

**Louis Belle-Isle Lumber Inc. v. Craft Finance Corp.
and Fernhill Homes Ltd. et al.¹**

by Jonathan Cbait *

The relative rights of building suppliers, contractors, and "mortgage" creditors who contribute to and make possible construction of buildings has been a subject of controversy and of considerable legal difficulty. In recent years in the construction industry, there has been more and more of interim financing by way of "mortgage" loans registered against buildings in the course of their construction. At the same time, suppliers and contractors have furnished merchandise or done work partly before and partly after the date of registration of the mortgage loan deed. The "mortgage" creditor, supplier and contractor all have real rights against the property being built. In addition the "mortgage" deed will usually contain a *dation-en-paiement* (giving-in-payment) clause, which purportedly permits the "mortgage" creditor in case of a default on the part of the debtor (builder or owner, as the case may be) to take title to the property with effect retroactive to the date of the registration of the deed of loan, free and clear of all encumbrances subsequently registered, including the privileged rights of suppliers and contractors. A recent decision of the Quebec Court of Appeal, *Louis Belle-Isle Lumber Inc. v. Craft Finance Corp. and Fernhill Homes Ltd.*,² has to a large extent clarified the position and the rights of the various parties involved in this conflict of interests.

The facts of this case may be briefly related. On or about February 1, 1963, the Plaintiff, Louis Belle-Isle Lumber Inc., entered into a verbal contract with the Defendant, Fernhill Homes Ltd., for the supply of lumber for fourteen duplexes to be constructed on land owned by the Defendant. The lumber was supplied on various dates from February 22, 1963, to March 29, 1963, inclusive.

By Deed of Loan registered on March 26, 1963, the Intervenant, Craft Finance Corp., loaned the Defendant the sum of \$105,000.00. To secure the payment of this loan, the properties in the course of construction and in which Plaintiff's lumber was incorporated were hypothecated.

¹ Q.B., Montreal, No. 8647, Aug. 16, 1965.

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² See *supra*. This case has been appealed to the Supreme Court of Canada.

On May 17, 1963, Louis Belle-Isle Lumber Inc. registered a supplier's privilege against the properties hypothecated in favor of Craft Finance Corp. On June 14, 1963, Fernhill Homes Limited was adjudged bankrupt.

The Deed of Loan contained the usual *dation-en-paiement* clause stipulating that in the event of a default on the part of the debtor, Craft Finance Corp. would have the right to become the absolute owner of the properties, free and clear of all encumbrances, charges, and privileges registered subsequent to the date of registration of the deed of loan.

Following a default on the part of Fernhill Homes Ltd., Craft Finance Corp. instituted an action to be declared owner of the properties hypothecated. Judgment was rendered on July 11, 1963, declaring Craft Finance Corp. the owner of the properties hypothecated with effect retroactive to March 26, 1963, the date of registration of the deed of loan.

On June 17, 1963, Plaintiff instituted action to have its privilege declared good and valid. On August 20, 1963, Craft Finance intervened in the action invoking their ownership and asked that the privilege be cancelled and radiated in pursuance of their *dation-en-paiement* clause.

The Intervenant contended that because the privilege was registered subsequent to the deed of loan, it was rendered null and void by the operation of the *dation-en-paiement* clause and should be radiated. Plaintiff's reply to this contention was that the privilege was born prior to the registration of the deed of loan on the date of the commencement of the deliveries of the lumber.

The Court had to determine whether or not the Plaintiff's right of privilege had been affected in any way by the operation of the *dation-en-paiement* clause. In order to determine this question, it was first necessary for the Court to determine the date of birth of the privilege.

An examination of the relevant articles of the Civil Code reveals an apparent contradiction on the question of the effective date of birth of a privilege.

Article 2013 states that:—

"The workman, supplier of materials, builder and architect have a privilege and a right of preference over all the other creditors on the immovable, but only upon the additional value given to such immovable by the work done or by the materials."

Article 2013e reads as follows:—

"The supplier of materials has a privilege on the immovable in the construction of which the materials supplied to the proprietor or builder have

been used, or for the construction of which they have been specially prepared. However, in the case where the supplier of materials contracts with the proprietor himself, such privilege is conserved only by registration, before the expiration of thirty days after the end of the work, of a notice containing:

.....”
 Article 2103 states that:—

“The privilege of every person, except the workmen, mentioned in article 2013, is created and preserved by the registration within the proper delay at the registry office of the division in which the immoveable is situated, of a notice, drawn up in the form of an affidavit of the creditor or his representative, sworn to before a justice of the peace, a commissioner of the Superior Court, or a notary, setting forth the name, occupation and residence of the creditor, the nature and amount of his claim, and the cadastral number of the immoveable so affected.

.....”
 Article 2103 appears to say that the registration *creates* and *preserves* the privilege, whereas 2013 C.C. and 2013e C.C. refer to *conservation* of the privilege by registration. In the Superior Court, Bertrand, J., basing himself on Art. 2103, dismissed the Plaintiff's action on the ground that the right of privilege arose subsequent to the registration of the anterior Deed of Loan and was consequently extinguished by the exercise of the *dation-en-paiement* clause.

The Court of Appeal was of a contrary view, holding that registration does not give birth to the privilege, but rather protects and conserves it. Montgomery, J.,³ stated that Article 2103 must be read together with Articles 2013 and 2013e. Article 2103 merely sets out the formalities to be observed in order to render enforceable the privilege. This would seem to be the most reasonable interpretation because in order to conserve a privilege by registration it must exist prior to the registration. Article 2013e precludes the notion which seems to be implied in Art. 2103 C.C., that registration gives rise to the right of privilege.⁴ Registration rather protects and conserves it.

Extensive jurisprudence⁵ supports the proposition of Giroux⁶ that a privilege is born without formalities.

³ At page 6 of his notes.

⁴ This question is discussed at some length in *Nadon Brick and Stone Ltd. v. H. Brummer Construction Co. Ltd. et al*, C.S., Montreal, No. 613, 137, March 26, 1965 (André Sabourin, J.) at page 3.

⁵ See *Vachon v. Bigras*, (1927) 33 R.L. n.s. 168; *Munn and Shea Limited v. Hogue Limitée and Davis*, 44 B.R. 198, [1928] S.C.R. 398; *Gadbois v. Stinson-Reeb Builders Supply Company*, [1929] S.C.R. 587 at 596; *Kirallah v. Gagnon*, 61 B.R. 264 at 280; *La Perrelle Lumber Co. Ltd. v. Langlois et Lizotte*, 77 C.S. 1; *Pagé v. Beach Construction Co. Ltd.*, [1953] C.S. 284.

⁶ Geo.-M. Giroux, *Le Privilège Ouvrier* (1933), No. 314, 315, 320 and 322.

The next question was to determine the exact date when the privilege was born. The leading case on the subject is *Munn and Shea Limited v. Hogue Limitée* and *Davis*.⁷ An action was instituted by the Respondent, Hogue Limitée, a supplier of materials against the Defendant, Davis, on a privilege affecting lots owned by Davis. Before the hearing, Appellant, Munn and Shea Limited, intervened in the case and prayed for the dismissal of the action, on the basis that it became owner of the immoveables before the privilege was registered. The Court of Appeal's ruling⁸ that the privileged rights of the supplier commenced from the date of the delivery of the materials was confirmed by a unanimous judgment of the Supreme Court.⁹

Another view is that the privilege originates with the contract and first delivery of the merchandise or the commencement of work by the contractor.¹⁰

The delivery of the materials had begun prior to the registration of the Deed of Loan, but a number of deliveries were made after this date. The Court was thus faced with the problem of determining whether the privilege for materials supplied or work done after the registration of the Deed of Loan was subordinate to the *dation-en-paiement* clause in the Mortgage Deed and was subject to cancellation and radiation in the event of implementation of this clause. The Court held that the privilege subsisted even as to materials supplied *after* the registration of the Deed of Loan.

It would, it is submitted, have been unreasonable to hold otherwise. The Plaintiff, before making its first delivery, searched the title at the Registry Office and found that it was free and clear. No mortgage deed or balance of sale with a resolatory clause had been registered against the properties. Then it began to deliver the materials in execution of its contract. Surely the law does not require that the supplier, before each subsequent delivery, should visit the Registry Office in order to ascertain whether the owner had dealt with the property in such a manner so as to prejudice his rights. If the Court had decided otherwise, it would have put the supplier in the almost impossible position of not being able to go ahead with the contract unless he made searches at the Registry

⁷ [1928] S.C.R. 398.

⁸ (1928) 44 B.R. 198.

⁹ [1928] S.C.R. 398.

¹⁰ *Nadon Brick and Stone Ltd. v. H. Brummer Construction Co. Ltd.* et al, cited at note 4, *supra*; *Clairment Delisle Inc. v. I. & S. Construction Corp.*, et al, C.S., Montreal, No. 609, 512, May 21, 1965, (André Nadeau, J.) at p. 4.

Office prior to each delivery. In the case of a contractor, it would require daily searches at the Registry Office since the contractor incorporates work daily on the immoveables as it executes its contract.

The position of the mortgage creditor is different, however. He sees what is actually going on by way of construction on the property which he takes as security for his loan. It would then be a simple matter for him to find out who is supplying materials or working on the property and to take the necessary precautions to protect his rights, such as securing renunciations of privilege or proper waivers of priority or ensuring payment to such contractors and suppliers.

It follows, then, that a supplier or contractor who assures himself that there is no registration which would defeat his right of privilege is justified in proceeding to execute his contract, without fear of having his privilege radiated by the operation of a *dation-en-paiement* clause. This judgment accordingly clarifies satisfactorily the rights of the mortgage creditor, supplier, and contractor, and indicates what steps each should take to ensure the preservation of his rights.