

THE CREATION BY THE FEDERAL PARLIAMENT OF SECURITY MECHANISMS IN THE *BANKRUPTCY AND INSOLVENCY ACT*

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Introduction

Private law generally provides rules for the creation of security mechanisms and the exercise of the remedies that allow the holders of such security mechanisms to enforce their rights. In the last few years, this area of law, which falls within the provinces' jurisdiction, has been considerably simplified. Thus, in Quebec, for example, the many and varied "privileges" under the *Civil Code of Lower Canada* [hereinafter *C.C.L.C.*] have been abandoned, and the hypothec is now the only genuine real security regime.

Parliament also creates new security mechanisms from time to time that are generally for the Crown's benefit. Apart from the constitutional aspect, which we shall not deal with, these mechanisms raise some issues that will be briefly outlined in this paper. The issues involve a number of legal considerations, including how the security is created, how it may be set up, how the remedies for each kind may be enforced and what right of preference they confer with respect to other security mechanisms. Moreover, the way a security on property is designated can pose some terminological problems.

These issues are of relevance to the program to harmonize federal legislation with Quebec civil law. The question arises to what extent do the rules set out in the *Civil Code of Quebec* [hereinafter the *C.C.Q.*] apply to these issues and to what extent should the legal expression of these concepts be harmonized with civil law in a federal context. These are issues that touch on harmonization and the legislative policy underlying the creation of these security mechanisms.

In the *Bankruptcy and Insolvency Act* [hereinafter the *B.I.A.*], Parliament has created certain kinds of security on property that raise precisely these kinds of issues. And because they are relatively recent and have been litigated to a limited extent, these issues are even more in need of analysis. The harmonizer, therefore, finds himself in the curious position of having to anticipate potential litigation and try to find solutions to the problems that might lead to litigation. The security mechanisms in question here include an immovable security for the costs of remedying environmental damage,¹ a "first charge" on the fees and disbursements of an interim receiver² and a security granted to farmers, fishermen and aquaculturalists for payment of their products.³

We will start with the problems that may be posed by the terminological designation accorded to these security mechanisms. We will then examine what problems the resolution of those problems

¹ Subs. 14.06(7) *B.I.A.*

² Subs. 47.2(1) *B.I.A.*

³ Subs. 81.2(1) *B.I.A.*

raise with respect to substantive law, i.e., creation, right of preference and, finally, exercise of the remedies to which they give rise.

1. Terminological designation of securities

For the civilian lawyer at least, the reform of the Civil Code rendered obsolete the terms used to designate certain security mechanisms.⁴ However, these terminological designations are still present in the federal legislative corpus, hence the need to harmonize them with the new civil law.⁵

Apart from obsolescence, the *B.I.A.* in general poses other terminological problems related to the fact that it is marked by common law.⁶ In a civil law context, such problems are generally resolved by consensus within the legal community.⁷ The courts have recognized that some of the terms in the Act are incorrectly employed as far as a civilian audience is concerned, which requires additional efforts of interpretation.⁸ Should the *B.I.A.* require such interpretive feats and such effort to

⁴ Examples of French terminology that became outdated include: in the *C.C.L.C.*, “antichrèse” (art. 1967), “nantissement” (art. 1966), “cession de créance en garantie” (art. 1571), “cession générale de créances comptables” (art. 1966), “nantissement forestier” (art. 1979(a)), “nantissement agricole” (art. 1979(a)), “nantissement commercial” (art. 1979(e)), and “privilège” (art. 1983ff.); in the legislative corpus, “cession de biens en stock” (*Act respecting bills of lading, receipts and transfers of property in stock*, R.S.Q., c. C-53), “acte de fiducie”, “charge flottante”, “charge spécifique” (*Special Corporate Powers Act*, R.S.Q., c. P-16), and “transports en garantie de créances” (*Forestry Credit Act*, R.S.Q., c. C-78; *Act to promote forest credit by private institutions*, R.S.Q., C-78.1; *Act respecting farm financing*, R.S.Q., c. F-1.2). We note that the French expressions “charge spécifique” and “charge flottante” did not appear in the legislation itself but was currently used by the legal community. M. Deschamps, “Les sûretés sur les équipements et les stocks” (1987) 1 C.P. du N. 125 at 146-147.

⁵ As an illustration, note the definition of “secured creditor” in subsection 2(1) of the *B.I.A.*:

“secured creditor” means a person holding a mortgage, hypothec, pledge, charge, lien or privilege on or against the property of the debtor or any part thereof as security for a debt due or accruing due to him from the debtor, or a person whose claim is based on, or secured by, a negotiable instrument held as collateral security and on which the debtor is only indirectly or secondarily liable.

⁶ Parliament largely based itself on the English *Bankruptcy Act of 1914* in drafting the *Insolvency Act of 1919*. The rewrite of the Canadian legislation in 1949 was, again, carried out under the inspiration of the British model. Traces of that inspiration survive to this day, despite the revisions of 1966, 1992 and 1997. *An Act to Consolidate the Law Regulating to Bankruptcy* (U.K.), 1914-1916, c. 59; *Insolvency Act*, S.C. 1919, c. 36; *Bankruptcy Act, 1949*, S.C. 1949, c. 7; *An Act to amend the Bankruptcy Act*, S.C. 1966-67, c. 32; *An Act to amend the Bankruptcy Act and the Income Tax Act*, S.C. 1992, c. 27; *An Act to amend the Bankruptcy and Insolvency Act, the Companies’ Creditors Arrangement Act and the Income Tax Act*, S.C. 1997, c. 12. See A. Bohémier, *Faillite et insolvabilité*, t. 1 (Montreal: Thémis, 1992) at 9-18 [hereinafter *Faillite et insolvabilité*]; B. Boucher and J.-Y. Fortin, *Faillite et insolvabilité — une perspective québécoise de la jurisprudence canadienne* (Scarborough: Carswell, 1997) at 2-1, 2-2 [hereinafter *Perspective québécoise*].

⁷ Recently, Professor Jacques Deslauriers decried the “modus vivendi” that Quebec’s legal community has developed with respect to the *B.I.A.*: J. Deslauriers, “Le projet de loi S-22 et l’harmonisation de la Loi sur la faillite avec le Code civil du Québec” (Conference of the Canadian Bar Association, Quebec, 24 October 2000) at 2.

⁸ The point is often illustrated by a passage from Pigeon J.:

We are confronted here by a major problem in the interpretation of federal legislation, and, at this juncture, it is proper to stop to consider the difficulty of the task facing our legislative draftsmen. They must not only formulate all legislative provisions in two languages, but also more often than not they must do so in terms of two different legal systems; the civil law of Quebec and the common law of the other provinces. In bankruptcy legislation, which everywhere impinges upon every area of public and private provincial law, the task is particularly difficult. It is therefore not surprising that major problems should be encountered. Moreover, it is a fact which cannot be ignored that the *Bankruptcy Act of 1949*, like the *Bankruptcy Act of 1919*, was not only derived almost entirely from English sources but was also poorly served by the authors of the French version.

Deputy Minister of Revenue (Quebec) v. Rainville, [1980] 1 S.C.R. 35 at 41. Incidentally, this statement was recently cited by the justices of the Quebec Court of Appeal in *Château d’Amos. Château d’Amos Ltée (syndic de)*, [1999] R.J.Q. 2612 at 2633 (C.A.) [hereinafter *Château d’Amos*].

reach a consensus, admirable as that may be? At the very least, it must be admitted that the *B.I.A.* poses some conceptual problems to civilists.⁹

As an illustration, federal Parliament regularly uses the expression “charge” to designate security mechanisms.¹⁰ In particular, it uses the expression “charge ranking ahead of any or all secured creditors/première charge” to designate the security mechanism it creates for the benefit of the interim receiver to guarantee payment of his claim for fees and expenses.¹¹ In order to benefit from this “first charge”, the interim receiver must apply to the court for an order to that effect. If this “first charge” is ordered, it may encumber part or all of the debtor’s assets.¹²

This use of the term “charge” may rightly cast confusion into the civilian lawyer’s mind. Since the term “charge” has a number of meanings,¹³ it may be asked whether, in civil law, a security mechanism can be designated by the term “charge”. To explore this hypothesis, the forms of security recognized by the *C.C.Q.* will be examined in turn as well as the extent to which they may be designated by the term “charge” in the context of the *B.I.A.*

1.1. Hypothecs

The *C.C.Q.* defines hypothecs as real rights.¹⁴ The literature also uses this classic definition of hypothecs.¹⁵ More precisely, hypothecs are accessory real rights,¹⁶ real securities.¹⁷ Real rights are rights an individual exercises directly on tangible things.¹⁸ For instance, hypothecs constitute real

⁹ This ambiguity persists despite Parliament’s recognition of the complementary relationship between bankruptcy and insolvency matters and property matters. Already, over a century ago, during the debates in the House for the repeal of Canadian bankruptcy legislation, views were expressed that provincial private law would be able to resolve problems arising from the insolvency of debtors. *Debates of the House of Commons of the Dominion of Canada*, (February 19, 1880) at 76ff. And when, following that repeal and after abandoning its exclusive jurisdiction over bankruptcy and insolvency for nearly forty years, a bill was finally tabled, Minister Hugh Guthrie raised the two obstacles facing Parliament when it exercised its exclusive jurisdiction over bankruptcy and insolvency. They were the fact that Canada has numerous legislative jurisdictions unlike Great Britain where there is only one central legislative power for the entire Kingdom, and the existence of two legal systems—civil law in Quebec and common law in the other provinces. *Debates of the House of Commons of Canada*, (March 28, 1919) at 968. These complementary ties are consecrated in the very wording of the legislation. See subs. 72(1) *B.I.A.* The courts have also recognized this complementarity. Beetz J. expressed himself as follows on this topic:

Insolvency lies at the core of those parts of the common law and of the civil law which relate to such matters as mortgage, pledge, pawning, suretyship and the securing of debts generally which are implicitly or explicitly predicated on the risk of insolvency and which produce their full effect when the risk has been converted into reality [...].

Robinson c. Countrywide Factors Ltd, [1978] 1 S.C.R. 753 at 804. Professors Jacques Auger, Albert Bohémier and Roderick A. Macdonald have similar views: “Clearly, the *B.I.A.* and the Civil Code are mutually interdependent, and it is accordingly important that they be in complete harmony.” J. Auger, A. Bohémier and R. A. Macdonald, “The Treatment of Creditors in the *Bankruptcy and Insolvency Act* and Security Mechanisms in the Civil Law of Quebec”, in *Harmonization of Federal Legislation with Quebec Civil Law and Canadian Bijuralism* (Ottawa: Justice Canada, 1997) 887 at 892 [hereinafter “The Treatment of Creditors”].

¹⁰ Ss. 42(1)(c), 74(2), 95(1), 95(2), 136(1)(e) and 197(6)(a) *B.I.A.*

¹¹ This is the interim receiver appointed under sections 47 or 47.1 of the *B.I.A.* The interim receiver will then have to follow the prescribed form in Form 18, entitled “Notice of Application for Taxation of Accounts and Discharge of Interim Receiver”. Subs. 47.2(1) *B.I.A.* See s. 79, *Bankruptcy and Insolvency General Rules* [hereinafter *B.I.G.R.*].

¹² The English version provides that the charge may be on “any or all of the assets of the debtor” [emphasis added].

¹³ A function (art. 179 *C.C.Q.*), property taxes (art. 1205 *C.C.Q.*), obligations (art. 776 *C.C.Q.*, 1834 *C.C.Q.*), among others.

¹⁴ Art. 2660 *C.C.Q.*

¹⁵ L. Payette, *Les sûretés dans le Code civil du Québec* (Cowansville, Que.: Yvon Blais, 1994) at 84; M. Bugnet, *Oeuvres de Pothier annotées et mises en corrélation avec le Code civil et la législation actuelle*, 2th ed., vol. 9 (Paris: Cosse et Marchal, 1861) at 423; G. Baudry-Lacantinerie, *Précis de droit civil*, vol. 3 (Paris: L. Larose et Forcel, 1884) at 682; P.B. Mignault, *Le droit civil canadien*, vol. 9 (Montreal: Wilson & Lafleur, 1916) at 83; C. Demers, *Traité de droit civil du Québec*, vol. 14 (Montreal: Wilson & Lafleur, 1950) at 195.

¹⁶ D. Pratte, *Priorités et hypothèques* (Sherbrooke: Revue de droit, 1995) at 95.

¹⁷ J. Deslauriers, *Précis du droit des sûretés* (Montreal: Wilson & Lafleur, 1990) at 251; P. Ciotola, *Droit des sûretés* (Montreal: Thémis, 1999) at 197ff.

¹⁸ H. Reid, *Dictionnaire de droit québécois et canadien* (Montreal: Wilson & Lafleur, 1994) at 203 [hereinafter *Dictionnaire de droit québécois*]; P.-A. Crépeau, *Dictionnaire de droit privé et lexiques bilingues*, 2d ed. (Cowansville, Que.: Yvon Blais, 1991) at 211 [hereinafter *Dictionnaire de droit privé*].

rights to guarantee the performance of an obligation.¹⁹ What about the term “charge”? It is interesting, in this regard, to distinguish between hypothecs on immovables and hypothecs on movables.

Immovable hypothecs

Both the literature and the cases seem to agree that a hypothec is a “charge”.²⁰ Moreover, it seems that the term “charge” can apply to conventional hypothecs as well as to legal hypothecs on immovables.²¹ Pigeon J., in *Town of Anjou v. C.A.C. Realty*, even went so far as to state that he did not see how it could be said that a hypothec was not a “charge”.²² Not only is this right included in the ordinary meaning of the expression, but this is also clear from the sections of the *Code of Civil Procedure* [hereinafter *C.C.P.*] relating to a judicial sale of immovables.²³ On this point, Beetz J., who wrote the minority opinion, was in agreement with Pigeon J.²⁴ As a result, it may be concluded that the Supreme Court of Canada has made it clear that the term “charge” may designate an immovable hypothec. This meaning does not seem to pose any problem under the *C.C.Q.* that it did not already pose in the *C.C.L.C.*²⁵ The task now is to see whether this name is appropriate for the other security mechanisms in the Code.

Movable hypothecs

One of the great innovations in the new Civil Code in terms of security on property was the introduction of the movable hypothec.²⁶ It brings together former real security mechanisms that existed under the *C.C.L.C.*²⁷ Although movable hypothecs are also real rights, the term “charge” is

¹⁹ Art. 2661 *C.C.Q.*

²⁰ D. Ferland and B. Emery, *Précis de procédure civile du Québec*, vol. 2 (Cowansville, Que.; Yvon Blais, 1994) at 240, 242 [hereinafter *Précis de procédure civile*]; *Dictionnaire de droit québécois*, supra note 18 at 86; G. Cornu, *Vocabulaire juridique*, 4th ed., (Paris: Presses universitaires de France, 1987) at 129-130. M. Fillion, *Dictionnaire du Code civil du Québec* (Saint-Nicolas, Que.: Éditions associations entreprises, 1998) at 79 [hereinafter *Dictionnaire du C.C.Q.*]; *Dictionnaire de droit privé*, supra note 18 at 84; *Town of Anjou v. C.A.C. Realty*, [1978] 1 S.C.R. 819 at 826, 827 and 834 [hereinafter *Town of Anjou*]; *Caisse populaire Ste-Famille de Sherbrooke v. Belzile*, [1995] R.D.J. 137 at 141 (Que. Sup. Ct.) [hereinafter *Belzile*]; *Caisse populaire de St-Marc-des-Carières v. Frenette & Frères Ltée*, [1985] R.D.J. 341 at 346 (Que. Sup. Ct.) [hereinafter *Frenette*].

²¹ For conventional hypothecs, see *Breton v. Jacques et Seabord Securities Limited*, [1972] R.P. 35 at 36-37 (Que. Sup. Ct.) [hereinafter *Breton*]. For legal hypothecs, see *Belzile*, *ibid.*

²² *Town of Anjou*, supra note 20 at 826.

²³ They are articles 671ff *C.C.P.*, in particular, articles 676 (opposition to secure charges), 677 (opposition to the sale of property subject to a charge) and 704 (with respect to charges which have not been discharged). Incidentally, until recently, the cases did not agree on whether a hypothecary creditor could make an opposition to secure charges. Some claimed that, because it was a charge, a hypothec allowed the holder to make the opposition. *Town of Anjou*, *ibid.* (see the opposing views of Pigeon and Beetz JJ. on this); *Frenette*, supra note 20; *Newman v. Archambault*, [1972] R.P. 82 (Que. Sup. Ct.) [hereinafter *Newman*]; Others argued that the sale by judicial authority of an immovable discharged the hypothec but allowed the holder to obtain the proceeds depending on the rank he occupied. *Commercial Litho Plate Graining (1970) Ltée v. Imprimerie Cyr Ltée*, [1980] S.C. 1123 [hereinafter *Litho*]; *Breton*, supra note 21; *Royal Bank of Canada v. Sheiner*, [1972] S.C. 750; *Union des Carrières et Pavages Limitée v. J.C. Bégin*, [1956] R.P. 234 (Que. Sup. Ct.). Under the *C.C.Q.*, the latter view seems to prevail. *Belzile*, supra note 20. The controversy was nevertheless marked by an epistolary confrontation between two legal experts. A. Lavallée, “À qui est ouverte l’opposition à fin de charge?” (1972) 32 R. du B. 24; P. Ferland, “L’opposition à fin de charge et l’hypothèque” (1972) 32 R. du B. 259.

²⁴ Beetz J. states that “the expressions “charges” and “real rights” are certainly broad enough to include hypothecs and privileges in another context”. *City of Anjou*, *ibid.* at 834. Bernard Gratton J., of the Quebec Superior Court, seems to adopt Beetz J.’s reasoning when he states that “[translation] it may well be the case that in ordinary usage a hypothec is a charge, but on reading the other relevant articles, 676, 677, 684 and 704 p.c., there is room for interpretation.” *Litho*, *ibid.* at 1124. See also *Cie Montréal Trust v. Roadrunner Jeans MFG Ltd*, [1983] S.C. 245 at 249.

²⁵ Fréchette J. of the Superior Court of St-François stated in a recent judgment that “[translation] there can be no doubt that a hypothec is a charge.” *Belzile*, supra note 20 at 141.

²⁶ Art. 2696ff *C.C.Q.*

²⁷ Pawning (art. 1968 and 1969 *C.C.L.C.*), commercial pledge (art. 1979 (e) and (k) *C.C.L.C.*), pledge of agricultural and forest property (art. 1979 (a) and (d) *C.C.L.C.*), assignment of claims as security (art. 1570 and 1578 *C.C.L.C.*) and general assignment of book debts (art. 1966 *C.C.L.C.*).

generally defined so as to designate only immovable real rights.²⁸ In addition, the Quebec legislature does not provide for “opposition to sale of property subject to a charge” and “opposition to charges” except in immovable matters.²⁹ This terminology is also employed to indicate the real rights registered in connection with an immovable in the land register³⁰ but not those registered in connection with a movable in the register of personal and movable real rights.³¹ As is apparent, the term “charge” is not of current use with respect to movable hypothecs. What is the case with prior claims? This is the topic that will be addressed next.

1.2. Prior claims

The C.C.Q. grants preferred creditor status on the basis of certain claims.³² Theoretically, prior claims should not be considered as “charges” since they do not confer real rights.³³ However, it appears that things are not that easy. On the issue of whether the word “charge” in the definition of “secured creditor” in the *B.I.A.* could include the concept of prior claim, the Quebec Court of Appeal, in *Château d’Amos*, through Brossard J., dissenting on the merits, held in obiter that the concept of “charge”, familiar to common lawyers, was poorly defined in Quebec civil law.³⁴ Although the Quebec legislature subsequently modified the concept of “prior claim” to make it “constitute a real right”,³⁵ Brossard J.’s words indicate that the use of the term “charge” in the context of a provision dealing with security on property is probably borrowed from common law.

In common law, “charge” refers, among other things, to “an instrument creating security against property for payment of a debt or obligation”; the term charge can embrace other meanings, including a lien, a claim and an encumbrance.³⁶ As an illustration, the Special Corporate Powers Act³⁷ [hereinafter the *S.C.P.A.*], which allows a corporation to be financed through the issuance of bonds secured by a trust deed mechanism whereby the debtor issuer charges his property with a “floating charge” and a “specific charge”, a terminology borrowed from common law.³⁸ The “floating

²⁸ “Droit réel couvrant un immeuble” [real right covering an immovable], A. Rey, *Le nouveau Petit Robert* (Paris: Dictionnaires Le Robert, 1993) at 347; “droit réel qui grève un immeuble” [real right charging an immovable], *Dictionnaire de droit québécois*, *supra* note 18 at 86; “certains droits réels grevant un immeuble” [certain real rights charging an immovable], *Vocabulaire juridique*, *supra* note 20 at 130; “droit réel qui grève un (bien) immeuble” [real right that charges an immovable (property)], *Dictionnaire du C.C.Q.*, *supra* note 20 at 79; “limitation du droit de propriété d’un immeuble, corrélatrice à un droit réel” [limitation on the ownership right of an immovable, corresponding to a real right], *Dictionnaire de droit privé*, *supra* note 18 at 84.

²⁹ Art. 676, 677 *C.C.P.*

³⁰ Art. 704 *C.C.P.*

³¹ Art. 2980 *C.C.Q.*, 592.2, 592.3 *C.C.P.*

³² They are (1) legal costs and expenses incurred in the common interest, (2) the claim of a vendor who has not been paid, (3) the claim of a retainer, (4) the claims of the State for amounts due under fiscal laws and (5) claims of municipalities for property taxes. Art. 2651 *C.C.Q.*

³³ In this regard, Professor Louis Payette noted that:

[Translation] [t]he Code does not define a prior claim as a real right as it does in the case of a hypothec. It grants it only some of the attributes of a hypothec; it does not cause any right to follow to flow from it [...]. In this context, it must be concluded that a prior claim is a right of preference *sui generis* that doubtless cannot be characterized as a real right.

L. Payette, “Des priorités et des hypothèques”, in *Barreau du Québec* and the *Chambre des notaires du Québec*, *La réforme du Code civil*, vol. 3 (Quebec: Les Presses de l’Université Laval, 1993) at 66.

³⁴ *Château d’Amos Ltée*, *supra* note 8 at 2635.

³⁵ *An Act to amend various legislative provisions regarding municipal affairs*, S.Q. 1999, c. 90, s. 42, 43. The C.C.Q. now provides that “prior claims of municipalities and school boards for property taxes constitute a real right.” Art. 2654.1 *C.C.Q.*

³⁶ D. A. Dukelow and B. Nuse, *The Dictionary of Canadian Law*, 2nd ed. (Toronto: Carswell, 1995) at 176; J.R. Nolan, *Black’s Law Dictionary*, 6th ed. (St-Paul, Minn.: West Publishing Co., 1990) at 233.

³⁷ *Supra* note 4.

³⁸ The expressions “floating charges” and “specific charges” did not appear in the *S.C.P.A.* but were of common use within the legal community.

charge” was on a universality of property, including the debtor’s present and future inventory. The debtor issuer thus retained possession of his property. The “specific charge” affected property that the debtor-issuer had specifically pledged, hypothecated or pawned. The trust deed mechanism disappeared in 1994 with the reform of the civil law, taking with it the “charges” that the S.C.P.A. had allowed to be created.³⁹

1.3. Other security mechanisms

The C.C.Q. provides for other mechanisms that can be used to secure the performance of an obligation.⁴⁰ They are the security trust,⁴¹ the right of retention,⁴² the right of revendication,⁴³ and suretyship.⁴⁴ Are these security mechanisms charges? Usually, the term “charge” designates a class of rights where one finds the dismemberments of the right of ownership: servitudes,⁴⁵ usufruct⁴⁶ and use⁴⁷ (or habitation).⁴⁸ Not all of the security mechanisms which we referred to precedently constitute such limits to the right of ownership. For instance, suretyship does not restrict immediately the right of ownership of a surety over his property.

Moreover, “charge” is a word that is not used by the C.C.Q. to identify a class of security on property. In fact, properly speaking, the correct use of the term “charge” is to designate an immovable hypothec as a restriction of the right of ownership of the debtor following the constitution on an immovable of a real right for the benefit of the creditor. In that sense, the real right conferred to the hypothecary creditor allows him to follow the property, to sell it and to be preferred upon the proceeds of the sale whereas the “charge” is the consequence, that is to say the limit imposed to the right of ownership of the debtor. This is probably how the remarks of Pigeon J. in *Town of Anjou v. C.A.C. Realty* are to be interpreted.⁴⁹

As a result, in civil law, the term “charge” may not be used to designate any security mechanism since not all of them restrict the right of ownership. In that respect, the use of the term “charge” to designate any security is improper and indeed ineffective in civil law.

³⁹ *An Act Respecting the Implementation of the Reform of the Civil Code*, L.Q. 1992, c. 57, s. 642ff. The Quebec legislature introduced floating hypothecs in 1994 to allow corporations to enjoy a flexible security over existing and future assets, without delivery. Art. 2715 C.C.Q.

⁴⁰ Professors Jacques Auger, Albert Bohémier and Roderick A. Macdonald offer a particularly interesting analysis from the perspective of harmonizing the B.I.A. with Quebec civil law. “The Treatment of Creditors”, *supra* note 9 at 951.

⁴¹ Art.1263 C.C.Q. The reference is to an “autonomous patrimony by appropriation” and not a “charge”.

⁴² Art. 1592 C.C.Q.

⁴³ Art. 1741 C.C.Q.

⁴⁴ Art. 2333 C.C.Q.

⁴⁵ Art. 1177 C.C.Q.

⁴⁶ *Précis de procédure civile*, *supra* note 20 at 239; *Caisse populaire Les Hauteurs v. Club récréatif Lac Morency Inc.*, (january 27, 1993), Saint-Jérôme 700-05-000539-910, J.E. 93-543 (Que. Sup. Ct.). See art. 1120 C.C.Q.

⁴⁷ *Précis de procédure civile*, *ibid.* 239. See art. 1172ff C.C.Q.

⁴⁸ *Caisse populaire Ste-Madeleine v. Les Immeubles Rives du St-Maurice Inc.*, [1990] RDI 818 (Que. Sup. Ct.).

⁴⁹ *Supra* note 20 at 826. This is also what emerges from the words of Fréchette J. of the Superior Court of St-François in a recent judgment where he states that “[translation] where an immovable is charged with a hypothec, the equity in it is affected or decreased, and, in this sense, there can be no doubt that a hypothec is a charge” (emphasis added). *Belzile*, *supra* note 20 at 141. See on this, art. 671ff C.C.P. See also *Newman*, *supra* note 23.

From a civilist standpoint, the word “security” is certainly preferred to the word “charge”. That, in fact, is what the federal Parliament does in subsection 14.06(7) of the *B.I.A.* to designate the security mechanism it provides to the Crown and in subsection 81.2(1) of the *B.I.A.* to designate the security mechanism it gives to farmers, fishermen and aquaculturists. Moreover, the use of the word “charge” tends to disappear from the terminology employed by the National Assembly as the program to harmonize public statutes with the *C.C.Q.* shows.⁵⁰

2. The legal framework for the security mechanisms created in the *B.I.A.*

How a security mechanism is designated is only one aspect of the problems raised by its inclusion in the *B.I.A.* When Parliament creates a security mechanism, as it does in the *B.I.A.*, it must not only do so in an area that in principle is governed by provincial private law, but must do it taking into account its own self-imposed rules. These rules concern, first, the creation of a security mechanism, second, the granting of a right of preference and, third, realizing on the security.

2.1. The creation of securities on property

In principle, in Quebec, legal hypothecs take effect by registration.⁵¹ As an exception, the *C.C.Q.* recognizes that a legal hypothec may be created as of right without publication. This is true for a builder's legal hypothec.⁵² However, the hypothec is extinguished if the holder fails to publish it in the appropriate register within thirty days after the work has been completed.⁵³ It may subsist by publication of a notice but is extinguished after six months unless the creditor, in order to preserve the hypothec, publishes an action against the owner of the immovable or registers a prior notice of the exercise of the hypothecary right.⁵⁴

With regard to the securities on property granted to the Crown, Parliament imposes, in the case of a bankruptcy or a proposal, a special condition for the validity of securities granted to it under a federal or provincial statute.⁵⁵ Under subsection 87(1) of the *B.I.A.*, for a security to be valid, it must be registered in the appropriate register⁵⁶ before the earliest of the dates listed.⁵⁷ The obligation to register securities on property to protect the claims of the Crown probably derives from Parliament's intention to treat creditors equally. It follows that a trustee in bankruptcy would not recognize a security on property expressly granted to the Crown unless it appeared on the appropriate register

⁵⁰ An Act to harmonize public statutes with the Civil Code, S.Q. 1999, c. 40, subs. 39(5) amending the *Cultural Property Act*, R.S.Q., c. B-4, subs. 20(3).

⁵¹ Art. 2725(2) *C.C.Q.*

⁵² Art. 2726 *C.C.Q.*

⁵³ The Code provides that “[a] legal hypothec in favour of persons having taken part in the construction or renovation of an immovable subsists, even if it has not been published, for thirty days after the work has been completed.” Art. 2727(1) *C.C.Q.*

⁵⁴ Art. 2727(2) *C.C.Q.*

⁵⁵ This condition for validity applies to claims of Her Majesty in right of Canada or a province and to “any body under an Act respecting workers' compensation”. Subs. 86(1) *B.I.A.*

⁵⁶ Subsection 87(1) of the *B.I.A.* refers to prescribed systems of registration. Section 111 of the *B.I.G.R.* provides that:

For the purposes of subsection 87(1) of the Act, a “prescribed system of registration” referred to in that section is a system of registration of securities that is available to Her Majesty in right of Canada or a province and to any other creditor holding a security, and is open to the public for inspection or for the making of searches.

⁵⁷ The dates are: the date a petition is filed against the debtor, the date the debtor makes an assignment, the date the debtor files a notice of intention and the date on which a proposal is filed. Par. 87(1)(a), (b), (c) and (d) *B.I.A.*

or if had been registered after the earliest of the dates listed in subsection 87(1) of the *B.I.A.* The Crown would then rank as an unsecured creditor.⁵⁸

The issue of the validity of the securities on property granted to the Crown by Parliament or a provincial legislature raises an interesting problem with respect to the security provided for in subsection 14.06(7) of the *B.I.A.* The purpose of this security mechanism is to guarantee payment of Crown claims for the costs of remedying environmental damage, for example when corporations discharge large quantities of pollutants into rivers. In Quebec, when this type of environmental pollution occurs, the *ministère de l'Environnement du Québec* may clean up the pollution if it considers it necessary to do so, particularly on private immovables.⁵⁹ The *Ministère* may then claim the cleanup costs by presenting the invoice to the property owners.⁶⁰ If the owner of a property thus cleaned up by the *Ministère* becomes bankrupt or makes a proposal, the claim by the *Ministère* is immediately secured by a immovable security on the immovable of the debtor that is contiguous thereto; this security guarantees payment of the claim by the *Ministère*, which ranks above any other claim. The claim by the *Ministère* is enforceable "in the same way as a mortgage, hypothec or other security on real property".

Parliament does not expressly require registration for the security so created to be valid. Should the general obligation of registration in subsection 87(1) of the *B.I.A.* be relied upon? There are three possibilities to consider. First, the nature of the principal rights giving rise to the Crown's claim; second, the technical problems due to the moment of birth of this security and, finally, the exceptional nature of this security.

- **The nature of the principal rights giving rise to the claim**

It has been claimed that the registration rule imposed on the Crown for its securities, although it is not expressly excluded in subsection 14.06(7) of the *B.I.A.*, would not apply in this case since the Crown's rights would be in the nature of an interest in land.⁶¹ "Interests in land" do not have to be registered at common law.⁶² In Quebec, where dual domain is recognized, the situation is quite different.⁶³ It would appear that the rule of registering securities granted to the Crown on property should apply. In this case, there would be a real discrepancy between the situation in Quebec and that in the other provinces. But there may also be other problems.

⁵⁸ Prior to the review of 1992, the Crown ranked last among preferred creditors. Paragraph 136(1)(j) of the *B.I.A.* still bears the marks of that time. Section 137 of the *B.I.G.R.* however limits the application of this section to claims arising prior to November 30, 1992. Since then, the fundamental principle introduced by subsection 86(1) of the *B.I.A.* is that the Crown's claims must be considered as unsecured claims. The registration of security devices granted to the Crown by statute is not only a matter of validity but forms an exception to the general rule and allows the Crown to benefit from secured creditor status. *Perspective québécoise, supra* note 6 at 2-674; D. St-Onge, "Les priorités de la Couronne : rendra-t-on moins à César?" in *Développements récents en droit de la faillite (1992)* (Cowansville, Que.: Yvon Blais, 1992) 15 at 24.

⁵⁹ The *Environment Quality Act* provides that the Minister [i.e. the Minister of Environment] may take all such measures as he may indicate to clean, collect or contain contaminants that are or that are likely to be emitted, deposited, discharged or ejected into the environment, where he considers such measures necessary to avert or diminish the risk of damage to public or private property, human beings, wildlife, vegetation or the general environment. R.S.Q., c. Q-2, s. 115.1.

⁶⁰ The Minister may claim the direct and indirect costs related to such measures, in the same manner as any debt owing to the Government, from any person or municipality who had custody of or control over the contaminants and from any person or municipality responsible for the emission, deposit, discharge or issuance of the contaminants, as the case may be, whether or not the latter has been prosecuted for infringement of this Act. Liability is joint and several where there are several debtors involved. Where the Minister has exercised his powers under the first paragraph of section 115.1, the judge may order the offender to pay back the direct and indirect costs related to the measures taken. *Ibid.* subs. 109.1.1.(2), 115.1.

⁶¹ This is the situation that would prevail in common law. It would be by virtue of this interest in land that the Crown could undertake remedial work. J. Marin and A. Ilchenko, "Amendments to the *Bankruptcy and Insolvency Act*—Bill C-5 Environmental Liabilities of Trustees and Receivers" (1997) 14:2 *Nat. Insol. Rev.* 18 at 42 [hereinafter "Environmental Liabilities"].

⁶² See the *Land Titles Act*, R.S.O. 1990, c. L-5; *Registry Act*, R.S.O. 1990, c. R-20.

⁶³ In Quebec, property belongs to persons or to the State. Art. 915 C.C.Q.

- **The technical problems flowing from the date of birth of the security**

For technical reasons, it may be wondered whether the Crown could comply with the registration obligation imposed on it. According to subsection 87(1) of the *B.I.A.*, in order for the Crown to take advantage of its security, it would have to have registered it before one of the times listed: the date the petition is filed against the debtor, the date the debtor makes an assignment, the date the debtor files a notice of intention or the date on which a proposal is filed. It must be remembered, however, that the security granted the Crown to secure repayment of the cost of remedial action is not created until the date on which a proposal is filed or the date on which the debtor declares bankruptcy. In other words, this security is not created until after one of the dates listed in subsection 87(1) of the *B.I.A.* It may then be wondered how the Crown could have registered that security in advance? How could it register a security device that is not yet created in order to comply with the times imposed by Parliament? There indeed is a technical problem. But there is still another aspect to consider.

- **The exceptional nature of the security**

Parliament gives the Crown almost absolute top ranking for the latter's claim for costs of remedying environmental damage. This preference is granted "notwithstanding any other provision of this Act or anything in any other federal or provincial law." The use of "notwithstanding" terminology would appear to indicate that the intent of Parliament was to give the Crown a particular treatment, which could probably be explained by the public interest significance of government intervention in a case of environmental damage. However, it might be asked what the position of a trustee in bankruptcy would be in such a claim if the Crown had failed to register its security in accordance with the procedure set out in subsection 87(1) of the *B.I.A.* Would the exceptional nature of this security be sufficient to ensure recognition of its validity despite the subsection 87(1) obligation to register?⁶⁴ We submit that it would.

In conclusion, it is well to point out the absence of any reference to a registration obligation for the security granted to farmers, fishermen and aquaculturists as well as that granted to an interim receiver.⁶⁵ In the latter case, the procedure whereby the security is created is still more uncertain for the civilian lawyer since it depends on judicial discretion.

2.2. Granting a preference

Since the reform of the Civil Code in 1994, the sole reasons in the *C.C.Q.* for a preference are prior claims—a legal security—and hypothecs—a legal or conventional security. In applying the *B.I.A.*, it is necessary to refer to the scheme of distribution set out in subsection 136(1) of the *B.I.A.*, which establishes the ranking of the various creditors, subject to the rights of secured creditors.⁶⁶ If

⁶⁴ The exceptional nature of this security has been described by M^e André Prévost. A. Prévost, "Le régime particulier des paragraphes 14.06(2) à (8) de la *Loi sur la faillite et l'insolvabilité* applicable à l'environnement," in Service de la formation permanente, Barreau du Québec, *Développements récents en droit de l'environnement* (Cowansville, Que.: Yvon Blais, 1998) 1 at 22 [hereinafter "Le régime particulier"].

⁶⁵ Subss. 47.2(1) and 81.2(1) *B.I.A.* Obviously, the registration obligation imposed on the Crown does not apply here.

⁶⁶ The Supreme Court of Canada has had an opportunity—on five occasions—to rule on the distinctiveness of subsection 136(1) of the *B.I.A.* by comparison to provincial private law. It has identified the following principles:

- The provinces may neither create priorities among the creditors nor modify the distribution scheme in bankruptcy matters provided for in subsection 136(1) of the *B.I.A.*;

the claim of the secured creditors is not listed in subsection 136(1) of the *B.I.A.*, then the secured creditors may choose to participate in the bankruptcy insofar as their claim is presented in the prescribed form,⁶⁷ or they may enforce their security under provincial law, in which case the preferences provided in the provincial legislation will apply.⁶⁸ However, the *B.I.A.* grants to the federal and provincial Crowns, the interim receiver, farmers, fishermen and aquaculturalists, securities that give them preference over the rights of other creditors.

▪ **A preference that ranks ahead of the rights of other creditors**

To illustrate, Parliament provides in subsection 14.06(7) of the *B.I.A.* that “notwithstanding any other provision of this Act or anything in any other federal or provincial law,” the claim of the Crown in relation to environmental damage that is secured by a charge gives it first preference.⁶⁹ The use of the words “[the charge] ranks above any other claim, right or charge against the property” indicates Parliament’s intention to ensure that no other security can rank higher than the Crown’s. The purpose of this is to keep other creditors from benefiting from a windfall gain due to the increase in the value of the immovable as a result of the remedial action. This superiority applies whether or not the claim arises before or after the bankruptcy and whether or not the Crown participates in the bankruptcy.⁷⁰ Moreover, it confers a ranking higher than that given hypothecary creditors who registered their claims previously in the land register in respect of contiguous immovables of the debtor.⁷¹ This means that the benefits conferred by a civil law hypothec are subordinate to repayment of the Crown’s claim for the costs of remedying the environmental damage.⁷²

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- Although a provincial statute may validly modify the order of priority in a context other than bankruptcy, as soon as there is a bankruptcy, it is subsection 136(1) of the *B.I.A.* that determines the status and the order of priority of the claims expressly referred to therein;
 - If the provinces could create their own order of priority or modify the one established by virtue of the *B.I.A.*, the effect would be to encourage the establishment, in a bankruptcy context, of a scheme of distribution that differed from one province to the next, which is unacceptable;
 - In a bankruptcy context, when expressions such as “secured creditor” are defined in the *B.I.A.*, they must be interpreted according to the definition assigned to them by Parliament and not that provided for by provincial legislatures. The provinces cannot modify the way these expressions are defined for the purposes of the *B.I.A.*;
 - To determine the relationship between a provincial statute and the *B.I.A.*, the form of the provincially created right must not prevail over the substance. The provinces do not have a right to do indirectly what they are prohibited from doing directly; and
 - In order for the provincial statute to be inapplicable, it is not necessary for the province to have intended to encroach on exclusive federal jurisdiction over bankruptcy and to be in conflict with the *B.I.A.* It is enough that the provincial statute has that effect.

Rainville, *supra* note 8; *Deloitte Haskins and Sells Ltd. v. Workers' Compensation Board*, [1985] 1 S.C.R. 785, *Business Development Bank of Canada v. Quebec* (Commission de la santé et de la sécurité du travail), [1988] 1 S.C.R. 1061, *British Columbia v. Henfrey Samson Belair Ltd.*, [1989] 2 S.C.R. 24 and *Husky Oil Operations v. M.N.R.*, [1995] 3 S.C.R. 453.

⁶⁷ S. 122-124 *B.I.A.*, Form 31 intitled “Proof of Claim”.

⁶⁸ Provided that the remedies of secured creditors are not suspended by the effects of sections 69ff *B.I.A.* L.W. Houlden and G.B. Morawetz, *The 2000 Annotated Bankruptcy and Insolvency Act* (Toronto: Carswell, 1999) at 498 [hereinafter *The 2000 Annotated B.I.A.*].

⁶⁹ M^e André Prévost describes this kind of security as a “super-privilege”. “Le régime particulier”, *supra* note 64 at 21.

⁷⁰ Subsection 14.06(8) of the *B.I.A.* provides that:

[...] a claim against a debtor in a bankruptcy or proposal for the costs of remedying any environmental condition or environmental damage affecting real property of the debtor shall be a provable claim, whether the condition arose or the damage occurred before or after the date of the filing of the proposal or the date of the bankruptcy.

⁷¹ This leads M^e André Prévost to remark that some financial institutions could be expected to take additional security to forestall such a possibility. “Le régime particulier”, *supra* note 64 at 23.

⁷² *Ibid.*

▪ **A preference that ranks ahead of the bank's claim**

The security attributed to the interim receiver for repayment of his expenses and fees also confers a preferential ranking, if the Court permits.⁷³ This gives the interim receiver a preference over all the secured creditors,⁷⁴ including a bank that holds a bank guarantee.⁷⁵ The court must however ensure that the secured creditors have been notified. Before making an order, it may allow them to make representations.⁷⁶ The determination of the security may be effected at the hearing for the appointment of an interim receiver or at a subsequent hearing.⁷⁷

▪ **A preference that ranks ahead of the claims of the Crown secured by deemed trusts**

Subsection 81.2(1) of the *B.I.A.* creates a security for the benefit of farmers, fishermen and aquaculturists to secure their claims in respect of the unpaid amount of the products that they have delivered to the debtor who has become bankrupt or made a proposal.⁷⁸ This security charges all the inventory of or held by the purchaser. It is in addition to the right of repossession provided for in subsection 81.1(1) of the *B.I.A.*⁷⁹ It provides an almost absolute security for the repayment of the farmer, fisherman or aquaculturalist. In fact, this security gives the latter a preferential right over any

⁷³ The *C.C.L.C.* recognized judicial hypothecs. *Précis de droit des sûretés*, *supra* note 17 at 265 ff. See article 2034 *C.C.L.C.* The *C.C.Q.* now recognizes legal hypothecs for claims under a judgment. Art. 2724(4) *C.C.Q.* The comparison ends there, however, since these securities are not recognized by Parliament in a bankruptcy context. Subsection 70(1) of the *B.I.A.* provides that:

[e]very receiving order and every assignment made in pursuance of this Act takes precedence over all judicial or other attachments, garnishments, certificates having the effect of judgments, judgments, certificates of judgment, judgments operating as hypothecs, executions or other process against the property of a bankrupt, except those that have been completely executed by payment to the creditor or his agent, and except the rights of a secured creditor.

From this it follows that a legal hypothec published in the register for the publication of rights in order to secure a claim under a judgement is without effect in a bankruptcy context since it would then constitute a process of execution likely to distort equal footing among creditors. *Faillite et insolvabilité*, *supra* note 6 at 43. See also *Larue v. Royal Bank of Canada*, [1926] S.C.R. 218 aff'd [1928] A.C. 187 (P.C.). The "judicial" security granted an interim receiver for his fees and expenses is thus an exception.

⁷⁴ The English version conveys a nuance lacking in the French version. The English version specifies that this security ranks "ahead of any or all secured creditors" (emphasis added). The French version simply provides that this security has "préséance sur les réclamations de tout créancier garanti" (emphasis added). By comparison, the claim of the trustee in bankruptcy for his fees is collocated after the claims of the secured creditors. See par. 136(1)(a) *B.I.A.* In the case of a proposal, it is the responsibility of the trustee in bankruptcy to come to an agreement with the author of the proposal and the creditors to ensure that his fees will be paid and his expenses reimbursed. *Infra* note 77 at 144.

⁷⁵ *Ibid.* This was a case where the debtor had made a general assignment of all accounts to the CIBC. The bank also held claims under a general security agreement.

⁷⁶ The creditors may file a notice of objection under section 80 of the *B.I.G.R.*

⁷⁷ A judgment of the Ontario Court of Justice a few years ago recognized that security and the top-ranking preference it conferred on the interim receiver, that is, it came even ahead of the secured claims. In that case, Chadwick J. had appointed an interim receiver but had decided to postpone the decision whether to grant the interim receiver top ranking security, as the Act provides. One of the secured creditors, the CIBC, however, claimed that the determination of the security should have taken place at the time of the hearing for the appointment of an interim receiver and that the court could not recognize *a posteriori* the existence of that security. Section 47.2 of the *B.I.A.* provides that:

[w]here an appointment of an interim receiver is made under section 47 or 47.1, the court may make such an order respecting the payment of fees and disbursements of the interim receiver as it considers proper, including an order giving the interim receiver a charge [...] (emphasis added).

Chadwick J. dismissed the claim of the bank and stated that subsection 47.2(1) of the *B.I.A.* should not be interpreted too narrowly. The judge added that he had appointed the interim receiver, that the latter had carried out his obligations in accordance with the order, that for that reason he should be compensated for his services and should rank ahead of secured creditors. *Re N.T.W. Management*, [1994] 29 C.B.R. (3th) 139 at 142-143 (Ont. Bkcty).

⁷⁸ These creditors may avail themselves of that security only if all the following conditions are met:

- the farmer delivered the product within the fifteen day period preceding the day on which the purchaser became bankrupt or a receiver was appointed to administer the property of the bankrupt, and
- as of the day on which the purchaser became bankrupt or a receiver was appointed, the farmer had not been fully paid for the products, and
- the farmer files a proof of claim in respect of the unpaid amount with the trustee or receiver within thirty days after the bankruptcy of the purchaser or the appointment of a receiver to administer the bankrupt's property, and
- the claim must be in the prescribed form (Form 31) (this is the general claim form).

⁷⁹ Subs. 81.2(4) *B.I.A.* See *The 2000 Annotated B.I.A.*, *supra* note 68 at 355.

other claim, right, charge—regardless of when it arose—against the purchaser’s inventory.⁸⁰ In addition, it ranks ahead of the Crown’s rights in respect of its deemed trust for its tax claims.⁸¹ Interestingly enough, the deemed trust was created so that it would prevail over the *sui generis* right of ownership of the banks that follows the guarantee provided for in section 427 of the *Bank Act*.⁸² In theory, it should follow that the inventory secured by the charge does not form part of the bankrupt’s property.

In fact, only the supplier’s right to repossession of the goods under subsection 81.1(1) of the *B.I.A.* takes precedence over the preference conferred by subsection 81.2(1) of the *B.I.A.* Lastly, subsection 81.2(1) of the *B.I.A.* specifies that if the disposition of the bankrupt’s property causes the value of the bankrupt’s entire inventory to be decreased below the value of the latter’s claim, the trustee himself is liable for the amounts covered by that security.⁸³

The creation of these securities interferes with the benefits granted under Quebec civil law to hypothecary creditors. They are, in sum, “super-preferences” that benefit some creditors to the detriment of the others, despite the secured creditor status granted them under the *B.I.A.*, including, with regard to the charge granted to farmers, fishermen and aquaculturalists, the Crown, despite the “super-preference” created by the deemed trust. In the latter case, the property on which the security can be realized is simply removed from the patrimony of the debtor even before it is transferred to the trustee in bankruptcy to administer the bankruptcy. In the case of the security granted to the interim receiver, the latter only has to apply to the court to obtain a preference over the rights of such secured creditors as the banks. In fact, it is only the Crown’s realizing on the security granted it in respect of its claims relating to environmental damage that raises questions from the standpoint of provincial private law. That is the next topic to be covered.

2.3. The exercise of remedies

In 1994, the Quebec legislature considerably amended the law of security on property and, in particular, the rights related to the exercise of the hypothecary remedies. In sum, it extended the rules relating to the exercise of these remedies to certain contracts such as the trust by onerous title established by contract to secure the performance of an obligation,⁸⁴ the sale with right of redemption to secure a loan,⁸⁵ and instalment sales involving the published reservation of property.⁸⁶

⁸⁰ As section 81.2 of the *B.I.A.* is worded, this charge ranks above every other claim “notwithstanding any other federal or provincial Act or law”.

⁸¹ *Income Tax Amendments Act, 1997*, S.C. 1998, c. 19, subs. 227(4.1). For an in-depth analysis of the deemed trust, see L. L’Heureux, “La fiducie présumée de recouvrement de la *Loi de l’impôt sur le revenu*” (1999-2000) 21:3 *Revue de planification fiscale et successorale* 481.

⁸² *The 2000 Annotated B.I.A.*, *supra* note 68 at 249. See *Royal Bank v. Sparrow Electric Corp.*, [1997] 1 S.C.R. 411.

⁸³ Subsection 81.2(1) *in fine* of the *B.I.A.* provides that:

If the trustee or receiver, as the case may be, takes possession or in any way disposes of inventory covered by the charge, the trustee or receiver is liable for the claim of the farmer, fisherman or aquaculturist to the extent of the net amount realized on the disposition of that inventory, after deducting the cost of realization, and is subrogated in and to all rights of the farmer, fisherman or aquaculturist to the extent of the amounts paid to them by the trustee or receiver.

⁸⁴ Art. 1263 C.C.Q.

⁸⁵ Art. 1756 C.C.Q.

⁸⁶ Art. 1749 C.C.Q.

It follows that the differences between “security ownership”, “security trusts” and “traditional securities” have been considerably lessened.⁸⁷

The system of hypothecary remedies established by the Quebec legislature provides four types of remedies: taking possession for purposes of administration,⁸⁸ taking in payment,⁸⁹ sale by the creditor by public auction, by agreement or by a call for tenders⁹⁰ and sale by judicial authority.⁹¹ The exercise of these remedies must, however, be preceded by the issuance of prior notice of the creditor’s intention to avail himself of one of the remedies against the debtor after twenty days, in the case of a movable property, or after sixty days, in the case of an immovable property.⁹²

Where a debtor becomes bankrupt or files a proposal, the hypothecary creditor will be considered as a secured creditor for the purposes of a bankruptcy case.⁹³ He may realize on his security, subject to the stay provided for in sections 69 to 69.31 of the *B.I.A.*, as if he were a stranger to the bankruptcy.⁹⁴ There are, however, two exceptions to this principle: the specific features that Parliament gives the securities it creates in its own legislation and the obligations to act honestly and in good faith provided for in Part XI of the Act.

The special features given by Parliament to the security it creates in its own legislation

Under subsection 14.06(7) of the *B.I.A.*, the Crown could decide not to take part in the bankruptcy and to realize on the security protecting its claim for the costs of remedying the damage caused to the environment—as Parliament provides, “in accordance with the law of the jurisdiction in which the real property is located, in the same way as a mortgage, hypothec or other security.”⁹⁵ What does this mean? Should it be concluded that this is a reference to provincial private law in the area of securities on property? Do the rules governing hypothecary rights, in particular, apply?

It has been argued that, despite Parliament’s apparently explicit intent, the realisation of this security “in the same way as a mortgage”, presents certain problems of a substantive nature.⁹⁶ Under provincial private law, the debtor’s failure to pay a debt or perform an obligation allows hypothecary creditors to realize on their security.⁹⁷ But in this case, what allows the Crown to realize upon its security is the fact that the debtor has become bankrupt or has filed a proposal. However, could it not be considered that, by reason of the fact that he is insolvent, the debtor is *de facto* in

⁸⁷ “The Treatment of Creditors”, *supra* note 9 at p. 931.

⁸⁸ Art. 2773ff C.C.Q.

⁸⁹ Art. 2778ff C.C.Q.

⁹⁰ Art. 2784ff C.C.Q.

⁹¹ Art. 2791ff C.C.Q.

⁹² If the security mechanism giving rise to the hypothecary remedy is collateral to a consumer contract, the period is 30 days. In cases involving immovable and movable property, the time does not start to run until the notice has been registered. Art. 2758(2) C.C.Q.

⁹³ The Parliament defines “secured creditor” by listing a certain number of forms of security that confer on their holders the title of “secured creditor”. Among these mechanisms, Parliament expressly provides for the hypothec. Subs. 2(1) of the *B.I.A.*

⁹⁴ A secured creditor may, however, always decide to participate in the bankruptcy and file his proof of claim. *Faillite et insolvabilité*, *supra* note 6 at 73.

⁹⁵ The Crown, considered as a secured creditor pursuant to subsection 2(1) of the *B.I.A.*, can realize on its special security outside the proposal under the rules set out in subsection 69.1(2) of the *B.I.A.* The Crown may also realize on its special security outside the bankruptcy, under the rules set out in subsection 69.3(2) of the *B.I.A.*

⁹⁶ The remedies presented in subsection 14.06(7) of the *B.I.A.* may be enforced when the debtor makes a proposal or becomes a bankrupt without regard to his failure to pay his bills. “Environmental Liabilities”, *supra* note 61 at 42.

⁹⁷ Art. 2748(2) C.C.Q. *Mortgage Act*, L.R.O. 1990, c. M-40, Part II. See *Ibid.*

default?⁹⁸ The difficulty stems from the fact that the security is not created until after the debtor's insolvency or bankruptcy.

The Crown could, in principle, assert its "super-preference" securing its claim for remedial costs on the gross realizable value of the property charged.⁹⁹ The trustee in bankruptcy, in order to protect the assets' interests, may try to recover any surplus generated by the sale of the immovable by the Crown.¹⁰⁰ This may prove to be a delicate transaction because of the fluctuations in the value of the property that, first, has been environmentally damaged and, then, remedied by the Crown.

The obligation to act with honesty and good faith in Part XI of the Act

Since 1992, the *B.I.A.* has contained provisions governing the exercise of the remedies of secured creditors. Parliament imposes on secured creditors obligations of honesty and good faith in administering and liquidating the debtor's property.¹⁰¹ However, such rules do not apply until a receiver takes possession of the debtor's property in order to administer it.

Parliament defines in subsection 243(2) of the *B.I.A.* "receiver" within the meaning of Part XI of the *B.I.A.*¹⁰² There are two basic aspects to this definition. First, the receiver described is the one who takes possession of the property of an insolvent debtor. Second, the receiver must be appointed under a court order or a security agreement. The definition is worded ambiguously, however, and permits of two contradictory interpretations.

On a broad and liberal construction, the words "a person who has been appointed to take (...) [possession of the property]", on the one hand, and "or has taken" on the other hand, present a conceptual alternative: the traditionally accepted concept of a receiver and what would appear to be a new concept of a "receiver". Thus, the "receiver" described in this definition can be the one who is traditionally appointed under a security agreement or court order, but he may also be a creditor who simply takes possession of the property that forms part of the security agreement in order to realize upon it.

⁹⁸ The *B.I.A.* defines an insolvent person as one:

- (a) who is for any reason unable to meet his obligations as they generally become due,
- (b) who has ceased paying his current obligations in the ordinary course of business as they generally become due, or
- (c) the aggregate of whose property is not, at a fair valuation, sufficient, or, if disposed of at a fairly conducted sale under legal process, would not be sufficient to enable payment of all his obligations, due and accruing due.

⁹⁹ "Environmental Liabilities", *supra* note 61 at 42.

¹⁰⁰ *The 2000 Annotated B.I.A.*, *supra* note 68 at 322.

¹⁰¹ These obligations are set out in sections 246 and 247 of the *B.I.A.* The receiver must, in addition, administer the property "honestly and in good faith" and in a "commercially reasonable manner". He must also make reports describing the exercise of his duties with respect to the property.

¹⁰² It states that a:

- [...] "receiver" means a person who has been appointed to take, or has taken, possession or control, pursuant to
 - (a) an agreement under which property becomes subject to a security (in this Part referred to as a "security agreement"), or
 - (b) an order of a court made under any law that provides for or authorizes the appointment of a receiver or receiver-manager, of all or substantially all of
 - (c) the inventory,
 - (d) the accounts receivable, or
 - (e) the other property of an insolvent person or a bankrupt that was acquired for, or is used in relation to, a business carried on by the insolvent person or bankrupt.

According to the narrow interpretation, on the other hand, subsection 243(2) of the *B.I.A.* refers only to the traditional receiver. It follows that the “receiver” described in this definition is the one who takes possession of the property of an insolvent debtor in conformity with a security agreement or a court order.¹⁰³

These were the arguments submitted to Baynton J. of the Saskatchewan Court of Queen’s Bench.¹⁰⁴ Baynton J. began by acknowledging the merits of the two interpretations, but then opted for the narrow interpretation. Taking into account the purposes of Part XI of the *B.I.A.*, he added, however, that a secured creditor could be a “receiver” as defined in subsection 243(2) of the *B.I.A.* provided that he was appointed under a security agreement or a court order to take possession of the property of his debtor.

Applied to Quebec, this would mean that subsection 243(2) of the *B.I.A.* could not apply to the situation of hypothecary creditors.¹⁰⁵ The legal basis for hypothecary creditors to enforce their rights in the event of the debtor’s default is not found in a contract of security or a court order but in the *C.C.Q.* itself.¹⁰⁶ It could be added that the use of the concept of “receiver” in the context of subsection 243(2) of the *B.I.A.* probably refers to a concept that was traditionally recognized solely in common law. The sequestrator under civil law is more akin to a depositary.¹⁰⁷ In civil law, the provisions governing the administration of the property of another apply.¹⁰⁸

The method of realizing on the securities described in subsection 243(2) of the *B.I.A.* was, in Quebec, the taking of possession of a company under a trust deed in order to liquidate the debtor’s inventories, accounts receivable and assets. The *S.P.C.A.* permitted a trust deed to be created for the benefit of the obligees under which they could enter into possession of the property of the debtor issuer and administer or liquidate it should the debtor default.¹⁰⁹ However, the disappearance of the

¹⁰³ Since the effect of the obligations imposed on secured creditors under Part XI of the *B.I.A.* is to limit their freedom to enforce their rights, a narrow interpretation of these provisions would be consistent with the rules of statutory interpretation. See P.-A. Côté, *Interprétation des lois*, 3th ed. (Montreal: Thémis, 1999) at 594.

¹⁰⁴ *Farm Credit Corporation v. Corriveau*, (1993) 20 C.B.R. (3th) 124 (Sask. Q.B.).

¹⁰⁵ It should be remembered that giving in payment, in the context of security on property, is a concept that was abandoned by the National Assembly with the reform of the Civil Code. However, no cases in Quebec have questioned the application of this definition of “receiver” in Quebec. Therefore, it is not possible to determine how a Quebec court would react if it had to deal with the application of subsection 243(2) of the *B.I.A.* Although it can always be argued that a broad and liberal interpretation of these provisions should be preferred by a Quebec court, we believe that the narrow interpretation taken in *Farm Credit Corporation* should be favoured.

¹⁰⁶ Article 2748 of the *C.C.Q.* provides that:

In addition to their personal right of action and the provisional measures provided in the *Code of Civil Procedure*, creditors have only the hypothecary rights provided in this chapter for the enforcement and realization of their security.

See A. Riendeau, “L’insolvabilité et l’exécution des garanties” (Conference of the faculty of law of University McGill, Montreal, 29-30 March 1996) at 27. It should be noted that the situation could be completely different for some creditors whose security is granted them under an Act of Parliament. For example, a creditor with a bank guarantee may take possession of the property of his debtor outside the cases provided for by subsection 427(3) of the *Bank Act* without court authorization. *Atomic Slipper Co. v. National Bank of Canada*, [1991] 1 S.C.R. 1059 at 1080 and 1081. See *Bank Act*, 1991 S.C. c. 46. See also *Droit des sûretés*, *supra* note 17 at 372ff.

¹⁰⁷ Art. 2280ff *C.C.Q.*

¹⁰⁸ Art. 1299ff *C.C.Q.*

¹⁰⁹ The authorization to take possession of the debtor’s property in the event of his default had to be expressly provided for in the trust deed. L. Lévesque, *L’acte de fiducie*, coll. Minerve (Cowansville, Que.: Yvon Blais, 1991) at 28ff. The taking of possession did not transfer the ownership, which remained in the debtor’s hands. *Liberté v. Larue*, [1931] S.C.R. 7. An interesting detail: it was confirmed that a trustee under a trust deed could act directly without having to appoint a “receiver”. Y. Caron, “De l’action réciproque du droit civil et de common law dans le droit des compagnies de la province de Québec” in J.S. Ziegel, *Studies in Canadian Company Law* (Toronto: Butterworths, 1967) at 141. See also *Droit des sûretés*, *supra* note 17 at 251ff.

trust deed with the reform of the Civil Code can give the impression that Part XI of the *B.I.A.* is a dead letter in Quebec.¹¹⁰

However, this blunt statement must be qualified. In the first place, there are creditors in Quebec with securities under other legislation besides the *C.C.Q.* that can be realized on by the intervention of a “receiver”.¹¹¹

In the second place, some rules in Part XI apply to all creditors with claims secured by a security. Subsection 244(1) of the *B.I.A.* imposes on all secured creditors the obligation to send a notice to an insolvent creditor before executing on their security.¹¹² In particular, a secured creditor cannot execute on his security before the expiration of a ten-day period.¹¹³ The *C.C.Q.*, however, provides for the immediate surrender of the debtor’s property where there is reason to fear that otherwise recovery of his claim may be endangered, or where the property may perish or deteriorate rapidly.¹¹⁴ At first glance, there would appear to be an inconsistency between the possibility of obtaining an immediate surrender of the debtor’s property and the obligation to provide 10 day’s notice under subsection 244(1) of the *B.I.A.*¹¹⁵

Another comment concerns the defence under section 252 of the *B.I.A.* Parliament allows the secured creditor in any proceeding, where it is alleged that a secured creditor or a receiver contravened one of the obligations under Part XI of the *B.I.A.* (for example, concerning the sending of a notice under section 244 of the *B.I.A.*), to show that he had reasonable grounds to believe that the debtor was not insolvent. This section is addressed to the secured creditor himself and to the receiver defined in subsection 243(2) of the *B.I.A.*, which means that this defence is open to any secured creditor even if he does not qualify as a “receiver”.

¹¹⁰ It could be added that the Quebec legislature governs the administration and liquidation of the property of an insolvent debtor by a hypothecary creditor under the rules pertaining to the administration of the property of others. However, as noted by M^e Riendeau, Quebec’s rules for the administration of the property of others are in a number of respects “[Translation] similar, indeed redundant” to those imposed on the “receiver” under Part XI of the *B.I.A.* Accordingly, the objective sought by Parliament in introducing Part XI of the *B.I.A.* would be achieved in any case. “L’insolvabilité et l’exécution des garanties”, *supra* note 106 at 31.

¹¹¹ For example, creditors with a bank guarantee. *Bank Act*, *supra* note 106, s. 427. One can consider, with respect to banks, the application of the provisions of the *C.C.Q.* regarding the administration of the property of others. Since banks hold a *sui generis* right of ownership over the property of their debtors, could it still be said that, after taking possession of this property, banks administer the property of others? On this topic, see M. Cantin Cumyn, *L’administrateur du bien d’autrui* (Cowansville, Que.: Yvon Blais, 2000) at 112.

¹¹² Unlike the rest of Part XI of the *B.I.A.* which deals with the receiver, subsection 244(1) of the *B.I.A.* refers in particular to secured creditors. It provides that:

[a] secured creditor who intends to enforce a security on all or substantially all of

(a) the inventory,

(b) the accounts receivable, or

(c) the other property of an insolvent person that was acquired for, or is used in relation to, a business carried on by the insolvent person shall send to that insolvent person, in the prescribed form and manner, a notice of that intention.

Section 124 of the *B.I.G.R.* provides that:

[t]he notice of intention to enforce a security that a secured creditor is required to send to an insolvent person pursuant to subsection 244(1) of the Act must be in prescribed form and must be sent in the manner provided for in the security agreement or, in the absence of any provision in the security agreement, must be served, or sent by registered mail or courier.

Notice of intention to enforce a security must be in the form prescribed by Form 86 entitled “Notice of Intention to Enforce a Security”.

¹¹³ Subs. 244(2) of the *B.I.A.* It should be remembered that the ten days’ notice is a minimum notice period. It is not added to the notices of exercise of hypothecary rights provided for in *C.C.Q.* (20 and 30 days for movables, 60 days for immovables). Filing such a notice would be sufficient under subsection 244(2) of the *B.I.A.* *Société générale (Canada) v. 2967-6804 Québec Inc.*, [1994] R.J.Q. 1684 (Que. Sup. Ct.); “L’insolvabilité et l’exécution des garanties,” *supra* note 106 at 4ff.

¹¹⁴ Art. 2767(1) *C.C.Q.*

¹¹⁵ “L’insolvabilité et l’exécution des garanties,” *supra* note 106.

It is apparent that the exercise of the remedies to which Parliament refers for realization of the security it grants the Crown for its claims related to environmental damage raises some questions because of the hybrid and exceptional nature of this security. The application of Part XI of the *B.I.A.* is limited in Quebec to the rare cases where creditors whose claim is secured by a security on property exercise their remedy against a debtor by appointing a receiver under a security agreement. An example might be a bank with a bank guarantee whose remedies do not appear in section 427 of the *Bank Act.* but in the security agreement.

General conclusions

After this rapid overview of the situation created by Parliament's introduction of new security mechanisms in the *B.I.A.*, we can offer a few comments in lieu of a conclusion. From the terminological point of view, it is not incorrect to assert that the word "charge" designates a hypothec. However, in order to avoid confusion with the common law meaning of "charge", it would be preferable to use the terminology recognized by the *C.C.Q.*; "sûretés" or "garantie" for example.

From the standpoint of substantive rights, while Parliament has sufficient jurisdiction over bankruptcy and insolvency to put in place any security mechanism that it desires, nevertheless, by creating security mechanisms outside those provided for in provincial private law and Quebec civil law in particular, it confuses relationships among creditors. However, for creditors to be reasonably able to govern their conduct, some stability is required in the legal framework in which they operate. An analysis of some of the security devices created by Parliament in the *B.I.A.* seems to show, however, that creditors' rights are subject to significant variations in terms of the rules for setting up, preferences and remedies. Such variations are probably a matter for concern in the legal community. The harmonization program implemented by the Department of Justice Canada cannot serve as a forum to address these concerns except by respecting in the federal legislative corpus the terminology and concepts in force in Quebec private law.

These questions, and many more, are presently the subject of studies within the Justice Department in collaboration with Industry Canada.