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MORTGAGE LENDERS – DUTY TO NOTIFY THE INSURER OF A MATERIAL CHANGE IN RISK

Louis-Martin Dubé and Ariana Lisio

All fire insurance policies which cover a mortgaged immovable contain a clause dealing with the mortgage security (the "mortgage clause"). Financial institutions are familiar with this clause, which is considered as a separate contract from the insurance policy between the insurer and the mortgage creditor (the "creditor") of the insured immovable.[1] Under this separate contract, the actions, negligence or statements of the insured—for example, misrepresentations by the insured when the policy is first taken out—cannot be invoked against the mortgage creditor. Moreover, this characteristic of the mortgage clause is also its cornerstone.

However, the protection afforded to the creditor by the mortgage clause does suffer from imperfections, which are underlined in the judgment rendered on January 25, 2011 by the Quebec Court of Appeal in the matter of *Xceed Mortgage Corporation* v. *Wawanesa*[2].

In the aforementioned case, the creditor exercised his hypothecary rights against its debtor, who was insured by Wawanesa. Unfortunately, a fire substantially damaged the mortgaged building (the "building") before the creditor completed its recourse. The creditor therefore filed a claim with Wawanesa who refused to indemnify it, arguing that the creditor failed to inform the insurer that the insured no longer lived in the building and had rented it to a third party.

Indeed, in the certificate of service of the motion to institute proceedings for forced surrender which was served by the creditor, the bailiff mentioned that a third party, and not the insured, occupied the insured building.

The mortgage clause attached to the policy issued by Wawanesa contained the following provision:

> [Translation] *The mortgage creditors must promptly disclose to the insurer (if the insurer is known to them) any circumstances that increase the risks set out in the policy and that are a result of their actions if the said circumstances would materially affect the insurer in setting the*

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rate of the premium, assessing the risk, or deciding to maintain the insurance [...]

Wawanesa's refusal to pay was based on the fact that since this was a homeowners' policy, Wawanesa would not have agreed to insure the building knowing that it was rented to a third party. According to the insurer, this fact would have had a material impact on its decision to maintain the insurance and ought to have been disclosed to it by the lender.

In its judgment, the Court concluded that the insurer never intended to insure for the risk of fire where the insured did not live in the building as a homeowner and that, if it had been informed of this on a timely basis, it would have terminated the policy before the loss occurred. The lender's action for payment of the insurance indemnity was therefore dismissed.

This Court decision without a doubt brings to light the significant impact that a material change in risk may have on a mortgage creditor.

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[1] *National Bank of Greece (Canada)* v. *Katsikonouris*, [1990] 2 SCR 1029.

[2] *Xceed Mortgage Corporation et Xceed Funding Corp.* v. *Wawanesa compagnie mutuelle d'assurance*, 2011 QCCA 197.

UNDIVIDED CO-OWNERSHIP AND THE RIGHT OF REDEMPTION

Chantal Joubert

Immovables are frequently owned by several co-owners, residential condominiums being one example that naturally comes to mind. However, while commercial immovables are not exceptions to co-ownership, they do, on the other hand, more frequently take the form of undivided co-ownership, where each co-owner has an undivided right of ownership to the whole property. This type of ownership, and especially the associated rights, are frequently misunderstood. The judgment in *2159-4395 Québec Inc.* v. *Gérard Lamarche et Richard Cousineau* is a good example.

FACTS – Lamarche and Charbonneau were co-owners of an immovable property. Charbonneau sold his 50% share in the immovable to 2159-4395 Quebec Inc. ("Quebec Inc.") for a price of $570,000, including $50,000 in cash, with the balance payable in six (6) interest-free instalments. There was also a hypothec on the immovable maturing in 2007.

Article 1022 of the Civil Code provides that an undivided co-owner may, within sixty days of learning that a third party has acquired the share of the other co-owner, purchase the said share himself by paying the third party the sale price and associated costs. This is known as the right of redemption. However, the right of redemption may not be exercised if the undivided co-ownership agreement contains a right of preference in favour of the co-owners, provided the agreement was registered against the immovable.

In this case, Lamarche exercised his right of redemption within the requisite time and offered to reimburse Quebec Inc. for the first payment of $50,000, and to take over Quebec Inc.'s hypothec with the hypothecary creditor. He also filed a letter of credit for the balance of the sale price.

Quebec Inc. objected to the exercise of the right of redemption, claiming that it had not been validly exercised because Lamarche's offer was insufficient: it should have included the full payment of the sale price, since Lamarche did not benefit from the terms of payment offered to Quebec Inc.

JUDGMENT – The trial judge and the Court of Appeal ruled in favour of Lamarche, holding that his

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offer to pay the $50,000, plus the letter of credit for the balance, were sufficient, and that he benefited from the terms of payment given to Quebec Inc.

It should be added that the deed of sale to Quebec Inc. included a provision that was designed to counteract Lamarche's right of redemption by stipulating that if Lamarche exercised his right of redemption, the full payment of the balance of the sale price would become due—causing Lamarche to lose the benefit of the terms of payment if he exercised the right of redemption. Without much discussion on this point, the Court of Appeal refused to give effect to a scheme aimed at discouraging Lamarche from exercising his right of redemption.

CONCLUSION – The existence of a right of redemption has the effect of making the purchaser's title to an undivided share quite precarious. The right of redemption must be exercised within one year of the sale. This means that, on the sale of an undivided share to a third-party purchaser, the purchaser's acquisition can be challenged for a year following the sale. Mechanisms should therefore be set up to stabilize the transaction, i.e. to prevent the right of redemption from coming into existence. To do so, the undivided co-ownership agreement should either provide for a pre-emptive right—which closely resembles the right of redemption, except that it is exercised prior to the sale and does not therefore give rise to the same uncertainty—or simply a waiver by the co-owners of the right of redemption.

DID YOU KNOW THAT...

... failure to pay when due one instalment of municipal or school taxes can cause the unpaid balance of the taxes billed, to become immediately payable, thus causing the taxpayer to lose the benefit afforded by instalment payments.

UNPUBLISHED SERVITUDES

Nicole Messier

Like all other immovable real rights which must, by law, be published (registered) to be enforceable against third parties, servitudes must be registered in the land register.

Once a servitude is registered in the land register against the immovables that it affects, all persons dealing with the immovables are deemed to have knowledge of it.

What then is the fate of an unpublished servitude? When a servitude is not published, it is effective between the parties who created it, but is not binding on the purchasers of the immovables it affects or that benefit from it, even if the deed of sale provides that the immovable is sold "with all the active and passive, apparent or unapparent servitudes" charged against it.

Also, based on the well-established principle in article 2963 of the Civil Code of Québec, which states that "[n]otice given or knowledge acquired of a right that has not been published never compensates for absence of publication," even where the purchaser has knowledge of an unpublished servitude, this does not cure the failure to register it in the land register. However, a line of cases has considered whether knowledge of an unpublished servitude could affect its unenforceability. Quite recently, the Quebec Court of Appeal[1] was asked to rule on the enforceability of a servitude for the drawing of water that was not registered in time. The owners of the property benefiting from the servitude alleged that the owner of the servient land was aware of the existence, or tolerated the exercise, of the servitude even before it was registered in the land register.

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Relying, among other things, on the principle in article 2963 of the Civil Code of Québec, the Court of Appeal held that this servitude for the drawing of water was unenforceable against the owner of the servient land. However, in its reasoning, the Court of Appeal confirmed that, nonetheless, it is still possible to present evidence that the owner of the servient land had knowledge of an unpublished servitude, but stressed that this evidence must be very strong:

> [Translation] *If one wishes to prove that he verbally or implicitly acknowledged the servitude, which is a priori unenforceable against him, one cannot be content to adduce evidence of the tolerance, even over a long time, or of the exercise, albeit lengthy, of the servitude in question. The burden of proof to be met by the owner of the allegedly dominant land is therefore a heavy one.*[2]

In addition, the Court of Appeal added that this evidence must attain a “necessary threshold” (without otherwise defining it) to reach the conclusion that a servitude has been implicitly created or recognized.

Ultimately, the Court of Appeal’s judgment reminds us that, to avoid any conflict over the existence of a servitude, the first thing you should do is register it.

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[1] *Beaulieu* v. *Sinotte*, 2011 QCCA 1743.

[2] Op. cit. no. 1, p. 12.

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