LAPOINTE ROSENSTEIN
MARCHAND MELANÇON
S.E.N.C.R.L. Avocats

A new look at the extinctive prescription of hypothecary rights by the Supreme Court of Canada

July 7, 2020

Antoine Leduc, Ad. E.
Doctor of Laws, Partner, Chair of the *Banking and Financial Services* and of the *Bankruptcy, Insolvency and Restructuring* practise groups

In a rather surprising decision rendered on June 19, 2020 by the Supreme Court of Canada in the matter of *Toronto-Dominion Bank v. Young,* [1] it was held that, unless the debtor of a personal obligation (or principal debtor) was served or impleaded, the institution of a hypothecary action against the person who holds the hypothecated property but who is not the principal debtor of such secured obligation does not, in and of itself, interrupt its prescription, which continues to run during the proceeding, notwithstanding the principal debtor's lack of ownership in the hypothecated property and the absence of any damage resulting therefrom.

This ruling constitutes a departure from previously established case law and doctrine. Should it be followed, it would result in a more onerous monitoring of credit and recourses for hypothecary creditors.

The factual context

On October 17, 2011, second-ranking hypothecary creditors, Harold and Robert Young (the "**Respondents**"), took in payment an immovable property (the "**Immovable**") belonging to Linda Macht (the "**Debtor**"), subject to a first-ranking hypothec registered in favour of the Toronto-Dominion Bank (the "**Bank**").

On February 6, 2012, the Bank filed an application to institute proceedings in forced surrender and taking in payment against the Debtor. The Bank eventually withdrew from its application following the payment under protest by the Respondents of the amounts then due by the Debtor to the Bank, pursuant to a declaration of aggressive intervention by the Respondents in this proceeding, the latter alleging that the Bank could only exercise its hypothecary right to take in payment against them, since the Debtor no longer owned the Immovable.

In October 2012, the Bank filed a new application in forced surrender and taking in payment of the Immovable, however this time only against the Respondents, without serving, impleading or pursuing the Debtor personally, as the location of the latter was unknown at that time. The Bank therefore invoked the forfeiture of the term of the principal obligation and demanded full payment of the loan, despite the fact that the loan, originally concluded on September 14, 2009, and renewed in October 2010, only expired on November 1st, 2015.

It took more than four years between the filing of this application and the date of the initial judgment of the Superior Court, as the Respondents had presented an application for the postponement of the hearing initially scheduled for February 24, 2014, due to medical reasons, which was finally heard on November 2, 2015.

On February 19, 2016, the Superior Court granted the Bank's hypothecary recourse, declared the Bank to be the owner of the Immovable and ordered the Respondents to surrender same. Regarding the prescription issue, which was raised by the Respondents late in the proceedings, the Superior Court was of the opinion that the Bank had instituted its action in a timely manner, that is to say within a year of the default of the Debtor, and that the fact of not having served the introductory proceedings upon the Debtor "was not fatal", [2] thus following established case law and doctrine. [3]

The judgement of the Québec Court of Appeal

On May 17, 2018, the Court of Appeal set aside the first instance judgement and ordered the discharge of the hypothec and prior notices of the Bank as registered in the Land Register, [4] for the following reasons.

A claim is a personal right prescribed by three years, pursuant to article 2925 of the *Civil Code of Québec* (the "**Civil Code**" or "**CCQ**"). The starting point for the prescription period is the date of the Bank's second prior notice, that being July 10, 2012, when the Bank invoked the loss of the benefit of the term of the principal obligation, which must not be extinct at the time when the creditor undertakes its hypothecary action, whether it is brought against the principal debtor or against the real surety. In addition, the prescription of this obligation must not be extinct at the time of the judgment ruling on the hypothecary recourse.

The Bank's application for forced surrender only interrupted the prescription with regard to the Respondents, and not with regard to the Debtor, who was not a party to the proceedings. Indeed, pursuant to its reading of articles 2892 and 2896 of the Civil Code, the Court of Appeal affirmed that the interruption of prescription only applies to the parties to the proceedings. Therefore, the Debtor's principal obligation in favour of the Bank is extinguished by prescription at the time of judgment in first instance, along with its accessory, the Bank's hypothec.

By this ruling, the Court of Appeal departed from its own precedent in *Poulin-Sansoucy v. Simmco D.P. Real Estate Services Inc*. ("**Poulin-Sansoucy**"). [5] This judgement establishes that, in the context of an action to recover a hypothecated claim under article 2713 CCQ, the absence of impleading one or another interested party (that is to say, the debtor or, as the case may be, the creditor) is not in and of itself fatal, if the circumstances show that the party who should have been impleaded knew of the existence of the action, or if the dispute could nevertheless be settled in a complete and final manner. [6] Just as the application for forced surrender interrupts prescription, the action to recover under article 2713 CCQ also interrupts it, if it is brought before the extinctive prescription of the principal obligation has been fulfilled, even in the absence of any recourse against the principal debtor. [7]

The dissent of the Honourable Suzanne Côté and the judgment of the Supreme Court

Although the majority accepted the reasoning of the Court of Appeal without discussion, it is nonetheless necessary to account for the important dissent of the Honourable Suzanne Côté in this case.

For Justice Côté, it is at the time of the exercise of the hypothecary recourse that the Court must assess whether the secured claim is prescribed or not, since it is the application in forced surrender and taking in payment which constitutes a legal action capable of interrupting prescription within the meaning of the Civil Code, which was the case here.

In this, her interpretation of article 2892 CCQ is to the effect that the hypothecary debtor is "*the person to be prevented from prescribing*", in this case the Respondents, since the Debtor no longer has any rights in the Immovable and is not suffering any damage from the exercise of the Bank's hypothecary recourse. Furthermore, Justice Côté reiterated that the hypothecary remedy and the claim to which it is incidental have the "same source". Therefore, under the second paragraph of article 2896 CCQ, a hypothecary claim "*has effect with regard to all the parties with respect to any right arising from the* ***same source***", including with respect to the Debtor and thus interrupting the prescription.

In fact, when filing a hypothecary recourse, compliance with the conditions provided for in articles 2748 and 2749 CCQ interrupts the prescription of the principal obligation on an hypothecary basis.

Finally, as the Bank has the choice of recourses, it is not required to exercise a personal right of action in addition to its hypothecary recourse in order to interrupt prescription. The underlying economics of the Civil Code promote this position; moreover, the attributes of ancillary hypothecary real rights, most notably conferring upon the creditor the right to follow the property in whatever hands it lies, would be rendered meaningless if it were not so.

Since the Court of Appeal remained silent on these fundamental questions, most certainly, they have not found definitive answers and will undoubtedly be the subject of future debates.

Conclusion

Whatever conclusions may be drawn from this judgment, as a precaution, hypothecary creditors would be well advised to serve their hypothecary claims on all principal debtors in the future, or even to implead or to pursue them directly, without limiting themselves to the sole real surety, as the case may be, in order to interrupt prescription and to avoid finding themselves in a similar situation preventing the recovery of secured claims, and this, regardless of the context.

They will also have an interest in obtaining an acknowledgment of debt, a renunciation to the benefit of the term that has elapsed or, even, a renunciation of the prescription acquired, as the case may be, from the principal debtor.

The author would like to thank his colleagues Sara Korhani and Julien Dubois for their assistance in the preparation of this article, as well as Francis C. Meagher, Jacquelin Caron, André Rousseau and Julien Grenier for their comments.

To assess the impact this judgment may have on your business, the *Banking and Financial Services* team, as well as the *Bankruptcy, Insolvency and Restructuring* team of our firm are at your disposal to help you find out more.

Antoine Leduc | **Partner**
514 925-6323
antoine.leduc@lrmm.com

Francis C. Meagher | **Partner**
514 925-6320
francis.meagher@lrmm.com

Mélissa Rivest | **Partner**
514 925-5087
melissa.rivest@lrmm.com

Jacquelin Caron | **Partner**
514 925-6314
jacquelin.caron@lrmm.com

André Rousseau | **Partner**
514 925-6389
andre.rousseau@lrmm.com

Harry H. Dikranian | **Partner**
514 925-5082
harry.dikranian@lrmm.com

Julien Grenier | Attorney
514 925-5002
julien.grenier@lrmm.com

Julien Dubois | Attorney
514 925-5039
julien.dubois@lrmm.com

Sara Korhani | Attorney
514 925-6405
sara.korhani@lrmm.com

1 *Toronto-Dominion Bank v. Young*, 2020 SCC 15, Côté J, dissenting.
2 *Toronto-Dominion Bank v. Young*, 2016 QCCS 838.
3 See notably : Louis PAYETTE, *Les sûretés réelles dans le Code civil du Québec*, 5th ed. (Montréal : Éditions Yvon Blais, 2015) nos 15, 1656, 1689-1691, 1769 et 1774, at 8-10, 893-895, 912-913, 956, 958-959, as well as the case law cited by this author.
4 *Young* c. *Banque Toronto-Dominion*, 2018 QCCA 810 ("**Young**").
5 SOQUIJ AZ-50076268, J.E. 2000-1156 (C.A.), confirming *Services immobiliers Simmco D.P. inc.* c. *Dub*, SOQUIJ AZ-98021600, J.E. 98-1303 (C.S.), Jasmin J.
6 L. PAYETTE, *op. cit.*, *supra* endnote 3, no 1210, at 639; Pierre CIOTOLA, *Droit des sûretés*, 3rd ed., (Montréal: Les Éditions Thémis, 1999) no 3.88, at 299.
7 L. PAYETTE, *op. cit.*, *supra* endnote 3, no 1634, at 881-882.