
The Fondé de pouvoir for Holders of Secured Indebtedness: Article 2692 Revisited, A Critical Examination

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In the general reform of Quebec's civil law in 1994, the special and exceptional legislation that authorized secured financings through the issue of bonds or debentures (*Special Corporate Powers Act*) was replaced by a single provision: article 2692 of the *Civil Code of Quebec*. Although its basic intent is to sanction the normal requirement that the security for the payment of the debt be held by a person (a trustee) other than the holder of the title of indebtedness (the bondholder), the author observes that it does so in language that, given its plain meaning, would embrace a significant number of modern commercial banking or financing practices where such separation may not reflect the desire of the parties or where the desired separation does not fit within the structures dictated by article 2692. Moreover, the imperative and punitive form of the provision can be construed to prohibit or render null a significant number of such transactions.

The author identifies a number of types of such transactions. He then analyses the intended thrust and the basic characteristics of article 2692 as well as related characteristics of other aspects of the civil law which, through the reform process, would bear upon the structure of such transactions. He finds that, as an article of exception, the provision must receive a restrictive interpretation. Moreover, the author concludes, a literal application of the provision to many of the transactions would place the Quebec commercial borrower in an inferior position in contrast to the legislative regime found in other jurisdictions. The author infers that this was not the intention of the legislature.

At the same time, he suggests that an article addressing the same subject matter, but in enabling rather than in imperative and punitive language, is highly desirable and he therefore proposes an appropriate text.

Lors de la réforme générale du droit civil du Québec en 1994, la législation spéciale et exceptionnelle autorisant le financement garanti par l'émission des bons ou des obligations (*la Loi sur les pouvoirs spéciaux des corporations*) a été remplacée par le seul article 2692 du *Code civil du Québec*. Malgré son intention de sanctionner l'exigence que la caution pour le paiement de la dette soit détenue par une personne (fiduciaire) différente de celle qui détient le titre de dette (détenteur de l'obligation), l'article 2692 achève ceci par un langage qui, dans son sens ordinaire, inclurait un nombre important de pratiques modernes en commerce bancaire ou en financement où une telle séparation ne refléterait pas le désir des parties. De plus, la séparation désirée ne serait pas nécessairement compatible avec les structures imposées par l'article 2692, et sa forme impérative et punitive pourrait être interprétée comme prohibant ou annulant un nombre important de transactions.

L'auteur énumère plusieurs types de ces transactions. Il analyse ensuite la portée cherchée par le législateur ainsi que les caractéristiques de base de l'article 2692. Il examine aussi des caractéristiques se trouvant parmi d'autres aspects du droit civil qui, à travers le processus de réforme, auraient un impact sur la structure de ces transactions. L'auteur trouve que l'article 2692, étant un article d'exception, doit être interprété de façon restrictive. De plus, il conclut que l'application à la lettre de l'article 2692 à plusieurs des transactions pourrait placer l'emprunteur commercial québécois dans une position inférieure par rapport à sa situation dans un régime législatif d'une autre juridiction. L'auteur sous-entend que ceci n'était pas l'intention du législateur.

En même temps, l'auteur suggère qu'un article abordant le même sujet, mais qui soit permissif et non pas impératif ni punitif, serait désirable ; il propose donc un texte approprié.

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Introduction

One would think that enough has been written about article 2692 of the *Civil Code of Quebec* ("C.C.Q.") to address the basic problems of its interpretation and application. The provision speaks of a *fondé de pouvoir* for creditors; one who is to hold the hypothec securing bonds or other titles of indebtedness held by others. In 1994, Louis Payette explained in a compelling way that a *fondé de pouvoir* was in fact not a mandatary,¹ and that in essence article 2692 continued the regime contemplated by the operative provisions of the *Special Corporate Powers Act*,² which, with reform, were repealed by the *Act Respecting the Implementation and Reform of the Civil Code*.³ Similar conclusions were drawn in the author's book of the same year.⁴ A number of other papers have also visited the subject.⁵ In 1997 in a study tracing the origins of article 2692 through the history of the corporate trust deed, the author also concluded that a *fondé de pouvoir* could be a trustee and that the constituting corporate trust deed could be a Quebec-constituted trust.⁶ This study is essentially a sequel to the latter study.

Five years of experience with the C.C.Q. has revealed to the lawyer practising in the commercial and banking fields that, unfortunately, although article 2692 may reasonably be construed to permit transactions of the nature of the corporate trust deed, its structure is such as to restrict or even prohibit several types of parallel transactions which have become commonplace in the financial markets of North America, including Quebec. It is not only the term "*fondé de pouvoir*" that gives rise to the difficulty, but the entire framing and phraseology of article 2692.

The problem is not just how the provision should be applied to certain esoteric transactions. It is the opinion of many practising counsel that unless the concerns raised by the provision are addressed, Quebec business and industry will be unable to put in place with reasonable certainty the security structures required to attract many types of investment capital.

¹ L. Payette, *Les Sûretés dans le Code Civil du Québec* (Cowansville, Qc.: Yvon Blais, 1994) at 164ff.

² R.S.Q. c. P-16 [hereinafter *SCPA*]. The repealed provisions may be found in R.S.Q. 1977, c. P-16, ss. 27ff.

³ S.Q. 1992, c. 57, ss. 642-48 [hereinafter *Implementation Act*].

⁴ J.B. Claxton, *Security on Property and the Rights of Secured Creditors under the Civil Code of Québec* (Cowansville, Qc.: Yvon Blais, 1994) at 226ff. [hereinafter *Security on Property*].

⁵ See X.C. Martis, "Loan Syndication in Secured Transactions" in *Meredith Memorial Lectures 1997: Contemporary Utilisation of Non-Corporate Vehicles of Commerce* (Montreal: Faculty of Law, McGill University, 1997) [hereinafter *Non-Corporate Vehicles*] 489.

⁶ J.B. Claxton, "The Corporate Trust Deed under Quebec Law: Article 2692 of the *Civil Code of Québec*" (1997) 42 McGill L.J. 797 [hereinafter "Corporate Trust Deed"].

At the same time, the inclusion of one or more articles embracing the same subject matter as article 2692 is highly desirable. With the repeal of the operative provisions of the *SCPA*,⁷ the express sanction for the issue of secured titles of indebtedness—where for practical purposes the security is vested in a person other than the creditor-holder of the title of indebtedness—was replaced by a provision that often seems to compel such vesting where none is desired. It is the drafting of article 2692 that is at fault, not the separate underlying legal concepts that it reflects.

However, although article 2692 is the pivotal article in this study, it cannot be examined in isolation. One must have a basic understanding of the structure of the transactions to which it may apply. Other and perhaps more fundamental principles of the civil law also inform all of these transactions. In some cases some transactions may be concluded without invoking the application of article 2692. Some assessment of the likely impact of these fundamental principles on the transactions and on article 2692 itself is also required. The main principles of the law that come into play, apart from the law of hypothecs generally, are the new law of trusts,⁸ the law of mandate,⁹ and article 59 of the *Code of Civil Procedure* (“C.C.P.”) concerning suits by one representing others. Section 32 of the *SCPA*, although of lesser importance, will also apply to many of them.

The purpose of this study is to examine these underlying concepts. Thereafter, comments on the phrasing employed in article 2692 will be made in response to a number of stated questions. A possible solution to the uncertainties stemming from the provision will be examined. The author proposes, where possible, answers to questions on the interpretation of particular texts of the law that should prove both reasonable in legal theory and acceptable to the business community.

I. Types of Transaction Affected

A number of types of transaction are affected by article 2692. They are not mutually exclusive, and are often combined. They are generally identified and described by commercial jargon, although individually their structure may vary a good deal. Each may be decorated by many “bells and whistles”, but the descriptions which follow are thought to be sufficient for them to be understood in the terms required for this study.¹⁰ First, however, it is useful to state briefly the problem that arises from article 2692 in addressing all such transactions.

⁷ *Supra* note 2.

⁸ Arts. 1260ff. C.C.Q.

⁹ Arts. 2131ff. C.C.Q.

¹⁰ All of the transactions described, and the manner of their implementation, are affected in large measure by tax law. The use of some forms of transaction is even driven by tax law. Many such transactions have cross-border and conflict of law considerations. The statutes regulating banks, trust companies, and other financial institutions all impose restrictions on their respective capacities to do certain types of transactions. The application of corporate law and of securities law is often an important factor. These considerations are all beyond the scope of this study.

A. *The Problem*

The problem flows from the notion that the security granted for an obligation may be held by a person other than the holder of the obligation. In transactions which do not employ a corporate trust deed, the parties often desire that the security be held by a third party in circumstances not contemplated by article 2692. On the other hand, the provision seems to compel the security to be held by a third party where this is not the desire of the parties. It is now appropriate to turn to a description of the principal transactions which give rise to the application of the provision.

B. *The Transactions*

1. The Corporate Trust Deed

The corporate trust deed is a contract between a corporation and a trustee providing for the issue by the corporation of bonds or other titles of indebtedness secured by hypothec in favour of the trustee or a *fondé de pouvoir*. In addition to the sale of such securities, they may also be pledged by the issuer to secure any type of obligation, including one for borrowed money. The history, uses, legal effects, and most restraints respecting the use of the corporate trust deed were examined in "Corporate Trust Deed".¹¹ The conclusion reached there is that the corporate trust deed can still be employed in Quebec with very little change (if any) in its content and form; and that the term "*fondé de pouvoir*" of article 2692 is broad enough to encompass the transaction, to permit the use of the term "trustee", and also to qualify the deed as creating a trust under article 1260 C.C.Q., or not, as the draftsman desires.

2. Secured Credit Agreements

Generally, secured credit agreements are bilateral agreements between an enterprise borrower and one or more than one financial institutions providing for loans or advances secured by hypothecs or other charges on property. They may be for a fixed loan, or for a revolving credit, or both. They may be with a single borrower or with a borrower group, such as a parent and its subsidiary corporations in several jurisdictions. The credit is usually secured by one or more hypothecs, or charges on, or other interests in, property of all members of the borrower group; sometimes on all property, movable and immovable, corporeal and incorporeal, present and future. The credit, as it is advanced from time to time, may or may not be evidenced by one or more promissory notes or other acknowledgements of indebtedness. The basic credit agreement is supported by various sub-agreements and guarantees from the related corporations in the group, often in the different jurisdictions.

¹¹ *Supra* note 6.

3. The Stand-Alone Secured Debenture

Frequently, the borrower delivers to the creditor a unilaterally-executed document called a "debenture". It evidences a stated amount of debt, states the terms of repayment, often contains a list of covenants and events of default and may be negotiated by endorsement and delivery. The debenture itself may contain a grant of security if the security is on movable property only. If immovable property is charged as security, a deed collateral to the debenture effects such charge. The debenture (in unilateral form) is itself the credit agreement. This practice would seem to have been generally discontinued in Quebec at about the time the *SCPA* came into force in 1914, but the practice is still employed in other jurisdictions. Quebec borrowers sometimes issue such debentures in Ontario.

4. Syndications

a. Syndication of Lenders—"Direct-Loan" Syndications

Agreements involving a syndication of lenders reflect a variation of the secured credit agreement. Today, where large credits are involved, the financial institution lender wishes to spread its credit risk among a number of other financial institutions, or to provide that it may at its option do so in the future. Each lender will agree to provide a stated portion of the total credit. This is called "syndication" (and in this study, the term will be used to identify "direct loan syndications"—where the borrower and the lead lender contract with each member of the syndicate). The agreement may expressly provide for substitution and replacement of members of the syndicate.¹² Normally, they are not solidarily bound to make the advances. Syndication in most cases will involve, not novation, but the purchase by each new lender of a portion of the interest in the credit agreement, including the claim for the outstanding advances and of an undivided interest in the underlying security. Normally, the security is held by the lead lender alone as "security agent" for the benefit of all the lenders in proportion to their interests.

b. Participations—"Farm-Out" Syndications

With a direct loan syndication of lenders, the borrower contracts with each member of the syndicate, although *de facto* all his communications may be entirely with the lead lender, who also acts as mandatary for the other members of the syndicate. With participations, the borrower contracts only with the lead lender, but the contract provides that the latter may grant, or "farm-out" sub-participations in the loan to other

¹² Replacement could involve novation of the debtor of the obligation to make the advances (*i.e.*, the lead lender for a portion of his obligation) and his release when replaced. Generally speaking, the problems of novation and release are no different under Quebec law than those found in other jurisdictions. They and their known solutions are beyond the scope of this study.

financial institutions on agreed terms. Participations are most often effected by a sale of a portion of the loan to maturity,¹³ either by a flow-through arrangement—where the lead lender transfers a portion of the principal and interest (and an undivided interest in the related security held by the lead lender) to the participant—or on a different basis—where the lead lender retains a portion of the interest earned on the loan as servicing agent.

5. Securitizations

The term “securitization” is employed in the financial markets to describe a transaction where a financial institution assembles a large portfolio of similar assets that provide a periodic cash flow—*e.g.* hypothecary loans or other claims—for sale (to the public, pension funds, etc.) *en bloc* to a special purpose vehicle (“SPV”), which is usually a trust or a corporation designated for the purpose, which then sells undivided units of participation to the investors. The proceeds of sale are used to pay the purchase price. In the model that is of interest in this study, the assets sold, and their underlying hypothecs, are transferred with a sufficiently detailed list to permit the SPV to register its title if later required, or on default; but at the time of the initial transfer no notice is given to the original claim debtor. The notice of registration describes a class or universality of claims, but the list and description of the claims and supporting hypothecs is not initially registered, and normally is only registered if the originating institution defaults. The originating institution is usually named servicing representative or manager. It retains any registered title and looks after all aspects of collection, administration, and enforcement. It gives no guaranty, but may make representations as to collectability or may undertake to make substitutions for defaults in collection or to otherwise make good the collection. On occasion, the securities sold to the investor are further secured by a hypothec on all the assets of the SPV.¹⁴ They are referred to in this study as “mortgage-backed securities” (“MBS”).

C. The Basis of the Transactions

Multi-lender financings have become an established part of North American financial practice. The credit needs of doing multi-jurisdictional business, the large size

¹³ Direct loan syndications and farm-out syndications are described in *Canadian Deposit Insurance Corporation v. Canadian Commercial Bank* (1986), 43 Alta. L.R. (2d) 24, 59 C.B.R. (N.S.) 1 (Q.B.) [hereinafter *Deposit Insurance*]; and *Re Canadian Commercial Bank* (1986), 46 Alta. L.R. (2d) 111, 62 C.B.R. (N.S.) 205 (Q.B.) [hereinafter *Commercial Bank*]. See also D.B. Simpson, “Loan Participations: Pitfalls for Participants” (1976) 31 Bus. Law. 1977 at 1977; W.N. Stahl, “Loan Participations: Lead Insolvency and Participants’ Rights (Part I)” (1977) 94 Banking L.J. 882; and W.N. Stahl & L. Pike, “Loan Participation: Lead Insolvency and Participants’ Rights (Part II)” (1978) 95 Banking L.J. 38.

¹⁴ The legal and certain tax issues of securitizations are further examined by E.B. Claxton, “Securitizations, Monetizations, Royalty Trusts and the Quebec Trust” in *Non-Corporate Vehicles*, *supra* note 5, 357.

of loans, the competition among lenders, and their need to spread the risks are all factors that have given rise to these practices. They are often compelled by both domestic and international regulation of the lending policies of the individual financial institutions. These may impose standards of capital adequacy, institutional liquidity, risk assessment and limits, as well as loan limits to the individual borrower. In Canada, as regards banking, they are imposed by the *Bank Act*¹⁵ and the regulations and guidelines thereunder. The latter reflect the standards last referred to and found in the Accord of 1988 of the Bank for International Settlements' Committee on Banking Regulations and Supervisory Practices, known as the "BIS Accord".¹⁶

Through securitization transactions, a secondary market and an enormous source of loan and investment capital have been developed. In a timely securitization, everyone is a winner. The original borrowers who granted hypothecs have stable loans at an acceptable interest cost and they remain customers of their lender. The latter, by the sale of the portfolio, renews his fund of loan capital. (It is axiomatic that the loan funds of financial institutions is limited.) The institution often sells the portfolio at a profit as the present value—the discounted average cash flow—of the portfolio can be greater than the face value. Through the management agreement, the institutional originator often makes a further return by way of management fees. The investor in the MBS makes a return on his investment that is usually better than comparable market rates. It is backed by first mortgages on real property, with the risk spread among many borrowers. Administration and collection is professionally managed. Finally, the amount of loan capital in the community is renewed and increased and this should lead to greater competition among lenders and a reduction of loan rates.

MBS originated in the United States in the 1960s. They were further advanced by the programs of secondary investment in pooled mortgages developed by the National Mortgage Association in the early 1970s. In 1986, Canada Mortgage and Housing Corporation ("CMHC") introduced a similar MBS program ("CMHC-MBS") for the pooling of insured mortgages to permit a CMHC-guaranteed "pass through" to investors of the qualified principal and interest less the approved administrative fees.¹⁷ CMHC has advised that under this program between January 1, 1987 and March 31, 1998, pools aggregating \$38.6 billion were issued, of which \$4.6 billion or 12.12% reflected Quebec hypothecary loans. The CMHC annual report for 1997 discloses that

¹⁵ S.C. 1991, c. 46.

¹⁶ Committee on Bank Regulations and Supervisory Practices, "International Convergence of Capital Measurement and Capital Standards (1988)" (1988) 51 Banking Rep. (B.N.A.) 143.

¹⁷ Canada Mortgage and Housing Corporation, *NHA Mortgage-Backed Securities Program Guide*, looseleaf NHA 6404 (Ottawa, C.M.H.C., 6 September 1996), online: CMHC-SCHL: NHA Mortgage-Backed Securities Program <<http://www.cmhc-schl.gc.ca/infocmhc/mbs.html>> (date accessed: 20 August 1999), adopted pursuant to the *National Housing Act*, R.S.C. 1985, c. N-11.

in 1997, there were outstanding guarantees of CMHC-MBS in the amount of \$15 billion of which not quite one-half were issued in that year.¹⁸

Apart from CMHC securitizations, it is estimated by the Dominion Bond Rating Service that there were approximately \$27.3 billion of asset-backed securities outstanding at the end of 1997. This figure includes short-term commercial paper (usually discount notes) of \$22.8 billion. A good deal of this securitization is of accounts receivable that are not backed by security interests in corporeal assets. However, where the latter are available, they are normally included. The same service notes that the growth of securitizations is enormous. It grew by 114% in 1997 over 1996. The growth figures through February 1998 are equivalent or greater. In the normal course, the Quebec loan market could absorb about 15% of the capital made available by this means.¹⁹

II. The Thrust of Article 2692

A. The Origin of Article 2692

Article 2692 is the only article in the C.C.Q. that speaks of the holding of a hypothec by a person other than the creditor of the secured obligation. It does so implicitly but not directly. It is derived from the provisions of the *SCPA*. The *Commentaires du ministre de la Justice* contain a single statement on article 2692:

Cet article est conforme au droit antérieur. En effet, la *Loi sur les pouvoirs spéciaux des corporations* prévoit que l'hypothèque qui garantit le paiement d'obligations ou d'autres titres d'emprunt doit être constituée par acte de fidéi-commis en forme notariée et en minute.²⁰

Under the *SCPA*, and indeed under much earlier special legislation, a number of major problems of reconciliation of the security regime (sanctioned by that legislation) with the principles of Quebec civil law arose and occupied the courts. The leg-

¹⁸ Canada Mortgage and Housing Corporation response to a direct enquiry: C.M.H.C., 1997 Annual Report, online: Annual Reports (CMHC) <<http://www.cmhc-schl.gc.ca/infocmhc/annual-report/1997.html>> (date accessed: 20 August 1999).

¹⁹ Dominion Bond Rating Service, *1997 Year-end Review of Canadian Asset Backed Securities* (31 December 1997), online: DBRS Industry Studies <<http://www.dbrs.com/cgi-bin/IndustryStudies/Public/industryStudiesSummary.cgi>> (date accessed: 20 August 1999). For a review of new extensive development of securitizations in the United States, see J.A. Rosenthal & J.M. Ocampo (J.P. Morgan Securities), *Credit Research Report* (New York, 8 January 1998); and J.A. Rosenthal & J.M. Ocampo, *Securitization of Credit* (New York: Wiley & Sons, 1988) at 199ff., estimating that \$US 44 billion of commercial MBS were issued in 1997.

²⁰ *Commentaires du ministre de la Justice* (Quebec City: Publications du Québec, 1993) [hereinafter *Commentaires*], t. 2 at 1686. In *Doré v. Verdun (City of)*, [1997] 2 S.C.R. 862 at 873, 150 D.L.R. (4th) 308 [hereinafter *Doré*], the Supreme Court affirmed the decision of the Court of Appeal in *Verdun (Municipalité de) v. Doré*, [1995] R.J.Q. 1321, online: QL (AQ), to the effect that the *Commentaires* were admissible, not as absolute authority, but to aid the evaluation of legislative intention.

islature had sanctioned the form of deed, the charges by way of security in favour of a "trustee", on any kind of property, present and future, and the position of the trustee as holder of the security and representative of the creditors. The legislature did so often with terminology borrowed from the common law ("mortgage", "convey", "cede", "transfer", sometimes combined with "hypotheque", "pledge", "privilege", "take possession", and "as security"), but failed to identify, define, or characterize such terms with concepts known to the civil law.

In the seventy-five years following the adoption of the *SCPA*, the courts did a remarkable job of reconciliation.²¹ By exception, the courts failed with the characterization of the trustee for the bondholders. One line of cases involving close-held security issues (a single or very few bondholders) describe the trustee as a form of mandatary.²² The other line of cases involving widely held issues of bonds (many holders, possibly some with bearer bonds and unknown) prefer to characterize the trustee as the "virtual creditor".²³ Yet the forms and essential terms of corporate trust deed employed in both types of issue were (and still are) the same. Does a close-held issue become widely held when there are five bondholders, ten, or more than that? Moreover, through the sale and transfer of the bonds, a widely held issue can become a close-held issue, and *vice versa*. The two characterizations (mandatary and virtual-creditor) are mutually exclusive. The language of article 2692 does not deal with this problem, but in the opinion of some, it would seem to perpetuate it.

It also seems clear today that, had the legislature intended to force such form of secured financing exclusively under the rules of mandate,²⁴ the term "mandatary" would have been used in article 2692.²⁵ Equally, had it intended that the representative of the creditors be a trustee in the sense of Quebec's new law of trusts²⁶ to the exclusion of other types of representation, it would have used the term "trustee". One may reasonably conclude that the term "*fondé de pouvoir*" is to have a broad meaning; one that may include the trustee, or the mandatary, or another form of *sui generis* representative of the creditors who is neither.

²¹ See "Corporate Trust Deed", *supra* note 6.

²² See *Trust général du Canada v. Marois*, [1986] R.J.Q. 1029, 4 Q.A.C. 161 [hereinafter *Trust général*]; *Société nationale de fiducie v. Québec (Sous-ministre du Revenu)*, [1990] R.J.Q. 92, [1990] R.D.F.Q. 134 (C.A.) [hereinafter *Société nationale*]; *Atillasoy v. Crown Trust Co.*, [1974] C.A. 442, online: QL (AQ); *Banque canadienne nationale v. Normandeau*, [1976] C.S. 285, online: QL (AQ); *Commission des normes du travail v. Cie de gestion Thomcor* (26 February 1986), Montreal 500-05-005867-831, J.E. 86-400 (Sup. Ct.); and *Vermatex Inc. (Syndic de) v. Meubles Bermex Inc.*, [1988] R.J.Q. 2136, 20 Q.A.C. 189.

²³ In contrast, see *Trois-Rivières (Cité des) v. Sun Trust Company* (1922), 34 C.B.R. 351 (K.B.); *Zoltom Investments Inc. v. Rodgers*, [1979] C.A. 534, online QL (AQ) [hereinafter *Zoltom*]; *Laliberté v. Larue* (1930), [1931] S.C.R. 7, (*sub nom. Lafontaine Apts. v. Larue*) [1931] 2 D.L.R. 12 [hereinafter *Laliberté* cited to S.C.R.]; and *Mercure, Bêliveau et Associés v. Gaz métropolitain*, [1980] C.S. 471, 35 C.B.R. (N.S.) 174.

²⁴ Arts. 2130ff. C.C.Q.

²⁵ Payette, *supra* note 1 at 164.

²⁶ Arts. 1260ff. C.C.Q.

B. Possible Approaches to Construction

Two possible constructions of article 2692 present themselves. The first is the conservative or traditional view. According to this view, since a hypothec is an accessory to an obligation,²⁷ it can only be held by the creditor of the secured obligation, except (and it would be a restrictive exception) where the law expressly allows it to be held by another. The *SCPA* provided such an exception. Only article 2692 expressly sanctions such an exception today.

The second construction is the view of the reformist; one who would argue that, as long as the principle that a hypothec is an accessory to the secured obligation is observed, the holding of the hypothec may be separated from the holding of the obligation. The reformist would argue that, since all the essential, although originally exceptional, features of the *SCPA* were adopted in the reform process as general principles of the civil law, the separation of the holding of the hypothec from the holding of the secured obligation is now an acceptable principle of the civil law as long as the hypothec continues to be an accessory of such obligation. The reformist view posits that through other measures of the reform process, this principle is now a part of the civil law notwithstanding the existence of article 2692.

The language of article 2692 itself is not very helpful in determining which of these two approaches was intended by the legislator. Nonetheless, the C.C.Q. reveals a number of arguments to support the reformist's position. In this study, an effort will be made to canvass this approach. The author admits to being a reformist. One of the thrusts of this study is also to show, not only that the reformist's approach would provide a more consistent legal theory, but would also harmonize Quebec civil law with the essential features of the modern financial markets and the needs of a modern legal system.

Article 2692 provides:

2692. L'hypothèque qui garantit le paiement des obligations ou autres titres d'emprunt, émis par le fiduciaire, la société en commandite ou la personne morale autorisée à le faire en vertu de la loi, doit, à peine de nullité absolue, être constituée par acte notarié en minute, en faveur du fondé de pouvoir des créanciers.

2692. A hypothec securing payment of bonds or other titles of indebtedness issued by a trustee, a limited partnership or a legal person authorized to do so by law shall, on pain of absolute nullity, be granted by notarial act *en minute* in favour of the person holding the power of attorney of the creditors.

Parenthetically, one must note that article 2692 now replaces the term "trustee" of the *SCPA* with the term "*fondé de pouvoir*". Although the Supreme Court of Canada recently affirmed that the two linguistic texts of the Code are equally authoritative,²⁸ in

²⁷ Art. 2661 C.C.Q.

²⁸ In *Doré*, *supra* note 20, the Supreme Court provided a broad interpretation of the C.C.Q. as the *jus commune* in relation to other public statutes, and further held that in the event of a difference be-

the case of article 2692, the term of the English version, "person holding the power of attorney of the creditors" is an abomination. It is thought to be merely a bad translation. It evokes the idea of an express documented mandate from the holders of the securities to the holder of the hypothec, a bilateral contract.²⁹ However, in practice, in all cases of a public issue of securities there is no mandate, express or implied. When the bonds or titles of indebtedness are first issued, the creditors who would grant such mandate are unknown. They are often unknown when the titles are sold. The French language term—"fondé de pouvoir"—is much broader and does not necessarily invoke the concept of an express mandate.³⁰ In this study, the term "fondé de pouvoir" or, more simply, the term "representative" of the creditors will generally be used.

C. Basic Characteristics of Article 2692

Article 2692 is one of only three provisions of the C.C.Q. that address the question of form for the creation of a valid conventional hypothec. Article 2693 C.C.Q. states that an immovable hypothec is, on pain of absolute nullity, granted by notarial act *en minute*. Article 2696 C.C.Q. states that a movable hypothec without delivery shall, on pain of absolute nullity, be granted in writing.³¹ As all property is either movable or immovable,³² articles 2693 and 2696 together cover all types of property that can be the object of a hypothec. They reflect article 2665 C.C.Q., which characterizes all hypothecs and states a hypothec is movable or immovable depending on whether the object is movable or immovable property. Together and alone, articles 2693 and 2696 would exhaust the necessary subject of the form required to create a valid hypothec.

Article 2692, on the other hand, is not concerned with the type of hypothec or the type of property that is the object of the hypothec. Exceptionally, it addresses both the type of obligation secured and the type of grantor of that obligation.³³ In such circumstances, the normal rule of construction is that article 2692 constitutes a special exception to the general rules for the form of document for the creation of hypothecs. As a rule of exception, it ought to be restrictively construed.³⁴ This principle of construc-

tween the two linguistic texts, one should not accept the narrower version, but search for the true intent of the enactment.

²⁹ Art. 2130 C.C.Q.

³⁰ Payette, *supra* note 1 at 166.

³¹ By an express limited exception to this rule, arts. 2702ff. C.C.Q. permit a movable hypothec with delivery, a pledge, to be granted by delivery.

³² Art. 899 C.C.Q.

³³ Another exception is found in art. 2699 C.C.Q. which provides that where certain types of collateral are charged (bills of lading, negotiable instruments, and claims), value must be given before the hypothec is valid. This exception does not address the form of execution. A writing is still required.

³⁴ P.A. Côté, *Interprétation des lois*, 2d ed. (Cowansville, Qc.: Yvon Blais, 1990) at 457; S.G.G. Edgar, ed., *Craies on Statute Law*, 7th ed. (London: Sweet & Maxwell, 1971) at 121; and Sir P.B. Maxwell, *On the Interpretation of Statutes*, 11th ed. by R. Wilson & B. Galpin (London: Sweet & Maxwell, 1962) at 275, 278, 285.

tion would reflect the established view of the legislation that article 2692 purports to replace, the *SCPA*. Authority is consistent to the effect that this statute effected an exception to the ordinary law and ought to be restrictively construed.³⁵

Article 2692 as drafted should be interpreted restrictively for another reason: it is in neither declarative nor enabling form. It contains no express declaration of any principle of substantive law, nor does it enable any principle to be applied in a particular way. On the contrary, it commands that certain transactions must be completed in a defined way and a defined form. It is in imperative form, with a penalty. The *SCPA*, in contrast, although also a law of exception, was declarative and enabling. As an exception, it had to be strictly construed, but once complied with, a valid hypothec was created. (Article 2692, by inference, does have some declaratory effect as it recognizes certain judicial facts or underlying concepts—this will be examined below.) Being in imperative form, the penalty should result only when the precise transactions described by article 2692 exist and the imperative dictates of the provision are not complied with. This, one must conclude, can be the only consequence of an expressly imperative and exceptional provision that provides a penalty. Thus, the penalty of absolute nullity should result only if the precisely defined circumstances described in article 2692 are present and the requirements of form which it dictates are not followed.

D. The Elements that Invoke Article 2692

One approach to the interpretation of article 2692 is to apply the principles of the interpretation of statutes in three steps as follows. The first step is to identify the “judicial facts” (herein sometimes called “elements”) that invoke the application of the provision.³⁶ The transactions addressed by article 2692 (the grammatical subject of the provision) must have three elements to qualify: (i) there must be a hypothec; (ii) it must secure bonds or other titles of indebtedness; and (iii) the titles of indebtedness must be issued by a trustee, a limited partnership, or a legal person authorized to do so by law. If all three elements are not present in the transaction, article 2692 will not apply and the penalty cannot be invoked. If, however, they are present, the penalty applies only if the remaining prescriptions of the provision are not complied with. In this sense article 2692 implies a prohibition.

The prohibition is not, however, absolute. Where the three elements forming the subject of article 2692 are present, one may still escape the application of the penalty if two other elements (the grammatical predicate of the provision) are present. Both must be present. They are: (iv) the hypothec must be granted by notarial act *en minute*; and (v) the grant must be in favour of a *fondé de pouvoir*.

³⁵ Y. Renaud & J. Smith, *Droit québécois des corporations commerciales*, vol. 2 (Montreal: Judico, 1974) at 942, and the jurisprudence cited therein.

³⁶ Identification of “judicial facts” is an important first element in the assessment of the effect of a law: see Côté, *supra* note 34 at 130.

The second step in the interpretation of a statutory enactment, one the courts have consistently applied, is to apply what has become known as the “golden rule” of interpretation. The rule was amply expressed by Pigeon J. in *Wellesly Hospital v. Lawson*: “En premier lieu, c’est méconnaître la plus fondamentale des règles, savoir qu’on ne doit s’écarter du sens littéral qu’en cas d’ambiguïté ou d’absurdité.”³⁷

The “golden rule” for the interpretation of statutes would be applied, and the grammatical and ordinary sense of the words of article 2692 would be adhered to, when the provision is interpreted as set forth above. Article 2692 will apply to a transaction when the transaction involves each of the first three elements. Thereafter, the transaction is absolutely null unless by express exception it is written in compliance with each of the final two elements. This is the grammatical and ordinary sense of the words employed in article 2692. This is also the full extent of the application of the provision.

This having been said, it is useful at this point to introduce a possible alternative construction. One may argue that, despite the plain grammatical construction of article 2692, the reference to the *fondé de pouvoir* is a fourth element that truly should form a part of the subject matter of the provision. Thus, article 2692 would be invoked only if there is a hypothec, securing titles of indebtedness, issued by a trustee, etc., and the hypothec is in favour of a *fondé de pouvoir*. Only in such event must the transaction be by notarial act *en minute*. This construction will be examined more closely in response to a specific question below.³⁸

The third step in the interpretation of article 2692 is to determine the meaning of the words identifying each element. They will be examined more closely in response to the specific questions which are listed later in this study. It is submitted that the application of the “golden rule” to article 2692 can only result in a number of “ambiguities or absurdities”, to use the words of Pigeon J.

E. Broad Import of Article 2692

Notwithstanding that article 2692 should be restrictively interpreted, one cannot simply conclude that it has no effect on our law other than to impose its imperative and penal provisions for a failure to comply with its prescriptions. Article 2692 contributes more than this to Quebec civil law. As with much of the drafting of the C.C.Q., one must infer an action or a juridical concept from the context of its use or

³⁷ (1977), [1978] 1 S.C.R. 893 at 902, 76 D.L.R. (3d) 688. Pigeon J. cited case law that traced the origin of the rule to the House of Lords decision in *Grey v. Pearson* (1857), 6 H.L.C. 61, [1843-60] All E.R. Rep. 21. His Lordship cited *Grand Trunk Pacific Railway Co. v. Dearborn* (1919), 58 S.C.R. 315, 47 D.L.R. 27 (among others) as the case that adopted the rule in Canada. See also Côté, *ibid.* at 429ff.

³⁸ See Part VII.F., below. This is the right construction if one accepts the comment to art. 2692 C.C.Q. found in the *Commentaires*, *supra* note 20, t. 2 at 1686, or the observation of Payette, *supra* note 1 at 169.

description in a provision, even though it is neither the direct object of the provision nor defined elsewhere in the C.C.Q. Only in this indirect sense is the provision declarative of what the law addresses. One must infer from the phrases employed in article 2692 a number of principles that affect the law of hypothecs more generally. All these are necessary or inescapable inferences. They constitute underlying judicial facts. They are:

- (1) Quebec's law contemplates the hypothecation of property to secure bonds or titles of indebtedness.
- (2) Quebec's law expressly acknowledges that at least a trustee, a limited partnership, or a legal person authorized by the law may issue secured bonds or titles of indebtedness.
- (3) It is not repugnant to Quebec law that a *fondé de pouvoir* acting for creditors should hold a hypothec securing the obligation to the creditors.
- (4) Such a *fondé de pouvoir* need not necessarily be a trustee or a mandatary. This principle results only from a construction placed on the term by all authority to date.³⁹

The reformist concludes that today these principles are a part of Quebec law and, apart from the last principle, would exist even if article 2692 did not. Note that none of these principles constitute the direct object of article 2692. Although it would be preferable if these principles were confirmed through a provision expressed in positive and enabling form, the fact remains that Quebec law reflects these principles and confirms them through their expression in article 2692.

F. *The Traditional View Examined*

The traditionalist would not read article 2692 in the same sense. He would begin with the premise (which the reformist fully accepts) that every grant of security giving the creditor the right to be paid by preference is exceptional and exists only where permitted by law.⁴⁰ He would note that hypothecation can take place only on the conditions and according to the formalities authorized by law.⁴¹ He might maintain that the holding of a hypothec separately from the debt it secures is a further restriction of the general exception, that article 2692 is the only provision in the C.C.Q. that deals with this idea, and that such a transaction can only be effected on complete compliance with the provision.

The traditionalist seems to overlook the fact that, although any grant of hypothecary security is exceptional and may be effected only as permitted by law, the rules on

³⁹ Payette, *ibid.* at 167; *Security on Property*, *supra* note 4 at 232; and "Corporate Trust Deed", *supra* note 6 at 854.

⁴⁰ Arts. 2644, 2647 C.C.Q.

⁴¹ Art. 2664 C.C.Q.

hypothecs are optional and enabling. Once the essential rules are complied with, the draftsman is free to structure the uses and holding of a hypothec as he may elect to do so. If there is no rule opposed to such a structure, the courts must give effect to the hypothec.

The traditionalist's argument, it would seem, confuses the act of hypothecation with the manner in which the hypothecs are held. Apart from article 2692, the provisions of the C.C.Q. on hypothecs are silent as to who must be the holder of a hypothec. The only other article of any relevance is article 2661 C.C.Q., which states that a hypothec is merely an accessory right, and subsists only as long as the obligation whose performance it secures continues to exist. This is one of the most important of the principles that define when a hypothec may exist,⁴² but it does not follow that the holder of the hypothec and the holder of the obligation it secures must be the same person. The accessory principle can be fully complied with through the terms of the contract between the holder of the hypothec and the holder of the obligation secured.

The language of article 2692 does not support the conservative view. Such view does not reflect the plain meaning of the words employed by article 2692. The word "issued" is not preceded by the words "shall only be". Neither words in the provision nor anything else in the C.C.Q. convey the idea that article 2692 affords the only means of creating secured titles of indebtedness where the holder of the title is not the holder of the hypothec.

The traditional view also leads to an unlikely construction when one considers article 2688 C.C.Q. This provision states that a hypothec granted to secure a sum of money is valid even if, when it is granted, the debtor has not received the prestation (the loan) in consideration of which he has consented to the obligation. Article 2688 states the rule is applicable in particular to lines of credit and the issue of bonds and other titles of indebtedness. Article 2797 C.C.Q. reaffirms the principle. For more than one hundred years, practice has accepted that an issue of secured bonds or titles of indebtedness which rank *pari passu* may be held by many persons (some future and unknown), that it is inappropriate that the holders should be undivided holders in the security, and that in consequence the law should permit security to be vested in a third person acting on behalf of the holders.⁴³ Article 2688 affirms that the hypothec may exist apart from the obligation it secures. The separation of other elements—of the holder of the obligation from the holder of the hypothec—involves a much simpler modification, indeed no modification, of principle.

Reform was intended, among other things, to extend the regime encompassed exceptionally by the *SCPA* (and other special laws) to the general law providing for security on property, and make the special devices available to all, at least in the devel-

⁴² Payette, *supra* note 1 at 87ff.; and D. Pratte, *Priorités et hypothèques* (Sherbrooke, Qc.: Revue de droit, Université de Sherbrooke, 1995) at 35ff.

⁴³ "Corporate Trust Deed", *supra* note 6.

opment and the prosecution of an enterprise.⁴⁴ Thus, one can now hypothecate movables, corporeal and incorporeal, present and future, including claims, and a class or universality of properties. The expanded remedies were also borrowed from the special legislation; namely, the rights to enter, to take possession, and to sell privately. It seems inconsistent with the reform process to limit unduly the circumstances where one can entrust the security for an obligation to a holder other than the creditor.

III. Enforcement of the Hypothec—Article 59 of the *Code of Civil Procedure*

The holding of a hypothec by a person, a *fondé de pouvoir*, other than the holder of the obligation secured would be sterile unless such *fondé de pouvoir* could exercise the rights attaching to such hypothec. The reform process was not silent in this area, but brought about a complementary change in the C.C.P. Article 55 C.C.P. states that whoever brings an action must have a sufficient interest therein. Article 59 C.C.P. adds a corollary in enshrining the principle "*personne ne plaide par procureur*." It then lists an extensive number of exceptions in its second and third paragraphs. After listing those who represent incompetents in the third paragraph, reform added a new exception:

Il en est de même de l'administrateur du bien d'autrui pour tout ce qui touche à son administration, ainsi que du mandataire dans l'exécution du mandat donné par une personne majeure en prévision de son inaptitude à prendre soin d'elle-même ou à administrer ses biens.

This also applies to an administrator of the property of others in respect of anything connected with his administration and to a mandatary in the performance of a mandate given by a person of full age in anticipation of his incapacity to take care of himself or administer his property.⁴⁵

The amendment to article 59 C.C.P. reflects the general principle of article 1299 C.C.Q., which states that a person charged with the administration of property or a patrimony that is not his own assumes the office of administration of the property of others. It states that the provisions of that Title of the C.C.Q. apply unless another form of administration applies under the law or under the constituting act, or due to circumstances. Article 1316 C.C.Q. (in the same Title) states that an administrator may sue and be sued in respect of anything connected with his administration. It is important to note that the new exceptions added to article 59 C.C.P., when read with the rules for the administration of the property of others, are "stand alone" provisions. They are not tied in directly with article 2692 or, by their terms, with any other article.⁴⁶

⁴⁴ See *Commentaires*, *supra* note 20, t. 1 at 748, 751; and t. 2 at 1666, 1669, 1682, 1686, 1687, 1695, 1698, 1700, 1701, 1720, 1736.

⁴⁵ *Implementation Act*, *supra* note 3, s. 190; and art. 59 C.C.P.

⁴⁶ The C.C.Q. does adopt them by reference when it declares expressly that such rules apply through the following articles: 233 (tutorship), 274 (protective supervision), 644, 753 (successions), 794, 802 (liquidator of successions), 1029 (manager—undivided co-ownership), 1085 (syndicate in divided co-

However, for these rules to apply, the administrator must hold “property or a patrimony” of another.⁴⁷ A hypothec is a real right in property. It is an accessory to any obligation, including an account receivable or a claim. Part of its very essence is that it gives rise to a right of action, the old hypothecary action, which is now called an application for the exercise of hypothecary rights.⁴⁸ A claim and rights to enforce that claim and the security therefor are patrimonial assets.⁴⁹ Generally, all patrimonial assets are property.⁵⁰ The holder of a hypothec securing a claim or any other enforceable patrimonial obligation is a holder of property.

Article 59 C.C.P. endorses the conclusion that a *fondé de pouvoir*, or other mandatary who holds a hypothec through a different provision, can represent joint holders of a hypothec. After asserting that a person cannot use the name of another to plead, article 59(ii) C.C.P. states that “[n]evertheless, when several persons have a common interest in a dispute, any one of them may appear in judicial proceedings on behalf of them all if he holds their mandate.” (It then adds some procedural rules on the use and extent of the mandate.) It is clear that joint holders of a hypothec who desire to enforce their secured claims and their hypothec have such a common interest. Those whose security is held by one of them as the others’ mandatary also have a common interest.⁵¹ One should also observe that the express mandate to exercise hypothecary rights required by article 59(ii) C.C.P. could be set out in the basic secured credit agreement in anticipation of the subsequent syndication of the credit and the related security by the lead lender.

It must also be noted that the C.C.Q. makes no express statement concerning enforcement by the *fondé de pouvoir* under article 2692. It speaks only of exercise of hypothecary rights by the “creditor”.⁵² Indeed, Chapter 5 (“Exercise of Hypothecary Rights”) of Title 3 (“Hypothecs”) of Book 6 (“Prior Claims and Hypothecs”) uses the term “creditor” throughout when speaking of the exercise of hypothecary rights. However, if the intended purpose of article 2692 is to permit continuance of the regime of the *SCPA*, one must conclude that the *fondé de pouvoir*, as the sole registered

ownership), 1142, 1145 (usufructuary), 1224 (institute in substitutions), 1278 (trustee), 1484 (management of the business of another), 1709 (person charged with the sale of the property of another), 1778 (exempts rules of sale of an enterprise from hypothecary sales), 2135 (general mandatary), 2168 (mandate in anticipation of incapacity), 2238 (general partners), 2266 (liquidator of partnership), 2768 (temporary possession by hypothecary creditor), and 2773 (possession by hypothecary creditor for administration). If the mandatary with a general mandate has these powers, there would seem to be no inherent principle of civil law that prohibits the granting of such powers expressly to a mandatary who holds a hypothec.

⁴⁷ Art. 1299 C.C.Q.

⁴⁸ Art. 2748 C.C.Q.; and art. 795 C.C.P.

⁴⁹ Arts. 2, 3148 C.C.Q.

⁵⁰ “Corporate Trust Deed”, *supra* note 6 at 842.

⁵¹ *Quaere*: Is the exception provided by article 59(ii) C.C.P. available to the holder of the security who is not also a holder of one of the obligations secured or of an aliquot part of the obligation secured?

⁵² Arts. 2748, 2751, 2757, etc. C.C.Q.

holder of the hypothec, may alone take suit in the exercise of hypothecary rights. One must conclude that the term "creditor", as used in Chapter 5 on the exercise of hypothecary rights, must be interpreted broadly to mean "holder". Note also that the *SCPA* before reform contained no provision expressly authorizing the "trustee" to take proceedings in enforcement of the security held on behalf of the bondholders, but a constant jurisprudence allowed him to do so.⁵³

In addition, the general rules governing the exercise of hypothecary rights do make a specific reference to the rules on administration of the property of others. Article 2768 C.C.Q. states that after an ordinary surrender of the property, the person to whom the property is surrendered has "simple administration". Article 2773 C.C.Q. provides that when surrender is for purposes of administration, it entrusts "full administration" to the holder. Both "simple administration" and "full administration" are defined in the rules for the administration of property of others.⁵⁴ The right to sue in connection with such administration is found in article 1316 C.C.Q. Thus, the remedies for the exercise of hypothecary rights, including those held by the *fondé de pouvoir*, are expressly tied into the rules for the administration of the property of others as well as the amendment to article 59 C.C.P.

From this analysis one must conclude that a person who holds a hypothec granted for the benefit of a creditor of the secured obligation can, if authorized by such creditor, exercise such hypothecary rights whether or not he is qualified as a *fondé de pouvoir* under article 2692. The position of the trustee and the mandatary holding hypothecs will be examined in greater detail later in this study.

IV. Section 32 of the *Special Corporate Powers Act*

A study of the import of article 2692 on various types of secured-loan transactions should also touch on section 32 of the *SCPA*. This section antedates reform, but the reform process modified its language to reflect the wording now used in article 2692. Section 32 now provides as follows:

32. Le fondé de pouvoir des créanciers en faveur duquel est consentie une hypothèque pour garantir le paiement d'obligations ou autres titres d'emprunt ne peut acheter de la compagnie la première émission, par souscription éventuelle à forfait, achat, souscription ou autrement des obligations ou autres titres d'emprunt garantis par hypothèque.

32. The person holding the power of attorney of the creditors in whose favour a hypothec is granted to secure payment of bonds or other titles of indebtedness cannot purchase from the company the first issue, by underwriting, purchase, subscription or otherwise, of the bonds or other titles of indebtedness secured by hypothec.⁵⁵

⁵³ "Corporate Trust Deed", *supra* note 6 at 827ff.; *Laliberté*, *supra* note 23 at 14.

⁵⁴ Arts. 1301, 1306 C.C.Q.

⁵⁵ *SCPA*, *supra* note 2, as am. by the *Implementation Act*, *supra* note 3, s. 645. It is curious that the word "company" was not replaced by the phrase "a trustee, a limited partnership or a legal person authorized to do so by law." In all probability, this was merely an oversight by the drafter.

This section of the *SCPA* was originally adopted in 1933.⁵⁶ Its obvious and only purpose was to assure the avoidance of a conflict of interest between the *fondé de pouvoir* and the holders of the titles of indebtedness in public or widely held issues of securities.⁵⁷ Thus, in *Madill v. Lirette*,⁵⁸ the Court of Appeal, noting that there is no legislated sanction for a breach of section 32, held that it provided a relative nullity only, one that could be raised only by one of the holders of the titles of indebtedness. Article 1420 C.C.Q. reflects this principle in stating that a relative nullity may be invoked only by the person in whose interest it is established, and that such a person must act in good faith and sustain serious injury therefrom. Moreover, such person may waive or renounce the invocation of such nullity.⁵⁹

Section 32 of the *SCPA* expresses a blunt and rather clumsy prohibition that has been superseded today by the new, much more subtle and far reaching provisions of articles 1309 to 1318 C.C.Q. These provisions provide in themselves an extensive regime on conflicts of interest. They will have application to any *fondé de pouvoir* who holds hypothecs or other security. In addition, they by inference empower the court to examine each case on its merits and order (or refuse to order) redress according to the circumstances.

However, taken at face value, the blunt prohibition of section 32 of the *SCPA* may conflict with the new and more elastic provisions of the C.C.Q. on conflicts of interest. Unless the prohibition of section 32 has been waived, its blunt prohibition could be invoked in regard to transactions today where there is in fact no such conflict, or where it has been fully disclosed, accepted, agreed to by the parties, and regulated by the credit agreement. It should be repealed and until it is, to the extent possible, its application should be waived by the secured creditors in the documents constituting the rights of the *fondé de pouvoir*.

V. Hypothec Held by a Trust

A. Basic Elements of the Trust

The expression "*fondé de pouvoir*" is broad enough to include the trustee under a Quebec trust and the deed granting the hypothecs can create a Quebec trust under ar-

⁵⁶ *Loi modifiant la Loi des pouvoirs spéciaux de certaines corporations*, S.Q. 1933, c. 84. The section was originally s. 136.

⁵⁷ S. Le Bel, "Les émissions d'obligations dans le droit de la province de Québec de 1890 à nos jours" (1980) 21 C. de D. 43.

⁵⁸ [1987] R.J.Q. 993, 8 Q.A.C. 81. At the time of the decision, s. 32 was s. 27 of the *SCPA*, R.S.Q. 1964, c. 275.

⁵⁹ Art. 1423 C.C.Q.

ticles 1260 and following.⁶⁰ Moreover the use of the trust to permit a trustee to hold hypothecs securing titles of indebtedness held by another would apply whether article 2692 existed or not. Article 1263 C.C.Q. (as amended recently) expressly declares that a trust may be created for such purpose.⁶¹ The *SCPA* sanctioned such an arrangement expressly. If article 2692 did not exist, the civil law would now recognize a trust created for such a purpose.⁶²

The difficulty with this construction is that article 2692 does exist. If the several elements which invoke it are present, it could be found to apply to such a trust and thereby render it null unless the prescriptions of article 2692 are complied with.⁶³

In many situations, the use of a trust to hold the security could be desirable.⁶⁴ It will be particularly desirable where the issue of bonds or other titles of indebtedness is to be widely held. It may be the preferred method of shielding a large group of distant investors from the consequences of a finding that the *fondé de pouvoir* is a mandatary and that they have assumed the full responsibilities of a mandator.⁶⁵ This may be achieved through the use of a corporate trust deed securing titles of indebtedness that are widely held.

B. Problems in Using a Trust

The use of a trust may, however, present a number of problems. Firstly, the C.C.Q. imposes restrictions on the persons who may qualify as the trustee. If the trustee is a legal person it must be a Quebec licensed and qualified trust company.⁶⁶ If the trustee is also a beneficiary, that is to say, a creditor of the obligation secured, the C.C.Q. imposes the need for a second independent trustee.⁶⁷

In many cases, the requirement that there be a third party corporate trustee would be both an expensive and an inflexible means of securing what have become fairly routine banking transactions. The initial and annual fees of the trustee are a factor. In most circumstances, the Quebec borrower ultimately bears the cost and inconvenience imposed by these restrictions.

⁶⁰ The required elements of such a trust are examined more fully in "Corporate Trust Deed", *supra* note 6 at 839ff.

⁶¹ For an imaginative and wide ranging examination of the uses of the Quebec law of trust as a security device, see R.A. Macdonald, "The Security Trust: Origins, Principles and Perspectives" in *Non-Corporate Vehicles*, *supra* note 5, 155.

⁶² See Parts II.E. and III, above.

⁶³ The limits of its application are more fully examined in Parts VII.B. and VII.C., below.

⁶⁴ "Corporate Trust Deed", *supra* note 6 at 804.

⁶⁵ *Ibid.* at 836.

⁶⁶ Art. 1274 C.C.Q.

⁶⁷ Art. 1275 C.C.Q.

VI. Hypothec Held by a Mandatary

One cannot examine the effect of article 2692 without some review of the principles of mandate.⁶⁸

A. *The Role and Powers of a Mandatary*

1. Mandatary as a Hypothecary Creditor

Quite outside article 2692, the creditor of a Quebec secured loan may choose to act through his own representative or mandatary, who would be entrusted with the administration (even the making) of the loan, and with the holding and administration of the security.⁶⁹ Here, one might normally assume also that the relationship between the creditor and his mandatary is disclosed both to the debtor and to the public. The relationship would be disclosed by appropriate declarations in the deed of hypothec. If immovables are hypothecated, the deed is registered at length or by a summary, and disclosure is made by this process. If movables are hypothecated, the notice of registration in the Register of Personal and Movable Real Rights would disclose the name of the mandatary as the grantee of the hypothec and the name of the creditor as the holder.⁷⁰ The regulations under article 2981 C.C.Q. speak of "holder" in the sense of the creditor and not in the sense of the mandatary.⁷¹ In addition, the Ministry of Justice manual of instructions concerning such registrations contains the following passage: "[S]i une des parties a agi comme mandataire, c'est le mandant, c'est-à-dire le représentant, le véritable titulaire ou le constituant du droit, qui doit être désigné dans la réquisition d'inscription du droit."⁷²

2. Loan and Security Held by a *Prête-Nom*

The lender may also act through the intervention of a *prête-nom* or representative who appears opposite the borrower and the public as the lender and the holder of the hypothec, but who in fact acts as the mandatary of the true lender who wishes to remain silent and unknown. Articles 2157(ii) and 2159 C.C.Q. acknowledge this concept. It is also to be inferred from the rules of administration of the property of others. Article 1319(ii) C.C.Q. states that an administrator is liable to third persons if he acts in his own name. The Supreme Court of Canada expressly affirmed that a mandate may be given to a silent *prête-nom* in the following passage: "En droit québécois,

⁶⁸ Arts. 2130ff. C.C.Q.

⁶⁹ Art. 2130 C.C.Q.

⁷⁰ Art. 2981 C.C.Q.

⁷¹ *Regulation respecting the register of personal and movable real rights*, O.C. 1594-93, 17 November 1993, G.O.Q. 1993.II.6215.

⁷² The instructions also provide that the name of the mandatary may be disclosed in a supplementary form designated "Annex A.P".

comme en droit français, le contrat de prête-nom est une forme licite du contrat du mandat."⁷³

In the case of a *prête-nom* for an undisclosed mandator, the instrument of registration would not disclose the latter's interest as the "holder" of the hypothec notwithstanding the regulations respecting registration and the instructions for registration. Neither the regulations nor the instructions can operate to modify the substantive law.⁷⁴

3. Only Security Held by a *Prête-Nom*

The use of a *prête-nom* assumes that the name of the true creditor and beneficiary of the hypothec is unknown to both the debtor and to the public. In financial practice, if one excludes the public issue of bonds, this is almost never the case. Where an advance of credit is to be made, the name of the true creditor is generally fully known to the borrower and the grantor of the hypothec. But in a given case, the creditor may elect, with the knowledge and consent of the borrower, to have the hypothecs securing the credit (distinct from the debt owing) held by another as representative of the creditor. The representative holds them for the exclusive benefit of the creditor. His holding of the hypothec is published by registration, but his mandator's interest is not. The hypothecs are held by a *prête-nom*. The *Victuni*⁷⁵ case provides a direct parallel for this arrangement. Where no bonds or other titles of indebtedness secured by hypothec are issued, there is nothing in Quebec civil law that prohibits a transaction that is structured in this manner.

B. Effects of Mandate on Certain Transactions

1. Secured-Credit Agreements

Quebec law continues to permit the security arrangements for credit agreements employed in modern banking practice. The initial credit agreement would state the full amount of the credit and create the security. The borrower and all lenders would

⁷³ *Victuni Aktiengesellschaft v. Minister of Revenue of the Province of Quebec*, [1980] 1 S.C.R. 580 at 584, 112 D.L.R. (3d) 83, Pigeon J. [hereinafter *Victuni*]. Here the mandator held immovable property charged with a hypothec securing debentures issued to the public, all on behalf of a mandator. The Minister of Finance was unable to collect the tax on capital (essentially a tax on paid-up capital, long term debt, reserves, and surpluses) as the mandate, although withheld from the public, was fully disclosed to him. The court held that a third party (the Minister) who knows of the existence of the mandate is not in a position to ignore it.

⁷⁴ One must also note that generally the mandator whose existence is disclosed is alone responsible for the acts of his mandatary (arts. 1319, 1322, 2157, 2160 C.C.Q.), while the *prête-nom* for an undisclosed or hidden mandator is personally responsible for his acts (arts. 1319, 2157 C.C.Q.). So is the mandator when he later becomes known (arts. 2159, 2160 C.C.Q.).

⁷⁵ *Supra* note 73.

be parties to it. The hypothecs could be registered in the name of the lead lender alone. The borrower understands this and would consent to it. As regards the public, though, the lead lender would be the registered holder of the hypothecs for the full amount of the authorized credit.⁷⁶ To the extent that the lead lender acts as the holder of the security for the other lenders that are members of the lending group, he would act as a *prête-nom*, a mandatary for his co-lenders as undisclosed mandators.⁷⁷

It should also be noted that the structure avoids the creation of a trust. Assuming the lead lender is a bank, being a bank, it cannot act (at least in Canada) as a trustee of an express trust. Its statutory powers preclude acting as a trustee. It may act, however, as a fiduciary (as may anyone else).⁷⁸

If no bonds or titles of indebtedness are to be issued, article 2692 would not be relevant. Unless land is to be hypothecated, notarial form is not required. However, if bonds or other titles of indebtedness are to be issued, article 2692 may apply.⁷⁹

2. Direct-Loan Syndications

Direct-loan syndications are viewed under Quebec law as secured credit agreements with several lenders, except that the parties to the original credit agreement are only the borrower and the lead lender, while the agreement itself makes provision for additional lenders to be added (or replaced or deleted) in the future. New lenders are brought in by the lead lender through the sale of a participation in the loan. As the lead lender sells interests to members of the syndicate, he would transfer an undivided interest in the borrower's debt and the underlying security.⁸⁰ The borrower would acquiesce.⁸¹ The lead lender remains the only registered holder of the hypothecs and as such is a *prête-nom* for the interests of the other members of the syndicate.

⁷⁶ Some have suggested that s. 427 of the *Bank Act*, *supra* note 15, obliges each bank to hold its own security directly. It is the author's opinion that the bank may hold through a mandatary; that which is held by a mandatary is held by the bank.

⁷⁷ Counsel will be obliged to assure, of course, that adequate disclosure of the interests of the true creditors is made to the insurers of the underlying security, as the courts have consistently held that a mere *prête-nom* who fails to disclose that he acts for others has no insurable interest: see R.P. Godin, "The Development of Major Real Estate Projects under the Laws of Québec" in *Meredith Memorial Lectures 1989: Current Problems in Real Estate* (Cowansville, Qc.: Yvon Blais, 1990) 259 at 294.

⁷⁸ In Quebec, the rules for the administration of property of others have codified a standard of behaviour for all those acting in a fiduciary capacity. They bring him to much the same position as the constructive or resulting trustee in the common law jurisdictions. In Quebec, they include the right to sue to enforce his administration. For a definition of "constructive trust" and "resulting trust", see D.W.M. Waters, *Law of Trusts in Canada* (Toronto: Carswell, 1974) at 277ff.

⁷⁹ The limits of its application are more fully examined in Parts VII.B. and VII.C., below.

⁸⁰ Art. 1637 C.C.Q.: a sale or transfer of a claim is quite distinct from novation of the creditor (art. 1660 C.C.Q.) under Quebec law. The latter creates a new obligation, the former does not. See J.-L. Beaudoin, *Les Obligations*, 4th ed. (Cowansville, Qc.: Yvon Blais, 1993) at 510.

⁸¹ Art. 1641 C.C.Q. If he does not acquiesce, the comments on farm-outs in Part VI.B.3, below, might apply.

Some counsel have suggested that the Quebec law of mandate is insufficiently flexible to support such arrangement. They argue that, since mandate is a bilateral contract,⁸² the parties to it must exist at the time of its creation.⁸³ In the opinion of the author, in the example just given, they do exist. The transaction starts with a credit and security agreement between the borrower and the lead lender. There is no mandate at this time as there is no syndication and no co-creditor/mandator. But the contract can anticipate and provide for this event. When the lead lender sells an interest to the first and to each subsequent syndicate member, the lead lender becomes a security agent and a mandatary for the interest of the new syndicate members. The mandate is then created and the relationships between the mandators and the mandatary then exist.⁸⁴ The borrower acquiesces in the sale⁸⁵ through his consent. As additional members of the credit facility syndicate arrive and depart, the mandators of the security agent and the ultimate beneficiaries of the security change, always with the consent of the borrower and of the security agent. Each time a mandate exists, so do the parties who grant it and so does the bilateral characteristic of the contract.⁸⁶

Thus, for direct-loan syndications, counsel need not require any change or renewal of the security. The parties are generally reluctant, in any case, to change or even renew the security because of expense. Also, since no change of security is needed, the parties can continue to benefit from the fact that the original security would be "seasoned" against the deemed preference rules under bankruptcy law from the date on which it is first granted. It would rank from its original date. The burden and expenses of researching the names of third party secured creditors at the time of the syndication and obtaining their consent can be avoided.

3. Farm-Outs

For farm-out secured loan syndications, where the borrower does not expressly consent to the sale of a participation, the response of Quebec law is a little more uncertain. The uncertainty arises by reason of the absence of a *lien de droit* between the sub-lender and the borrower. This problem is not unique to Quebec law. Moreover, it

⁸² Art. 2130 C.C.Q.

⁸³ See Payette, *supra* note 1 at 163; and Martis, *supra* note 5.

⁸⁴ Although mandate involves a bilateral contract and comes into being upon its acceptance by the mandatary (art. 2130 C.C.Q.), the mandate is often unilateral in form, and acceptance is often evidenced merely by the actions of the parties. The express power of attorney, the corporate resolution, and the written instruction to a stock broker or bank are all evidenced by a unilateral writing issued by the mandator. Certain deposit receipts, consignment receipts, and the commodity broker's confirmation are all examples that originate with the mandatary: see C. Fabien, *Les règles du mandat* (Montreal: Chambre des notaires du Québec, 1989) at 110ff.

⁸⁵ Art. 1641 C.C.Q.

⁸⁶ A mandate can also be ratified. Moreover, when there is ratification the effect is retroactive to the moment of the performance of the act. It is also binding on third parties unless they can show they suffered a prejudice: see A. Popovici, *La couleur du mandat* (Montreal: Thémis, 1995) at 52. See also Fabien, *supra* note 84 at 272.

does not arise solely in consequence of the Quebec law of hypothecs. There is no release of the lead lender for the portion of the future loans to be made by the sub-lender. Nor does the borrower acquire the right to call upon the sub-lender to make a portion of the future loans. Generally, the borrower would preserve his rights to oblige the lead lender to make all advances. Under Quebec law, one cannot normally transfer the performance of an obligation to another without the consent of the person to whom it is owed.⁸⁷

One can, however, transfer a claim such as the borrower's debt owing, or a portion of it, including an undivided portion of it.⁸⁸ If the borrower is notified of the sale, the hypothec securing it, or rather the same undivided portion of the hypothec securing it, is also transferred.⁸⁹ If the loan is fully disbursed, the legal requirements for a perfected transfer of a claim and its security have been complied with and the result is one that should be acceptable to the parties. If, however the loan is not fully disbursed, or is for a revolving credit, it is doubtful if the sub-lender has any obligation to make further advances (there being no *lien de droit* between the sub-lender and the borrower) and it is doubtful if he acquires an interest in the underlying hypothecs. The sub-lender's interest, or at least a portion of it, would be no more than a personal claim against the lead lender. The debt secured by the hypothecs might be restricted to the aggregate debt owing to the lead lender alone.

Caution suggests that the sub-lender obtain the concurrence of the borrower to any such sale. It also suggests that if the lead lender desires a release of a portion of his obligation to make advances after the farm-out, he have the borrower consent to the farm-out and the release.

4. Farm-Outs at Common Law Compared

In the Alberta cases concerning the insolvency and winding-up of the Canadian Commercial Bank, the court found that the participation farm-out agreements created an express trust, with the bank as the trustee.⁹⁰ There was a *bona fide* sale of an undivided participation in the loans combined with the creation of a trust. The court found that the terms of the farm-out agreements led to this conclusion. They provided that all repayments of the debt be held for the benefit of the participants, and be promptly remitted to the participants according to their interests and without any commingling of the proceeds of repayments with the funds of the bank.

In Quebec, a court could not find the existence of such a trust unless the original holder and transferor of the claim and any related security was an individual or a qualified trust company.⁹¹ However, the Quebec court should find, at least for direct-

⁸⁷ See L. Faribault, *Traité de droit civil du Québec*, t. 11 (Montreal: Wilson & Lafleur, 1961) at 460.

⁸⁸ Art. 1637 C.C.Q.

⁸⁹ Art. 1638 C.C.Q.

⁹⁰ See *Deposit Insurance*, *supra* note 13; and *Commercial Bank*, *supra* note 13.

⁹¹ Art. 1274 C.C.Q.

loan syndications and for farm-outs where the borrower consents (provided the credit agreement admitted of it), that the lead lender becomes a mandatary for the sub-lender's interest in the claim and in the underlying security. Perhaps, even more simply, the court should find the lead lender becomes an administrator of the property of others for the interests sold to the sub-lender, and that in consequence the lead lender is obliged to account as a fiduciary. In either case, as long as there is a segregation of the funds repaid by the borrower to the lead lender from the other funds of the lead lender, the sub-lender should obtain an enforceable right respecting his undivided interest in such funds. He should obtain an enforceable right against the lead lender respecting his undivided interest in the security.

5. Securitizations

As regards securitizations, the originator of the portfolio of secured receivables remains, opposite the claim debtor, his creditor and holder of the hypothec. The claim debtor gets no notice of the sale to the SPV. The originator of the portfolio is a *prête-nom* for the purchaser of the MBS. One should also note that if an original borrower defaults, the SPV re-transfers the hypothec to the originator before the latter takes proceedings to enforce the borrower's hypothec. This is the manner in which CMHS-MBS were written before reform and remains the manner in which they are written today. Article 2692 is not invoked by these transactions. If, however, the SPV grants a further hypothec on its assets to secure the holders of the MBS it intends to issue, article 2692 must be complied with.

VII. Specific Questions Arising from Article 2692

Having now examined the basic concepts of law that inform the transactions described in this study, it is now appropriate to return to the precise phrasing of article 2692, and to examine the substantial number of questions that it invokes. Generally, the separate phrases of the provision will be examined in the order of their occurrence.

A. *Who May Grant the Hypothec Securing the Titles of Indebtedness?*

Article 2692 starts with the words "A hypothec securing". The words are unqualified as to the type of hypothec or the grantor of the hypothec. They must therefore include any type of hypothec and anyone's hypothec. It could be the hypothec of the issuer of the bonds or titles of indebtedness. It could be that of another; that of a parent, subsidiary, or other affiliate of the issuer (if the relevant corporation's law permits it); or it could be that of another guarantor. It could be that of an individual.

One of the deficiencies of the *SCPA* was that it could not be employed by a guarantor to secure his obligation toward the creditor of a third party issuer of the bonds.⁹² The grantor of the hypothec could invoke the statute only to secure payment of "its" bonds, debentures, or debenture-stock. Reform has removed this restriction. There is now no reason why, under the prescriptions of article 2692, one cannot hypothecate one's property to secure the bonds or other titles of indebtedness issued by another.

One must also note that the first words, "A hypothec", are in the singular. Here the singular must include the plural. The *Interpretation Act* provides that the singular number shall extend to the plural whenever the context admits of it.⁹³ It does so here. To suggest that one would escape the strictures of article 2692 if the transaction includes several hypothecs would be to give it an unreasonable and too narrow a construction. Moreover, whether the grant is of a hypothec upon a list of properties or a hypothec upon each property in the list is strictly a matter of the draftsman's style.

B. What Does "Securing Payment Of" Mean?

The second element of the subject matter of article 2692 is found in the phrase "securing payment of bonds or other titles of indebtedness." This phrase modifies and defines the word "hypothec". It restricts the application of the provision to hypothecs securing payment of certain types of obligation. Two aspects of the phrase deserve some attention.

The first arises where the principal transaction for which the hypothec is given is reflected by an agreement, and incidentally, the amount of the debt is also evidenced by a bond or other title of indebtedness. Does article 2692 apply if the credit agreement provides that the advances outstanding from time to time are to be evidenced by a promissory note or a unilateral acknowledgement of indebtedness delivered to the bank? At first sight, both are "obligations ou autres titres d'emprunt," or in English, "titles of indebtedness" secured by a hypothec, and article 2692 would apply. Would it apply if the credit agreement alone contains the obligation for the indebtedness, and the bank then in addition obtains from the borrower a note for each advance? The bank could merely advise its borrower that this is its customary practice and that it provides certainty as to the amount of the loan from time to time outstanding. Is the application of article 2692 and the validity of the hypothec to depend on the subtlety of the draftsman? Should counsel warn the bank that if it obtains notes its hypothec may be in jeopardy?

As regards the stand-alone secured debenture, if one ignores article 2692, the debenture itself could contain a hypothec of movable property. If immovable property were to be charged, the hypothec could be granted by a collateral or supplementary

⁹² J. Tétrault, "Pitfalls under Trust Deeds" in *Meredith Memorial Lectures 1976-77: Corporate Debt Financing* (Toronto: Richard De Boo, 1978) 17.

⁹³ R.S.Q. c. I-16, s. 54.

notarial deed running in favour of the registered debenture holder. At first sight, a debenture is a title of indebtedness.

The legislature could not have intended that the creditor be obliged to employ a *fondé de pouvoir* to hold the security in all circumstances where a promissory note, debenture, or other title of indebtedness is to be used to affirm the amount of the debt. To dictate that every agreement for a secured loan that is to be evidenced or further evidenced by a note or other title of indebtedness must be in notarial form with a *fondé de pouvoir* (who, by inference, must be a third party as the C.C.Q. speaks of his acting on behalf "of the creditors"/"des créanciers") makes no sense. To dictate that in all cases where there is a secured title of indebtedness, the security must be held by a person other than the creditor would be a radical departure from the traditional law of hypothecs. It would result in an absurdity. No legal utility is to be served by such a rigid and formalistic structure. Yet article 2692, being in imperative and penal form, and read literally can be construed in this sense. One must endorse the statement of Louis Payette noted earlier to the effect that he favours an interpretation of article 2692 in a spirit of continuity, to reflect the continuance of the regime of the prior law.⁹⁴ Continuity dictates that this phrase of article 2692 cannot be read literally.

One can reasonably conclude that, notwithstanding the literal text of article 2692, where there is an agreement between the debtor and the creditor—whether in bilateral or in unilateral form—stating the amount or the maximum amount of the obligation secured, article 2692 is not invoked merely because the debt is evidenced by, or further evidenced by, the delivery of a promissory note, debenture, or other acknowledgement of indebtedness. This conclusion is also reinforced by the conclusion on the meaning of the phrases "bonds or other titles of indebtedness" and "granted to".⁹⁵

The second aspect of the phrase "securing payment of bonds or other titles of indebtedness" involves consideration of the object of the words "payment of". Securing payment of bonds or other titles of indebtedness does not include securing payment of a balance of price, a loan, break payment clauses, penalties, obligations for specific performance, or other non-monetary obligations. It would, however, do so where such obligations are incidental to the securing of payment of the bonds or other titles of indebtedness. Most loan agreements contain several such obligations. Nor do the words "securing payment of" have such an object where the bonds or titles of indebtedness are issued under a pledge agreement in order to guarantee the performance of an obligation.⁹⁶ The importance of this aspect will become more apparent in the following section.

⁹⁴ Payette, *supra* note 1 at 169.

⁹⁵ See Parts VII.C. and VII.F., respectively, below.

⁹⁶ The bonds so pledged could be held by the creditor of the principal obligation, or by another on his behalf.

C. What is a "Bond or Title of Indebtedness"?

What is to be included in the term "obligations ou autres titres d'emprunt"/"bonds or other titles of indebtedness" and the additional words "émis par"/"issued by"? If the phrase were given a large meaning, it could include any contract involving a debt for borrowed money, a credit agreement, a bill of sale with a balance of price, an invoice for goods sold and delivered on terms, a banker's acceptance or other bill of exchange, a guaranty, etc. Suretyship⁹⁷ is often evidenced by a unilateral contract, which is in insurance practice usually called a "bond". It is sometimes secured by a hypothec. It could include almost any obligation that can be secured by a hypothec. Such a large meaning would place article 2692 in direct conflict with article 2696 concerning movable hypothecs without delivery. It is unreasonable to suggest that security for such obligations must be in notarial form and in favour of a *fondé de pouvoir*.

The phrase in question should be given a meaning that is more consistent with the historical antecedents of this provision in Quebec. Under the *SCPA*, the phrase employed was: "bonds, debentures or debenture-stock."⁹⁸ This phrase would not appear to have been judicially construed in Quebec, but is thought not to provide a precise, limitative list of words of art. It includes "notes" and similar titles of indebtedness.⁹⁹ All authority seems to hold that the phrase refers, not to the indebtedness itself, but to a document evidencing it.¹⁰⁰ It is a "title" evidencing a claim.¹⁰¹ Consistency suggests that generally the new words should have the same meaning as the old.

Because the relevant law, now reflected in article 2692, is in imperative form, it is important to define the limits of the phrase. A grammatical analysis of each of the phrases "obligations ou autres titres d'emprunt" and "bonds or other titles of indebtedness" involves a different emphasis, but each brings one to the same conclusion. In the French version, "obligations" means "bonds"; it is also the broad generic term for all contractual obligations. It is restrictively modified by the term "ou autres titres". If "autres" were absent, "titres d'emprunt" would merely be an alternative to "obligations" and the latter could have a very large meaning. The use of the word "autres"

⁹⁷ Art. 2333 C.C.Q.

⁹⁸ *Supra* note 2, s. 27. The term "debenture-stock" is a disused term to signify a stock in or share of a consolidated mass of debt or debenture financing, often where the security was held by a trustee, in a period when "debentures" were often individually issued and secured (*pro rata* with others): see F.E. Wegenast, *The Law of Canadian Companies* (Toronto: Carswell, 1979) at 631; and C.M. Schmitthoff, ed., *Palmer's Company Law*, 23d ed. (London: Stevens & Son, 1982) at 532.

⁹⁹ W.K. Fraser, *Company Law of Canada*, 5th ed. by J.L. Stewart & M.L. Palmer (Toronto: Carswell, 1962) at 382.

¹⁰⁰ *Ibid.*; see also L.C.B. Gower, *The Principles of Modern Company Law*, 3d ed. (London: Stevens & Sons, 1969) at 347.

¹⁰¹ Renaud & Smith, *supra* note 35 at 347; and "Corporate Trust Deed", *supra* note 6 at 809-10.

however restricts it to "obligations" of the same kind as "titres" under the *ejusdem generis* principle.¹⁰²

In the English version, on the other hand, the term "bonds" is the specific term, while "other titles of indebtedness" is the generic term. The application of the same *ejusdem generis* principle would suggest that the term "titles of indebtedness" should include only things of the same kind or class as "bonds".

The term is also qualified by the word "issued". As used in article 2692, "issued" merely means validly authorized and legally "delivered". "Issued" is not thought to be a technical term, but a mercantile term. It would exclude documents that are stolen or deposited merely for safekeeping.¹⁰³ This also suggests that a document or paper evidencing a unilateral acknowledgement of a debt for a specified sum is involved. Both the French and the English phrases would thus include bonds, debentures, notes, units of indebtedness, and other titles where the evidence of the debt is reflected by a documentary title: by the issue of a paper, a security, a *valeur mobilière*.

Another use of the term supports this interpretation. The French term "obligations ou autres titres d'emprunt," may now be words of art in the C.C.Q. In its English version, the C.C.Q. sometimes uses the term "bonds or other *evidences* of indebtedness" instead of "*titles* of indebtedness". One finds the latter phrase used in the second paragraph of article 2688 C.C.Q., concerning hypothecs to secure lines of credit. The former phrase is used extensively in the sub-paragraphs of article 1339 C.C.Q. concerning presumed sound investments by those having the administration of the property of others. This list of qualified investments (with modifications) is modelled on the list of the *Civil Code of Lower Canada*,¹⁰⁴ which in turn reflects the similar lists found in dozens of statutes of Quebec, of the other provinces, and of Canada.¹⁰⁵ If one reads these in their proper context, one must conclude the term "obligations ou autres titres d'emprunt" is restricted to what are generally known as "valeurs mobilières" or "securities" (debt securities) contemplated by the Quebec *Securities Act*.¹⁰⁶

All of this leads one to conclude that "bonds or other titles of indebtedness" involve documentary titles that are issued or delivered and are of the nature of "securities" as known to securities law. They are usually sold for cash, but this is not an essential feature of their nature. They are often, but not always, sold to the public. Normally, but not essentially, such titles also constitute contracts of adhesion.¹⁰⁷ Normally, but also not essentially, such titles form part of a series of titles, where each consti-

¹⁰² A. Mayrand, *Dictionnaire de maximes et locutions latines utilisées en droit*, 3d ed. (Cowansville, Qc.: Yvon Blais, 1994) at 123.

¹⁰³ Wegenast, *supra* note 98 at 638; and Fraser, *supra* note 99 at 385.

¹⁰⁴ *Commentaires*, *supra* note 20, t. 1 at 806.

¹⁰⁵ These statutory lists of defined investments are known in legal jargon as the "legal for life statutes"; see e.g. *Pension Benefits Standards Act*, R.S.C. 1985 (2nd Supp.), c. 32, and Regulations, S.O.R./93-299; and *Trustee Act*, R.S.O. 1990, c. T-23, s. 26.

¹⁰⁶ R.S.Q. c. V-1.1.

¹⁰⁷ Art. 1379 C.C.Q.

tutes a part of the whole series and benefits and ranks *pari passu* with the other titles comprising the series. Frequently, but again not essentially, they may be transferred by delivery or by endorsement and delivery. The debt that they evidence is rarely also definitively quantified in a bilateral contract between the debtor and the creditor. All of these criteria will be pertinent in assessing whether article 2692 is to apply to a transaction. It will still be up to counsel (and the courts) in each case to determine when the delivery of an evidence of indebtedness (a paper) secured by a hypothec constitutes one contemplated by the provisions of article 2692.¹⁰⁸

Unfortunately, until this aspect of article 2692 is clarified through amendment, and in the absence of a more definitive construction by the courts, the imperative and penal form of the provision will cause many counsel to hesitate before approving a number of transactions that would otherwise reflect normal business practices.

D. Who May Issue Titles of Indebtedness Secured by Hypothec?

The third element of the subject matter of article 2692 speaks of titles of indebtedness issued by "a trustee, a limited partnership or a legal person authorized to do so by law." This listing, in the context of article 2692, is curious. One should conclude that if another, not embraced by the list, issues secured titles of indebtedness, the penalty of article 2692 will not apply. The list does not refer to the individual, not even the entrepreneur. Nor, one can argue, does it refer to the ordinary corporation or legal person.

An individual may also issue such titles of indebtedness. The issue may be secured by his hypothec or by that of a guarantor, including a corporate guarantor (a "legal person").¹⁰⁹ Such a practice might be unusual, but nothing in our law, especially not article 2692, prohibits it. And nor should it, at least for the entrepreneur. The ordinary individual, it is true, can only grant certain types of hypothec, but one who carries on an enterprise is not so restricted.¹¹⁰ If his enterprise is substantial, he may be able to raise debt capital by an issue of debentures or notes. The notes could be secured *pari passu* by a hypothec. The hypothec could be held by a trustee or possibly another who either is, or is not, qualified as a *fondé de pouvoir*. The individual issuer could do so free of the strictures of article 2692.

The position of the individual may be examined from another point of view. The *Bills of Exchange Act*, in speaking of bills, notes, and consumer notes, constantly speaks of "persons".¹¹¹ The term "person" includes an individual. A "person" may issue a note. A note is not invalid by reason only that it contains also a pledge of collat-

¹⁰⁸ *Quaere*: As art. 2692 is imperative and penal, would it apply if only a single bond is issued? This interpretation would be inconsistent with that of the *SCPA*, but that was not an imperative and punitive enactment: see *Trust général*, *supra* note 22; and *Société nationale*, *supra* note 22.

¹⁰⁹ Fraser, *supra* note 99 at 386.

¹¹⁰ Arts. 2684-89 C.C.Q.

¹¹¹ R.S.C. 1985, c. B-4, ss. 4, 16, 25, 59, 176, 189, etc.

eral security.¹¹² Such security would now be a hypothec in Quebec, and if it is a movable hypothec, it could be granted in the note itself. Thus, the *Bills of Exchange Act* clearly implies that an individual may issue a title of indebtedness secured by hypothec. The list of those who may do so that is found in article 2692 should not be limitative.

Accordingly, although an individual who is an entrepreneur may issue a series of secured notes as securities without regard to form, if the issuer is not an individual but an entity named by article 2692, it can only do so by notarial act in favour of a third party *fondé de pouvoir* who would hold the security. Article 2692 would impose the penalty of nullity on some issuers, but not on others. No legal purpose seems to be served by this consequence.

A closer examination of each of the terms “a trustee”, “a limited partnership”, “or a legal person authorized to do so by law” is warranted. It is convenient to examine the last of these terms first. The list ends with the words “authorized to do so by law.” Does this phrase modify all items in the list, or only the last, “legal persons”? The French version, which uses the phrase “autorisée à le faire en vertu de la loi” suggests that the phrase modifies “legal persons” only. This phrase grammatically agrees with “personne morale”, but not with “fiduciaire”.

The term “authorized to do so by law” raises other questions. Does it mean authorized “by a statutory text of law,” or merely “according to the formalities prescribed by law” (statutory borrowing power, authorizing by-law, resolution of the board, etc.)? If it means the latter, it is redundant. Such qualification, although inherent in all acts of alienation, is never found in the articulation of the civil law by the C.C.Q. It is not found in relation to “trustee” or “limited partnership”, the preceding items of the list.

It is most likely that the phrase “authorized to do so by law” is intended to refer simply to certain amendments to the *SCPA* brought in by reform. Although the operative provisions of the *SCPA* permitting corporate trust deed financing were repealed, two other provisions were recast. Section 34 of the *SCPA* now empowers a legal person constituted in Quebec or elsewhere without capital stock and which does not carry on an enterprise, “if empowered by its charter or by the law governing it,” to grant a hypothec, even a floating hypothec, on a universality of its property, movable and immovable, present and future, and notwithstanding the restrictions of the C.C.Q. Section 27 of the *SCPA* contains similar provisions respecting similar legal persons with share capital.¹¹³ There are thousands of corporations (school boards, hospitals, fabriques, municipal corporations, etc.) in Quebec and elsewhere that are creatures of special legislation that do not have power to borrow or to grant security.¹¹⁴ The phrase “authorized to do so by law” would seem to be intended to refer merely to these pro-

¹¹² *Ibid.*, s. 176(3).

¹¹³ *Supra* note 2, ss. 27, 34, as am. by *Implementation Act*, *supra* note 3, ss. 643, 648.

¹¹⁴ See *Commentaires*, *supra* note 20, t. 1 at 200-01.

visions; that “authorized” really means “having the capacity to do so conferred upon them by the law.” However, if this is the case, the phrase is redundant as the amendments to the *SCPA* referred to above are complete and stand alone.

The result is even more anomalous. If the phrase “authorized to do so by law” is intended to refer to the new provisions of the *SCPA*, although redundant, a strict and restrictive reading of article 2692 means that it does not embrace the ordinary legal person, the commercial corporation. This means that such a corporation can either issue secured bonds or other titles of indebtedness without complying with article 2692, or if one accepts the conservative view that the provision is restrictively enabling, that such a corporation cannot issue such securities at all. Neither of these conclusions concerning the meaning of these words is acceptable. Article 2692, whatever its meaning, cannot have these results. This analysis does serve, however, to illustrate the difficulty the practitioner faces in attempting to apply the provision in a rational way.

The inclusion of the “trustee” in the list must also be examined. One must turn to the instrument creating the trust to determine the powers of the trustee to borrow, to hypothecate trust property, as well as any formalities he must follow to do so. If the instrument is silent and contains no restrictions, the trustee acts as the administrator of the property of others charged with full administration.¹¹⁵ One with full administration may “alienate the property by onerous title, charge it with a real right or change its destination [etc.]”¹¹⁶ To hypothecate is to “charge”¹¹⁷ with a “real right”.¹¹⁸ The inclusion of the “trustee” in the list of who may issue secured titles of indebtedness under article 2692 is unnecessary and also redundant.

The reference in the list to “limited partnership” would appear to be equally unnecessary. The C.C.Q. expressly states that a limited partnership—presumably, as with the trustee, one authorized by the constituting instrument—may make a distribution of securities to the public and issue negotiable instruments.¹¹⁹ One should not construe the use of the term “negotiable instruments” in a narrow or restrictive way. The provision is clearly enabling and would have to include “other titles of indebtedness” which may or may not be negotiable instruments. There is nothing in the civil law that makes it inherently wrong that the limited partnership should borrow and issue titles of indebtedness. This is also established by the further principle that, again subject to the agreement, the general partners have the powers with respect to partnership property of a general partnership, and opposite the special partners are bound as administrators of the property of others charged with full administration.¹²⁰ Article 2211 C.C.Q. also expressly admits the hypothecation of partnership assets where the con-

¹¹⁵ Art. 1278 C.C.Q.

¹¹⁶ Art. 1307 C.C.Q.

¹¹⁷ Arts. 2644, 2645, 2647 C.C.Q.

¹¹⁸ Art. 2660 C.C.Q.

¹¹⁹ Art. 2237 C.C.Q.

¹²⁰ Arts. 2238, 1278 C.C.Q.

tract so provides. The position of the limited partnership is the same as that of the trustee. The listing of "limited partnerships" in article 2692 is also redundant.

It is most probable that in formulating the phrase "a trustee, a limited partnership or a legal person authorized to do so by law" (the third element of the subject matter of article 2692) the draftsman merely intended, firstly, to replace the term "company" with the term "legal person" and secondly, to extend the scope of article 2692 to the trustee and the limited partnership. However, as noted, he failed to include the individual, particularly the entrepreneur. The reference to "legal persons" is in a form that is most ambiguous. These oversights, when found in an imperative and penal expression of the law, produce a result that is most unsatisfactory.

E. What Does it Mean to Grant to a Fondé de pouvoir?

The meaning of the phrase "granted ... in favour of the person holding the power of attorney of the creditors"/"être constituée ... en faveur du fondé de pouvoir," has two aspects that require examination. First, did the draftsman truly intend that if at any time the several elements that are the subject of article 2692 exist in a transaction, the hypothec must, on pain of nullity, run in favour of a *fondé de pouvoir*? Are not the principles of the civil law protected equally well if the hypothec runs to the creditors directly? Under credit agreements, there are often two or three banks acting together. Although the lead bank often holds all the security on behalf of the other banks, in many cases the banks hold the security jointly. They then enter into an administrative agreement in favour of one of them. If they have to exercise their hypothecary rights, they act in concert. They often evidence their claims by having the borrower issue titles of indebtedness. Must they be represented by a *fondé de pouvoir*?

A literal construction would give article 2692 an application that does not reflect the former law. It would do so without any apparent utility. Either the statement of the Minister¹²¹ that article 2692 is in conformity with the prior law is false, or the construction of the phrase "bonds or other titles of indebtedness" according to its plain meaning is false. One is obliged to conclude that the "golden rule" of statutory interpretation cannot be followed; that if one applies the literal sense of the words of the provision to all transactions embraced by the provision, an absurdity will result.¹²² If, once again, continuity is to be reasonably observed, article 2692 should be read as if the draftsman had made an error in syntax; as if the phrase "granted ... to a *fondé de pouvoir*" came after and were to modify the word "hypothec". Article 2692 would then read "A hypothec granted to a *fondé de pouvoir* to secure bonds ..."

Article 2692 would then have four elements identifying the circumstances when its imperative requirements would apply. As the provision must be strictly construed, all four elements would have to be present before it applied. This construction would at least restrict the imperative and punitive effects of article 2692 substantially. Con-

¹²¹ *Commentaires, supra* note 20, t. 2 at 1686.

¹²² See the "golden rule", *supra* note 37 and accompanying text.

sistency and a rational construction of the law compels such a construction of article 2692 even though this construction goes far beyond a literal reading of its words.¹²³ Unfortunately, however, one may expect counsel in a given transaction to hesitate before giving an opinion that assumes the courts will eventually arrive at a finding of this construction.

The use of the words “granted ... to a *fondé de pouvoir*” gives rise to a second question. Does “granted” mean originally written by the grantor directly in favour of the *fondé de pouvoir*, or does it merely mean “held” by the *fondé de pouvoir*? A strict construction suggests that it means only the former. Article 2692 will not apply if the hypothecs are granted to one, and subsequently acquired by another. Many securitizations will therefore not be affected by article 2692. In such securitizations, the outstanding claims and related hypothecations are acquired by the SPV, which issues titles of indebtedness or participations “backed” by the hypothecs.

F. Why Should the Hypothec be in Notarial Form?

The clarity of the phrase of article 2692 “on pain of absolute nullity, be granted by notarial act *en minute*” is not in question. One ought to question, however, the utility of this obligatory requirement of form. The *SCPA* had a similar requirement, although this statute had an infinitely narrower scope of application. No doubt it was thought in the early part of this century that such a requirement would give the assurance of certainty, stability, and proof of a then exceptional and complex contract (the corporate trust deed securing bonds or debentures). Moreover, it extended the law of hypothecs to enable the creation of charges of the nature of hypothecs on all types of property, movable and immovable, corporeal and incorporeal, present and future. Perhaps most important of all, at that time, the normal form of deed for the creation of an ordinary hypothec (confined to a charge on immovable property) was by notarial act.

Today, circumstances are very different. In the modern economy the importance of land has diminished. A hypothec may be granted on any type of property whatsoever. It has replaced a variety of charges or grants of security interests that never required notarial form. With the enormous expansion of the field of hypothecs, most hypothecations today will not involve immovables. The level of activity on the financial markets for secured financings has also increased exponentially. The widely held issue of secured debt securities of the time of the *SCPA* represents only a fraction of such financings. In response, developments in the preparation of documents, their reproduction, their communication and their proof have revolutionized both legal and commercial practice. All this has been recognized in reform, which permits the hypothecation of movable property by any written instrument.¹²⁴ Apart from article 2692, notarial form is reserved only for the traditional field of hypothecs on immovable property. Moreover, article 2692, as noted earlier, addresses the characteristics of the

¹²³ It would reflect the observations made in Part VII.B., above.

¹²⁴ Art. 2696 C.C.Q.

issuer and the obligation secured. The *SCPA*, on the other hand, addressed essentially the nature of the property charged and the manner in which the charge is held. In article 2692, the exceptional domain of the notary has been preserved, but by reason of the quality of certain grantors and of the form of the obligation secured. No social, economic, or juridical utility is served by this rule.

To prepare a document in notarial form is now considered to be burdensome, time consuming, and expensive. It is the Quebec borrower who pays for this. Extending this requirement to the vastly enlarged field of the hypothecs contemplated by article 2692 places the Quebec enterprise at a disadvantage when compared to the requirements of other jurisdictions. It is submitted that the requirement that transactions embraced by article 2692 be in notarial form *en minute* ought to be removed.

In the alternative, the requirement should at least be restricted to the securing of issues of marketable securities to be offered to the public. This was the essential practical feature of the *SCPA* at the time of its adoption.

G. What is a "Fondé de pouvoir"?

The term "*fondé de pouvoir*" employed in article 2692 has not been a word of art under Quebec law. Perhaps, with reform, it is now a new term of art in the civil law legal lexicon. If, as the *Commentaires* state, "[c]et article est conforme au droit antérieur,"¹²⁵ the use of the term is merely to replace the term "fidéicommissaire", and in English, the term "trustee" of the *SCPA*. The term is now also used in article 3060 C.C.Q., which restricts the right of the registrar to discharge from registration hypothecs granted to secure bonds or titles of indebtedness. As noted earlier, it is also used in section 32 of the *SCPA* that prohibits a *fondé de pouvoir* from subscribing to an issue of the bonds or titles of indebtedness where he holds the hypothecs. To the knowledge of the author, it has not been used elsewhere. It would seem the draftsman of article 2692 sought a new term that was expressly generic in order to embrace anyone who acts as the representative of the creditors; a term which did not essentially embrace nor exclude the concept of mandate, or that of trust. An English-language equivalent term would simply be "representative". One might say this generic term was adopted to permit the law to adapt to the "innominate" relationships required for creative commercial practice.

The term "*fondé de pouvoir*" may identify a new form of representative who holds rights in or to property as a fiduciary. The C.C.Q. names a good number of other types of representative: the tutor,¹²⁶ the curator,¹²⁷ the trustee,¹²⁸ and the mandatary holding a general mandate¹²⁹ are some of the examples.¹³⁰ All must, subject to the

¹²⁵ *Supra* note 20.

¹²⁶ Art. 177 C.C.Q.

¹²⁷ Art. 258 C.C.Q.

¹²⁸ Art. 1260 C.C.Q.

¹²⁹ Art. 2130 C.C.Q.

terms of their appointment, follow the rules for the administration of property of others.¹³¹ These rules are suppletive in nature and apply save to the extent that “another form of administration applies under the law or the constituting act, or due to circumstances,”¹³² exception being made for the principles of public order. Thus, the *fondé de pouvoir* can be a representative of the creditors whose powers and duties are strictly determined by the contract of his appointment. It would be a contract *sui generis* similar, or at least parallel, to the corporate trust deed drafted under the *SCPA*. As Rinfret J. (as he then was) stated when characterizing the rights of the trustee under a corporate trust deed qualified under the *SCPA*: “[C]’est le contrat, et non le statut, qui doit déterminer la nature des relations de la faillie, du fiduciaire et des porteurs d’obligations.”¹³³

Where the *fondé de pouvoir* is neither a mandatary nor a trustee, what basic characteristics should he have? His rights (powers) and obligations will be strictly defined by the contract, as was the case under the *SCPA*. He will be the holder of the hypothecs, of course, and will have all powers necessary to exercise the rights that attach to hypothecs.

With respect to other characteristics, it is appropriate to examine his position in contrast to that of the trustee and the mandatary. Thus, as regards the trustee, the *fondé de pouvoir* who is not also a trustee would be a fiduciary subject to the rules for the administration of property of others, but free of the qualifications for Quebec trustees.¹³⁴ If a legal person, it need not be a Quebec licenced and qualified trust company.¹³⁵ If the *fondé de pouvoir* is also a creditor (the provisions of section 32 of the *SCPA* having been waived), the need for an independent trustee will not apply.¹³⁶ The *fondé de pouvoir* will have the administrative duties and powers that are settled upon it by the contract.

The hypothecs the *fondé de pouvoir* holds will probably remain a part of the patrimony of the collective holders of the titles of indebtedness, the creditors he represents. They would run with their claims, their titles of indebtedness. The question of which patrimony held the hypothecs did not seem to present a practical problem under the *SCPA*, as it was never the subject of any of the more than one hundred reported judgements. However, the creditor’s rights and the *fondé de pouvoir*’s powers and his obligation to take proceedings in the exercise of the hypothecs he holds would be regulated by the act of his appointment. The traditional act of this kind—the corpo-

¹³⁰ Those found in the C.C.Q. were listed at *supra* note 46.

¹³¹ Arts. 1299ff. C.C.Q.

¹³² Art. 1299 C.C.Q.

¹³³ *Liberté*, *supra* note 23 at 15. See also *Perron v. L’Eclaireur (Léé)* (1933), 57 B.R. 445 (K.B.); and *Quebec Productions Corporation v. Lavigne*, [1972] C.A. 172, online: QL (AQ).

¹³⁴ This construction of our law would bring it into line with the common law and its doctrine of constructive trust or resulting trust, which may apply in other jurisdictions in parallel circumstances: see *Waters*, *supra* note 78 at 277.

¹³⁵ Art. 1274 C.C.Q.

¹³⁶ Art. 1275 C.C.Q.

rate trust deed—normally reserves to the creditors some deferred right to take suit. Under the *SCPA*, the trustee's right to take proceedings was always upheld where the other requirements of the Act were complied with.¹³⁷ This suggests that any property right in the hypothecs remains in the patrimony of the creditors.

How would the rules governing a mandatary under a mandate compare with those governing a *fondé de pouvoir* who is not a mandatary? Generally, he would be a *prête-nom*, whose principals are not known to the public.¹³⁸ They may or may not be known to the borrower-issuer. His obligations to supervise the security, to monitor the performance of the borrower-issuer, to report and to act and take suit in the event of default, can all be regulated by the contract. This was the case with the corporate trust deed governed by the *SCPA*. It continues to be the case for the thousands of corporate trust deeds still outstanding. The process of reform has not changed this relationship.

The contract governing the *fondé de pouvoir* could also regulate and substantially restrict the extent of the responsibility of the creditors for the actions of their representative to a degree that may not be possible if the *fondé de pouvoir* were an ordinary mandatary. Such regulation was the normal practice in corporate trust deeds written under the *SCPA*. In public issues of titles of indebtedness, the title holder would not accept that the *fondé de pouvoir* is his mandatary. He would not accept that he is responsible for the acts of the *fondé de pouvoir*,¹³⁹ must indemnify him,¹⁴⁰ cover his expenses,¹⁴¹ pay interest on his advances,¹⁴² or be liable to third parties for damages caused by him.¹⁴³ The issuer and the *fondé de pouvoir* would also not accept that the death or bankruptcy of the title holder ends the relationship.¹⁴⁴

H. Who May be a Fondé de pouvoir?

Who should be empowered to hold hypothecs on behalf of the creditors of the obligation secured? Article 2692 does not address the question. Neither the C.C.Q. nor the pre-reform *SCPA* places any restriction or requirements on the person who is to act as the *fondé de pouvoir*. Under the *SCPA*, an individual occasionally acted as the trustee.¹⁴⁵ Thus, any person may act as a *fondé de pouvoir*. The individual may so act. So may the duly authorized legal person unless the rights granted in favour of the *fondé de pouvoir* create an express trust. If a trust is created, the trustee must be an in-

¹³⁷ See Laliberté, *supra* note 23 at 14; and "Corporate Trust Deed", *supra* note 6 at 808.

¹³⁸ Art. 2157 C.C.Q.

¹³⁹ Art. 2152 C.C.Q.

¹⁴⁰ Art. 2154 C.C.Q.

¹⁴¹ Art. 2150 C.C.Q.

¹⁴² Art. 2151 C.C.Q.

¹⁴³ Art. 2160 C.C.Q.

¹⁴⁴ Art. 2175 C.C.Q.

¹⁴⁵ Zoltom, *supra* note 23. The fact that the defendant, Rodgers, who acted as trustee was a Quebec resident was considered, but the fact that Rodgers was also an individual was not raised in the Court of Appeal decision.

dividual or a trust company licensed to do business in Quebec.¹⁴⁶ Moreover, as noted above, if the *fondé de pouvoir* is also one of the creditors and a trust is created, there must be an independent trustee.¹⁴⁷

Apart from section 32 of the *SCPA*, which was examined earlier, there is nothing in article 2692, nor in Quebec law generally, that prohibits one of the creditors of the obligation secured from acting as the *fondé de pouvoir*, holder of the hypothecs, for the benefit of all the creditors.

VIII. Suggested Modified Text for Article 2692

The questions reviewed in this study are of great concern to the lawyer practising financial law in Quebec. The interpretation and possible construction of the part of the law reflected in this study is an attempt to examine how the practicing lawyer would expect article 2692 to be applied, given the drafting of the provision and a basic understanding of the objectives or at least the thrust of the reforms as expressed in the Title of the C.C.Q. on hypothecs and the *Commentaires* of the Minister of Justice.

Perhaps, over time, the courts could arrive at similar conclusions and answer the questions posed in this study in the same way. Unfortunately, the modern practice of law is likely to preclude reconstruction of article 2692 by the courts in this manner within any reasonable period of time. Today, in every major secured financing involving one of the transactions described earlier, instructed counsel for both the borrower and the lead-lender are expected to give a categorical, non-interpretative, written opinion that the transaction itself and the security for it are valid and enforceable in accordance with their terms. Lenders will generally not accept "reasoned" opinions. If counsel cannot give the required opinion and cannot find a reasonable alternative form of structure at reasonable cost, the transaction will not be concluded. If the financing contemplated is important to the borrower, and if the North American financial markets are prepared to provide it, the borrower will be obliged to complete it in another jurisdiction. He may charge his Quebec property (often channelled into a subsidiary) merely to secure a guaranty supporting the foreign transaction. This is in fact happening repeatedly today because of the uncertainty created by this area of the law in Quebec.

One solution would be to have the Quebec National Assembly simply repeal article 2692. It adds nothing of a positive nature to the protection of the rights of creditors, both secured and unsecured, nor more generally to the law of hypothecs. The argument that one can still separate the holder of the hypothec from the holder of the obligation secured by invoking the law of trusts or the law of mandate is almost unsailable. Even with the repeal of the relevant enabling provisions of the *SCPA*, all authorities agree it was not the intention of the reform process to throw out practices that Quebec borrowers and secured lenders have enjoyed for more than the last cen-

¹⁴⁶ Art. 1274 C.C.Q.

¹⁴⁷ Art. 1275 C.C.Q.

ture. Moreover, where such practices, and the related secured banking practices, have become commonplace throughout the North American financial markets and are essential to permit borrowers to participate in such markets, it cannot be the intention of the reform process to deny Quebec borrowers access to such markets.

Mere repeal of article 2692, however, would leave a climate of uncertainty as to the status of the corporate trust deed. It would create further uncertainty as to the rights of the Quebec secured creditor in many of the transactions. This uncertainty would leave the Quebec borrower in an inferior position. This has been noted repeatedly in this study in relation to almost all of the questions that have been examined.

The most appropriate solution is to have the Quebec National Assembly recast the basic provisions of article 2692 in positive and declaratory form,¹⁴⁸ and to do so with words that are reasonably open in their meaning, while preserving the principles of Quebec civil law as now expanded and reflected by reform. The following text endeavours to do this:

2692. L'hypothèque peut être détenue par un fiduciaire, un mandataire ou autre fondé de pouvoir des créanciers de l'obligation garantie. Les règles d'administration du bien d'autrui s'appliquent au détenteur de titre d'hypothèque.

2692. A hypothec may be held by a trustee, a mandatary or other representative of the creditors of the obligation secured. The rules for the administration of the property of others shall apply to the holder of such hypothec.

L'hypothèque peut être consentie pour garantir le paiement des obligations ou autres titres d'emprunt émis par la personne qui exploite une entreprise, une personne morale, le fiduciaire ou la société en commandite, sous réserve des restrictions imposées par la loi ou de l'acte constitutif.

A hypothec may also be granted to secure bonds or other titles of indebtedness issued by a person who carries on an enterprise, a legal person, a trustee or a limited partnership, subject to such restrictions as may be imposed by law or by the constituting act.

It is the author's opinion that such a provision, combined with the repeal of section 32 of the *SCPA*, would solve the vast majority of the problems and questions of uncertainty raised in this study. The first paragraph of the proposed article 2692 is in positive and permissive form. It declares that the law will recognise that a hypothec may be held by the representative of the creditor secured. Replacing the verb "granted" with "held" would expand the scope of the declaration. Reference to the rules for the administration of the property of others is made to affirm how Quebec law will treat such a holding of a hypothec, and also assure greater clarity. It reflects a practice found repeatedly in the C.C.Q.¹⁴⁹ It retains the expression *fondé de pouvoir* (in

¹⁴⁸ Coté, *supra* note 34 at 491, 498.

¹⁴⁹ *Supra* note 46.

English, “representative”) but adds the terms “trustee” and “mandatary”. The provision then admits of the interpretation that each of the three may have separate attributes. The mention of all three would be entirely consistent with the principles of reform, and indeed, with the text of the existing article 2692.

The second paragraph is in the same form. It declares expressly that bonds or other titles of indebtedness may be secured by hypothec and also affirms who may issue them. Because of its subject matter, it would probably be more appropriate to combine it with article 2687 C.C.Q. or possibly with the second paragraph of article 2688 C.C.Q., rather than include it as part of a revised article 2692. The suggested paragraph could be readily recast to encompass this idea.

The list of those who might reasonably issue bonds or titles of indebtedness is useful as it clarifies the scope of the law. The term “legal person” is unqualified. It is unnecessary to qualify the term “legal person” by reference to the need for “authorization” or “capacity”. As noted, the reform amendments brought to sections 27 and 34 of the *SCPA*, which enable non-commercial and non-share capital corporations to obtain such capacity in certain circumstances, stand alone. As specific statutory enactments, they would override any general enactment.¹⁵⁰ Thus, the reference without qualification to “legal persons” in the proposed article 2692 will not eliminate the need for such qualification in cases where none exists.

However, if the legislature were to conclude that the need for some qualification should still be expressed, one could add after the words “legal person” the phrase “having the capacity to do so by law,” and in French “ayant la capacité à le faire en vertu de la loi.” Note the word to be employed should be “capacity” rather than “authorized”. This term would mesh better with the intent of the amendments to the *SCPA*.

In the second paragraph, the phrase “bonds or other titles of indebtedness” has been retained. If the provision is drafted in permissive and enabling form, the phrase seems adequate without further definition. Note also that it defines those who are embraced by the provision and who might issue such titles. This would not prohibit the individual who is not an entrepreneur from granting a hypothec to secure his surety “bond”, etc.

Today, hypothecs which invoke the application of article 2692 should not be required to be in notarial form *en minute*. Such a requirement is a departure from the requirements of form for the modern hypothec on movables and seems to serve no legitimate legislative objective. It is truly an impediment to the ability of the Quebec entrepreneur to compete for secured financing on reasonable terms. It greatly impedes his flexibility. If, however, some concession to the traditional prerogative of the notary as reflected in the *SCPA* is still required, the provision could contain a further paragraph that would read as follows:

¹⁵⁰ *Doré*, *supra* note 20. See also the discussion at *supra* note 28.

L'hypothèque consentie pour garantir le paiement des obligations ou autres titres d'emprunt à être émis au public, doit, sous peine de nullité absolue, être constituée par acte notarié en minute.

A hypothec granted to secure bonds or other titles of indebtedness prepared to be sold to the public shall, on pain of absolute nullity, be granted by notarial act *en minute*.

Finally, as examined earlier, section 32 of the *SCPA* should now be repealed. To expressly prohibit the *fondé de pouvoir* from acquiring the bonds or titles of indebtedness at the time of their first issue is no longer necessary. This blunt and clumsy prohibition has now been superseded by the adoption into Quebec law of more comprehensive provisions respecting conflicts of interest. Such repeal is not merely to tidy up a redundant provision of law. Such general prohibition interferes seriously with the normal practices employed in North American syndicated credit transactions; practices that are disclosed to all the parties to such agreements, are regulated by the agreement to their satisfaction, and are acceptable to them.

Conclusion

It took almost seventy-five years after the adoption of the *SCPA*¹⁵¹ to arrive at a reasonable understanding of its terms and its operation within the civil law. Moreover, and most important, the *SCPA* was an exceptional statute designed to enable and sanction certain transactions where the hypothecs securing an obligation were held by one, while the secured obligation was held by another. If it was complied with, the courts were obliged to uphold the contract. Any disputes were confined to the characterization, meaning, and effects of the special regime created by the *SCPA*. With reform, the enabling statute, the sanction, is gone. Reform did, however, incorporate all the exceptional principles found in the *SCPA* as general principles of the civil law. The special devices permitting a charge on any type of property, both present and future, permitting a floating charge, and authorizing the special remedies of entry, possession, and private sale are now available to any secured creditor of an enterprise. It is submitted that under reform, the separation of the holding of a hypothec from the holder of the secured obligation is permitted, even if article 2692 did not exist, as long as the fundamental principle that the hypothec remains an accessory of the secured obligation is maintained.

Although analysis of the C.C.Q. fully supports this conclusion, the only provision of the C.C.Q. that deals expressly with the separation of the holder of the hypothec from the holder of the secured obligation is article 2692. It is not in declarative or enabling form, but in imperative and penal form. Whatever it means, it is a rule of exception and must, on pain of nullity, be strictly complied with. For the courts to read it as expressing the positive enabling principles of law that reform intended would re-

¹⁵¹ Originally enacted by S.Q. 1914, c. 51 as an addition to *The Quebec Companies Act*, R.S.Q. 1909, Title 11, c. 3, ss. 2ff.

quire a radical reconstruction of its text. It seems likely that any legal tests and interpretation of article 2692 in the courts will be directed to determining whether the impugned contract grants a valid security interest or that the security interest is "absolutely null" rather than interpreting the meaning of the legislation.

Moreover, the language employed in many of the separate judicial facts or elements identified by article 2692 is vague and ambiguous when employed in the context of an imperative and penal provision. Cautious counsel will usually conclude that when a transaction is likely to engage the application of the provision, its prescriptions be rigidly complied with. In the alternative, the transaction will be structured, if possible, so that there is no chance that article 2692 would be invoked by it. The provision itself could be interpreted to permit essentially only the form of corporate trust financing that we have known for nearly one hundred and thirty years and that was sanctioned by the *SCPA*. Unfortunately, however, the language employed in article 2692 could also be interpreted to embrace many other types of transactions involving the financing of an enterprise. Because of its imperative and penal form, the existence of article 2692 is likely to impede a good number of transactions that it was not intended to embrace.

In the past thirty years, the world of corporate finance has evolved a great deal. As the markets for world trade have opened, the markets and the availability of financing have also opened. They are much more flexible than before. New financial products are being developed every day. Credit is more available to the entrepreneur than ever before. It has become an essential tool for his growth. Co-extensive with these developments, and perhaps because of them, there are now new controls on financial institutions which impose standards respecting capital adequacy, liquidity, and risk assessment. To comply with these controls, major loans are syndicated among a number of lenders, only one of which holds the security for the benefit of all. However, the bulk of the security that is expected to be given for such an extension of credit is most frequently to be found in a particular jurisdiction. Much of it, and particularly accounts receivable, is often located in the jurisdiction of the principal office of the borrower. Interests in the underlying security in any tangible property tend to be dealt with in the same place. If the Quebec entrepreneur expects to participate fully in the benefits made available by world markets, he must be able to get the financing required and be able to give the security required. Article 2692 presents a real impediment to these expectations of the Quebec entrepreneur.

A provision of the C.C.Q. that addresses the same subject matter, but in positive and enabling form, is desirable. Such a provision would identify the basic elements of the transactions it contemplates and declare how the law will respond when certain of them come together. It should enable such transactions to take place. Article 2692 should be replaced with such a text.
