

## CORPORATE COMMERCIAL LAW

# SCC highlights "antiquated" Quebec law on security over personal property

By Daniel Frajman

Two recent decisions rendered by the Supreme Court of Canada on appeal from Quebec, *Lefebvre* (Trustee of), [2004] S.C.J. No. 62 ("Lefebvre"), and *Ouellet* (Trustee of), [2004] S.C.J. No. 59 ("Ouellet"), along with subsequent cases, including the Quebec Court of Appeal decision of *Transport International Pool Inc. v. St-Georges, Hébert Inc.*, [2005] J.Q. no 259 ("TIP"), underline an antiquated aspect of Quebec's law concerning security over movable (personal) property, namely that lessors of commercial movable property such as equipment may not always be required to properly perfect their security agreements in order to retain secured rights. This may allow such lessors to claim that their rights outrank the unregistered super priorities often held by the federal and provincial Crown, and therefore encourage Quebec suppliers of commercial equipment to lease property to their customers rather than to supply under other mechanisms.

## Title retention

In *Lefebvre*, a lessor of movable property did not satisfy the major perfecting step, as the lease was not registered within 15 days of being entered into. (Under articles 1847 and 1852 of the *Civil Code of Quebec*, or "CCQ", this 15 day rule applies with regard to leases with a term greater than one year, and all so-called financial leases.) Similarly in *Ouellet*, which concerned an instalment sale (conditional sale), the major perfecting step, being registration of the sale within 15 days of its being entered into (art. 1745 CCQ), was not satisfied.

## Court reversed Commission decision

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should have sought direction on notice to Philip as to how to treat these documents."

On this basis, the court reversed the Commission decision and ordered that the extracts from the legal opinions contained in the Statement of Allegations be removed. The Divisional Court decision was not appealed.

Bradley Davis (and David Byers) were counsel for Philip (by its receiver) and are members of Stikeman Elliott LLP's National Litigation Group.

As is common in Quebec, the lease in *Lefebvre* and the instalment sale in *Ouellet* were drafted as title retention agreements, with no mention made of a hypothec (security interest) being created. In both cases, the trustee in bankruptcy argued that the registration error meant that the property in question could be distributed among the ordinary creditors, and should not be returned to the lessor or vendor of the property.

Although not commented upon in the two cases, it is notable that there were apparently no competing secured creditors against the lessor and vendor in question.

The Supreme Court in its decisions in *Lefebvre* and *Ouellet* found in favour of the lessor and vendor, and against the trustee in bankruptcy. In so doing, the high court departed from an earlier line of case law in the Quebec Court of Appeal (found in, for example,

*Massowis* (Trustee of), [2002] J.Q. no 595), by essentially overriding the above-mentioned provisions of the CCQ and holding that the ownership rights of the lessor (in *Lefebvre*) and the vendor (in *Ouellet*) remained opposable against a trustee in bankruptcy even though the agreements were not properly registered. The rationale of the Supreme Court appears to be based on an aspect of Quebec security law that seems old-fashioned, namely that unless a deed explicitly creates a hypothec (a security interest), it cannot be presumed that it creates a hypothec. In

see *LEFEBVRE* p. 16



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## Suppliers may want to adjust their forms of agreement

LEFEBVRE  
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effect then, Quebec legislation does not contain the presumptive security provision typical to the common law provinces, such as s. 2 of the Ontario *Personal Property Security Act* which states that any transaction that in substance creates a security interest is governed by the general security regime.

### For leases only

In an interesting twist relating to the interplay between provincial security law (here, the CCQ) and federal legislation (here, the *Bankruptcy and Insolvency Act*, or "BIA"), the Supreme Court indicated in *Ouellet* that the above-mentioned title retention analysis would not apply to instalment sales coming before the courts after May 2001, at which time an amendment was made to the definition of "secured creditor" at s. 2 of the BIA to the effect that a vendor under a Quebec "conditional or instalment sale" (but not it seems a lessor under a Quebec lease) would be considered to be a secured creditor for most aspects of insolvency law, and that proper registration of an instalment sale (but not it seems a lease) would thereafter be required if the creditor's retention of title was to be opposable to a trustee in bankruptcy.

Several subsequent Quebec

decisions, including the Quebec Court of Appeal's decision in *TIP*, appear to support this view that as against the trustee, a lessor need not perfect by registration. For lessors, the *TIP* case also has the advantage of taking a simplistic approach that appears to treat all leases in this same way, regardless of whether the lessee holds an option or other rights to purchase the property at the end of the lease.

### Crown super priorities

An important super priority

debtor's possession.

Therefore, if one of the goals of a Quebec supplier of property, such as equipment, is to hold rights over the property that may rank ahead of Crown super priorities, then even though this question seems not yet to have been squarely addressed by a court in Quebec, it appears to be logical given the *Lefebvre* and *Ouellet* cases to supply the property under a lease, rather than under an instalment sale or under a vendor take-back hypothec. This would be based on the Supreme Court's apparent view in these cases that leased property (as opposed to property sold under an instalment

with respect to goods delivered within the last 30 days and remaining in the debtor's possession.

### Tax and accounting

From an accounting point of view, the supplier and user of equipment both should normally be neutral in deciding whether the transaction should be a contract of lease or an instalment sale. This is because when the circumstances of the lease transfer substantially all of the benefits and risks of ownership of the equipment to the user (which is most often the case), both the supplier and user would treat the property as having been sold, and transferred to the user's

balance sheet. (Generally accepted accounting principles in this regard are at chapter 3065 of the *Canadian Institute of Chartered Accountants Handbook*.) Furthermore, tax treatment of the contract in these circumstances generally should not impact the decision.

Therefore, there is generally not a tax or accounting reason that would block the use of a lease in Quebec, rather than an instalment sale, for purposes of the supplier's ownership right arguably outranking Crown super priorities. Suppliers may want to adjust their forms of agreement accordingly.

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**"There is generally not a tax or accounting reason that would block the use of a lease in Quebec, rather than an instalment sale, for purposes of the supplier's ownership right arguably outranking Crown super priorities."**

held by the federal and Quebec Crowns is the unregistered deemed trust arising under various statutes, securing various tax debts owed to the Crown such as payroll levies and Quebec sales tax ("QST"), and meant to rank ahead of other secured creditors (See, for example, ss. 227(4) and following of the ITA, and s. 20 of the Quebec *Minister of Revenue Act*). Additionally, article 2651 CCQ provides for an unregistered Crown "prior claim" (in favour of Quebec, but possibly not the federal Crown) that ranks ahead of other secured creditors, so long as the collateral has remained in the

sale, or hypothecated property), regardless of whether the lessee has an option to purchase the property or to otherwise become owner upon completion of a payment schedule, is a title retention mechanism that is not security per se. Therefore it appears that leases would not compete against Crown super priorities aimed at assets of the debtor and possibly also at assets that are charged with security. Furthermore, a lessor need not meet the strict provisions of s. 81.1 BIA (the so-called "30 day goods" rule) that allow an unpaid vendor to repossess goods ahead of Crown super priorities, but only