MORTGAGES—ALBERTA JUDICATURE ACT, SEC. 34(17)—NO RESTRICTION ON SECURITY ADDITIONAL TO LAND MORTGAGE —ACTION ON CHATTEL MORTGAGE NOT INDIRECT ATTEMPT TO ENFORCE PERSONAL COVENANT IN LAND MORTGAGE

Krook v. *Yewchuk*[1] is a recent Supreme Court of Canada case that cannot be ignored by the legal profession in Alberta.

There is no doubt that the *Krook* case changes the law in Alberta. However, difficulties are encountered in the process of determining the extent of the change: Is the decision as wide as some think it is? Is it now possible to succeed in a deficiency action against a chattel mortgagor when the chattel mortgage involved is collateral to a land mortgage? Is the interpretation which the Alberta courts have for many years placed upon section 34(17) of The Judicature Act[2] now incorrect? Is the time-honored view that one "cannot do indirectly what one cannot do directly" now obsolete?

The purpose of this article is to assess the effect of *Krook* v. *Yewchuk* on Alberta law, with special emphasis on an attempt to answer the questions, such as those above, posed by the case.

First, the importance of the facts in the *Krook* case requires that they be set out in some detail. On June 30, 1959, the appellants,[3] by an agreement in writing, agreed to sell a hotel located at Cold Lake, Alberta, along with the furniture, furnishings, fixtures and equipment therein, to the respondents. The total price was $90,000. An initial payment of $20,000 was made, with the remaining $70,000 to be paid, with interest, by monthly instalments of $1,000, starting September 1, 1959.

In accordance with the agreement, a transfer of the lands was registered. On August 25, 1959, the appellants executed a bill of sale of the goods and chattels in favor of the respondents. On August 31, 1959, a chattel mortgage on the same goods and chattels was executed by the respondents in favor of the appellants, to secure payment of the sum of $70,000. Both documents were registered on November 4, 1959. Also on August 31, a land mortgage from the respondents to the appellants was executed, to secure the payment of the sum of $70,000. It was registered on November 5, 1959.

The bill of sale stated that the goods and chattels were transferred in consideration of the sum of $20,000 paid by the respondents to the appellants. Martland, J. said there was no evidence as to how the $20,000 figure was determined, but that it was the amount of the initial payment made under the agreement of June 30, 1959.

The chattel mortgage recited the indebtedness of the respondents to the appellants in the amount of $70,000 under the agreement for the sale of the hotel, and that the sum was to be secured by a mortgage on the land and a collateral mortgage on the personal property included in the sale. It was stated in the chattel mortgage that it was collateral to the mortgage on the land.

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1 [1962] 39 W.W.R. 13. (S.C.C.)

2 R.S.A., 1953 c. 164.

3 Appellants (plaintiffs): Andrew, Barbara, Ivan and George Krook. Respondents (defendants): Peter Yewchuk and Mike Panas.

The respondents fell behind in the monthly payments. As a result, the appellants started foreclosure proceedings in respect of the lands and the chattels. A judgment[4] was obtained, in which Primrose, J. declared that as of June 19, 1961, the respondents owed the sum of $67,955—to be realized by sale of the mortgaged lands, goods and chattels. In default, foreclosure might be ordered. In other words, Primrose, J. held the chattel mortgage to be valid. In so holding, he contradicted what was the prevailing view of practitioners in Alberta: that even though the chattels were those involved in a sale of land, a chattel mortgage could not be enforced against them. The prevailing view was based upon the following cases: *Macdonald* v. *Clarkson*,[5] *Holland-Canada Mtge Co.* v. *Hutchings*,[6] *Br. American Oil Co.* v. *Ferguson*,[7] and *Crang* v. *Rutherford*.[8] These cases gave section 34(17) of The Judicature Act the reputation of protecting the little man from the chattel mortgages which otherwise might be taken by mortgage companies.[9] The relevant portions of section 34(17) are as follows:

> (17) In an action brought upon a mortgage of land whether legal or equitable, or upon an agreement for the sale of land, the right of the mortgagee or vendor thereunder is restricted to the land to which the mortgage or agreement relates and to foreclosure of the mortgage or cancellation of the agreement for sale, as the case may be, and no action lies.
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> (a) on a convenant for payment contained in any such mortgage or agreement for sale.[10]

On appeal, the Appellate Division of the Supreme Court of Alberta held that the chattel mortgage contravened section 34(17) and was therefore invalid.[11] Thus, foreclosure of the goods and chattels was refused. Macdonald, J.A. held that "the chattel mortgage is, in my view, an indirect method of attempting to enforce the personal covenant contained in the land mortgage."[12] He was also of the opinion that "the chattels were paid for in full, according to the consideration expressed in the bill of sale dated August 25, 1959."[13] Macdonald, J.A. felt that the position of the mortgagee under the chattel mortgage "cannot be any higher than if the mortgagors had pledged goods *other than those* they had obtained under the bill of sale."[14]

The Supreme Court of Canada, in a judgment written by Martland, J., found in favor of the appellant vendor.[15] Martland, J. pointed out that the appellants were not seeking anything more than foreclosure of the land and of the chattels, and that they did not ask for a judgment over in respect of any deficiency.

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4 Not reported.

5 [1923] 3 W.W.R. 690, 19 Alta. L.R. 694. (Alta. C.A.)

6 [1934] 2 W.W.R. 137. (Alta. C.A.)

7 [1951] 1 W.W.R. N.S.) 103. (Alta. C.A.)

8 [1936] 2 W.W.R. 205. (Alta. C.A.)

9 "During the past forty years the Legislative Assembly of Alberta has, from time to time, legislated to eliminate most, if not all, of the rights of recovery which may be exercised at common law by a mortgagee or vendor of land against the mortgagor or purchaser. The effect of two world wars and recurring depressions seriously affected the economy of the province, and the people's representatives in the Legislative Assembly felt it necessary to curtail these rights."—*Waiver of Statutory Rights and the Judicature Act*, E. A. D. McCuaig and D. C. McDonald, (1960) 5 Alberta L. Rev. 441.

10 R.S.A., 1955, c. 164.

11 [1961-62] 36 W.W.R. 547. (Alta. C.A.)

12 *Ibid.*

13 *Ibid.*

14 *Ibid*, italics supplied.

15 *Supra*, n. 1.

Martland, J. disagreed with the Alberta Appellate Division regarding the effect of section 34(17) of The Judicature Act. In his judgment he distinguished the cases upon which the prevailing view in Alberta had been based.[16] He then proceeded to make the statement that has caused vendors and their solicitors to take such an interest in the *Krook* case:

> I do not find anything in this provision [34(17)] which forbids a debtor to give security for a debt on property *in addition* to[17] a mortgage on land or which forbids the creditor to enforce such security. It derogates from the common-law rights of a mortgagee of land and, consequently, I see no reason to read into it any intention beyond what is to be determined by a strict consideration of the words actually used.[18]

In light of this wide statement, the question arises whether by taking a chattel mortgage collateral to a land mortgage one could evade the principle that one "cannot do indirectly what one cannot do directly." By virtue of section 34(17) one could not directly enforce a covenant to pay under a land mortgage; and neither could one enforce it indirectly by taking a bond or other security in addition and suing thereon. However, Martland, J. held that in the instant case the principle that one "cannot do indirectly what one cannot do directly" was not offended. He stated that:

> In my opinion the taking of the chattel mortgage in the present case was not an indirect method of attempting to enforce the personal covenant contained in the land mortgage, nor was this action, in so far as it sought foreclosure of the chattel mortgage, an action based upon a mortgage of land, whose purpose was to recover the debt referred to in the land mortgage. The essence of the present transaction is that it consisted of a sale of a totality of assets, consisting partly of land and partly of chattels, under the terms of which the vendor was to be entitled to security on all assets sold. The chattel mortgage was a security upon a specific part of those assets and its enforcement is not, in my view, merely an indirect attempt to enforce the covenant for payment contained in the land mortgage.[19]

The question may be asked whether the appellant vendors could have taken a mortgage for $50,000 on the chattels and instead of foreclosing, have sued personally for the amount? Equally important, what is the result if a chattel mortgage is placed upon something not involved in a sale as in the *Krook* case, but upon other personalty of the purchaser? Would such transactions satisfy Martland, J. as falling outside the ambit of section 34(17)?

It is submitted, contrary to some wishful thinking on the part of security-conscious vendors, that the *Krook* decision does not extend far enough to allow these transactions. They would be unenforceable attempts to do indirectly by chattel mortgage or collateral instrument what one cannot do by direct covenant in the land mortgage.

Such transactions would appear to be permissible from Martland, J.'s words, "I do not find anything in this provision [34(17)] which forbids a

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16 See cases cited in footnotes 5, 6, 7, 8, *supra*. Martland J. also considered *Martin* v. *Strango* [1943] 2 W.W.R. 123, (Alta C.A.) as case not mentioned by the Alberta Appellate Division in *Krook* v. *Yewchuk*, *supra*.. In the *Martin* case, a chattel mortgage was held unimpeachable, at is was in *Piper* v. *Canadian Bank of Commerce*, [1922] 1 W.W.R.

17 In the agreement, the chattel mortgage was said to be "collateral to" the land mortgage. P. 3,*supra*. "Collateral to" means "in addition to." See *Benning* v. *Thibaudeau* [1892] 20 S.C.R. at 121; and Jowitt, *The Dictionary of English Law*, (1959), at 403 and authorities there discussed.

18 Brackets and italics supplied. Sec. 34(17) has received a strict construction in *Northern Alberta Railways* v. *Little* [1943] 3 W.W.R. at 445. The general principle is well established and reference may be made to *In Re Certain Questions Etc.* [1926] D.V.T. 246 at 266, and *B. and R. Co.* v. *McLeod* [1912] 2 W.W.R. 1093 at 1906. Also on the basis of *Stadnick* v. *Bifrost* [1929] 1 W.W.R. 785 at 787, there is no power in the court to supply a deficiency in the statute if it fails to embrace the transaction therein.

19 *Supra*, n. 1 at 20.

debtor to give security for a debt on property in addition to a mortgage on land or which forbids the creditor to enforce such security."[20] However, this statement is considerably narrowed by Martland, J. in the paragraph last quoted above.[21] First, the words in the opening sentence of the latter paragraph indicate that Martland, J. still thinks it wrong to do indirectly what cannot be done directly, that is, to indirectly enforce a personal covenant contained in a land mortgage. More important, perhaps, is his statement that "the essence" of the transaction involved two assets and the taking of security on both. In other words, the decision is confined to the facts of the case—a sale of a totality of assets, consisting partly of land and partly of chattels, under the terms of which the vendor was to be entitled to security on all assets sold.

The view that a chattel mortgage on goods not involved in a sale is unenforceable is, of course, in conformity with the jurisprudence of the Province of Alberta. The surprise to many practitioners was that Martland, J. could find a distinction because the chattels were involved in the sale. If one looks upon the initial sale of chattels in the *Krook* case as passing property in the goods to the purchaser, then such purchaser was in effect mortgaging his own chattels just as much as if he had mortgaged chattels not involved in the sale. Apparently Martland, J. regarded the separate steps of bill of sale and chattel mortgage as merely parts of one complete contract. Thus the vendor was recovering only the value of the chattels on the contract of sale for these chattels and not on the land mortgage.

One cannot help feeling that this is somewhat specious in light of the fact that $20,000 had already been paid, ostensibly for the chattels for which a bill of sale had been made out. It is submitted that Martland, J. would have been unprepared to go any further in the direction of allowing the vendor some recovery on his contract beyond the land itself. Hence, looking upon the transaction as a sale and chattel mortgage of chattels, the vendor could have sued for a money judgment (rather than foreclosure as here) up to the true value of the chattels—here $20,000. However, if an inflated value had been placed upon the chattels, say $50,000, and there had been an attempt to recover personal judgment, this would have been held an indirect attempt to recover on the sale of land rather than a bona fide action on a sale of chattels. Similarly, in the case of a mortgage of chattels not involved in a sale, any action whether personal or for foreclosure would be disallowed as actually being for purposes of enforcing the land mortgage and not as security for a sale of chattels.

There is also the view that a promissory note may be used to evade section 34(17). Here one may ask what happens if a promissory note is taken, followed by a land mortgage and/or a chattel mortgage. It is submitted that these would be valid as there would be no 'doing indirectly what cannot be done directly," and the enforcement is not a covenant contained in a mortgage but is of a covenant to pay contained primarily in the note. If the documents were all executed as part and parcel of one transaction, then it could be argued that this is "doing indirectly what cannot be done directly". And what result follows if the promissory note is taken out after a land mortgage? It is submitted that this would

[20] *Supra*, n. 18.
[21] The statement to which n. 19 is affixed.

be "doing indirectly what cannot be done directly" and would therefore be bad. It is probably also an attempt to enforce the covenant in the land mortgage.

(Attention should also be brought to bear upon the oft-discussed point that if the Supreme Court of Canada had held that section 34(17) may be *waived* by the mortgagor, then there would be no need to determine whether a transaction amounted to a "doing indirectly what canot be done directly." However, Martland, J. did not discuss whether granting the chattel mortgage in the *Krook* case was an implied waiver of the provisions of The Judicature Act.[22])

Even though the *Krook* case is not as sweeping as those attracted to Martland, J.'s wide statement[23] might like, the case still makes a substantial change in Alberta law. The decision is important in that it refutes the view that even though chattels were involved in a sale of land in Alberta, a chattel mortgage could not be enforced against the chattel mortgagor. Martland, J. allows enforcement of such a chattel mortgage. Stress must also be placed upon the usefulness of the fact situation in *Krook* v. *Yewchuk* because sales of land and chattels are common. The value of the decision is particularly great from the point of view of vendors of going concerns. Up until now, vendors of going concerns have had difficulty in selling. They felt compelled to wait for a buyer who could make a substantial down payment, because there seemed to be no way to obtain substantial security. The *Krook* case provides more adequate protection for such vendors.[24]

Of course, an interesting point still open is whether or not there still is an all-embracing principle that one "cannot do indirectly what one cannot do directly." Clearly, there is conflict between this principle and Martland J.'s statement that section 34(17) "derogates from the common-law rights of a mortgagee of land" and should be construed strictly.[25] The realm of taxation in Canada provides an illustration of where it is permissible to *do* indirectly what cannot be done directly. The traditional view is that taken in *The Commissioners of Inland Revenue* v. *Duke of Westminster*;[26] that every man is entitled, if he can, to order his affairs so that the tax attaching under the appropriate acts is less than it might

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[22] In a recent article, E. A. D. McCuaig and D. C. McDonald contend that "The dictum of Ford J.A., in *Crang* v. *Rutherford, supra*, the reference by Clinton J. Ford J.A. in *British American Oil* v. *Ferguson, supra*, to other decisions of the Appellate Division, and the tacit assumption of W. A. Macdonald J.A., [in *Ferguson*] all give strong support to the view that the protection given by The Judicature Act to mortgagees and vendors under agreements for sale may be 'contracted out of' or 'impliedly waived.'" (Brackets mine)—*Waiver of Statutory Rights and The Judicature Act*, (1960) 5 Alberta L. Rev. 447.

Of course, it must be pointed out that the view that waiver is permissible is built upon *Crang* v. *Rutherford, supra*. Critics maintain that the decisions in *Martin* v. *Strange, supra*, and *B.A. Oil* v. *Ferguson, supra*, fail to consider the changes in The Judicature Act which took place after *Crang* v. *Rutherford* was decided.

Adherents of the latter view point to a recent Alberta decision in which Johnson J.A. in *Laboret* v. *Szabo and Szabo*, [1962] 39 W.W.R. 139, gives more effect to sec. 34(17) of The Judicature Act than Alberta courts have given it in the past. (Note that the *Laboret* decision was reached before the Supreme Court of Canada made its decision in *Krook* v. *Yewchuk*.) It is contended that an attempt is being made to correct the mistakes made by the Alberta Supreme Court based upon *Crang* v. *Rutherford, supra*. However, the whole question of waiver of the section might be more quickly settled if a proper case reaches the Supreme Court of Canada, as *Locke J.* stated while sitting in the *Krook* case, *supra*, that sec. 34(17) of The Judicature Act cannot be waived. (Latter statement unreported. The other members of the court apparently concurred.)

[23] *Supra*, n. 18.

[24] Some members of the legal profession in Alberta have urged, (before the decision was made in *Krook* v. *Yewchuk*) that commercial transactions be exempted from the effect of sec. 34(17) of The Judicature Act.

[25] *Supra*, n. 18.

[26] [1936] A.C. (H. of L.)

otherwise be. Taxing statutes, like penal statutes, are construed strictly—and the general feeling seems to be that if a man can do something indirectly that will save him money, then more power to him. The "principle" that one cannot do indirectly what one cannot do directly may well be another instance of blind acceptance of statements that appear to be legal principles, to which attention is called by Cardozo in *The Nature of The Judicial Process.*[27] Cardozo says it can be dangerous to adopt a phrase used by previous judges, without investigating to see if the words still have, or ever did have, any merit.

Further, there is the question of whether the Legislative Assembly will deem it necessary to change The Judicature Act slightly to counteract the *Krook* decision. Such an enactment might prohibit the taking, in a situation involving a land mortgage, of additional security "either directly or indirectly, whether contained in a collateral instrument or in any other form of security whatsoever." As discussed above,[28] the heavy burden hitherto placed upon vendors could be lightened by exempting commercial transactions from the effect of any such changes made in The Judicature Act.

In the final analysis, it cannot be disputed that *Krook* v. *Yewchuk* has changed the law in Alberta in an area that is a part of everyday practice. There will doubtless be several cases in the area covered by *Krook* v. *Yewchuk* appearing in the near future.[29] Perhaps they will resolve the questions still unanswered. Then we will know whether the *Krook* case is merely an eddy in the flow of Alberta law—or another example of the law "expanding and enlarging to meet the needs of trade."[30]

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[27] At 25.

[28] *Supra*, n. 24.

[29] One citation of *Krook* v. *Yewchuk* had already appeared at the time of writing of this comment. It was *Pirot* v. *Schmirler*, [1962] 39 W.W.R. 599, a Saskatchewan Court of Apeal Case. However, the *Pirot* case was heard before the Supreme Court of Canada decision in *Krook* v. *Yewchuk* was made known, and the Saskatchewan court cites the *Krook* case for the words of Macdonald J.A. in the Appellate Division of the Supreme Court of Alberta.

[30] Lord Chief Justice Cockburn in *Goodwin* v. *Roberts* [1875] L.R. 10 Ex. 337 at 346.