



# AVOIDABLE SILENT KILLERS

How mortgage defaults trigger limitation periods

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## ISSUE

Lenders have limited time to enforce mortgage defaults, before the lack of enforcement can turn a valuable mortgage into worthless paper. These limitation periods were changed considerably for B.C. lenders by the 2013 B.C. Limitation Act (LA), both as to the length of time and as to triggers that start the limitation clock ticking. It is important for lenders to understand and accommodate the changes.

Given the significant changes and their potential to compromise lenders' mortgage investments, B.C. lenders should obtain legal advice as to:

- monitoring mortgage defaults,
- prudent steps to take concerning defaults under their existing and future mortgage investments, and
- possibly making changes to existing and future mortgage documents to best account for events that trigger limitation periods.

## SAMPLE FACTS

You have lent money under the security of

a mortgage. The loan is payable on your demand. Until you make the demand, the borrower is to pay you monthly interest-only payments.

The borrower defaults under the mortgage and, according to the mortgage terms, this gives you the option of calling the entire mortgage due and to realize on the security property. You choose to not take these actions at the time.

Two years later the borrower again defaults under the mortgage by missing required monthly payments. You respond by sending a letter to the borrower demanding payment of the outstanding mortgage balance. The borrower does not pay you. You then start foreclosure proceedings to collect the entire balance due under the mortgage (including all unpaid interest) and to, if needed, realize on the security by way of a court-ordered sale or foreclosure.

Are you out of time to start a court proceeding to collect the balance? Are you entitled to collect all of the outstanding interest? Are you too late to enforce a claim

against the security property?

Answering these questions requires referring to the LA, the recent B.C. Court of Appeal decision in *Leatherman v. 0969708 BC Ltd*, 2018 BCCA 33, and the specific wording of your mortgage.

## B.C. LIMITATIONS ACT – RELEVANT SECTIONS

A limitation period is the time within which the lender must bring a court proceeding, after which the lender loses the right to pursue the claim in or out of court.

A lender has two years from the day a claim is discovered to start a court action. Generally, a claim is discovered when the lender knows or reasonably ought to know of the default. However:

- if the default is for a demand obligation, the claim is discovered the first day after the lender has made the demand and the borrower has failed to perform; and
- a claim to realize on security is discovered on the first day the lender has the right to start court proceedings to claim against it.



**EXAMPLE OF A DEMAND OBLIGATION**

The mortgage states that the lender can call the entire mortgage balance due if there is a default under the mortgage. The lender needs to make the demand to trigger the amount becoming due.

**EXAMPLE OF A CONTINGENT OBLIGATION**

In contrast to a demand obligation is a contingent obligation. A contingent obligation becomes due automatically upon the contingency (that is, the specified event) occurring. For example, the mortgage states that the borrower will pay the lender a specified payment on the first day of each month. The lender need not make any demand to make the payment amounts due.

A single mortgage is not necessarily, for purposes of determining limitations periods, entirely a contingent or demand mortgage. Each obligation in the mortgage carries its own classification. For example, if a security is realizable upon default, then the limitation period commences when the default, or right to enforce the security, occurs. If the security is enforceable on demand, then logically the limitation period will commence once the demand has been made, and there has been a default.

The result is that a single mortgage can have limitation periods for different obligations start and expire at different times. For example, the mortgage balance might be due on the demand of the lender, monthly payments might be due automatically on certain dates, and the right to enforce the security might be available automatically to the lender upon the borrower's defaulting under the mortgage.

The mortgage in **Leatherman** allowed the lender to choose whether to make the entire mortgage balance due in the event that the borrower defaulted. It said that the lender could issue a demand letter and/or sue for the amount. The court said that as the balance was not due until a demand was made, the obligation was a demand obligation. The limitation clock did not tick until the demand had been made and there was a default in response to the demand.

If a borrower acknowledges liability for the claim before the limitation period has expired, the date of discovery is on the date of the acknowledgement. An acknowledgement occurs either by:

- a written and signed document from the borrower to the lender or
- the borrower performing an obligation under the mortgage (such as making a payment).

If a borrower performs an obligation under the mortgage, the borrower is acknowledging liability for the lender's claim to realize on the security property. If a lender accepts payment from or performance by a borrower, the lender is acknowledging that the borrower has redeemed the security property (that is, negated the lender's right to pursue the security based on the default). If the borrower acknowledges being liable for interest, the borrower is also acknowledging liability for the principal and later interest.

The court has discretion to allow a lender's expired claim to be brought, if it is being brought in response to a claim of the

borrower (such as counterclaims, third party proceedings, a claim for set-off, or adding a new party as a plaintiff or defendant).

Regardless of any other sections of the LA, the maximum time within which a claim can be brought is 15 years from when it was discovered.

**Leatherman v. 0969708 BC Ltd**

The sample facts indicated earlier in this article is essentially what happened in **Leatherman**. The B.C. Court of Appeal decision in that case applied the changes in the LA concerning enforcing defaults to mortgages. It is the highest authority on the subject, the Supreme Court of Canada on October 4, 2018 having declined to hear appeals from the decision.

**Leatherman** demonstrates how important it is to understand whether the wording in the subject mortgage creates demand obligations, contingent obligations or both—the importance being that the limitation clock for each category of obligation is triggered differently.

The court proceedings were commenced within two years of the time the demand was made and so the limitation period had not expired, except for as to mortgage payments that were more than two years old (as discussed below).

The mortgage in **Leatherman** required the borrower to, until the lender demanded that the mortgage be paid in full, make minimum payments of interest only at the times specified in the mortgage. The court said the obligation to make the payments was a contingent obligation as the payment became due without demand at the times specified in the mortgage. The two-year limitation ticks for each payment from the date the payment was due and missed. Accordingly, unless the borrower agreed to postpone the limitation clock, time had expired to collect payments older than two years before the lender started the court proceedings.

The mortgage in **Leatherman** provided that if a default occurred, the lender could apply to the court for an order that the security property be sold on terms approved by the court and/or become owned by the lender. The court said that as the right to realize on the security arose upon the default (that is, when the payment was missed), without any demand being made, the limitation clock ticked from that time. Unless postponed, the limitation clock to realize on the security had expired as more than two years had passed from the time the first default occurred. The lender had the right to enforce the security from the time of first default.

The result in **Leatherman** was that:

- the lender was left as an unsecured creditor (the security having been extinguished), and
- the balance owing under the mortgage was, subject to any proof of the borrower's having acknowledged (that is, postpone) the claim, reduced by the amount of the payments that were due but not made more than two years before the lender started the foreclosure proceedings.

The case does not address whether any default under the mortgage, no matter how minor, triggers the right to commence action and accordingly starts the limitation clock. Can a borrower commit a very minor offence (such as not providing required records under a commercial mortgage) and lay in

the weeds for two years? If after two years of the default the lender has not commenced a court action, can the lender (or a subsequent chargeholder on title) have the property released as security based on the very minor default? When a lender starts a foreclosure action, the borrower is generally at least on one occasion able to cure the default and have the court reinstate the mortgage.

Will lenders faced with defaults have to start and participate in such actions to avoid losing their security (if not more)?

**Leatherman** is the first major word on applying the LA to mortgage defaults; it certainly will be far from the last.

So many questions remain.

lender making demand and the lender defaulting on the demand.

- The limitation period for each of these obligations is two years, after discovery. The limitation period is subject to postponement, if the borrower acknowledges the debt in writing or by performance of an obligation.

- Review your current mortgage portfolio to identify existing defaults and either, as appropriate, seek acknowledgements or commence court proceedings. (Don't be a test case. Seek legal advice as to even minor defaults.)

- Monitor your mortgages and address defaults quickly.



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#### TAKEAWAYS

This case provides opportunities for lenders to take steps to better protect themselves.

Following are some takeaways and suggestions lenders may want to review with their lawyers. This will require interpreting mortgage provisions in your specific mortgages:

- Not enforcing the obligation to pay the entire mortgage balance in a timely manner can extinguish the debt entirely.
- Not enforcing payments in a timely manner can make payments outside the limitation period uncollectable.
- Not enforcing security in a timely manner can extinguish the security and convert the mortgage into an unsecured loan.
- A mortgage can contain both contingent and demand obligations. Contingent obligations are triggered by the borrower making a default under the mortgage; demand obligations are triggered by the

- Use a calendar system, with lots of timely warnings, to diarize borrowers' obligations and limitation periods.

- Regarding defaults, seek acknowledgement (where you desire) or start court proceedings. (Don't be a test case. Seek legal advice as to even minor defaults.)

- If unsure of whether a default is a contingent or demand obligation, err on the side of considering it a contingent obligation and seek acknowledgement or commence court proceedings accordingly.

- Word your mortgages to create demand obligations, where possible, to avoid the limitation clock ticking without your active involvement of issuing a demand.

- Consider amending your template documents.

- Consider whether it is desirable and possible to amend your existing mortgage documents. ■