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Do Covenants to Compensate for Designation as an Historical Resource Run with the Land?

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Cases Considered:

Equitable Trust Company v Lougheed Block Inc, 2013 ABQB 209.

The foreclosure proceedings taken with respect to the historic Lougheed Building at 604 – 1 Street S.W. in Calgary have generated a number of legal controversies. I have previously blogged on interest issues in the "Perennial Problem of Section 8 of the Interest Act" and on security deposits matters in "Who Bears the Loss for Converted Security Deposits?" This latest judgment — a decision of Mr. Justice Paul R. Jeffrey — concerns compensation paid by the City of Calgary for the decrease in the value of the building when it was designated an "historical resource" under the *Historical Resources Act*, RSA 2000, c H-9. A Lougheed Building Rehabilitation Incentive Agreement dated September 2006 provided that total compensation would be $3,400,000 and it would be paid in fourteen annual installments of $227,000 each and a final fifteenth payment of $222,000. The question was who was to receive the balance of the annual installments. Would it be The Lougheed Block Inc (LBI), the owner of the building who entered into the Incentives Agreement with the City and did the required rehabilitation work? Or would it be 604 – 1st Street S.W. Inc (604), the purchaser on the judicial sale after LBI defaulted on their mortgage with Equitable Trust Company and Equitable Trust foreclosed. The outcome depended on the answers to one property issue and one (far less interesting) contract issue.

Facts

The *Historical Resources Act* provides for compensation to owners of buildings designated by City Bylaw as Municipal Historical Resources. Designation means that the owners cannot remove, destroy, disturb, alter, rehabilitate, repair or other permanently affect the designated building except in accordance with the Standards and Guidelines for the Conservation of Historic Places in Canada. If the designation decreases the economic value of the building, the City is required to compensate the owner for that decrease. The City and LBI entered into the Incentive Agreement in order to specify the rehabilitation work to be done of the Lougheed Building and the conditions under which the City would compensate LBI for that work and for any decrease in the building's economic value. Once the repairs were made to the satisfaction of the City's Heritage Planner, the City would pay the owners $3,400,000 in fourteen annual installments. A caveat was registered against the title to the Lougheed Building property that referred to the Incentives Agreement and attached a copy of it.

As part of Equitable Trust's foreclosure proceedings, the owner of 604 presented an offer to the court to buy the Lougheed Block (the Lougheed Building and the land on which it sits). That offer was approved by Master Prowse in July 2010. The lawyer for 604 requested, among other

things requested for the closing, an assignment in favour of 604 of the Incentive Agreement with the City. LBI resisted that request, taking the position that LBI's right to the City's payments was not included in the purchase, and applied to a Master in Chambers for a declaration to that effect. The matter was argued before Master Laycock at the end of 2010. The Master ordered that LBI was entitled to the remainder of the annual installments: 2011 ABQB 269.

The purchaser, 604, appealed on two different grounds. First, 604 argued that it was entitled to the Incentive Agreement payments because the covenant to pay ran with the land — the property law issue. Second, and in the alternative, 604 argued that the right to receive the payments was included in the assets it bought in the judicial sale — the contracts issue.

Did the covenant to pay the Incentive Agreement payments run with the land?

Like Master Laycock, Justice Jeffrey found that the entitlement to receive the annual Incentive Agreement payments from the City was not a covenant that ran with the land. Because the covenant did not run with the land, 604 did not get the right to receive the annual payments when it became the owner of the Lougheed Block.

In order for a covenant to run with the land at common law:

> (a) The covenant must be negative in substance and constitute a burden on the covenantor's land analogous to an easement. …
> (b) The covenant must be one that touches and concerns the land … [and] the land must be capable of being benefited by the covenant at the time it is imposed. …
> (c) The benefited as well as the burdened land must be defined with precision in the instrument creating the restrictive covenant. ...
> (d) The conveyance or agreement should state the covenant is imposed on the covenantor's land for the protection of specified land of the covenantee.
> (e) Unless the contrary is authorized by statute, the titles to both the benefited land and the burdened land are required to be registered. ...
> (f) Apart from statute the covenantee must be a person other than the covenantor.
> (at para 38, citing *Westbank Holdings Ltd v Westgate Shopping Centre Ltd*, 2001 BCCA 268 at para 16).

The relevant covenant is that of the City, the covenantor, and it is for the City to make the annual Incentive Agreement payments. Such a covenant is positive in substance and thus fails part (a) of the test set out above, which requires a negative covenant. A negative covenant, to use Justice Jefferey's definition (at para 37), is one where "the covenantor promises to not do something." I prefer to think of a negative covenant as one that can be fulfilled by the covenantor doing nothing. A positive covenant, on the other hand, requires the covenantor to do something. In this case, the covenant requires the City to spend money and it is therefore a positive covenant. The rule that positive covenants do not run with the land has been a settled principle of the common law for more than 100 years and has, without question, been adopted in Canada: *Parkinson v Reid*, [1966] SCR 162.

604 argued that section 29 of the *Historical Resources Act* changed the common law and allowed positive covenants, including the City's covenant to pay, to run with the land. However, section 29 does not apply to that covenant or that covenantor. The relevant portions of section 29 provide:

> 29(1) A condition or covenant, relating to the preservation or restoration of any land or building, entered into by the owner of land and
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> (a) the Minister,
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> (b) the council of the municipality in which the land is located,
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> (c) the Foundation, or
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> (d) an historical organization that is approved by the Minister,
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> may be registered with the Registrar of Land Titles.
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> (2) When a condition or covenant under subsection (1) is presented for registration, the Registrar of Land Titles shall endorse a memorandum of the condition or covenant on any certificate of title relating to that land.
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> (3) A condition or covenant registered under subsection (2) runs with the land and the person or organization under subsection (1) that entered into the condition or covenant with the owner may enforce it whether it is positive or negative in nature and notwithstanding that the person or organization does not have an interest in any land that would be accommodated or benefited by the condition or covenant.
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> (4) A condition or covenant registered under subsection (2) may be assigned by the person or organization that entered into it with the owner to any other person or organization mentioned in subsection (1), and the assignee may enforce the condition or covenant as if it were the person or organization that entered into the condition or covenant with the owner. (Emphasis added)

It is true that section 29(3) states that a covenant that has been registered against the designated land runs with the land. However, section 29(1) states that the covenants that can be registered are covenants that relate to the preservation or restoration of designated land or building — not covenants to pay compensation for the historical designation. Section 29 applies to LBI's promises, not the City's.

The purpose of making a covenant run with the land is to make it enforceable against the owner of that land, whoever they might be in the coming years. Thus section 29(3) also states that it is the entities listed in section 29(1) who may enforce the covenant, whether it is positive or negative in nature, and whether or not they have an interest in the land. Section 29(3) cannot be applied to the City's covenant to pay. That would require reading section 29(3) to say that the City may enforce their own covenant to pay against the Lougheed Building even if their covenant is positive in nature and even if they have no interest in the Lougheed Building. That argument makes no sense. The City would not be the entity to enforce their own covenant to pay. And they would not enforce it against the Lougheed Building. Instead, it makes sense that the City could enforce LBI's covenants to restore the Lougheed Building against that building and that is what section 29 is for — a covenant with a different subject matter and a different covenantor.

Justice Jeffrey recognized the same problems with 604's arguments, although he refutes them in a different way (at paras 36-43). He focuses more on the fact the covenant is not a burden on the covenantor's land and is not imposed on the covenantor's land in order to point out the flaws in 604's argument.

604 made one final point in its argument that the City's covenant to pay ran with the land. That was that, insofar as 604 and the Lougheed Building were burdened by the obligations to preserve and restore the building, 604 should be entitled to the associated benefit, the annual payments. (Justice Jeffrey does not consider the substance of this argument, an argument that has received some acceptance in the UK as the doctrine of benefit and burden in *Halsall v Brizell*, [1957] Ch

169 and gained some ground in Ontario in *Durham Condominium Corporation No 123 v Amberwood Investments Limited*, 2002 CanLII 44913 (ON CA).) Master Laycock had considered 604's argument and concluded that it is only the entity that owned the property at the time it was designated a historic resource that suffers an economic loss. A subsequent owner, such as 604, buys the already-designated building knowing about the designation and its impact on the property's value and factoring that into a reduced purchase price. Justice Jeffrey agreed (at para 46) that the conclusion that the City's covenant to pay does not run with the land was consistent with the purpose of the compensation provisions in the overall statutory scheme.

Was the right to receive the Incentive Agreement payments included in the assets bought in the judicial sale and assigned to 604?

What property did 604 offer to purchase in the judicial sale and what property was included in the Court's acceptance of the 604 Offer? The 604 Offer was to purchase the "Property," defined as being the Lougheed Block only. This was expanded to include some personal property in paragraph 10: "All fixtures, equipment and chattels located on the Property and which are owned by the Vendor shall be included in the Purchase Price." Neither definition of the "Property" that 604 was purchasing included the City's annual payments. However, 604 argued that its Offer also contained wording in two places that could be interpreted to expand the "Property" being purchased to include the right to receive the City's annual payments.

The first place was paragraph 3 of the Offer, which required the Court to direct the Receiver "to deliver ... a registrable transfer of title, free and clear of all encumbrances save and except only the matters referred to in Schedule 1 hereto ... together with ... a general conveyance re assets ...". Schedule 1 included the caveat with the attached Incentive Agreement. However, Justice Jeffrey held (at para 59) that the effect of this reference was only to identify what the title did not have to be free and clear of, i.e., what could be on title. The reference to "a general conveyance re assets" was just not specific enough, in the face of the definition of "Property," to include the annual payments under the Incentive Agreement.

The better argument relied on the last sentence in paragraph 6 of the Offer, which stated: "All leases and contracts that are assignable shall be assigned to the Purchaser as of the Closing Date and the Purchaser shall assume all obligations thereunder." The Incentive Agreement is assignable. Nevertheless, Justice Jeffrey held (at para 62) that just because the Incentive Agreement the type of contract that could be assigned did not mean that it had to be assigned to 604. The earlier definitions of the "Property" being purchased and the property ancillary to it established the substance of the transaction. The last sentence in paragraph 6 only set out a process for the transaction. This conclusion is supported by the fact that paragraph 6 otherwise dealt with 604 agreeing to accept the Property "as is" and acknowledging that the 604 Offer constitutes the entire agreement between the parties — boilerplate provisions.

Conclusion

A covenant by a government or historical organizations to pay compensation to the owners of property for the decrease in value of that property on its designation as an historical resource will never run with the land at common law because it is a positive covenant. Neither will it run under the *Historical Resources Act* because the Act only relaxes the common law test for

promises to preserve and restore made to the government or historical organization. However, it would be possible to draft an Offer to Purchase an historical resource that did include any remaining annual compensatory payments as part of the property being purchased.

This case thus illustrates one of the principle differences between property law and contract law. Whether compensatory payments run with the land is a question of law. As such, the parties and their wishes are irrelevant. Whether the payments were included in the Offer is a question of interpretation, and therefore all about what the parties want and what they have the bargaining power to negotiate.