COMMENTS
COMMENTAIRES

Acceleration Clauses and Article 1040b C.C.

Although the concept of *dation en paiement* is an old one in the civil law, its use in deeds of loan was not common before 1930.[1] As such clauses became more popular, they began to cause severe hardship among builders and other construction tradesmen who had previously found protection in the Civil Code under their respective privileges.[2] They soon realized that this protection was at best precarious and could be lost entirely should the lender choose to exercise his right under the *dation en paiement* clause.[3] In response to these problems, the National Assembly in 1964 amended the Civil Code by adding arts. 1040a to 1040e, under the title "Of Equity in Certain Contracts".[4]

This legislation has been analysed elsewhere in great detail.[5] It suffices to say here that the legislature chose two mechanisms to accomplish its purpose: firstly, that of requiring any creditor wishing to become the absolute owner of an immoveable to give a sixty-day notice to the debtor and any other creditors with rights in the immoveable and permitting the debtor or the other creditors to remedy the default complained of during the delay;[6] and secondly, that of allowing the courts to reduce or annul the obligations of a contract of loan where the cost of the loan is excessive.[7]

One of the questions which arose regarding these articles concerned the effect which the new legislation would have on

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[1] Harris, "Sale by Sheriff and Dation en Paiement", in *Meredith Lectures* (1969), 45, 46.

[2] Art. 2009(7) C.C.; arts. 2013 C.C. *et seq.*; art. 2103 C.C.

[3] See, for example: *Beaver Hall Investment Ltd.* v. *Ravary Builders Supply Ltd. et al.*, [1963] C.S. 388 and *Nineteenhundred Tower Ltd.* v. *Cassiani et al.*, [1967] B.R. 787.

[4] *An Act to protect borrowers against certain abuses and lenders against certain privileges*, S.Q. 12-13 Eliz.II 1964, c.67.

[5] Harris, *supra*, f.n.1, 45; Mayrand, "De l'équité dans certains contrats, nouvelle section Code Civil", in *Lois nouvelles* (1966), 51.

[6] Arts. 1040a and 1040b C.C.

[7] Art. 1040c C.C.

"acceleration clauses" or "*la clause d'échéance accélérée*". The effect of this clause purported to be that upon any occurrence which constituted a default the entire outstanding balance of the loan immediately (or shortly thereafter) became due. This clause provided lenders with added protection and was sufficiently popular that by 1964 it could be found in most contracts of loan. The question was therefore simple. If the creditor waited until the requirements for the operation of the acceleration clause were satisfied and then gave the notice required by art. 1040a C.C., stating the omission to be the full accelerated balance, would the debtor or other interested creditor wishing to "reinstate the loan" be required to pay the entire amount outstanding or merely the payments due as well as interest and costs? In other words, was the effect of arts. 1040a C.C. *et seq.* to deny a creditor who wished to exercise a *dation en paiement* the benefit of an acceleration clause?

The answer to this question lies in the way in which the courts interpret art. 1040b C.C., the relevant section of the new legislation which provides that:

> The debtor or any other interested person may prevent the exercise by the creditor of his right to become the absolute owner of the immoveable or to dispose thereof, by remedying the omission or breach mentioned in the notice and any subsequent omission or breach, and by paying the costs, at any time during the delay for notice and, thereafter, before the creditor has been declared, by deed signed voluntarily or by judgement, absolute owner of the immoveable, or, in the case of a right to dispose of it, before the creditor has exercised such right....

It is submitted that the wording of the legislation is less than clear. There are two arguments which support the view that art. 1040b C.C. does restrict the operation of acceleration clauses. Firstly, the historical background and the tenor of the legislation must be taken into account. The legislation was designed to provide relief to debtors and to protect other creditors whose security ranked below that of another creditor. To continue to permit such use of acceleration clauses would significantly reduce the effectiveness of the legislation. Secondly, since almost all contracts of loan include acceleration clauses, to allow them to operate in these circumstances would make the last phrase "and any subsequent breach or omission" redundant. On the other hand, one might well argue that a restrictive interpretation should be given to art. 1040b C.C. Freedom of contract is a fundamental principle of Quebec civil law,[8] and one must apply the presumption in statutory interpretation

[8] Arts. 13, 990, 1062 C.C.; *Christie* v. *York Corporation*, [1940] S.C.R. 139.

against any new legislation altering the general law.[9] Thus in the absence of an express statutory prohibition, contracting parties are free to draft their contracts as they wish. One could further argue that freedom of contract is a right which every individual within the jurisdiction of Quebec civil law enjoys. Therefore one should presume that an individual is not to be deprived of his common law rights.[10] Finally, the words "any subsequent breach or omission" are clearly required to protect creditors in situations where the contract of loan does not contain an acceleration clause.

Early commentators were somewhat divided on this question. R.C.T. Harris expressed no personal opinion and implied that the question was doubtful and would have to be resolved by the courts.[11] On the other hand, a more emphatic view was put forward by Professor Albert Mayrand, as he then was:

> *La clause d'échéance accélérée, en vertu de laquelle le défaut de payer un versement rend toute la dette exigible, va-t-elle obliger le débiteur à rembourser toute sa dette afin de remédier à sa contravention? Quoique le texte de l'article 1040b ne soit pas explicite à ce sujet, il nous semble contraire à l'esprit de la nouvelle législation de donner effet à la clause de déchéance automatique du terme.*[12]

One of the first judicial opinions on this matter appeared in 1967 in the unreported judgment of Lesage,J. in *Darveau* v. *Routhier.*[13] In this case the creditor attempted to exercise an acceleration clause in conjunction with a *dation en paiement.* The debtor argued that the notice given by virtue of art. 1040a C.C. was improper inasmuch as it alleged that the full outstanding balance of the loan was due. The Court held that even though the creditor had claimed more than was due, the notice was still valid:

> *Il faut même dire que si le créancier a exigé plus que l'omission donnant ouverture à une demande de dation en paiement, cette exigence ne détruit pas l'avis qui comporte tout ce que la loi exigeait ...* .[14]

Although the decision on the validity of the acceleration clause was *obiter,* the Court clearly implied that such a clause was inoperative in these circumstances.

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[9] *National Assistance Board* v. *Wilkinson,* [1952] 2 All E.R. 255, 260; *Beneficial Finance Co. of Canada* v. *Ouellette,* [1967] B.R. 721; *Hecke* v. *La Cie de Gestion Mascoutaine Ltée,* [1972] S.C.R. 22.

[10] *Langham* v. *City of London Corp.,* [1948] 2 All E.R. 1018; *Beneficial Finance Co. of Canada* v. *Ouellette,* [1967] B.R. 721; *Hecke* v. *La Cie de Gestion Mascoutaine Ltée,* [1972] S.C.R. 22.

[11] Harris, *supra,* f.n.1, 50.

[12] Mayrand, *supra,* f.n.5, 64.

[13] S.C. Quebec, 149-840. But *cf.* the earlier case of *In re Clément Jacques,* S.C. Québec, 15 September 1965, *contra.*

[14] Comtois, *Jurisprudence,* (1967) 70 R. du N. 192, 195.

In a subsequent comment, Professor Comtois states that this case decides that such a clause is inoperative:

> *Le créancier ne peut pas demander plus que le paiement des versements échus. La clause usuelle voulant que le défaut d'effectuer un paiement entraîne la déchéance du terme et rende exigible le paiement de la somme totale est sans doute valable dans les cas ordinaires, mais cette stipulation n'est pas admissible au bénéfice de celui qui veut en même temps se faire donner l'immeuble en paiement.*[15]

While I would, with respect, suggest that this is reading more into the decision than it actually held, three recent cases have confirmed this interpretation of the effect of art. 1040b C.C.

The first of these decisions was that in *Re Nadeau; Canada Permanent Trust Co.* v. *Miller*.[16] The litigation arose after the debtor was bankrupt and he was therefore represented by a trustee. O'Connor,J. stated that:

> The issue here is whether an acceleration clause in a deed of loan prevents a trustee from tendering only the payments which are in arrears or whether in view of such acceleration clause, the trustee must make full repayment of all moneys owing including all of the capital if he wishes to prevent the hypothecary creditor from exercising its right under the *dation en paiement* clause.[17]

The decision is complicated by the wording used by the creditor in his 60-day notice. After setting out the specific omissions and breaches, the notice continued:

> As a result of the foregoing, Daniel Nadeau is in default to make payment of the entire balance of principal of loan.[18]

In considering the notice, O'Connor,J. held that:

> ... the result is not a breach in itself. The fact that the capital has become due is a result of other breaches ... Article 1040b requires the debtor to remedy only those omissions or breaches mentioned in the said notice. The article does not require the debtor to remedy the "result" of such breaches.[19]

However, while the precise drafting of the 60-day notice was one of the reasons for the decision, it is argued that the Court grounded its decision principally on the broader view that art. 1040b C.C., when correctly interpreted, did not require a debtor who wished to remedy his default to pay the full outstanding balance. The Court gave two reasons for this conclusion. The first would appear

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[15] *Ibid.*, 194.
[16] (1969), 15 C.B.R. (N.S.) 171.
[17] *Ibid.*, 173.
[18] *Ibid.*, 174.
[19] *Ibid.*

to be an application of the "mischief" rule of statutory interpretation:[20]

> I certainly share the view that it would be against the whole spirit of this new legislation to permit a lender to require the repayment of the whole capital of a loan before the debtor could halt the effect of the *dation en paiement* clause.[21]

The second was the way in which art. 1040b C.C. was drafted:

> Another compelling reason for interpreting C.C. art. 1040b as meaning that the instalment payments in arrears for interest, capital, insurance, etc., are the omissions referred to and not the omission to repay the full amount of capital outstanding is the fact that reference in the article is also made to "any subsequent omission or breach". If the full amount of the capital... is to be paid under the remedying provision of C.C. art. 1040b there would of course be no "subsequent" omission or breach for the debtor to remedy.[22]

Lesage,J. considered this question again in *Chambly Realties Ltée* v. *Dame Lapointe*.[23] The issue in this case was very similar to that in *Darveau* v. *Routhier* and it could thus be argued that the comments of the Court on the effect of art. 1040b C.C. on acceleration clauses were not part of the *ratio decidendi*. However, Lesage,J. took the opportunity to remark that he had not altered his opinion on the matter and that the default which the debtor had to remedy was merely the payment of the arrears due and costs, but not the full accelerated balance.

The last and most recent decision was that of Batshaw,J. in *Forte* v. *Coast to Coast Paving Ltd.*[24] The Court defined the issue as follows:

> In the present case, the problem presented to the Court is whether the wording of article 1040b C.C. will allow a debtor to reinstate the loan by paying only the instalments in arrears plus the costs, in spite of the exercise of the creditor's right to claim the full amount under the acceleration clause.[25]

The Court, in deciding in favour of the debtor, considered that, given the tenor and the intent of the legislation, any doubts about its effects should be resolved in the debtor's favour. Secondly, although there was no jurisprudence directly on point, it was said that two decisions had implied the debtor's right in this

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[20] *Heyden's Case* (1584), 3 Co.Rep. 7a, 7b; 76 E.R. 637.

[21] (1969), 15 C.B.R.(N.S.) 171, 175. As O'Connor,J. noted, this view was previously put forward by Mayrand, *supra*, f.n.5, 64.

[22] *Ibid.*

[23] [1970] C.S. 361.

[24] [1972] C.S. 718.

[25] *Ibid.*, 718-19.

manner: *Chambly Realties Ltée* v. *Dame Lapointe*[26] and *Langlois* v. *La Banque d'expansion industrielle.*[27] While the former, as analysed above, certainly does support this view, it is submitted with respect that the latter did not deal with the point in question. Thirdly, it was noted that Quebec doctrine had adopted this interpretation, and in support of this assertion the Court cited Professor Comtois. Finally, the Court applied the "mischief" rule of statutory interpretation, as was done in *Re Nadeau; Canada Permanent Trust Co.* v. *Miller*:

> To permit the creditor to insist on payment of the entire capital in view of the acceleration clause would be an indirect way of defeating the relief which the legislator intended to give to a debtor in virtue of the legislation above referred to.[28]

In a recent note, Professor Comtois strongly approved of *Forte* v. *Coast to Coast Paving Ltd.*:

> *Nous sommes absolument d'accord avec cette interprétation. Ces dispositions ont été mises en vigueur pour venir en aide à un débiteur en difficulté. Elles doivent s'interpréter dans cette optique.*[29]

In conclusion, it is submitted that a sufficiently strong line of jurisprudence has been developed for one to safely say that one of the effects of art. 1040b C.C. is to render inoperative an acceleration clause in a contract of loan where the creditor wishes to foreclose upon the debtor in default by exercising his *dation en paiement* rights. In order to prevent the operation of the clause, the debtor need only repay any arrears on the loan as well as costs. This interpretation has been supported by Quebec doctrine and is logically consistent with the intent and purpose of the new legislation. It should be noted that a creditor can still exercise an acceleration clause. He is simply restricted in that his subsequent recourse cannot be a *dation en paiement.*[30]

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[26] [1970] C.S. 361.
[27] [1969] B.R. 456.
[28] [1972] C.S. 718, 720.
[29] Comtois, *Jurisprudence,* (1973) 75 R. du N. 349.
[30] He is of course free to take an hypothecary action.
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