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Backgrounder

LRC 84—Report on Personal Liability Under a Mortgage or Agreement for Sale

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This report focuses primarily on three separate issues arising on personal liability under a mortgage or agreement for sale. Most people are familiar with a mortgage. In simple terms it represents a promise to repay borrowed money, which is secured by way of a charge over property. An agreement for sale is less common and represents an alternative to a mortgage. It is a contract between a seller and purchaser under which the seller agrees to sell their interest in property to the purchaser for a certain sum payable over a specified period of time. Under the agreement, legal title remains with the seller until the full purchase price has been paid.

Most of the issues highlighted below arise where a borrower has sold their property subject to the existing mortgage. Unless the lender agrees to release the borrower from the mortgage covenant to repay the borrowed money, or the lender and purchaser substantially alter the mortgage, they remain liable as the primary debtor. Similar issues can also arise when a purchaser, under an agreement for sale, assigns the right to purchase; the purchaser remains liable under the agreement for sale until released by the vendor or until the subsequent purchaser enters into a new agreement with the vendor.

The first issue dealt with in the report relates to privity of contract. This is a fundamental principle of contract law, which says that a person is not personally liable on a contract unless they are a party to that contract. In the context of a lender and a transferee of the borrower's interest, the doctrine prevents the lender from maintaining an action against the transferee with respect to liability on the covenant to pay the mortgage, even though the transferee may ultimately be liable to pay through the effect of one or more proceedings for indemnity. The report recommends that the lender should be permitted to proceed directly against the transferee.

The second issue concerns the duration of a borrower's personal liability to a lender. Under the existing law, the original borrower will often remain liable to the lender even after there has been a transfer of the property and the lender has engaged in direct dealings with

the transferee up to and including modification of the mortgage in a manner which amounts to its renewal. Recommendations are therefore made concerning the termination of the original borrower's personal liability.

The report also examines the statutory indemnity in the *Property Law Act* where there has been a transfer of the borrower's interest. If, for example, A buys property, borrows money secured by a mortgage, and sells to B subject to the mortgage, 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. The report highlights a number of circumstances in which the statutory right of indemnity can operate unfairly and makes recommendations to clarify its proper sphere and operation.

A number of recommendations are also 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.

The report includes draft legislation amending the *Property Law Act* to incorporate the recommendations.

Further Developments

See *Law Reform Amendment Act, 1988*, S.B.C. 1988, c. 42, ss. 5–7 (now *Property Law Act*, R.S.B.C. 1996, c. 20–24).