



U.S. Perspectives from Canada's Law Firm

Taking security in Québec:
Guidance for U.S. lenders

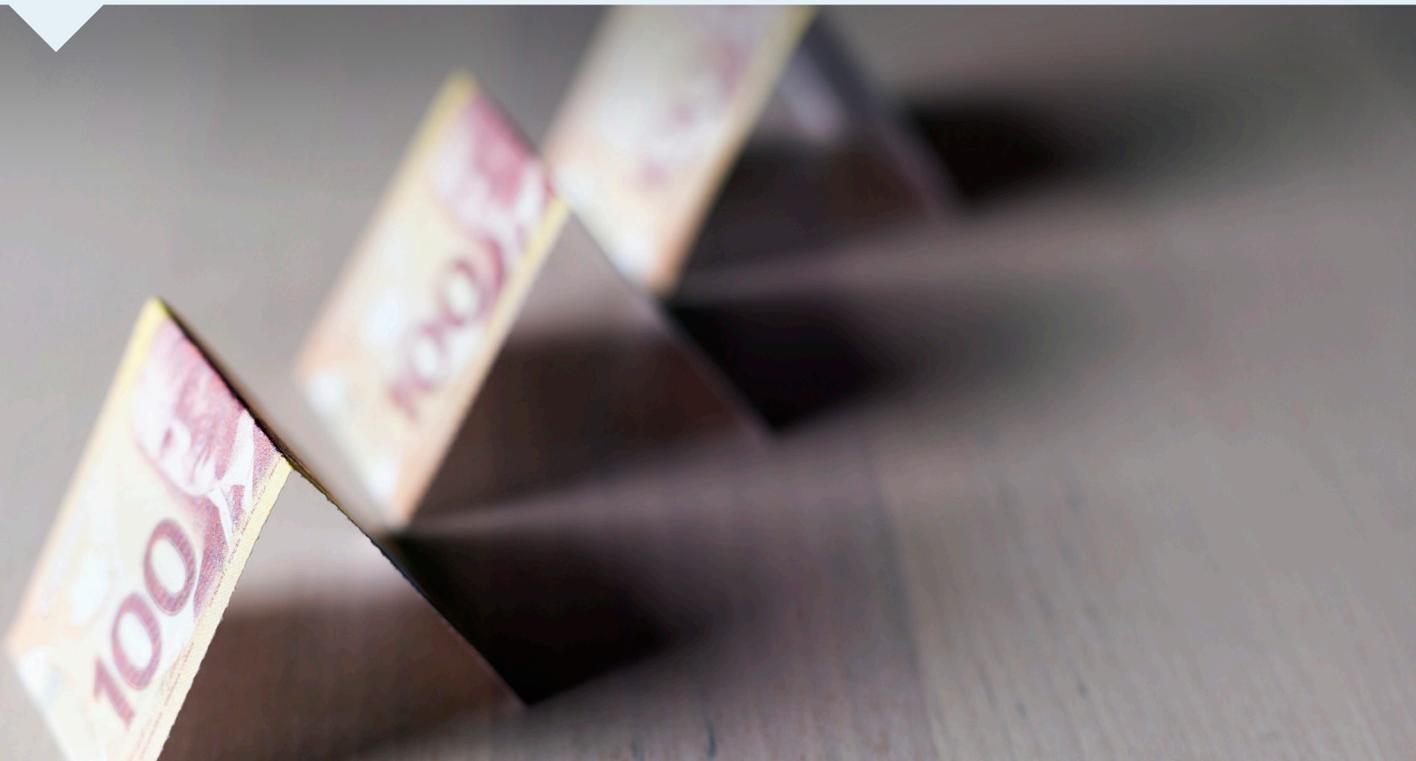
When a lender wishes to take security on assets located in a foreign jurisdiction, it is often required to engage local counsel in order to ensure that its security is enforceable and that, in the event of a default, the lender may exercise its recourses in a manner similar to the way it would enforce its rights in its home jurisdiction.

Taking security in Canada is no different. Canada is divided into 10 provinces and three territories, each with its own personal property security regime. All such regimes have personal property security acts substantially similar to Article 9 of the American *Uniform Commercial Code*, with the exception of the province of Québec which, due to its unique history, has a civil law system rooted in the Napoleonic tradition.

While taking security in Québec requires different formalities than those required in other parts of Canada, the process is relatively straightforward and ultimately leads to virtually identical substantive results. The aim of this document is to provide secured lenders with a high-level summary respecting what is involved in taking security on assets located in Québec.

Background

The fundamental means of taking security in Québec is by virtue of a “hypothec.” According to the *Civil Code of Québec* (the CCQ), a hypothec is essentially a charge on one or more assets. It is important to note that hypothecs are not conceptually identical to a “security interest” under the laws of other jurisdictions in Canada. While the concept of security interest used outside of Québec is intended to capture any form of a legal mechanism used to secure the performance of an obligation irrespective of legal form, the CCQ provides for other forms of security such as installment sales, long-term leases and retention of title agreements, all of which are governed by particular CCQ rules and are registrable in Québec’s centralized Register of Personal and Movable Real Rights (the RPMRR) in order to ensure that registered rights are enforceable against third parties. In this article we focus solely on hypothecs.



Hypothec

Notwithstanding the domicile (somewhat analogous to the notion of location in common law jurisdictions) of the debtor being financed or the obligor guaranteeing the debtor's obligations, Québec conflict of laws principles provide that if the assets being secured are located in Québec, then the province's legislation will govern the process of taking and perfecting security. As a general rule, corporeal (tangible) property is located in Québec if it is situated in the province and not also used in other provinces, and incorporeal (intangible) property is located in Québec if the debtor has its registered office there.

Charged property

Hypothecs may create a charge on specific corporeal or incorporeal property, movable (goods/personal property) or immovable (real estate), or may charge a universality of property. A "universality" under Québec law is generally understood to mean all property of a certain type or category, such as movable or immovable, or more specifically, equipment, machinery, vehicles, inventory, receivables, securities, intellectual property rights, etc. Consequently, a lender wishing to take security over present and after-acquired personal property (in UCC parlance) would require a hypothec over the "universality of the debtor's present and future movable property" in Québec. Therefore, an agreement securing the universality of a debtor's property would be conceptually equivalent to general security common in other jurisdictions.

The grantor

Hypothecs can be granted by legal persons (*i.e.*, corporations, partnerships, etc.) and by natural persons (*i.e.*, individuals). However, hypothecs granted by individuals are subject to strict prohibitions under Québec law, which are beyond the scope of this summary.

Only a person who carries on an "enterprise" within the meaning of the CCQ (which includes a business corporation or partnership) may for the purpose of its enterprise hypothecate a movable while retaining possession of same, or may grant a hypothec on a universality, present or future. All other persons may only grant a hypothec on immovable property or on movable property with delivery (*i.e.*, a pledge), with certain exceptions.

Formal requirements

As a general rule, in order to create a hypothec, the following elements are required:

- a written document (with the notable exception of a pledge, which does not require a written document);
- a sufficient description of the secured obligations (which can be described specifically or more generally as "all present and future obligations" of the debtor);
- a sufficient description of the charged property as mentioned above; and
- the amount of the charge expressed in Canadian dollars.

With respect to this final point, a hypothec on any kind of property must be granted for a specific amount bearing interest at a specifically stated rate or for an interest rate that can be determined from the expression of the grant. This rule applies even if the obligation secured has no stated amount. The amount of a hypothec should be viewed as a "cap" and does not necessarily reflect the actual amount of the underlying indebtedness or the value of the secured obligations.

In fact, under Québec law, since a creditor is prohibited from enforcing its hypothec for any amount in excess of the true underlying indebtedness, it is common for parties to agree on hypothec amounts that far exceed the actual amount of the underlying obligations, because doing so poses no additional risk for the debtor. It should also be noted that under the CCQ, certain fees incurred by a secured creditor in enforcing its security (such as certain attorney's fees) may not, under any circumstances, be guaranteed by hypothec. This represents an important departure from the state of the law in many other North American jurisdictions.

As an additional formality, hypothecs on immovable property and hypothecs in favour of an agent, acting on behalf of a syndicate of lenders, must be granted by way of a document that meets certain formal requirements which must be executed before a Québec notary. A Québec notary is not equivalent to a Notary Public, common in other jurisdictions, but rather is a legal professional that is often engaged in connection with real estate transactions, wills and estates. Consequently, for parties who do not have representatives or signing officers in Québec, a Québec notary must either travel to the appropriate jurisdiction to witness the execution of the hypothec or the parties must name a person to sign on their behalf in Québec before a Québec notary. This is commonly accomplished by way of power of attorney or authorizing resolution.

Perfection

In the case of a movable hypothec, an agreement must be executed by the debtor or obligor (as grantor of the hypothec) before a registration statement is filed at the RPMRR. Registration is required in order to perfect the security, or in Québec terms, render the hypothec opposable to, and enforceable against third parties and to establish its rank.

For real estate transactions, originals of the notarized deed of immovable hypothec are registered at the appropriate Land Registry Office.



Property

As a general rule, the CCQ provides that hypothecs rank from the date and minute of their registration (or publication) at the RPMRR or the Land Registry, as applicable. Consequently, publication is an essential element of the validity of any hypothec in order to allow the holder thereof to enforce its rights against third parties.

As in other jurisdictions, it is quite common for competing secured creditors to enter into priority agreements or intercreditor agreements to vary the order of priority of their respective security.

It is also important to note that the CCQ provides for certain super-priorities, which can trump a secured creditor's rights regardless of the date of publication of that creditor's hypothec. These super-priorities are of particular concern when financing real estate, as many of these priorities relate to unpaid taxes and construction liens.

Enforcement

In addition to its right of action against a debtor, a secured creditor may only exercise any one of four hypothecary rights provided for by the CCQ:

- have the property sold by judicial authority;
- sell the property;
- take the property in payment; or
- take possession of the property to administer it.

When a hypothecary debtor is in default, a hypothecary creditor must first register a prior notice which provides the debtor with a delay (20 days for movables and 60 days for immovables) to correct the default.

The rights of a hypothecary creditor and the attendant delays and procedures for enforcing such rights are set out in the CCQ and cannot be contractually varied or waived in advance.

If the debtor does not voluntarily surrender the hypothecated property to the creditor before or at the moment of the expiry of the relevant notice period, then the creditor must obtain a court order allowing it to seize the hypothecated property. This court order is obtained by filing a motion with the Superior Court of Québec, which is generally heard 30 days after the motion is filed. This delay is in addition to the 20 and/or 60 day notices described above.

Finally, it should be noted that under exceptional circumstances and in cases where the hypothecary creditor can prove there is a serious risk of the hypothecated property deteriorating or being fraudulently disposed of by the debtor within the prescribed notice period, a motion may be made to the Superior Court for an interim order to allow the creditor to seize the hypothecated property immediately and hold it pending the court's final order.

Extinction

Movable hypothecs are extinguished 10 years after the date of their registration unless they are renewed for another 10 years. Immovable hypothecs are extinguished 30 years after the date of their registration or registration of notice to renew it.

Conclusion

The purpose of this broad outline is to give the reader an overall appreciation of the essential elements associated with taking security in Québec. As demonstrated, while the legal concepts governing Québec security and names of the agreements used in Québec secured transactions vary from those typically used elsewhere in Canada and the United States, the legal efforts of such concepts and agreements are substantially similar in protecting the interests of secured creditors.



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