

Sureties

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The Supreme Court of Canada broadens the application of movable hypothecs with delivery

By Christian Trépanier

On June 5, 2003, the Supreme Court of Canada handed down a decision¹ on a dispute between the Caisse Populaire Desjardins de Val Brilliant (the “Caisse”) and the trustee of a couple of annuitants. The Caisse was appealing a decision rendered January 22, 2001 by the Court of Appeal of Québec, which allowed the appeal of the Superior Court decision.

In this case, two annuitants had deposited money in a registered retirement savings plan (RRSP) they had with Fiducie Desjardins. The amounts held by the Caisse were evidenced by deposit certificates. Some time later, the two annuitants wanted to withdraw the money previously invested in their RRSPs, but the deposit certificates could not be redeemed before maturity. They reached an agreement with the Caisse that a loan be granted to them and that they then grant their creditor a movable hypothec with delivery as security against the debt they contracted with Fiducie Desjardins, namely the amounts held in their RRSPs.

To create the hypothec, the Caisse received the deposit certificates from the two annuitants and notified the RRSP trustee, Fiducie Desjardins, that hypothecs had been granted in its favour. The trustee accepted these hypothecs.

Before reimbursing the Caisse loans, the annuitants made an assignment for the benefit of their creditors. In accordance with the granted hypothecs, the Caisse filled out the RRSP withdrawal forms and Fiducie Desjardins handed to the Caisse the amounts the annuitants had deposited in the RRSPs, minus tax withholdings.

The annuitants’ trustee dismissed the proof of claim filed by the Caisse in its capacity as secured creditor, contesting the validity of the movable hypothecs with delivery (pledge) the debtors had granted earlier. Generally speaking, the trustee claimed that the *Income Tax Act* prohibited the use of amounts held in RRSPs as surety and, subsidiarily, that the *Civil Code of Québec* did not authorize use of movable hypothecs with delivery (pledge) on claims represented by non-negotiable instruments.

The Superior Court ruled in favour of the Caisse, but the Court of Appeal, in a unanimous decision, reversed the first judgment and ruled that the hypothecs held by the Caisse were invalid.

The Court of Appeal reached this decision by declaring that the legislative provisions of the *Income Tax Act*,² as amended, governing the RRSPs³ prohibit any property held under a registered retirement savings plan from being pledged, assigned or in any way alienated as security for a loan. The Court of

Appeal characterized the RRSPs administrated by Fiducie Desjardins as “depository” and not “fiduciary” in nature from a fiscal point of view. In the alternative, the Court of Appeal also concluded that a movable hypothec with delivery (pledge), as defined in the *Civil Code of Québec*, could only be granted in connection with claims evidenced by negotiable instruments. Here the annuitants had granted a movable hypothec with delivery in connection with a claim they had to Fiducie Desjardins for amounts deposited in their RRSPs. This claim was evidenced by a non-negotiable deposit certificate payable on maturity. The Court of Appeal therefore declared that the hypothecs held by the Caisse were invalid and could not be set up against the trustee.

The Supreme Court dismissed the Court of Appeal of Québec’s position that the *Income Tax Act* prohibits any property held under a registered retirement savings plan from being pledged, assigned or in any way alienated as security for a loan. The Court unanimously concluded that, from a tax perspective, the RRSPs administrated by Fiducie Desjardins was “depository” and not “fiduciary” in nature. The *Income Tax Act* does not prohibit amounts held in this type of RRSP from being pledged. Quite the contrary, the Court mentions that the *Income Tax Act* provides for the tax consequences of such a security. The Court also affirms that the rules of tax law cannot be used to determine the validity of the hypothec, which must be based on civil law.

With a majority of four against three, the Supreme Court went on to conclude that the *Civil Code of Québec* allows debtors to grant movable hypothecs with delivery (pledge) in connection with claims evidenced by non-negotiable instruments. Limiting such hypothecs solely to claims evidenced by negotiable instruments would go against the will of the legislator, who did not deem such restrictions necessary. However, to validly grant and publish a movable hypothec with delivery in connection with a claim evidenced by a non-negotiable instrument, the debtor must hand the creditor control over the claim by granting it the right to obtain payment directly in the event of default without further consent from the debtors. Additionally, whenever physically possible, this type of claim must be remitted to the creditor. Finally, in order that a hypothec may be set up against the debtor of the assigned claim, those provisions set out in the *Civil Code of Québec* dealing with assignments of claim must be met. And all of these requirements having been met by the Caisse, i.e. the deposit certificates had been put in possession, the Caisse had been authorized to obtain payment of the claim directly in the event of a default and, lastly, Fiducie Desjardins had accepted the debtors’ hypothec in connection with the assigned claim, the Supreme Court allowed the Caisse’s appeal, declaring the hypothecs validly granted and published.

This decision is of considerable importance to the business community for two reasons. First, it allows financial institutions to use monies deposited in a registered retirement savings plan as security. This decision has possibly opened the door to the granting of other types of claims evidenced by non-negotiable instrument as security for loans. These might include promissory notes, acknowledgements of debt or contract balances. Moreover, this Supreme Court decision allows any individual not running a business to grant a movable hypothec with delivery (pledge) in connection with claims, whether they are evidenced by negotiable or non-negotiable instruments. This conclusion, which gives the opportunity of offering claims not represented by negotiable instruments as security, puts an end to the debate that has been raging among Quebec authors specializing in sureties and hypothecs.

Christian Trépanier often represents insurers, insurance brokers, professionals, manufacturers and distributors before the courts. Mr Trépanier specializes in civil and commercial litigation, with a particular focus on insurance and civil liability. Within the course of his practice, he is regularly called upon to plead before all types of courts. It was in just such a case that, last June 5, the Supreme Court of Canada ruled in favour of the Caisse Populaire Desjardins de Val-Brillant, whom Mr Trépanier was representing along with P.-Michel Bouchard, also with Fasken Martineau.

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- 1) 2003 CSC 31; <http://www.canlii.org/ca/cas/scc/2003/2003scc31.html>
 - 2) R.S.C. 1985, 5th Suppl., c. 1;
 - 3) Specifically section 146.