

# Commercial Litigation Insights: Power of Sale vs. Receivership: A Comparative Guide

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Both a power of sale and a receivership can be used by mortgagees to sell land to recover unpaid debts. However, that is where the similarities end. These are very different tools to achieve a similar purpose. How are these tools different, and when is it best to use each?

#### 1. Starting the Process

Typically, a mortgage will contain clauses that give the mortgagee the power to appoint a receiver and the power to sell the property. In addition, both the *Mortgages Act*[1] and the *Bankruptcy and Insolvency Act* ("*BIA*")[2] contain clauses that give the mortgagee the power to sell the property and the power to appoint a receiver.

To sell, the mortgagee must first wait at least 15 days after default, then give at least 35 days' notice in the prescribed form. [3] Once the 35 days pass, the mortgagee can start its sales process and, when a purchaser is identified, sell the property.

To appoint a receiver, the mortgagee must first give ten days' notice pursuant to the *BIA*.[4] Once the ten-day period expires, the mortgagee can bring an application to the court to appoint the receiver. The Ontario *Rules of Civil Procedure* require the mortgagee to give a minimum of ten days' notice to the debtor and any other affected parties, such as subsequent mortgagees, of the application.[5]

At first glance, it appears less notice is required to bring an application to appoint a receiver, but there are a few factors that extend this time.

First, the application must be served personally, which in most cases means locating the debtor and handing it to them in person. [6] Since it can take time to locate and serve the debtor, it is advisable to schedule the application more than ten days from when it is issued to give time to serve it. Scheduling the application will also depend on court time. Due to the current court backlogs and a shortage of judges, it may take weeks or even months for the application to be heard.

Once the application is served, the debtor can respond. Depending on the nature of the response, cross-examinations may be necessary, which may further delay the application.

All these steps require significant legal resources. Even a simple uncontested application will incur substantial costs. If opposed, cost can quickly rise to \$100,000 or more. In addition to the application itself, the mortgagee must also budget for the costs associated with the receiver and the receiver's lawyer.

In a power of sale, once the 15 days post-default and 35 days post-notice pass, the mortgagee can begin the sales process. However,

the debtor may create delays. For example, if the debtor denies access, selling may not be possible, and the mortgagee may have to start an action for possession of the property.

#### 2. Possession

The Commercial List Users' Committee has model orders for use in receiverships. The model receivership order contains clauses which give the receiver the exclusive power to take possession and exercise control over the property[7] and which require any person to cooperate with the receiver and to provide access to property.[8] If a person denies access, the receiver can bring contempt proceedings or seek police assistance.

Standard mortgage documents also give the mortgagee the power to enter upon and take possession of a property. However, if the debtor denies access, the mortgagee's sole recourse is to start an action for possession. The debtor's failure to give access is a breach of the contract but it is not contempt since there is no order requiring the debtor to give access for the debtor to be in contempt of. The mortgagee must obtain such order and try to enforce it before commencing contempt proceedings.

Moreover, possession carries with it liability. By taking possession, a mortgagee assumes the duty of treating the property as a provident owner would treat it.[9] In contrast, a receiver is protected by clauses in the appointment order and the *BIA*, which limit liability. For example, section 215 of the *BIA* provides that no action lies against a receiver except by permission of the court, and the model receivership order states that the receiver shall incur no liability or obligation except for gross negligence or willful misconduct.

#### 3. The Sale

A major difference between a power of sale and a receivership is who sells the property. In a power of sale, the mortgagee sells. In a receivership, the receiver sells.

Before selling a property, the receiver will bring a motion to approve the transaction. The receiver may also bring an earlier motion to approve the sales process. If any party wants to challenge the sales process, it must do so at the motion to approve the sales process. Similarly, any challenges to the transaction itself must be raised at the motion to approve the transaction.

One significant advantage of this approval process is that it precludes subsequent actions for improvident sale against the mortgagee. This is because the transaction has already been court-approved, and the mortgagee was not the party selling the property.

In a power of sale, the mortgagee is vulnerable to claims by the debtor or a subsequent mortgagee alleging that the sale was improvident. Further, the mortgagee will not know if such a claim will arise or succeed until long after the property is sold. If the court finds that the sale was improvident, the property cannot be returned to the market.

#### 4. The Debtor's Ability to Oppose the Sale

If a debtor wishes to oppose the sale by arguing there is a deficiency in the mortgage, the power of sale process offers recourse. Since it is a self-help remedy, the mortgagee does not have to apply to the court to start the process. The debtor's only recourse is to bring its own action for declaratory relief and to move for an injunction to prevent a sale. The onus is on the debtor with all the hurdles that have to be met to obtain an injunction. Stopping the process is not simple. In the meantime, the sale continues.

In contrast, a receiver is appointed by court order. This means the mortgagee has to apply to the court for an order appointing the receiver. The mortgagee, not the debtor, has the onus of proving it should get the order. The debtor can raise all its arguments, including any arguments attacking the mortgage, in response to the application. Until these issues are resolved, there is no appointment and no sale of the property which makes it easier for the debtor to raise these arguments and delay the process.

#### 5. Control of the Process

In a power of sale, the mortgagee is in charge of all aspects of the process. The mortgagee has to get possession, manage the property, run the sales process, and close the transaction. For institutional lenders, especially those with limited resources, managing this process can strain existing staff.

A receivership is run by a receiver, who oversees all steps of the process. The mortgagee can offload everything onto the receiver. The receiver has the expertise and network required to manage the process. It is in the business of selling assets and managing them in the interim.

#### 6. When is Each Process Appropriate?

A power of sale is most appropriate for properties where possession is not required or is easy to obtain and minimal management is required. Vacant land is a prime example of the type of property that can be sold effectively using a power of sale, as possession is typically not required, and there is no business to manage.

A receivership is most appropriate where the property includes an operating business which increases the value of the business, but which has to be managed during the sales process. If vacant land lends itself to a power of sale, then a construction site at the cusp of completion would be a prime example of the type of property that requires a receiver. Completing construction would maximize the property's value, and a receiver is best suited to oversee such process.

The information and comments herein are for the general information of the reader and are not intended as advice or opinion to be relied upon in relation to any particular circumstances. For particular application of the law to specific situations, the reader should seek professional advice.

- [1] Mortgages Act, R.S.O. 1990, c. M.40 ("Mortgages Act"), s 24 1.
- [2] Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3, s 243(1).
- [3] Mortgages Act, ss 31(1), 32.
- [4] BIA, s 244.
- [5] Rules of Civil Procedure, R.R.O. 1990, Reg 194, r 38.09(3).
- [6] Rules of Civil Procedure, rr 1.03 (1), 16.01, 16.02.
- [7] Commercial List Users' Committee Model Receivership Order, clause 3(a).
- [8] Commercial List Users' Committee Model Receivership Order, clause 4.
- [9] Capsule Investments Ltd. v. Heck, 1993 CanLII 8465 (ON CA).

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