Lessors and Instalment Sellers: Beware!

New Court Decisions on Legal Requirements for Registration of Instalment Sales, Ordinary Leases and Leasing Contracts: A Nightmare for Businessmen and Lawyers

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Summary

Executive Summary

Three recent decisions of the Court of Appeal of Quebec, namely *Massouris (Syndic de)*, J.E. 2002-726, *Mervis*, J.E. 2002-1650 and *Lefebvre and Services Financiers Daimler Chrysler (Rebis) Canada Inc.* v. *Lebel*, R.E.J.B. 2003-38975, in attempting to solve ambiguities in the law with respect to registering instalment sales, ordinary leases and leasings at the Register of Personal and Movable Real Rights (the "Register"), have created greater issues that threaten the very nature of these "title retention devices". In fact, the combined effect of these decisions is to:

(a) make failure to register any of these title retention devices within fifteen (15) days from the effective date of the underlying contract, ineffective against (i.e. inopposable to) third parties and subsequent acquirers. (Whether these third parties must be secured third parties who have registered their rights prior to the late registration of these title retention devices remains to be seen);

(b) make a trustee in bankruptcy a "third party" for the sake of (a);

(c) make each of an instalment sale, an ordinary lease or a leasing, a "security interest" rather than a true "title retention device".

Only One Safe Bet

This has the unfortunate effect of destabilizing the instalment sale, ordinary lease and leasing industries, making untimely or lack of registration very difficult to correct, if possible at all. These cases also have a negative impact on the possibility of selling these contracts under securitizations and other funder programs as the title of the instalment seller or lessor (under an ordinary lease or leasing) to the goods under these contracts is now more uncertain than ever.

The only safe bet is to register one's interest within fifteen (15) days of the date at which the instalment sale, ordinary lease or leasing contract becomes effective and prior to delivery of the goods thereunder. Guidance from the Supreme Court of Canada and the provincial legislator will have to be forthcoming in order to level the playing field between, on the one hand, instalment sellers and lessors (under ordinary leases and leasing agreements), and, on the other hand, other secured creditors.

Master instalment sales, master ordinary leases and master leasing agreements offer a good alternative to individualized contracts. There seems to be no requirement to register them within fifteen (15) days of the date they become effective. However, one should have these signed and registered prior to the first delivery of the goods thereunder. While drafting such a contract requires expertise so as to ensure that the goods flowing between the parties under these contracts are properly described and represent a "universality of property of the same kind", if properly done, a one-time registration at the Register will be effective for ten (10) years.

Ensure the Security of Your Transactions

Living with the present state of the law is a difficult task. The following should provide some guidance to instalment sellers and lessors (under ordinary leases and leasings) as to how to protect their rights over their goods, and what to do if an error has been made. As a result of the new case law, instalment sellers and lessors (under ordinary leases and leasings) should review their internal procedures and practices to ensure that registrations are made within the proper delays and that no delivery occurs prior to such timely registrations.

We invite you to read this bulletin and to communicate with us if you have any inquiries as to the matters further discussed herein, or as to how to better implement new procedures and practices that will ensure the security of your transactions.

Introduction

The rules for registering instalment sales, ordinary leases and leasing agreements have recently been transformed by Quebec Courts in ways that will require greater diligence on the part of instalment sellers and lessors to protect their rights and ensure the effectiveness of their "title retention device"[1]. The law as it now stands is uncertain and confusing, leaving practitioners and business people at a loss as to what to do in practice. Beware: the dangers are real even for the most seasoned players.

The Law Prior to the Recent Cases

Instalment Sales

An instalment sale is essentially a term sale where the seller reserves ownership of the property until full payment of the sale price (Article 1745(1) of the *Civil Code of Quebec* (the "**CCQ**")), and save in the case of a consumer contract or where the parties have stipulated otherwise, transfers to the buyer the risks of loss of the property (1746 CCQ).

A **reservation of ownership** in respect of a road vehicle or other movable property determined by regulation, or in respect of any movable property acquired for the service or operation of an enterprise, has effect against *third persons* from the **date of the sale** only if it has been registered at the Register of Personal and Movable Real Rights (the "**Register**") within **fifteen (15) days** after the agreement's date. As well, the **transfer** to a third party of such a reservation has effect against *third persons* only if it has been registered (1745(2) CCQ).

Where the reservation of ownership required registration but was **not registered at the Register**, the seller or transferee may take the property back (in its existing condition and subject to the rights and charges with which the buyer may have encumbered it) only if it is in the hands of the *original buyer* (1749(2) CCQ).

If the reservation of ownership required registration but was **registered late at the Register**, the seller or transferee may likewise take the property back (in its existing condition and subject to pre-existing rights and charges) only if it is in the hands of the *original buyer*, unless the reservation was registered before the sale of the property by the original buyer, in which case the seller or transferee may also take the property back if it is in the hands of a *subsequent acquirer* (1749(3) CCQ).

As such, it was always understood that failure to register an instalment sale within fifteen (15) days of the "date of sale", or to register it at all, lead to the consequences described in Article 1749 CCQ.

While Mr. Louis Payette[2] opines that the "date of sale" is the date at which the parties agree upon the essential terms of the sale whether or not an invoice or contract was drawn up at that point, we believe that the "date of sale" is the date at which the contract has become enforceable (usually the date it is fully signed by both parties or the time provided by the contract as being the effective date). As such, in most cases, registration would have to occur at the Register within fifteen (15) days of the signing of the contract. Further, no goods should be delivered prior to signature and registration thereof, so as to ensure priority in the collateral. This is because registration of the instalment sale only retroacts to the date of the signature if validly registered within the fifteen (15) day window. However, if the goods are delivered prior to the signature of the instalment sale, a trustee in bankruptcy or secured creditor could argue that the instalment sale had effectively taken place prior to its signature. As such, there would be doubt as to whether or not the instalment sale registered within fifteen (15) days from its signature protected the goods for that period of time between delivery and signature. The danger here is that any prior creditor of the buyer who had a charge wide enough to encompass the sold goods during that time may benefit from a prior rank over the goods to the instalment seller.

[1] MACDONALD, Roderick. *Teaching/Learning Materials on the Law of Security on Property*, (1998) 6th provisional ed. (Montréal: McGill Faculty of Law).

[2] PAYETTE, Louis. *Les sûretés réelles dans le Code civil du Québec.* (Cowansville: Les Éditions Yvon Blais, 2001) at paragraph 2071.

The instalment seller could however argue here that the delivery of the goods prior to the signature of the instalment sale constituted a "lease by tolerance" and that the instalment sale only occurred upon signing. In order to be safe, the instalment seller could also seek cessions of priority (as per below) or partial discharges (i.e. voluntary reductions) from the prior secured creditors of the instalment buyer.

With respect to the transfer of instalment sales (such as subrogations or assignments), Quebec authors and case law are silent as to whether or not these must also be registered at the Register within fifteen (15) days of the date of assignment, the CCQ juxtaposing the sentence dealing with transfers in Article 1745 CCQ with the sentence before it dealing with regular reservations of ownership. While this silence may be interpreted as the issue being non-existent, we believe that a logical interpretation of Article 1745 CCQ could certainly lead to the conclusion that the assignment of a reservation of ownership must be registered within fifteen (15) days of said assignment. In fact, we prefer this interpretation, as we see no reason to differentiate between an instalment seller's initial registration and the assignee's subsequent registration. In the case where the assignment is made at the time of the instalment sale, this argument only becomes stronger, as both the rights of assignor and assignee would be the same with respect to the fifteen (15) day delay.

What would happen if the registration of the instalment sale was made after the fifteen (15) day delay and the instalment seller wanted to avoid the effects of Article 1749 CCQ? Mr. Sterling Dietze[3] argues that the instalment seller could obtain a cession of rank (we prefer to use the term *cession of priority* here, as these are non-registrable according to the Registrar of the Register, as discussed below) from prior secured creditors of the instalment buyer so as to ensure his priority. Many practitioners, including ourselves, agreed with this opinion despite having been given no guidance by the legislator or Quebec Courts as to the validity of those cessions of priority. The CCQ also did not foresee the registration of these cessions of priority at Article 2956 CCQ, and thus, whether or not they could be registered was unknown. However, we point out that the Registrar's position since the inception of the registration requirements discussed herein is that there cannot be ranking issues between a hypothecary creditor and title retention devices and therefore the Registrar's policy is to refuse to register so called cessions of priority as between a registered titleholder and a hypothecary creditor. Thus, these cessions of priority cannot be registered at the Register. As such, it becomes important to ensure that each of these cessions of priority is drafted in such a manner that the prior ranking secured creditor subordinating its rights undertakes to bind its successors and assigns to such cession of priority. As can readily be seen, the Registrar's position leads to less "security" and reliance by the assignees on the credit worthiness and good faith of the subordinating creditor. Practitioners and businessmen may be especially concerned with relying on the credit worthiness and good faith of the subordinating creditor if said subordinating creditor is not a major financial institution, because the beneficiary of the cession of priority would only have a personal recourse against the assignor or subordinating party should such assignor or subordinating party assign its hypothec to a third party without notice of the cession of priority and such assignor becomes insolvent thereafter. More surprisingly, the case law discussed herein clearly shows that there are competing claims between a title holder and a hypothecary creditor, thus supporting the view that the Registrar's policy seems ill-founded.

A more attractive alternative to cessions of priority would be to obtain voluntary reductions (i.e. partial discharges) from prior creditors of the instalment buyer whose hypothecs are large enough to cover the goods under the instalment sale. Each partial discharge would attest to the fact that despite any one prior creditor's hypothecs, couched in language generally understood to catch the goods under the instalment sale, it has no hypothec in the specific goods under the instalment sale. Partial discharges only modify the prior creditors' hypothecs and thus, make no reference to the instalment sale as a general rule – but rather refer to the goods under the instalment sale. More importantly, they can be registered against these hypothecs, and thus, reliance on the credit worthiness and good faith of any prior secured creditor of the instalment buyer no longer has to be made by instalment sellers. This solution would not however bind a trustee in bankruptcy of a conditional purchaser or of a lessee, as shall be demonstrated hereafter.

[3] S. DIETZE, "Recent Developments in Secured Financing in Québec", (1999) 59 R. du B. 1 at 24; see also D. DESJARDINS, "Les conventions de priorité et de subordination ou au-delà de la simple cession de rang" in *Finance Commerciale et Crédits Syndiqués* (Montreal: McGill University Faculty of Law, October 31 and November 1, 1997) in respect of subordination and priority agreements.

Leasing Agreement (*"le crédit-bail"*)

Under the CCQ, leasing is a contract by which a person, the lessor, puts movable property at the disposal of another person, the lessee, for a fixed term and in return for payment. Consequently, to be valid, this transaction must involve three distinct parties: a vendor of the property, a lessor and a lessee. This is one of the main factors that distinguishes a leasing from an ordinary lease (discussed below), which only involves a lessor and a lessee.

The lessor acquires the property to be leased from a third person, at the demand and in accordance with the instructions of the lessee. Two further conditions must exist: leasing may be entered into for business purposes only (1842 CCQ) and the lessor must disclose the contract of leasing in the deed of purchase (1843 CCQ).

Once these conditions are complied with[4], the seller of the property is directly bound towards the lessee by the legal and conventional warranties inherent in the contract of sale (1845 CCQ), this being the major advantage for lessors under leasings over lessors under ordinary leases (discussed below). Upon taking possession of the property, the lessee assumes all risks of loss of the property, even by superior force, and all responsibility for maintenance and repair expenses (1846 CCQ).

The **rights of ownership of the lessor** have effect, however, against *third parties* from the **date of the leasing contract** only if they have been registered at the Register within **fifteen (15) days** thereof (1847(1) CCQ).

We believe the same fifteen (15) day rule applies to the transfer (e.g. assignment) of the lessor's rights of ownership, for the same reasons stated above for reservations of ownership, though the CCQ does not explicitly foresee a time frame to register these in (1847(2) CCQ), and Quebec authors and case law are silent on the issue. Practically, it appears to be the most prudent approach to take at this time.

Following the same reasoning as above for the "date of the sale", for all practical purposes, the "date of the leasing contract" (1847 CCQ) generally refers to the date the leasing contract is enforceable (i.e. in most instances when signed).

With respect to leasing agreements, however, the CCQ does not provide for sanctions regarding **late registration** and **lack of registration** as it does for instalment sales. According to Mr. Sterling Dietze[5], failure to register within fifteen (15) days would eliminate the retroactive effect of such **registration** and thus, the purchase money security interest (i.e. PMSI) like effect of a properly registered leasing agreement. The property would then be subject to prior creditors of the lessee whose security covers the property under the leasing contract, such as creditors secured by hypothecs registered at the Register earlier and which cover the universality of the property of the lessee. However, Mr. Dietze was of the opinion that the **late registration** of the leasing agreement should be effective against any secured creditor who would register a right against the lessee after the leasing is registered. Note that based on our reasoning above, this last rule should also apply to assignments of leasing contracts if such assignments must be registered fifteen (15) days from their date.

As in the case of instalment sales, a practice soon developed whereby lessors who had registered their leasing contract after the fifteen (15) day delay attempted to obtain cessions of priority or partial discharges (voluntary reductions) from prior secured creditors of the lessee. In the case of cessions of priority which could not be registered at the Register, lessors had to follow the same procedure as for the instalment sale in order to bind the successors and assigns of this prior secured creditor as well. In the case of partial discharges (voluntary reductions), as these could be registered, no such issue arose for lessors.

[4] Note that all of these conditions must be complied with . A. GRENON, "Le crédit-bail et la vente à tempérament dans le *Code civil du Québec"*, (1994) *Xerox Canada Ltée* v. *Pathfinder Marine Inc.*, S.C. Montréal, no. 500-05-014953-937, January 29, 1999, J.E. 99-580 (S.C.).

[5] S. DIETZE, *Supra* note 3.

As a last matter, if the contract does not comply with all the conditions of a leasing agreement as discussed above, there is doubt as to whether or not it needs to be registered within the fifteen (15) day delay in order to be effective against to third parties. For example, what happens if the lessor does not disclose the leasing contract in the deed of purchase with the manufacturer, but nevertheless buys the goods and puts them at the use of the lessee? One may argue from Article 2938(3) CCQ that personal and movable real rights (other than those described at 2938(2) CCQ, which are not pertinent here) require publication at the Register to the extent prescribed by law, and because this situation does not fall into the ambit of 2938(3) CCQ, the contract here should not be registered at the Register at all. However, in many instances, this contract could fall within the definition of an ordinary lease (as described below) and be subject to the registration requirements under 1852 CCQ (as discussed below). A safer approach would be to register these contracts both as leasing contracts under 1847 CCQ and as ordinary leases under Article 1852 CCQ.

Ordinary Lease ("bail ordinaire")

Lease is a contract by which a person, the lessor, undertakes to provide another person, the lessee, in return for a rent, with the enjoyment of a movable or immovable property for a fixed or indeterminate term (1851 CCQ). Being a bipartite agreement, it differs from the tripartite (i.e. lessor, lessee and vendor) leasing agreement, there being numerous recourses available to the lessee, such as abatement of rent further to defects, which recourses may not be waivable pursuant to so-called "hell or high water" clauses, because these recourses may be considered as being of public order.

Not all leases must be registered at the Register. Registration is required, however, in the case of **rights under a lease** with a term of more than one year in respect of a road vehicle or other movable property determined by regulation, or of any movable property required for the service or operation of an enterprise (subject to regulatory exclusions). Effect of such rights against *third persons* operates from the date of the lease provided they are registered within fifteen (15) days. It is to be noted that a lease with a term of one year or less is deemed to have a term of more than one year if, by the operation of a renewal clause or other covenant to the same effect, the term of the lease may be increased to more than one year (1852(2) CCQ).

As in the case of instalment sales ("date of the sale") and leasings ("date of the leasing contract"), we believe that the "date of the lease" (1852(2) CCQ) is the date at which the lease becomes enforceable (generally the date of signature).

The CCQ states that "the transfer of rights under a lease requires or is open to publication [registration], according to whether the rights themselves require or are open to publication [registration]" (1852(3) CCQ), without providing any guidance with respect to the delay for registering the assignment of the lease. Doctrine and jurisprudence are also silent on the issue. For our part, we believe that as written, Article 1852 CCQ requires that the **registration** of an assignment or an ordinary lease be made within fifteen (15) days of the date that the assignment becomes enforceable, for the same reason stated above for instalment sales and leasing contracts.

As stated above for instalment sales and leasing contracts, lessors who registered their rights under a lease at the Register late sought non-registrable cessions of priority from the prior secured creditors (in which they undertook to bind their successors and assigns) of the lessee so as to ensure their priority thereon, or sought registrable partial discharges (voluntary reductions) from these same prior creditors.

Master Instalment Sales, Master Leasings and Master Ordinary Leases

The CCQ provides additional rules in respect of master instalments sales, master leasings and master ordinary leases. Article 2961.1 CCQ permits the one time registration of reservations of ownership, registration of rights of ownership under leasing contracts and of "rights under leases with a term of more than one year", or of any transfer thereof, in respect of a "universality of movable property" of the same kind that may be involved in such contracts in the ordinary course of business between persons operating enterprises. Such registration preserves all the rights of the seller, lessor or transferee for up to ten years (which is renewable) not only in that property but also in any property of the same kind involved in said contracts between these persons *subsequent* to registration. However, such reservations, rights or transfers do not have effect against a *third person* who acquires any such property in the ordinary course of business of the seller's (or lessor's) enterprise.

Certain distinctions must be made between registering master instalment sales, master leasings or master leases and registering ordinary instalment sales, leasings and leases. First, it should be noted that the notion of the fifteen (15) day window for registration at the Register is not applicable to master instalment sales, master leasings and master leases. As such, opposability (i.e. the effectiveness) of a reservation of ownership, the rights of ownership of the lessor or the rights under a lease to *third parties* only begins at the moment of registration. Consequently, we strongly advise that no goods be delivered until an executed master agreement is registered at the Register. This is the only way to ensure that the instalment seller or lessor (under a leasing or ordinary lease) has priority over all other third parties on the goods lawfully sold or leased thereunder.

For example, if a prior creditor has a hypothec on the universality of the instalment buyer or lessee's property or a hypothec where the collateral is described widely enough to include the goods under the particular master agreement and the instalment seller or lessor (i.e. under a leasing or an ordinary lease) delivers those goods before the registration of the master agreement, then the prior secured creditor (whose right is registered beforehand) would have first rank on those goods. As such, the instalment seller or lessor (under a leasing or ordinary lease), as the case may be, would have to obtain a cession of priority or a partial discharge (voluntary reductions) from the prior secured creditor to ensure that it has priority over the collateral. The cession of priority cannot be registered in Quebec, and thus, was drafted in such manner that the prior ranking creditor subordinating its rights undertook to bind its successors and assigns to such cession of priority, with the credit risk (i.e. the subsequent assignee not signing the agreement whereby he assumes the obligations of the assignor under the cession of priority and the assignor of priority of rank being insolvent) and good faith issues associated therewith and damages being the only recourses when a breach occurs. The partial discharge (voluntary reduction) of the prior creditor's hypothec, on the other hand, is registrable, offering more security to the seller or lessor.

Second, whereas under instalment sales, leasings and ordinary leases one would describe specific collateral being charged in the application for registration at the Register, this is not the case for master agreements. Rather, description of the collateral in general terms is sufficient. However, because of the words "universality of movable property of the same kind" in Article 2961.1 CCQ, such description of the collateral may be somewhat tricky. For example, many practitioners express doubt as to whether or not the terms "a universality of all present and future property of brand X leased between the parties and whose description is annexed to this master lease agreement from time to time" is a valid description of a "universality of property of the same kind" if not all that type of property owned by the lessee shall be the object of the master lease. The same could be said for a description such as "the universality of all present and future red cars at location X" if the lessee has several locations and different colour cars. While we follow the opinion that these are "universalities of property of the same kind", little guidance has been provided by courts and doctrine. We strongly recommend that you consult local counsel when the need to enter into such agreements occurs.

Securitizations

Many issues arise with respect to securitizations involving instalment sales, leasings, ordinary leases, master instalment sales, master leasings and master leases.

First, there is confusion as to whether absolute assignments of the receivables under these contracts are subject to registration at the Register or not. More precisely, there is doubt as to whether the terms "reservation of ownership of the seller" (in the context of instalment sales or master instalment sales) or "the rights of ownership of the lessor" (in the context of leasings or master leasings), assignment of which must be registered under either of Sections 1745, 1847 or 2961.1 CCQ, include the receivables under the respective contracts. As a result of the doctrine being somewhat divided here, the only prudent approach would be to register assignments of receivables under instalment sales (1745 CCQ) and leasings (1847 CCQ) within fifteen (15) days of said assignment(s), and register the assignment of master instalment sales or master leasings immediately following said assignments (as no fifteen (15) day window applies here). It should be noted that this issue does not arise in the case of leases (1852 CCQ) and master leases (2961.1 CCQ) as there is little doubt that the term "rights resulting from the lease" includes the right of a lessor to the rent under these contracts, and thus, that an assignment of a lease should be registered at the Register within fifteen (15) days of the assignments, whereas that of a master lease should be registered at the Register immediately following said assignment.

Second, the assignment of receivables under instalment sales, leasings or ordinary leases are also subject to the notification requirements at Article 1641 CCQ to be effective against third parties. That is, in order for the assignment of a claim to be set up against third parties the account debtors must acquiesce in such assignment or must receive a "copy or a pertinent extract of the deed of assignment or any other evidence of the assignment which may be set up against the assignor".

However, in most securitizations, the seller and the purchaser of the receivables do not want to notify the "obligors" (i.e. account debtors) of the assignment at the time of the assignment, as the assignor or seller of the receivables under the contracts will generally continue to collect such claims as "servicer" on behalf of the assignee. The danger here is that Section 94(1) of the *Bankruptcy and Insolvency Act* (the "BIA") states that "the assignment of book debts is void against the trustee in bankruptcy with respect to any book debts that have not been paid at the date of the bankruptcy" and only provides an exception at Section 94(2) for an "assignment of book debts that is (validly) registered pursuant to any statute of any province". Since the trustee in bankruptcy is almost certainly a third party under Article 1641 CCQ[6], this in effect would mean that if bankruptcy were to occur prior to proper notification of the assignment to the account debtor, the assignment of the contract could not be set up against the trustee, and the assignee would thereby loose his rights to the receivables thereunder.

Third, in most situations, a securitization will involve the purchase of the receivables under a large number of contracts. In this case, it may be more advantageous for the assignee to categorize its purchase as an "assignment of a universality of claims" so as to benefit from Article 1642 CCQ. Here, to set up the assignment of the universality of claims against third parties (including a trustee in bankruptcy) the assignee would have to register the assignment at the Register, and further, assure himself that "the other formalities whereby the assignment may be set up against the debtors who have not acquiesced in it" be accomplished. Thus, at the time of the assignment here, the assignee could seemingly register the assignment of the universality of claims at the Register and possibly circumvent the effect of Section 94 BIA. However, many argue that "the other formalities" discussed in this Article are those under 1641 CCQ, and until they are accomplished, the assignee could not circumvent Section 94 BIA. Even if one were to hold that this is not the case, using Article 1642 CCQ for securitizations is risky. In a recent transaction the Registrar of the Register rejected an application for an assignment of present and future leases, on the basis that the *Civil Code of Quebec* does not recognize the

[6] On this issue, see J.L. Baudouin, Les Obligations, 5th Edition, Cowansville, Les Éditions Yvon Blais Inc. 1998, no. 890 at p. 721 and Sterling Dietze, *supra* note 3.

assignment of future leases, and thus, in practical terms, of the receivables arising under future schedules to a master lease agreement (which we presume would also apply to master instalment sales and master leasings). We note that the Registrar's position does not take into consideration the fact that it is possible and commonplace to sell or hypothecate future receivables, which are not conditional sale or lease receivables.

Moreover, the concept of a "universality of claims" under 1642 CCQ has been interpreted narrowly in *Automobiles Mailhot Inc.*[7], where the Superior Court held that 95% and 97%, respectively, of the claims owing by the account debtors of two separate bankrupt companies to said bankrupt companies and which claims were assigned by said bankrupt companies to Ford of Canada Limited were **not** a universality of claims in respect of the bankrupt companies. While we disagree with this decision, especially in light of our comments above with respect to "universalities of property of the same kind" under 2961.1 CCQ, it is for better or for worse the present state of the law.

The above issues demonstrate how difficult it is for Quebec law firms to determine in an opinion whether or not a contract or the receivables owing thereunder purported to be assigned under a securitization or other funder program is in fact eligible to form part of the pool of receivables being conveyed.

Another issue in relation to securitization is that the Registrar of the Register will not permit an assignor of receivables to execute discharges relating to assigned receivables unless the assignee consents thereto by also executing the discharge form. This is highly impractical and in a recent matter involving a refinancing of equipment which had been subject to various prior leases and financings, we were faced with having to obtain the consent of 56 assignees in order to discharge various agreements registered against the assets being refinanced. Thankfully, the Registrar of the Register recently confirmed that it would permit a "servicer", which is named as such in the filing of the assignment, to sign complete releases and discharges (full acquittances) without obtaining such consent from the assignee, but not if the filing is only a partial or full release of the rights or charge, but not a full acquittance.

Recent Case Law of Interest

The Trustee in Bankruptcy as a Third Party – Effects on Title Transactions

In *Massouris (Syndic de)*[8], the Court of Appeal of Quebec decided that an ordinary lease (1852 CCQ) that was registered after the applicable fifteen (15) day delay and post-bankruptcy was ineffective against the trustee in bankruptcy of the lessee. This decision in this respect[9] was less surprising than that in *Mervis (Syndic de)*, discussed below, as the CCQ **does not** mention any specific rule for taking back goods under an ordinary lease. However, it went against a steady trend of recent case law[10] that had decided that the rights of ownership under a lease did not have to be published to have effect, they being separate from the "rights resulting from the lease" under Article 1852 CCQ, which were seen as personal rights.

In *Mervis*[11], the Court of Appeal of Quebec citing *Massouris* decided that failure to register a reservation of ownership within fifteen (15) days and prior to the bankruptcy of the buyer made its post-bankruptcy registration ineffective against the trustee in bankruptcy, who was considered a *third party*. Though, the Court left open the issue as to whether a registration within fifteen (15) days of the "date of sale" but after bankruptcy would be effective against *third parties*.

The Court's decision in this case was surprising in that it diminished the protection accorded to instalment sellers under the CCQ by making the failure to register in a timely fashion ineffective against a trustee in bankruptcy who was a *third party* under 1745 CCQ. Moreover, it left many doubts with respect to the effect of a late registration as the instalment seller could seemingly no longer take back the goods from the instalment buyer or the trustee in bankruptcy even though such goods had not entered the hands of a *subsequent acquirer* (1749 CCQ).

[7] J.E. 96-1843 (S.C.).

[8] J.E. 2002-726 [hereinafter "*Massouris*"].

[9] See discussion below with respect to the more striking elements of this decision regarding registration delays for certain title transactions.

[10] *National Bank of Canada* v. *J. Léveillé Tranport Inc.*, B.E. 2001-504 (S.C.); *Ferland (Syndic de)*, J.E. 2001-1900 (C.A.); *9080-9708 Québec Inc. (Syndic de)*, J.E. 2001-2084; *McMartin (Syndic de)* B.E. 2002-191 (S.C.).

[11] J.E. 2002-1650 [hereinafter "*Mervis*"].

As recently as March 19, 2003, the Court of Appeal of Quebec re-confirmed its decision in *Massouris* and *Mervis* in the case of *Lefebvre and Services financiers Daimler Chrysler (Rebis) Canada Inc.* v. *Lebel*[12]. There, a lease had been entered into between the parties on April 19, 1999. The lessee went bankrupt on November 1, 2000. The lessor registered its rights resulting from the lease on November 24, 2000, the day on which it made its claim to the trustee in bankruptcy. The trustee refused the claim, as in its opinion, failure to register the lease in a timely fashion was fatal to the claim. The Superior Court was of the same opinion. The majority of the Court of Appeal upheld the lower court decisions, basing themselves on *Massouris* and *Mervis*. More particularly, the majority of the Court of Appeal confirmed that failure to register the lease within the fifteen (15) day window and prior to bankruptcy of the lessee made such late **registration** at the Register ineffective against to the trustee in bankruptcy who was a third party. Justice Thibault, in writing for the majority, recognized that the legislator had, at the time of codification, refused to assimilate the reservation of ownership (Section 1745 CCQ) to a "security interest" and create a "presumption of hypothec" thereby, as the legislator had done in Section 1756 CCQ with respect to a sale with the right of redemption. Nevertheless, she held that the "reservation of ownership" is a "security interest". Madame Justice Thibault also decided that the usual meaning of "third party" means all persons not party to a contract, and thereby justifies the holding that the trustee in bankruptcy is a "third party" for the purposes of Article 1852 CCQ.

It should be noted that Mr. Justice Beauregard provides a powerful and compelling dissent. He agrees with the majority that failure to register the lease within the fifteen (15) day window and prior to bankruptcy makes the lease ineffective against third parties. However, he notes that in order to properly circumscribe who the third parties here are, one must look at Articles 1749(2) and (3) CCQ and the intention of the legislator. Moreover, Mr. Justice Beauregard states explicitly that it is "**abusive**" for the Court of Appeal to decide that the "rights resulting from the lease" are a "security interest" despite twice noting the fact that the legislator had expressly rejected the idea that Articles 1745, 1847 and 1852 CCQ create a "presumption of hypothec". He holds that the decision in *In re: Griffen R. West & ass.* v. *Telecom Leasing Canada Ltd.*[13] cannot be generalized into Quebec law for this reason, the British Columbia statute specifically providing that the lease was a security interest. In analyzing 1749 CCQ, Mr. Justice Beauregard demonstrates how failure to register or late **registration** of a "reservation of ownership" (Article 1749 CCQ) only affects the vendor's right to take back his goods vis-à-vis *subsequent acquirers and creditors having rights in said property*. Ordinary creditors and trustees in bankruptcy, he holds, do not fall within the term "third party" which is consistent with the CCQ, as such term is "a Joseph's coat of many colours"[14]. Mr. Justice Beauregard goes on to say that a "reservation of ownership" and the "rights resulting from a lease" are property rights which cannot simply be equated with a "security interest"[15]. As a result, he decides that the term "third party" at Articles 1745, 1749 and 1852 refers to *subsequent acquirers and creditors having rights in the property in question*. As a last point, Mr. Justice Beauregard further states that the ambiguity in these articles should eventually lead the Supreme Court of Canada to review and interpret them and should incite the legislator to seek to clarify the law promptly.

We agree with Mr. Justice Beauregard's position. From a civilian perspective, and regardless of whether one's clients are banks or other financial institutions, or lessors or vendors, the Court of Appeal's majority positions in *Massouris*, *Mervis* and *Lefebvre* simply do not accord with Quebec civil law or the intention of both the Quebec and Federal[16] legislators and represent a serious threat to the security of transactions.

It should be noted, however, that the Court of Appeal has confirmed its decisions in *Massouris*, *Mervis* and *Lefebvre* in two recent decisions: *Tremblay (Faillite de)*, REJB 2003-38977 (March 19, 2003) and *Ouellet (Faillite de)*, REJB 2003-42044 (May 16, 2003).

[12] REJB 2003-38975 [hereinafter "*Lefebvre* "].

[13] [1998] 1 R.C.S. 91.

[14] See Article 2964 CCQ under the chapter titled "Protection of Third Persons in Good Faith", where "any person" (i.e. third persons) has been interpreted to mean all interested persons.

[15] This opinion is supported by: Philippe H. BÉLANGER and Alain Norbert TARDIF "Quelle est la sanction du défaut de publication des droits résultant d'un bail portant sur un bien mobilier dans un contexte de faillite ?" text of a conference given at l'Association des praticiens en insolvabilité, 14 juin 2001, Montreal; GODBOUT, Lucien, *La phase II du RDPRM et le droit de faillite: de l'intention à la désillusion* in Conférence avancée sur la faillite et l'insolvabilité, 2001, Canadian Institute.

[16] See Section 4b) below, re: "The Time Period Allowed to Register Title Transactions: *Massouris, Mervis, Lefebvre* and their effects".

Thankfully for instalment sellers, the Superior Court of Quebec in *Automobiles Chabot inc. (Proposition d')*[17] stated that a trustee at the stage of the **notice of proposal** is not seized of the goods of the bankrupt, as thus, is not a *third party* for the purposes of Article 1847 CCQ (the rights of ownership of the lessor under a leasing contract), a decision which should also apply to instalment sales and ordinary leases if upheld by the Quebec Court of Appeal in a future case with similar facts.

As a result, it is safe to say that as the law in Quebec presently stands a trustee in bankruptcy is a *third party* for the purposes of Articles 1745, 1847 and 1852 CCQ post-bankruptcy, though, it may not be a *third party* at the stage of the notice of proposal or until it has seizing of said property of the bankrupt.

The Time Period Allowed to Register Title Transactions: *Massouris, Mervis, Lefebvre* and their Effects

As we have seen, instalment sales, leasings and ordinary leases must be registered at the Register within fifteen (15) days of their enforceability in order for them to be effective against *third parties* from the date of their enforceability. However, in the case of **late registration**, according to Messrs. Dietze and Payette (in his latest article discussed below), the instalment seller or lessor (under a leasing or ordinary lease) would maintain certain rights in the property as discussed above.

The *Massouris* and *Lefebvre* decisions seem to have transformed this rule. In deciding that publication after the fifteen (15) day delay and post-bankruptcy of an ordinary lease was ineffective against the trustee in bankruptcy (as discussed above), the Quebec Court of Appeal has now on two occasions noted in or supported in *obiter* that the fifteen (15) day window to register was a mandatory delay (i.e. *délai de déchéance*) rather than a grace period (i.e. *délai de grâce*). As understood under Quebec law, it would follow that any leasing agreement not registered within fifteen (15) days would be ineffective against the trustee in bankruptcy or any other third party, regardless of whether or not it were registered afterwards.

Mr. Justice Baudouin in *Massouris* stated:

> **"[office translation] In fact, long term leases with rights resulting from the lease, instalment sales and leasing agreements are three formulas for the same reality: the creation of a movable security. Thus, only the apparent legal structure (of the transaction) is different. If the publication [registration] requirements for one affects the effectiveness against third parties, why should it be different for the other?**
>
> **In both cases, in fact, the transferring of title of the property upon final payment to both the instalment seller, or the lessor is only a fiction permitting one to ensure the effectiveness of a mechanism of credit for the buying of a good."**

Thus, it would seem as though the *obiter* in *Massouris* extends to instalment sales and leasing agreements, making them ineffective against *third parties* if they are not registered at the Register within fifteen (15) days of the "date of sale" or date of the contract, as the case may be.

In a recent article[18], Mr. Louis Payette states in this respect:

> **"[office translation] Must we deduce from the *obiter* of the Court of Appeal that the expiration of the delay forfeits the lessor's right to effect registration with retroactive effect or, simply, of the right to register? We believe that one must read this *obiter* in its context, that of the bankruptcy of the lessee occurring within the fifteen (15) day delay; the expiration of this delay before the registration is effected constitutes a forfeiture: the trustee acquiring at that moment the right to allege the ineffectiveness."**

Consequently, in non-bankruptcy situations, Mr. Payette continues to follow the opinion of Mr. Sterling Dietze, in that **late registration** of a lease would not have any retroactive effect, but could be effective against creditors of the lessee who register their rights afterwards.

[17] J.E. 2002-1011 [hereinafter "*Chabot*"].

[18] L. PAYETTE. "*La location à long terme de matériel d'équipement et de véhicules routiers*", (2002) 62 Can Bar Rev 7, at 31.

While we agree that this should be the law, the weight of jurisprudence in Quebec with respect to the term "*délai de déchéance*" suggests that publishing an instalment sale, leasing or ordinary lease after the applicable fifteen (15) day delay has no effect whatsoever. Until further guidance by the Courts or the legislator, prudent business operators and practitioners should insist that diligence be applied here to ensure **registration** of these contracts at the Register within the applicable fifteen (15) day period.

This also opens the door to many other questions. For example: Would an instalment sale registered at the Register by the instalment seller after the fifteen (15) day delay but prior to the bankruptcy of the buyer be effective against a trustee in bankruptcy? A strict reading of *Massouris, Mervis* and *Lefebvre* would point to a negative response. However, in a recent case[19], Mr. Justice Hilton of the Superior Court decided that a prior creditor holding a movable hypothec on the universality of an instalment buyer's property had a "prior rank", with deference to the position of the Registrar[20], to the instalment seller who registered his instalment sale after the fifteen (15) day period, though the late registration of the instalment sale was said to have effect against subsequent creditors of the lessee. In this respect, the Court distinguished between opposability or effectiveness and rank, claiming it was the rank of the instalment seller that was thereby affected. From this, it seems as though a late registration of an instalment sale prior to bankruptcy may nevertheless secure the instalment seller's rights in the property sold thereunder and be effective against the trustee in bankruptcy.

This begs a further question. The CCQ already provides for the situation where an instalment seller registers an instalment sale **after** the fifteen (15) day period at Article 1749. However, the same cannot be said of leasings and ordinary leases. Thus, would a leasing or ordinary lease registered after the fifteen (15) day period but prior to the bankruptcy of the lessee be effective against the trustee in bankruptcy? A pure and simple application of the Court of Appeal's decision in *Massouris* would suggest not. An extrapolation of the Superior Court's reasoning in the more recent *Financière* decision to leasings and ordinary leases would seem to suggest the opposite. While we lean towards the second option, we recognize that the law here is unclear.

The result is a complicated mess for leasing and financing businesses active in Quebec and for practitioners, instalment sellers and lessors (under leasings and ordinary leases) alike. Simply registering these contracts late but prior to bankruptcy does not guarantee the validity of the **registration**. Should one register these contracts late but prior to bankruptcy and attempt to obtain cessions of priority or partial discharges (voluntary reductions) from prior secured creditors of the instalment seller or lessee (under a leasing or ordinary lease), as the case may be, on the basis that late registration is effective against creditors from the date of registration? If the late registration is invalid as a result of *Massouris*, *Mervis* and *Lefebvre* doesn't the cession of priority become invalid as well? (It should be noted here that the same issue would not arise if the lessor obtained a partial discharge (voluntary reduction) from the prior secured creditor, as it would not mention the registration number at the Register of the instalment sale, leasing or ordinary lease, but would rather mention the goods under such contracts by which the prior creditor's hypothec is being reduced. Thus, another reason to seek partial discharges (voluntary reductions) rather than cessions of priority. However, this does not solve the issue that a trustee is considered a third party).

Should one resort instead to having the contract re-signed and then registered within fifteen (15) days, with all the inconvenience it entails? What if the goods thereunder have already been delivered? Do Articles 1745, 1842 and 1851 CCQ not create the contract upon delivery of the goods to the instalment buyer or lessee (under a leasing or ordinary lease), as the case may be? If so, must the instalment seller or lessor (under a leasing or ordinary lease) not get the goods back from the instalment buyer or lessee (under a leasing or ordinary lease) prior to re-signing and registering the contract at the Register? Can he do so, or are the goods under these contracts immediately affected by the security of prior creditors whose rights charge the particular property under the instalment sale, leasing or

[19] *Financière du Québec v. Filiatures Canadienne Fidelity ltée (syndic de)*, [2002] J.Q. no. 3542 (S.C., J. Hilton) [hereinafter "*Financière* "].

[20] See our comments under the heading "Instalment Sales" above.

ordinary lease? Can the instalment seller or lessor argue that delivery prior to the undoing and re-signing of the contract was a "lease by tolerance" (*bail par tolérance*) and thus, that the contract of instalment sale, leasing or ordinary lease did not exist prior to its signature and that the security of prior creditors could not affect the goods? The lack of guidance on these matters makes advising clients a game of educated guesswork in a field where stability and certainty of one's claim on one's debtor is the most absolute goal.

A third issue exists with respect to errors in registration. Registration at the Register can be done either electronically or on paper. In either case, two files may be open: nominal files or descriptive files. Nominal files describe, amongst others, the rights registered as well as the names and surnames of the parties. The descriptive file contains a list of rights that are registered under the description of the movable property or right involved, which invariably are the 17-digit VIN numbers of motor-vehicles. Case law has shown that an error in the identification number of a motor vehicle is not fatal to the registration[21], though an error to the name of the instalment buyer under an instalment sale was fatal[22]. As such, one may argue that errors of substance in descriptive files are not fatal, while those in nominal files are. Though, one should further note that it does not appear that an error as to the serial number describing equipment on a nominal file is one of substance[23]. Consequently, if one were to make an error of substance in registering a nominal file for an instalment sale, leasing or ordinary lease, it would seem to follow from *Massouris, Mervis* and *Lefebvre* that such registration would be ineffective against *third parties*, including a trustee in bankruptcy. This is a far cry from the notion of a "title transaction".

A fourth issue is more telling: Article 3003(1) of the CCQ states that a hypothec transferred by subrogation or assignment must be registered in the land register or at the Register (depending on the immovable or movable nature of the hypothecated property). Also, a certified statement of registration must be furnished to the debtor together with the application for registration in the case of registration in the land register and, if such application is in the form of a summary, the accompanying document (3003(2) CCQ). If these formalities are not observed, the subrogation or assignment may not be set up against a *subsequent assignee* who has observed them (3003(3) CCQ). Moreover, a movable hypothec takes its rank from the day it is registered (2698 CCQ). Thus, not only is there **no** time limit to register a subrogation or assignment of a hypothec at the Register, but failure to do so may only be set up against a *subsequent assignee*. Furthermore, case law has traditionally held that *third parties* in general are not *subsequent assignees* for the purposes of 3003 CCQ[24] (and 2127 of the *Civil Code of Lower Canada*[25], its equivalent under the former law). In particular, a trustee in bankruptcy was not a *subsequent assignee* under the former law[26], and there is no reason to believe that the same does not hold true today.

This is surprising when compared to the fact that assignments of instalment sales, leasings and ordinary leases must be registered at the Register within the fifteen (15) day mandatory delay according to a possible reading of *Massouris* in order to be effective against all *third parties*, and including a trustee in bankruptcy according to *Mervis* and *Lefebvre*, giving the assignee of these contracts less rights than the assignee of a movable or immovable hypothec without delivery. This is so even though an instalment sale, a leasing and an ordinary lease were traditionally thought of as title retention devices, whereas the movable or immovable hypothecs were seen to be security devices giving creditors less rights.

[21] *Transport E.L. Campeau Inc. (Syndic de)*, J.E. 2002-1246 (S.C.).

[22] *9075-7899 Québec Inc. (Syndic de)*, J.E. 2003-318 (S.C.).

[23] See *Bomhoff Aerospace Corporation (Syndic de)*, J.E. 2002-1517 (S.C.).

[24] *Industrielle-Alliance (L')*, *Compagnie d'assurance sur la vie* v. *Québec (Sous-ministre du Revenu)*, [1997] R.J.Q. 2928 (C.A.); *Banque Laurentienne du Canada* v. *Placements Desma Inc.*, [1999] R.D.I. 309 (S.C.).

[25] *Sirois* v. *Carrier*, (1903) 24 S.C. 438; *Trépanier* v. *Services financiers Avco Ltée*, J.E. 92-253 (S.C.); *J.H. Genest* v. *Cafor International Holdings Ltd.*, [1974] C.A. 481.

[26] *Banque de Nouvelle-Écosse* v. *Perras, Fafard, Gagnon Inc.* [1985] P.A. 21.

From a practical perspective, this means that instalment sellers, leasing and lease companies are not afforded the same protection as those who generally are affected by 3003 CCQ (frequently banks and other short and long term lenders), and no practical reason for this has been stated by either the legislator or the Courts. When coupled with the fact that the law regarding registering hypothecs is much clearer than that regarding the registration of instalment sales, leasings and ordinary leases, it is evident that funders will prefer securitizations involving hypothecs over those involving instalment sales, leasings and ordinary leases. While some may argue that the new case law with respect to instalment sales, leasings and ordinary leases benefits the mass of the instalment buyer or lessee's (under a leasing or ordinary lease) creditors, and thus is good for the creditors as a whole, we believe that such a view does not take into consideration the real results of these decisions: the playing field between instalment sellers and lessors (both under leasings and ordinary leases) is simply not levelled with that of banks and other short and long term lenders obtaining hypothecs and the like. Title transactions originally meant to protect the former will systematically result in windfalls to the latter, who will benefit from property (which may likely not even form part of the intended borrowing base nor be intended to be charged since not owned by the grantor) that was never truly completely and unconditionally in the patrimony of the instalment buyers and lessees (under said leasing and ordinary lease contracts). In truth, the instalment seller or lessor (under leasings or ordinary leases) not only loses the value of the remaining payments upon bankruptcy of the instalment buyer or lessee (under a leasing or an ordinary lease), but also the ownership of the good. Moreover, rather than benefiting the "mass of creditors", as suggested by the Court of Appeal, it is very often banks and other long and short term lenders who are secured creditors who gain the right to the sold or leased goods and not the ordinary creditors of the bankrupt estate.

A last and serious question arises from the determination in *Massouris*, *Mervis* and *Lefebvre* that a "reservation of ownership" and the "rights resulting from the lease" are "security interests". If this were the case, then each of the vendor or lessor (in either a leasing or ordinary lease) would become "secured creditors" under section 2(f) of the BIA. We note that with the coming into force of Bill S-4 on May 10, 2001, titled *Federal Law-Civil Law Harmonization Act, No. 1*, this had already become a reality for instalment sales. However, leasings and leases had not been included in this definition. By equating leasings and leases to security interests, has the Court of Appeal effectively made lessors under these transactions "secured creditors" under the BIA making the leased property part of the lessee's (under a leasing or an ordinary lease) mass of goods? Can the Federal or Provincial Crown now argue that since title retention devices are tantamount to "security", the Crown superpriorities effectively charge the movable property under these title retention devices?

A further question arises from this. The definition of "secured creditor" in the BIA does not expressly include loans for use (Articles 2317 and following CCQ), deposits (Articles 2280 and following CCQ) and consignments sales and is not commonly interpreted as including these. However, each of these secures title in the lender, depositor or consignor respectively, without the need to register one's right. How then does the Court of Appeal deal with the tremendous distinction they have created between these title transactions and those under an instalment sale, a leasing and an ordinary lease? Once again, the playing field is not level for instalment sellers and lessees (under leasings and ordinary leases).

The intervention of the Supreme Court of Canada and of the legislator is needed here. We respectfully submit that as the law under Article 3003 CCQ has always worked in the context of subrogations or assignments of hypothecs, the same rule should be applied to instalment sales, leasings and ordinary leases and even master agreements. That is, failure to register these or to register them in a timely fashion should only be ineffective against *subsequent assignees* or third parties acquirers of such goods in the ordinary course of business without notice or knowledge of these rights who themselves have rights in the goods, and not to ordinary creditors or trustees in bankruptcy. Anything less diminishes their value as title based transactions.

Conclusion

The result of the present legislation and case law in Quebec is clear: the only safe avenue for instalment sellers, lessors (under leasings and ordinary leases) and their counsel is to make sure that instalment sales, leasings and ordinary leases, and the transfer (i.e. assignment or subrogation) thereof, are properly registered within fifteen (15) days of the date at which these contracts become enforceable, and prior to bankruptcy, and delivery of the property thereunder to the buyer or lessee (as the case may be) should only occur after timely registration has occurred. Note also that in the case of an assignment of claims, such as those under securitizations or other funder programs, the only truly safe avenue is to notify each account debtor as per 1641 CCQ in order to make said assignment opposable to these account debtors, which sellers and their funders do not want to effect, with all the inconveniences which this entails.

Instalment sellers and lessors (under ordinary leases and leasing agreements) should review their internal registration procedures and practices so as to ensure compliance with the new case law and should seek the services of counsel specialized in the area.

Contact Persons

For more information regarding this bulletin or any other matter regarding security on property or general financing matters, please contact any one of the members of our Financial Services Group or any of following:

Pierre Denis	877-2908
Corinne Lemire	877-2998
Benjamin Gross	877-2983

Montréal
Suite 4000
1 Place Ville Marie
Montréal, Quebec
H3B 4M4

Telephone:
(514) 871-1522
Fax:
(514) 871-8977

Québec City
Suite 500
925 chemin Saint-Louis
Québec City, Quebec
G1S 1C1

Telephone:
(418) 688-5000
Fax:
(418) 688-3458

Laval
Suite 500
3080 boul. Le Carrefour
Laval, Quebec
H7T 2R5

Telephone:
(450) 978-8100
Fax:
(450) 978-8111

Ottawa
Suite 1810
360 Albert Street
Ottawa, Ontario
K1R 7X7

Telephone:
(613) 594-4936
Fax:
(613) 594-8783

Web Site
www.laverydebilly.com