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A Q&A guide to finance in Canada.

The Q&A gives a high level overview of the lending market, taking security over assets, special purpose vehicles in secured lending, quasi-security, guarantees, and loan agreements. It covers creation and registration requirements for security interests; problem assets over which security is difficult to grant; risk areas for lenders; structuring of debt agreements; enforcement of security interests and borrower insolvency; cross-border issues on loans; taxes; and proposals for reform.

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This article is part of the PLC multi-jurisdictional guide to finance.

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Overview of the lending market

1. Please give a brief overview of the main trends and important developments in the lending market in your jurisdiction in the last 12 months.

Lending market. Canada has successfully weathered the financial crisis and earned a reputation as a market with a high level of financial stability. During the crisis, Canada successfully resolved problems affecting its asset-backed commercial paper market that were similar to the US sub-prime crisis. Although its financial institutions are currently world leaders and its markets are stable, Canada is still experiencing moderate lending activity. There are signs of increased liquidity and more attractive terms for borrowers but Canadian lenders continue to take a cautious approach.

Whether the economic recovery is sustained will depend on increased:

- Activity in the mid-market.
- Stability in the US and Canada's other significant trading partners.

Legal system. Canada has a federal system of government with ten provinces and three territories. All Canadian provinces and territories are common law jurisdictions except Québec, which is a civil law jurisdiction. This chapter considers the rules in the common law jurisdictions and in Québec.

Security: real estate

2. Please briefly state what is considered real estate in your jurisdiction. What are the most common forms of security granted over it? How are they created and perfected (that is, made valid and enforceable)?

Common law jurisdictions

Real estate. Real estate covers:

- Land, together with buildings and fixtures.
- Airspace above land.
- Forests.
- Crops.
- Non-navigable waters.
- Easements (a right of use over the property of another).
- Sub-surface land rights (including rights to access and extract minerals, oil and hydrocarbons), unless expressly excluded in the title to land. This may include certain mineral, oil and gas royalties that may be reserved in the transfer of land and in some Canadian jurisdictions construed as creating interests in land.
- Rental income and other profits derived from land, although they are sometimes treated as accounts receivable in secured lending transactions (*see Question 3*).
- Leasehold interests.

Common forms of security. The most common forms of security created over real estate are by way of:

- Mortgage.
- Debenture.
- Trust deed.

Formalities. Each province maintains its own real property title registration system. Security over real property is perfected by registration of the mortgage, debenture or trust deed against title to the land. In practice, the lender would typically register the security over real estate.

Certain types of real property are subject to special legislation. For example, special statutes govern most federally regulated facilities, including major shipping ports, prisons and airports.

Québec

Real estate. Real estate (immovables) includes (*Civil Code of Québec*) (CCQ):

- Land.
- Any constructions and works of a permanent nature located on the land.
- Anything forming an integral part of the land.
- Plants and minerals as long as they are not separated or extracted from the land.
- Personal (movable) property that is permanently physically attached or joined to an immovable and ensures its utility.
- Real rights in immovable property, as well as actions to assert such rights or to obtain possession of immovables,

Common forms of security. Security charging an immovable (or any rents produced from an immovable or insurance proceeds covering those rents) can only be granted by a hypothec.
Formalities. The hypothec is created under a deed. It is executed by the grantor and the secured party before a Québec notary. To perfect or publish a hypothec, it must be registered against title to the charged property in the registration division where the immovable property is situated. In practice, the hypothec is typically registered by the lender.
Hypothecs charging certain categories of immovables may require immatriculation, that is, the prior creation of a specific land file or registration in a special register. These categories of immovables include:

- Forest management (timber) rights.
- Mining rights and claims.
- Networks relating to railway.
- Cable communications.
- Water or gas distribution.
- Power lines.
- Oil or gas pipelines.
- Sewage conduits.

Security: tangible movable property

3. Please briefly state what is considered tangible movable property in your jurisdiction, for example, machinery, trading stock (inventory), aircraft and ships? What are the most common forms of security granted over it? How are they created and perfected?

Common law jurisdictions

Tangible movable property. Each province and territory in Canada has its own personal property security legislation (PPSAs). The PPSAs are modelled after Article 9 of the US Uniform Commercial Code. Under the PPSAs and in the context of commercial finance transactions, tangible movable property primarily means goods that are inventory or equipment.

Common forms of security. Security over tangible movable property is created when a debtor grants a security interest in such property to a creditor pursuant to a security agreement. The granting clause in the security agreement specifies what assets of the debtor are subject to the security interest. Typically, secured creditors receive a general security interest covering all of a debtor's present and after-acquired personal property, whether tangible or intangible.

Formalities. A security interest must attach to be enforceable against third parties. There are three elements to attachment:

- Value must be given.
- The debtor must have rights in the collateral.
- The security agreement must contain a description of the collateral, sufficient to enable it to be identified.

A secured creditor must perfect its security interest in movable property to establish priority of interest over the security interests of other creditors. Under the PPSAs, perfection against tangible movable property occurs through the registration of a financing statement against the debtor. This is a form of notice registered in a database that can be searched by the general public, including potential lenders and potential asset purchasers. A security interest in tangible movable property can also be perfected by possession. Possession is rare for goods but more practicable for assets such as:

- Chattel paper.
- Documents of title.
- Instruments.
- Money.

Under the PPSAs, formalities with respect to tangible moveable property will generally be governed by the law of the jurisdiction where the property is situated at the time of attachment. If a debtor has tangible movable property in multiple provinces and territories, the secured party will have to file financing statements in each applicable jurisdiction.

Québec

Tangible movable property. Although the CCQ does not specifically define tangible movable property, it includes things which can be moved either by themselves or by an external force.
Common forms of security. Security over tangible movable property is created by a hypothec.
Formalities. The validity and perfection of security over tangible movable property is governed by the law of the jurisdiction where the property is situated, and whether the hypothec is with or without delivery of the secured property:

- Without delivery: the hypothec is created by deed. It is not necessary to execute the deed before a Québec notary, unless the hypothec secures the payment of bonds or other titles of indebtedness. This hypothec is perfected by registration at the Register of Personal and Movable Real Rights.
- With delivery (pledge): no written agreement is needed. Perfection occurs by the physical delivery of the collateral to the pledgee or a custodian mutually agreeable to the pledgor and pledgee.

Federal jurisdiction

Ships, aircraft and most railways are governed by federal legislation. A security interest can be granted under the PPSAs or CCQ; however, secured parties should take any additional steps set out under the applicable legislation to establish a first-ranking claim.

Security: shares and financial instruments

4. What are the most common forms of security granted over financial instruments, such as shares and other securities (both in certificated and dematerialised form)? How are they created and perfected?

Investment property

Financial instruments such as shares and other securities (whether certificated or uncertificated) are considered investment property under the PPSAs. Recently, each of the provinces and

territories (except Prince Edward Island) has enacted a Securities Transfer Act or similar legislation (STA) based on Revised Article 8 of the Uniform Commercial Code.

Investment property under the PPSAs and the STA includes:

- Securities (certificated and uncertificated).
- Security entitlements.
- Securities accounts.
- Futures contracts and futures accounts.

Certificated securities are the most common type of investment property in secured lending deals in Canada. A typical example is a corporate borrower pledging subsidiary shares it holds directly to a lender to secure a credit facility.

Common forms of security

A security interest in securities (certificated and uncertificated) is taken under a securities pledge agreement and/or a control agreement. In Québec the security interest is taken under a hypothec (*see Question 3, Québec: Common forms of security*).

Formalities

A debtor must grant a security interest to a creditor in investment property and that interest must attach to the property.

A secured creditor can perfect its interest by registering a financing statement in accordance with the PPSA, obtaining control of investment property by obtaining possession of investment property (certificated securities) or by control is the preferred method for perfecting such a security interest as it gives the secured party a higher priority than a security interest perfected by registration alone. Different rules apply depending on whether the investment property is held directly or indirectly:

- **Direct holding system (certificated and uncertificated securities).** A secured party obtains control of certificated securities in registered form by taking physical possession of the certificates and either;
    - taking an endorsement; or
    - having the securities registered in its name.

    A secured party obtains control of uncertificated securities by either:
    - registering the securities in its name; or

- obtaining a control agreement from the issuer of the securities.

A control agreement is made among the issuer of an uncertificated security, the secured party and the debtor. It involves the issuer agreeing to comply with instructions from the secured party without the debtor's further consent.

- **Indirect holding system (control of security entitlements).** A secured party obtains control of security entitlements by either:
  - arranging for the applicable securities intermediary (for example, a clearing house) to record the secured party, for example, the lender or administrative agent, as the entitlement holder;
  - obtaining a control agreement from the securities intermediary; or
  - a third party having control for the benefit of the secured party.

Certain conflict of laws rules apply to taking security over investment property under the PPSAs and the STA, which are relevant to formalities:

- Perfection by registration must occur in the jurisdiction in which the debtor is located, that is, its chief executive office if it has more than one place of business (in Québec, its domicile or registered office).
- For certificated securities, the laws of the jurisdiction in which the certificated securities are located at the time of attachment govern the validity, perfection and priority of a security interest.
- For uncertificated securities, the laws of the jurisdiction where the issuer of the securities is located (in Québec, where the issuer is constituted) govern the validity, perfection and priority of a security interest.
- For security entitlements, the laws of the jurisdiction where the securities intermediary is located (or, in Québec, the laws applicable to the contract governing the securities account maintained by the securities intermediary) govern the validity, perfection and priority of a security interest.

Security: claims and receivables

5. What are the most common forms of security granted over claims and receivables (such as debts or rights under contracts)? How are they created and perfected?

Common law jurisdictions

Common forms of security. Claims and receivables (such as debts or rights under contracts) are considered intangible property under the PPSAs. The most common forms of security and perfection requirements are the same as for tangible movable property (*see Question 3, Common law jurisdictions: Common forms of security*).

Formalities. The law of the jurisdiction where the debtor is located at the time of attachment governs the validity, perfection, effect of perfection and priority of a security interest for intangible property.

Québec

Common forms of security. Security interests over intangible movable property (such as claims, receivables or contractual rights) are created by way of hypothec (*see Question 3: Québec: Common forms of security*).

Formalities. Under the CCQ, the law of the jurisdiction where the grantor is domiciled (that is, has its registered office) governs the validity and perfection of security affecting incorporeal movable property (such as claims, receivables or contractual rights).

Security: intellectual property

6. What are the most common forms of security granted over registered and unregistered intellectual property (such as patents, trade marks, copyright and designs)? How are they created and perfected?

Common law jurisdictions

Common forms of security. Intellectual property rights are regulated by federal legislation but constitute personal property under the PPSAs. They are considered intangible property and the most common forms of security are the same as for other intangible property (*see Question 5, Common law jurisdictions: Common forms of security*).

Formalities. Under the PPSAs, intellectual property, whether registered or unregistered, is considered intangible property and perfection requirements are the same as for other intangibles (*see Question 5, Common law jurisdictions: Common forms of security*).

As standard practice, a secured creditor with a security interest in Canadian patents, copyrights or registered trade marks should file a copy of the security agreement with the federal Canadian Intellectual Property Office (CIPO). This should be done in addition to registering a financing statement under the PPSAs.

Although federal Canadian intellectual property legislation is not designed for the recording of security interests, filing with CIPO provides notice that the debtor's intellectual property is encumbered.

Québec

Common forms of security. Under the CCQ, intellectual property is secured by way of hypothec and subject to the same rules as claims and receivables (*see Question 5, Québec: Common forms of security*).

Formalities. The same formalities apply as for claims and receivables (*see Question 5, Québec: Formalities*).

As standard practice, a secured creditor with a hypothec over intellectual property should also file it with CIPO.

Security: problem assets

7. Are there types of assets over which security cannot be granted or is difficult to grant? Consider the following and give brief details of any additional requirements:

- **Future assets.**
- **Fungible assets.**
- **Other assets.**

Future assets

Under the PPSAs and the CCQ secured creditors can be granted general security interests that include future assets (commonly referred to in Canada as ''after-acquired property''). The secured creditor's interest attaches to the property on the debtor acquiring rights in that property (*see Question 3*).

Fungible assets

Under the PPSAs, fungible assets that are personal property can be reliably secured. If goods are transformed through manufacturing and no longer identifiable, any previously perfected security interest in these goods will continue in the transformed end-product.

Under the CCQ, a hypothec can charge future or fungible assets. It continues to subsist on any new movable property resulting from the transformation of the collateral. It extends to property resulting from the combination of several movables, some of which are charged.

Other assets

Other types of assets can be problematic for taking security. The most notable are:

- Insurance policies and contracts of annuity. The PPSAs expressly exclude an interest in or claim under any insurance policy or annuity contract from their scope. Secured creditors must take additional steps to secure their interest in an insurance policy. If a debtor has insurance on other secured personal property assets, the concept of ''proceeds'' under the PPSAs provides that the original security interest extends to any insurance proceeds received as compensation or loss to those assets. In Québec, however, insurance policies can be charged by a hypothec.
- Certain government receivables payable by the federal government and the provincial governments cannot be assigned or transferred as security in the usual manner. Occasionally, secured parties can comply with certain conditions and obtain an assignment of these types of receivables.

Special purpose vehicles (SPVs) in secured lending

8. Is it common in your jurisdiction to take security over the shares of an SPV set up to hold certain of the debtor's assets, rather than to take direct security over those assets? If so, please give brief details of the practice and risks associated with it.

It is common for lenders to use an SPV to protect against the risk of substantive consolidation in bankruptcy and by borrowers to limit recourse (often in connection with project financings). Substantive consolidation involves a bankruptcy court treating a group of affiliated companies as one, merging their assets and liabilities for the purposes of the bankruptcy proceeding. Typically, lenders will take security in both the SPV's assets and ownership interests. This facilitates realising on the security, protects from any risk of substantive consolidation and limits claims against the SPV.

Quasi-security

9. What types of quasi-security structures (that is, legal structures used instead of taking security but which have a similar effect to security) are common in your jurisdiction? Is there a risk of such structures being recharacterised as a security interest? Consider the following and give brief details of the structure and risks associated with it:

- **Sale and leaseback.**
- **Factoring.**
- **Hire purchase.**
- **Retention of title.**
- **Negative pledge.**
- **Other structures.**

Certain quasi-security structures are frequently used in Canada. Canadian courts are generally reluctant to interfere with privately negotiated commercial bargains but might recharacterise a transaction where the agreement is vague or different in substance from what parties specified in them.

Sale and leaseback

Sale and leaseback and factoring structures are frequently used in Canada.

Factoring

See above, *Sale and leaseback*.

Hire purchase

Hire purchase arrangements are not commonly used in Canada as quasi-security structures.

Retention of title

Consignment arrangements based on retention of title are used, but are not common due to their inherent uncertainty. There is a risk that such an arrangement will be viewed as a true consignment, which is excluded from the PPSAs. Chattel leases (i.e. leases of moveable personal property) are very common, but leases for a term of more than one year are subject to the PPSAs and must be registered.

Negative pledge

Although they do not create a security interest, negative pledges are sometimes used in Canada and are particularly important where senior debt is unsecured.

Other structures

Due to the PPSAs' very broad scope, common financing arrangements like conditional sales contracts are no longer used, as they are subject to the PPSAs and would be treated as security agreements.

Under the CCQ, any clause under which a creditor reserves a right to become the irrevocable owner of the debtor's property, or to dispose of it, if the debtor fails to perform its obligation, is invalid.

Guarantees

10. Are guarantees commonly used in your jurisdiction? How are they created?

Guarantees are commonly used in Canada in the commercial lending context. Typically, a guarantor will enter into a stand-alone guarantee with a secured creditor. Such a guarantee supports obligations that a third-party debtor owes to the secured creditor.

Suretyships are often used in commercial lending in Québec. They are usually made in writing and are not subject to any particular formality.

Risk areas for lenders

11. Do any laws affect the validity of a loan, security or guarantee (or the terms on which a loan, security or guarantee are made)? For example, rules on:

- **Financial assistance.**
- **Corporate benefit.**
- **Loans to directors.**
- **Usury.**

Financial assistance

Rules prohibiting financial assistance have largely been eliminated from corporate statutes in Canada. Subject to certain disclosure obligations, Canadian companies can provide financial assistance to affiliated entities or third parties. However, several Canadian corporate statutes prohibit a company from providing financial assistance for the acquisition of its own shares.

Corporate benefit

Canadian corporate statutes do not impose a corporate benefit requirement on transactions. Transactions with no benefit to the corporation can, however:

- Breach directors' fiduciary duties.
- Be challenged as oppressive by minority shareholders or creditors.

Guarantees supporting the debt of related companies are generally enforceable in Canada as long as the financing is beneficial to the corporate group as a whole.

Loans to directors

Canadian corporate law contains no specific restrictions on loans by companies to directors. Where a director has an interest in any matter to be decided by the board, the corporate statutes generally require the director to abstain from voting on that matter. However, the director will be able to enter into the loan once it has been approved by the board.

Usury

In all provinces and territories of Canada, including Québec, it is an offence to (*section 347, Criminal Code*):

- Enter into an agreement or arrangement to receive interest at a criminal rate.
- Receive payment or partial payment of interest at a criminal rate.

The criminal rate is defined as an effective annual interest rate of more than 60%. Regardless of the stated term of the loan, it is calculated over the period during which the loan is outstanding. Interest is defined broadly, and covers charges of any kind and in any form that are paid or payable in connection with the advance of credit. Examples of interest include:

- Facility fees.
- Structuring fees.
- Work fees.
- Commitment fees.
- Bonuses.
- Miscellaneous charges.

Lenders generally insert provisions into loan agreements that invalidate any interest in excess of the criminal rate and include a mechanism for converting any excess to repayments of principal.

Lenders in Canada must be aware of the criminal rate, particularly in a situation which shortens the term of a loan and could inadvertently push the actual rate above 60% per annum.

Aside from the criminal rate, no additional usury laws apply in Québec. However, a court can, if it finds that one of the parties has been exploited (suffered lesion):

- Void a contract for the loan of money.
- Order the reduction of the obligations arising from the contract.
- Revise the terms and conditions of the performance of the obligations.

Other rules

Canadian corporate law does not have any other rules which affect the validity of a loan, security interest or guarantee.

12. Can a lender, merely by making a loan or holding or enforcing a security or guarantee, be liable under environmental laws for the actions of the borrower, security provider or guarantor?

Generally, a lender will not be liable under Canadian environmental laws simply by making a loan or holding or enforcing security or a guarantee.

However, liability may arise if enforcement includes the lender going into possession or control. For example, if the lender has the ability to appoint directors and approve environmental programmes or policy, there is a theoretical risk that it would be viewed as having sufficient control over the land to trigger liability.

This risk applies even if the lender is not in actual possession of the land and did not participate in any activity that polluted the land. Lenders should be aware of this risk and examine each situation on a case-by-case basis, including possible provisions for relief in local environmental statutes. Typically, however, lenders are more concerned with the impact environmental issues have on a borrower's ability to service the loan.

Structuring of debt agreements

13. Is contractual subordination of debt possible and common? If so, how can it be achieved, for example by an inter-creditor agreement between senior, mezzanine and junior creditors? Is structural subordination possible?

Contractual subordination of debt is common. It can be achieved by an inter-creditor or subordination agreement negotiated between or among the relevant creditors. The PPSAs and the

CCQ provide that subordination agreements are effective in accordance with the terms set out in such agreements as agreed by the parties.

Structural subordination is also possible in Canada.

14. Is debt traded in your jurisdiction? If so, what transfer mechanisms are used? How do buyers ensure that they obtain the benefit of the security and guarantees associated with the transferred debt?

Secured debt is traded in Canada. The steps required to effect debt transfers depend on how the debt was originally advanced and how the security was originally held:

- Debt advanced directly by a lender who holds security. The transfer mechanism is typically a standard form assignment and assumption agreement. The assignment provides for the outright transfer of the debt and the related loan agreement, guarantees and security documents to the purchaser. Updates to existing lien filings (both under the PPSAs and applicable land registries) should be made to reflect the identity of the purchaser.
- Debt not advanced directly by the lender but by an agent or trustee who also holds the security. In this case, typically the agent advances the debt under a credit/loan agreement or a trustee advances the debt under a trust indenture for the lenders' benefit. The agreement or indenture would normally provide for a register of lenders or holders that facilitates transfers and evidences the relevant interest. The agent or trustee can continue to hold the security despite any transfers of underlying interests. The agreement or indenture and related documents will provide that the purchaser can enjoy the benefits of the security without needing to update existing lien filings.

15. Is the agent concept (such as a facility agent under a syndicated loan) recognised in your jurisdiction? If not:

- **Is an agency arrangement created under the law of another country recognised in your jurisdiction?**
- **Can a facility agent enforce rights on behalf of the other syndicate lenders in the courts in your jurisdiction?**

Common law jurisdictions

The agent concept is recognised and is commonly used in syndicated loans.

Québec

The agent concept is recognised. However, most financing practitioners consider that an agent must be formally appointed as a person holding the lenders' power of attorney (*fondé de pouvoir*) to hold a hypothec without delivery on behalf of future, unknown members of a syndicate of lenders. The deed of hypothec must be executed before a Québec notary and granted as security for the payment of a bond. The bond is simultaneously pledged to the agent as custodian bondholder as security for all obligations to the lenders under the syndicated credit facility.
As the party holding the hypothec, the agent, in its capacity as ''*fondé de pouvoir*'', may enforce all rights under the hypothec.

16. Is the trust concept (such as a security trustee holding security on behalf of two or more creditors) recognised in your jurisdiction? If not:

- **Is a trust created under the law of another country recognised in your jurisdiction?**
- **Can a security trustee enforce its rights in the courts in your jurisdiction?**

Common law jurisdictions

Domestic and foreign trusts are recognised. A security trustee can enforce its rights in Canadian courts.

Québec

Québec law recognises the trust concept. A *fondé de pouvoir* is equivalent to a security trustee (*see Question 15, Québec*).

17. Do the different types of security in your jurisdiction need to be documented separately or does your jurisdiction allow a single security document?

Common law jurisdictions

It is possible to use a single security document for different types of security but this is not common practice. Typically, secured parties use a number of different security agreements to take a full collateral package. A full security document set from a borrower might include items such as a debenture, a general security agreement, a securities pledge agreement and a control agreement.

Québec

Single security documents are commonly used by commercial lenders in Québec. Chartered banks in Québec typically use a multi-document approach.

18. Are there any rules on how loans (including syndicated loans) should be documented for the loan to be enforceable?

There are no rules on how loans should be documented for the loan to be enforceable.

Enforcement of security interests and borrower insolvency

19. Please briefly state the circumstances in which a creditor can enforce its loan, guarantees or security (for example, when an event of default occurs). What requirements must the creditor comply with?

The circumstances in which a creditor can enforce its loan, guarantees or security are set out in the particular contract with the debtor. Typically, these rights are set out in a credit, loan or guarantee agreement and/or in any related security agreements.

Common law jurisdictions

In common law jurisdictions, the secured party has its rights and remedies set out in the loan documents and the applicable PPSA (in relation to enforcement, see *Question 20*).

Québec

In Québec, a creditor under a hypothec can enforce the hypothec on the debtor's default. The statutory remedies available to the creditor are set out in the CCQ (in relation to enforcement, see *Question 20*).

20. How are the main types of security interest usually enforced? What requirements must a creditor comply with (for example, a mandatory public sale of the secured asset through the courts)?

Common law jurisdictions

General rules. Security interests are enforced by secured creditors themselves or through a receiver (appointed by the courts or privately) primarily by:

- Selling the underlying collateral.
- Foreclosing on the collateral.

- Liquidating the collateral.

There are a number of requirements creditors must comply with under the PPSAs and bankruptcy laws. This includes notifying the debtor of the default, demanding payment and then giving the debtor a ''reasonable period of time'' to repay before taking enforcement action.

Notice. The PPSAs generally provide for a 15-day notice period before a private sale of personal property.

In addition, secured creditors must send a notice of intention in a prescribed form and manner when enforcing on all or a substantial amount of inventory, accounts receivable or other property used in an insolvent person's business (*Section 244, Bankruptcy and Insolvency Act*) (BIA). As a matter of prudence, secured lenders almost always send notices prior to enforcing. The secured party cannot enforce for ten days after the sending of the notice, unless this is waived by the debtor after the notice of intent has been given.

The secured lender will be stayed from enforcing its security under a general stay of proceedings if, within this ten-day period, the debtor:

- Files a notice of intention to make a bankruptcy proposal.
- Files for and receives protection under the federal Companies' Creditors Arrangement Act (CCAA).

Secured creditors who are stayed from enforcing their security as a result of the commencement of reorganisation proceedings under the CCAA or the proposal provisions of the BIA can apply to the court for relief from the stay. This may be granted if the secured creditor can demonstrate that it is being materially prejudiced by the stay.

Self-help. In PPSA jurisdictions, secured creditors can exercise self-help remedies; that is, take possession of collateral. Typically, a secured creditor who has taken possession has the right to:

- Sell the collateral.
- Recover the debt.
- Foreclose and take the secured property in satisfaction of the debt.

If the debtor objects to foreclosure, the secured lender must sell the collateral. Exercising foreclosure extinguishes the debt and prevents recovery of any deficiency between the amount recovered and the debt, whereas the sale process does not.

Appointment of receiver. When provided for in security documents, a secured creditor may have the right to appoint a private receiver or manager to take possession of and realise the collateral on its behalf. A secured creditor has the right to seek the appointment of a court-appointed receiver/manager to assist in the enforcement and realisation process. A court-assisted process is

generally slower and more costly but the oversight and approval of the court minimises the risk of criticism and lender liability.

Liquidation. Liquidation of most insolvent businesses is conducted under the BIA. On bankruptcy the BIA imposes a stay of proceedings against the debtor. In the context of a BIA liquidation, the stay does not generally apply to secured creditors who are free to exercise their rights of self-help or otherwise realise their security outside the BIA.

The only exception to this rule is that a trustee in bankruptcy can apply to the bankruptcy court to stay the rights of a secured creditor for up to six months. Generally, secured creditors may proceed to realise on the collateral of their bankrupt debtors and receiverships are often run in parallel to BIA liquidation proceedings.

Québec

Under the CCQ, an enforcing secured party has four hypothecary rights:

- Taking possession for purposes of administration.
- Taking the property in payment of the debt.
- Private sale of the property.
- Sale of the property by judicial authority.

The creditor must give the grantor (and any other person against whom it intends to exercise such rights):

- A prior notice setting out the events of default.
- The right to remedy the events of default.
- The amount of the claim.
- The nature of the hypothecary right being exercised.
- A description of the collateral.
- A call for the surrender of the collateral before the expiry of the period specified in the notice.

The notice period is 20 days for movable property and 60 days for immovable property. It is automatically reduced in both cases to ten days where the creditor intends to take possession for the purposes of administration. The creditor can also apply to the court for it to be reduced where the recovery of the claim is endangered or the collateral may perish or deteriorate rapidly.

The creditor must register prior notice in the same register where the hypothec is registered, unless the hypothec is a pledge which is perfected by delivery (*see Question 3, Québec: Formalities*).

The debtor, the person against whom a hypothecary right is exercised, and any interested party, can defeat exercise of the hypothecary right by:

- Paying the enforcing creditor the amount due.
- Remedying the omission or breach set forth in the prior notice and any subsequent omission or breach.
- Paying the costs incurred.

Failure to pay or remedy the default or to voluntarily surrender the collateral will entitle the creditor to seek a court order for the forced surrender of the collateral.
Where the collateral consists of claims (including rents), the creditor can withdraw any prior authorisation granted to the debtor to collect those claims, by notifying the debtor and the account debtors and filing the notice in the appropriate register.

21. Are company rescue or reorganisation procedures (outside of insolvency proceedings) available in your jurisdiction? If yes, please give brief details, including voting requirements to approve such procedures. How do they affect a creditor's rights to enforce its loan, guarantees or security?

Plans of arrangement

A company can restructure certain forms of debt by converting it into new debt and/or new equity by way of a court-supervised plan of arrangement process under the federal legislation (the Canada Business Corporations Act (CBCA)) or provincial corporate legislation. Corporate plans of arrangement typically require approval by:

- The supervising court.
- A two-thirds majority of the affected creditors.

If the plan is approved, minority creditors will be bound by the plan.

Effect on creditors' rights

Plans of arrangement under the CBCA typically involve a stay of all affected creditors' rights pending voting and court approval of the plan. If the plan is pursued under the corporate legislation of a particular province (rather than the CBCA), that province's corporate legislation should be carefully reviewed to determine whether or not it authorises the court to order a stay of creditors' rights as part of those proceedings.

Beyond that, a company rescue or reorganisation outside of insolvency proceedings can only be achieved by private contract with the company's creditors. A private contract will not affect a secured creditor's rights to enforce its security without its agreement.

22. How does the start of insolvency procedures affect a creditor's rights to enforce its loan, guarantees or security?

The start of bankruptcy proceedings under the BIA does not stay the rights of secured creditors unless the debtor files a notice of intention to make a bankruptcy proposal. If the debtor files such a notice, all secured creditors will be stayed during the proposal period, except for secured creditors who:

- Took possession of their collateral before the filing.
- Gave notice of their intention to enforce on their security more than ten days before the debtor's filing of its notice of intention.

The commencement of reorganisation proceedings under the CCAA stays all secured creditors' enforcement rights on the court's granting of an initial CCAA order (*see Question 21*). Initial CCAA orders typically contain broad stay provisions that replicate the automatic stay in the US.
Companies in Canada may reorganise under the proposal provisions of the BIA or under the CCAA. The CCAA is more popular, but is only available to companies with more than Can$5 million in debt (as at 1 April 2011, EUR1 was about Can$1.40).

23. What transactions involving loans, guarantees, or security interests can be made void if the entity that received the loan or granted the guarantee or security becomes insolvent? Please briefly state the time limits that apply and the conditions that must be met for the transaction to be made void.

The federal BIA and CCAA both contain provisions that allow for the setting aside of transactions that constitute preferences or transfers at undervalue.
Preferences are transactions that have the effect of preferring one creditor over other creditors. Subject to certain other conditions and exemptions, transactions made with a view to giving one creditor a preference over others may be set aside under the BIA or CCAA if entered into during:

- Three months before the initial bankruptcy event (defined in the BIA) for transactions at arm's length.
- One year for transactions not at arm's length.

Transfers at undervalue are transactions in which the consideration the debtor receives is less than the fair market value it gives. Subject to certain other conditions and exemptions, transfers at undervalue can be set aside under the BIA or CCAA if entered into during:

- One year before the initial bankruptcy event (defined in the BIA) for transactions at arm's length.
- Five years before the initial bankruptcy event for transactions not at arm's length.

There is also provincial legislation allowing a court to set aside fraudulent conveyances or preferences. Common law provinces generally have a limitation period of two or six years (depending on the province) that applies to these kinds of provincial proceedings. In Québec, the limitation period is either one or three years, depending on the provision of the CCQ on which the claim is based.

Generally, Canadian debtors, BIA trustees and CCAA monitors are less aggressive in attacking pre-filing transactions than their US counterparts.

24. Please list the order in which creditors are paid on the borrower's insolvency, assuming the security interests have been validly perfected. Consider:

- **The secured creditors considered in *Questions 2* to *6*.**
- **Statutory claims.**
- **Unsecured creditors.**
- **Subordinated creditors.**

Subject to certain fact-specific exceptions, the general priority of claims in a bankruptcy is:

- Certain statutorily prescribed super-priority claims. For example:
    - the federal government has a super-priority claim and charge against the debtor's current assets, up to a maximum of Can$2,000 per employee for any unpaid wages (including vacation pay) earned up to six months before the date of the bankruptcy (Wage Earner Protection Program Act);
    - compensation to the Crown for the costs of environmental damage;
    - amounts that should have been remitted to federal authorities but were not:
        - income tax withholdings;
        - employment insurance premiums; and

        - Canada Pension Plan contributions.
    - fees and expenses of the bankruptcy trustee and any other court-ordered charges that may be granted over the debtor's property.
- Secured creditors (with respect to their security).
- Preferred creditors whose claims are entitled to priority over unsecured creditors, including (*section 136(1), BIA*):
    - costs of administering the bankruptcy;
    - a superintendent of bankruptcy's levy on all payments made by the trustee to creditors (approximately 5%);
    - municipal taxes; and
    - landlords' claims up to the maximum amount prescribed by statute.
- Unsecured creditors. In bankruptcy, this includes a number of federal and provincial statutory liens and deemed trusts that would, outside of a bankruptcy, have priority over secured creditors (for example, liens for unremitted federal and provincial sales tax).
- Shareholders.

There is no separate category of subordinated creditors under Canadian insolvency laws. Subordination is a matter of contract between creditors. The US doctrine of equitable subordination has not been applied to any meaningful extent in Canada.

25. If more than one creditor holds the same security interest over the same asset, how is priority between them determined? Please briefly set out any specific ranking rules that apply.

Common law jurisdictions

Under the PPSAs, the time of registration generally determines priority for security interests that are only perfected by registration. For general priority rules affecting investment property (*see below, Investment property*). The priority of charges registered against real property is determined by the time of registration of the charge (*see Question 3, Common law jurisdictions: Formalities*). There are exceptions to these general rules. For example, certain registered and unregistered liens can arise, such as a lien over inventory and equipment (Bank Act security), which is only available to Canadian chartered banks (*section 427, Federal Bank Act*). Purchase money security interests (commonly known as PMSIs) under the PPSAs are another exception.

Québec

Under the CCQ, the first creditor in time to publish its hypothec by registration (or obtains physical delivery in case of a pledge) has priority. However, the following exceptions apply:

- Priority of a hypothec over a life insurance policy is established by notice to the insurer regardless of the date of registration.
- A hypothec held by a secured party that is in control of hypothecated securities or security entitlements ranks ahead of any other hypothec (*see below, Investment property*).

Investment property

Particular rules apply to security over investment property. A security interest perfected by control has priority over any security interest that has not been perfected by control (*see Question 4, Formalities*). If multiple security interests in the same investment property are perfected by control, they rank in priority according to the time control was established. In certain circumstances, special priority is given to claims of securities intermediaries.

26. If a security interest has not been validly perfected, where does the security holder rank on the borrower's insolvency?

If a security interest is not validly perfected, the security holder ranks as an unsecured creditor. Unperfected security interests are unenforceable against:

- The trustee in bankruptcy.
- Other secured creditors.
- A bona fide purchaser of the collateral for value without notice of the interest.

The claim of an unperfected security interest holder ranks subordinate to the claims of validly perfected secured creditors. However, the claim would rank equally and proportionately with other unsecured creditors.

Cross-border issues on loans

27. Are there restrictions on the making of loans by foreign lenders or granting security (over all forms of property) or guarantees to foreign lenders? If yes, please give brief details, for example registration requirements.

There are no restrictions on the making of loans by foreign lenders, granting security or guarantees so long as they are not carrying on business in Canada. However, realisation on collateral by a foreign lender may trigger certain foreign ownership and other restrictions.

28. Are there exchange controls that restrict payments to a foreign lender under a security document, guarantee or loan agreement?

There are no exchange controls that restrict payments to a foreign lender under a security document, guarantee or loan agreement.

29. Is a foreign choice of law clause in a security agreement, guarantee or loan document recognised and applied by the courts in your jurisdiction? Does local law always apply in certain circumstances?

In general, Canadian courts will recognise and apply the parties' choice of law. However, this is subject to certain exceptions and conditions being met.

Canadian courts will not apply the foreign law if it is contrary to public policy. Further, Canadian courts will apply Canadian procedural law and certain provincial and federal laws that have overriding effect, such as:

- Bankruptcy and insolvency statutes.
- Federal criminal legislation.
- Employment legislation.
- Consumer protection legislation.

Local law will generally apply to collateral-related matters.

Tax and fees on loans, guarantees or security interests

30. Are taxes or fees paid on the granting and enforcement of a loan, guarantee or security? Consider the following and state the tax rates and fee amounts, if they are more than a nominal amount:

- **Documentary taxes (for example, stamp duty).**
- **Registration fees.**
- **Notaries' fees.**

With the exception of a modest tax on real property charges in certain Canadian jurisdictions, there are no taxes or fees payable on the granting or enforcement of a loan, guarantee or security interest in Canada. Registration fees payable in connection with the filing of PPSA financing statements are nominal.

If a deed (including one for a loan or hypothec) is executed before a Québec notary, they will generally charge a nominal fee for keeping it in their notarial records and for issuing copies.

31. Are there strategies to minimise the costs of taxes and fees on the granting and enforcement of a loan, guarantee or security?

As fees are nominal, there are no strategies to minimise the costs of taxes and fees (*see Question 30*).

Reform

32. Please summarise any proposals for reform and state whether they are likely to come into force and, if so, when.

There are currently no proposals for reform that would materially affect secured lending practices in Canada.

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Areas of practice. Banking; domestic and cross-border financings; debt restructuring.

Recent transactions

- Financing for acquisition by RBJ Schlegel Holding Inc. of The Homewood Corporation.
- Allen-Vanguard and The Brick Group Income Fund's recapitalisations.
- Frontera Copper Corporation's restructuring.
- TD Securities in Clean Power and Cardinal Power's refinancing and credit facility extension.

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Recent transactions

- TD Bank: US$255 million refinancing of Arctic Glacier Income Fund.
- SkyPower Limited: US$210 million of renewable energy project financings (First Light 1&2, 13th Sideroad, Ryerse, Erie Ridge, Thunder Bay 1&2).
- Aleris: US$1.075 billion, ABL DIP facility from Deutsche Bank and US$500 million multi-country, multi-currency ABL exit facility from Bank of America .
- Wells Fargo and PNC Bank: various financings.

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Recent transactions

- Restructurings of Calpine Canada, Pliant, Lear, Mechachrome, SemCanada, Allen-Vanguard, Frontera Copper, Compton Petroleum and White Birch Paper.
- Pan-Canadian Committee of Investors responsible for developing and implementing the Can$32 billion restructuring of Canadian third party structured asset-backed commercial paper.