Foreclosure by Power of Sale: Securing a Proper Price in New Brunswick, 1983-1987

This essay follows an article published in this journal in 1983.[1] At that time it was argued that forced sale practices in New Brunswick could not ensure reasonable sale prices and that creditors were thereby exposed to potential liability for failure to adhere to the appropriate standard of care when exercising a power of sale. Also, attention focused on the statutory right of a foreclosing creditor to buy in at its own sale and the extent to which the exercise of that right could lead to an abuse of a remedial process. Since then there have been both trial and appellate decisions which warrant further analysis and, in certain instances, critical comment. A critical analysis is necessary given the development of a rule of law permitting the creditor to purchase at its own auction for a nominal amount and to sue the debtor for virtually the full amount of the indebtedness, without obligation on the creditor to reconvey the lands taken as security. How the law endorses such a consequence will be explained and it will be argued that the prevailing law cannot be justified.

Law review articles may seek to effect changes in the law or to point out the inadequacies of judicial analyses. Both goals underlay the writer's earlier piece. It must be said, however, that neither the issues raised nor the arguments advanced in the earlier article have been fully addressed by the courts. Accordingly, it is appropriate at the outset to provide the reader with a summary of the earlier analysis together with an examination of the subsequent relevant decisions of the New Brunswick courts. In addition to pursuing the aforementioned objectives, this essay also seeks to emphasize the degree to which foreclosure practices in New Brunswick constitute an abuse of a remedial option. Furthermore, it is becoming increasingly apparent that the ineffective foreclosure practices followed in this province could result in substantial liability claims against solicitors acting on behalf of foreclosing creditors. This last assertion should in itself stimulate a renewed interest in mortgage law among members of the profession.

Summary

The analysis offered in 1983 demonstrated that adherence solely to the terms of the mortgage contract and the relevant provisions of the *Property Act* as a means of attracting potential purchasers has nearly always been a futile exercise.[2] The insertion of legal notices of sale in local newspapers, the posting of notices at locations of purely historical significance and publication in the *Royal Gazette* can best be described as devices favouring the foreclosing creditor as successful purchaser. With respect to the last requirement, the legislature did intervene in 1986 by amending the *Sale of Lands Publication*

[1] See J.T. Robertson, "Foreclosure by Power of Sale: Securing a Proper Price in New Brunswick" (1983) 32 *UNB LJ* 83.

[2] *Ibid.* at 106, note 89.

(1987), 36 *UNB LJ* 115.

Act and the *Property Act* so as to dispense with publication in the *Gazette*.[3] In any event, it is unlikely that publication in this medium ever achieved its alleged purpose. Thus it is patent that foreclosure practices afford little protection to those who remain liable on the mortgage covenant and particularly those who are subject to a deficiency judgment determined by an arbitrary bid of the foreclosing creditor. Since creditors have an entrenched right to purchase at their own auction, the primary legal issue concerns the standard of care to be required of the foreclosing creditor when exercising the power of sale. In other words, what obligations are to be imposed on the creditor when marketing and selling to ensure that the sale price is reasonable? No one can deny the existence of a "duty of care". Traditionally the legal debate has centered on whether the standard of care is circumscribed by mere good faith considerations or is augmented by the obligation to adopt reasonable precautions in accordance with the usual notions of delictual responsibility.

Despite various judicial formulations of the appropriate standard, the issue can be reduced to a simple question: will the creditor be held accountable for negligent acts even though he may be said to have acted in good faith? According to 19th-century law a creditor who acted in good faith would not be held responsible for negligent conduct. Of course there remained the difficulty of determining the point when negligent behaviour constituted acting in bad faith. Nonetheless, developments in English law in the 20th-century have resulted in the adoption of a more stringent standard: that of good faith and accountability for negligent acts. In *Cuckmere Brick Co.* v. *Mutual Finance Ltd.* the English Court of Appeal noted that the foreclosing creditor had failed to disclose to potential purchasers an alternative and more valuable use for the undeveloped lands that were being auctioned.[4] Notwithstanding a comprehensive effort to bring the property to the attention of the market place, that omission resulted in the creditor being held accountable for what might have been offered had the creditor met the required standard of care.

In *Canadian Imperial Bank of Commerce* v. *Haley* the New Brunswick Court of Appeal applied the *Cuckmere* standard to render a creditor with security under section 88 of the *Bank Act* [now s.179] accountable for selling inventory hastily without any effort to attempt a sale to other comparable companies in the vicinity.[5] A year later that same standard was applied by Mr. Justice Angers in *Nova Scotia Savings & Loan* v. *MacKenzie*.[6] The foreclosing creditor sought a deficiency judgment after buying in at its own sale for $10,000 and effecting a subsequent sale for $19,000. The deficiency judgment sought was based on the first sale price. In what must be regarded as an important, albeit brief, judgement, his Lordship held that a marketing scheme based solely on the provisions of the *Property Act* could not be considered reasonable. Since the only evidence as to the market value of the property was that of the second sale effected through the efforts of a real estate agency, the

[3]R.S.N.B. 1973, c. S-2, s.1 as rep. S.N.B. 1986 c.73, s.1; R.S.N.B. 1973, c.P-19, s.45(1)(a) as rep. S.N.B. 1986, c.73, s.3.

[4](1971), [1971] 2 All E.R. 633 (C.A.).

[5](1979), 25 N.B.R. (2d) 304 (S.C.A.D.).

[6](1979), 29 N.B.R. (2d) 78 (Q.B.).

debtor was deemed to have suffered a loss equivalent to the difference between the two sale prices. Therefore, the deficiency judgment was based on the higher sale price. The decision in *MacKenzie* demonstrated clearly the need to evaluate and alter foreclosure sale practice and yet the practices of the past continue.

One of the purposes of my earlier article was to examine the weaknesses of the *MacKenzie* decision which might enable the creditor to continue to claim immunity for conduct amounting to negligence. At that time three possible defences were raised. Two were noticed by Mr. Justice Angers in *MacKenzie*.[7] However, the court declined to interpret the two provisions of the *Property Act* which could be invoked to exonerate the foreclosing creditor of liability.[8] The third possible challenge stemmed from the misconceived notion that strict compliance with the mortgage document and *Property Act* constituted a complete defence to apparently tortious conduct.

Turning first to the provisions of the *Property Act,* subsection 47(6) states that the foreclosing creditor is not responsible for any involuntary loss arising from the exercise of the power of sale. By implication the creditor is responsible for voluntary loss. This provision neither supports nor undermines the creditor's position. Until a meaning is ascribed to the phrase "involuntary loss", the relevance of the subsection remains undetermined. If, however, the *Cuckmere* standard is applied (which this writer advocates), a court could define voluntary loss as any loss resulting from the failure to adhere to that standard; that is, those accruing from a failure to act in good faith or failure to adopt reasonable precautions. Involuntary losses would be restricted to those beyond the control of the creditor as, for example, those attributable to depressed market conditions at the time the power is to be exercised. Of course, it is clear at law that the creditor is under no obligation to postpone a sale until market conditions have improved.

Paragraph 44(1)(a) of the *Property Act* is also relevant; read literally it suggests that the creditor has the power to sell and may buy in without being answerable for any loss occasioned thereby. However, if as a matter of policy a court believes that the *Cuckmere* standard should prevail, this end could be achieved easily by holding that the word "loss" means involuntary losses. Such a reading would be consistent with the interpretation given to subsection 47(6) of the Act. Ultimately the issue is whether the arguments which can be advanced in favour of the more stringent standard outweigh those supporting the good faith standard. The decision in *Haley* elicits a positive response.[9]

The final argument is not an acceptable justification for confining the creditor's obligations to one of good faith. That is, to argue that strict compliance with the requirements of the mortgage document and the *Property Act* precludes any claim based on negligence (the action is properly one of "accounting") is simply to apply mechanically a legal device limiting the creditor's

[7]See "Foreclosure by Power of Sale", *supra*, note 1 at 114.

[8]R.S.N.B. 1973, c. P-19.

[9]*Supra*, note 5.

obligations without offering adequate policy reasons. Proponents of the more rigorous standard would hold that "strict compliance" should only be regarded as a minimum standard. Yet an argument dealing strictly with the statute avoids the central policy issue and merely reinforces preconceived notions of what the law is or should be. Nevertheless, the strict compliance test can be challenged since it derives from an unsupportable premise, namely that the notice provisions prescribed by the Act and transcribed in the mortgage contract are intended to attract purchasers to a pending auction. The original purpose of the notice provisions of the Act was to provide the foreclosing creditor with alternative methods of informing the mortgagor of the proposed exercise of the power.[10] Admittedly that purpose was obscured as a result of an amendment to the Act in 1979 requiring compliance with each of the notice provisions. However, the fact that all of the legal notices of sale are directed solely at the mortgagor and toward those with an interest in the equity of redemption cannot be ignored. One rarely, if ever, sees an advertisement directed at the market place or one which emphasizes the marketable features of the property. Consequently the possibility of effecting a genuine sale at a reasonable price is remote. In such circumstances, it is unreasonable to maintain that strict compliance with the notice requirements is equivalent to acting in good faith.

The Intervening Years (1983-1987)

In forced sales of property other than realty, the New Brunswick Court of Appeal continues to apply the *Cuckmere* standard adopted originally in the *Haley* case. In *Bank of Nova Scotia* v. *Beck*, the court *dismissed* a deficiency action against a chattel mortgagor where the bank had sold security for $20,000 which the mortagor had purchased two years earlier for $50,000.[11] However, unlike sales of realty, the marketing techniques adopted prior to the auction — at which other equipment was offered — successfully attracted over 800 bidders. Nonetheless the deficiency judgement was *denied*. The mortgagee failed to obtain an appraisal of the security, to set a reserve bid and to attempt first a sale in the local retail market. The auction in this case was directed at wholesalers. It must be asked whether a valid distinction can be drawn between the standard of care required of a chattel mortgagee and that demanded of a creditor whose security is real property. Absent contractual or statutory considerations the answer to this question is obvious. Rules of law which result in differing degrees of protection for debtors on the basis of the type of property secured should be rejected on principle. Indeed, the provisions of our *Property Act* apply equally to mortgages of both chattels and realty.[12]

Before turning to the New Brunswick decisions at first instance, there remains one appellate decision which, by oversight, was omitted from discussion in the earlier essay. In *Central Trust* v. *Rosebowl Holdings Ltd.* the late Mr. Justice H. Ryan dealt with the problem of price adequacy in the context of a

[10]See "Foreclosure by Power of Sale", *supra*, note 1 at 108-10.

[11](1986), 67 N.B.R. (2d) 6 (C.A.); Failure to adhere to the proper standard of care has never, until this case, been an absolute bar to a deficiency judgement. *Quaere:* was this aspect of the case overlooked by both the parties and the court?

[12]R.S.N.B. 1973, c. P-19, ss 40 & 44(5).

foreclosing creditor of realty.[13] While this judgement may appear to challenge the proposition advocated, it does not preclude the adoption of the more rigorous standard of care. The material facts are straightforward. In 1972 the defendant Rosebowl purchased a property for $101,000 of which $75,000 was raised by way of mortgage to the plaintiff. The defendant Heustis guaranteed the mortgage loan. In 1973 Rosebowl sold the property to a third party for $105,000 with the purchaser assuming the plaintiff's mortgage. In 1976 the purchaser defaulted on the mortgage and the plaintiff exercised its power of sale and bought in at the auction for $25,000. The plaintiff then offered the property to the defendants for $72,000 which offer was rejected. Subsequently the property was sold to a third party for $30,000. The plaintiff then sought a deficiency judgement against the defendants on the basis of the difference between the outstanding indebtedness and the price paid at the auction sale. The evidence revealed that at the time of the forced sale the property was appraised at $60,000. Six months later an appraisal placed the fair market value of the property at $60,000, although realizable market value was estimated to be $45,000 due primarily to a change in market conditions. Counsel for the defendants argued simply that the deficiency should be calculated in regard to the $60,000 market value. The court held that the plaintiff was not obligated to sell for this amount, nor prohibited against selling for a lower amount. As the standard of care required of a foreclosing mortgagee was not addressed by counsel or the court, it is extremely difficult to challenge such reasoning. At no time has it been suggested by the writer or held by a court that a foreclosing creditor is under an obligation to sell for the alleged market value of the property. However, a sale to the foreclosing creditor at forty per cent of the property's market value should not be viewed as acceptable. Ultimately the Court of Appeal may be called upon to reconcile its decisions in *Haley* and *Beck* with that in *Rosebowl Holdings*. The application of the *Cuckmere* standard would not seem to contradict the reasoning of the court in *Rosebowl*.

There is, however, a trial decision that does provide a great obstacle to the adoption of the *Cuckmere* standard, that of Mr. Justice Dickson in *Bank of Montreal* v. *Allender Investments Ltd.*[14] The foreclosing bank bought for $100 at its own sale a property which had been appraised earlier at $46,000. In time the bank made application to have the court answer questions relevant to the obligations of a mortgagee when effecting a forced sale and in particular with respect to the right to claim a deficiency judgement calculated by reference to the $100 sale price. Ultimately the court declared that the bank was entitled to a judgement for the difference between the outstanding indebtedness of $45,000 and the $100 purchase price. As to the standard of care required of the bank, the court held that a creditor who adheres strictly to the terms of the mortgage contract and to the provisions of the *Property Act* cannot be held accountable for negligence. In short, strict compliance represents the limits of the creditor's obligations. Accordingly the *Haley* and *Cuckmere* cases were distinguished, as both held the creditor responsible for a sale effected at an undervalue because of negligence. As for the result in *MacKenzie*, Mr. Justice

[13](1981), 34 N.B.R. (2d) 308 (C.A.).

[14](1983), 53 N.B.R. (2d) 143 (Q.B.).

Dickson concluded that, "it was not founded upon a recognized principle of law".[15]

With deference, the equitable solution adopted in the *MacKenzie* case does not stand alone in Canadian jurisprudence. In Newfoundland a deficiency judgement is calculated with regard to the higher of the two sale prices and the same solution is mandated by the Civil Code of Quebec.[16] Moreover, the provisions of the *Conveyancing Act* of Newfoundland mirror those of the *Property Act* of New Brunswick.[17] In Newfoundland and Quebec the problem of price adequacy which stems from ineffective marketing schemes has been recognized and an equitable solution provided. The more appropriate solution, however, would be to require an effective sale in the first instance. But until that solution is implemented the requirement that deficiency judgements be calculated with regard to the higher of the sale prices does provide debtors with some protection.

While a charge of unjustified enrichment would be warranted where a foreclosing creditor claimed the right to a deficiency judgement based on a $100 sale to itself and the right to retain the property, such a defence would have been inappropriate in *Allender*. The bank sought only the former and stood prepared to reconvey the land in question on payment of the debt. Nevertheless the invitation to compromise was deemed by the court "inconsequential" and accordingly a potential windfall accrued to the bank. Had the court accepted the bank's gratuitous offer, it would have been difficult to assail the result as it is one accepted and applied by courts of equity in analogous situations. Equating a sale to the foreclosing creditor with the granting of an equitable decree for foreclosure absolute, whereby the creditor obtains title to the land, the established rule is that the creditor may seek and execute upon a personal judgement provided that he remains in a position to reconvey the land.[18] Of course, by rejecting the bank's offer Mr. Justice Dickson enabled the creditor to be enriched contrary to fundamental equitable principles.

But the criticisms of *Allender* do not end here. Though the creditor's obligations are addressed in terms of "strict compliance", one must presume that the good faith requirement remains intact. Thus, it is still open to ask whether or not the result is supportable in law. To the extent that a creditor's obligations are confined to good faith, that standard of care is held to be breached if the creditor either fraudulently, wilfully or recklessly sacrifices the mortgagor's interests.[19] Does not a sale at a price of $100 constitute a reckless sacrifice of the property? But even if the creditor can be said to have acted in

[15] *Ibid.* at 156.

[16] See Art. 1202b(a) C.C.Q. with respect to Quebec law. In Newfoundland that result was sanctioned in *Nova Scotia Savings and Loan* v. *Miller* (1985), 53 Nfld. & P.E.I.R. 41 (Nfld. S.C.).

[17] R.S. Nfld. 1970, c.63, ss 5-7.

[18] *Lockhart* v. *Hardy* (1846), 50 E.R. 378 (Ch.); *Bank of Nova Scotia* v. *Dorval* (1979), 25 O.R. 579 (C.A.) and *Rushton* v. *Industrial Development Bank* (1973), [1973] S.C.R. 552.

[19] *Kennedy* v. *De Trafford* (1896), [1896] 1 Ch. 762 (C.A.), aff'd (1896), [1897] A.C. 180 (H.L.); *British Columbia Land & Investment Agency* v. *Ishitaka* (1911), 45 S.C.R. 302.

good faith, the granting of the deficiency judgement in these circumstances is contrary to another accepted principle. In *Haddington Island Quarry Co.* v. *Huson* the Privy Council held that as long as the power is exercised in good faith the court will not interfere even though the sale was made at a disadvantageous price, unless the price is so low as in itself to evidence a fraud.[20] Surely a sale of property valued by the foreclosing creditor at $46,000 for $100 evidences fraud or provides a valid reason for setting aside the sale. Why have creditors, selling under judicial supervision, failed to convince the courts that a deficiency judgement should be granted where the foreclosing creditor has purchased for 25¢ or $50, yet a sale for $100 under a power of sale is immune from challenge?[21]

In *Allender*, Mr. Justice Dickson concluded that the responsibility for ensuring that the debt is adequately covered by the amount bid in at the auction falls on the mortgagor and any other person liable on the covenant:

> [T]o go to limits in advertising beyond the requirement of the statutes would be tantamount, in the case of virtually all mortages to transferring to the mortgagee itself the responsibility for obtaining payment and to render nugatory the effect of any covenant for payment entered into by either a mortgagor or its guarantor.[22]

The simple response to this line of reasoning is that the creditor may sue on the covenant independently of the security extracted without negating the effect of the personal covenant. Alternatively, the creditor may elect to proceed against the security in which case the obligation is to adopt reasonable measures to ensure that the sale price is a proper one in the circumstances and not one which necessarily equals or exceeds the outstanding indebtedness. It is unrealistic to require that the debtor bid in at the auction where the exercise of the power stems from the inability to pay on the covenant. If, on the other hand, it is assumed that the debtor may bid solely for the purpose of preventing a sale at an undervalue, what is to happen when sale prices are distorted by intermeddling debtors whose perceptions of market value may well ensure that any auction sale is aborted? Given the present odds of seeing a proper price realized, the debtor would indeed be justified in augmenting the chaotic nature of an already anarchical process.

Without question, in many instances subsequent encumbrancers will attend a sale in order to protect their interests. However, most are financiers and are very familiar with the deficient sale practices and thus better able to ensure that the foreclosing creditor's conduct does not adversely affect them. It must also be admitted that certain guarantors possess both the acumen and financial resources to counter a defective foreclosure process. But can we assume that all guarantors have sufficient assets either to extinguish the entire debt or to purchase the property for a realistic price? One can reasonably assume that most creditors would not be prepared to sell to anyone but themselves for

[20](1911), [1911] A.C. 722 (P.C.).

[21]*Canada Permanent Mortgage Corporation* v. *Jesse* (1909), 11 W.L.R. 295 (Sask. Q.B.); *Briand* v. *Carver* (1967), 66 D.L.R. (2d) 169 (N.S.S.C.T.D.).

[22]*Supra*, note 14 at 154.

$100.[23] If the foreclosing creditor elects to realize on its security rather than first suing on the guarantee, then the guarantor should also be able to bid in for the purpose of preventing a sale at an undervalue and without incurring further liability if that bid is accepted.

The argument that the onus of ensuring a reasonable sale price should rest with all parties other than the foreclosing creditor ignores the simple fact that it is he who has conduct and control of the sale. Moreover, the notion that the debtor is responsible for ensuring the reasonableness of the sale price may be inappropriate in circumstances such as those presented in *Allender*. The debtors were the original mortgagor and guarantor, the property having been sold subject to their mortgage to a third party who had, in turn, conveyed the equity of redemption to a fourth party who placed the mortgage in default. It might reasonably be presumed that notice of the exercise of the power of sale must be served on these individuals, but recently a New Brunswick trial court held that such parties are not entitled to notice even though they are liable for any deficiency which results.[24]

Despite its particular and limiting factual context, *Allender* has been applied by other trial courts to the extent that the auction price overrides the resale price when calculating the deficiency. In *Nova Scotia Savings & Loan Company* v. *Doucet* Mr. Justice Jones granted a deficiency judgment where the foreclosing creditor bought for $30,000 a property appraised at $49,000 but which had been resold for $39,000.[25] Prior to the *Allender* decision the same result was imposed by Mr. Justice Hoyt in *Nova Scotia Savings & Loan Company* v. *Buraglia*.[26] However, in that case the difference between the two sale prices was a mere $875.

The Abuse of a Remedial Option

While the problem of price adequacy in New Brunswick can be attributed in part to inappropriate sale practices, it is exacerbated by the right of the foreclosing creditor to purchase its security. Indeed, the creditor has little incentive to get the best price and is better off selling the property to himself at the lowest possible price. Before *Allender*, the solution adopted by Mr. Justice Angers in *MacKenzie* (deficiency calculated by reference to subsequent sale) obviated the need to categorize the exercise of the power of sale as an abuse of a remedial process. Nonetheless, a sale to the foreclosing creditor for a nominal sum and on which a deficiency judgement is to be determined cannot be viewed as a proper sale under any circumstances. Regardless of the manner in which one wishes to characterize the obligations of a secured creditor, such dispositions run contrary to fundamental equitable principles entrenched in the law.

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[23]No matter how reasonable the assumption, there are instances where foreclosing creditors have acted otherwise; see text, *infra*, note 40.

[24]*Caisse Populaire de Saint Jacques Limitée* v. *Belanger* (1986), 71 N.B.R. (2d) 382 (Q.B.); but see s.40 of the *Property Act*, R.S.N.B. 1973, c. P-19, and the editor's note to this case reported at (1986), 41 R.P.R. 216 at 218.

[25](1984), 54 N.B.R. (2d) 72 (Q.B.).

[26](1983), 47 N.B.R. (2d) 64 (Q.B.). His Lordship felt it unnecessary in the circumstances to reconcile *Rosebowl Holdings*, *supra*, note 13 and *Haley*, *supra*, note 5.

A close analysis of New Brunswick practice underscores the English courts' rejection of the notion that a creditor foreclosing by power of sale should be permitted to purchase lands taken as security.[27] Even where foreclosure was by judicial sale the English creditor, though permitted to purchase, was subject to certain safeguards invoked by the court of equity.[28] The most onerous requirement was the debtor consent to the creditor's purchase. Secondly, the court would set the reserve bid and finally, control of the sale would in all likelihood be given to another party. What safeguards should be accorded the debtor in New Brunswick? Would it be unreasonable to require foreclosing creditors to offer an amount approximating the fair market value of the land? The judgements in *Rosebowl* and *Allender* expressly reject such a requirement.[29] In contrast, that very safeguard is required in Nova Scotia's Rules of Court.[30] If a foreclosing creditor in Nova Scotia buys in at the auction for an amount less than the fair market value and a deficiency judgment is sought, the court is empowered to calculate that amount utilizing the fair market value. However, the prohibition against a creditor realizing a potential windfall is tempered by the creditor's right to postpone the application for a deficiency judgement until a sale in the open market can be effected.[31] Of course, that option resembles the solution imposed by Mr. Justice Angers in *MacKenzie*.

The disparate protections offered debtors in these two provinces requires explanation. In Nova Scotia the guiding principle is that the creditor is entitled to no more than the amount owing, particularly where the creditor is seeking a deficiency judgement. The possibility of the creditor being enriched at the expense of the debtor is diminished if the sale is to an independent third party. In New Brunswick the issue of unjustified enrichment remains unrecognized. This is the result of the mistaken notion that a "public" auction will of itself ensure the reasonableness of the sale price. The fact that the foreclosing creditor may be the sole bidder and the reasons for this are deemed irrelevant considerations.

For clarity, it must be said that the *Allender* decision does not stand alone as an example of the inequitable treatment of debtors. An earlier judgement of 1970, *Corporation d'Administration et de Placement Limitée* v. *Castonguay*, speaks to the injustices of $100 sales.[32] Though the issues of price adequacy and the standard of care required of a creditor did not strictly require consideration, the extent to which the exercise of the power of sale can be characterized as an abuse of a remedial option is underlined by this decision.[32] The debtor had given a first and second mortgage to one Simard securing

[27]See "Foreclosure by Power of Sale", *supra*, note 1 at 113.

[28]W.R. Fisher, Sir A. Underhill, *Fisher & Lightwood's Law of Mortgage*, 9th ed. by E.L.G. Tyler (London: Butterworths, 1977) at 370; R.L. Ramsbotham, ed., *Coates Treatise on the Law of Mortgages*, vol. 2, 9th ed. (London: Sweet and Maxwell, 1927) at 1074.

[29]See *Rosebowl Holdings*, *supra*, note 13 at 319 and *Allender*, *supra*, note 14 at 154.

[30]Rule 47.10 (2)(a), Nova Scotia Civil Procedure Rules.

[31]Rule 47.10 (2)(b) and 47.10 (3), Nova Scotia Civil Procedure Rules.

[32](1970), 3 N.B.R. (2d) 624 (S.C.A.D.).

$12,000 and $6,000 respectively. Eventually a third mortgage with a principal amount of $12,000 was granted to the corporation of which Simard was president. The second mortgage was later assigned to the plaintiff corporation. Default occurred on Simard's first mortgage and the property was sold under a power of sale to the corporation for $100. The debtor's financial problems did not end there. The unsecured creditors obtained judgement against him for $3,465 requiring the sale of his personal property. The successful purchaser was the corporation which obtained title to the chattels for $3,500. Litigation arose when the corporation sought to share the proceeds of that sale with the other unsecured creditors on the basis that under the relevant legislation it was a creditor of the debtor for all money secured by the second and third mortgages.

The Appeal Court concurred with the corporation's arguments, allowing it to receive $2,900 of the $3,500 which it had paid for the chattels. As a consequence, the foreclosing creditor obtained both the real and personal property of the debtor for $700. Also a deficiency of over $15,800 remained on the second and third mortgages in addition to the $11,900 that might have been sought on the first. With respect to the sale of the real property for $100 the Court stated:

> While it would appear both unfortunate and inequitable that the debtors should lose their property to the [corporation] and remain liable to repay the second and third mortgages they did not contest their liability in these proceedings and the only issue raised by the judgement creditor must be resolved in favour of the [corporation].[33]

While the Court of Appeal was limited to the issue posed, the fact that the sale of the real property went unchallenged reveals a further dimension to the problem. How is a debtor to question the conduct of a sale when unable to honour monthly financial obligations?

Solicitor's Liability

The reluctance of the judiciary and bar of New Brunswick to accept that forced sale practices constitute negligence *per se* is understandable. Such an admission would open the floodgates to potentially successful challenges to past and present foreclosure sales. The accepted and standardized sale practices, when compared with the expected standard of care in the common law and also in other forced sale situations, would almost always render the foreclosing creditor liable for monies which should have been received. Depending on the extent to which the solicitor for the foreclosing creditor has either control of the sale or advises the creditor in that regard, it is only logical that the creditor seek indemnification or contribution from the lawyer. Solicitors denying liability on the basis of standard practice or custom must be aware of two adverse arguments. First, such a defence is only *prima facie* evidence that the defendant acted reasonably. Secondly, the custom itself must be reasonable at law.[34] The folly of seeking refuge behind accepted practice is revealed in recent

[33] *Ibid.* at 626.

[34] See generally J.G. Fleming, *Law of Torts* (Sydney: Law Book, 1983) at 113-14; *Jones* v. *River East School Div. No. 9* (1975), 64 D.L.R. (3d) 338 (Man. C.A.). See also *Cec. MacManus Realty Ltd.* v. *Bray* (1970), 14 D.L.R. (3d) 564 at 568 (N.B.S.C.A.D.), Hughes J.A.

cases holding a purchaser's solicitor negligent for having accepted an undertaking from the vendor's counterpart to discharge encumbrances out of the sale proceeds.[35]

The basis of the solicitor's liability would rest not so much on a failure to adhere to the proper standard of care, but rather on the failure to inform the foreclosing creditor of the conflicting decisions with respect to the standard of care to be followed. Surely the creditor should be informed of the divergent judicial opinions and of the right to elect and to pursue a private sale through the efforts of a real estate broker as is done in the case of voluntary sales. Admittedly, the issue of solicitor responsibility is one step removed from the task of determining whether or not the more onerous standard of care will prevail in New Brunswick. But even if it should not, the potential liability of solicitors acting for these secured creditors and in regard to other sale procedures cannot be ignored.

It must be admitted that as long as present sale practices remain intact and the foreclosing creditor is permitted to buy in at its own auction, foreclosure by power of sale in New Brunswick is a charade. All the formalities of an independent sale are adhered to, however the foreclosing creditor generally negotiates with no one but himself as to what price will be paid for the debtor's property. Unfortunately, on two occasions either the foreclosing creditor or its solicitor failed to appreciate that sales for nominal amounts are only "commercially" acceptable if the foreclosing creditor is the successful bidder. The first example of the omission surfaced after the "Riviera Motel" in Caraquet was sold by the foreclosing creditor, a first mortgagee, to the second mortgagee for $200. This puisne creditor then sold the property a day later for $75,200; whereby the resale price equalled the amount due on the second mortgage, plus $200. This particular forced sale attracted notoriety Canada-wide when the federal Auditor-General reported that the Department of Regional Economic Expansion had honoured loan guarantees for $315,000 following the $200 sale.[36] A "trial by media" ensued with allegations of negligence being swapped by Ottawa and the foreclosing creditor. An out of court settlement provided for the repayment of $186,000 by the creditor.[37] Canadian taxpayers were required to contribute $129,000.

While one might have hoped that the sale of the Riviera Motel was an anomalous forced sale, devoid of rational analysis, there exists a comparable sale. A cedar shingle mill in McAdam, New Brunswick, valued at 1.3 million dollars sold for the paltry sum of $5,000.[38] The mill which had been in operation for two years prior to the time of the sale, opened with the help of a $450,000 provincial government loan guarantee and federal government grants totalling $550,000. Notwithstanding the fact that the *Allender* decision

[35]See *Polischuk* v. *Hagarty* (1984), 14 D.L.R. (4th) 446 (Ont. C.A.), revg. 149 D.L.R. (3d) 65 (Ont. H.C.) and *Edward Wong Finance Co.* v. *Johnson* (1983), [1984] 2 W.L.R. 1 (P.C.).

[36]"Ottawa Plans Suit Over Sale of Motel" [Toronto] *Globe and Mail* (1 June 1984) 9.

[37]"Taxpayers Lose $129,000 in N.B. Motel Incident" [Saint John] *Telegraph-Journal* (1 September 1984) 5.

[38]L. Billings, "Purchase of Mill Gives McAdam Renewed Hope" [Fredericton] *Daily Gleaner* (12 September 1984) 3.

legitimizes both these sales, it would be unrealistic to assume that a creditor relying on its solicitor would not have a sound cause of action against counsel for permitting such sales. It is one thing for a foreclosing creditor to purchase for a nominal amount, and quite another to permit the property to be sacrificed to a third party at everyone's expense.

Regardless of the rationalizations which might be offered with respect to the sale price in these two examples, one would normally expect the foreclosing creditor to bid up the sale price in order to avoid a windfall accruing to a third party. Obviously the creditor must predetermine the maximum amount which he is willing to offer. However, the determination does not necessarily require that the sale be publicized as subject to a reserve bid. Such a requirement is now imposed at law. In *Bank of Nova Scotia* v. *Beck*, the Court of Appeal admonished the creditor for failing to set a reserve bid.[39] Of course, the imposition of that safeguard further weakens the authority of *Allender*. Moreover, one can reasonably presume that no creditor would set a reserve bid of $100, nor would a solicitor recommend that such a meagre amount be set.

The failure of the creditor's solicitor to advise of the practical necessity of adopting such a precaution has required judicial resolution. In *Glennie* v. *Canadian Imperial Bank of Commerce* a solicitor was instructed by the defendant, a foreclosing creditor, to bid up to $50,000 on its behalf.[40] Through inadvertance, the solicitor failed to respond to the sole bid of $25,000 made by the plaintiff who was successful in obtaining a decree of specific performance. In the circumstances and despite the confusion which surrounded the auction sale, the court was not prepared to declare it a nullity. Yet the facts surrounding the litigation in *Glennie* are not unique in Canadian mortgage law. For example, in the Nova Scotia case of *Atlantic Trust Company* v. *H. & E. General Stores Ltd.* the solicitor for the foreclosing creditor was unable to attend the auction when his automobile broke down.[41] Consequently, property worth $19,000 was purchased by the second mortgagee for $1,000. Unlike the result achieved in *Glennie*, the creditor's application to have the sale set aside, was granted.

Where a reserve bid is to be set, there remains the difficulty of determining the minimum acceptable offer. Undoubtedly the creditor will not be willing to sacrifice his interest in the property and will be perhaps more inclined to look for an amount which equals the indebtedness. Should the creditor purchase for this amount and should the property have an equivalent or greater fair market value, then the creditor is not only fully protected but is also enriched. If the property is worth less than the indebtedness and the amount owing is bid, then the creditor must be taken to have voluntarily abandoned the right to seek a deficiency judgement. However, the *potential folly* of a foreclosing creditor (and its solicitor) who purchases for the indebtedness and who approaches a foreclosure sale differently than one in the open market is

[39] *Supra*, note 11.

[40] (1979), 25 N.B.R. (2d) 227 (S.C.T.D.).

[41] (1978), 3 R.P.R. 176 (N.S.S.C.T.D.).

revealed in *Canada Permanent Trust Company* v. *Letcher*.[42] The plaintiff's solicitor (one of the defendants) failed to have a co-owner execute a first mortgage on two properties. Subsequently both co-owners gave a second and a third mortgage on the properties to the defendants. Default occurred on the plaintiff's first mortgage and the property was sold under the power of sale to them for the amount of the indebtedness. After the sale the plaintiffs realized that they had not obtained the fee simple to the properties but rather only a one-half undivided interest. The other half was subject to what now became the first and second mortgages of the defendant mortgagees. The resulting action proceeded on the basis that the subsequent mortgagees took subject to the plaintiff's equitable right to have the other co-owner execute a first mortgage in its favour. That is, the subsequent mortgagees took subject to a prior equitable mortgage of which they had notice. With regard to this aspect of the case the plaintiff was unsuccessful and accordingly the solicitor was held responsible for the loss sustained.

But did the plaintiff in fact suffer a loss? As a mortgagee it obtained what was owing to it on the first mortgage, and thus suffered no loss traceable to the defendant solicitor. As a purchaser the plaintiff must accept responsibility for the amount which it bid. Surely, all purchasers should search the title to the property before closing the transaction. If we are to perpetuate the validity of incestuous auction sales, then liability for miscues should not lie necessarily on the defendant solicitor. That dubious honour should fall on the solicitor who acted for the plaintiff on the exercise of the power of sale. The omission to undertake a search of title prior to the auction, with the result that the plaintiff bid more than the fair market value, is one for which the defendant solicitor in this case could not have been held liable. However, the foregoing analysis is not to be regarded as a denial of the responsibility and liability for non-feasance by the defendant solicitor. Rather it serves to point out that a foreclosure system which permits the creditor to purchase its own security is fundamentally flawed and leads to incongruous results when applied strictly.

As noted above it will be necessary for the solicitor of the foreclosing creditor to undertake a proper search of title prior to the auction in the event that the creditor wishes to bid. Such advice may seem misguided as the solicitor may have already acted on the original mortgage transaction. Accordingly, all that is needed is a sub-search for the purpose of determining those who are to be served with notice of the pending action. This qualification would be appropriate provided that in the original transaction each party had retained their own solicitor. However, as it is customary in this province for the solicitor to represent both parties, particularly in the purchase and sale of residential housing, it is contrary to ethical standards for a solicitor to act for the mortgagee when foreclosing against the mortgagor.[43] For those who might

[42](1981), 35 N.B.R. (2d) 630 (C.A.).

[43]See The Canadian Bar Association, *Code of Professional Conduct* (Ottawa: Canadian Bar Association, 1975), at 19 and *Banque Provincial* v. *Adjutor Levesque Roofing* (1968), 68 D.L.R. (2d) 340 at 345 (N.B.S.C.A.D.), Limerick J.A. "The solicitor acting for the defendant...drew the mortgage and advised the said defendant on the effect thereof. Later the same solicitor acting for the mortgagee bank brought action against his former client based on a claim arising out of and related to that mortgage. Solicitors should not so conduct themselves even with the knowledge and consent of all parties". See also *Flynn Development Ltd.* v. *Central Trust Co.* (1985), 51 O.R. (2d) 57 (H.C.).

feel that this conflict of interest rule ignores the realities of the legal market place, readers are reminded that lawyers should not act as "hired guns" willing to sell their services to the highest bidder.

Should a solicitor breach this fiduciary obligation relating to conflict of interests, the debtor-client might properly consider suit. Notwithstanding the fact that a foreclosing creditor might be insulated from liability as in *Allender*, the debtor may seek to establish an independent claim against the solicitor for breach of fiduciary duty. Liability would not stem from a failure to abide by prevailing standards of care but rather the failure to protect the legitimate interests of the debtor as would any solicitor retained by a debtor faced with a foreclosure sale.

An Appropriate Solution

The need for reform in this area of the law has engaged the attention of practitioners and academics. In 1981 the Rules Revision Committee considered the possibility of resurrecting judicial foreclosure proceedings to offset the "little" protection afforded mortgagors, but concluded that any imbalance could best be remedied by amending the relevant provisions of the *Property Act*.[44] At about the same time the New Brunswick Branch of the Canadian Bar Association presented a report to the Minister of Justice on the state of mortgage law in this jurisdiction.[45] Therein the need for reform was stressed, but to date the government has not responded to the recommendations of either group.

History reveals that other provincial legislatures have not ignored flagrant abuses of remedial foreclosure options. During the Depression both Saskatchewan and Alberta abolished actions on the covenant.[46] The devaluation of properties or the absence of a market by which market values could be determined, coupled with the right of the foreclosing creditor to purchase its security and pursue unrealistic deficiency judgements were deemed sufficient reasons to invoke this reactionary measure. More recently, the British Columbia legislature reacted to chattel mortgagees who were abusing the power of sale. That is, on default, these creditors entered into "sweetheart deals" in which they would repossess goods, sell them to an associate or affiliate for an unrealistically low price and then sue the debtor for the deficiency.[47] The legitimacy of such sales was rationalized on the basis that the foreclosing creditor was under no obligation to act in a commercially reasonable manner. (Of course, the same result can be achieved in New Brunswick without creating the illusion of a genuine sale.) The British Columbia legislature implemented

[44]Barrister's Society of New Brunswick, *Civil Procedure Rules Revision Committee Final Report May, 1981* (Fredericton: Barrister's Society of New Brunswick, 1981) at 39.

[45]J.T. Robertson, "Report on Mortgagee's Remedies" (Fredericton: Canadian Bar Association, New Brunswick Branch, Real Property Subsection, 1980).

[46]The legislation was amended in the 1960's such that corporate mortgagors could not claim the benefit of the legislation; see *Law of Property Act*, R.S.A. 1980, c. L-8, s.41(1) and the *Limitation of Civil Rights Act*, R.S.S. 1978, c. L-16, s. 2(1).

[47]British Columbia Law Reform Commission, *Report on Debtor Creditor Relationships, Project No. 2* (Victoria: Queen's Printer, 1975) at 142.

the recommendation of its Law Reform Commission that the creditor be restricted to suing either for the debt owing or to realizing on the collateral, but not both.[48]

Without doubt the need for legislative interference was justified and the same holds true in New Brunswick. However, the writer does not embrace the solutions imposed in any of the western provinces. Indeed those solutions have served only to generate other legal issues some of which have been resolved by the courts but with seeming inconsistency.[49] Moreover, it is clear that the legislation in certain instances exceeded its proclaimed goal; debtors are being unjustly enriched at the expense of their creditors. It is simple enough to advocate that the immediate legislative solution for New Brunswick would involve the abolition of the right of the foreclosing creditor to purchase for his own benefit and the imposition of a more onerous standard of care. However, if the government refuses to respond then the onus will fall on the Court of Appeal to determine the nature and scope of the creditors obligations, but only if and when this issue is presented for consideration. While that possibility may be the sole means of redressing the particular inequities described above, it would be preferable that mortgage laws be reevaluated generally.

To that end, legislative reform should seek to provide secured creditors with an efficient and effective process for liquidating debts while at the same time providing adequate protection to all interested parties, including the debtor. Such legislation should seek to effect a process which ensures the adequacy of sale prices and insulates the creditor from liability. The appropriate solution may well require the preservation of elements of the power of sale and the resurrection of certain aspects of the judicial sale, such as court confirmation of sale proceedings and price. Such a liquidation process could eliminate the debtors concern over the adequacy of the sale price and the creditor's fear that someone will allege that the matter was not properly handled. Until the need for reform is recognized we are left with an over-abundance of conflicting opinions and a foreclosure process which seems oppressive at the very least.

Conclusion

Notwithstanding the lack of judicial or legislative protection afforded this species of debtor, it would be inappropriate to characterize the New Brunswick market place as a haven for unrelenting creditors preying on the misfortunes of the indigent. Indeed, it is likely that in cases where the pursuit of a deficiency judgement is deemed practical, the creditor will delay until a resale has been effected on which the deficiency may be calculated. But even if the creditor is prepared to calculate the deficiency according to the resale price, there is still no assurance that it will be reasonable in the circumstances. At the same time,

[48]See *Chattel Mortgage Act*, R.S.B.C. 1979, c. 48, ss 23, 25.

[49]For example in British Columbia a seizure of the chattels operates to extinguish the debt and yet the creditor may have taken security on other assets. The effect of the legislation is to prevent the creditor from realizing on the latter: *Continental Bank of Canada* v. *Hildebrandt* (1985), 64 B.C.L.R. 367 (S.C.); but see *Dewar* v. *Bank of Montreal* (1984), 59 B.C.L.R. 167 (C.A.) where the creditor had secured the loan by taking a chattel mortgage on two vehicles respectively and where the court held that the act of seizing one did not eliminate the right to seize the other.

foreclosure by power of sale provides a trap for unwary creditors and those unable to appreciate the illogical nature of the rules governing this game. Ultimately, it must be recognized that the potential for abuse in the exercise of the power of sale is omnipresent and is not merely a matter of academic speculation. There is no doubt that New Brunswick law is uniquely distant from the mainstream of Canadian jurisprudence.

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