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Ride the Coattails –Yahoo!

By Cliff Shaw

Cases Considered:

Toronto Dominion Bank v Letendre, 2012 ABQB 323 rev'g 2012 ABQB 369.

This was a competition for the surplus funds paid into court in a mortgage foreclosure action. The case examined policy and operational aspects of the two year limitation in section 3(1) of the *Limitations Act*, RSA 2000, c L-12 ("Act").

The issues were:
1. Can a subsequent encumbrancer who is not a defendant invoke the Act against a competing creditor?
2. Did the proviso "warrants bringing a proceeding" in section 3(1) (a) (iii) of the Act apply to the subsequent mortgagee?
3. Did the subsequent mortgagee have an "enforceable claim" against the surplus funds?

A subsidiary topic that caught my eye was the disposition of funds creating priority among writs of enforcement.

The first mortgagee Toronto Dominion Bank ("TD Bank") commenced this foreclosure action ("Foreclosure Action"). The second mortgagee Community Futures Lesser Slave Lake Region ("CFLS") never commenced a foreclosure action. A limitations argument was raised against CFLS by a subsequent writ holder Alberta Indian Investment Corporation ("AIIC").

The facts were undisputed. On November 1, 2007, the defendant Letendre defaulted in making payments on the loan from CFLS secured by a demand mortgage. CFLS never commenced an action to enforce its mortgage. On February 12, 2009 the TD Bank commenced the Foreclosure Action. The defendant Letendre never responded to the Foreclosure Action. On May 28, 2009 the TD Bank obtained an Order Nisi with a three month redemption period and a judicial listing at $255,000. In February 2010, the listing was extended. In June 2010, the listing price was reduced to $210,000. In August 2010, an Order Confirming Sale for $200,000 was granted. On November 5, 2010 the TD Bank mortgage was paid out from the sale proceeds and the surplus of $74,197.30 was paid into court. CFLS had notice of the proceedings in the Foreclosure Action and was present at some of these applications, including the application for the Order Nisi.

On May 26, 2011 CFLS brought this application for payment out of court seeking $57,410.83 plus interest and costs for the CFLS mortgage, payment of a realtor's commission under a prior caveat, and the balance to subsequent writ holders registered against title to the mortgaged lands on a pro rata basis. The application was opposed primarily by AIIC on the basis that CFLS was statute-barred and did not have an enforceable claim when the CFLS mortgage was removed

from the title by the Order Confirming Sale. AIIC argued that CFLS should have commenced an action to establish its claim before November 1, 2009 (within two years of the defendant Letendre defaulting on the CFLS mortgage). CFLS argued only a defendant can invoke the Act and that a proceeding by CFLS was not "warranted" under section 3(1) (a) (iii) of the Act.

Section 3(1) reads:

> 3(1) Subject to section 11, if a claimant does not seek a remedial order within
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> (a) 2 years after the date on which the claimant first knew, or in the circumstances ought to have known,
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> (i) that the injury for which the claimant seeks a remedial order had occurred,
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> (ii) that the injury was attributable to conduct of the defendant, and
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> (iii) that the injury, assuming liability on the part of the defendant, warrants bringing a proceeding,
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> or
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> (b) 10 years after the claims arose,
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> whichever period expires first, the defendant, on pleading this Act as a defence, is entitled to immunity from liability in respect of the claim.

Master W. S. Schlosser held that CFLS was statute-barred by section 3(1) (a) of the Act from having an enforceable claim against the surplus funds in court. He concluded (at para 12) it was necessary to consider a relevant limitation period to determine if a competing creditor has an "enforceable claim." This includes where the limitation period is raised by another competing creditor and not the defendant debtor. Master Schlosser expressed concern (at para 13) that if it were otherwise it would permit the courts to enforce an unenforceable claim.

CFLS also argued before Master Schlosser that commencing a proceeding was not "warranted" until the Foreclosure Action was well advanced and it was determined there would be a surplus. Be careful what you wish for CFLS. Master Schlosser applied (at paras 22 and 23) the facts of this case to "warrants bringing a proceeding" in section 3(1) (a) (iii). He pointed out the Order Nisi was granted five months before the two year limitation expired for CFLS to commence an action. Based on the judicial listing at $255,000 CFLS would have known at that time there would be a surplus available in the Foreclosure Action to payout the CFLS Mortgage. CFLS should have protected its position by commencing an action. Master Schlosser acknowledged (at para 24) it would be pointless for a subsequent mortgagee to commence an action where there is little or no equity in the property after paying a prior creditor.

Master Schlosser's conclusion on "warrants bringing a proceeding" raised several questions and thoughts in my mind. We know real estate values can fluctuate rapidly in Alberta. The shelf life of a real estate appraisal prepared for a foreclosure action is limited. The initial listing price in this case was reduced by $45,000 (approximately 17%) and the property eventually sold for an amount about 20% below the initial listing price in the Order Nisi. When will a subsequent

mortgagee know for sure there will be surplus proceeds? What if the order nisi (now called "redemption order") in protracted litigation is granted after the subsequent mortgagee's own two year limitation has expired? Wouldn't it be best practice for a subsequent mortgagee to have commenced an action within its own two year limitation period?

The Master's dismissal of the CFLS application was reversed by Justice Don J. Manderscheid.

Concerning standards of review, Justice Manderscheid (at paras 15-20) determined the standard of review on the appeal was the appellate standard of correctness where an error of law is alleged.

On the issue of who can rely on the Act, Justice Manderscheid concluded (at para 47) that only a defendant against whom a remedial order is sought can plead the Act as a defence. AIIC was not a defendant. In analyzing this issue, Justice Manderscheid noted (at para 36) the law and practice in Alberta of generally not naming subsequent encumbrancers as defendants in a foreclosure action. He quoted (at para 38) former r 688 of the *Alberta Rules of Court*, Alta Reg 390/1968, and also Rule 3.77 of the *Alberta Rules of Court*, Alta Reg 124/2010 that reads: "A plaintiff in a foreclosure action must not make any subsequent encumbrancer a party to the claim unless possession is claimed from the subsequent encumbrancer." (Emphasis added by the Court.) Justice Manderscheid confirmed (at para 42) the Act applies to seeking a "remedial order" in a foreclosure action and the limitation period for commencing a foreclosure action is two years. For clarity, he explained (at para 46) that an order for payment out of court in an existing action is not a "remedial order" as defined in section 1(i) of the Act and AIIC was not in the position of a defendant opposing the application by CFLS.

Justice Manderscheid determined the proviso "warrants bringing a proceeding" in section 3(1)(a)(iii) of the Act did not apply to CFLS on the facts. He stated (at para 57) "…in the context of the law and practice in this jurisdiction, once the Plaintiff TD Bank commenced a foreclosure action within the limitation period, CFLS as a subsequent encumbrancer may as well "ride the coattails" of the Plaintiff TD Bank." (Emphasis added). He also stated (at para 57) "[t]he law and practice in Alberta support the course of action adopted by CFLS in waiting until the Plaintiff TD Bank, the first mortgagee, commenced the Foreclosure Action against the mortgaged lands…". Justice Manderscheid stated (at para 57):

> It seems to me that from both a policy and interpretation perspective, it would be counter-productive for the rule to prescribe … that a plaintiff in a foreclosure action must not make any subsequent encumbrancer a party to the claim … and … for the subsequent encumbrancer to … commence a separate foreclosure proceeding … of the same mortgaged lands … against the same defendant… .

Justice Manderscheid acknowledged (at para 58) "…that the privilege of "riding the coattails" of the Plaintiff TD Bank which is conferred on CFLS by the law and practice in Alberta is equally available to the Respondent AIIC, if it wishes to seize the same privilege as a subsequent encumbrancer." He concluded (at para 59) on "warrants bringing a proceeding" that "…the existing jurisprudence, the *Alberta Rules of Court* and the general practice of the Bar in Alberta, the circumstances of the present case ... do not warrant that CFLS should bring a separate proceeding for the "injury" that resulted from…" the defendant Letendre not making the required mortgage payment to CFLS on November 1, 2007.

On the "enforceable claim" issue, Justice Manderscheid stated (at para 66) "[t]he present position of the law is that the Court cannot give effect to a limitation period where the defendant never pleaded it nor tried to plead it" citing case law from the Alberta Court of Appeal and the Ontario Court of Appeal. He concluded (at paras 70 and 73) that CFLS did have an "enforceable claim" against the surplus funds in court on the date of the Order Confirming Sale absent the CFLS mortgage being invalid and absent any evidence the defendant Letendre would plead the limitation defence if CFLS had commenced an action.

Justice Manderscheid endorsing a "ride the coattails" mentality for a subsequent mortgagee raised several questions and thoughts in my mind about limitations relevant to foreclosure law and practice: Can a subsequent mortgagee *always* "ride the coattails" of the plaintiff prior mortgagee and never need to commence its own foreclosure action? Where the plaintiff prior mortgagee's foreclosure action never proceeds to a sale order for the mortgaged lands, will a subsequent mortgagee become statute-barred from pursuing its own foreclosure action when the defendant mortgagor pleads section 3 of the Act? As best practice shouldn't a subsequent mortgagee always commence a foreclosure action within two years of a default under its own mortgage? A message to all subsequent mortgagees –beware the lure of complacency includes not taking initiative when it's appropriate to do so.

Justice Manderscheid's decision contains the subsidiary topic that caught my eye. It was the disposition of funds (at para 76) creating priority among the writs of enforcement. From an unsecured creditors' remedies perspective, the "first in time" or so-called "race to the registry" approach adopted by Justice Manderscheid conflicts with the general policy of no priority among writs in section 42 of the *Civil Enforcement Act*, RSA 2000, C-15 ("CEA"). The distribution provisions in Part 11 of the CEA apply to surplus funds in a foreclosure action. By sections 96(2) and 99(3) (g) of the CEA all writ holders share on a prorated basis. See *Resmor Trust Co. v Wood*, 2006 ABQB 841 where Master J. B. Hanebury explained (at paras 21-24) that any uncertainty about surplus funds generated in a foreclosure action being distributed according to Part 11 Distributions in the CEA was eliminated by the amendment in 2000 adding "pursuant to a judicial sale" to section 96(2)(b). There is no priority as between writs of enforcement. See the discussion about section 42 of the CEA and "interaction between writs" in Dick Dunlop & Tamara M. Buckwold, *Debt Recovery in Alberta* (Toronto: Carswell, 2012) at 399-402.

The CEA (in force January 1, 1996) consolidated and rationalized unsecured creditors' remedies in Alberta.