RECENT DEVELOPMENTS IN REAL PROPERTY CONVEYANCING LAW

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The law reports regularly bring news relevant to the lawyer whose practice includes closing out purchases and sales of real property. The news is good when a previously unclear area of law is given direction by an articulate and authoritative statement from an appellate Court on the subject. The news is bad when a previously generally accepted legal doctrine is misapplied by a judge in a well meaning effort to do what he thinks is fair in particular circumstances. An example of each is dealt with in this article.

Negligent Misstatement in Real Property Transactions

In a recent article in this Journal, the learned author made the following comment about the availability of relief for a purchaser damaged by a negligent misrepresentation of the vendor in the making of a real estate transaction:

> The position has thus been reached that a party, induced to enter into a contract by another's misrepresentations, is potentially protected in both contract and tort. Through a combination of both contractual and tortious remedies, there are very few situations in which a deserving plaintiff will fail. Tort can be used where the basis of the plaintiff's claim is that he has relied to his detriment upon the defendant's negligent misrepresentations by entering into a disadvantageous contract.[1]

This optimistic view of the case law as it had developed to the end of 1983 was not shared by the learned trial judge in the recently reported Manitoba case of *Mann and Mann* v. *Elmore*[2].

This case involved the purchase of an older home in Winnipeg equipped with galvanized iron pipes for hot and cold water. After paying a deposit and having their offer accepted, the purchasers were inspecting the home to make certain measurements and engaged the vendor in conversation about the pipes. The purchasers were aware that the plumbing was of galvanized iron and that such pipes tend to deteriorate. However, the defendant stated that the last work done on the pipes had been ten years earlier and there had been no problem since. The truth was that approximately a year prior to that date, the vendor had made an opening in the plaster in the kitchen to repair a pin-hole leak in the pipe. Instead of replacing the defective pipe, a temporary repair was made by wrapping a piece of rubber tubing around the pipe, held in place by a clamp. This repair job was then hidden by replacement of the panelling in the kitchen and remained that way at the time the purchaser bought the home. Immediately after closing, the purchaser found that water was leaking in various portions of the house. Instead of finding the source of the leak, the purchasers simply installed new copper piping outside the walls, disconnected but did not remove the old pipes, and assumed that they would have to bear the loss.

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1. N. Rafferty, "Liability for Pre-Contractual Misstatements" (1984), Man. L.J. 63 at 93.
2. (1983), 24 Man. R. (2d) 130 (Cty. Ct.).

Approximately a year later, when remodelling the kitchen, the temporary repair of the existing galvanized pipes was discovered, and the purchasers realized that the vendor had misrepresented the situation. The purchasers sued the vendor in Small Claims Court for the cost of replacing the pipes ($750.00). They won in Small Claims Court, but the vendor appealed and the matter came on as a trial de novo before Thompson C.C.J. of the County Court of Winnipeg. The purchasers claimed damages for negligent misrepresentation. The Judge held that although the vendor was not protected by the waiver of reliance provision in the Standard Real Estate Broker's form, such provision only being applicable to patent and not latent defects, the purchasers were nevertheless precluded from recovering for negligent misstatement by virtue of the doctrine of merger. His authorities for this proposition were the cases of *Redican* v. *Nesbitt*[3], *Richview Construction Co. Ltd.* v. *Raspa*[4], and *Dalladas* v. *Tennikat*[5], not to mention *Derry* v. *Peek*[6].

These cases are cited as authority for the proposition that collateral warranties are merged in the executed conveyance in the absence of fraudulent misrepresentation or error in substantialibus. What the learned trial judge overlooked was the fact that this notion was expressly overruled by the Supreme Court of Canada in the recent case of *Fraser-Reid* v. *Droumtsekas*[7]. In that case the Supreme Court of Canada held that the doctrine of merger is inapplicable to collateral warranties. Dickson, J. stated that "There is no presumption of merger. The proper inquiry should be to determine whether the facts disclose a common intention to merge the warranty in the deed; absent proof of such intention there is no merger."[8] Suggestions to the contrary in the *Richview*[9] case were expressly disapproved of.

The non-applicability of the doctrine of merger to collateral warranties was subsequently recognized in an obiter dictum in the Alberta Court of Appeal case of *Morretta* v. *Western Computer Investment Corp. Ltd.*[10].

Part of the problem in *Mann and Mann* v. *Elmore*[11], was that of finding any cases on point where damages for oral negligent misstatement were awarded to a purchaser after the closing of a real estate transaction. In the absence of such authority, it is not difficult to understand why a trial judge on a Small Claims Appeal could be mislead by the earlier authorities. There was the case of *Smith* v. *Mattacchione*[12], a decision of the County Court of York, Ontario, in which the Court awarded damages for negligent misrepresentation to a purchaser where the misrepresentation was discovered by

3. [1924] S.C.R. 135.
4. (1976), 11 O.R. (2d) 377 (C.A.).
5. [1958] O.W.N. 169 (C.A.).
6. (1887), 14 A.C. 337.
7. (1979), 103 D.L.R. (3d) 385.
8. *Ibid.*, at 397.
9. *Supra* n. 4.
10. (1983), 3 D.L.R. (4th) 738.
11. *Supra* n. 2.
12. [1970] 3 O.R. 541.

the purchaser after closing. In that case the misrepresentation was set out in the sale agreement itself and was not an oral representation. Furthermore, the finding based on negligent misrepresentation was an alternative to the finding of fraud by the learned trial judge. In that case, the Court held that the doctrine of merger did not preclude the plaintiff from recovering because the conveyance was only part performance of the vendor's obligations. The Court construed the express provision of the agreement as being intended to survive the closing. That case then is not of direct assistance in dealing with oral representations.

The problem of finding direct authority may now be resolved by the recent decision of the Ontario Court of Appeal in *Hayward* v. *Mellick*[13]. In that case, the vendor, in connection with the sale of 94 acres of farm land, made an oral misrepresentation prior to the making of the sale agreement that the 94 acres of land which were being sold contained 65 acres of workable land. Both the trial judge and all the judges of appeal were of the view that this was a material misrepresentation that induced the purchaser to enter into the contract of purchase and sale. The judges held that this gave the purchaser a cause of action for damages notwithstanding the closing of the transaction, based on the decision of the Supreme Court of Canada in *Fraser-Reid* v. *Droumtsekas*[14].

It does not follow from this that, had the trial judge in *Mann and Mann* v. *Elmore*[15] considered the tort of negligent misstatement applicable, the purchasers necessarily would have recovered damages. It is to be noted from the facts of this case, that the oral misrepresentation which upset the purchasers was made after the sale agreement had been entered into, but before closing. Even if the vendor had told the truth at that point about the state of the pipes, the purchasers may well have obliged to close the transaction. Although it is possible that the act of concealing the temporary plumbing repair might have given rise to a cause of action, as in the case of *Gronau* v. *Schlamp*[16] and *Unrau* v. *Gay*[17], even this is doubtful, as the defect which was concealed by the replacement of the panelling in the *Mann and Mann* v. *Elmore*[18] case was a latent defect rather than a patent one. Also, there is no finding by the learned trial judge to indicate that the state of the plumbing was a material inducement to the purchase.

As well, in *Mann and Mann* v. *Elmore*[19], it was not clearly established that the damage claimed from the negligent misrepresentation had actually flowed therefrom. The purchasers had bought an older home in the knowledge that it was equipped with galvanized iron plumbing which was known to deteriorate. It is entirely possible that this fact was already built into the selling price. If it were, then only in the case of an express warranty that

13. (1984), 5 D.L.R. (4th) 740.
14. *Supra* n. 7.
15. *Supra* n. 2.
16. (1974), 52 D.L.R. (3d) 631 (Man. Q.B.).
17. (1983), 30 R.P.R. 198 (N.S.S.C.).
18. *Supra* n. 2.
19. *Supra* n. 2.

the plumbing was in good condition would the purchaser be able to recover the cost of the plumbing repair. The measure of damages in negligent misstatement is limited to the actual loss sustained by the purchaser; namely, the difference between what was paid and the value of what was purchased. If, in fact, the general condition of the plumbing was built into the purchase price, then no damage would be recoverable by this measure[20].

The error by the learned trial judge in raising the doctrine of merger as a reason for not considering the tort of negligent misstatement, reflects a common misconception in the profession regarding the scope of the doctrine of merger. This misconception reveals itself in practice, for example, in the regular attempts by practitioners in dealing with U.F.F.I. warranties, to require a declaration as to possession on closing, reaffirming the U.F.F.I. warranty. It is thought that such a declaration as to possession will somehow overcome the doctrine of merger, so as to allow the warranty to survive the closing. In fact, there would be no presumption of merger in the case of such warranty.

Although, in advising purchasers who have suffered damage as a result of negligent misstatements by vendors, there is no longer any concern about the doctrine of merger on collateral matters that cannot be routinely checked out before closing; nevertheless, before advising a purchaser of his rights, the solicitor should make a careful analysis as to whether the ingredients of the tort of negligent misstatement are potentially satisfied. If there has been no reliance on the misstatement to a material degree in entering the purchase, or if the damages do not flow from the negligent misstatement, there will be no relief.

One further question that usually arises in considering negligent misstatement is that of whether or not the purchaser has contracted out of his remedy, due to the waiver of reliance provision usually found in a sale agreement. The question of whether a waiver of reliance provision will prevent a purchaser from recovering is usually a contentious issue. For example, in *Gallen* v. *Allstate Grain Co. Ltd.*[21], the British Columbia Court of Appeal split 2 to 1 on whether an oral warranty was overridden by a written exemption clause in the written contract. In that case, the Court held in favour of ignoring the exemption, thereby concurring with the trial judge. In the case of *Hayward* v. *Mellick*[22], the Ontario Court of Appeal, in a 2 to 1 decision, held that the negligent misrepresentation was overridden by the exemption clause, thereby overruling the learned trial judge on that point. However, this case has been appealed to the Supreme Court of Canada, which has since granted leave to appeal.[22a]

In *Mann and Mann* v. *Elmore*[23], the learned trial judge also had to consider the applicability of the waiver of reliance provision in the Standard

20. See for example, *Beaver Lumber Co. Ltd.* v. *McLenaghan* (1982), 143 D.L.R. (3d) 139 (Sask. C.A.).
21. (1984), 25 B.L.R. 314.
22. *Supra* n. 13.
22a. It is understood that this case has since been settled and the appeal abandoned.
23. *Supra* n. 2.

Real Estate Broker's form. In this case, the learned trial judge held, correctly it is submitted, that the language of the particular provision found in the Real Estate Broker's form will not protect the vendor in relation to latent defects.

Thus, while there is considerable justification for the optimism expressed by the learned author[24] regarding the availability of a remedy in the tort of negligent misstatement to a victimized purchaser, nevertheless, for the practitioner advising such a purchaser, careful consideration must be given to the ingredients of the tort and whether they are present in the particular facts being considered, and also to the waiver of reliance provision, invariably found in the written agreement, and whether it will be applicable.

Blanket Mortgages

A blanket mortgage is a widely known form of financing instrument used in real property transactions. It consists of a second or subsequent mortgage, the consideration for which includes the prior mortgage or mortgages which are assumed by the mortgagee, leaving the mortgagor with a single mortgage account in favour of the blanket mortgagee who becomes responsible for the payments under the prior mortgage or mortgages.

For example, if a mortgagor has two $50,000.00 loans arranged as conventional first and second mortgages, each mortgage will be issued for the amount of $50,000.00 and the mortgagor will make payments under each mortgage. In such a case, the second mortgagee, to protect its security, will have to monitor the mortgagor's payments on the first mortgage to make sure that they are at all times in good standing. If the mortgagor goes into default under the first mortgage, the second mortgagee may reserve the right under his mortgage to make the payments under the first mortgage to keep it in good standing and such payments would then be added to the second mortgage account pursuant to a provision to that effect set out in the second mortgage.

If, on the other hand, the second mortgage was arranged as a blanket mortgage, the mortgage would be written for the sum of $100,000.00, not $50,000.00, and the mortgage would state that as part of the consideration for the mortgage loan the mortgagee has assumed the obligation to pay the first mortgage of $50,000.00 and will be charging interest at the second mortgage rate on that sum from the date of assumption. Typically, the obligation to assume the first mortgage would be conditional upon the mortgagor keeping the second mortgage in good standing. In this arrangement, there is only one account that the mortgagor has to pay, and that is the second blanket mortgage. There would be a separate account between the second mortgagee and the first mortgagee. This arrangement facilitates the second mortgagee in keeping the first mortgage in good standing. Also if there is a difference in the rate of interest under the first mortgage and the second mortgage, it is usually an intended part of this arrangement that the benefit or burden of the difference will inure to or be borne by the

24. *Supra* n. 1.

blanket mortgagee. If there is such a difference, and it has been agreed between the mortgagor and blanket mortgagee that the mortgagee will get the benefit of the difference, then the factor of this difference will usually be taken into consideration in the rate of interest that is charged on the blanket mortgage, and usually it will be a lower rate of interest than in the case where a straight second mortgage is taken.

Two recent cases have pointed up the care that must be taken in drafting blanket mortgages in order to avoid the propensity that sometimes persuade judges to provide debtors with a holiday from their obligations as interpreted by the mortgagee. This is done by importing supposed doctrines of equity that have the effect of frustrating the apparent agreement of the parties.

The case of *Wagner* v. *Argosy Investments Ltd.*[25] concerned a 26 month mortgage loan of $97,500.00 with interest at 11½% and monthly payments of $1,122.57. The mortgage was a third mortgage, subject to a first and second mortgage totalling approximately $68,500.00, bearing interest that averaged 7¾% per annum and with maturity dates coinciding approximately with that of the third mortgage. The first and second mortgages were already in existence when the third mortgage loan was arranged, and the third mortgage provided that as part of the consideration there was to be a cash advance of approximately $29,000.00 and the balance of the consideration was made up by the assumption of the obligation to pay the first two mortgages.

The evidence at trial established that the property on which the mortgage security was given had a total value only slightly in excess of $100,000.00, and that because of the low equity of the mortgagor, an interest rate from 18% to 20% per annum would have been the market rate of interest to be paid by the borrowers on the $29,000.00 cash advance. In fact, on the surface, that is what the blanketing arrangement negotiated by the mortgagee was intended to provide. An 11½% return on the $29,000.00 would have yielded an annual return to the mortgage of $3,335.00. The difference between the average first and second mortgage rate of 7¾% and the third mortgage rate of 11½%, namely 3¾ points, which the third mortgagee thought it was earning on the amount of the first and second mortgages (3¾% of $68,500.00) would have yielded the third mortgagee an additional return of $2,570.00 per annum, which, when added to the return on the $29,000.00 of $3,335.00 per annum, would have provided a total yield to the third mortgagee of $5,905.00 per annum. This is a rate of return of 20% (5,905/29,000), which the evidence indicated was the market value of the money advanced.

The circumstances indicated so far, suggest a fairly straight forward transaction. However, there were certain additional unconscionable features of the loan which caused the borrower ultimately to challenge the entire transaction. The worst features were that out of the $29,000.00 cash advance, a bonus of $5,000.00 was paid and, on top of that, approximately $6,000.00

25. (1979), 7 R.P.R. 305 (Ont. Dist. Ct.).

was charged in brokerage and appraisal fees. If one considers these additional charges as adding $5,500.00 per annum to the cost of the loan, the effective rate of interest was raised to in excess of 40% per annum. The evidence indicated that the borrower had been induced to enter the transaction in this form on the basis that the advantage of the low interest on the first and second mortgages would accrue to the borrower. Further, nothing in the documentation indicated expressly that the mortgage was entitled to charge interest on the blanketed mortgages from the date of the mortgage.

When the matter reached trial, the defendant mortgagee admitted that the $5,000.00 bonus was unwarranted, and that the brokerage fees were excessive, although it was suggested that some brokerage fee should have been allowed. The main issue at the trial however, was the attempt by the mortgagee to salvage the benefit for himself of the interest differential arising from the blanketing of the first and second mortgages; namely, approximately $5,000.00 over and above the 11½% return on the $18,000.00 that was considered to have been advanced after refunding to the borrower the $11,000.00 in fees improperly charged.

The problem for the Court was that with the mortgage advance reduced to $18,000.00 rather than $29,000.00, the benefit to the mortgagee of the blanketing arrangement produced a return in excess of 25% per annum, whereas the market value of the money was indicated by the evidence to be only 18% to 20%. This figure is arrived at by taking 11½% of $18,000.00 or $2,070.00 per annum and adding to that the $2,570.00 per annum benefit from the blanketing which sum produces an annual yield of $4,640.00 on $18,000.00, or a 26% return per annum.

Thus faced with an excessive charge on the blanketing arrangement, an unsubstantiated promise to the mortgagor that the mortgagor would benefit from the preservation of the low interest first and second mortgages, and inadequate articulation of the blanketing arrangement, the Court invoked the principle enunciated in the earlier Ontario cases of *Edmonds* v. *The Hamilton Provident and Loan Society*[26] and *Manley* v. *The London Loan Company*[27]. These cases held that, in the absence of an agreement to the contrary, the mortgagee could only charge interest on the mortgage money from the date of advance unless the mortgagee had set aside the mortgage proceeds to be advanced with off-set interest credited to the mortgagor.

The effect of this principle is simply that the court will look behind the form of the mortgage to the actual circumstances. If the mortgage is written for one amount and a lesser amount is advanced, only the lesser amount can be recovered. Similarily, if the mortgage provides that interest is to commence from a specified date or from the date of the mortgage, and if the advance of the mortgage funds is delayed, interest will commence to accrue from the date of the actual advancement of the funds. Only if the

26. (1891), 18 O.A.R. 347.

27. (1896), 230 O.A.R. 47.

parties have agreed to some other arrangement as confirmed either in the loan agreement or in the mortgage itself, will these rules not apply. In the *Wagner*[28] case, because of the circumstances, the court took advantage of the lack of clarity in the documentation of the loan and held that the mortgagor had not agreed to pay interest on the blanketed mortgages except from the date that the mortgagee advanced the money to make payments on such mortgages. As a result of this finding, the mortgagee was deprived of the benefit of the difference in rates between the blanket mortgage, and the two blanketed mortgages, being the 3¾ percentage points. This result would have been avoided had there been a bona fide agreement between the mortgagor and mortgagee that interest would accrue in favor of the mortgagee on the amount of the blanketed mortgages from a specified date, and that the benefit of the difference in rates would inure to the blanket mortgagee rather than the mortgagor.

There is no question that the interest advantage bargained for under blanket mortgages will be enforced by the courts if the documentation is appropriate. The Supreme Court of Canada in *The London Loan and Savings Co.* v. *Meagher*[29], settled for Canada that if the terms of the loan are not otherwise unconscionable, a mortgagee may validly require some additional advantage or benefit over and above the stipulated principal, interest and costs of the mortgage loan. In that case, the validity of a bonus charged by the mortgagee was upheld.

Unfortunately, however, the *Wagner*[30] case may have commenced a pattern in which blanket mortgages may be unfairly attacked. This cause for concern arises from the recent British Columbia decision of *Re: Lapointe and Robinson Holdings Ltd.*[31] In the *Lapointe*[32] case, Mr. and Mrs. Lapointe had sold certain lands and premises comprising a resort to Robinson Holdings Ltd. in 1977 for $650,000.00. $550,000.00 of the purchase price was deferred and Lapointe took back a blanket mortgage for $550,000.00 as security. This mortgage blanketed four F.B.D.B. mortgages totalling approximately $200,000.00. Under the mortgage back, the Lapointe's agreed to indemnify and save harmless Robinson Holdings from the F.B.D.B. mortgages, providing Robinson Holdings Ltd. made all their payments.

The Lapointe mortgage called for periodic payments with interest to be charged at 7% per annum from June 30th, 1977 on the said sum of $550,000.00 or on so much thereof as remains unpaid from time to time until the 30th day of June 1981 and thereafter at the rate of 9% per annum, mortgage to come due on July 1st, 1992. These rates exceeded that charged under the F.B.D.B. loans.

The mortgagee kept its accounts on the basis that the amount owing by Robinson Holdings Ltd. was $550,000.00 against which were credited

28. *Supra* n. 25.
29. [1930] S.C.R. 378.
30. *Supra* n. 25.
31. (1984), 8 D.L.R. (4th) 750 (S.C.).
32. *Ibid.*

the various payments made and the appropriate interest was charged. The F.B.D.B. mortgages were treated as for the account of the mortgagee and not included in the accounting between Robinson Holdings Ltd. and Lapointe. This method of accounting was agreed to between Robinson Holdings Ltd. and Lapointe in a modification agreement executed in July of 1982. However, subsequently, Robinson Holdings Ltd. applied to court for a ruling that the benefit of the difference in the interest rates between the Robinson Holdings Ltd. mortgage to Lapointe and the F.B.D.B. mortgages should accrue to the mortgagor and not the mortgagee based on the *Wagner*[33] case. In effect, it was submitted that the mortgage, although it read for $550,000.00, was really only for $350,000.00 and that the F.B.D.B. mortgages could only be charged to the account when payments were actually made. Further, it was submitted that although the mortgage called for interest to be paid from June 30th, 1977 on the full face amount of the mortgage, there was nothing in the mortgage to indicate expressly that interest would run from that date, whether monies were advanced or not, and accordingly, interest could only be charged from date of advance.

The court, noting among other things, that the mortgage contained a clause found in all printed mortgage forms that neither the execution or registration of the mortgage obliged the mortgagee to advance monies thereunder, held that the applicable principle is that the mortgagee can only recover interest on monies actually advanced from the time of such advances unless there is an express agreement permitting such charges. The court held that the mortgage was to secure payment of monies due Lapointe in exchange for the transfer of clear title to the property. Since $200,000.00 worth of mortgages had been blanketed and not paid off, only $350,000.00 should be treated as having been advanced under this mortgage. Thus, by importing the principle expressed in the *Wagner*[34] case to the arrangement between the parties, the blanketing arrangement originally stipulated and agreed to in the previous accounting between the parties was frustrated by the court.

It is respectfully submitted that the principle dealt with in the *Wagner*[35] case had no application in the Lapointe circumstances which involved a mortgage back to vendor. Notwithstanding the terminology in the printed form of mortgage, the Lapointe mortgage involved no advance of funds. The law under which a vendor is entitled to charge interest on the purchase monies due on the sale of his land is well settled, and it has nothing to do with the date of an imaginary advancement of funds. The correct principle is set out in, Di Castri, *The Law of Vendor and Purchaser*[36], as follows:

> "In the absence of an express agreement to the contrary, or, it is apprehended, a recognized custom, equity requires a purchaser, who takes possession of the subject matter of the contract before the payment of the purchase price, to pay interest on the purchase money outstanding, from the date of such taking of possession until the date of payment . . .

33. *Supra* n. 25.
34. *Supra* n. 25.
35. *Supra* n. 25.
36. V. Di Castri, *The Law of Vendor and Purchaser* (2d ed. 1976) 383.

> At one time it was held that where a purchaser has accepted the title, but a difficulty as to title renders precarious his taking possession, interest runs only from the date when he may safely have taken possession. However, the generally accepted view now is that the state of the title, and difficulties respecting the title, do not exempt the purchaser from his contractual liability to pay interest; nothing short of willful default on the part of the vendor can help the purchaser."

It is obvious from the above statement and from the authorities cited by the learned author, that the vendor's entitlement to interest has nothing to do with the advancement of money nor with the actual conveyance of title, but rather with the delivery of possession by the vendor to the purchaser and the enjoyment by the purchaser thereafter of the fruits of possession. There is no basis for the statement by the court in the *Lapointe*[37] case that the mortgage back to vendor was to secure payment of the monies due Mr. and Mrs. Lapointe in exchange for the transfer of clear title to the property. The parties had in effect agreed that the vendor need not deliver clear title, and the purchaser accepted the vendor's indemnity for the blanketed mortgages. It is submitted that the vendor became entitled to interest on the entire unpaid balance of purchase price, at the agreed rate, once the purchaser went into possession, and that the concept of advancing monies in connection with such mortgage is irrelevant. Counsel for Lapointe conceded that the Lapointe mortgage does not disclose an agreement of the parties that interest on the principal sum, whether advanced or not, is payable from the date of the mortgage. It is submitted that the inclusion of such a provision would be silly, in view of the fact that no monies were intended to be advanced under the mortgage back to vendor. The mortgage was in fact given to secure an existing indebtedness arising from the agreement of purchase and sale, under which the vendor became entitled to interest once possession was delivered to the purchasers.

The above cases illustrate how an established principle, taken out of context, can be misapplied. It is hoped that the *Lapointe*[38] case will not lead to a further erosion of the useful concept of the blanket mortgage.

37. *Supra* n. 31.
38. *Supra* n. 31.