

The Coming into Force of Bill 181: Movable Rights Register and Mandatory Registrations

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Bill 181, entitled "An Act to amend the Civil Code and other legislative provisions as regards the publication of personal and movable real rights and the constitution of movable hypothecs without delivery" (the "Bill"), was assented to on April 16, 1998. Parts of the Bill came into force on July 1, 1998; the remainder of the Bill will take effect on September 17, 1999 at which time the filings discussed herein will be required.

Review of Certain Definitions Used in the Bill

To better understand the amendments to the Code set out in the Bill, here is a review of certain terms used in the Code and referred to herein:

Enterprise

This concept is very broad: according to the Code, the carrying-on by one or more persons of an organized economic activity, whether or not it is commercial in nature, consisting of producing, administering or alienating property, or providing a service, constitutes the carrying-on of an enterprise.

Mandatory registrations :

- *Leasing Contracts*
- *Most Lease Agreements*
- *Installment Sales*
- *Master Agreements*

With the coming into force of the new Civil Code of Québec (the "Code") in 1994, the new Register of Personal and

Movable Real Rights (the "Register") was to be implemented in successive steps: registration (filings) of certain contracts and the implementation of the regime for consumer movable hypothecs without delivery (non-possessory security) were postponed to a later date. The implementation of the latter was further postponed several times thereafter.





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Consumer Contract

A difference persists between the definition of a “consumer contract” in the Code and the term “consumer”, as understood under the Québec *Consumer Protection Act*.

Under the Code, a consumer contract is a contract whereby a natural person, the consumer, obtains, for personal, family or domestic purposes, property or services from an enterprise. The *Consumer Protection Act*, however, defines a consumer as “a natural person, except a merchant who obtains goods or services for the purposes of his business”.

Québec Courts have given a much broader scope of application to the notion of “consumer” as understood under the *Consumer Protection Act* than the term “consumer contract” as defined in the Code. For example, farmers, craftsmen, sole proprietors and professionals operating an enterprise within the meaning of the Code are nonetheless considered consumers under the *Consumer Protection Act*, unless they are incorporated or in a partnership.

Installment Sale Contract

This is a term sale by which the seller reserves ownership of the property until full payment of the sale price. The buyer, who can be either a natural or legal person, becomes owner of the good upon full payment of the sale price.

Contract of Sale with a Right of Redemption

This is a contract of sale by which the seller transfers the ownership of the property to the buyer while reserving the right to redeem it. The buyer, who can be either a natural or legal person, becomes owner of the good once the sale is concluded, but subject to the subsequent exercise of the seller’s right of redemption.

The right of redemption can be used by a borrower, including a natural person, to secure a loan: the borrower acts as seller and the lender as buyer. Upon default, the borrower loses its right of redemption, provided the lender complied with the Code’s prior notice requirements relating to hypothecary recourses.

Leasing Contract

This type of financing requires a tripartite contractual relationship between a person who wishes to lease a good for his enterprise (the lessee), the supplier of the good and the person who purchases the good, pays the purchase price and leases the good (the lessor). This relationship has strict legal parameters:

- the lessor must acquire the good from the supplier, at the demand of and in accordance with the lessee’s instructions;
- the leasing contract must be disclosed in the contract between the lessor and the supplier;
- the leasing contract may be entered into for purposes of the lessee’s enterprise (business purposes) only;
- the leasing contract must have a fixed term and exist in return for lease payments; and
- the good must be placed at the lessee’s disposal.

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Contract of Lease

All rental agreements which do not meet the criteria for a leasing contract constitute contracts of lease, colloquially referred to as “ordinary” leases.

Registration Requirements

Installment Sale Contracts and Sales with a Right of Redemption

The Bill modifies the scope of transactions involving corporeal movables which will be required to be registered and, indirectly, the categories of buyers henceforth affected by these contracts, so as to encompass, in addition to all movable property acquired by a person for the operation of his enterprise, road vehicles and movable property to be determined by regulation, regardless of who the buyer is (i.e. whether a consumer or an enterprise).

Filing and Opposability to Third Parties (“Perfection”)

Opposability of the rights of the vendor against third persons is linked to compliance with the registration requirements. The vendor’s rights take effect against third persons from the date of the sale, provided the reservation of ownership or the right of redemption, as the case may be, is published within 15 days of the sale. Assignments of reservations of ownership and of rights of redemption are also opposable to third persons, if published within 15 days from the date of the assignment. (The Code refers to the registration within fifteen (15) days “...from the date of the sale...”. This particular formulation should be read as meaning the date on which the sale becomes valid and enforceable, which date does not necessarily correspond with the date on which the transaction is signed.)

The protection lasts for up to ten (10) years with the possibility of renewals (except for rights of redemption which, by virtue of Article 1753 of the Code, cannot exceed five (5) years).

All registrations in the Register are done by way of standard application-for-registration forms (similar to financing statements) and not by document filing (i.e. the agreements themselves need not to be filed).

Late Registration Delay and Failure to Register

The scope of the seller’s or assignee’s rights varies, depending on whether registration occurred late or not at all:

- *Failure to Register*

The seller or its assignee may repossess the property only if it remains in the hands of the original buyer. The property is repossessed in its existing condition and subject to the rights and charges which such buyer may have granted on such property.

- *Late registration*

The seller or its assignee may repossess the property in the hands of a subsequent buyer or acquirer, when the late registration of the sale pre-dates the date of resale by the purchaser. The seller repossesses the property in its existing condition, but subject to such rights and charges which the buyer may have granted prior to the time of the late registration of the seller's right.

Master Agreements

Persons operating an enterprise who enter into an agreement with one another in respect of a universality (a class) of movable property, present and future, of the same kind, which may from time to time be the subject of an installment sale, a sale with the right of redemption or an assignment thereof, in the ordinary course of business between them, may proceed by way of a single filing of the master agreement at the Register. In all other cases, a separate filing for each transaction will be required.

With respect to a universality of movable property of the same kind, a sale with a reservation of ownership, a sale with a right of redemption and an assignment thereof between persons who operate an enterprise, even if published, such rights are not opposable to third persons who acquire any such property in the ordinary course of the seller's business. This means that when such property forms part of the inventory of the buyer which he holds for resale, the subsequent buyer thereof acquires such property free of the rights of the seller.

This provision raises the question of whether the conditional seller has prior rights to the proceeds of such a resale, when another creditor holds a security interest on the buyer's receivables. Presently, there exists no consensus on the answer to this question.

Leasing Contracts, regardless of their Term

Article 1847 of the Code provides that the ownership rights of a lessor under a leasing agreement must be registered in order to be set up (i.e. to render them opposable) against third persons. The application of this requirement had been suspended until the implementation of Phase 2 of the Register. The Bill removes the suspension of the registration requirement for leasing contracts, regardless of the term of the contract at issue (i.e. contracts with a term both shorter and longer than one (1) year). By doing so, the Bill treats leasing contracts in a similar manner to other financing techniques available by way of title retention as security (such as installment sales and sales with a right of redemption).



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Article 1842 of the Code was not amended by the Bill. Therefore, use of a leasing contract remains limited to the purchase of movable property for business purposes (i.e. for the purposes of an enterprise), regardless of whether the business is owned by a natural or legal person.

The Impact of the Bill

Registration of leasing contracts in the Register becomes a necessary prerequisite for the ownership right of the lessor or its assignee to be opposable against third persons. The ownership right takes effect against third persons from the date of the leasing contract, provided the rights are registered within fifteen (15) days of the transaction. (The Code refers to the registration within fifteen (15) days “...from the date of the lease...”. This particular formulation should be read again as meaning the date on which the lease becomes valid and enforceable, which date does not necessarily correspond to the date on which the transaction is signed). The registration lasts for a period of up to ten (10) years.

Note that the provisions regarding a failure to register or late registration applicable to installment sales and

sales with a right of redemption were not repeated for leasing contracts and lease agreements (as discussed below). It follows that until this question is clarified, it would be prudent to register leasing contracts and lease agreements within 15 days from the date they become enforceable.

The Bill extends the option of proceeding by way of registration of a master agreement to leasing contracts, in accordance with the same conditions as those established for reservations of ownership and rights of redemption (please see above).

“Ordinary” Contracts of Lease

Term of One (1) Year or Less

Under Article 1852 of the Code, as amended, the rights resulting from a lease with a term of one (1) year or less (including renewal periods and other clauses having the same effect) may (but need not) be registered.

Term of More than One (1) Year

The Bill will henceforth impose registration requirements on all rights resulting from a contract of ordinary lease with a term of more than one (1) year, including renewal periods and other clauses having the same effect, in respect of certain movables leased by lessees, namely:

- all movable property leased for the operation of an enterprise, subject to regulatory exclusions (presently, none exist);
- road vehicles and movables determined by regulation, regardless of whether the lessee is a natural person or an enterprise.

Registration is mandatory for the assignment of rights under a lease whenever such rights are themselves subject to the registration requirement.

Filing Methods

The filing methods are identical to those for leasing contracts and have the same effect. It is also possible to register master agreements.

Consumer Movable Hypothecs Without Delivery

Article 2683 of the Code, as amended, will henceforth allow a natural person who does not carry on an enterprise to grant a movable hypothec without delivery (e.g. non possessory security) on road vehicles and other movable goods prescribed by regulation¹, both at the time of and after their acquisition.

The Bill harmonizes certain rules of the Code relating to consumer contracts with those which already exist under the *Consumer Protection Act*. The significant changes are as follows:

- New Article 1749 of the Code on installment sales provides that in the case of a consumer contract as defined in the *Consumer Protection Act*, only the rules of the *Consumer Protection Act* are applicable to the exercise, by the seller or its assignee, of the right of repossession;

- Article 1751 of the Code, as amended, extends from 20 to 30 days the prior notice period of the notice of intention which must be given by a seller wishing to exercise his right of redemption for all movable goods which are the object of a consumer contract;
- Article 2683 of the Code, as amended, provides that where an instrument that creates a hypothec is accessory to a consumer contract, it is subject to the rules as to form and content prescribed by the Code or by regulation. It should be noted that presently, no regulation and no rule as to form or content exists on this subject;
- Article 2758 of the Code, as amended, extends the delay for the prior notice of a recourse relating to movable property charged with a hypothec from 20 to 30 days, for hypothecs constituted by an act accessory to a consumer contract.

Certain Practical Problems related to the Application of the Bill

Installment Sales: The Application of the "Seize or Sue" Principle

Under the Code before the adoption of the Bill, a conditional vendor had the choice of either (1) repossessing the goods, in which case the underlying debt is deemed extinguished and the right to collect any deficiency disappears or (2) accelerating the payments remaining due and suing to recover them, in which case the conditional vendor loses its ownership right in the goods and becomes an unsecured creditor for the judgment amount. The explanatory notes of the Department of Justice in the preamble of the Bill state that this problem was to be resolved by the amendments to the Code made by the Bill. Unfortunately, the amendments do not clearly resolve this issue and consequently, until the relevant provisions are re-amended or Québec courts clearly conclude that the seize or sue issue no longer exists, conditional vendors must continue to bear this problem in mind.

¹ The *Regulation to amend the Regulation respecting the register of personal and movable real rights* 1999, 131 G.O. II, 2720 provides that the following goods may be hypothecated: a motorized all-terrain vehicle equipped with handlebars and at least two wheels, that is designed to be straddled and whose net weight does not exceed 600 kilograms; a passenger vehicle; a motorcycle; a motor home; a snowmobile of a model year more recent than 1988; a caravan or a fifth-wheel; a mobile home; a boat; a personal watercraft; an aircraft.

Can or must Sub-leases resulting from a Lease or Leasing Contract Governed by the Bill be Registered?

The Bill is silent on this issue. By analogy with the intent underlying the Bill in respect of leases and leasing, we believe that registration is required for all sub-leases with a term of more than one (1) year so as to preserve opposability against third persons, as provided in Article 1852 of the Code. It would also be prudent (albeit not compulsory) to register a sub-lease of one (1) year or shorter.

Registration of Partial Assignments Effected Under Registered Master Agreements

When a master agreement for installment sales, leases or leasing contracts is signed, we previously noted that it will be possible to proceed by way of a single filing which will cover all other similar goods which could presently or in the future be sold or leased between the parties to such a master agreement.

As this registration will not cover any specific goods, but rather a universality or class of goods, it is unclear whether an assignee of an installment seller or of a lessor under a lease or leasing contract will subsequently be able to register a partial assignment while leaving in place the registration of the initial master agreement between the original parties to the master agreement. It should be possible to register such partial assignments by specifically mentioning the goods being assigned in the relevant schedules to the master agreement and referring to the schedule numbers of the schedules so transferred.

Are you Ready?...

Given that the effect of non-compliance with these new requirements could have a major impact on the continued opposability of contracts vis-à-vis third persons, it is very important to begin preparing now both for the transition of existing contracts (see below) and the implementation of procedures and practices for the timely registration of new contracts.

Registration of Rights in Existing Contracts (the Transition)

Section 24 of the Bill provides that reservations of ownership, rights of redemption, and assignments thereof, as well as a lessors' ownership rights under a leasing contract or long-term lease, including assignments thereof, granted before the date the remainder of the Bill comes into force must be registered within one (1) year of that date so as to retain their opposability against third persons.

A review of portfolios of contracts will have to be carried out by all businesses concerned to determine the duration of the remaining term of the contracts after the remainder of the Bill comes into force, and business decisions will have to be taken based on a cost/benefit analysis (i.e. the anticipated advantages of having rights opposable to third persons should be weighed against all expenses to be incurred, including the preparation of registration forms, registration fees, etc., taking into consideration the remaining term after the end of the year of transition). Such an internal review process should be undertaken as soon as possible.

Registration of New Contracts

Prior to the coming into force of the remainder of the Bill, business practices will have to be internally reviewed to ensure that the implementation of appropriate policies and procedures for the filings relating to the contracts discussed in this Bulletin are set in place.

The undersigned will be pleased to answer any questions you may have on the issues dealt with in this Bulletin.

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