



LAPOINTE ROSENSTEIN
MARCHAND MELANÇON
L.L.P. Attorneys

Newsletter

Financing

November 2015

Monetary claims: Make it your priority!



M^{re} Jean-François Vadeboncoeur



M^{re} Larisa Albu

This newsletter was written in collaboration with M^{res} Christina Bresciani and Marissa Carnevale.

Pursuant to *An Act Mainly to Implement Certain Provisions of the Budget Speech of 4 June 2014 and Return to a Balanced Budget in 2015-2016*, the Civil Code of Quebec (the “**CCQ**”) has been amended to include provisions relating to movable hypothecs with delivery (i.e., pledges) (known outside of Quebec as security interests) on certain monetary claims (“**Monetary Claims**”). The new provisions of the CCQ establish the manner in which a “pledge” (which carries with it a better rank (priority) than other types of security interests) on Monetary Claims is established and set up against third parties notwithstanding the practical impossibility of physical delivery of incorporeal property (intangibles): hypothecary creditors (i.e., secured parties) must obtain control of the Monetary Claim. Prior to these legislative amendments, it was not possible to grant this type of security under Quebec law.

The legislative amendments come into force on January 1, 2016¹. The new rules are largely inspired by the rules regarding hypothecs on securities and security entitlements under *An Act Respecting the Transfer of Securities and the Establishment of Security Entitlements*, as well as the principles governing security interests on bank deposits under Article 9 of the U.S. *Uniform Commercial Code*.

Definition of Monetary Claim

Article 2713.1 of the CCQ defines a “Monetary Claim” as “any claim requiring the debtor to reimburse, return or restore an amount of money or make any other payment in respect of an amount of money.” Accordingly, bank deposits, deposits subject to an escrow agreement, balances of sale, margin deposits and cash collateral can all be considered Monetary Claims. However, Monetary Claims do not include (i) claims represented by negotiable instruments; (ii) claims that are securities or security entitlements;² or (iii) claims resulting from the delivery of certain and determinate currency whose repayment must be made by restitution of the same currency.

Governing law

The law governing the validity, publication (i.e., perfection) and the effects of publication of a pledge on a Monetary Claim is the law expressly indicated in the contract governing the Monetary Claim.

If the contract governing the Monetary Claim does not provide such information, the applicable governing law with respect to the pledge thereof will differ depending on whether it is a claim relating to the credit balance of a financial account or a claim relating to an amount of money transferred to secure the performance of an obligation towards a secured party:

- In the case of a claim relating to the credit balance of a financial account, the pledge thereof would be governed by the law of the province or state in which the applicable branch is located. The applicable branch is the branch expressly mentioned in the contract governing the financial account or, if no branch is so mentioned, the branch identified in an account statement as the branch serving the accountholder of the financial account. If the account statement does not include sufficient information to be determinative, the law that governs the pledge of a claim relating to the credit balance of a financial account is the law of the province or state where the financial institution's decision-making centre is located.
- In the case of a claim relating to an amount of money transferred to secure the performance of an obligation towards the secured party, the pledge thereof would be governed by the law of the province or state where the decision-making centre of the person to whom the money was transferred is located or, if the person is a natural person, the law of the province or state where such person is domiciled.

How to obtain control?

According to the new Article 2713.3 of the CCQ, where a Monetary Claim is owed by a person to whom the intent is to grant security, such person obtains control over such Monetary Claim following the consent of the accountholder to the effect that such Monetary Claim secures the performance of an obligation. While this consent may be oral or written, it is strongly advised that it be written for evidentiary purposes. Consider, for example, the case of bank deposits: if they are maintained by a debtor in an account held with a financial institution that is the party to which such deposits are to be pledged, control will be conferred automatically as soon as the grantor of the pledge, which is the holder of the account where the deposits are made, consents that the bank deposits secure the performance of an obligation towards the financial institution.

Alternatively, if the bank deposits are maintained in an account with a financial institution that is *not* the person to whom the intent is to grant security, then the depositary financial institution, the secured party and the grantor of the pledge will all be required to enter into a "control agreement" whereby the depositary financial institution agrees to comply with the secured party's instructions with respect to the Monetary Claims without the further consent or intervention of the grantor of the pledge.³

Finally, control can be obtained by the person to whom the intent is to grant security becoming the accountholder.

Secured obligations

In both cases, the obligations secured by the pledge may be those of the grantor or those of a third party – in other words, the grantor of the pledge need not be the primary debtor, but may also be the guarantor of a third party's obligations towards the secured party.

Entering into the control agreement

It is important to note that pursuant to Article 2713.5 of the CCQ, the depositary financial institution is under no obligation to enter into a control agreement with the secured party, even if the grantor so requests. Furthermore, the depositary financial institution cannot be forced to confirm the existence of a control agreement, unless the grantor so requires.

Rank (Priority)

A pledge of a Monetary Claim that is published (i.e., perfected) by granting control over the Monetary Claim "**ranks ahead of any other movable hypothec encumbering that claim.**"⁴ This effectively creates a "super-priority" from the time that control over a given Monetary Claim is obtained by a secured party, regardless of when any other rights are published in respect of such Monetary Claim.

In practice, this means that it is not necessary to register a pledge on Monetary Claims in the *Register of Personal and Movable Real Rights* (the "RPMRR") in order for the pledge to be set up against third parties. Moreover, a secured party that obtains control over Monetary Claims as part of its security package will not be required to conduct searches of the RPMRR in order to determine whether there are any intervening registrations of rights that may affect the rank of its security on those Monetary Claims, nor will it be required to obtain any assignments of rank or discharges from other secured parties who may have prior-ranking rights in respect of those Monetary Claims. It should be noted, however, that these typical processes would likely still be required in cases where a hypothec is granted on property *other than* Monetary Claims or on both Monetary Claims *and* other property.

Notwithstanding the above, it is important to note that a hypothec on a Monetary Claim granted in favour of the debtor of the Monetary Claim (e.g., the financial institution with which the account is held) ranks ahead of all other hypothecs with delivery effected by control that encumber that Monetary Claim except where control has been obtained by a hypothecary creditor becoming the actual accountholder.

Conclusion

As a result of the legislative amendments, it is strongly recommended for hypothecary creditors (i.e., secured creditors) to put control agreements in place prior to January 1, 2016 where Monetary Claims form an important part of the collateral subject to a hypothec so as to avoid any loss of rank, priority or rights with respect to such Monetary Claims when the legislative amendments come into force.

It should also be noted that a pledge on Monetary Claims may be put in place to secure a party's rights before January 1, 2016, but will only take effect as of that date.

-
1. *An Act mainly to implement certain provisions of the Budget Speech of 4 June 2014 and return to a balanced budget in 2015-2016*, § 325.
 2. Defined in the *Act respecting the transfer of securities and the establishment of security entitlements* (chapter T-11.002).
 3. Civil Code of Quebec, Article 2713.4.
 4. Civil Code of Quebec, Article 2713.8.

The content of this newsletter is intended to provide general comment only and should not be relied upon as legal advice.

For more information, please contact:

Jean-François Vadeboncoeur

514 925-6384

jean-francois.vadeboncoeur@lrm.com

Larisa Albu

514 925-6372

larisa.albu@lrm.com