<u>SUPREME COURT OF NOVA SCOTIA</u>
Citation: *Canadian Imperial Bank of Commerce* v. *Hurlburt*, 2008 NSSC 408

Date: 20081218
Docket: Ken No. 273779
Registry: Kentville

Between:

Canadian Imperial Bank of Commerce

Plaintiff

v.

Janet Marie Hurlburt

Defendant

Judge:	The Honourable Justice Gregory M. Warner
Heard and oral decision:	December 18, 2008 in Kentville, Nova Scotia
Written Decision:	February 10, 2009
Counsel:	Oliver Janson, Counsel for the Applicant (Defendant) Andrew N. Montgomery, Counsel for the Respondent (Plaintiff)

By the Court:

A. Summary

[1] Does section 42 of the **Judicature Act**, the "second chance" rule, apply to foreclosure actions where the bank makes demand for repayment of a revolving personal line of credit, expressly stated to be repayable on demand, secured by a collateral mortgage?

[2] Subsection 42(2), (3) and (4) read:

> **Discontinuance of foreclosure proceeding**
>
> 42 (1) In this Section, "mortgagor" means the original mortgagor to a mortgage document and includes any person deriving title through him.
>
> (2) A mortgagor, who is in default of a mortgage
>
> a) either
> i) in failing to make a payment of principal or interest or a payment otherwise due under a mortgage, or
> ii) in failing to observe a covenant or term of the mortgage; and
>
> b) if, as a result of the default referred to in either subclause (i) or (ii) of clause (a) or both, the whole of the balance of the outstanding principal and interest secured by the mortgage has become due and payable, may before the granting of an order for foreclosure or foreclosure and sale make an application to the Supreme Court to have any proceedings commenced by the mortgagee for the order for foreclosure or foreclosure and sale discontinued.
>
> (3) The Supreme Court may grant an order of discontinuance conditional upon
>
> a) the payment of all arrears of principal and interest and any other payments due under the mortgage;
>
> b) the performance of the covenant in default;
>
> c) the payment of any costs and expenses incurred by the mortgagee and allowed by the Supreme Court; and
>
> d) the performance of the conditions of the order within such time as the Supreme Court may allow.
>
> (4) The Supreme Court may not grant more than one order pursuant to this Section in respect of the same mortgage.

[3] It effectively permits a mortgagor, who is in default under a mortgage (or loan agreement secured by a mortgage), resulting in acceleration of payment of the mortgage balance, to apply for discontinuance of the foreclosure action once during the life of the mortgage. Discontinuance is

conditional on payment of all arrears then due, the mortgagee's foreclosure costs, and, if applicable, the performance of any covenant in default, within the time ordered.

[4] By oral decision on hearing the application on December 18, 2008, I dismissed the application. The respondent bank has requested written reason.

B. Agreed Statement of Facts

[5] On or about July 22, 1998, the customer entered into an agreement with the bank for a personal line of credit ("PLC") in the amount of $45,000.

[6] The PLC was secured by a collateral mortgage on the customer's property.

[7] Under the terms of the PLC agreement, and the mortgage, the PLC was payable on demand.

[8] The customer made a payment on the PLC in November 2005 that was not credit to her PLC until March 2006.

[9] Between November 2005 and March 2006, when the November 2005 payment was credited by the bank to the PLC, the customer had the opportunity to, but chose not to, make any further monthly payments.

[10] On April 6, 2006, the bank made written demand on the customer pursuant to the terms of the PLC and the mortgage for payment in full of the principal and accrued interest on the PLC.

[11] The customer did not respond to the bank's demand for payment in full.

[12] In November 2006 the bank commenced a foreclosure action.

[13] The PLC agreement, collateral mortgage, and bank's April 6th letter of demand are attached to the Agreed Statement of Facts.

[14] The applicant's affidavit further declares that the applicant (customer) attempted to pay the arrears of interest after the November 2005 payment was properly credited but the bank refused anything less than repayment in full.

C. Terms of the PLC Agreement and Collateral Mortgage

[15] The PLC is a revolving line of credit entitling the customer to draw on her available credit at any time. Interest on the daily balance was calculated monthly.

[16] The customer agreed to pay the Indebtedness to the bank on demand. Until demand, the customer agreed to pay on the payment due date shown on the monthly statement a payment at least equals to the interest and any insurance premiums shown on the statement. The Indebtedness was defined as including any payment due under the agreement, including the months of credit drawn, interest, insurance and service charges.

[17] The bank sent the customer a monthly statement showing the transactions, credit limit, interest charges, service charges (if any), insurance premiums (if any) and summary of payments made, together with the minimum payment required to be paid and the date that payment was due.

[18] The collateral mortgage was in the principal amount of $45,000. It was expressly stated to be continuing collateral security for any Indebtedness owed by the customer to the bank.

[19] Paragraph 3 "Payment on Demand" reads:

> You will pay us the Indebtedness on demand. If, however, one or more of your obligations to us is a term obligation, we will not make demand unless an Event of Default has occurred, in all or any part of the Indebtedness.

[20] Paragraph 15 "Default" reads:

> In addition to our rights (whether under this Mortgage or otherwise), and without affecting our right to make demand in any other circumstance, we will not demand payment under section 3 unless one of the following events occurs:
> a) you do not pay when due any of the Indebtedness or any other amount payable (whether under a promissory note, loan agreement, guarantee or other agreement) to us;
> b) you do not observe or perform any provision or obligation contained in this Mortgage or in any other document (including a promissory note, loan agreement and guarantee) now or later entered into with us;
> (subsections c, d, e, f, g, h and i are not relevant to this application)

[21] Paragraph 16 "Remedies on Default" reads in part:

> If any Event of Default occurs, we may (but do not have to) enforce one or more of the following remedies . . .
> a) sue you for all or part of the Indebtedness;
> b) go to court to foreclose your interest in the Property, to take possession of it and/or to sell, lease or otherwise deal with it; . . .

D. Section 42 in the Context of Foreclosure Actions

[22] Foreclosure practice in Nova Scotia, and its evolution, is properly summarized in the **Discussion Paper** on "Mortgage Foreclosure and Sale", dated July 1997, and the **Final Report**, dated September 1998, of the Law Reform Commission of Nova Scotia.

[23] In the **Final Report**, "Overview" (p. 5):

A "mortgage" is taken out by individuals or businesses who wish to buy a home or commercial property and need extra money to help pay the purchase price. . . .

The borrower and lender enter into a legal agreement known as a "mortgage". In exchange for the lender providing money to the borrower to buy the property, the borrower pledges the property as security for the loan. The borrower is therefore said to "give" a mortgage. The property is thus transferred to the lender and the lender has "legal title" to the property. The borrower is left with the "equitable title" to the property, known as the "equity of redemption". This means that the borrower has the right, on paying the full amount of the loan, to claim back the property from the lender. This known as the borrower's "right to redeem". If the borrower pays off the loan and redeems the property, the mortgage becomes null and void. . . .

If, however, the borrower does not make the payments under the mortgage or defaults in some other way, the lender may "foreclose" on the property. This means that the borrower's right to redeem is extinguished or foreclosed. In foreclosing, the lender takes steps to obtain ownership of the property. In Nova Scotia, the lender also gets the right to sell the property and use the sale proceeds to pay off the mortgage. This is known as "foreclosure and sale". . . .

In Nova Scotia, there is no specific act or statute dealing with mortgages or foreclosures. . . . Instead, it is governed largely by the Nova Scotia Civil Procedure Rules. . . . In addition, much of the law in Nova Scotia regarding foreclosures is "judge made" or common law.

[24] The history of foreclosure practice is described in the **Discussion Paper**, pp. 4 to 17:

Historically, both the common law and equity have been applied to foreclosure. The two systems, however, viewed a mortgage differently. Under the common law, the borrower's obligations were viewed very seriously. A borrower who did not make payments by the date indicated in the mortgage would lose the property. Once payments were late, the borrower would not be able to regain title by paying the amount outstanding on the mortgage. The lender would retain title and become absolute owner of the property. As a result, the borrower would lose any value built up in the property. This was seen as a rather harsh result.

Equity provided a more just solution. Equity viewed a mortgage as a security agreement to which the conveyance of legal title was secondary. The lender's principal claim related to the payment of the debt. As a result, equity imposed restrictions on the lender's right to seize title to the property once the borrower failed to make payments. If the borrower could show the loan would be repaid within a reasonable period of time, the borrower was given another chance. By making the payments owing, the borrower regained title to the property even though the time set out in the mortgage for making payment had passed. . . .

Once it became standard practice for borrowers to have extra time to redeem, it was necessary for lenders to have a remedy in case the borrower was unable to pay the outstanding amounts even with the benefit of extra time. This was called *foreclosure*. It resulted in the borrower's right to redeem being forever erased, or foreclosed, once certain conditions were met. Upon default, a borrower could file a bill of foreclosure in the equitable court. The court would then set a final date for payment, usually six months from the date of the order. This would be contained in an order known as a decree *nisi*, a kind of conditional judgment. If payment was not made by the date set by the court, the lender could apply for a final order known as a decree *absolute* of foreclosure. After this point, equity would not intervene again to assist the borrower. . . .

> In England initially, foreclosure existed on its own, without any provision for a sale of the property. If the borrower failed to make the payments by the date set by the court, the lender simply foreclosed and became the full owner of the property. . . .
>
> In 1852 the *Chancery Procedure Act* was enacted. It introduced the concept of a sale to foreclosure proceedings in that it gave the English Court of Chancery the authority to order sale of the property. The law still did not, however, permit the lender to bid at an auction or acquire the property through an intermediary.
>
> The Irish system involved both foreclosure *and* sale. When the borrower defaulted, the Irish court would issue an order *nisi* (again, a kind of conditional judgment) for sale and foreclosure. If the borrower did not pay the amount owing by the date set, the court would order the property to be sold by public auction by the Sheriff. As in England after 1852, the lender was not permitted to bid at the auction or acquire the property through an intermediary. Unlike in England, the lender could, without reopening the foreclosure, sue for any balance owing on the mortgage. . . .
>
> After the founding of Halifax in 1749, the English approach to foreclosure was followed. Orders were granted for foreclosure only. Almost 30 years later, however, the court began to grant orders of foreclosure and sale, consistent with the Irish practice. There is no indication as to why the process changed. . . .
>
> Nova Scotia practice began to diverge from both the English and Irish systems in the late 1700s when lenders were permitted to acquire the property at Sheriff's sale. Again, it appears no law was passed authorizing this practice. . . . It was not until almost a century later that the courts commented on the practice of the lender bidding at the Sheriff's sale. . . . In response, the government passed legislation declaring it legal for the lender to purchase the property at the Sheriff's sale. . . .
>
> There are various pieces of legislation in Nova Scotia relevant to foreclosure and sale and mortgage transactions. One of the most significant is the **Judicature Act**. Section 42 permits a borrower who defaults to make an application to the court to discontinue proceedings commenced by the lender. Standard mortgage documents permit a lender to require that a borrower pay the full amount owing under the mortgage, even if only one payment is missed. Section 42 permits the mortgage to be reinstated. This reflects the "second chance" given by the law of equity to a borrower who missed payments but could make them up within a reasonable period of time. Under Section 42, the court may grant an Order of Discontinuance conditional upon the borrower paying all arrears and performing the covenants in default. The court also has authority to order the borrower to pay any costs and expenses incurred by the lender. Subsection (4) allows the court to grant only one Order of Discontinuance for each mortgage. Presumably this is to deal with repeat defaulters and the potential for abuse by borrowers.

[25] That is the context in which the "second chance" rule was legislated by its insertion as s. 38A of the Judicature Act (S.N.S. 1978-79, chapter 2), renumbered as s. 42 in the Revised Statutes of Nova Scotia, 1989.

E. Section 42 Case Law

[26] There is little case law in Nova Scotia respecting s. 42.

[27] One decision is **Credit Foncier Franco-Canadien** v. **Fort Massey Realties Ltd**., 1981 CarswellNS 260 (N.S.S.C.), upheld on appeal 1981 CarswellNS 241. Justice Glube (as she then was) declined to grant an Order of Discontinuance where the term of the mortgage was ended and the whole of the principal and interest was due. She stated:

> 80 It would normally be anticipated that the section would apply to a mortgagor in default of a mortgage which has an unexpired term. This seems to be the natural interpretation of the section based on sub-s.3 which allows the court to grant an order of discontinuance conditional on the payment of all arrears of principal and interest in default.
>
> 81 In the present case, I am unable to find that there are any arrears. What has occurred is that the 5-year mortgage has ended and the whole of the principal and interest was due. I am unable to order the plaintiff to enter negotiations to renew the mortgage under this [section]. The parties negotiated for a considerable period of time following September 1, 1979 and have been unable to reach agreement. Although several payments were accepted after the September 1 date, I find this has not created a new mortgage, nor continued the old mortgage. The parties were trying to reach agreement on a new mortgage, but were unsuccessful. I find that this section is not applicable in the present case.

[28] Similarly, in **CIBC Mortgage Corp.** v. **Jordan**, 2001 CarswellNS 63, Justice Davison declined to order discontinuance in respect of a mortgage in which the payments were substantially in arrears, and which mortgage had matured and not been renewed. Citing Justice Glube in **Credit Foncier** Justice Davison stated:

> 7 I agree with that reasoning. The mortgage and the renewals of the mortgage are ended. All of the balance of principal and interest is outstanding. Even if the mortgagor was not in default, the mortgagee has the right to seek and obtain the full amount owed under the mortgage.
>
> 8 I would note that even if the mortgage had not matured, no relief could be advanced under s. 42 until all arrears of principal and interest and any other payments due under the mortgage had been paid pursuant to s. 42(3)(a). There has been no payment and there is only a promise to pay, sometime during the month of March, 2001.
>
> 9 Section 42 has been referred to as a "second chance" section. Because the mortgagee can apply for foreclosure when the mortgagor defaults in a payment and, under a standard form of mortgage, require the mortgagor to pay the full amount owing under the mortgage, this section permits reinstatement of the mortgage. As stated by the Law Reform Commission in its report on mortgage foreclosure and sale:
>
> > This reflects the second chance given by the law of equity to a borrower who missed payment but could make them up within a reasonable time.
>
> 10 In my opinion, the court is not able to give a discontinuance of the foreclosure proceeding because:
>
> (1) Section 42 is not applicable to a mortgage whose terms have ended;
> (2) There has been no payment of arrears;
> (3) The legislature did not intend that section should apply to the factors in this present proceeding.

F. Analysis

[29] In this historical context, I conclude that the purpose of s. 42 of the **Judicature Act** is to mitigate against unfairness in foreclosure actions of term mortgages (or loan agreements secured by mortgages) where the consequence to the mortgagors (specifically the loss of the equity of redemption) from a default is disproportionately harsh, and the prejudice to the mortgagee is minimal. It is a tool of equity.

[30] The applicant submits that "the wording of [s. 42] is flexible enough to consider this new breed of mortgage which allows clients more flexibility in paying off their loans". Counsel further argues that a debt payable on demand is not similar to a mortgage that becomes due at the end of its term because the mortgage in this case (presumably the PLC agreement and collateral mortgage) has no due date. "If the bank were allowed to argue that the mortgage was due at the end of every month, then they would be able to demand the mortgage be paid in full regardless of whether the Mortgagor was abiding by the covenants of the mortgage."

[31] Counsel argues that the mortgagor's rights under the **Judicature Act** "should not be taken away simply because this is a collateral mortgage rather than a conventional type mortgage".

[32] Counsel's second submission is that the mortgagor was not in default. When the bank misapplied her November 2005 interest payment, she "was acting in a prudent manner by not making any other payments under the bank had the first payment credited properly".

[33] In oral argument, he expanded on this by submitting that as long as the customer paid the minimum payment (interest only) set out in the monthly PLC account statement, she was entitled to continuation of the use of the line of credit for so long as she wanted; that is, she was not in default so long as she paid the monthly minimum, and the PLC had no term.

[34] There is no merit to the second argument. This argument quite simply ignores the plain language of both the PLC agreement and collateral mortgage. The agreement and mortgage did not have a term, but were, in simple plain language, payable on demand. Nothing in either document suggests, or permits an inference, that the right claimed by counsel in oral argument - the customers' right to continued use of the Line of Credit so long as she paid the interest, is a possible interpretation of the Agreement or mortgage.

[35] The bank made demand on the customer for payment of the full Indebtedness on April 7, 2006. The customer did not pay. Seven months later, the bank commenced this foreclosure action.

[36] The mortgagor's first argument has some merit. Counsel's argument that the **Judicature Act** should be flexible enough to encompass revolving lines of credit secured by collateral mortgages is, in effect, a submission that s. 42 should be read remedially to give effect to the **Judicature Act** "according to its spirit, true intent and meaning" (s. 9(1) **Interpretation Act**).

[37] I agree that s. 42 should be read remedially to effect equity and fairness as between a mortgagor and mortgagee regardless of the form of the mortgage. It should not be limited to conventional mortgages. I acknowledge that the case law presented to the Court has been, to date, in the context of conventional term mortgages.

[38] Section 42 is, and should be interpreted as, an equitable remedy applicable to mitigate against harsh, unfair or unconscionable consequences to a mortgagor that do not prejudice a mortgagee. However, the court must be careful not to interfere with the plain meaning of the contract between the borrower and lender. Mortgages securing demand loans (such as this revolving line of credit) should not be "rewritten", in the name of equity, to alter the fundamental nature of demand loan agreements; they are payable on demand.

[39] The factual matrix in this case does not suggest harsh or unfair conduct by the mortgagee, or inequity to the mortgagor.

[40] It is unreasonable for the mortgagor in this case to expect entitlement to the continuation of the line of credit so long as she made the minimum interest payment on each monthly statement. Such is contrary to the PLC agreement and mortgage, both of which are written clearly and in plain language and provide for the Indebtedness to be paid on demand.

[41] Furthermore, it was not objectively reasonable to cease making the minimum monthly interest payments by reason of the misapplication of one payment.

[42] There is no evidence that the bank made the demand for repayment in full on April 7, 2006, for any improper purpose.

[43] The application is dismissed.

J.