

THE Canadian TAXPAYER

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ISSN 0225-0608

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Subscription rate: \$455 per year, plus shipping, handling and GST
Published Twice Monthly
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PAP REGISTRATION #8961
PUBLICATIONS MAIL AGREEMENT #1410091

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that Dexter and his party will try to emulate the fiscal success of Manitoba's NDP government under Gary Doer.

The next step will obviously be to put together a cabinet and to bring down a budget. The detailed budget which we reported on in Issue #11 will not likely even be the framework for the NDP budget given not just some of the promises made but also the fact that the former government fell because it attempted to shift funds earmarked for debt reduction to current use. . . and thus showed a surplus.

Dexter won't be able to do that so it is likely that he will bring down a deficit budget.

While it is tempting to suggest that it was the economic climate which did in the Conservatives, there really isn't any firm evidence of that. Our read of the situation is that the time had come for a change and that Dexter was more familiar to the voters than was Liberal Leader Stephen McNeil, who was chosen leader only two years ago. With a viable three-party system, Nova Scotia looks to be particularly interesting to watch over the next several years.

OPCO GRANTING SECURITY OVER INVESTMENTS: NEW RULES¹

by Daniel Frajman

An operating company ("Opco") may grant security over its assets for a variety of reasons. For example, security could be granted when Opco's equity is converted into secured debt held by a corporate shareholder ("Holdco"),² or it could arise when an arm's length lender such as a financial institution makes a secured loan to Opco.

Whether the secured creditor is Holdco or a bank, steps must be taken by it to perfect the security as against Opco and other creditors. Recent changes in the law require extra care when the security is over investment property such as near-cash, marketable securities or private company shares that may be owned by Opco or one of its principals. These changes in the law, including those relating to preserving the usefulness of paper-based share and other security certificates, and concerning the importance of control agreements with respect to brokerage and other securities accounts, are briefly reviewed below.

Securities Transfer Acts

Most provinces have recently enacted a *Securities Transfer Act* ("STA"), and this new legislation highlights that in the area of taking a security interest (or in Quebec terms, a hypothec) over shares or other securities such as bonds, it may be more advantageous and less expensive for a secured creditor to perfect its security interest by taking possession of a security certificate.

Holding a humble share or bond certificate therefore may be seen as "king", trumping other interests and providing advantages over relying on

¹ An earlier version of this article appeared in the May 15, 2009 issue of *The Lawyers Weekly*, published by LexisNexis Canada Inc.

² For example, when the proceeds of an intercorporate dividend that is tax-free because of a deduction under subsection 112(1) of the *Income Tax Act* (Canada), are loaned-back by Holdco to Opco against security.

a registered security interest and related perfecting steps for book-based brokerage accounts.

The Quebec securities transfer legislation³ came into force on January 1, 2009, and the Ontario legislation⁴ on January 1, 2007. Many of the Quebec rules have been integrated into the *Civil Code of Quebec* ("CCQ"), and many of the Ontario rules have been integrated into the Ontario *Personal Property Security Act* ("OPPSA"). The American states have similar rules dating back over 10 years, found in articles 8 and 9 of the U.S. *Uniform Commercial Code* ("UCC").

The Certificate

A security interest in a security certificate (in principle, issued by either a private or public company, or a government⁵) registered in the debtor's name and put into the creditor's possession so as to set up a security interest by way of a possessory pledge, should rank ahead of any earlier registered security interest over the investment represented by the certificate (a. 2714.4 CCQ; s. 30.1(3) OPPSA).

Furthermore, conflict of law rules often indicate that the law governing the continuing perfection of the possessory pledge is the law of the place where the security certificate is kept on behalf of the secured creditor (a. 3108.8(1) CCQ; s. 7.1(2) OPPSA; a. 9-305(a) of the U.S. UCC). This will give secured creditors who take pledged certificates back to their place of business (in Canada or the U.S.) for safekeeping a degree of comfort, since the law governing the continuing validity of their pledges is usually that of the jurisdiction where they are located.

The Brokerage Account

In comparison with the simplicity of the above-mentioned possessory pledge of a security certifi-

cate, a registered security interest over a debtor's brokerage account often requires that the securities broker acknowledge that the secured creditor has a right to take over the account, usually on the default of the debtor (usually set out in an unregistered "control agreement" concerning the account, among the creditor, broker and debtor). This requirement arises because the first secured creditor to obtain a control agreement should rank first over the account, regardless of the order of registered interests (ss. 113-4 QSTA; ss. 25 and 28 OSTA; a. 2714.2 CCQ; s. 30.1(4) OPPSA).⁶ Proper due diligence by a creditor securing without a pledge therefore includes inquiring as to whether others already hold a control agreement over the account, and whether the debtor owes or may owe money to the broker.

When Holdco is the secured creditor, it is often privy to Opco's activities, and therefore Holdco may be able to delay taking steps to obtain a control agreement until a competing secured creditor requests one. Conversely, when a financial institution or other arm's length party is the secured creditor, it is important for the creditor to obtain a control agreement as soon as possible over material investment property, to prevent a subsequent secured creditor from obtaining one first.⁷

Control

Among other notable issues, the following should be considered:

- A creditor should obtain "control" of the security if possible (either by holding a security certificate that the debtor has endorsed, by being inscribed as owner in the records of the issuer of the security, or by obtaining a control agreement), because a creditor having control can obtain, by contract with the debtor, a right to sell the collateral on default without going to court (a. 2759 CCQ; s. 17.1(2) OPPSA);

3 An Act respecting the transfer of securities and the establishment of security entitlements, R.S.Q., c. T-11.002 (the "Quebec Securities Transfer Act", or "QSTA").

4 Securities Transfer Act, 2006, S.O. 2006, c. 8 ("OSTA").

5 One of the necessary elements of such a security interest is that the underlying security represented by the certificate must be transferable, often confirmed either by obtaining consent to a transfer from a private company's board of directors (or shareholders if necessary), or for securities issued by a public company or a government, by reviewing transferability rules in the prospectus and/or related documents.

6 Where a margin account is not intended, the control agreement also should include if possible a waiver by the broker of its prior-ranking lien over the account which otherwise arises when securities are purchased on credit (aa. 2714.1 and 2714.3 CCQ; ss. 11.1(1) and 30.1(5) OPPSA).

7 Obtaining a control agreement is even more pressing for a financial institution when the investment property is held by a broker/custodian unrelated to the financial institution.

- If cross-border issues will arise, it is often best to use wording that has meaning in multiple jurisdictions (such as "security interest and hypothec over personal and movable property", and usually stating a maximum monetary hypothecary amount⁸). The law governing the debtor's securities account will often end up being the law governing security interests over that account (aa. 3108.8(3) and 3108.7(1) CCQ; s. 7.1(2) OPPSA; s. 45 OSTA).
- For limited partnerships that do not publicly trade, consider inserting a clause in the partnership agreement subjecting the limited partnership units to the STA (s. 14 QSTA; s. 12 OSTA). Otherwise, it may be impossible to obtain a pledge or control of those units (a. 2714.7 CCQ; s. 22 OPPSA). A similar rule exists in the U.S. (a. 8103(c) U.S. UCC).

In summary regarding the STA, one of its aims is to harmonize among the provinces, and with the U.S., the law relating to security interests over shares and other investment property.⁹ The law preserves and even promotes the usefulness of paper-based security certificates, and also recognizes the realities of modern book-based securities, as well as securities accounts.

Securing Personal Guarantees

Regarding a related issue, note that Quebec also recently harmonized a basic rule concerning the securing of personal guarantees.

The old rule in this regard in Quebec prevented an individual from granting non-possessory (i.e.

non-pledge) security over most non-business movable or personal property (including non-business investment property), one effect of which was to hinder individuals from providing movable/personal security to guarantee corporate debts.¹⁰ This changed recently when the Quebec government took the unusual step of amending a regulation to the *Civil Code* by decree and without advance notice, to stipulate in a new rule that an individual could henceforth grant non-possessory security over all of his incorporeal/intangible property (such as bank and brokerage accounts, personally owned life insurance, etc.), and over certain listed corporeal/tangible movable property.¹¹

This change seems to be an about face in Quebec. In 1991, the old rule in this regard was referred to in debates in the Quebec National Assembly as being necessary to prevent individuals in Quebec from borrowing too much. Conversely, the above-mentioned recent Quebec government decree states that the new rule is meant to prevent "an increase in credit costs prejudicial [to individuals], particularly in the current economic context".

Note that this new rule by exception prohibits an individual from hypothecating an RRSP, RRIF, RESP or registered disability savings plan, which is a useful way to prevent the possible unintended deregistration of such a plan by way of encumbering it with a security interest.¹²

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8 Article 2689 CCQ: A deed constituting a Quebec hypothec must indicate "the specific sum [i.e., hypothecary amount] for which it is granted" in principal, and interest if possible. The hypothecary amount must be stated in Canadian dollars. However, arguably a pledge, which need not be in writing, need not state a hypothecary amount. *Quaere*: does the existence of a control agreement turn a Quebec hypothec into a pledge which would not need to state a hypothecary amount? See articles 2714.1 and 2714.2 CCQ.

9 Section 1 of the QSTA states that the legislation is "part of an effort by the Canadian provinces and territories to harmonize their laws" on the transfer of securities and the establishment of rights to financial assets.

10 Article 2683 CCQ. This old rule was attenuated in *Caisse Populaire Desjardins de Val-Brillant v. Blouin*, [2003] 1 S.C.R. 666, 2003 CarswellQue 1113, 36 C.C.P.B. 62, 2003 D.T.C. 5420 ("Val-Brillant"), which held that an individual could in certain circumstances grant a hypothec over non-business monetary "claims". *Val-Brillant* helped in the personal planning context, but financial institutions often may have been uncomfortable in relying upon it. Note that the CCQ does not and never has prevented an individual from hypothecating immovable property (real estate).

11 Quebec Order in Council, 30-2009, of January 14, 2009, Quebec Official Gazette, January 16, 2009, Vol. 141, No. 2A, at pp. 17A-18A.

12 *Re Whaling*, 1998 CarswellOnt 4888, [1999] 4 C.T.C. 221, 99 D.T.C. 5478 (Ont. C.A.).