be ultimately responsible for repayment of money secured by a mortgage or agreement for sale. The current law adopts that position, but where property has been conveyed a number of times, indemnity must be sought from each purchaser in the chain before the current holder is required to satisfy the liability. Procedural problems that result from the current law can be overcome by permitting the lender, original borrower or any other person called upon to indemnify his transferor for liability under a mortgage or agreement for sale, to proceed directly against the current holder of the property. The following recommendation is not aimed at altering the law substantively. It is designed to correct a procedural defect.

The Commission recommends that:

3. (a) For the purposes of this recommendation, the "current holder of the property" means

(i) the owner of the property, or
(ii) either the purchaser under an agreement for sale or, if the purchaser has transferred his interest, the ultimate transferee of that interest whose interest has been registered.

(b) Subject to (d) and (e), a person who is liable, or required to indemnify a person who is liable, under a mortgage or an agreement for sale should be entitled to recover the amount of his liability from the current holder of the property.

(c) Subject to (d) and (e), a mortgagee or vendor by agreement for sale should be entitled to recover any amount due and owing under a mortgage or agreement for sale from the current holder of the property as if he were the original covenantor.

(d) No person shall be entitled to recover an amount under (b) or (c) from the current holder of the property, where the current holder of the property establishes that a person from or through whom he derived his right or title was neither

(i) obliged to indemnify his transferor, nor
(ii) directly liable to the mortgagee or vendor in respect of the liability under the mortgage or agreement for sale.

(e) In an action under (b) or (c), the current holder of the property is not liable to pay any amount in excess of the sum he would have been obligated to pay his transferor by way of indemnity.

(f) The rights to be conferred by legislation enacting this recommendation should be in addition to any rights the mortgagee, vendor by agreement for sale, or person entitled to indemnity may have against any person apart from this recommendation.

It should be observed that nothing in these recommendations prevents a lender from proceeding only against the original covenantor. In the usual course, however, the lender would likely proceed against the original covenantor and the current holder of the property at the same time. If the lender does not join the current holder of the property, the original covenantor may still proceed directly against him. That in itself is a desirable result. All parties necessary to the proceedings would be joined, without the necessity of issuing third party notices along the chain of indemnity.

One of our correspondents observed that currently the original mortgagor and current holder of the property are, as a matter of course, joined in foreclosure proceedings. While that observation is true, it also misses the point. If, for example, the property subject to the foreclosure proceedings was transferred by the mortgagor to T, who conveyed the property to its current owner, there is currently no way for the mortgagee or original mortgagor to proceed directly against the owner with respect to liability on the covenant. While the original mortgagor and the current holder of the property are parties to the proceedings, T is not. The mortgagor must add T to the proceedings as a third party and T must claim a right of indemnity from the current owner of the property. Recommendation 3 removes the need to add T as a third party to the proceedings.

The "current holder of the property" is defined in terms of registered interests. A mortgage lender, for example, would not be able to proceed directly against a person who "owns" the property pursuant to a conveyance or assignment that has not been registered. We have adopted this approach for practical considerations. The mortgage lender can rely on the register when bringing his action. If "current holder of the property" was defined in terms of unregistered interests, it might be difficult to discover who was actually the current holder of the property.

The Commission's recommendation departs from the tentative proposal made in the Working Paper in one important respect. Subparagraph (d) has been redrafted to clarify that the onus of establishing a break in the chain of indemnity is on the current holder of the property. The former drafting was ambiguous regarding who was to bear that onus. Clarifying this issue should answer the concerns of several of our correspondents, who felt that the recommendation might be unworkable. These concerns were based on the conclusion that the mortgage lender would have to establish that there had been no break in the chain of indemnity, an approach that would require joining all transferees of the property and present a difficult evidentiary burden.

Some concern was expressed that the procedure required by Recommendation 3 would be complex. In fact, in the usual case involving the mortgage lender, original mortgagor and his purchaser, the procedure is straightforward. Where there have been multiple transfers of the property, the proceedings contemplated by Recommendation 3 will be vastly simpler than those in which the parties must pursue their remedies along the chain of indemnity. In any event, nothing obliges a mortgage lender, or a person liable under a mortgage or agreement for sale, to proceed against the current holder of the property if, in the circumstances, it will be procedurally complex.

2. The Limits of the Right of Indemnity

The essential policy of section 20 of the *Property Law Act* is sound. Usually, if property subject to a security interest is transferred, the parties intend the transferee to indemnify the transferor for personal liability under the security interest. For that reason, the proceeds of the sale are calculated by deducting the value of security interests registered against the property from the purchase price.

Sometimes the parties will not have intended any right of indemnification to arise. It is difficult to say how often that will occur, but it is possible to imagine such circumstances. For example, a father who owns several parcels of property may give one piece to his daughter and her new husband as a wedding present. The father may have previously granted mortgages on his property to secure a business debt, and the value secured by the mortgage on the property given to the daughter may exceed the value of the property. It is unlikely anyone intended the newlyweds to indemnify the father for his personal liability under the mortgage.

In the last several years, in order to sell property, vendors have resorted to innovative financing arrangements. One problem which must often be accommodated is a mortgage that is worth more than the property it is registered against. Several methods are used to deal with this problem. The vendor might "buy down" the mortgage, or the vendor might promise to pay the purchaser a sum of money to offset the difference. In either case, the transaction contemplates an informal or formal assumption of the mortgage, with or without the mortgage lender's knowledge.

Other forms of innovative financing do not involve a formal or informal assumption of the mortgage. For example, the property may be worth $50,000 and the mortgage against it worth $80,000. The vendor might sell the property by agreement for sale for $50,000. In this transaction, it is not intended that the purchaser, informally or formally, assume the benefit of, or liability under, the mortgage. Once the purchaser has satisfied the terms of the agreement for sale, he is entitled to a transfer of the property. The vendor retains responsibility for discharging the mortgage. If he is unable to do so, he will be liable to his purchaser.

There are circumstances, consequently, when the statutory indemnity may arise, contrary to the parties' expectations. Of course, section 20 is subject to a contrary intention, but the reason section 20 was enacted was because parties seldom address the issue of indemnity for personal liability. Whether it is any more likely parties who do not wish the indemnity to arise will contract out of section 20 is open to question.

The problem can be resolved by an amendment to section 20. Where a transfer of the mortgage debt is part of the consideration for the conveyance of the property, then it is likely that the parties, had they addressed the issue, would provide for an indemnity with respect to the transferor's personal liability under the mortgage. Where the conveyance is subject to a security interest which is not taken into account when calculating the purchase price, then it is likely the parties would not wish the indemnity to arise.

This approach may not deal satisfactarily with transactions involving gifts of real property, and legislation should deal with this issue directly. For example, property worth $100,000 has a mortgage registered against it for $100,000. The vendor might convey the property to a stranger, or he might convey it to a family member. In either case, no money changes hands. The conveyance to the stranger is a business transaction, under which the purchaser is to make the mortgage payments. The conveyance to the family member, however, may be a business transaction or a gift. The statutory indemnity should not arise if the conveyance is intended to be a gift. This issue will usually be resolved by reference to who made, or was intended to make, the payments under the mortgage. If the vendor continued to make the payments under the mortgage after the conveyance, then the conveyance was likely a gift of property free of the mortgage liability.

The Commission recommends that:

4. *Section 20 of the* Property Law Act *be amended by adding provisions which reflect the following principles:*

   (a) Where the mortgage or agreement for sale was not credited to the transferee in calculating the consideration for the transfer, the obligation to pay and indemnify provided by section 20 of the Property Law Act *shall not arise.*
   (b) Section 20 of the Property Law Act *does not apply to a transfer of property which is in essence a gift.*

Recommendation 4(a) defines the general limits on the statutory right of indemnity. For example, property may be sold for $100,000. If the property is subject to a mortgage for $70,000 which is to be assumed by the purchaser, the value of the mortgage will be credited to the purchaser in the Statement of Adjustments prepared for the conveyance. The purchaser will pay the vendor $30,000 (subject to any other adjustments, for taxes, etc.). Under Recommendation 4(a), the purchaser's obligation to indemnify the vendor would be limited to $70,000.

Recommendation 4(b) confirms that no obligation to indemnify arises where property is transferred as a gift. If the parties wish such an obligation to exist, they must specifically agree to it, or it must be a condition of the gift. Where the value of the property equals the value of a mortgage registered against it, for example, no money may change hands. That does not mean the transaction is necessarily a gift. The parties may have credited the value of the mortgage to the purchase price or they may have intended a conveyance free of the mortgage debt. The courts must determine whether this situation is governed by Recommendation 4 (b).

Recommendation 4 may not represent a complete answer to the problems we have identified, as indicated by a recent Ontario decision, *Regional Trust Co.* v. *Avco Financial Services Realty Ltd*. In that case a second mortgagee took a quitclaim deed from the mortgagor. Sale of the property resulted in a deficiency, for which the mortgagor was liable. It was held that the second mortgagee was required to indemnify the mortgagor. The first mortgagee was entitled to proceed directly against the second mortgagee for the deficiency.

The case raises several questions. First, it might be argued, the mortgagor and second mortgagee did not intend the indemnity to arise. The quitclaim represents a conveyance of whatever interest the mortgagor had in the property. It does not necessarily relieve the mortgagor of all personal liabilities as-

sociated with the property. The actions taken by the second mortgagee were intended to safeguard his security, and he should not be subject to a penalty for having taken those steps.

On the other hand, it might be argued that the transaction was intended to relieve the mortgagor of his liabilities associated with the property together with his interest in it. The second mortgagee took that step in order to safeguard his security. It really does not make sense for the mortgagor to give up whatever interest he has in the property if he is still responsible, without right of indemnity, for his personal liability under the first mortgage. A quitclaim, however, does not relieve a person of his personal liability. Many people probably do not appreciate its significance. The mortgagor is released from obligations under the second mortgage. That may, or may not, be sufficient reason to execute a quitclaim.

It was, of course, open to the parties to expressly waive the obligation to indemnify. Whether the original mortgagor would be prepared to do that is open to question. The result of the current law is to place the onus on the transferee to obtain such an agreement, alerting the mortgagor, in consequence, to his continuing obligations. If the statutory indemnity did not arise in these circumstances, the mortgagor would be liable without notice of his continuing obligations. Mortgagors are usually unrepresented, while most second mortgagees have legal counsel or, because of their experience, are familiar with the law. The current law, arguably, places the onus on the party best able to deal with it.

In the Working Paper, we invited comment on whether this aspect of the law required revision. Those correspondents who commented on this issue argued that the onus of obtaining a waiver of indemnity should remain with the transferee. A majority of the Commission agrees with that position.

E. Duration of Liability on the Covenant

The original mortgagor remains liable on the covenant until he is released or there is novation of the agreement. In many cases, this position facilitates transfers of real property. A subsequent purchaser may not be able to qualify for a mortgage on the same terms as the current mortgage. Since the original mortgagor remains liable on the covenant, the mortgage lender is less concerned as to the creditworthiness of a subsequent purchaser.

This method of purchasing property would appear to benefit all parties. The mortgagor has a larger group of potential buyers for his property. The purchaser is able to purchase property on terms more advantageous than if he were to arrange new financing. The mortgage lender is protected since he may still look to the mortgagor in the event of default.

Usually the original mortgagor is not at risk. Either the purchaser is able to keep the mortgage in good standing or, if there is a default, the value of the property exceeds the mortgage. In the past several years, however, the number of foreclosures has increased dramatically and property values, in many cases, have fallen below the mortgage debt. Mortgage lenders have sought their remedies against original mortgagors. A correspondent describes the events of the last several years as follows:

> What happened to all these people would appear to be largely the product of a set of circumstances, which through pure chance, all occurred sequentially or simultaneously. The first was the unprecedented real estate boom and escalation of the cost of housing which took place in 198081. Modest homes, which a year or two before had sold in the $60,000 $80,000 price range now sold for over $100,000 and carried mortgages of $80,000. This was accompanied by a sense of near panic by some people who thought they saw their chances of owning a home vanishing in the rapid price escalation, and accordingly jumped into the market when perhaps they should not have.
>
> The second important development was the rapid escalation of interest rates to historic heights of 2021%. This made existing mortgages at more reasonable rates far more attractive than new mortgages at the going rate. A home with a large assumable mortgage at a reasonable rate became a very much more saleable commodity than a similar home on which new mortgage financing would have to be obtained. Real estate agents developed what they called "innovative financing" to overcome the resistance of buyers to these staggering interest rates.

Thirdly, there was an economic downturn as a result of which many people lost their jobs and became unable to make their mortgage payments. Foreclosures reached unprecedented levels.

Finally, there was the substantial downturn in the price of most real estate, especially residential. This produced deficiency balances on foreclosure sales, not just with high ratio mortgages, but with mortgages that would, in normal times, have been considered quite well secured.

New mortgages are now at the lowest level in almost 10 years and housing prices are more stable. It may be years before conditions once again combine to produce a repeat of the situation under discussion. On the other hand, if it happened once it can happen again.

Frequently, neither the mortgagor nor the purchaser are aware of the position respecting liability on the personal covenant. In many cases, the original mortgagor will convey property subject to a mortgage, believing that he is no longer liable.

While, from a business viewpoint, it is important that agreements be kept, and the mortgagor's continuing liability on the covenant probably does enhance the marketability of real property, we think consideration should be given to limiting the duration of a person's personal liability after he has conveyed mortgaged property. It is our conclusion that, as a general rule, when the mortgage lender accepts the purchaser as the primary debtor under the mortgage, the mortgagor should be released. There are, however, circumstances where the mortgage lender deals with the purchaser as the new debtor, in which the mortgagor is not released. At the end of the mortgage term, or whenever a modification agreement of the mortgage is entered into, the mortgage lender deals directly with the purchaser. Unless the mortgage lender and purchaser substantially alter the terms of the mortgage, the original mortgagor will not be released from his personal liability.

The difficulty faced by the Commission is to translate these general principles into a workable legislative scheme that adequately balances the competing interests of lenders and borrowers. In the Working Paper, we tentatively proposed that where property is transferred subject to a mortgage, the transferor's personal liability on the covenant should end three months after the term of the mortgage expires, unless the mortgagee takes positive steps to preserve his right of action.

1. Comment on the Proposals

A number of people and groups commented on the Commission's proposals. The majority of comment favoured limiting personal liability after sale of property subject to a mortgage. There was little consensus, however, on how that should be accomplished. In the following sections we discuss suggestions and issues raised by our correspondents.

(a) Need for Reform

Two submissions questioned the need for reform. It was submitted that the current law serves the requirements of both the mortgagor and mortgagee and that legislative amendment was not called for.

This is the essential issue addressed by the Commission, and it is not easily answered. On the one hand, until recently, the current law did not cause hardship in the majority of cases. Moreover, it is consistent with contract theory. A person who borrows money is responsible for its repayment. On the other hand, the last several years has witnessed a number of individual tragedies resulting from the current law. The Commission received a number of complaints to the effect that the current law does not accord with the reasonable expectations of mortgagors.

What is the original mortgagor to do to protect himself? Our correspondents who favour the current law suggest that he need not allow his mortgage to be assumed. Another correspondent suggested that assumable mortgages should be abolished. These are solutions which we do not believe are satisfactory.

Frequently, property is purchased subject to an existing mortgage to take advantage of a desirable interest rate. That is not the only reason this practice is popular. A mortgagor often wants to sell property subject to the mortgage since in that way he may avoid a penalty for discharging the mortgage before the end of its term. The amount payable by the mortgagor reflects the anticipated cost to the mortgagee of placing the funds in new investments. A conveyance of property subject to an existing mortgage seems to be a highly beneficial mechanism. It helps in the transfer of property and it protects both mortgagor and mortgagee from the costs of early discharge of a mortgage.

The real issue is whether it is appropriate to deprive the mortgagee of the protection provided by keeping the original mortgagor to his covenant. Here a distinction must be drawn between transferees who are creditworthy, and those who are not. If the transferee is creditworthy then nothing stands in the way of replacing the existing mortgage with new financing under which the original mortgagor is no longer liable. This does not often happen because the original mortgagor is unaware of his continuing liability. There would, in these circumstances, be little practical difference in result, whether legislation were to require notice to the original mortgagor, or relieve him, of his continuing liability.

Where the transferee is not creditworthy, then the lender has a legitimate interest in seeing that the original mortgagor remains liable in one form or another. Our proposals in the Working Paper left this issue to be resolved by the parties by negotiation.

The practices adopted by mortgagees encourage mortgagors to sell property subject to an existing mortgage, and also obscure the need to negotiate for a release from liability at the end of the term. Persons who have experienced financial disaster over the last several years from liability under assumed mortgages are very much the victims of these practices. Amendments to the law are called for. The majority of our correspondents agreed with this position.

(b) Methods of Limiting Personal Liability

As mentioned earlier, the Commission tentatively proposed that where property is transferred subject to a mortgage, personal liability under the mortgage should end three months after the term of the mortgage expires. Some of our correspondents who agreed that the duration of liability on the personal covenant should be limited favoured different positions.

(i) Mortgagor as Guarantor

It was suggested that, upon sale of property subject to a mortgage, the relationships between the mortgage lender, mortgagor and his transferee, should alter. The transferee should be regarded as the principal debtor under the mortgage and the mortgagor only a guarantor to ensure performance of the transferee's obligations. When the mortgage lender and the purchaser subsequently enter into a contractual arrangement altering the term of, or the interest rate payable under, the mortgage, the original mortgagor should be released from liability.

Not much is really gained by altering the original mortgagor's status. In the absence of agreement, a guarantor's obligations will differ from those of the principal debtor's, and some circumstances will release a guarantor from liability which would not affect the position of the principal debtor. If this approach were adopted, one would expect mortgage documents to define the guarantor's continuing obligations, so that they would not differ from those of the principal debtor. We are reluctant to adopt this approach for this reason. Moreover, we do not believe that it is desirable for the mortgagor to be able to unilaterally alter his status from principal debtor to guarantor in those circumstances where mortgage lender and mortgagor have not addressed the issue of the guarantor's obligations.

(ii) Liability Should End When a Modification Agreement is Entered into By the Mortgage Lender and the Purchaser

This approach is based on the conclusion that when the mortgage lender enters into a contract with the transferee he treats him as the principle debtor under the mortgage. At that time, the mortgagee can determine whether the transferee is creditworthy. If the transferee is creditworthy, the original mortgagor should be released from personal liability. If the transferee is not creditworthy, the mortgage lender should refuse to enter into the modification agreement and call the loan.

Criticism of the approach adopted by the Commission centered mostly on concern that the mortgage lender would, through administrative error, neglect to act to protect its interests. Ending liability by reference to the making of a modification agreement would limit that possibility. A submission on behalf of one group made the following observations:

> We would prefer to see some kind of mechanism whereby the termination of the original mortgagor's liability would be tied to an extension or renewal by the mortgagee of the original term. It should also be clear that the existing law regarding novation would continue to apply to deal with other alterations to the mortgage prior to the end of the original term.

This was a position that the Commission seriously considered before making the tentative proposals published in the Working Paper, and it is one for which the Commission has some sympathy. Nevertheless, it is our conclusion that it should not be adopted.

In principle, we agree that it is correct to end liability when the mortgage lender enters into direct contractual relations with the transferee. This approach, however, admits to practical problems in application.

Should any agreement modifying the provisions of a mortgage affect the original mortgagor's liability? Modification agreements usually address the interest rate and term of the mortgage, but it is not uncommon to agree to modify relatively insignificant aspects of a mortgage. For example, mortgage lender and transferee may agree that monthly payments should include taxes. The mortgage lender would set that money aside to satisfy taxes when they became due. A mortgage lender may not fully consider its position when making an oral agreement modifying an unimportant provision of a mortgage. On the other hand, the significance of modifying the mortgage may discourage mortgage lenders from agreeing to modifications of relatively minor provisions. On balance, we suspect this approach would work well only if it required the making of a written agreement modifying a material term. What constitutes a material term could be left to be decided by the courts on a case by case basis, or particularly defined in legislation.

In our opinion, this approach is not very much different from ending liability by reference to the end of the mortgage's term, since that is the time that mortgage lender and transferee will usually enter into a modification agreement. Selecting the end of the term as the single event for terminating liability on the covenant has a number of advantages. It provides a certain and objectively verifiable method of determining when personal liability ends. It establishes the duration of liability on the covenant. It ensures that a modification agreement relating to minor matters does not unexpectedly release the mortgagor. It also probably corresponds to what most people are likely to believe (incorrectly) is the current law. Moreover, this approach does not discourage a mortgage lender from entering into a modification agreement with the transferee that may be to the transferee's advantage, before the expiry of the mortgage's term.

Several correspondents felt that the three month period following the expiration of the term, during which the mortgage lender must make its election whether to release the original mortgagor, would be too short. Mortgage lenders would require more time than that to determine the balance owing, the location of the parties, completion of pending lititgation, and so on. The shortness of the period would contribute to the possibility of prejudice to the mortgage lender through administrative error. Six months was identified as a suitable period.

We believe the concerns over administrative error are overstated. Mortgage lenders need not, and usually do not, wait until the last minute to consider their position under a mortgage the term of which is about to end. In practice, commercial lenders communicate with mortgagors well before the end of the term to remind them of the need to modify the mortgage agreement. If the term of the mortgage expires and neither the original mortgagor nor his purchaser renegotiates the mortgage, all the mortgage lender need do is call the loan to protect his position. Mortgage lenders should have little difficulty in developing systems for dealing with these problems. If they do not, then whatever approach is adopted, there will be the possibility of administrative error.

(c) Agreements For Sale

There is little practical difference between sale of a property subject to a mortgage and assignment of a right to purchase under an agreement for sale. A purchaser under an agreement for sale remains liable under the agreement for sale even after he has assigned his interest in it. There is no reason to distinguish between the rights and liabilities of a mortgagor and a purchaser under an agreement for sale in these circumstances.

The personal liability of a person who held a right to purchase under an agreement for sale should end when the vendor accepts the assignee of the right to purchase. Acceptance should be deemed to occur by reference to the expiry of the term of the agreement for sale.

(d) Mortgages and Agreements For Sale Payable on Demand

Not all mortgages are subject to a specific term. Some mortgages are payable on demand. There is no reason to except these mortgages from similar treatment. The original covenantor should be permitted to give the mortgage lender written notice of the coveyance, and the mortgage lender should have a reasonable time after that to decide either to accept the purchaser as primary debtor and release the orginal covenantor, or to call the mortgage.

So far as we know, agreements for sale are usually subject to a specific term, which would suggest little need for legislation governing agreements for sale payable on demand. Unless legislation deals with such arrangements, however, there is the possibility of leaving a gap. Vendors by agreement for sale might be encouraged to adopt payment on demand, in order to avoid termination of the purchaser's personal liability.

(e) Recommendations

The Commission recommends that:

5. *A person who conveys property, subject to a mortgage, should cease to be liable on the personal covenant three months after the expiration of the term of the mortgage unless demand for payment of the sum secured by the mortgage in full is made upon the covenantor within that period, whether or not the mortgage requires the payment of principal and interest at the expiration of the term without demand.*

6. *A person who assigns the right to purchase under an agreement for sale, should cease to be personally liable three months after the expiration of the term of the agreement for sale, unless demand for payment of the sum secured by the agreement for sale in full is made upon the assignor within that period, whether or not the agreement for sale requires the payment of principal and interest at the expiration of the term without demand.*

7. *Where a mortgage or agreement for sale is payable on demand, a person who conveys property subject to it should cease to be personally liable under the mortgage or agreement*

for sale three months after written notice of the conveyance is given to the mortgagee or vendor by agreement for sale, unless demand for payment of the sum secured by the mortgage or agreement for sale in full is made within that period.

The mortgage lender may not wish to release the original mortgagor. He may not be satisfied that the current holder of the property is creditworthy. In that case, the mortgage lender should call the loan. The transferee will have to refinance the property or the original mortgagor will have to guarantee the new owner's indebtedness. If the property is refinanced, all problems are resolved. If the original mortgagor acts as guarantor, the position is not significantly different from the current law, except that the original mortgagor is now well aware of his ongoing liability. Moreover, the rules governing discharge of a guarantor differ from those governing discharge of the original mortgagor. The original mortgagor would no longer be the primary debtor under the mortgage.

The impact of these recommendations may be frustrated if all mortgage lenders call the loan rather than let the original mortgagor be released from his personal liability. That is unlikely to happen where the current holder of the property is creditworthy, since it will be easy for him to refinance. If the current holder of the property is not creditworthy, it is in the best interests of the parties to address that problem in a timely fashion, as is contemplated by the recommendations.

F. Notice

1. Notice to the Mortgage Lender

Recommendation 7 addresses problems raised by mortgages or agreements for sale which are payable on demand. It is recommended that notice of a conveyance of property subject to a mortgage or agreement for sale payable on demand be given to the mortgage lender or vendor. One of our correspondents suggested that legislation enacting this recommendation should provide specifically for the manner in which such notice is to be given:

> ... the adequacy of the notice of conveyance is not set out. Any notice should be written notice. Again, because mortgage accounts are often handled by different departments within large institutional lenders, notice given to the original branch at which the mortgage was made may not be adequate. The terms of notice should be set out more clearly.

We agree that notice should be in writing, and Recommendation 7 has been drafted to include that requirement. We find it difficult, however, to provide a legislative formula for determining to whom notice should be given.In many cases, for example, the original lending branch will be the appropriate body to act on the notice. The parties are best placed to determine who should receive notice. The mortgage document or the agreement for sale can provide specifically for the manner in which notice should be given.Failing that, in the event of a dispute, the courts can determine whether notice was adequate in the circumstances.

2. Notice to the Mortgagor

Several of our correspondents suggested that problems arise with assumed mortgages because original mortgagors are not made aware of their continuing liability, and of their purchaser's default, under it. It was suggested that the mortgage lender should be under a duty to advise the mortgagor of both of these facts. A mortgage lender that fails to give notice should be prevented from proceeding against the original mortgagor on his personal covenant.

The Commission is in some agreement with this suggestion, but doubts whether it would go very far in solving current problems. Notice in the mortgage document that the mortgagor remains personally liable even after the mortgage is assumed by a purchaser will not accomplish very much. The mortgagor receives notice when the mortgage document is signed. The mortgagor requires notice when he sells his

property. That can only be provided by his real estate agent, or the lawyer responsible for the conveyancing. As we mentioned earlier, both the Law Society and the Real Estate Board have published reminders to their members on this point.

The importance of notice to the mortgagor of his purchaser's default is difficult to determine. We were advised of several cases where the mortgagor was not advised of the default until it had continued for eight months or longer. If the mortgagor were advised at an earlier date, it was suggested, steps could have been taken to remedy the default. The Commission has several doubts concerning this suggestion. First, a mortgagor advised of his purchaser's default will probably not be able to do much to rectify the matter. Second, a mortgage lender might experience practical difficulties locating the mortgagor to give him notice. Last, many mortgage lenders are prepared to tolerate default for a period of time, since in most cases it reflects temporary financial problems that are quickly resolved. Requiring the mortgage lender to give notice of default might alter this practice, and discourage mortgage lenders from accommodating mortgagors in these circumstances.

For these reason, we do not favour requiring mortgagee's to give notice to the original mortgagor of his continuing liability under a mortgage or of his purchaser's subsequent default.

G. Scope of the Recommendations

While we have concluded that various aspects of the law governing mortgages and agreements for sale should be changed, we recognize that the recommendations to release a mortgagor or purchaser under an agreement for sale from personal liability are inconsistent with the principle of freedom of contract. If a person is prepared to accept personal liability, continuing until release, as a condition of borrowing money, are there sound reasons for releasing him from that agreement? In a commercial context, where the borrower is likely to have experience and some measure of sophistication or adequate legal counsel, we suspect that there is less need to provide legislative protection.

Many mortgages are arranged in order to purchase a family home. Most purchasers of a home are unlikely to be involved in many real estate transactions, and a lawyer retained to do a conveyance is unlikely to counsel them on the considerations with respect to personal liability that may arise when they subsequently sell their home. Section 20 of the *Property Law Act*, which provides that the transferee of property subject to a mortgage is under an obligation to indemnify the transferor for liability under the mortgage, reflects the legislature's conclusion that unsophisticated borrowers require some protection.

Mortgages may also be arranged on residential premises to secure money borrowed for other consumer purposes, and in most cases these transactions will involve unsophisticated borrowers equally in need of protection.

In the Working Paper, we arrived at the following tentative conclusions:

> It is our tentative conclusion that [these Proposals] should not protect borrowers who arrange mortgages in pursuance of a commercial enterprise. That is a concept which presents some difficulties in legal definition. Alberta, attempting to make a similar distinction, provided that certain sections of their *Law of Property Act* did not apply to mortgages given by corporations. That approach would protect mortgagors who personally give mortgages for commercial reasons and, consequently, is incomplete.
>
> One option is to provide that [these Proposals] should apply to borrowers who obtained the mortgage, or used an agreement for sale, as a means to purchase a home. Such a mortgage or agreement for sale might be called a "residential purchase money security." A "residential purchase money security" should include funds borrowed and secured, which are used to improve the home.
>
> That approach would not include other consumer borrowing transactions secured by a mortgage, and consequently does not go far enough. Our tentative preference is that [these Proposals] apply to real property security interests arranged to

secure money borrowed for nonbusiness purposes, and that concept is probably best described for the purposes of legislation as a "consumer purchase money security."

Comment on these conclusions tended to be negative. Although our correspondents were sympathetic with the goal of protecting consumer borrowers, the majority of comment favoured extending the Commission's recommendations to commercial transactions as well.

One submission made the following observations:

> We agree that the considerations warranting implementation of the Commission's proposals are applicable primarily to consumer transactions. However we also feel that the case law dealing with novation has not always led to expected results. This factor favours making the proposed change in respect of all transactions whether commercial or consumer. Further, there is some advantage to having the law consistent for all types of transactions where there is no undue onus placed on either party.

Another submission objected to the Commission's proposal primarily because of the difficulties that would arise in distinguishing between consumer and corporate transactions:

> We are not in agreement with [the] Proposal ... We do not think that there should be a distinction between commercial and nonbusiness transactions. Although we agree that the primary concern should be to protect consumer borrowers, we see no harm in affording such protection to commercial borrowers. We think that once such a distinction is drawn, the courts will be called upon to dissect each alleged consumer transaction to determine its true character. Such an exercise consumes time and money, and often leads to uncertainty in the market place. The result is usually detrimental to the consumer.

We are convinced by the arguments made by our correspondents and, consequently, do not recommend limiting the scope of our recommendations respecting the duration of liability on the personal covenant.

H. Collateral Agreements and Contracting Out

Our recommendations are directed to problems relating to personal liability under a mortgage. They contemplate that the original mortgagor will be released from liability, or the parties will negotiate a new arrangement under which the original mortgagor's liability is precisely defined.

These recommendations are primarily for the protection of the unsophisticated borrower, and it is a matter of concern if their effect can be avoided. For example, the lender might require the borrower to agree in advance that he will not be released from liability in the event of sale of the property subject to the mortgage. Alternatively, the lender might require additional collateral security for the debt secured by the mortgage.

It is our conclusion that legislation should close off these options.

The Commission recommends:

8. Legislation implementing recommendations 5, 6 and 7 should provide that:

- *(a) a waiver of the benefit of these provisions is ineffective unless it is entered into after property subject to a mortgage or agreement for sale is transferred by the mortgagor or purchaser under the agreement for sale; and*
- *(b) release from liability under a mortgage or agreement for sale extinguishes the liability of the mortgagor or purchaser by agreement for sale to repay the sum secured by the mortgage or agreement for sale.*

Recommendation 8(a) is designed to prevent a lender from including a standard provision in a mortgage or agreement for sale waiving the benefit of legislation limiting the duration of liability on the covenant. When the property is later transferred, the lender may decline to accept the purchaser as the debtor under the mortgage or agreement for sale. In that case, the original borrower may wish to guarantee the performance of his purchaser's obligations, and should be able to enter into an agreement to that effect. Recommendation 8(a) is intended to accommodate these circumstances.

Recommendation 8(b) is intended to clarify the consequences of a release of personal liability under a mortgage or agreement for sale. Sometimes lenders will require a borrower to provide security against a number of different assets for repayment of money. After a borrower has been released from personal liability under a mortgage, may the lender proceed for repayment pursuant to the other securities? Recommendation 8(b) provides that the debt obligation is extinguished or reduced by the amount secured by the mortgage or agreement for sale. For example, if the borrower owes the lender $100,000, and that sum is secured by a mortgage for $100,000 against property conveyed to another, the release from liability extinguishes the borrower's obligations to the lender. The lender may not proceed against the borrower on other securities for that debt. In more rare circumstances, the borrower may owe the lender more than the face value of the mortgage. If the borrower owed the lender $150,000, then release from liability under the mortgage would reduce the borrower's obligations to $50,000. The lender could look to his other securities to recover that amount.

I. Application

The recommendations we have made, when implemented by legislation, will alter substantive rights in several respects. Parties will have arranged their affairs in light of the current law, and it would be disruptive to alter these rights retrospectively. Legislation implementing our recommendations, consequently, should address issues of transition and the application of the revised law.

Recommendations 1, 3 and 8 do not raise problems of transition. Recommendation 1 provides a general rule for calculating interest on a judgment on the personal covenant. Recommendation 3 is procedural. Recommendation 8 is ancillary to Recommendations 5, 6 and 7. Legislation implementing these Recommendations should apply in all circumstances.

Recommendations 2, 4, 5, 6 and 7 alter substantive rights. Recommendations 2 and 4 concern a purchaser's obligation to pay and indemnify his transferor for liability under an assumed mortgage or agreement for sale. Legislation implementing these Recommendations should apply only to transactions occurring after implementation.

Recommendations 5,6 and 7 concern the duration of the transferor's liability under a mortgage or agreement for sale. It is contemplated that a person who transfers property subject to a mortgage or agreement for sale will be released from liability unless the mortgagee or vendor by agreement for sale is unprepared to accept the transferee in the transferor's stead. The mortgagee or vendor by agreement for sale must determine whether he is prepared to accept the transferee. This determination must be made when the term of the mortgage or agreement for sale expires, or upon receiving notice of the transfer. It is our conclusion that legislation implementing Recommendations 5, 6 an 7 should only apply when these events occur after implementation.

The Commission recommends that:

9. Legislation implementing

(a) Recommendations 1, 3 and 8 should apply in all circumstances;
(b) Recommendations 2 and 4 should apply only to transactions completed after implementation;

(c) *Recommendations 5 and 6 should apply only when the term of a mortgage or agreement for sale expires after implementation;*
(d) *Recommendation 7 should apply only when notice is given after implementation.*

CHAPTER IV SUMMARY

A. Summary

While not reason in itself for reform, it is a matter of concern when results achieved by the law depart from popular expectations. If justice can still be done, then it is often desirable to amend the law so that it conforms more nearly to what most people believe it to be.

Frequently, a person who has the benefit of a mortgage or agreement for sale is not personally liable to the lender for the debt represented by the security interest in question. In the event of default, the lender can only look to the original borrower, who may be entitled to an indemnity from the current holder of the property.

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

Liability of the original covenantor should not extend indefinitely after property has been transferred. It should extend to the time when the mortgage lender or vendor by agreement for sale accepts the purchaser of the property as the primary debtor under the mortgage or agreement for sale. That should be deemed to occur by reference to the expiry of the term of the security, unless the mortgagee or vendor is unprepared to accept the purchaser as primary debtor. Modifications along these lines would again bring the law more into line with the expectations of unsophisticated borrowers.

Recommendations have also been made to vary rights of indemnity that may arise on the transfer of property subject to a mortgage or agreement for sale.

B. Comment on the Working Paper

The Commission's recommendations, for the most part, do not depart from the tentative proposals made in the Working Paper that preceded this Report. Throughout this Report, specific reference has been made to comments and criticisms received on the Commission's tentative proposals. It is useful, however, to summarize generally the comment we received.

The issues addressed in this Report involved balancing the interests of lenders and borrowers. Not surprisingly, a portion of the submissions we received were from persons identifiable with one or the other of the groups directly affected by the Commission's proposals. With one exception, (a person who thought the Commission's "jaundiced conclusions and proposals" were designed to "squeeze and hound borrowers") comment reflected careful and objective consideration of the issues we raised. All of the comment we received, except on behalf of institutional lenders, agreed that the law should limit the duration of personal liability under a mortgage or agreement for sale after a conveyance of the property.

Submissions from persons on behalf of institutional lenders were divided in their support for the Commission's proposals. Most of the submissions falling into this group endorsed the Commission's proposals, but two did not. The two submissions critical of the Commission's proposals appreciated the position of mortgagors but felt that practical difficulties would arise from the amendments to the law contemplated by the Commission. We have attempted to address the problems anticipated by these correspondents in the preparation of the recommendations in this Report.

C. List of Recommendations

The recommendations made in this Report concern five separate issues and, in this list, we group them by issue.

1. Calculation of Interest on the Personal Judgment

Recommendation 1

Unless the court otherwise orders, interest on an amount owing under a mortgage shall be calculated as if judgment had been granted with the order nisi *of foreclosure.*

2. Amendments to Section 20 of the Property Law Act

Recommendation 2

The transfer of a purchaser's rights under an agreement for sale should give rise to the obligations to pay and indemnify contained in section 20 of the Property Law Act *in the same way as does a conveyance of property subject to a mortgage.*

Recommendation 4

Section 20 of the Property Law Act *be amended by adding subsections comparable to the following:*

(a) Where the mortgage or agreement for sale was not credited to the transferee in calculating the consideration for the transfer, the obligation to pay and indemnify provided by section 20 of the Property Law Act *shall not arise.*
(b) Section 20 of the Property Law Act *does not apply to a transfer of property which is in essence a gift.*

3. Direct Right of Action Against Current Holder of the Property

Recommendation 3

(a) For the purposes of this recommendation, the "current holder of the property" means

(i) the owner of the property, or
(ii) either the purchaser under an agreement for sale or, if the purchaser has transferred his interest, the ultimate transferee of that interest whose interest has been registered.

(b) Subject to (d) and (e), a person who is liable, or required to indemnify a person who is liable, under a mortgage or an agreement for sale should be entitled to recover the amount of his liability from the current holder of the property.

(c) Subject to (d) and (e), a mortgagee or vendor by agreement for sale should be entitled to recover any amount due and owing under a mortgage or agreement for sale from the current holder of the property as if he were the original covenantor.

(d) No person shall be entitled to recover an amount under (b) or (c) from the current holder of the property, where the current holder of the property establishes that a person from or through whom he derived his right or title was neither

(i) obliged to indemnify his transferor, nor

(ii) directly liable to the mortgagee or vendor in respect of the liability under the mortgage or agreement for sale.

(e) In an action under (b) or (c), the current holder of the property is not liable to pay any amount in excess of the sum he would have been obligated to pay his transferor by way of indemnity.

(f) The rights to be conferred by legislation enacting this recommendation should be in addition to any rights the mortgagee, vendor by agreement for sale, or person entitled to indemnity may have against any person apart from this recommendation.

4. Duration of Liability on the Personal Covenant

Recommendation 5

A person who conveys property, subject to a mortgage, should cease to be liable on the personal covenant three months after the expiration of the term of the mortgage unless demand for payment of the sum secured by the mortgage in full is made upon the covenantor within that period, whether or not the mortgage requires the payment of principal and interest at the expiration of the term without demand.

Recommendation 6

A person who assigns the right to purchase under an agreement for sale, should cease to be personally liable three months after the expiration of the term of the agreement for sale, unless demand for payment of the sum secured by the agreement for sale in full is made upon the assignor within that period, whether or not the agreement for sale requires the payment of principal and interest at the expiration of the term without demand.

Recommendation 7

Where a mortgage or agreement for sale is payable on demand, a person who conveys property subject to it should cease to be personally liable under the mortgage or agreement for sale three months after written notice of the conveyance is given to the mortgagee or vendor by agreement for sale, unless demand for payment of the sum secured by the mortgage or agreement for sale in full is made within that period.

Recommendation 8

Legislation implementing recommendations 5, 6 and 7 should provide that:

(a) a waiver of the benefit of these provisions is ineffective unless it is entered into after property subject to a mortgage or agreement for sale is transferred by the mortgagor or purchaser under the agreement for sale; and

(b) release from liability under a mortgage or agreement for sale extinguishes the liability of the mortgagor or purchaser by agreement for sale to repay the secured under the mortgage or agreement for sale.

5. Application

Recommendation 9

Legislation implementing

(a) Recommendations 1, 3 and 8 should apply in all circumstances;
(b) Recommendations 2 and 4 should apply only to transactions completed after implementation;
(c) Recommendations 5 and 6 should apply only when the term of a mortgage or agreement for sale expires after implementation;
(d) Recommendation 7 should apply only when notice is given after implementation.

D. Draft Legislation

Draft legislation to implement the Commission's recommendations has been prepared by Commission staff with the assistance of Legislative Counsel. The Commission has not considered this draft legislation and does not make any formal recommendation that legislation should follow the draft set out in the Appendix to this Report. The draft legislation is offered only for the purpose of illustrating the lines along which legislation might proceed.

E. Acknowledgments

We wish to express our appreciation to all those who responded to the Working Paper which preceded this Report. The responses we received were numerous and offered thoughtful advice. The Commission is grateful for the assistance these responses provided in the preparation of this Report.

We also wish to express our thanks to Thomas G. Anderson, Counsel to the Commission, who prepared the Working Paper and this Report.

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September 26, 1985

APPENDIX

DRAFT LEGISLATION

An amendment to the interpretation section of the *Property Law Act* would be added to provide that an agreement for sale would have the same meaning as it has in section 16.1 of the *Law and Equity Act*, i.e. "agreement for sale" means a contract for the sale of an interest in land under which the purchaser agrees to pay the purchase price over a period of time, in the manner stated in the contract, and on payment of which the vendor is obliged to convey the interest in land to the purchaser, but does not include a contract under which

the purchase price is payable in less than 6 months from the time the contract was entered into, and

the purchaser is not, during the 6 month period, entitled to possession of the land that is the subject matter of the contract.

Recommendation 1

The *Property law Act* would be amended by adding a new section as follows:

Calculation of interest on the personal judgment

27.1 Unless the court otherwise orders, interest on a judgment for an amount payable under a mortgage shall be calculated as if judgment had been granted with the order *nisi* of foreclosure.

Recommendations 2 and 4

Section 20 of the *Property Law Act* would be re-enacted to read as follows:

Implied covenant in a mortgage or agreement for sale

20. (1) In an instrument transferring

(a) an interest in land subject to a mortgage, or
(b) the purchaser's interest in an agreement for sale

There is implied, unless the parties have otherwise agreed in writing, a covenant by the transferee with the transferor to make payments under the mortgage or agreement for sale in accordance with its terms, and to indemnify the transferor against liability to pay the principal sum, interest, any other money secured, and liability on any express or implied covenants of the mortgagor or purchaser, as the case may be.

(2) Where, in a transfer of an interest referred to in subsection (1),

(a) the amount secured by the mortgage or agreement for sale was not credited to the transferee in calculating the consideration for the transfer, or
(b) the transfer is in substance a gift,

The obligation to pay and indemnify provided in subsection (1) does not arise.

Recommendation 3

The *Property Law Act* would be amended by adding a new section:

Direct action against current owner

20.1 (1) In this section "current owner" means

(a) the registered owner of land that was transferred subject to a mortgage, or
(b) where the purchaser's interest under an agreement for sale has been transferred, the last registered transferee of that interest

(2) A person who, under a mortgage or agreement for sale, is liable for has been required to indemnify a person who is liable, is entitled to recover the amount of his liability from the current owner.

(3) A mortgagee or vendor under an agreement for sale is entitled to recover from the current owner any amount due and owing under the mortgage or agreement for sale in the same manner as though the current owner had convenanted to make payments on the mortgage or agreement for sale.

(4) The liability of a current owner under subsections (2) and (3) is limited to that amount that the current owner is under an obligation to pay or indemnify his transferor in respect of liability under the mortgage or agreement for sale.

(5) It shall be presumed that the liability of the current owner under subsections (2) and (3) is for the amount payable under the mortgage or agreement for sale unless the current owner establishes that subsection (4) limits his liability to a lesser amount.

(6) This section does not abrogate any other rights or remedies that a mortgagee, a vendor under an agreement for sale or a person with a right of indemnity, may otherwise have or pursue.

Recommendations 5 to 8

These would be implemented by the addition of a new section to the *Property Law Act* as follows:

Extinction of the liability under the personal covenant

20.2 (1) A person who

(a) transfers land subject to a mortgage, or
(b) assigns the right to purchase under an agreement for sale

ceases to be liable under the personal covenant in the mortgage or agreement for sale, or otherwise, unless the mortgagee or vendor under the agreement for sale makes a demand for payment for the sum secured, on all persons who are personally liable for payment of the mortgage or agreement for sale, within 3 months after the term of the mortgage or agreement for sale has expired.

(2) Subsection (1) applies notwithstanding any term of the mortgage or agreement for sale that provides that all amounts outstanding at the end of the term are payable without a demand.

(3) A person who

(a) transfers land that is subject to a mortgage that is payable on demand, or
(b) assigns the right to purchase under an agreement for sale that is payable on demand

ceases to be liable under the personal covenant in the mortgage or agreement for sale, or otherwise, unless the mortgagee or vendor under the agreement for sale makes demand for payment of the sum secured, on all persons who are personally liable for payment of the mortgage or agreement for sale, within 3 months after he has received written notice of the transfer or assignment.

(4) A waiver of the benefit contained in subsections (1) and (3) is of no force and effect unless it is entered into by the original parties to the mortgage or agreement for sale after the transfer or assignment referred to in subsections (1) and (3).

[Draft legislation has not been prepared to implement Recommendation 9 regarding application. Recommendation 9 provides as follows:

Legislation implementing

> Recommendations 1, 3 and 8 should apply in all circumstances;
>
> Recommendations 2 and 4 should apply only to transactions completed after implementation;
>
> Recommendations 5 and 6 should apply only when the term of a mortgage or agreement for sale expires after implementation;
>
> Recommendation 7 should apply only when notice is given after implementation.]