

MOVABLE HYPOTHEC ON MONETARY CLAIMS: NEW SECURITY UNDER THE CIVIL CODE FOR CASH COLLATERAL



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MONETARY CLAIMS¹

Highlights

- A monetary claim is a concept in force since January 1, 2016.
- A monetary claim is a claim for a payment solely in money.
- A monetary claim is owed to the debtor by his creditor or a third party.
- A hypothec on a monetary claim assures a creditor first rank, whatever the date of his hypothec on that claim.
- A hypothec on a monetary claim is an undisclosed security that does not require publication in the Register of Personal and Movable Real Rights (RPMRR).
- A number of situations lead creditors to obtain a hypothec on a monetary claim, for example:
 - a banker on the credit balance he owes his borrower;
 - a supplier for volume discounts and other rebates he owes his client;
 - a joint-stock corporation for dividends it must pay its stockholder.

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Since January 1, 2016², the *Civil Code of Québec* (“CCQ”) has included new provisions regarding monetary claims.

A. Introduction

Before the introduction of provisions concerning monetary claims, the amounts paid by a debtor to his creditor could not be simply retained by the creditor as security. The only way for the creditor to protect himself was to obtain from his debtor a movable hypothec without delivery, which charged the claim that the creditor owed the debtor based on the amounts that had been paid to him by the debtor. In other words, the creditor had to obtain a movable hypothec without delivery on the claim he himself owed his debtor. In all cases, the rank of this movable hypothec without delivery was determined by its publication date in the Register of Personal and Movable Real Rights (“RPMRR”) and accordingly subject to all other movable hypothecs without delivery already granted by the debtor on this same claim.

Furthermore, it has always been possible to hypothecate a claim by way of a movable hypothec with delivery, but before January 1, 2016, the claims likely to be hypothecated with delivery were those evidenced by a title whose physical delivery to the creditor would be sufficient to constitute a pledge³. Creation of the pledge by physical delivery of the title avoids the movable hypothec agreement in writing, as well as waiving the creditor from having to publish his hypothecary creditor rights in the RPMRR, the physical possession of the title being equivalent to the publication measures required by the CCQ. Pledging a claim evidenced by a title delivered to the creditor has never been a common practice.

Creditor problems in easily obtaining a security for the amounts paid to them by their debtor, i.e. the amounts that the creditor himself owes his debtor, has occasioned changes in the CCQ by the introduction of a new concept that did not previously exist in Québec law, the monetary claim.

B. US system

The reform of the CCQ with respect to monetary claims based on US law which provides a similar security but is limited to balances in bank accounts. The Québec reform is more innovative than the US system because most of the amounts of money owed by a creditor to his debtor can be considered a monetary claim that can be subject to a movable hypothec with delivery. Because of the definition given to the monetary claim, the situations in which a creditor may take advantage of this form of security are much more numerous and varied than under US law.

C. Definition of monetary claim

A monetary claim is a claim requiring the debtor to reimburse, return or restore an amount of money or make any other payment in respect of an amount of money⁴.

A monetary claim can be defined as a claim that belongs to the debtor and is payable to him by way of a sum of money from:

- a) his creditor; or

² Art. 2713.1 to 2713.9 CCQ

³ Art. 2702 and 2709 CCQ

⁴ Only claims payable by an amount of money are considered. A claim that is not payable by a sum of money cannot be a monetary claim.

- b) a third party:
 - (i) because of a credit balance in a financial account maintained by the debtor with this third party, or
 - (ii) because of a sum of money paid and delivered by the debtor to this third party to guarantee an obligation of the debtor to one of his creditors.

The concept of monetary claim implies either a two-party or three-party relationship. In the first case, there must be a debtor and a creditor in a bilateral relationship and in the second, there must be a debtor, his creditor and a third party in a tripartite relationship.

D. Exclusions from the definition of the monetary claim

The very broad definition of monetary claims in the CCQ nevertheless lists (3) types of claims that are expressly excluded from the regime applicable to monetary claims⁵. The following are not monetary claims:

- a) amounts in a certain and determinate currency delivered by the debtor to the creditor, when the agreement between the parties provides that its repayment by the creditor to the debtor must be in the same currency;
- b) a claim that is a security or an security entitlement according to the provisions of the *Act respecting the transfer of securities and the establishment of security entitlements*⁶; and
- c) A claim represented by a negotiable instrument is not a monetary claim. For example, a promissory note governed by the *Bills of Exchange Act*⁷ is an instrument that is not a security⁸ nor is it a monetary claim pursuant to the CCQ. A claim created by a promissory note can be hypothecated without delivery like any other claim and it can also be hypothecated with delivery because it qualifies for the purposes of articles 2702 and 2709 CCQ. The fundamental difference between a pledge of a claim established by an instrument like a promissory note and the pledge of a monetary claim is the rank of the creditor's security. The pledge of a claim established by an instrument like a promissory note ranks from the time the note is delivered to the creditor⁹ and it remains subject to all the other movable hypothecs without delivery published at that date in the RPMMR and charging the same claim.

Without having been specifically excluded from monetary claims, a claim for rent payable pursuant to a property lease cannot be a monetary claim. The CCQ provides that the rent generated by an immovable property can be hypothecated only by way of an immovable

⁵ Art. 2713.1 CCQ

⁶ *Act respecting the transfer of securities and the establishment of security entitlements*, CQLR, c.T-11.002. (hereinafter "ATS")

⁷ *Bills of Exchange Act*, L.R.C. (1985), c. B-4.

⁸ Section 15 A.S.T. provides that while a promissory note is not a security, it may nevertheless be a financial asset.

⁹ The CCQ however provides a "phantom pledge" for a period of ten (10) days under the conditions provided in Article 2708 CCQ

hypothec¹⁰. Accordingly, if the CCQ requires an immovable hypothec, a movable hypothec cannot be considered for the rent generated by an immovable property.

The CCQ provides that a monetary claim may be pledged by an individual but only to the extent that this individual may create a movable hypothec without delivery on that claim¹¹. It is necessary to refer to the *Regulation respecting the register of personal and movable real rights*¹² to identify which claims that an individual cannot hypothecate without delivery.

E. Monetary claim – bilateral relationship

In cases involving only a debtor and creditor, the monetary claim is the sum of money that the creditor owes its debtor.

In this context, as in the case of a banker and his borrower, each party is simultaneously both the other's debtor and creditor. As an example, ABC Inc. owes its bank \$10,000 and maintains a credit balance of \$5,000 in its bank account with the same bank. For the bank that is the creditor of ABC Inc., the \$5,000 is a monetary claim that belongs to ABC Inc. and which is payable to it by the bank. The situation varies depending on the perspective used. Thus, for ABC Inc., the credit balance of \$5,000 that it is owed by the Bank is its main claim, while the monetary claim on which ABC Inc. may wish to obtain a security is the amount of \$10,000 it owes the Bank.

In a bilateral relationship between a creditor and its debtor, it is not conceptually problematic for each of them to obtain a hypothec with delivery on its respective monetary claim.

The situations allowing monetary claims between two parties, i.e. the debtor and the creditor, are also those eligible for compensation. However, monetary claims are much more flexible than compensation and can be applied in cases where offsetting is not available. For example, compensation can be used only if the debts are reciprocal, liquid and exigible¹³. Monetary claims allow the creditor to obtain a security on an amount he does not yet owe his debtor or if the amount has not yet been determined. In such cases, compensation is of no use.

Subject to the exclusions provided by the CCQ, any kind of claim payable by the creditor to its debtor can be considered a monetary claim. The only requirement is that it be a claim payable in money, to the exclusion of any other form of performance. Accordingly, there are very many kinds of claims that can be considered monetary claims.

E.1 Examples of monetary claims between the debtor and creditor (bilateral relationship)

With respect to financing by financial institutions, some cases are more common than others, for example:

¹⁰ Art. 2695 CCQ

¹¹ Art. 2713.9 CCQ

¹² Article 15.02 of the *Regulation respecting the register of personal and movable real rights*, CQLR, c. CCQ, r.8 provides that the assets constituting a registered retirement savings plan, a registered retirement income fund, a registered education savings or a registered disability savings plan cannot be hypothecated without delivery by an individual and, accordingly, any claims that result from them cannot be monetary claims that can be subject to movable hypothecs with delivery. The assets to which article 15.02 refers are assets against which an individual cannot create any security.

¹³ Art. 1673 CCQ

- a) the sums owed by a financial institution in connection with the positive bank balance payable to a borrower in its capacity as holder of the bank account;
- b) the sums owed by a financial institution to its borrower based on amounts entrusted by the borrower as provisions for property taxes as part of an immovable hypothecary loan;
- c) the sums owed by a financial institution that collects deposits from its borrowers that may be remitted to the borrowers under certain conditions.

The CCQ is not limiting and the courts will be asked to decide about other situations applicable to monetary claims. The following situations are some examples:

- a) joint-stock corporation and shareholder: the shareholder is the debtor of the corporation because of a loan he has contracted with it and he can also become the creditor of the corporation because of dividends that the corporation may eventually owe him;
- b) buyer and vendor: the buyer is the debtor of the vendor for the balance of the sale price unpaid and can also become the creditor of the vendor for the payment of adjustments or for damages incurred by the buyer further to inaccurate or erroneous representations by the vendor;
- c) supplier and client: the client is the debtor of its supplier for purchases made in the normal course of business and can also become the creditor of the supplier for reimbursements associated with defective merchandise returned or the payment of rebates or other volume discounts;
- d) builder and building owner: the owner is the debtor of his builder and he can also become the creditor of his builder because of deficient or incomplete work¹⁴.

Each of these situations allows a security to be obtained on monetary claims to the extent that they are payable in money.

F. Monetary claims – tripartite relationship

The CCQ also allows situations in which a third party is involved, in addition to the debtor and his creditor. In all cases of tripartite relationship, the third party is also the debtor of the creditor's debtor.

The CCQ restricts to only two situations¹⁵ the cases of monetary claims that can be owed by a third party to the debtor, to wit:

- a) A claim on the positive balance of a financial account held by a third party on behalf of the debtor; and

¹⁴ The builder benefits from the protection of the construction hypothec but a monetary claims hypothec could offer interesting protection for the owner of the building.

¹⁵ Art. 2713.4(1) CCQ

- b) A claim that is payable by a third party because of an amount of money remitted, paid or entrusted by the debtor to this third party in order to secure the performance of an obligation towards his creditor.

F.1 Positive balance of a financial account

The CCQ provides a definition of a financial account. It is an account to which sums of money owed to the debtor are credited¹⁶.

The CCQ already provides that banks and financial services cooperatives may hold financial accounts. However, the CCQ also provides that a financial account may be held by any person who, in the normal course of his activities, holds a financial account for others, i.e. for the benefit of the debtor. This definition is broad and allows for numerous situations involving financial accounts held not by financial institutions but by other types of parties and even by individuals.

For example, law firms are regularly required to hold sums of money for the benefit of their clients in their trust accounts. It is probable that this type of claim due by legal counsel can be treated as the positive balances of financial accounts held by law firms on behalf of others.

F.2 Sums of money paid, remitted or entrusted to a third party by the debtor

The CCQ provides for the case of a debtor who entrusts a sum of money to a third party in order to guarantee the performance of an obligation to his creditor. The sums entrusted by a debtor to his legal counsel can also be considered by the debtor and his creditor to be a monetary claim. The CCQ imposes no requirement with respect to the third party, and anyone can hold sums of money to guarantee the performance of an obligation to the creditor of the person who has remitted the funds to the third party.

G. Creation of the hypothec with delivery on a monetary claim

First, it must be understood that a security on a monetary claim is a movable hypothec with delivery. The fact that it is a hypothec with delivery implies remittance of the monetary claim held by the creditor, i.e. a delivery to the creditor. This delivery is entirely conceptual since there is no physical delivery by one or physical possession by the other.

Then, it is important to remember that a hypothec with delivery is waived publication in the RPMMR, which makes it an undisclosed security that can remain unknown to other creditors, even though it can be set up against them.

G.1 Creation of the movable hypothec with delivery in the context of a bilateral debtor/creditor relationship

The CCQ provides a very simple method of creation, with no formal requirements. It suffices for the debtor to consent that the monetary claim owed to him by his creditor guarantee what the debtor owes the creditor. This consent may be written but may also be inferred from the facts and circumstances. To avoid any problem associated with the lack of a written record, lenders can be expected to integrate in their offers to finance or their loan agreements or even in their security documents a section recording the

¹⁶ Article 2713.6 CCQ excludes a securities account within the meaning of the AST. from the definition of the financial account.

borrower's consent to the monetary claims payable to him by the lender being hypothecated in his favor in the guarantee of what is due from the borrower.

G.2 Creation of the movable hypothec with delivery in a context of a tripartite relationship – debtor/ creditor/third party

When the monetary claim is payable by a third party, the CCQ provides two different ways of creating a movable hypothec with delivery:

- a) a control agreement: this agreement between the debtor, the creditor and the third party enables the creditor to obtain from a third party a commitment to dispose of the monetary claim only in accordance with the instructions of the creditor; and
- b) by becoming the holder of the financial account: in the case of a positive balance in a financial account, a creditor can, pursuant to an agreement between the debtor, the creditor and the third party, become the holder of the financial account in place of the debtor.

It should be noted that a third party is never required to become a party to a control agreement and may refuse to do so. But even if the third party refuses to participate in a control agreement, he may not refuse to disclose whether he is already a party to such an agreement when the debtor so requests¹⁷.

If a debtor does business with two different financial institutions, except in special situations, it is likely that each of them will refuse to be a party to a control agreement benefitting the other financial institution.

The movable hypothec of a monetary claim is subject to the provisions of the CCQ that determine whose laws are applicable to the creation of movable hypothecs. In Québec, the CCQ establishes that the security which can charge an intangible asset, such as a claim, is determined pursuant to the domicile of the grantor¹⁸. With respect to the monetary claims involving a debtor, a creditor and a third party, the CCQ provides the following rules¹⁹:

- a) the applicable law is that specifically designated in the juridical act governing the monetary claim; or
- b) if the deed governing the monetary claim is silent, the applicable law is that of the State in which the third party holds the financial account or, in the case of a sum remitted to a third party to secure the performance of an obligation, the law applicable to the third party.

The rules stated above are those applicable to a tripartite relationship. In the simpler case of a bilateral relationship between a debtor and his creditor, the general rule associated with the domicile of the grantor continues to apply.

¹⁷ Art. 2713.5 CCQ

¹⁸ Art. 3105 CCQ; articles 75 and 307 CCQ list the criteria for identifying the domicile of a person and a legal entity.

¹⁹ Art. 3106.1 CCQ the movable hypothec with delivery

H. Rank of a hypothec with delivery charging a monetary claim

The marked advantage of the movable hypothec with delivery of a monetary claim is the rank it confers on the creditor. To determine the rank, it is necessary to distinguish the case of a bilateral relationship from a tripartite relationship.

H.1 Rank of a movable hypothec with delivery as part of a bilateral (debtor/creditor) context

A movable hypothec with delivery of a monetary claim confers on the creditor a first rank, ahead of all movable hypothecs without delivery published in the RPMMR, regardless of its date of creation.

H.2 Rank of the movable hypothec with delivery as part of a tripartite (debtor/creditor/third party) relationship

In cases where a third party is involved, it is necessary to determine if the monetary claim is the positive balance of the financial account owned by the third party or the sums of money are instead in the hands of the third party because they were remitted and entrusted to him by the debtor to secure the performance of his obligations toward one of his creditors.

- a) If the third party has received the sums of money from the debtor to secure the performance of his obligations toward one of these creditors, the control agreement between the three parties will confer on the creditor first-rank movable hypothec on the monetary claim, ahead of all other movable hypothecs, whether it is a hypothec without delivery published in the RPMMR or a movable hypothec with delivery created under the terms of a subsequent control agreement.
- b) If the monetary claim is the positive balance of a financial account, the rank of the movable hypothecs that can charge this monetary claim in favour of several creditors is determined in the following order:
 - (i) first rank, to the creditor who has become the holder of the financial account;
 - (ii) second rank, to the creditor who holds the financial account and who is the debtor of the monetary claim;
 - (iii) third rank, to the creditor who has signed a control agreement with the debtor and the third party who maintains the financial account (i.e. the creditor identified in (ii) above); and
 - (iv) fourth rank, between the various other creditors who hold a movable hypothec without delivery and, among them, according to their respective date of publication in the RPMMR²⁰.

²⁰ Art. 2713.8 CCQ

I. Some examples of situations involving monetary claims

I.1 Hypothecary Representative

Since 1994, the CCQ²¹ has allowed a hypothec in favour of a hypothecary representative as holder of the hypothec granted by the debtor for the benefit of all his creditors, present and future. This hypothec must, subject to be null, be in notarial form, except for movable hypothecs with delivery²².

A movable hypothec on a monetary claim is a pledge of claims and accordingly, notarial form is not required for a movable hypothec of a monetary claim in favour of a hypothecary representative.

The hypothec in favour of a hypothecary representative is a bilateral act between the debtor and the hypothecary representative. As part of a syndicated loan that involves several lenders, there is generally one lender who acts as the bank of the borrower and with whom the operating bank accounts are maintained allowing the debtor to deposit and withdraw funds. The positive balances of these bank accounts held by this lender are, with respect to the representative and also of all the other lenders, monetary claims owed to the debtor by a third party, this third party being the lender with whom the funds are maintained in a financial account held by this lender.

It is necessary to provide a control agreement between (i) the debtor, (ii) the hypothecary representative who represents the present and future creditors and (iii) the lender who acts as the banker of the borrower and who is a third party for all the other lenders and the hypothecary representative.

The control agreement is, in such a case, the document creating the movable hypothec with delivery on the monetary claims. Because of the amendments made in 2015 to article 2692 CCQ, notarial form is not required to create such a movable hypothec with delivery in favour of the hypothecary representative on this monetary claim.

In situations involving a hypothecary representative, it should be expected that movable hypothecs with delivery on monetary claims will be created by means of control agreements under private writing, which avoids publication in the RPMMR.

I.2 Situations linked to dividends and other sums owed by a joint stock corporation to its shareholder

The sums of money payable by a joint stock corporation to its shareholder are, for the corporation, monetary claims on which it may obtain a movable hypothec with delivery. This possibility can only be contemplated if the shareholder is himself indebted, or becomes so, to the corporation. This situation occurs specifically if the corporation has granted a loan to its shareholder or if it has secured its obligations toward a third party.

If there is an interest in the corporation obtaining a movable hypothec with delivery in its favour on sums of money it owes its shareholder, it will be likewise of interest for the creditor of the corporation, its banker for example, to require that the corporation obtain a hypothec on such monetary claims. Generally, institutional lenders are always

²¹ Art. 2692 CCQ

²² The provisions of Article 2692 CCQ to this effect were amended on April 21, 2015.

interested in having the sums due to their debtors, themselves secured by hypothecs, especially if they are first-ranking.

In financing offers, it is likely that there will be, in the cases for which it is appropriate, a demand by the lender that its borrower obtains movable hypothecs with delivery on monetary claims.

However, for sums of money payable by a corporation to its shareholder, it is necessary to distinguish whether they are dividends or sums of money payable because of a share buyback. It is also important to verify whether the shareholder who is the creditor of these sums has himself hypothecated the shares he owns and, if he has, whether the movable hypothec on the shares is with or without delivery.

First of all, it should be remembered that an individual can hypothecate his shares with delivery. This is an exception to the general rule regarding movable hypothecs, which provides that an individual can only hypothecate the movable assets of his own company, but this rule is not applicable to hypothecs of shares or claims²³.

a) **Situation in which the shareholder is indebted to the corporation but has not hypothecated his shares**

In this case, the corporation may easily obtain a hypothec on the monetary claim owed to the shareholder, i.e. on the amounts of money payable or to become payable by the corporation to its shareholder whatever the origin.

b) **Situation in which the shareholder is indebted to the corporation and has hypothecated his shares**

(i) **By way of a movable hypothec without delivery**

A movable hypothec without delivery takes its rank from its RPMMR publication. Moreover, it is known that a hypothec without delivery on shares does not confer on the creditor a right to dividends or the proceeds of a buyback of the shares. Accordingly, in this case, the amount of the dividends and proceeds of a buyback of shares payable in money constitute a monetary claim belonging to the shareholder that does not benefit his creditor, who is the holder of a movable hypothec without delivery on the shares²⁴.

(ii) **By way of a movable hypothec with delivery of shares**

If the shares have been pledged to a creditor of the shareholder, the CCQ provides that such a creditor with security on the shares has, by law, hypothecary rights that extend not only to the shares but also to the dividends and the proceeds of a buyback of the shares²⁵. In this case, the

²³ Art. 15.02 of the *Regulation respecting the register of personal and movable real rights*.

²⁴ The shares of corporations, whether or not evidenced by a certificate, are securities according to section 10 of the ATS. Moreover, it may be useful to point out that the CCQ mentions certificated or non-certificated shares. Under our laws governing corporations, only certificated shares are possible. Bearer shares disappeared in Quebec with the reform of the *Business Corporations Act* actions, CQLR, c S-31.1.

²⁵ Art. 2737 and 2738 CCQ

monetary claims associated with the dividends and the buyback proceeds hypothecated by the shareholder in favour of the corporation could be in conflict with the rights of another creditor of the shareholder who has a pledge on the shares, thereby giving him also a right to dividends or the proceeds of their buyback by the issuer because a pledge of shares by transfer of endorsed share certificates always confers a first-ranking movable hypothec on the creditor²⁶.

J. Conclusion

Hypothecs of monetary claims will be very frequent, and the challenge facing lenders and counsel will be to identify the situations that allow monetary claims and verify whether they have been hypothecated, given the undisclosed nature of this new security, which exists without publication in the RPMMR.

Montréal, January 1, 2016

²⁶ Art. 2714.2 CCQ