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SECURITY UPON MOVEABLE PROPERTY IN THE PROVINCE OF QUEBEC

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At a time when the economy is experiencing a quite remarkable expansion of credit, it seems appropriate to consider a legal aspect of the subject which must always be a preoccupation of creditors, namely, the kind of security which may be obtained by agreement upon the movable property of a debtor. Most creditors understandably share one weakness, and that is the desire to be secured against the failure or incapacity of their debtor to pay what he owes them at due date. It is the task of law, not merely in the interest of equity and justice, but of commerce itself, to determine which creditors shall enjoy this favour and under what conditions, and what shall be the order of preference among them. The free flow of commerce requires not only that certain persons or institutions be encouraged to extend credit by the guarantee which they are able to obtain of being paid, but that the ordinary unsecured creditor should not be driven from the field by the unreasonable extent to which others have by law or contract been given a preference over him. Among the considerations which must influence the legislator are the types of credit to be encouraged, the protection to be given to the creditor, the debtor and third persons, and the practical necessities of daily life and trade which will determine the kind of collateral offered and the appropriate security device for giving it. The subject is a vast one and capable of becoming very complex as the rapidly developing body of literature on it in France and the United States will attest. An attempt will be made in this article merely to give some general idea of the present state of the law in Quebec. Although reference will necessarily be made to the special rights or privileges which are conferred by law on certain creditors, the subject is what may be called contractual security upon movable property, or in the much more concise French expression — *les sûretés mobilières conventionnelles.*

THE GENERAL LINES OF THE QUEBEC SYSTEM

The development in Quebec of the law and practice in this field has been a curious mixture of commercial improvisation within the limits of a fairly

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static body of traditional civil law principles, and the dominance in certain aspects of the field of special legislation of a very advanced and quite original character, deriving its inspiration from common law rather than civil law sources. Several factors have contributed to this pattern but the most important is undoubtedly the strength of the chartered banks in this country and the extent to which the exercise of the federal legislative jurisdiction over banks and banking has been able to meet the demands of the commercial community for new forms of secured financing. The lack of a comparable legislative initiative from the province in favour of other financing agencies has left the banks with a virtual monopoly in certain fields. The existence of this federal legislation is noteworthy not only for its commercial and economic importance but for its juridical impact on the civil law system. In order to appreciate the nature of this impact and the framework within which other lenders are obliged to operate, it is necessary now to consider, if only in the briefest outline, the fundamental principles of that system.

The basic principle governing the rights of creditors in Quebec, and the point of departure for the present discussion, is the rule which is found in article 1981 of the civil code: "The property of a debtor is the common pledge of his creditors, and where they claim together they share rateably unless there are amongst them legal causes of preference." The bias of the law is against favouring one creditor at the expense of others. The burden is on a creditor to show cause why he should be preferred. It is constantly affirmed that legal causes of preference are *de droit strict*;[1] while recognizing their necessity, the law is concerned that they should not be extended beyond their necessary limits.

At civil law the legal cause of preference which a creditor may claim is either a privilege or a hypothec.[2] The first is defined by the Code as follows: "A privilege is a right which a creditor has of being preferred to other creditors according to the origin of his claim. It results from the law and is indivisible of its nature."[3] Privilege is thus a right of preference *conferred by law* on *certain* creditors because of the nature of their claim. It cannot, in principle, be created by contract,[4] that is, be obtained by *any* creditor.[5] A particular contract may give rise to a claim to which privilege attaches, as for example, sale or lease, but it is not a contract which has the creation of a privilege as its principal object. The only way in which *any* creditor, regard-

[1] *Wells* v. *Newman* (1897), 12 Que. S.C. 216; *Dallaire* v. *Gauthier & Scott* (1903), 24 Que. S.C. 495.

[2] Art. 1982 C.C.

[3] Art. 1983 C.C.

[4] *Kouri* v. *Ferguson and Canada Maple Exchange Ltd.* (1922), 33 Que. K.B. 208; *Richardson* v. *Beaubien* (1924), 62 Que. S.C. 413; *Beique* v. *Asbestos Motor Sales Limited and Vermette and Brassard* [1953] Que. Q.B. 699.

[5] The privilege, however, attaches to the claim and not to the person of the creditor, and it can accordingly be transferred with the claim.

less of the origin of his claim, can obtain a privilege on the movable property of his debtor is to take a pledge, or pawn,[6] of such property as security for his debt. "The pawn of a thing gives to the creditor a right to be paid from it by privilege and preference before other creditors."[7] This, too, is a privilege conferred by law, but it is one which any creditor may acquire for any kind of indebtedness.

Pledge requires for its validity that the debtor (or person who offers the security on his behalf) give up possession of the thing pledged by putting it into the hands of the creditor or some other person appointed by the parties to hold it.[8] (Where the thing is already in the hands of the creditor or third party, the contract may be constituted by the debtor consenting to it being retained as security for the debt.) Where the debtor is left in possession, there may be an agreement which the courts will recognize as a *promise* of pledge, enforcable by the creditor against the debtor in the event of default,[9] but it will not avail against third parties. The law requires that the debtor transfer possession of the thing pledged in order that persons who deal with him should not be deceived as to the extent of his unencumbered assets. There must be a real, apparent and unequivocal change of possession to constitute a valid pledge. Many are the cases in which the parties attempt to create the semblance of pledge while in fact leaving the thing pledged within the actual reach and control of the debtor. The creditor's privilege lasts only as long as he or the person appointed to hold the thing retains actual possession of it.[10] The pledgee who voluntarily gives up possession loses his security.

Privilege, or the right to be paid by preference out of the proceeds of a judicial sale of the thing, is only one aspect of this security. Joined to this right, and the means of safeguarding it, is a right of retention based on the creditor's control over the thing. He has a right to hold it until full and final payment of the indebtedness;[11] he can oppose the seizure of it by other

[6]Although the civil code states in article 1968 that "the pledging of movable property is called pawning", the term "pledge" will be used in this article because the words "pawning" and "pawn" are reserved in practice for a particular type of lender, the *pawnbroker,* who is engaged in the business of making small loans upon the pledge of movable property and is regulated by special laws: The Quebec Licence Act, (1941) R.S.Q. c. 76, s. 107 *et seq.* The Pawnbrokers Act, (1952) R.S.C. c. 204.

[7]Art. 1969 C.C.

[8]Arts. 1966 and 1970 C.C. Where the thing is placed in the custody of a third party there must still be a real and apparent change of possession so that third parties are not misled: *Payenneville & Martineau* v. *Prévost* & *Major* (1916), 25 Que. K.B. 246. For creditor's recourses on default where thing is left with third party: *Paquette* v. *Rainville & Papineau* M.L.R. 2 S.C. 123.

[9]*The Canada Paper Co.* v. *Cary* (1878), 4 Q.L.R. 323; 10 R.L. 501. Cf. *Savard* v. *Tremblay* (1906), 30 Que. S.C. 423.

[10]Art. 1970 C.C.

[11]Prescription of the debt is interrupted so long as the thing pledged remains in the hands of the creditor. *Macdowell* v. *Johnson* [1948] Que. K.B. 633.

creditors of the debtor and insist on payment before giving up the thing.[12] This may result in his being paid before creditors who would normally outrank him. If he allows the thing to be sold, or brings it to sale himself, he will be paid by preference out of the proceeds according to the rank given him by law. Nor need his ultimate right in Quebec be confined to payment by preference. In the ordinary case, where the parties have not stipulated otherwise, the pledgee cannot "on the debtor's default, dispose of the thing in any manner he pleases"; if he wishes to realize on his security he must "cause it to be seized and sold in the usual course of law under the authority of a competent court and obtain payment by preference out of the proceeds."[13] But the parties may agree that on default the creditor shall have the right to keep the thing as his own property without any accounting to the debtor. This is the *pacte commissoire,* prohibited by Roman and old French law, and by the law of France today.[14] Thus while the interests of third parties and the creditor are safeguarded by the transfer of possession in the contract of pledge, there is less concern in the Quebec law for the protection of the debtor.

The importance of the right of retention, from the creditor's point of view, is only appreciated if one considers the extent to which possession is still treated in the civil law as a basic concept around which the whole system of rights in movable property is organized. The corollary of reliance on possession as evidence of such rights is the protection of possession as the basis of ownership. Such a system necessarily involves some limitation of the *droit de suite.* If movable property is to circulate freely it must not carry too many hidden charges. It is only possible here to suggest in the briefest outline the extent to which this policy has been worked out in Quebec law.

The insistence on possession as the basis of contractual security upon movable property is reflected in a rule concerning the second of the legal causes of preference: hypothec. Movable property is not susceptible of hypothecation.[15] The only exceptions expressly recognized by the code are the maritime mortgage and bottomry.[15a] This rule is expressed in French in the very old maxim: *les meubles n'ont pas de suite par hypothèque.* It is understood to mean not only that a creditor cannot acquire by

[12]Art. 646 C.C.P. Mignault, *Le droit civil canadien,* v. 8, p. 409; Demers, *Traité de droit civil du Québec,* p. 46; *Baudry* v. *Lepine* (1882), 5 L.N. 103; *Belleau* v. *Piton & Whelan* (1887), 13 Q.L.R. 337; *Leclerc* v. *Valin* (1908), 14 R.L. n.s. 236. This point, which has always been a controversial one in French doctrine, has not been free from uncertainty in Quebec. Cf. *Fortier* v. *Hebert & Hirst* (1887), 15 R.L. 476; *Gauthier* v. *Fortin & Lapointe* 1 Que. P.R. 500.

[13]Art. 1971 C.C.

[14]Codifiers' 6th Report, p. 50.

[15]Art. 2022 C.C.

[15a]Maritime mortgages are provided for and regulated by the Canada Shipping Act, (1952) R.S.C. c. 29, s. 45 *et seq.*

agreement with his debtor a real right in movable property which will entitle him to follow it into the hands of third parties in satisfaction of his claim, but that he cannot even acquire a right to be paid by preference out of the proceeds of movable property which remains in the possession of the debtor, and is seized in the latter's hands. In referring to this rule it is often said that Quebec law does not allow a chattel mortgage.

While many of the privileges on movable property are hidden, in that they exist without any external evidence upon property which is in the possession of the debtor, they either carry no *droit de suite* or at most a very limited one. The rule varies somewhat from case to case. For example, the privileged rights of the unpaid vendor to revendicate the thing sold or to be paid by preference last only so long as the property has not passed into the hands of a third party *who has paid for it.*[16] (His right to have the sale dissolved and to recover possession of the thing for non-payment of the price, whether the sale be one for cash or on credit, exists only while the thing sold remains in the possession of the buyer.[17]) The landlord has a right to follow the movables subject to his privilege within eight days after their removal from the premises. In the case of merchandise in commercial premises his right to seize lasts only as long as the merchandise remains the property of the debtor.[18] The lumberman's privilege for wages is extinguished "as soon as the lumber shall have passed into the hands of a third person who has bought it, received delivery thereof, and has paid the price therefor in full."[19]

Quebec law has not shown the same disposition as the modern law of France to admit the principle of *la subrogation réelle.* Where they once refused,[20] the courts now seem prepared to allow a privileged creditor to exercise his right of preference upon the proceeds of a *vente amiable,*[21] which have been garnished in the hands of the third party purchaser, but the law still does not allow the privilege to be exercised upon the insurance indemnity which is payable in the event of the loss or destruction of the thing.[22]

Limitations on the *droit de suite* in Quebec law do not operate merely against those exercising a right of privilege on movable property. Possession

[16]Art. 1999(3) C.C. Cf. *Mechanic Supply Co.* v. *Hudon et al.* (1933), 71 Que. S.C. 400.

[17]Art. 1543 C.C.

[18]Art. 1623 C.C.

[19]Art. 1994c C.C.

[20]*Lanthier* v. *Avard Denis Ltée & Wilson* (1920), 58 Que. S.C. 463.

[21]*Mechanic Supply Co.* v. *Hudon & Compagnie de Machinerie Mercier* (1933), 71 Que. S.C. 400; *Tremblay & Villeneuve Enrg.* v. *Coopérative de Colombier et al.* [1944] Que. S.C. 281.

[22]*Wood* v. *Lamoureux & The Commercial Union Ass. Co.* (1887), 15 R.L. 313; *Voscelles* v. *Laurier & The Aetna Insurance Company & Dame Marie Virginie Valade* (1895), 8 Que. S.C. 404; *Dame Ella Vaughan* v. *Pelletier & The Manchester Fire Insurance* (1899), 15 Que. S.C. 123; *Isaacs* v. *Talfler & The Guardian Assurance Co. Limited* 11 Que. P.R. 359; *Sachs* v. *Cohen* 35 Que. P.R. 390; *Comtois* v. *Lamarre & Brulé* [1952] Que. S.C. 252.

acquired under certain circumstances is protected against the assertion of a right of ownership itself. While introducing an important change in the Quebec law by the rule that ownership should pass in contracts for the alienation of a thing certain and determinate by consent alone, without the necessity of delivery,[23] the codifiers did not give full effect to this change by the organization of a system of publicity for real rights in movable property. Possession continued to be the only evidence of such rights on which third parties could rely. The extent to which the new rule should be made to affect third parties was in the early years, at least, a matter of uncertainty, disagreement and misgiving. The nature of the problem is fully set out in the judgment of Sir A. A. Dorion C.J. in the case of *Dupuy* v. *Cushing*.[24]

The uncertainty turned in part on a difference of wording between the draft of article 1027 C.C., as adopted by the legislature, and the official text of the code. Whatever the reasons may have been for the change, as article 1027 reads in the accepted version today, it makes the rule concerning transfer of ownership by consent alone "apply as well to third persons as to the contracting persons", with one express exception: "if a party oblige himself successively to two persons to deliver to each of them a thing which is purely movable property, that one of the two who has been put in actual possession is preferred and remains owner of the thing although his title be posterior in date; provided, however, that his possession be in good faith." Some would confine the application of this exception to a subsequent *purchaser* who has taken possession in good faith;[25] others would extend the protection to a pledgee under similar circumstances.[26] Beyond these exceptions the general rule operates against third persons, in the absence, of course, of fraud. The contention of Dorion C.J. in *Dupuy* v. *Cushing*, that creditors are entitled to property remaining in the possession of their debtor as against a third person to whom it has been sold in a *bona fide* transaction, has definitely been rejected.

Creditors of a buyer who is in possession of a thing sold under a conditional contract of sale reserving ownership in the seller are in a similar position. Notwithstanding the fact that they have no notice of the conditional seller's right (the conditional contract of sale does not have to be registered in Quebec) the seller is able to revendicate or oppose the seizure of the thing. This is the rule of article 1027 in reverse: the reservation of ownership by the seller, where possession is given to the buyer, affects not only the parties to the contract but third persons as well. The exceptions in this case are found in the rules which protect a person to whom a thing is sold or pledged under

[23]Art. 1025 C.C. Also art. 1472 C.C.

[24](1878), 22 L.C.J. 201.

[25]Trudel, *Traité de droit civil du Québec*, vol. 7, p. 378.

[26]*Church* v. *Bernier* (1892), 1 Que. Q.B. 257, per Lacoste C.J., at p. 271.

certain circumstances by one who is not the owner.[27] If the thing was bought in good faith at a fair or market, or at a public sale, or from a trader dealing in similar articles, or in any other sale which is deemed to be commercial, such as the sale of a business,[28] the owner will not be able to revendicate unless the thing had been lost or stolen, and then only upon reimbursing the purchaser what he has paid for it. A pledgee enjoys the same protection if he has taken the thing in good faith from a trader dealing in similar articles or in a transaction which is otherwise commercial.[29]

Because of what is comprised in the term "stolen" — for example, the buyer under a conditional contract of sale who re-sells the thing in violation of the terms of the contract is deemed to have stolen it[30] — there will be few cases in practice in which the thing will not have been either lost or stolen and the owner not entitled to revendicate upon reimbursing. This does not seriously affect the pledgee who cannot ask more than a right of retention until he is paid. The buyer may be able to oppose the revendication in such case on the ground of prescription. A person who acquires possession of a corporeal movable in good faith becomes the owner of it by prescription, regardless of how long he has possessed it or, when his possession began,

[27]Arts. 1487-1490, 2268 and 1966a C.C.

[28]The extension of the protection to any sale which is deemed to be commercial may still be disputed by many in Quebec. It is not possible to enter into the difference of opinion which has existed for many years over the meaning of the words "nor in commercial matters generally" in art. 2268 C.C. and the word "valid" in art. 1488, which reads: "The sale is valid if it be a commercial matter, or if the seller afterwards becomes owner of the thing." But it is the writer's belief, based on recent expressions of judicial opinion, that the law as stated in the text is substantially what the Quebec courts will apply in the future. *Globe Slicing Machine Co. Ltd.* v. *Ethier* [1948] Que. S.C. 257; *Aluminum Co. of Canada* v. *Selig* [1952] Que. S.C. 455, at pp. 457-458. For a full discussion of the issues on this point see: Perrault, *Traité de droit commercial,* v. 2, nos. 622, 625, 629; Pouliot, "Nullité de la vente de la chose d'autrui", (1933-34), 12 R. du D. 450; Owen, (1936), 14 Can. Bar Rev. 434; Challies, (1936), 14 Can. Bar. Rev. 801; Baudouin, *Le droit civil de la province de Québec,* p. 441 ff. The more important cases have been: *Cassils* v. *Crawford* (1876) Q.B. 21 L.C.J. 1; *The National Cash Register* v. *Demetre* (1905), 14 Que. K.B. 68, 97; *Tremblay* v. *Mercier and Lachaine* (1910), 38 Que. S. C. 57; *Kriziuk* v. *McBride* (1923), 29 R.L. n.s. 328; *Frigidaire Corp.* v. *Malone* (1933), 54 Que. K.B. 462; [1934] S.C.R. 121. In the writer's opinion the true relationship between arts. 1488 and 2268 is not that art. 1488 makes the sale transfer ownership in a thing which does not belong to the seller, and art. 2268 merely states the obvious consequence of this, namely, that the previous owner cannot now revendicate, but that art. 1488 prevents the buyer from repudiating such a sale when it is commercial in nature because of the protection which art. 2268 gives to the possession acquired under such circumstances.

[29]Art. 1966a C.C. Mayrand, "Nantissement de la chose d'autrui", (1943), 3 R. du B. 313, at p. 317. Cf. *Gotfredson Corporation Limited* v. *Filion* (1929), 46 Que. K.B. 52.

[30]*Commercial Credit Corp.* v. *Mulville Motor Sales Reg'd. & U.S. Fidelity & Guaranty Co.* [1953] Que. S.C. 140. For the broad construction to be given to the word "stolen" see *Charron* v. *Walker* (1918), 54 Que. S.C. 439.

if three years have elapsed since the original owner lost possession, even when such loss of possession was occasioned by theft.[31] Even where the *droit de suite* does exist then, it is only for a limited period. In effect, the owner or other person claiming possession cannot revendicate from the possessor in good faith unless he does so within three years from the time he lost possession. Moreover, possession of the thing creates a presumption of lawful title and the burden is on the person claiming it to prove not only his own right or basis of claim, such as ownership or pledge, but the reasons why the person from whom he claims is not entitled to protection, either on the ground of prescription or because of the special circumstances under which he acquired possession.

The law governing the sale or pledge of a thing by one who is not the owner of it is completed in Quebec by articles 1739 and following of the civil code, which protect persons who deal in good faith with an agent who has been entrusted with the possession of goods or documents of title. These provisions, which were modelled on the English Factors Acts of the early nineteenth century, were originally adopted because of the prevalence and importance of the old style factor or commission agent to whom goods were consigned for sale.[32] Because of changes in merchandising and distribution techniques — the "factor" today is mainly engaged in purchasing accounts receivable and furnishing a credit service for his clients — these articles of the code have become something of a dead letter, though they are still invoked from time to time. In their terms they apply to "any agent" entrusted with the possession of goods or documents of title, but in view of their source, it would probably be proper to interpret them in the light of English decisions under the United Kingdom act of 1842, holding that the agent must be one to whom the goods have been entrusted for sale, and he must have made the sale or pledge in the ordinary course of his business.[33]

In the above context of the civil law it will be seen that of the two security devices to which reference has been made — pledge and the conditional contract of sale — pledge offers the greater protection to the creditor and third parties. Not only does the transfer of possession by the debtor protect persons who deal with him, but it protects the creditor from the loss of his security by the debtor's acts. But these advantages are in particular cases outweighed by two very important drawbacks: it may be inconvenient or impossible for the debtor to give up possession of the security; the creditor may not want to assume responsibility for the care of the thing. To appreciate the import-

[31]Art. 2268 C.C.

[32]For the history of these provisions see *Clark* v. *Lomer & Clark* 1860 S.C. 4 L.C.J. 30, affirmed by 1861 Q.B. 6 L.C.J. 77; *Robertson* v. *Lajoie* 1878 Q.B. 22 L.C.J. 169, at p. 196 *et seq.*

[33]*Cole* v. *North Western Bank* 43 L.J. C.P. 194; 9 C.P. 470; 44 L.J. C.P. 233; 10 C.P. 354. See *City Bank* v. *Barrow* (1879-80), 5 A.C. 661, per Blackburn J., at p. 679.

ance of the first objection it is necessary to consider briefly the various classes of borrower and types of collateral encountered in practice.

Secured financing involving movable property may be classified roughly for present purposes as follows: the personal loan on the security of personal property; financing the retail sale of consumer goods and other sales to the ultimate purchaser for use; financing dealers and manufacturers on the security of inventory and accounts receivable; financing the agricultural or other primary producer on the security of products or equipment.

In the case of the personal loan on the security of personal property, the contract of pledge is unsuitable for a large class of borrower but it still has an important area of application. The only property of any value which the average borrower can offer as collateral — and the automobile is one of the chief items today — consists very largely of things which he is unable or unwilling to hand over to the creditor because they are necessary to his livelihood or personal convenience and comfort. But the contract of pledge continues to he suitable for a wide range of important forms of collateral such as commercial paper, investment securities and insurance policies.

The need for a security device which does not deprive the debtor of possession is felt particularly by the commercial borrower who requires the use of the collateral in the course of his daily operations. Such is the manufacturer whose inventory consists of raw materials, work in process and finished goods. The wholesale or retail dealer, even though he is not processing his inventory like the manufacturer, cannot generally afford the expense and inconvenience of placing it in a public warehouse for the purpose of creating a documentary pledge. The farmer or other primary producer who wishes to borrow on the security of his products or equipment cannot do so effectively unless he can give such security without the transfer of possession. The needs of such borrowers, and those in the field of personal finance who wish to give security on such property as automobiles, have created over the years a demand for new security devices or the adaptation of old ones to new purposes. Not all the devices for creating security without transfer of possession have had legislative sanction or have met with success in the courts.

Under the provisions of the federal Bank Act[34] the banks can take security by assignment without transfer of possession from farmers, fishermen, producers of hydrocarbons, wholesale distributors of primary products, and from manufacturers on their goods, wares and merchandise. In all of these cases the Act now provides for the protection of third parties by requiring registration of the security instrument or a notice of intention to give security. Because of its importance in practice and the interest from a legal point of view of its applieation in a civil law jurisdiction, the security taken under section 88 of the Bank Act from wholesale dealers and manufacturers will be considered in some detail presently.

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[34]Stat. Can. 2-3 Elizabeth, c. 48.

Apart from the right to secure a bond issue by trust deed under the Special Corporate Powers Act,[35] and the maritime mortgage and the contract of bottomry, to which reference has already been made, provincial legislation has only departed in one instance from the basic civil law pledge: articles 1979a and following, added to the code in 1940, allow a farmer to "pledge, as security for a loan which he contracts, for a term not exceeding eighteen months, all his livestock, and farm produce, present and future, while at the same time retaining them in his possession." The written document evidencing the pledge must be registered in the registration office of the division in which the farm is situated. On the borrower's default, the creditor has the right to demand delivery of the security and to sell it by public auction after notice, but he must account to the borrower, or his creditors, for any surplus. The *pacte commissoire* is forbidden. The creditor must realize on the security promptly if the borrower so requires.

The creation of this particular security and its characterization as "pledge" confronts the Quebec civil law with theoretical and practical problems similar to those which have been raised in France by the marked development there of what are called les *sûretés mobilières conventionnelles sans dépossession.* The French *warrant agricole,* although by no means identical, corresponds to the agricultural pledge in Quebec. The Quebec law has followed the general tendency of French legislation in treating this type of security as a pledge rather than a hypothec upon movable property, but French doctrine has argued strenuously over the merits of this approach. "En réalité," it is said by some, "ces prétendus 'gages sans dépossession' sont de véritables hypothèques mobilières, et le législateur aurait mieux fait de leur reconnaître leur véritable earactère, plutôt que de maintenir certaines règles du gage là où les principes de l'hypothèque auraient seuls dû recevoir application."[36] Those who take this view see the transfer of possession as indispensable to the constitution of pledge. On the other hand, hypothec is characterized by a *droit de suite.*

Article 1979d of the civil code concerning the pledge of agricultural property provides: "As to the rest, this pledge gives to the creditor the rights resulting from pawning." Under pawn, or the ordinary pledge of movable property, the creditor has a privilege as long as he, or the third party to whom the thing has been given, remains in possession. He has a right of retention which he may oppose even to other creditors. Can the pledgee of agricultural property oppose the seizure and sale by other creditors? Does he lose his privilege when the thing passes into the hands of third persons or does he have a *droit de suite*? The essence of the pledge is not a *droit de suite* but a right of retention. Does registration change this?[37] And, if so, would the

[35](1941) R.S.Q. c. 280.

[36]Planiol et Ripert, *Traité pratique de droit français,* XII, par E. Brecqué, p. 296.

[37]See *Caisse Populaire de Ste. Melanie* v. *Coopérative des Tabacs Laurentiens et Pelletier* [1952] Que. S.C. 22, where it was held that the registration under arts. 1979a and following has the same effect as the registration of rights in immovable property.

jurisprudence which has been persistently followed by the courts in Quebec[38] (despite the contrary holding of the Supreme Court),[39] to the effect that registration creates at most a presumption *juris tantum* and not a presumption *juris et de jure* of knowledge of real rights, be applicable in this case? Or, in other words, could a subsequent purchaser or pledgee be in good faith in the face of such registration? How would the pledgee of agricultural property, whose rights have been assimilated to those of a pledgee of movable property, rank as against creditors claiming a right of privilege or hypothec on an uncut crop as immovable property? Should the principle contained in article 1966a CC., respecting the pledge of a thing which does not belong to the pledgor, apply to a case in which the pledgee is not put in possession?

These are only some of the questions which suggest themselves in connection with a "pledge" of movable property in which registration takes the place of a transfer of possession. The rules governing the pledge of agricultural property show a greater concern for the protection of the debtor than those which regulate the ordinary pledge, but they do not deal adequately with the rights of the creditor and third parties. This particular venture of provincial legislation into the field of security without transfer of possession suggests that it may be a mistake to try to fit what is essentially a radically new departure into traditional molds, and that it is wiser, as federal legislation seems to have done, to create a new security device out of new cloth.

Quebec law has not created a device by which financing agencies under provincial legislative jurisdiction may acquire security similar to that which is obtained by the banks under section 88 of the Bank Act upon the inventory of wholesale dealers and manufacturers. The industrial factor, for example, cannot obtain in Quebec the non-possessory "factor's lien" which exists under the New York Personal Property Law and similar legislation in many other states of the American union, and his operations in this province are, therefore, almost exclusively confined to the purchase of accounts receivable. Financing agencies other than the banks are free to lend on the security of accounts receivables, but the banks, because of their ability to meet seasonal demands for loans on inventory, are in a stronger position competitively. When they take security on inventory they obtain a right to the receivables as well. Because of this situation, the possibilities of the documentary pledge as a device which may be adapted to minimize, if not eliminate, the disadvantages of the physical pledge will be given special consideration in this study. But here again it will be seen that existing legislation favours the banks.

The sale of consumer goods and equipment for industrial and commercial purposes and the purchase of dealer inventories of manufactured goods are

[38]*Darling* v. *Bricault* (1924), 37 Que. K.B. 388; *Beaudry* v. *Vandal* [1953] Que. S. C. 328; Mayrand, "Bonne Foi et Prescription par Tiers Acquéreurs", (1942), 2 R. du B. 9, 151.

[39]*Meloche* v. *Simpson* (1898), 29 S.C.R. 375; *Groulx* v. *Bricault* (1922), 63 S.C.R. 32.

financed by means of the conditional sale contract which continues to occupy a somewhat anomolous and only partially regulated position in the civil law system. It has already been observed that Quebec law does not require the conditional sale to be registered. A certain amount of regulation is provided by articles 1561a and following of the civil code for commercial instalment sales at retail in which the price does not exceed eight hundred dollars, but there are a number of important articles, including automobiles and other motor vehicles, which are expressly excluded even if they come within the eight hundred dollar figure.[40] The regulations cover the amount of the down payment, the term allowed for payment of the balance, the interest which may be charged, the buyer's right to pay by anticipation and the allowance to which he is entitled in such case, the information which the contract must contain and the form and characters in which it must be printed, and the recourses of the seller on the buyer's default. It would appear, however, that despite the imperative form of these provisions a failure to comply with them does not import nullity, for it is stated in article 1561i that any sale which does not comply with the foregoing provisions "is a sale with a term, subject to the ordinary provisions of obligations with a term, which transfers to the buyer the property of the thing sold, notwithstanding any stipulation or declaration to the contrary."[41]

Two of the provisions in this section of the code apply to all conditional sales and other contracts having a similar purpose, such as promises of sale or lease-hire arrangements, regardless of the price or the nature of the commodity involved.[42] Where the thing sold has been re-possessed by the seller, article 1561h gives the buyer or his creditors the right to recover the thing within twenty days of such re-possession upon payment to the seller of the balance owing on the price and the reasonable expenses which the seller has incurred by re-possession and the preservation of the thing. By article 1561g any creditor of the buyer has the right (presumably at any time) to pay the seller the balance of price and thus make the thing sold subject to seizure and sale as property of the buyer. The creditor in such case acquires the privilege of an unpaid vendor for the sum which he has paid.

The true position of the purchaser under a conditional sale is only appreciated, of course, if one bears in mind that in practice the conditional

[40]In these cases there is only such protection against harsh conditions in the contract as the courts are prepared to give, and their approach has not been uniform. Cf. *Commercial Acceptance Corporation Ltd.* v. *Partridge* [1955] S.C. 89, in which it was held that the condition, however unjust, had to be applied as it was not illegal nor contrary to good morals or public order; and *Commercial Acceptance Corporation* v. *Proulx* (1941), 79 Que. S.C. 325, where the court refused to apply a similar condition.

[41]Cf. *Paquette* v. *Metropolitan Plumbing and Heating Co. Ltd.* [1942] Que. S.C. 430, where it was held that failure to comply with federal wartime regulations concerning down-payment made the contact null and void.

[42]Art. 1561j C.C. *Tremblay* v. *Tremblay* [1949] Que. K.B. 539.

seller generally transfers his right in the contract, the property sold, and the promissory note signed by the buyer to a finance company. The finance company is able to sue on the note as a holder in due course free from defences which the buyer may have arising out of the contract of sale.[43] Moreover, even where the company bases its action on the contract of sale, it is a nice question how far under Quebec law the buyer may be prevented by statements in the contract,[44] and his consent to or acceptance of the assignment,[45] from raising defences which he might have against the seller himself.

Outside of the regular pattern of commercial financing permitted by existing legislation, efforts are continually made by lenders of all kinds to obtain security without transfer of possession by means of sales with right of redemption and similar devices. Such devices have been and still are resorted to by institutional lenders in, for example, the field of automobile financing, not only for personal loans on the security of automobiles, but for advances on the used car inventories of dealers. They are frequently used by private lenders to whom borrowers turn when they are unable to obtain bank credit. The validity of such devices has been the subject of much litigation and for a time, at least, of conflicting jurisprudence.

SALES WITH RIGHT OF REDEMPTION AND SIMILAR DEVICES

These attempts to obtain, within the framework of the civil law principles, a valid security without transfer of possession have taken a variety of forms. Their main object is the transfer of ownership to the creditor, but they usually provide that the debtor shall have the right to redeem the thing. There may be a sale with right of redemption, properly speaking, in which the transfer of ownership to the creditor and the seller's right to redeem are stipulated in the same contract, or there may be an outright sale in one document and in another a conditional sale, lease with promise of sale, option or other agreement giving the debtor the right to recover the ownership of his property upon payment of a sum of money which represents his indebtedness. The particular form which the transaction has taken does not seem to have had too much influence on the courts in their consideration of its validity. It is the purpose of the transaction which has been stressed.

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[43] *Laurentide Acceptance Corp. Ltd.* v. *Lemay* [1951] Que. S.C. 469; *Laurentide Acceptance Company* v. *Corneau* [1952] Que. S.C. 379.

[44] *Continental Guaranty Corporation of Canada Ltd.* v. *Papineau* (1930), 49 Que. K.B. 366; *Guaranty Acceptance Corporation* v. *Rittner* [1942] Que. S.C. 116.

[45] *Continental Guaranty Corp. of Canada Ltd., supra,* per Tellier J., at p. 371 citing art. 1180 C.C.; art. 1192 C.C. Mignault, *Droit civil canadien,* v. 5, pp. 643 ff.; v. 7, p. 184; Baudry-Lacantinerie et Saignat, *Vente,* nos. 848, 849. Laurent, *Principes de droit civil,* v. 24, no. 511. Aubry et Rau, *Droit civil français,* V, 6th ed. 1946, p. 162. Sometimes the contract removes all doubt on the question by some such clause as the following: "[Buyer] accepts said assignment and acknowledges that [the assignee] shall not be affected by any equities existing between the seller [and the assignee]."

There is a well established jurisprudence that such transactions, so long as they are not completely fictitious and non-existent in the intention of the parties, are valid and binding between the parties to them.[46] In such cases the courts apply the principle that the parties have the right to give their contract the form they prefer, and they treat the contract as the parties appear to have intended it to be, namely, a transfer of ownership as security for indebtedness; they hold that such transfer takes place by consent alone without the necessity of delivery. As regards the effect of such transactions on third parties, there have been several schools of thought and at one time two distinct lines of jurisprudence, but the prevailing view today is that a sale with right of redemption or other transfer of ownership of movable property for the purpose of securing a loan is of no effect against third parties, such as the creditors of the seller, if possession is not transferred to the buyer.

The grounds on which such sales have been held to be of no effect against third parties, usually on the contestation of an opposition to seizure or a petition for possession in bankruptcy made by the buyer, fall into roughly three categories. There are the cases in which the court has found that the sale was made with the intent to defraud the creditors of the seller,[47] and it has been possible to apply the rules of the *action paulienne;*[48] there are those in which the transaction has been set aside on the ground of simulation as being, in the real intent of the parties, a contract of pledge, invalid for failure to transfer possession;[49] and finally, although this may be regarded by some as simply another application of the doctrine of simulation, there are those in which the sale has been held invalid as contravening what the court appears to have treated as a principle of public order embodied in articles 1966 and

[46]*Despins* v. *Despins* (1922), 33 Que. K.B. 153; *Conover* v. *Commercial Acceptance Corporation Limited & Dame Skelcher* [1950] Que. K.B. 116; *Stewart* v. *Leblanc* [1951] Que. S.C. 237; *Booth* v. *McLean* [1927] S.C.R. 243; [1927] 2 D.L.R. 289; *General Motors Acceptance Corporation* v. *Ricndeau* [1953] Que. S.C. 420.

[47]*Lahaie* v. *Cayouette & Messier* (1931), 51 Que. K.B. 459; *In re Goyer & Boisvert* v. *St. Amour* (1902), 21 Que. S.C. 502; *Edgerton v. Lapierre* (1903), 5 Que. P.R. 389; *Champagne* v. *Jackson & Shapiro* (1918), 54 Que. S.C. 388; *Rickaby* v. *Bell* (1877-79), 2 S.C.R. 560.

[48]Arts. 1032 *et seq.* C.C.

[49]*Cushing* v. *Dupuy,* P.C. (1880), 24 L.C.J. 151; *Boulanger* v. *Caisse Populaire de St. Sylvere* (1936), 60 Que. K.B. 538; *Chevalier & Beauchemin* v. *Latraverse* (1890), 18 R.L. 614; *Moffat* v. *Burland* (1884), 4 D.C.A. 59; *Bouchard* v. *Couture & Jacob* (1933), 71 Que. S.C. 536; *Stern* v. *Trustee, In re La Mode Dress Company Limited* (1923-24), 4 C.B.R. 563; *In re Rene Huot* v. *Bonnier & Le Foyer de Placement Inc.* (1934-35), 16 C.B.R. 43; *Imperial Oil Ltd.* v. *Gagnon & Caisse Populaire de Ste. Clothilde* [1945] Que. S.C. 32; *Campbell Auto Finance Co. Ltd.* v. *Comtois* [1946] Que. S.C. 136; *Campbell Auto Finance* v. *Bonin* S.C., St. François, No. 2289; K.B., No. 2362, October 27, 1944; leave to appeal to the Supreme Court refused, [1945] S.C.R. 175. Cf. *Le Garage Central D'Amos Limitée* v. *Lamarre* [1955] Que. Q.B. 725, where the Court of Appeal upheld the transaction on the ground that it was not, as alleged by the trustee, "fictitious".

1970 requiring that the creditor or third party custodian be in possession for a valid pledge and in article 2022 prohibiting the hypothecation of movables.[50] In the last category of cases the conclusion amounts to a finding that in so far as third parties are concerned the civil law does not recognize security on movable property without transfer of possession or other form of notice. Often the courts will rely on a combination of the above grounds so that the cases cannot all be assigned exclusively to one or another of them.

With the cases based on a finding of fraud one cannot quarrel. *Fraus omnia corrumpit.* The application of the doctrine of simulation requires closer examination. So also does the view that even where the parties intend a *bona fide* sale with right of redemption of movable property it contravenes a basic principle of Quebec law to allow such a sale to take effect against third parties when there has been no transfer of possession.

There is simulation[51] when the parties clothe their transaction in one form but really intend to enter into another contract as evidenced by a secret agreement. The secret understanding or counter-letter may completely destroy the effect of the apparent agreement, in which case the transaction is said to be fictitious, or it may merely modify the effect of the contract, when the transaction is said to be disguised. Simulation is not in principle a cause of nullity, but third parties must not be prejudiced by it. Those who have acted on the faith of the apparent contract may invoke it in their favour; those who are prejudiced by the apparent contract may call for application of the rules which govern the transaction that was really intended. Although simulation is frequently prompted or accompanied by fraud, it must not be equated with fraud and may exist in the absence of any fraudulent intent.

The finding of simulation in the cases under discussion is based on the assumption that there cannot be a *bona fide* sale where the purpose is to secure repayment of a loan. The real contract in the intention of the parties is deemed to be one of loan, with an accessory contract of pledge. In fact, although the purpose which they wish to achieve may be similar in both cases, the parties do not intend pledge, they intend sale. And neither the seller's right of redemption nor his remaining in possession changes that fact. The real question in such cases, but one which is not asked too often, is whether there remains an obligation on the debtor's part to repay and if so, whether such an obligation is compatible with a valid sale with right of redemption. The fact that the buyer's reason for entering into the sale is not that he is particularly interested in acquiring the thing in question, but that he wishes to be guaranteed against the seller's failure to repay a loan, should not make it any less a transfer of ownership in the intention of the parties.

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[50] *Thompson and Alix Ltd.* v. *Gerard Lapierre & Cyrille Lapierre* (1934), 72 Que. S.C. 461; *Beaupré, Lamarre* v. *Campbell Auto Finance Co. Ltd.* [1942] Que. S.C. 97.

[51] Ripert (Boulanger), *Traité élémentaire de Droit civil,* v. 2, nos. 580 ff.

There may be a basis here for distinguishing, as the courts do not seem to have done, between the sale with right of redemption, properly speaking, and the transaction in which the parties enter first into an absolute sale and then some other agreement providing for re-purchase or redemption. The buyer in the latter case claims under what purports to be a straight sale which it was not the intention of the parties to effect. The courts examine such a transaction for *indicia* of an ordinary sale and, finding that they do not exist but that the real intention was to give security, conclude that there has been simulation. Such was the case in *Dupuy* v. *Cushing*,[52] now one of the leading authorities for the application of the doctrine of simulation to such transactions. In addition to the absence of a transfer of possession, which the Privy Council said "must still be one of the material facts to be regarded in determining the question whether any particular sale is real or simulated", there was a finding that the transaction lacked a "fixed price."

The civil code recognizes the validity of a sale with right of redemption. It makes no distinction between immovable and movable property. In the wording of article 1550a — " . . . and in the case of an immovable or an immovable right . . . " — it clearly contemplates that there may be a sale with right of redemption of other than immovable property, and in fact, the authors and numerous judicial decisions recognize the sale with right of redemption of movable property. Moreover, as has been pointed out on several occasions, the sale with right of redemption has traditionally had hardly any other purpose in practice than that of obtaining and assuring the repayment of an advance of money. It is true that there is technically a distinction to be drawn between the legal relation of the parties under this contract and their rights and liabilities under a loan secured by pledge, even when the latter carries the *pacte commissoire,* and this distinction will be considered. But the fact that the sale with right of redemption is entered into to enable the seller to have the use of the buyer's money for a certain limited period of time does not alter the intention of the parties to effect a sale.

This point was well made by Girouard J. of the Supreme Court of Canada in the case of *Salvas* v. *Vassal*,[53] a decision which has been relied on by a line of jurisprudence taking a different view than that which has followed *Dupuy* v. *Cushing*.[54] Here a sale with right of redemption of *immovable* property for the usual purpose of securing what amounted to a loan was held in the absence of fraud, to be valid as against a third party even though possession had not been transferred to the buyer. After reviewing the history of the sale with

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[52] 24 L.C.J. 151; 22 L.C.J. 201.

[53] (1896-97), 27 S.C.R. 68.

[54] *Beaubien* v. *Perrault & Piché* (1900), 17 Que. S.C. 410; *Bergeron* v. *Campeau & Ruthman* (1904), 25 Que. S.C. 26; *Creed* v. *Haensel & William Strachan Company* (1903), 24 Que. S.C. 178; *In re Victory Pop Corn; Prevost* v. *Feliciano* (1923-24), 4 C.B.R. 429; *Bélanger* v. *Desjardins* (1929), 32 Que. P.R. 317; *Pomerance* v. *Desroches & Homes and Lands Ltd.* (1940), 78 Que. S.C. 244.

right of redemption, its use in France to evade the prohibition against the *pacte commissoire* in the contract of pledge, and the absence of such considerations or reasons for declaring it invalid in Quebec law, Girouard J. concluded that there was no reason for not applying the clear intention of the parties where it was manifestly, as in this case, to enter into a contract of sale with right of redemption and not one of pledge. He drew a distinction between the contract intended by the parties and the motives for making such a contract, or the object which it was to serve. "Pour décider la question, même vis-à-vis des tiers, il s'agit de rechercher non pas les motifs, ou le but immédiat ou ultérieur, ou les résultats possibles ou probables que les parties avaient en vue, mais la nature de la convention qu'elles avaient l'intention de faire, et qu'en réalité elles ont faite . . . Où se trouve ici la simulation? Les parties n'entendaient-elles pas faire une vente irrévocable, si le prix n'était pas remboursé?"[55]

In the application of this decision to the average case in which an attempt is made by means of a sale with right of redemption to obtain security upon *movable* property without transfer of possession, there are two possible difficulties: the extent to which an obligation on the part of the seller to repay may be incompatible with a sale with right of redemption, and the fact that in a sale with right of redemption of *immovable* property, without transfer of possession, as in *Salvas* v. *Vassal,* third parties are protected by the registration of the deed of sale.

With respect to the first point, the test of a sale with right of redemption is the alienation of the thing with the intention that the buyer should become absolute owner of it on the seller's failure to redeem it. Where the intention is that the transfer of ownership should not be irrevocable on the seller's default but that the buyer should have the option of keeping the property or claiming from the seller the amount which he has received, the contract has been held to be one of pledge.[56] The authors emphasize this basic distinction between the sale with right of redemption and the loan secured by pledge: the seller is not indebted to the buyer, nor is he obliged to redeem; unlike the pledge, even with *pacte commissoire,* in which the thing pledged does not automatically become the property of the creditor on default but only at his option,[57] the sale of the thing with right of redemption is intended to extinguish the seller's indebtedness.[58] The jurisprudence has recognized this to be its effect.[59] For this reason some commentators have seen a contradiction in terms in the use of the word "security" in connection with such a transfer of

[55](1896-97), 27 S.C.R. 68, at p. 81.

[56]*La Compagnie d'Assurance sur la Vie "La Sauvegarde"* v. *Ayers* [1938] S.C.R. 164.

[57]*Holman* v. *Scott* (1906), 15 Que. K.B. 193.

[58]Laurent, *op. cit.,* vol. 24, no. 380; Baudry-Lacantinerie et Saignat, *op. cit.,* no. 607.

[59]*Landry* v. *Nicole* (1917), 51 Que. S.C. 253; *J. R. Booth, Limited* v. *McLean* [1927] S.C.R. 243; [1927] 2 D.L.R. 289; (1926), 40 Que. K.B. 331.

ownership. In the recent case of *Rousseau Inc.* v. *Boulanger & Lepine*,[60] in which the Quebec court of appeal was able to dispose of an attempt to give security without transfer of possession on the ground that the actual terms of the contract were those of pledge rather than sale, Marchand J. referred to "des concepts de propriété et de garantie qui répugnent à coexister au sujet du même objet".[61] In connection with the documentary pledge and security under section 88 of the Bank Act, it will be seen that there is nothing incompatible in a transfer of ownership subject to redemption and a continuing obligation in the debtor to repay the advance.

With the sale with right of redemption, however, the law would seem to be otherwise. The following statement of Gagné J. in the *Rousseau* case expresses the traditional view: "Et pour qu'il y ait vente réelle ou encore dation en payement comme le dit le savant juge de première instance, il faut que la dette soit éteinte, c'est-à-dire que le créancier ne puisse plus poursuivre son débiteur pour autre chose que l'objet même qui lui est transporté. Telle est la condition essentielle. Si l'on ajoute un droit de réméré, cela n'y change rien: la dette doit être éteinte et le débiteur libéré s'il n'exerce pas son droit de réméré."[62] But the Supreme Court admitted an important qualification of this rule in the case of *The Queen* v. *Montmigny*,[63] where it was agreed by the parties that, if on the purchaser becoming absolute owner and taking possession, the amount realized on a sale of the property was less than the price stipulated in the sale with right of redemption, the purchaser should have a claim against the seller for the difference. It was held that "La clause par laquelle le vendeur garantit que l'immeuble vaut le prix payé et que la vente en rapportera le montant n'a rien d'incompatible avec la vente." Thus a creditor taking a sale with right of redemption of movable property without transfer of possession should be able to protect himself to the extent allowed in the *Montmigny* case without invalidating the transaction.

The second difficulty involved in the application of the holding in *Salvas* v. *Vassal* to a sale of movable property without transfer of possession — the fact that third parties do not have the protection of registration — is the real reason why the majority of Quebec judges have refused to give effect to such a contract where third parties were involved. They have created a rule of public order out of the spirit and intention which they believe emanate from the articles requiring a transfer of possession for pledge and the article prohibiting the hypothecation of movables. It is a frank assertion of judicial policy to supply the deficiencies of the law. Others have felt that such a position could not be justified in the face of articles 1025 and 1027 which, with one exception, make the transfer of ownership perfect by consent

[60] [1952] Que. K.B. 772.
[61] At p. 777.
[62] At p. 780.
[63] (1898-9), 29 S.C.R. 484.

alone even against third parties.[64] In *Creed* v. *Haensel & William,*[65] which has been followed as recently as 1940 in the Superior Court,[66] but never apparently in the Court of Appeal, Doherty J., relying on *Salvas* v. *Vassal,* says that he sees "no reason for making a distinction between the acquisition for such purpose of movables and immovables," though he does not make specific reference to registration. Faced with the usual arguments drawn from articles 1970 and 2022, he contends that these articles refer to security other than a transfer of ownership, which cannot be said to be prohibited by them. He points to the case of the conditional sale to show that there is no general principle operative in Quebec law requiring that ownership in movables be evidenced by possession to avail against third persons. But this view, however logical it may be, has not prevailed.

An interesting commentary on the relative weight of legal logic and the judicial "hunch" about policy in this matter is to be found in certain remarks of Ramsay J. in two of the earlier cases. Dissenting in *Dupuy* v. *Cushing*[67] he said: " . . . I consider article 1025 is a serious disimprovement to the law. The rule of the old law was perfectly clear. As against third parties secret sales were of no avail. If by jurisprudence we can come back to this doctrine, I shall be very glad, but it certainly is not the law of the Code." Later, in *Moffat* v. *Burland,*[68] he said: "It seems to me that both of our courts of appeal have declared themselves against concealed sales, and I am very glad they have been able to find law for it, which I willingly take from them on trust. In several cases we have applied the doctrine in the most absolute form . . . This is going back to the old law *sans phrase.*"

THE DOCUMENTARY PLEDGE

The documentary pledge, which is security in the form of a bill of lading, warehouse receipt or other document of title, conforms in its essential elements to the requirements of pledge, but offers the parties more flexibility. The borrower can give such security while the goods are in transit or safekeeping; the creditor does not have the bother of the physical custody and handling of the goods which nevertheless remain beyond the debtor's control in the custody of a disinterested third party. In its traditional use, however, this device suffers from the chief disadvantage of the physical pledge: the borrower may be greatly inconvenienced by being deprived of possession. Where, for example, the goods are warehoused at some distance from his premises he may be put to considerable expense and loss of time in handling and moving the goods as they are released by the creditor. Modern adaptation

[64]See note 54, *supra.* Also *The Sonne Awning, Tent and Tarpaulin Co.* v. *McDonald & Walterer* (1908), 33 Que. S.C. 481.

[65](1903), 24 Que. S.C. 178.

[66]*Pomerance* v. *Desroches & Homes and Lands Ltd.* (1940), 78 Que. S.C. 244.

[67]22 L.C.J. 201, at pp. 201-202.

[68](1884), 4 D.C.A. 59, at p. 64.

of the documentary pledge has been designed to reduce these disadvantages as much as possible.

The documentary pledge is governed in Quebec, for the most part, by legislative provisions which are essentially of common law derivation. They stand in sharp contrast, both in terminology and substance, to the civil law rules respecting pledge. The banks are governed by section 86 and following of the Bank Act, other lenders by the Quebec Bill of Lading and Warehouse Receipt Act[69] and the rules of the civil code applicable to agents entrusted with the possession of goods or documents of title.[70] The provisions of the present Bill of Lading and Warehouse Receipt Act in Quebec are in essence those which regulated the right of banks as well other lenders to take security on documents of title in the province of Canada at the time of Confederation.[71] While the terms of the Bank Act have undergone considerable change and modernization since then, those of the Quebec law have undergone almost none. This has meant that in certain particulars — for example, when the debt must be contracted and the length of time for which the security may be held — the Quebec law offers less flexibility to lenders than the Bank Act.[72] This example of legal atrophy cannot be put down simply to legislative indifference; once again it reflects the pattern of commercial activity in the country and the importance and centrality of the position occupied by the banks in this particular field of secured financing. It is difficult to avoid the conclusion that here, as in the case of security without transfer of possession on the inventory of manufacturers, it is less the law which has determined the pattern of financing than it is commercial and economic factors — such as interest charges and the comprehensiveness of services — which have determined the shape of the law. Nonetheless, a liberalization of the provincial law on the documentary pledge might conceivably make this type of security, particularly in the field warehouse form, sufficiently attractive to other lenders to make possible the kind of volume that would allow them to be more competitive in the matter of rates.

Under section 86 of the Bank Act, a bank "may acquire and hold any warehouse receipt or bill of lading as security for the payment of any debt incurred in its favour, or as security for any liability incurred by it for any person, in the course of its banking business." The bank thereby acquires "all the right and title to the warehouse receipt or bill of lading and to the goods, wares and merchandise covered thereby of the previous holder or owner thereof", and in the case where, instead of being endorsed to the bank, the bill of lading or warehouse receipt is issued directly to it, "all the right and

[69](1941) R.S.Q. c. 333.

[70]Arts. 1739-1754 C.C.

[71]Cons. Stat. Can. c. 54, s. 8; 24 Vic. c. 23; 29 Vic. c. 19.

[72]The same time limits are to be found in The Mercantile Law Amendment Act of Ontario, (1950) R.S.O. c. 231.

title to the goods mentioned therein of the person from whom the goods, wares and merchandise were received or acquired by the bank." It would appear from the wording of section 86, therefore, that the bank cannot acquire a better title to the bill of lading or warehouse receipt, or the goods covered by it, than that of the person from whom it acquired the security, and that despite a contrary holding by the Quebec court of appeal in an early case,[73] the civil law rules governing a pledge taken from one who is not the owner would not apply to section 86 security. This is further indicated by section 87, which states the exceptional cases in which the bank may acquire the rights of the owner upon taking security from a person who has been put in possession by the owner. This section was originally intended to apply the provisions regarding factors to section 86 security, but it is much broader in its terms than the usual factors legislation[74] — certainly it is broader than the terms of the Quebec civil code on that subject. The term "person", for example, is used instead of "agent" and there is no mention of the requirement of good faith. Whatever the scope of section 87, it excludes the application of the civil code rules on factors.

Under division I of the Quebec Bill of Lading and Warehouse Receipt Act, lenders other than banks may take security in the form of a bill of lading or warehouse receipt on cereal grains, goods, wares or merchandise, and under division II, on logs, pulpwood or other timber, boards, deals, staves or other lumber or products thereof. The document of title may be taken by endorsement from the "owner of, or person entitled to receive" the property in question or "his attorney or agent"; such endorsement vests in the endorsee "all the right and title of the endorser to or in" the property in question. Once again it would appear that except in a case covered by the rules of the code regarding factors — which should apply to any documentary pledge taken by lenders other than banks — the creditor cannot acquire a better title than the person from whom he takes the security. But in contrast to the ordinary pledgee, when he takes from an owner or one deemed to be owner, he does not become simply a depositary but acquires all the rights of the owner in the security.

The debt, liability, loan or advance for which section 86 security is given must be contracted or made at the time the security is given or upon a written promise to give the security.[75] In the latter case the Bank Act says that the debt, liability, loan or advance may be contracted or made before or at the time of or *after* the security is acquired. Under division I of the Quebec statute the debt must be contracted at the time the security is given.[76] There

[73]*Canadian Bank of Commerce* v. *Stevenson* (1892), 1 Q.B. 371, reversed by the Supreme Court (23 S.C.R. 530) without discussion of this point.

[74]See Falconbridge, *Banking and Bills of Exchange*, 5th ed., 1935, p. 225.

[75]Stat. Can. 2-3 Elizabeth, c. 48, s. 90(1).

[76](1941) R.S.Q. c. 333, s. 5.

is no provision, as there is in division II of the Act dealing with security on timber, for taking a written promise to give security.[77] In this respect there is an important discrepancy between division I of the Act and article 1748 of the civil code concerning factors, which validates the security taken under a written promise existing at the time the debt was contracted. This distinction, which does not exist in the corresponding provisions of the Mercantile Law Amendment Act of Ontario,[78] could well be removed from the Quebec act. It has been held under division I of the Quebec act that the security must not be taken *before* the loan is contracted.[79]

The Bank Act places no limit on the length of time for which section 86 security may be held, whereas under the Quebec Bill of Lading and Warehouse Receipt Act security can only be held on cereal grains, goods, wares or merchandise for six months[80] and on timber for twelve.[81] It is difficult to say just how seriously the six months' rule limits the usefulness of the provincial legislation, but it probably accounts in some measure for its infrequent application. When these delays were retained in the federal Bank Act for a certain time after Confederation, they could be extended with the consent of the borrower.[82]

To appreciate the full possibilities of the documentary pledge as a practical device answering the needs of a businessman who must have ready and inexpensive access to his inventory for his daily operations, it is necessary to consider the extent, under the two acts, to which a valid warehouse receipt may be given for goods which remain on the premises of the borrower. The warehouse receipt which a bank may take includes "any receipt given by any person for goods, wares and merchandise in his actual, visible and continued possession as bailee thereof in good faith and not as of his own property."[83] Under the terms of this definition the courts seem prepared to allow arrangements whereby the borrower sets aside a part of his premises to serve as a warehouse and leases the space for a nominal rental to an officer or employee who issues a receipt for the property and acts as custodian of it, presumably releasing it only in accordance with the instructions of the creditor.[84] Such an

[77]Sec. 8.

[78](1950) R.S.O. c. 231, s. 11(3)

[79]*Re Inter-British Trading Co. Inc.* (1946), 27 C.B.R. 203.

[80]Sec. 5. See *MacNider* v. *Beaulieu & Allen* 14 L.N. 59; *Re Inter-British Trading Co. Inc.* (1946), 27 C.B.R. 203.

[81]Sec. 8.

[82](1871), 34 Vic. c. 5, s. 50. *Molson's Bank* v. *Lanaud* (1882), 5 L.N. 263.

[83]Stat. Can. 2-3 Elizabeth, c. 48, s. 2(1) (ac) (i).

[84]*La Banque Nationale* v. *Boyer* (1911), 20 Que. K.B. 341, where wholesale grocers rented for a nominal fee two floors of their premises to one of their clerks who acted as custodian and issued a receipt which was transferred as security to the bank. It must be noted, however, that two judges dissented in the Court of Appeal, and a majority of all those in the three courts which heard the case were of the opinion that there had not been a compliance with the Act. Cf. *In re Wedlock* [1926] 2 D.L.R. 263; 7 C.B.R. 147,

arrangement obviously lends itself to abuse, and no clear standard emerges from the little judicial opinion that is available on the question as to the care and propriety with which the operation must be carried out to satisfy the requirement of good faith in the definition. The Quebec law does not lend itself to similar arrangements for it requires that the document of title be "given by a warehouseman, miller, wharfinger, master of a vessel or a carrier."[85] In view of decisions interpreting another provision of the Act which allows these classes of persons to give security in the form of receipts issued by them for their own goods,[86] there is little doubt that if the courts did not require the custodian's sole occupation to be that of warehouseman, they would at least require evidence of transactions in which he had acted as warehouseman for the goods of others.

Such a scheme, however, even when using the services of an employee of the borrower as custodian, is an entirely different thing when carried out as a modern field warehousing operation under the control of a recognized field warehousing company. Although well established in the United States for several years now, field warehousing is only beginning to take hold in Canada. The field warehousing company leases space on the borrower's premises which is fenced off or segregated in some other way and put under lock and key in charge of one of the borrower's employees who is formally put on the payroll of the warehouseman and covered by fidelity bond. The warehouse company itself issues the negotiable warehouse receipt on information supplied to it by the custodian. A sign is usually posted to show that the premises rented from the borrower are being occupied as a field warehouse. Spot checks of the inventory covered by the warehouse receipt are made regularly by a representative of the warehouse company. There can be no doubt about the validity of a *bona fide* field warehousing operation of this kind under the Bank Act, and there would seem to be no reason why it should not be equally valid under the provincial law. The important thing, however, is not simply that the receipt be issued by a recognized warehouseman, but that there be that actual and visible change of possession which has always been required for the protection of third parties in the contract of pledge.[87] While supervision by a

where a company dealing in automobiles leased a show-room to its Secretary-Treasurer who made a daily check of inventory and reported to the bank.

[85](1941) R.S.Q. c. 333, s. 2.

[86]Sec. 3, also sec. 7. *Ross* v. *Thompson & Laird* 9 Q.L.R. 365; 10 Q.L.R. 308; *Young* v. *Demers* (1895), 4 Q.B. 364; *Banque Molson* v. *Janes* 9 L.C.J. 81; *The Merchants' Bank of Canada* v. *Smith* (1880-84), 8 S.C.R. 512.

[87]See *Payenneville & Martineau* v. *Prévost & Major* (1916), 25 Que. K.B. 246, where the pledge of two automobiles was held invalid because although they were supposedly in the hands of a third party custodian in a part of the premises not rented to the debtor, there was nothing to suggest to third persons that they had passed out of the debtor's possession and control. Cf. *Merchants Bank et al.* v. *Monteith* (1886), 10 O.R. 529 and *Milloy* v. *Kerr* 3 O.A.R. 350; 8 S.C.R. 474 for a case where warehouseman issued receipt for accomodation of the borrower or lender without having the goods in his actual custody and control.

reliable warehouse company affords the creditor adequate protection, unless some form of notice is made mandatory, third parties are liable to be misled. The American courts have been fairly strict in the requirement of notice to third persons.[88] Uncertainty on the adequacy of formalities in this respect is removed by the Uniform Commercial Code which requires the filing of a financing statement to perfect security under a field warehouse receipt even where a sign has been posted.[89] Because of its practical utility, not only in cases where a lender cannot obtain security without transfer of possession, but where a bank may desire a greater measure of control or protection than it enjoys under section 88 security, there is every reason why field warehousing should become increasingly popular in Quebec. As it does so, it may be found desirable to follow the American example of providing for some form of registration of the security interest.

A point of some importance in connection with the documentary pledge in Quebec is the legal nature and effect of a trust receipt. The trust receipt is used in Quebec almost exclusively by the banks, although there is nothing to prevent other lenders on the security of a documentary pledge from making use of it as well. It is a document which is signed by a person to whom the bank surrenders a bill of lading or warehouse receipt for certain limited purposes, such as clearing the goods through customs, the substitution of one kind of bill of lading for another on trans-shipment, or sale of the goods on the bank's behalf. The borrower acknowledges in the trust receipt to have received the document of title as an agent, "trustee" or "bailee" for the purpose mentioned therein, and if the purpose be sale, he undertakes to sell the property and collect the proceeds for the account of the bank. There is no doubt that this undertaking is binding on the borrower and that he is liable to criminal prosecution for acts in fraud of the lender's rights, but what effect as regards third parties, such as the borrower's creditors, does such a surrender of the document of title have on the lender's security in Quebec?

The practice is a well established banking custom, and it has been settled in English law, since the decision of the House of Lords in *North Western Bank Ltd.* v. *John Poynter, Son & Macdonald,*[90] that by surrendering the document of title to the borrower for a limited purpose under trust receipt (or "letter

[88]Friedman, "Field Warehousing", (1942), 42 Col. L.R. 991, at p. 999; Birnbaum, "Form and Substance in Field Warehousing", (1948), 13 Law and Contemporary Problems, 579, at pp. 590-591. The American law requires that the warehouseman have "actual, open and exclusive possession" of the goods.

[89]Uniform Commercial Code, secs. 7-205(2), 9-305(2), 9-401. Certain of the French commentators who have been sufficiently attracted by the American experience with field warehousing to advocate its development in France have recommended a system of publicity by registration. Cabrillac, *La Protection du Créancier dans les sûretés mobilières, conventionnelles sans dépossession,* 1954, no. 303.

[90][1895] A.C. 56. See also *In re David Allester, Ltd.* (1922), 2 Ch. 211; *Official Assignee of Madras* v. *Mercantile Bank of India Ltd.* [1935] A.C. 53.

of trust" as it is generally called in England) the lender does not lose his security interest as pledgee in the goods or the proceeds thereof. It would appear, however, that a third party purchaser or pledgee in good faith will be protected as taking from an agent who has been entrusted with the possession of the goods or the documents of title for sale.[91]

The federal Bank Act does not deal expressly with the trust receipt, although section 90(2), which states the cases in which a bank may exchange one document of title or form of security for another, might be considered at first sight to have a bearing on the question. It declares that the bank may exchange a bill of lading for a warehouse receipt and vice versa and "surrender any bill of lading or warehouse receipt held by it and receive in exchange therefor *any security that may be* taken under this Act." Subsection 2 and section 90 must be understood in the light of subsection 1; its purpose is to show that the bank is not prevented by the rules as to when security may be validly taken from substituting one form of security for another. In the English decisions the "trust receipt" has not been treated as a form of security or an instrument creating a security interest; the lender is regarded as having retained the security interest which was originally created by the documentary pledge. A trust receipt is not a "security that may be taken under" the Bank Act if by that is meant a security which is created or expressly authorized by the Act. It is submitted that the effect on the bank's rights of surrendering the document of title on trust receipt is a matter to be determined by law outside the Bank Act, and that where the security has been given in Quebec, the question should be determined by Quebec law.

Although there is not much authority on this question in Quebec, and what there is of it is old and conflicting, it would seem on the whole that Quebec law differs from the common law on this point. In *Merchants Bank of Canada* v. *McGrail and Lajoie*,[92] the Quebec Court of Review held that the bank had not lost its rights by surrendering the document of title under trust receipt. But some ten years later in *La Banque Molson* v. *Rochette*,[93] in a judgment which was unanimously confirmed without further comment in the Court of Appeal,[94] Casault J. of the Superior Court, held that by doing so the bank in that case had given up possession and in virtue of article 1970 of the Civil Code had lost its rights as pledgee. He added: "Le droit anglais et américain est, sous ce rapport, différent du nôtre (Jones on Pledges, No. 40). Là, une remise temporaire, ou une possession par le propriétaire à titre d'agent ou de fidei-commissaire du nanti, conserve le gage . . . Mais notre droit ne reconnaît pas ces distinctions, ni ces conversions de possession par

[91] *Lloyd's Bank, Ltd.* v. *Bank of America Trust and Savings Association* [1937] 2 K.B. 631; [1938] 2 K.B. 147.

[92] 22 L.C.J. 148; 1 L.N. 231.

[93] (1888), 14 Q.L.R. 261.

[94] 17 R.L. 139.

le propriétaire de sa chose, sauf dans un cas, celui où ce propriétaire est gardien d'entrepôt . . . "[95] There is no reference to the earlier decision.

Mignault, likewise making no mention of *The Merchants Bank of Canada* v. *McGrail and Lajoie,* approves the holding in the *Rochette* case and cites it in support of the following proposition of law: "Ainsi, si le créancier remet l'objet du gage au débiteur qui s'engage à le conserver pour lui, il perd son droit de gage. De même le débiteur ne peut se constituer dépositaire pour le compte du gagiste, en remettant à ce dernier un reçu où il reconnaît posséder pour lui."[96]

Although this view may be in strict conformity with the civil law principles, it is from the commercial point of view extremely inconvenient, and one may ask whether this is not a case for application of article 1978 of the Civil Code which provides: "The rules contained in this chapter, are subject in commercial matters to the laws and usages of commerce." The English decisions on this question appear to have been influenced very largely by consideration for commercial necessity and usage. As Lord Wright put it in the Privy Council: "Such procedure is the usual course of business, and is obviously either necessary, or at least convenient for the conduct of the business in question."[97] The fact, however, that this is a necessary and well established commercial practice is one thing: whether, as a matter of commercial usage, a bank is regarded and treated by other creditors as retaining its security interest under a trust receipt, is another thing. But quite apart from commercial usage in this sense, it may be argued that inasmuch as the creditor is treated by both federal and provincial law as having a right of ownership in virtue of a documentary pledge, the civil law rule of 1970 should not be applied to the analysis of his position under a trust receipt; that in such case he should be regarded as an owner who has entrusted property for certain limited purposes to an agent, and he should have the right, not only as regards the borrower but as regards the borrower's creditors as well, to claim as his own property the document of title, the goods themselves or even the proceeds of their sale if they are identifiable. As will be seen, this view is consistent with the one which is taken of the bank's rights as holder of section 88 security.

The objection will be made, of course, that whereas the Act requires the registration of notice of intention to give security under section 88, there is no such requirement for section 86, and to allow a lender to surrender the document of title and still retain his security interest is to allow a documentary pledge to be converted by means of trust receipt into security without transfer of possession and without notice to third parties. In Quebec, subsequent purchasers or pledgees in good faith would be protected; in so far as

[95](1888), 14 Q.L.R. 261, at pp. 263-264.

[96]*Droit civil canadien,* v. 8, p. 403.

[97]*Official Assignee of Madras and Mercantile Bank of India, Limited.* [1935] A.C. 53, at p. 64.

other creditors of the borrower are concerned, their position would be no different than that of creditors of a buyer who are in possession under a conditional sale. But as in the case of sales with right of redemption and similar devices, the Quebec courts are not likely to be persuaded by arguments drawn from their own inconsistency to allow further exceptions to the principle that contractual security upon movable property must be evidenced by transfer of possession or some other form of notice to third parties.[98]

SECURITY UNDER SECTION 88 OF THE BANK ACT

The rights and priorities given to a bank by what has come to be known as "section 88 security" constitute, from both the juridical and economic point of view, the most important qualification in Quebec of the principle that the movable property of a debtor is the common pledge of his creditors. Compared to the civil law pledge, section 88 security is a breath-takingly modern and streamlined device. Not only does the bank obtain security without depriving the borrower of possession, but it is able to secure a revolving line of credit by a kind of floating charge over all the property of the borrower, existing or after acquired, which answers a given description and is found in designated places. The security exists on the raw materials, work in process and finished goods of a manufacturer.[99]

Prior to 1923, the bank's lien was a secret one. Today the protection afforded to third persons by the transfer of possession in the case of pledge is supplied under section 88 security by the registration in the Bank of Canada, in the province where the borrower has his principal place of business, of a notice of intention to give security. Such notice does not specify the property to be given as security nor the extent of the borrower's indebtedness to the bank, but it is in effect a warning to third persons, if they bother to consult it,

[98]In the United States the trust receipt has developed into a very important security device of much wider application than its traditional use by banks in foreign trade transactions. It has been especially important in the financing of automobile dealers' inventories. (In Quebec such financing is carried on by means of the conditional sale "floor plan") Because of judicial hostility to secret liens, the Uniform Trust Receipts Act was drafted to put American trust receipt financing on a sound basis. The Act has been adopted by many states. It requires the filing of a financing statement to perfect the creditor's security interest.

[99]Sec. 89(5) of the Bank Act, which states that the security interest of the bank in goods, wares and merchandise extends to the work in process and finished goods into which they are turned by the manufacturing process, applies in its terms to section 86 as well as section 88 security. Similarly, under the Quebec Bill of Lading and Warehouse Receipt Act, the security on timber extends to "all property into which the same or any thereof may be converted." It is difficult to see the application of this rule to the documentary pledge, except in cases where the law allows a person to give security in the form of a receipt issued by him for his own goods. This is permitted by the Quebec law, but no longer by the Bank Act. For a case applying the principle of sec. 89(5) to such a situation when it was allowed by the Bank Act see *Re Goodfallow Traders Bank* v. *Goodfallow* (1890), 19 O.R. 299.

that the bank will have a right to all the borrower's property of a given class, including the receivables from the sale of same, and that consequently they deal thereafter with the borrower at their own risk.

The bank, on the other hand, does not enjoy the protection afforded by the civil law rules to the person who relies in good faith on the apparent right of ownership evidenced by the possession of the one with whom he deals. It is clear from the wording of the Act, and decisions under it,[100] that in order to obtain a valid security under section 88 the bank must take from the owner of the property assigned or from one who becomes owner before the release of the security. In subsection 2 of section 88 the only rights and powers which the Act speaks of a bank acquiring in virtue of an assignment under section 88 are those "in respect of property therein described . . . of which the person giving the security is the owner at the time of the delivery of such document or of which such person becomes the owner at any time thereafter before the release of the security . . . " Moreover, under the form of assignment prescribed in schedule C of the Act, the borrower only assigns property of a given description of which he "is now or may hereafter become the owner." Thus, under the form which is used by the banks, a bank could not claim to have received an assignment of property not owned by the borrower.

The precise nature of the bank's right under section 88 security has been the subject of conflicting judicial opinion. It has been variously characterized as a "lien",[101] "essentially a mortgage transaction",[102] "security in the nature of chattel mortgage or bills of sale",[103] a sale with right of redemption,[104] a "contrat de gage *sui generis*",[105] "une constitution de droit de propriété *sui generis*".[106] The Act says that the bank "acquires the same rights and powers as if the bank had acquired a warehouse receipt or bill of lading in which such property was described."[107] It will be recalled that when the bank takes a warehouse receipt or bill of lading it acquires "all the right and title

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[100]*The Port Royal Pulp and Paper Company Ltd.* v. *The Royal Bank of Canada*, P.C. [1941] 4 D.L.R. 1; [1939] S.C.R. 186; [1939] 1 D.L.R. 337; 12 MP.R. 219; (1937) 4 D.L.R. 254; *Ackroyd Brothers (Canada) Limited* v. *Brackon Products Inc., and Bank of Nova Scotia* [1948] Que. S.C. 407; *The Union Sulphur Co. of New York* v. *Riordon Company Limited & The Bank of Montreal* (1924), 30 R.L. n.s. 144, holding that art. 1966a C.C. did not apply to section 88 security; *Barry* v. *The Bank of Ottawa* 17 O.L.R. 83, holding that sec. 87 of the Bank Act did not apply to sec. 88.

[101]*Landry Pulpwood Company Ltd.* v. *Banque Canadienne Nationale* [1927] S.C.R. 605, at p. 615.

[102]*Bank of Montreal* v. *Guaranty Silk Dyeing and Finishing Company Limited* (1934-35), 16 C.B.R. 104, at p. 111.

[103]*Clarkson* v. *Dominion Bank* (1917-19), 58 S.C.R. 448, at p. 481.

[104]*Lefaivre* v. *Bank Canadienne Nationale & Right Electronics Co. Ltd.* [1951] Que. K.B. 83, at p. 87; *La Commission des Accidents du Travail de Quebec* v. *Les Industries de Tourville Ltée* [1951] Que. P.R. 394.

[105]*Lefaivre* v. *Banque Canadienne Nationale, supra*, at p. 112.

[106]*Banque Provinciale du Canada* v. *Jacques* [1955] R.L. 197, at p. 218.

[107]Sec. 88(2).

to the warehouse receipt or bill of lading and to the goods, wares and merchandise covered thereby of the previous holder or owner thereof."[108] Since the bank must take section 88 security from the owner of the property it is reasonable to conclude, as the weight of opinion has done, that the bank acquires a right of ownership, subject to a right of redemption in the borrower. Davis J., who in an earlier ease[109] in the Ontario Supreme Court had described section 88 security as "essentially a mortgage transaction", took a much less complieated view of the matter when sitting on the Supreme Court of Canada in *The Royal Bank of Canada* v. *Workmen's Compensation Board of Nova Scotia.*[110] "The bank", he says, "acquires ownership in the goods by the statute."[111] He offers the following as a possible explanation for the original or *sui generis* character of this security: "This type of security is peculiar, so far as I know, to our Bank Act and it may be that in view of the civil law of the province of Quebec, the draftsman of the Act refrained from setting up the English form of mortgage involving the equitable doctrines (unknown to the Quebec civil law) of redemption and foreclosure."[112]

Quebec draftsmen have not always avoided this particular kind of difficulty. One may compare the case of *Laliberté* v. *Larue,*[113] in which the Supreme Court had to decide whether the words "céde, transporte et donne en gage" in a trust deed securing a bond issue under The Special Corporate Powers Act[114] meant a transfer of ownership, or whether the word "gage" controlled the sense and assimilated the trustee's right to one of pledge or hypothec. Commenting on the unhappy use of the word "mortgage" in the English version of the Act, Rinfret J. said: "Or, il convient peut-être de souligner que le système de droit de la province de Québec ne comporte pas la conception de la *common law* qui reconnaît le *beneficial ownership* dans une personne et le *legal title* dans une autre. Dans le Québec, les deux sont invariablement réunis sur la même tête".[115] Such are the living problems of comparative law in Quebec!

The bank's right of ownership in the property covered by section 88 security was made the basis of an important decision recently by the Quebec court of appeal in *Lefaivre* v. *Banque Canadienne Nationale & Right Electronics Co. Ltd.*[116] The bank claimed, on the bankruptcy of the borrower, to have the right to accounts receivable arising out of the sale by the borrower of property

[108]Sec. 86(2).

[109]*Bank of Montreal* v. *Guaranty Silk Dyeing and Finishing Company Limited* (1934-35), 16 C.B.R. 104.

[110][1936] S.C.R. 560; [1936] 4 D.L.R. 9.

[111][1936] S.C.R. 560, at p. 567.

[112][1936] S.C.R. 560, at pp. 566-567.

[113][1931] S.C.R. 7.

[114](1941) R.S.Q. c. 280.

[115][1931] S.C.R. 7, at p. 16.

[116][1951] Que. K.B. 83.

covered by its security. At the time the security was taken the borrower signed the usual collateral agreement which contained, among several clauses defining the rights and obligations of the parties in connection with the loan and security, one which purported to assign to the bank all proceeds from any future sale of the property by the borrower. The clause added that any further assignment was to be deemed in furtherance of the present agreement and not an acknowledgment of any right in the horrower to such proceeds. There does not appear to have been any other assignment, nor was the purported assignment in the collateral agreement signified, as required by the civil law to make it binding on third parties. The Superior Court[117] treated the clause in the special agreement as an assignment subject to the civil law requirement of signification and denied the bank's claim. The majority of the Court of Appeal, with two judges dissenting, took the view that the bank had entrusted property, of which it was the owner in virtue of section 88, to the borrower as its agent, and that accounts receivable from the sale of such property by the borrower were property of the bank in the hands of its agent. In other words, the majority took the position that the bank's right did not rest on assignment but on the right of an owner to the indentifiable proceeds from the sale of his property.[118]

The minority argued that section 88 security, being an exceptional right, must be confined to the kinds of property expressly covered by it in the Bank Act, that is, in the case of a manufacturer, to goods, wares and merchandise, and not accounts receivable or other proceeds from the sale of such property. Bissonnette J. denied, moreover, that the bank's right was one of ownership and likened it to one of pledge. His opinion abounds in pungent comment on the necessity of keeping an innovation that is alien to civil law principles within reasonable limits.

Among all the authorities consulted by the Court of Appeal only the case of *Canadian Hart Products Limited, ex parte Royal Bank of Canada*[119] is directly in point. There the Supreme Court of Ontario, ruling on essentially the same clause in a collateral agreement as the one in the *Lefaivre* case, held that the Bank was entitled as against the borrower's trustee in bankruptcy "to all cash realized from the sale of goods covered by the bank's lien received by the trustee and to any book accounts for or securities given on the sale of the goods covered by the bank's lien, subject to the bank identifying the cash, book accounts or securities as being received by the trustee for the goods covered by the bank's lien . . . "[120]

If one accepts the basic premise that the bank's right is one of ownership, there appears to be no particular reason why the conclusion of the *Canadian Hart Products* case should not be applicable in Quebec as regards identifiable

[117][1951] Que. S.C. 75.
[118]Cf. *In Re Grondin* v. *Lefebvre* [1931] S.C.R. 102, per Rinfret J., at p. 111.
[119](1923-24), 4 C.B.R. 211.
[120]At p. 216.

cash or negotiable paper, but as regards accounts receivable, a distinction might have been made by the Court of Appeal in the *Right Electronics* case. The question before the court was simply this: were the accounts receivable property of the bank or property of the borrower? The property consisted of contractual rights or claims for goods sold and delivered. They were rights which the borrower, and the borrower alone, had against third parties. As regards these third parties the bank could only be considered an undisclosed principal, and it is now the jurisprudence of Quebec, even if it was once otherwise, that an undisclosed principal has no right of action based on contract against the person who dealt with his agent other than that which he acquires in virtue of an assignment of the agent's rights.[121] There could be no *lien de droit* between the bank and third party purchasers apart from assignment. The accounts receivable were not rights or property of the bank; they were rights or property of the borrower. The clause in the collateral agreement, in so far as it purported to be an assignment, or any subsequent assignment of specific debts would not be binding on third parties unless properly signified in accordance with the provisions of the civil code. On this view of the question, to contend as Bertrand J. did in the *Right Electronics* case, that registration of a notice of intention to give section 88 security dispenses with the signification required by civil law, is to extend the effect of such registration beyond what is reasonably contemplated by the Bank Act.

The priority given to the bank over other creditors by section 89 of the Bank Act raises nice questions of interpretation. With the exception of a claim for wages for the three months period prior to the bankruptcy of the borrower,[122] the bank is given priority over all rights subsequently acquired "in, on or in respect" of the property covered by its security. This is in contrast to the civil law principle governing privileges on movable property which makes the rank depend entirely on the nature of the claim. In principle, the bank takes subject to rights acquired before it took its security. It must be noted, however, that in relation to certain claims against the debtor, such as those for taxes or workmen's compensation assessments, the special nature of the bank's rights and powers — its right of ownership and power to take possession of its security — may place it in an entirely different position than the creditor with an ordinary privilege. The result will depend, of course, on the terms of the particular taxing statute.[123]

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[121] *Young* v. *Côté* (1922), 33 Que. K.B. 55; *Balfour, White Co.* v. *Finlayson* (1923), 34 Que. K.B. 436; *Cumby* v. *Brunton* [1944] Que. S.C. 64; *Chartrand* v. *Darabaner* (1928), 66 Que. S.C. 135.

[122] Sec. 88(5).

[123] Cf. *Royal Bank* v. *Nova Scotia Workmen's Compensation Bd.* [1936] S.C.R. 560; *La Commission des Accidents du Travail de Québec* v. *Les Industries de Tourville Ltée.* [1951] Que. P.R. 394; *In re P. W. Ellis Company Limited,* 10 C.B.R. 491; *In re Metal Studios Limited, Ex parte City of Hamilton* 15 C.B.R. 305; *In re James Steele Limited,* 15 C.B.R. 339.

There is an express exception to the rule that the bank takes subject to the rights acquired before it takes its security. The bank has priority over the claim of any unpaid vendor, regardless of when his claim arose, unless at the time the bank acquired its security such unpaid vendor had a "lien" upon the property to the knowledge of the bank.[124] It is difficult to determine the application of this proviso in Quebec. Although it is used with different meanings in several places in the code,[125] "lien" is not a term of the civil law. The words "without knowledge on the part of the bank of such lien" in section 89 may suggest some right in the seller to which the buyer has agreed, as distinct from one conferred by law — and this has been the view taken by one of our judges in Quebec[126] — but it is submitted that the Act also contemplates the case where at the time the bank takes an assignment under section 88 it knows that certain property which has been sold to the borrower, and which will be affected by its security, is still in the possession of the vendor who has not yet been paid and who, therefore, has a lien or right of retention.[127] The equivalent case under Quebec law would be one where, to the knowledge of the bank, the unpaid vendor is in possession of the property under circumstances which entitle him to a right of retention within the meaning of articles 1496 and 1497 of the Civil Code. Outside of this case, the fair meaning in Quebec of the words in section 89 would seem to be that the bank's rights always take priority over the privileged claim of the unpaid vendor. Thus the bank is placed by the Act in a superior position to the civil law pledgee who normally ranks behind the unpaid vendor.[128]

This result, however, may be largely off-set in practice if Quebec courts follow the decision in the case of *In re Wm. A. Marsh Co. Ltd. and L. N. Buzzell*[129] from which it may be inferred that a bank takes subject to the right of an unpaid vendor under article 1543 C.C. to have a sale dissolved for non-payment of the price while the thing sold remains in the possession of the buyer. The right must be exercised within 30 days of delivery in the case of insolvency, and for this reason it is usually referred to in connection with bankruptcy as the right of "30 day goods". It was held in the *Marsh Co. Ltd.*

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[124]Sec. 89.

[125]Arts. 1739ff., 1816a, 1994a C.C.

[126]Gibsone J. in the case of *In re Wm. A. Marsh Co. Ltd. and L. N. Buzzell* (1928-30), 11 C.B.R. 463, at p. 467. The Act is certainly not referring to the right of ownership reserved by a conditional seller because the Bank must take its security from the owner of the property. The Bank will always take subject to the right of the conditional seller in Quebec. In a province where a conditional sale agreement must be registered to take effect against subsequent purchasers and mortgagees in good faith, a bank may take free from the conditional seller's right if the agreement has not been registered and the bank does not have notice of it. In such a case the buyer is deemed to be the owner of the property as against third persons. *Royal Bank* v. *Hodges* [1930] 1 D.L.R. 397.

[127]See *Mutchenbacker* v. *Dominion Bank* (1911), 21 M.L.R. 320.

[128]Cf. arts. 1994, 2000. C.C.

[129](1928-30), 11 C.B.R. 463.

case that the unpaid vendors had a right to recover the possession of their goods from the buyer's trustee in bankruptcy, and where the trustee used the goods in continuing operations, the court ordered the unpaid vendors to be collocated "in preference to the bank for the value of their merchandise existing at the date of the assignment." Although the discussion of what is meant by the "lien" of an unpaid vendor is not too clear in this ease, the result would appear to be logical enough if the bank's right is regarded as one of ownership subject to the same resolutive conditions and causes of nullity or dissolution as that of the borrower from whom the security is acquired. The recourse under Art. 1543 C.C. should only lie, however, if the bank has not taken possession of its security. The unpaid vendor may safeguard his action, if taken in time, by accompanying it with a conservatory attachment.

Conflicts between the privileged claim of the landlord for rent and the bank's right under section 88 have made it necessary for Quebec courts to consider how extensive an effect should be given to the registration of the notice to give security under section 88. The landlord's privilege exists not only on property of the debtor but on property of third persons brought onto the premises with their consent, unless and until he is notified or otherwise acquires knowledge of their rights.[130] It has been held that the registration of the notice to give security under section 88 does not satisfy the civil law requirement of notice to the landlord.[131] The bank is obliged to notify the landlord directly of the particular property covered by its security. Until it does so, the property is affected by the landlord's privilege for all rent owing up to the time of notice.

It does not appear to have been decided whether the terms of section 89 of the Bank Act give the bank a right to follow the property covered by its security into the hands of subsequent purchasers in good faith in the ordinary course of trade. The bank is given "priority over all rights subsequently acquired in, on or in respect of such property" so that the terms of the section do not exclude such a possibility.[132] If the bank has such a right in virtue of this wording, it is contrary to a fundamental principle recognized by all modern thinking on security devices, and the Act should be changed accordingly. Certain langnage of Mignault J. in the Supreme Court decision in *Landry Pulpwood Company Ltd.* v. *Banque Canadienne Nationale*[133] suggests that he considered the question one which was open to discussion, although he did

[130]Art. 1623 C.C.

[131]*Spivack* v. *Ettenberg* (1927), 33 R. de J. 118; *L'Expansion Jeromienne Inc.* v. *Delma Plastics Ltd. & Banque Canadienne Nationale* [1950] Que. S.C. 326.

[132]See also Sec. 88(4) of the Bank Act which states that the rights and powers of the bank are null and void as against "creditors of the person giving the security and as against subsequent purchasers or mortgagees in good faith of the property covered by the security" unless the notice of intention to give security is registered.

[133][1927] S.C.R. 605, at p. 615.

not express an opinion on it. Apart altogether from the commercial necessity of good faith purchasers in the ordinary course of trade being able to take in perfect confidence, the principle which should govern this issue is the same one which was applied in *Bank of Montreal* v. *Guaranty Silk Dyeing and Finishing Company Limited.*[134] There it was held that, when a bank instructed its customer to deliver property covered by its security to a dyer for processing, it could not claim priority over the dyer's lien. By the same token, the bank which consents to the sale of the property covered by its security in the ordinary course of trade should not have the right to follow it into the hands of purchasers in good faith. The exercise of any rights of an unpaid vendor which it might acquire from the borrower is, of course, another thing.

An important problem, recently considered by the Quebec Superior Court in the case of *Banque Provinciale* v. *Jacques*[135] is the nature and effect of the bank's right to take possession of property covered by section 88 security. In contrast to the case of security taken on oil or other hydrocarbons under section 82(3), or security from a farmer under section 88, the Bank Act does not expressly provide, in the case of security taken from a wholesale dealer in natural products or from a manufacturer, for the right to take possession and operate the business of the borrower for the better preservation and realization of the bank's security. But this right is stipulated in the usual collateral agreement which is signed by the borrower at the time the security is taken. In the *Banque Provinciale* case, the bank took possession and operated the business of the borrower for a certain period through an appointed representative, but for some reason failed to realize on its security or satisfy the indebtedness of the borrower by this process. It then turned to personal sureties of the borrower for payment of what remained owing. Lalonde J. in the Superior Court did not question the right of the bank to acquire these exceptional powers by agreement, but he held that the bank's exercise of them constituted an acceptance in payment (or as he put it, a *dation en paiement*), which discharged the sureties under article 1960 of the civil code. The decision may have been equitable in the circumstances because the court seems to have concluded that the bank was acting in bad faith and abusing its powers, but the proposition of law on which the decision was based is very questionable and is one which is bound to cause some consternation in banking circles. The bank's taking of possession is given the same effect as retention by a pledgee of his security under a *pacte commissoire*. The latter is deemed to be a *dation en paiement*, which extinguishes the debt.[136]

This is a misunderstanding of the true nature and purpose of the exceptional right to take possession and carry on the business of the borrower which is expressly conferred by the Bank Act in certain cases and which the bank

[134](1934-35), 16 C.B.R. 104, 363.
[135][1955] R.L. 197.
[136]Mignault, *Droit civil canadien*, v. 8, p. 415.

acquires by agreement in others. The purpose of this right is to enable the bank in critical circumstances to act in relation to its security in such a manner as to protect itself from loss and to assure the maximum realization. It is illogical that the bank which takes possession for the purpose of realization by regular trading operations — a form of sale which will generally be much more advantageous to the debtor than a sale *en bloc* — should not have a claim for any balance still owing to it. In the exercise of its right to sell under section 88(4) the bank is accountable to the borrower for any surplus. It would seem perfectly clear that it should have a claim for any deficiency remaining after the sale. It must be admitted, however, that the default provisions of the Bank Act — and for that matter the Quebec Bill of Lading and Warehouse Receipt Act as well — could do with some clarification, particularly with regard to the right to enter into a *pacte commissoire*.[137] Unfortunately, it has not been possible to deal with this problem in the present study.

CONCLUSION

An introductory survey of this kind is not the place to attempt to deal seriously with the question of reform. The purpose here has been simply to sketch the outlines of the subject and to touch on some of the more interesting or important questions which suggest themselves in a cursory examination. The coverage of the material has been necessarily selective and does not pretend to present an adequate, much less a complete picture of secured financing in Quebec. Certain matters like the conditional sale contract, which could be the subject of detailed study, have received only the most summary treatment; the practical importance of others, such as accounts receivable financing,[138] has probably not been sufficiently emphasized. Mention has not even been made of certain security devices of very special and limited application, such as the equipment trust for financing the purchase of railway rolling stock.[139] Under such circumstances it would be out of place to attempt to offer detailed proposals for changes in the law. Moreover, if the law in this

[137]The *pacte commissoire* must be viewed from the point of view not only of the protection of the debtor but of the protection of his other creditors as well. As to the bank's right to make an agreement with the borrower concerning the application of any surplus to other indebtedness: *Thompson* v. *The Molson Bank* 16 S.C.R. 664; 12 L.N. 339.

[138]Art. 1571d of the Civil Code permits the assignment of a block of book debts, present or future, to be registered in the office of the registration division where the assignor has a place of business and notice of such registration to be published in the newspapers. These formalities not only dispense with the need for the usual signification to individual debtors, but they bring the assignment within the terms of section 63(2) of the Bankruptcy Act, which makes any general assignment of book debts null and void against creditors of the debtor unless there has been compliance with provincial legislation providing for registration of such assignment.

[139]The Railway Act, (1952) R.S.C. c. 234, s. 137-146.

field is to answer commercial needs it must reflect the realities of social and economic conditions and business practice, and a great deal of systematic study and discussion is required before one can speak with confidence of these. A beginning must be made somewhere, however, and the following brief observations are offered merely to focus attention on what appear to be some of the issues today.

Probably the chief question of practical importance at the moment in Quebec is whether the provincial law should provide for a security device which would serve the same purpose as the chattel mortgage does in the other provinces. There are at least two considerations here: whether it is desirable to make it easier for certain lenders to obtain security upon the movable property of debtors; and secondly, whether, from a practical point of view, a system of registration or filing of security interests in movable property represents a real measure of protection for third parties. With respect to the first point, there seems no good reason why the law should be amended to permit lenders in the personal loan field to obtain security upon movable property without transfer of possession. They get along quite nicely as it is, and probably make fewer bad loans because they are not able to rely on such security. Nor is a system of registration or filing of much practical value to third parties who deal with this category of borrower. Quite apart from the difficulty of organizing a satisfactory system of registration for property that moves about a great deal, it is too much to expect of the average creditor that he should go to the trouble of consulting the records. For the same reason there is little point to requiring registration of conditional sales of consumer goods. The chief problem here is the sale of stolen automobiles,[140] and the answer to that is a title certificate system.

The commercial borrower presents quite a different case. Here the law could be more helpful than it is. As a "purchase-money" device the conditional sale contract is adequate for the financing of dealer inventories of manufactured goods, but there is no device for securing advances on existing inventory, such as, for example, the *used* car inventory of automobile dealers. Lenders must still get what comfort they can from sales with right of redemption and similar devices. There would not seem to be any reason, either, why lenders other than the banks should not be able to obtain security without transfer of possession on the inventory of manufacturers. Although admittedly the volume of business here might not be too significant (the finance companies are able to offer low rates on the wholesale floor plan only because they obtain the lucrative consumer paper), the right to obtain such security would enable the factors, for example, to tide their customers over

[140]The conditional seller is protected by the terms of the Quebec Motor Vehicles Act, (1941) R.S.Q. c. 142, s. 21. Only licensed dealers are deemed to be traders dealing in similar articles, and all dealers are required to post a surety bond to guarantee that the owner who has to reimburse the third party purchaser on revendication will be able to recover what he has paid.

seasonal difficulties. The manufacturer's inventory calls, of course, more for the floating charge type of security than the individual item approach to dealer inventories.

The protection afforded by a system of registration or filing of security interests is not nearly as illusory in the case of the commercial borrower as it is in the case of the non-commercial one. It pays the creditors of commercial borrowers to check such records or to consult credit information agencies which do so. Even if no new security devices are created in Quebec, the law could well be amended to require, in the interests of creditors, the registration of conditional sales to commercial buyers, whether they be sales of equipment[141] or sales of goods for re-sale in the ordinary course of business.

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[141]Cf. *La Banque d'Hochelaga* v. *The Watrous Engine Works Company* (1896-97), 27 S.C.R. 406; *Bernier* v. *Durand & Pageau* (1916), 25 Que. K.B. 461.