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THE PERSONAL PROPERTY SECURITY ACTS AND THE QUEBEC CIVIL CODE

Similarities and Differences

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INTRODUCTION

Under the Personal Property Security Acts (“*PPSAs*”), any interest in personal property that secures performance of an obligation is a security interest, without regard to its form or to the person who has title to the collateral. For instance, a title reservation agreement in a contract for the sale of goods is treated as a security interest under the *PPSAs*, notwithstanding that the debtor does not hold title to the goods.

Under the Civil Code of Quebec (“*CCQ*”), the comparable right, known as a hypothec, is a right created by the grantor in the grantor’s own property, to secure the performance of an obligation. Security devices where title is not held by the debtor (e.g. a conditional sale) are not hypothecs; for convenience, such security devices are generally referred to as “quasi-security interests”.

This conceptual difference between the *PPSAs* and the Quebec legal regime becomes less significant when one notes that most quasi-security interests are subject to the same publicity requirements and enforcement limitations as those applicable to hypothecs.

1! SCOPE OF APPLICATION OF PERSONAL PROPERTY SECURITY LAW

1.1 The *PPSAs* apply to all transactions that, in substance, create a security interest in personal property, even though the debtor may not have title to the collateral. The *PPSAs* also apply to certain transactions that do not secure the performance of an obligation such as a sale of accounts and, except in Ontario, a non-financial lease for a term of more than one year.

1.1 In Quebec, the legal regime for security interests only applies to hypothecs. Quasi-security interests are autonomous security mechanisms and have their own rules.

1.1 However, Quebec law provides that most quasi-security interests are subject to publicity requirements (i.e. filing) similar to those prescribed for non-possessory hypothecs:

- title reservation agreement;
- leasing agreement (i.e. financial lease);
- sale with a right of redemption;
- security trust.

1.1 To be enforceable against third parties, a general assignment of debts and a lease for a term of more than one year must also be registered in the same manner as a hypothec, even if the transaction has not been made for security purposes. However, there is no need to register an assignment of a specific debt if the assignment is not by way of security.

1.1 Quasi-security interests which do not fall in either of the categories listed in 1.3 are not subject to registration; for instance, a commercial consignment is not subject to registration and would be enforceable against the consignee's creditors to the extent that the transaction would not be characterized as a disguised conditional sale. There is some scope, therefore, under the CCQ to fashion security devices that are exempt from normal registration or perfection requirements.

1! VALIDITY AND EXTENT OF A SECURITY

1.1 Under the *PPSAs*, a debtor must have rights in the collateral in order for a security interest to "attach"; however, the debtor need not be the owner of the collateral. Under the CCQ, a hypothec is by definition a right held by the creditor in property owned by the grantor.

1.1 The *PPSAs* require that the debtor sign a security agreement describing the collateral in order for a non-possessory security interest to be enforceable against third parties. Under the CCQ, in the case of a non-possessory hypothec, a written instrument is required not only for the

enforceability of the hypothec against third parties but also for its validity as between the debtor and the secured party; in addition to describing the collateral, the instrument must specify the maximum amount for which the hypothec is granted.

1.1 The CCQ, contrary to the *PPSAs*, restricts the ability of individuals to grant non-possessory security interests. As a general rule, an individual may grant a non-possessory hypothec only if he carries on an enterprise and then only on collateral which is an asset of the enterprise. However, most quasi-security interests are not subject to this rule (title reservation agreements, leases, security trust).

1.1 Under the *PPSAs*, a security interest in collateral extends to proceeds, while this is not the case in Quebec (except for some exceptions). Accordingly, if goods hypothecated under Quebec law are sold with payment terms, the receivable arising from the sale will be subject to the hypothec only to the extent that the description of the collateral in the hypothec also includes proceeds. As a practical matter, this difference between the two systems is not of much importance, since most hypothecation agreements describe the hypothecated property as also including proceeds of the original collateral.

1.1 The *PPSAs*, except the Ontario one, provide that an assignment of an account is effective notwithstanding any prohibition on assignment in the original contract between the assignor and the account debtor. In Ontario, the relevant common law rule would give effect to the assignment as between the assignor and the assignee without however the latter being entitled to enforce the assignment against the account debtor. The CCQ does not address explicitly these issues and there is no consensus among commentators as to the effectiveness of anti-assignment clauses.

2! PERFECTION AND PRIORITIES

1.1 The *PPSAs* and the CCQ generally provide that any security interest may be perfected by registration (i.e. by filing a notice with the appropriate registry).

1.1 Possession of the collateral by the secured party or by another person on behalf of the secured party also perfects a non-possessory security interest in the *PPSA* provinces as well as in Quebec. However, the categories of collateral susceptible of being pledged are less numerous in Quebec. For instance, the chattel paper concept is unknown in Quebec law and it is doubtful that possession of chattel paper by a secured party would be sufficient to create a possessory hypothec in the rights evidenced by such a document.

1.1 As a general rule, the *PPSAs* and the CCQ determine the priority of the rights of a secured party on the basis of the time of perfection of the secured interest.

1.1 The "first in time" rule is subject to more exceptions in the *PPSAs* than in the CCQ. For instance, under the *PPSAs*, a pledgee in good faith of securities will rank ahead of a prior registered non-possessory security interest in the same securities. Under the CCQ, possession of the collateral cannot by itself confer priority over a prior registered security in the same collateral.

1.1 Under the *PPSAs*, purchase-money security interests ("*PMSI*") are another exception to the "first in time" rule. In Quebec, a similar protection is available to sellers or lessors but not to lenders; therefore, a financial institution which finances the acquisition of goods cannot benefit from a priority equivalent to that conferred by a *PMSI* under the *PPSAs*, if the financing is provided through a direct loan to the purchaser.

1! REMEDIES

1.1 Remedies available to a secured party are similar under the *PPSAs* and the CCQ: the secured party may take possession of the collateral, sell the collateral or take the collateral in satisfaction of the debt. Where the collateral consists of accounts, the secured party may also collect same.

1.1 The enforcement of these remedies is however subject to more constraints in Quebec than in the *PPSAs* provinces.

1.1 Two significant differences between the two systems are noteworthy:

- in Quebec, the holder of a hypothec needs a Court order to be empowered to take possession of the collateral, if the debtor does not voluntarily surrender possession of same to the secured party; in the *PPSA* provinces, self-help is possible and no such Court authorization is required; and
- although both the *PPSA*s and the CCQ require the secured party to give the debtor a prior notice before realizing on the security, there are in the *PPSA*s many instances where the secured party is exempt from such prior notice requirement (including where the collateral consists of securities tradeable on a recognized market). In Quebec, save one exception of a limited scope, the holder of a hypothec cannot be exempted from the obligation to give the debtor a prior notice of his intention to dispose of the hypothecated property; if the collateral is perishable or likely to decline speedily in value, the hypothecary creditor still has to give the required notice but he may apply to the Court to shorten the notice period.

1.1 The legal framework governing realization of most quasi-security interests is in Quebec the same as for hypothecs. However, enforcement under a lease (financial or not) is not subject to notice requirements and self-help is then possible.

1! CONFLICTS OF LAWS

1.1 The general principles which form the basis of the conflict rules are the same under the *PPSA*s and the CCQ:

- the law of the location of the collateral governs the validity and perfection of a non-possessory security in tangible property (“goods”) and of any possessory security;
- the law of the location of the debtor governs the validity and perfection of a non-possessory security in non-tangible property (including securities) and in tangible property (“goods”) which are of a type that are normally used in more than one jurisdiction.

1.1 There are some differences with respect to the application of these principles. For instance, under the *PPSA*s, a corporation is located at its

place of business and, if it has more than one place of business, at its chief executive office. Under the CCQ, a corporation is located at its statutory head office (i.e. registered office).

1.1 Since the CCQ, contrary to the *PPSAs*, does not subject sales of accounts to the legal regime governing security interests, it follows that the conflict rules for security interests do not apply to sales of accounts. One must then refer to the property law general conflict rules, which point to the law of the location of the property, without regard to the tangible or intangible nature of the property. Therefore, the validity and perfection of the sale of an account are governed by the law of the situs of the account.

1.1 With respect to quasi-security interests, although not being security interests in the internal law of Quebec, there is a debate as to whether they should be characterized as security interests for private international law purposes. In the absence of such characterization, the conflict rules applicable to quasi-security interests would be those for property law in general.