

CORPORATE COMMERCIAL

Caselaw trend clear for Quebec's security devices

By Daniel Frajman

Recent Quebec caselaw shows a general trend to interpret Quebec's movable (i.e., non-real estate) security legislation so that Quebec's security scheme is more aligned with those in the other provinces.

This article should be useful for vendors that sell movable property to Quebec customers, as it will first look at this general trend in the courts, and then review generally the more important security and related devices that apply to movable property sold to Quebecers, including the very short time period within which instalment sales and certain leases of movable property must be registered.

Recent court decisions

Quebec's security legislation (most of which is found in the *Civil Code of Quebec* (CCQ)) formerly did not require the registration of instalment sales (similar to conditional sales in other provinces), or of leases of movable property, but rather treated such financing devices as title transactions, providing the vendor or lessor with an unregistered ownership right that ranked prior to the claims of any other creditors.

Since September 1999, the CCQ has required that these devices be registered, and several cases have dealt with the effect of improper registration upon the creditor's rights.

On March 19, in *Lefebvre* (*Trustee of/Syndic de*), [2003] R.J.Q. 819, in a 2-1 decision, the Quebec Court of Appeal held that failure to register an automobile lease within the applicable delay rendered the lessor's ownership rights impossible to the trustee in bankruptcy.

Justice France Thibault, writing one of the majority judgments, held that due to the new registration rules, such a lease could no longer provide what in the past was a secret lien, but rather, in the context of modern commercial reality, should be seen as a security device that required proper registration.

"Financial institutions which are parties to these agreements [instalment sales and certain leases] do nothing but offer credit and consequently, title retention [provided to the creditor by the sale or lease] must be considered as an underlying security to the loan granted," wrote Justice Thibault (emphasis added, author's translation).

The majority judgments in *Lefebvre* follow *Mervis* (*Trustee of/Syndic de*), [2002] R.J.Q. 2268 (C.A.), and *Massouris* (*Trustee of/Syndic de*), [2002] R.J.Q. 901 (C.A.), dealing respectively with an instalment sale and a lease.

Lefebvre subsequently has itself been followed twice by the

Quebec Court of Appeal, in *Tremblay* (*Trustee of/Syndic de*), [2003] J.Q. No. 2305, and in *Ouellette* (*Trustee of/Syndic de*), J.E. 2003-1061 (May 16, 2003).



Daniel Frajman

However, some doubt remains on this issue, because leave to appeal the 2003 judgments in *Lefebvre* and *Tremblay* was granted by the Supreme Court of Canada (file numbers 29770 and 29780) on August 28.

It is also notable that recent Supreme Court judgments, on slightly different issues, show the above-mentioned trend to treat security-related contracts in Quebec in a manner that is as analogous as possible with their treatment outside Quebec.

For example, in *Caisse-Populaire Desjardins de Val-Brillant v. Blouin*, [2003] S.C.J. No. 29, the court held in a 5-4 decision that the CCQ allows a physical person to grant security over term deposit certificates.

"The approach adopted [in this case] has the advantage of being compatible with the most recent developments in the North American law of ... security," wrote Justice Charles Gonthier, for the majority. "Legis-

lation in relation to personal property security that has been enacted in the common-law provinces of Canada allows individuals to grant security interests [in the present circumstances] ... [The present decision] reflects the general development of the law of security interests in claims of the [present] nature, as well as providing Quebecers with a form of access to credit that is generally available elsewhere in the world, and fostering a degree of uniformity in this area, one that is crucial to the conduct of numerous business activities, while remaining faithful to the letter and spirit of the Civil Code of Quebec..."

Also showing this trend are comments in a recent tax case (*Autobus Thomas Inc v. Her Majesty the Queen*, 2001 DTC 5665 (S.C.C.)), upholding the decision of the Federal Court of Appeal (99 DTC 259).

Selling to Quebecers

Against this background, the security devices open to a vendor selling movable property to Quebecers can be more readily understood. The principal devices are as follows:

Movable hypothec: A hypothec is similar to a security interest under personal property security legislation in other provinces. A hypothec charges properties (article 2666 CCQ) to secure the performance of obligations (art. 2687 CCQ).

The CCQ does not contain a provision similar to s. 2 of the Ontario *Personal Property Security Act*, stating that any transaction that in substance creates a security interest is governed by the general security regime. It is commonly thought that unless a deed explicitly creates a

hypothec, it cannot be presumed that there is a hypothec.

Hypothecs must be registered to be opposable to third parties (art. 2941 CCQ), and other registered creditors need not be otherwise notified of the hypothec. The registration rules for hypothecs are found in a part of the CCQ dealing with registration of security, which is perhaps why it has never been seriously doubted that a hypothec must be properly registered in order to be opposable to a trustee in bankruptcy. This is in apparent contrast to the registration rules for instalment sales and leases, which are found in a part of the CCQ dealing with title transactions, perhaps explaining the recent frequency with which the courts have been asked to rule on the effect of improperly registering a sale or a lease.

As a general rule, hypothecs over both present and future (after acquired) property (arts. 2670 and 2954 CCQ) rank according to their time of registration (art. 2945 CCQ). A hypothec therefore is usually a poor security device for the vendor, because the hypothec would usually rank behind a hypothec previously registered by the purchaser's institutional or other lender.

Unlike the legislation in the common-law provinces, the CCQ does not state (subject to the one exception referred to immediately below) that hypothecs can be set up in such a way as to provide a creditor with so-called "purchase money security" that outranks previous registrations.

The one exception to this, the so-called "vendor's hypothec" set out at art. 2954 CCQ, which ranks ahead of earlier registrations, is usually unworkable for

vendors because it is generally thought that art. 2954 CCQ, in addition to requiring the vendor's hypothec to be registered within 15 days of the sale, also requires the hypothec to be contained in a deed of sale between the vendor and the purchaser. Nevertheless, if a vendor is making an important sale (e.g., of specialized mining or manufacturing equipment, or of assets outside the ordinary course of business) and is willing to take the time to properly document such a vendor's hypothec, the vendor may find this device to be useful.

By comparison, the CCQ implies that a vendor or lessor retaining title under a properly registered instalment sale or lease will always be able to set up its ownership right in priority to a trustee in bankruptcy, or a creditor having previously registered a general hypothec.

The *Lefebvre*, *Mervis*, *Massouris*, *Tremblay* and *Ouellette* cases, however, currently suggest that failure to register such a sale or lease within the applicable time delay means that a vendor or lessor will lose its right to claim that priority.

Instalment sale, or lease: By an instalment sale, the vendor claims ownership of the property sold until full payment of the sale price (art. 1745 CCQ).

For "leasings" of movable property (similar to financial leases in other provinces), and for leases of movable property with a term of one year or more (or with renewal provisions allowing for such a term), the creditor maintains its right of ownership over the property in question.

see *INSTALMENT SALE* p. 14



HOW THINGS ARE DONE

It's more than just our software

DO PROCESS
LAW OFFICE PRACTICE SYSTEMS

TEL: (416) 322-6111
FAX: (416) 322-6106
1-866-367-7648
www.doprocess.com

At Do Process, our business is helping you! We've made a career of safeguarding your place in the conveyancing marketplace. We know we're succeeding because over 2,500 Ontario law firms have selected our software to automate their practices.

Look to us for:

- Superb document production and practice management software
- Fast response technical support from qualified professionals
- Leading title insurance integration
- Electronic data exchange with the e-reg system
- Optional transaction-based pricing (client disbursement)

PROVEN SOFTWARE
The Conveyancer
Fast Company
estate-a-base
GREAT SUPPORT

Consignment may not have to be registered

INSTALLMENT SALE
—continued from page 11—

It is crucial for creditors to note that the CCQ requires that these contracts be registered within a very short period, that is within 15 days of the contract being entered into (arts. 1745, 1847 and 1852 CCQ).

In some cases, such a contract may be entered into when a sales or lease quotation (*i.e.*, an offer) and a subsequent purchase/lease order (*i.e.*, acceptance of the offer), or similar relatively informal documents, are exchanged, apparently requiring registration in the 15 days following such an exchange, even if the goods in question are not delivered for some time afterwards. There is no need to inform other registered creditors of the sale or lease in question.

Contrast this to purchase-money security devices in the common-law provinces, where certain perfecting steps, including in certain circumstances the sending of notices to other registered creditors, must be carried out prior to the goods in question being delivered.

A single global registration to cover present and future instalment sales or leases is possible, apparently, so long as it reflects the intention of the parties (art. 2961.1 CCQ). Lenders and vendors that finance inventory or even manufacturing equipment

typically register in this way.

Choosing a device

Although each specific situation should be addressed with counsel, note that in choosing between a hypothec or another device, a number of factors are relevant. There is no rule requiring an instalment sale or lease to be in a particular form, or even to be in writing, making those devices relatively simple to set up. Conversely, a movable hypothec must be in writing (art. 2696 CCQ), and state in Canadian dollars the maximum amount that it secures (art. 2689 CCQ). However, if the goods sold are smaller items that will be integrated into a larger property (for example, small component parts to be installed in a large machine or other end product), a general property rule in the CCQ (art. 971) will usually deprive the vendor of the small parts of its ownership rights, even if they are properly registered, and ownership of the small parts would vest with the owner of the large end product.

Conversely, when hypothecated movable property is integrated into a larger property, the hypothec rules allow for secured rights to be shared proportionately among the competing hypothecary creditors (arts. 2671, 2673 and 2953 CCQ).

Also notable is that although

a hypothec on an individual property extends to replacement property or traceable proceeds (art. 2674 CCQ), no similar provision exists for instalment sales and leases, and there is little caselaw on whether an instalment sale or a lease also extends to traceable proceeds of the property in question.

Finally, two more points beg brief mention. First, for vendors of property that will be incorporated into immovable property (*i.e.*, real estate) in Quebec, an older line of cases dealing with these rules has held that a supplier of materials selling to another supplier rather than to the building contractor or to the owner of the building may have no practical way to secure its claim. Second, for vendors shipping goods into Quebec under a true consignment arrangement, the CCQ does not explicitly regulate consignment, and an older line of cases has held that a true consignment does not have to be registered in Quebec, nor do other registered creditors have to receive notice of the consignment.

Daniel Frajman practises law at Spiegel Sohmer in Montreal. His practice areas include commercial transactions, asset-based lending, real estate, trusts and shareholder matters. E-mail: dfrajman@spiegelsohmer.com.