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# QUEBEC'S EXECUTORY HYPOTHEC: A HISTORY REWRITTEN?

Tom Johnson\*

## Résumé

*Sauf dans des circonstances extraordinaires prévues par des dispositions particulières, le droit québécois des sûretés mobilières ne permet pas l'utilisation d'une charge flottante semblable à celle de common law. Mais la réforme du Code civil introduira dans le droit d'application général un concept similaire. L'auteur prétend qu'il existait au Québec, avant la codification, un équivalent fonctionnel de la charge flottante de common law. La réforme est donc un retour à la tradition plus qu'une innovation. Si cette prétention est exacte, et qu'une telle charge remonte au droit coutumier français du seizième siècle, alors se pose des questions intrigantes sur l'origine de la charge anglaise. Et s'il est vrai que, jusqu'au milieu du siècle dernier, le droit québécois permettait l'hypothèque tant des meubles que des immeubles, certaines des raisons "traditionnelles" d'une telle distinction sont d'origine relativement récente.*

*Dans une première partie, l'auteur décrit la vision traditionnelle du développement du droit québécois des hypothèques mobilières dès après la codification de 1866. Il étudie ensuite des clause "tout bien" de certains actes québécois du début du dix-neuvième siècle. Puis, comparant les sûretés existant dans les coutumes de Paris et de Normandie avec la charge flottante anglaise, l'auteur démontre que la charge flottante moderne avait son équivalent fonctionnel dans ces coutumes. Il conclut en spéculant sur les raisons qui ont pu amener la disparition de l'hypothèque mobilière avant la codification.*

## 1. Introduction

The impending modernization and rationalization of security devices in Quebec's Civil Code heralds modifications similar to those contained in Canadian Personal Property Security Act

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\* Assistant Professor, Osgoode Hall Law School. This paper was presented at the 18th Annual Workshop on Commercial and Consumer Law, held at McGill University on October 14-15, 1988. I benefitted from discussions at and following the session. I also benefitted greatly from comments by David Vaver, Rod Macdonald and Jeremy Webber on an earlier draft. I would like to acknowledge the research assistance of Gwen Shulman and Gordon Pansegrau. All errors are mine. [The Annual Workshop is sponsored by the Commercial and Consumer Law Section of the Canadian Association of Law Teachers and by the Faculties of Law of the University of Toronto, McGill University, Queen's University, and the Osgoode Hall Law School (Ed.).]

("PPSA") regimes. Among the intended changes is the extension of the concept of hypothecation, which presently covers immovable property only, to moveables, both corporeal and incorporeal, and the introduction within the Code of the capacity to charge present *and* future property.<sup>1</sup> Under art. 2022 of the present Civil Code, creditors are not able to take a hypothecary interest (that is, a non-possessory security interest) in moveable property, other than in exceptional circumstances permitted by certain legislative enactments. With the same exception, it is not possible to hypothecate future property.<sup>2</sup> Among other changes, the new reform will therefore introduce into the basic fabric of the civil law a concept similar to the English floating charge.

There is a widely held belief that these proposed reforms are innovations for the civil law. However, this paper will claim that these reforms, far from being novel, actually revert to a pre-codification civil law concept — the executory hypothec. Although my research is still in progress, I can presently say with some confidence that the executory hypothec on all property, both present and future, was a well-established security device in France and Quebec prior to the 19th century, and indeed dates at latest from the 16th century. At a minimum, we can say that the civil law in the pre-Napoleonic era contained a *functional equivalent* to the floating charge. The corollary to this claim is dealt with only peripherally in the following pages: contrary to the received wisdom, the English floating charge was not a unique development of the British judiciary in the late 19th century; rather, it was borrowed, consciously or subconsciously, from the civil law.

To date, I have been unable to uncover a judicial decision in the period 1790-1866 that directly addresses the validity of these Quebec charges, but circumstantial evidence strongly suggests that they were valid. Such evidence includes the fact that the charges appear in standard form contracts drafted by and used in

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<sup>1</sup> Furthermore, the new hypothec will be a consensual lien, as is the security interest created under modern PPSA regimes; see R.A. Macdonald, "The Reform of Secured Transactions Law in Quebec: From Corrective Justice to Distributive Justice", paper presented to the 18th Annual Workshop on Commercial Law, McGill University, Montreal, October 14, 1988.

<sup>2</sup> This capacity is made available to Quebec creditors under the Special Corporate Powers Act (An Act to Amend the Revised Statutes, 1909 by inserting therein articles 6119a, 6119b, 6119c and 6119d, S.Q. 1913-14, c. 51), and similar statutes; see *infra*, footnotes 9, 10. It is possible to create quasi-pledges pursuant to art. 1979a *et seq.*

the offices of many of the notaries of the period, indicating widespread, customary usage. Further, the notaries who drafted these clauses were the senior notaries in the province, acting for most of the wealthy strata of the society (*e.g.*, Molson, Redpath, McGill, Gerrard), and also for the major financial institutions (*e.g.*, the Bank of Montreal). A clause of this type was usually the only charging clause in these deeds although negative pledge covenants were sometimes included. Presumably, if the charge was invalid, the notaries for the creditor would have insisted upon a fixed charge on immoveables, in order to ensure that their client obtained the status of secured creditor.

In addition, deeds containing these clauses came before the judiciary on other matters throughout the early 19th century, yet in no instance did advocates challenge the validity of the clauses in an attempt to have the deed invalidated, nor did any member of the Bench raise the issue. Understandably so: given the widespread usage of the clause by the major creditors in the province, invalidation would have instantly conferred unsecured status upon most financiers. Circumstantial evidence suggests, therefore, that the clauses were accepted as valid in early 19th century Quebec.

The claim that the executory hypothec was a common security device in French civil law, rather than a British innovation, raises some intriguing questions concerning the disappearance of this charge in Quebec law, and the traditional narrative of the development of the floating charge in British common law doctrine. I have no definitive answer to these questions.

I shall first outline the traditional understanding of the development of Quebec law of hypothecation with respect to moveables. I shall then, in the next section, describe certain clauses in Quebec instruments from the early 19th century that purport to charge all the debtor's property, moveable and immovable, present and future, and shall discuss the scope of these charges. Although what legal effect these charges had is not now known, there was an available precedent for them in the Custom of Paris, the legal regime in force in Quebec during the period in question. In the third section, in an attempt to ascertain whether these clauses had the characteristics of a floating charge, I will compare the common law floating charge and the functional features of the executory hypothec contained in the Custom of Paris and the Custom of Normandy. My conclusion is that these

French charges were functionally similar to the English floating charge.

Lastly I shall speculate about the disappearance of this charge from Quebec law, placing the discussion in the economic context of the day: what factors led to its disappearance — to the point where it now seems to have passed from public consciousness — at precisely the same time as the common law courts in Upper Canada and England were striving to develop a similar concept? Was this concept of an executory hypothec superseded by other forms utilized by Quebec's legal community, or was it abandoned for the sake of conceptual unity? I have no answers, although I suspect that the cause of the disappearance can be attributed to the restraints imposed upon the infant chartered banks by their charters.

## 2. The Traditional Development of Doctrine

If we turn to the received wisdom regarding the development of non-possessory security interests in moveables in Quebec, we first observe that the narrative of this development is constructed largely through the medium of doctrine — that is, case law and statutes.

The traditional story is familiar enough. It begins with the inability to hypothecate moveable property at the time of codification in Quebec and moves from there to the gradual development, through law reform, of legal institutions through which non-possessory security interests in moveables could be acquired. The social reality invoked to complement (or rationalize) the story is that the doctrine developed, so it has been stated, in response to the need to encourage, or facilitate, capital expansion.<sup>3</sup>

Article 2022 of the Civil Code of Lower Canada (“C.C.L.C.”) reads in part: “Moveables are not susceptible of hypothecation”. In 1866, at the time of codification, the only means for asserting a right of preference upon the proceeds of a judicial sale of moveables known to Quebec law were the pledge,<sup>4</sup> the privilege,<sup>5</sup> the seller's right of revendication and resolution,<sup>6</sup> title transactions

<sup>3</sup> See, e.g., R. R. Pennington, “The Genesis of the Floating Charge” (1960), 23 *Mod. L. Rev.* 630 at pp. 630-4. See also R.H. Anstie, “The Historical Development of Pledge Lending in Canada — Part 1” (1967), 74 *The Canadian Banker* 81 at p. 82.

<sup>4</sup> Articles 1966 *et seq.* C.C.L.C.

<sup>5</sup> Articles 1994 *et seq.* C.C.L.C.

<sup>6</sup> Articles 1998 to 2000 and article 1543 C.C.L.C.

(e.g., the conditional sale), and the pledge of documents of title (e.g., warehouse receipts and bills of lading).<sup>7</sup> Therefore, in 1866, according to the conventional story, there was no non-possessory security interest available to general creditors in Quebec, other than these specified interests.<sup>8</sup>

By the turn of this century, hypothecation of moveables was allowed by special statutes, as an exception to the general rule of art. 2022.<sup>9</sup> These special statutes empowered certain corporate entities with specific "public" purposes or goals, such as railway and hydro projects, to give a non-possessory security interest in moveables to the corporation's creditors. Such was the belief in the unusual nature of the powers granted to these enterprises that the facility was granted only after some contention; indeed, one still finds recent comments to the effect that these special statutes introduced certain "common law" concepts into the civil law.<sup>10</sup> Then, in 1914, the Special Corporate Powers Act<sup>11</sup> was intro-

<sup>7</sup> See Macdonald, *supra*, footnote 1, at p. 34. See also Anstie, *supra*, footnote 3; and Alfred Dubuc, "The Advent of Banking Credit on the Guarantee of Warehouse Receipts in Canada" (1963), 70 *The Canadian Banker* 51.

<sup>8</sup> The pledging of certain documents of title (namely, warehouse receipts) was, at its inception in Quebec, a relatively clumsy concept, in that the owner of the goods could not hold a receipt while retaining possession of the goods. Actual delivery to a warehouse was essential. It therefore did not truly involve a concept of "non-possessory" security interests. The earliest known usage of pledging warehouse receipts was 1848 (see Dubuc, *supra*, footnote 7). Statutory recognition of this practice occurred in 1849 in An Act for the Punishment of Warehousemen and others Giving false Receipts for Merchandize, and of Persons receiving Advances upon Goods, and afterwards fraudulently disposing of the same (S.L.C. 1849, c. 12.); and again in 1859, with An Act granting additional facilities in commercial transactions (S.L.C. 1858, c. 20). These Acts were amended in 1861 to allow for the issuing of "fictitious" warehouse receipts, issued by the owner of the goods, who then retained possession (An Act to amend chapter fifty-four of the Consolidated Statutes of Canada, entitled: An Act respecting Incorporated Banks, S.L.C. 1861, c. 23), and ultimately incorporated in the current Bank Act, S.C. 1980-81-82-83, c. 40, Part I, s. 2, as amended (now R.S.C. 1985, c. B-1), s. 179. These Acts are discussed in greater detail in Anstie, *supra*, footnote 3.

Early usage of bills of lading for the same purposes is more difficult to trace, but fictitious bills of lading were addressed in the same statutes as warehouse receipts (fictitious bills of lading are also recognized in the Bank Act, s. 179). Placing warehouse receipts and bills of lading to one side, the only known form of non-possessory hypothecation of moveables at the time of codification in Quebec was the contract of *respondentia*.

However, warehouse receipts, bills of lading and *respondentia*, even if allowing for non-possessory security interests in moveables, do not allow for the hypothecation of future moveable property.

<sup>9</sup> The general rule is outlined in F.W. Wegenast, *The Law of Canadian Companies* (Toronto, Burroughs and Co., 1931), pp. 656 *et seq.*

<sup>10</sup> See, e.g., S. La Bel, "Les émissions d'obligations dans le droit de la province de Québec de 1890 à nos jours" (1980), 21 *Les cahiers de droit* 43.

<sup>11</sup> *Supra*, footnote 2.

duced. Later, the agricultural pledge in 1940,<sup>12</sup> and the commercial pledge in 1962,<sup>13</sup> modified the ability of private persons to hypothecate moveables.

Thus, the traditional image of hypothecation of moveable property in Quebec is that apart from fictitious documents of title, *respondentia*, and certain well-defined privileges, it was not possible in 1866 to hold a non-possessory security interest in present moveables. In addition, although the position with regard to the capacity to hypothecate future property may not have been crystal clear in 1866, this possibility was definitely precluded by 1901.<sup>14</sup> Throughout the last part of the 19th century, this incapacity was altered by legislative enactment to meet the needs of capital development.

### 3. Commercial Practice of the Early 19th Century

When, however, one turns to empirical evidence of commercial practice in early 19th century Quebec, one finds a noticeable discrepancy between that evidence and the doctrinal narrative. One finds the presence of clauses in pre-codification deeds which in effect granted to the creditor an executory hypothec over all the debtor's assets, moveable and immovable, "now-owned and after-acquired".

Prior to codification, there were literally thousands of deeds executed between debtors and creditors in which the creditor took this right of preference on the debtor's assets. The typical phrase that one finds inserted in the Quebec deeds reads as follows:<sup>15</sup>

<sup>12</sup> *Loi du nantissement agricole*, S.Q. 1940, c. 69.

<sup>13</sup> *Loi relative au nantissement*, S.Q. 1962, c. 57.

<sup>14</sup> *Corporation du Village de la Pointe Gatineau v. Hanson* (1901), 10 B.R. 346. Compare *Holroyd v. Marshall*, *infra*, footnote 26.

<sup>15</sup> *Archives national du Québec à Montréal* (ANQM) CN 601-187 #3908 — contract of loan (£6,000) made by Samuel Gerrard (merchant, creditor) to Thomas Torrance (merchant, debtor), executed before Henry Griffin, notary, September 25, 1821. A typical clause in the French language, in deeds concerning seigniorial lots, reads as follows:

... au paiement de laquelle dite somme, outre le Privilège primitif acquis sur ladite Terre, ledit Preneur a affecté, obligé & hypothéqué généralement tous ses biens, meubles & immeubles, présents & à venir, une Obligation ne dérogeant à l'autre; & si ledit Preneur sesdits Hoirs & ayans cause avoient manqué à satisfaire au contenu ci-dessus, en ce cas pourra mon dit Sieur Seigneur Baillieur, rentrer de plein droit en ladite Terre, sans pour se garder ni observer aucune forme ni figure de procès: ces Présentes néanmoins demeurant en leur force & vertu, pour les arrérages desdits Cens & Rentes lors dûs & échus, & dommages faits sur ladite Terre.

See ANQM CN 601-269 #3 *Concession par Monsieur Le General Christie ... à Amant*

... and, for the more ample security whereof, both principal and interest, he the said [debtor] doth hereby specially bind, obligate, mortgage and hypothecate all and singular his real and personal property, present and future (*meubles et immeubles présents et avenir*). One obligation not derogating from the other: for thus, etc., ...

I first came across this language in my research on Quebec's seigniorial system. These clauses were commonly inserted in deeds of sale of *censitaire's* lots when the sale was vendor-financed. The deeds within which I first found these phrases were drafted between 1790 and 1796. Moreover, they were standard form contracts — printed, rather than handwritten, with blank spaces for the names of the parties, description of the lots, price, etc., and executed before notaries. The fact that the deeds were in printed form immediately suggests that they were customary rather than unique.

Two features of the charge reproduced above attract attention. First, it purports to cover moveable property — this is in direct contrast to the principle later set out in art. 2022 of Quebec's Civil Code.<sup>16</sup> Secondly, it purports to cover future assets. This may be starkly contrasted with the statements contained in several Quebec cases at the turn of this century, which track post-Napoleonic Code French doctrine on the nature and specificity of a real right, and which claim that one cannot hypothecate after-acquired property in Quebec.<sup>17</sup>

The first question that sprang to mind was, were these charges limited to sales of seigniorial land? The short answer is no. With the assistance of members of the Montreal Business History Project,<sup>18</sup> I expanded my research to cover early 19th century contracts of loan. The "executory hypothec" clause exists in most

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*Broux, dans le Seigneurie Déléry*, executed before Pierre Lukin, Sr., notary, June 25, 1790.

The clauses varied over the years, and even within a given time period. Although absent in this instance, acceleration clauses were not uncommon; see, e.g., ANQM CN 601-187 #6259 — contract of loan made by the Bank of Montreal to Abner and Stanley Bagg, and Oliver Wait (traders), executed before Henry Griffin, notary, February 18, 1826.

<sup>16</sup> See also *Esplin v. Campbell* (1900), 6 R. de J. 81 (Sup. Ct.).

<sup>17</sup> See, e.g., *Corporation du Village de la Pointe Gatineau v. Hanson*, *supra*, footnote 14.

<sup>18</sup> The Montreal Business History Project is an inter-university research group established in 1976 at McGill University in Montreal. It consists of historians interested in social, legal and business history. The group's research has centered on early 19th century Montreal. Current research focuses on the legal history of mid-19th century Montreal, and in particular issues such as dower, codification, and master/servant relations.



contracts of loan for diverse enterprises in Quebec, at least, through to the 1820s.

Another question that occurred was whether the concept of an executory hypothec was restricted to a certain class or vocational group within the society, for example, loans between merchants only, just like the later special statutes applied only to certain enterprises? Again, the answer is no. The phrases exist in loans not only where a merchant acts as creditor, but also where the creditor is listed as an artisan,<sup>19</sup> a builder,<sup>20</sup> and even a yeoman.<sup>21</sup> In short, the lien was available to all categories of creditor, merchant and yeoman alike.

These clauses were not unique to the early 19th century. Discussions with other members of the Business History group indicated that these clauses were present from the earliest moments in New France, and can be traced back at least to the 17th century. They are not, therefore, some aberration caused by the confluence of civil and common law concepts following the conquest of 1760. Rather, as we shall shortly see, these civil law clauses anticipate the English common law by at least three centuries.

One might ask whether these clauses were “true” security interests: was the charge exercisable against third parties? I have no evidence as to how the charges were interpreted in the courts, although I am currently researching that issue. I do however have evidence that the clauses were meaningful: in several instances, competing security interests were created by several creditors in the same collateral with full knowledge of the other security interest.

For example, on February 18, 1826, a contract of loan between the Bank of Montreal (creditor) and Abner and Stanley Bagg, and Oliver Wait, traders (and debtors) was executed before Henry Griffin, notary. The instrument contained a clause of the type outlined above. Attached to this document was another instrument listed as “An Act of Indemnity”, in which it was

<sup>19</sup> See, e.g., ANQM CN 601-187 #3925 — contract of loan between Samuel Gerrard (merchant, creditor) and Louis Graveland and Peter Lamoureux (joiner and painter respectively, debtors), executed before Henry Griffin, notary, October 2, 1821.

<sup>20</sup> See, e.g., ANQM CN 601-187 #6016 — contract between Samuel Gerrard (President of the Bank of Montreal, creditor) and J. Redpath (mason, debtor), executed before Henry Griffin, notary, September 16, 1825.

<sup>21</sup> See, e.g., ANQM CN 601-187 #4910 — contract of loan between John Wilson (yeoman, creditor) and James Bowes (brewer, debtor), executed before Henry Griffin, notary, September 27, 1823.

acknowledged that Abner Bagg was the principal debtor to the Bank of Montreal. He had borrowed several sums of money from the bank, giving in exchange promissory notes which he could not honour "without a great sacrifice of valuable property". Accordingly, Stanley Bagg and Oliver Wait acted as guarantors (sureties) for the rescheduled loan from the bank. In return, the guarantors received a mortgage charge over all Abner Bagg's property, moveable and immoveable, present and future.<sup>22</sup>

It seems unlikely that the second creditors would go to the trouble to create a junior charge unless that charge had some legal effect as against previous and subsequent charges. As for the issue of "true" security interest, I note that a charge need not be exercisable against third parties in order to constitute it a security device, as is true, as we shall see shortly, with the English floating charge.<sup>23</sup>

Although I have no evidence of how these Quebec clauses were interpreted in the courts, there was a right of preference in the Custom of Paris similar in substance to the floating charge. Since the Custom of Paris was the law in force during the period in question, this most likely was the precedent for the clauses in the Quebec instruments. Therefore, in order to consider whether French civil law contained the concept of an executory hypothec, we shall now examine some of the principal features and characteristics of the common law floating charge.<sup>24</sup>

The traditional rationale or narrative about the development of the English common law floating charge is that it was developed in the 19th century by the British judiciary. During the early stages of development, there were actually two theories of the floating

<sup>22</sup> See ANQM CN 601-187 #6277.

<sup>23</sup> In fact, to claim that a charge is not a "true" security device unless it is immediately exercisable against third parties is to adopt the American position on the English floating charge; see, e.g., *Geilfuss v. Corrigan*, 95 Wis. 651, 70 N.W. 306 (S.C., 1897); and *Benedict v. Ratner*, 268 U.S. 354, 45 S. Ct. 566, 69 L.Ed. 991 (1925). See also Grant Gilmore, *Security Interests in Personal Property* (Boston, Little, Brown, 1965), Chapters 6, 8.

<sup>24</sup> Much of what follows is taken from R.M. Goode, *Legal Problems of Credit and Security*, 2nd ed. (London, Sweet and Maxwell, 1988), pp. 45-91. See also Pennington, *supra*, footnote 3; J.S. Ziegel, "Recent and Prospective Developments in the Personal Property Security Law Area" (1985), 10 C.B. L.J. 131; J.S. Ziegel, "Recent and Prospective Developments in the Personal Property Security Area and the Recommendations of the Ontario Advisory Committee" in *Special Lectures of the Law Society of Upper Canada 1985* (Don Mills, De Boo, 1985), p. 1. See also Wegenast, *supra*, footnote 9, at pp. 659 *et seq.*

charge: first, that it was a fixed charge, with a licence to deal; second (and this became the dominant theory), that it was a non-specific or general charge, with postponed attachment. Under the second theory, during the period of the postponement the debtor had the power of management over the assets, and the creditor was bound not to interfere in transactions in the ordinary course of business.<sup>25</sup> The general rationale given for the creation of the floating charge in English common law is that it was developed to facilitate creditors' capacity to take security in stock in trade as capital intensive industries were growing; in short, to facilitate inventory financing.

The crucial first stage in the development of the English common law floating charge is often seen as originating in the landmark decision of *A.P. Holroyd v. J.G. Marshall*,<sup>26</sup> which upheld a clause containing a fixed charge on future property. Within a decade of that decision, in a case before Giffard L.J. in 1870,<sup>27</sup> the common law judiciary developed a notion of a general charge on present and future property.

The oft-quoted passage of Buckley L.J. in *Evans v. Rival Granite Quarries, Ltd.*<sup>28</sup> neatly summarizes the essential nature of a common law floating charge:

A floating security is not a future security; it is a present security, which presently affects all the assets of the company expressed to be included in it. On the other hand, it is not a specific security; the holder cannot affirm that the assets are specifically mortgaged to him. The assets are mortgaged in such a way that the mortgagor can deal with them without the concurrence of the mortgagee. A floating security is not a specific mortgage of the assets, plus a licence to the mortgagor to dispose of them in the course of his business, but is a floating mortgage applying to every item comprised in the security, but not specifically affecting any item until some event occurs or some act on the part of the mortgagee is done which causes it to crystallize into a fixed security . . . This crystallization may be brought about in various ways. A receiver may be appointed, or the company may go into liquidation and a liquidator be appointed, or any event may happen which is defined as bringing to an end the licence to the company to carry on business.

<sup>25</sup> See Ziegel, *Special Lectures*, *supra*, footnote 24, at pp. 11-12, and Pennington, *supra*, footnote 3, particularly at pp. 644-6. For an excellent description of the latter theory see *Governments Stock and Other Securities Investment Co. Ltd. v. Manila Railway Co. Ltd.*, [1897] A.C. 81 (H.L.) at p. 86, *per* Lord Macnaghten.

<sup>26</sup> (1861-62) 11 E.R. 999, 10 H.L.C. 191. See also Pennington, *supra*, footnote 3, at pp. 634-7, and Goode, *supra*, footnote 24, at p. 45.

<sup>27</sup> In *Re Panama, New Zealand and Australian Royal Mail Co.* (1870), 5 Ch. App. 318, 39 L.J. Ch. 482. See Wegenast, *supra*, footnote 9, at p. 660; Pennington, *supra*, footnote 3, at p. 639; and Goode, *supra*, footnote 24, at p. 47.

<sup>28</sup> [1910] 2 K.B. 979 (C.A.) at pp. 999-1000, *per* Buckley L.J.

The three characteristics of a floating charge identified by Romer L.J. in *Re Yorkshire Woolcombers Association Ltd.*<sup>29</sup> are: first, it is a charge on a class of company assets both present and future; second, the class is one within which the particular assets of the company are constantly changing in the ordinary course of the business; and third, while the charge "floats", the debtor is given the power to manage the assets of the company, free from the creditor's interference. A floating charge might, therefore, be described as a present security in a constantly changing fund of assets. Throughout the course of the charge "floating", the debtor has the power to manage the assets in the ordinary course of business.<sup>30</sup>

Although the security interest under a floating charge has immediate existence, it does not attach until a later event ("crystallization"). During the pre-crystallization period within which the interest "floats", assignees of specific assets within the charge fund take free of the floating charge.<sup>31</sup> Given this vulnerability, what advantages do creditors gain from a floating charge?

The first and most obvious advantage is that the debtor is able to manage the assets of the company without interference from the creditor. As a result, the debtor need not acquire further permission from the creditor for the sale or assignment of specific assets within the fund. Such permission would normally be essential if assets within the fund were subject to a fixed charge. Second, no new act is required when the crystallizing event occurs. At that stage the creditor may take possession of the assets covered by the floating charge and realize on the collateral. A judicial order for sale is not necessary. Third, once crystallization occurs the charge becomes fixed on the assets then in existence. Consequently, assets dealt with after crystallization are subject to

<sup>29</sup> [1903] 2 Ch. 284 (C.A.) at p. 295, affd [1904] A.C. 355 (H.L.) at p. 358 *sub nom. Illingworth v. Houldsworth*, per Lord Macnaghten. See also Pennington, *supra*, footnote 3, at pp. 645-6; Goode, *supra*, footnote 24, at pp. 48-9; Wegenast, *supra*, footnote 9, at pp. 659-60.

<sup>30</sup> The Ontario Court of Appeal firmly supports this description in *Re Urman* (1983), 3 D.L.R. (4th) 631, 44 O.R. (2d) 248.

<sup>31</sup> See generally Ziegel, *supra*, footnote 24; Goode, *supra*, footnote 24, at pp. 50-2; Wegenast, *supra*, footnote 9, at pp. 659 *et seq.* As to the ability to assign specific assets, *Re Borax Co.*, [1901] 1 Ch. 326, 70 L.J. Ch. 162 (C.A.), held that a firm could sell the whole of its undertaking if it was within its corporate powers to do so. The basic principle was established in *Re Panama*, *supra*, footnote 27. Other examples are found in Wegenast, *supra*, footnote 9, at pp. 662-3; see also *Re Urman*, *supra*, footnote 30.

the charge, unless the creditor has explicitly or implicitly authorized such dealings.<sup>32</sup> Fourth, execution creditors who do not complete the execution process before crystallization take subject to the floating charge.<sup>33</sup> Fifth, the creditor can appoint a receiver to manage the business in the event of default, rather unlike the case under a fixed charge, where a sale of assets is the sole remedy.<sup>34</sup>

There are, however, several disadvantages with a floating charge. As noted, assets covered by the floating charge are vulnerable to third party transactions. Thus a third party assignee who takes (either conditionally or absolutely) prior to crystallization and in the ordinary course of business usually takes free of the floating charge.<sup>35</sup> The chargee's vulnerability exists until the moment of crystallization, when the floating charge is converted into a fixed charge. Therefore, the crucial moment with a charge of this type is the crystallizing event. What events trigger crystallization?

Essentially, crystallization is triggered by any event that revokes the debtor's power to manage the business, most commonly the appointment, out of court, of a receiver. Similarly, revocation occurs through taking possession, or a judicial order for possession or sale,<sup>36</sup> cessation of trade (either express or, if the

<sup>32</sup> Implicit authorization might arise, for example, in the situation where a creditor's receiver continues the operation of the business, rather than realizing on the collateral. From a third party's perspective, the charge has not crystallized in such instances. See Ziegel, *Special Lectures*, *supra*, footnote 24, at p. 14, and *idem* C.B.L.J., at p. 153; and Goode, *supra*, footnote 24, at pp. 60-4. For a more general discussion of the role of a privately appointed receiver, see *Sperry Inc. v. Canadian Imperial Bank of Commerce* (1985), 17 D.L.R. (4th) 236, 50 O.R. (2d) 267 (C.A.); and Ziegel, *Special Lectures*, *ibid.*, at pp. 25-8.

<sup>33</sup> *Evans v. Rival Granite Quarries Ltd.*, *supra*, footnote 28, at p. 996, *per* Fletcher Moulton L.J.; *Geisse v. Taylor and Hartland*, [1905] 2 K.B. 658. See also Ziegel, *Special Lectures*, *supra*, footnote 24, at p. 16; Goode, *supra*, footnote 24, at p. 50; Wegenast, *supra*, footnote 9, at pp. 663-4.

<sup>34</sup> *Edwards v. Standard Rolling Stock Syndicate*, [1893] 1 Ch. 574; *Re Victoria Steamboats Ltd.*, [1897] 1 Ch. 158. See also Goode, *supra*, footnote 24, at p. 50.

<sup>35</sup> See *Re Urman*, *supra*, footnote 30; *Re Huxley Catering Ltd.* (1982), 134 D.L.R. (3d) 369, 36 O.R. (2d) 703 *sub nom. Irving A. Burton Ltd. v. Canadian Imperial Bank of Commerce*. See also, Wegenast, *supra*, footnote 9, at pp. 663-4; Goode, *supra*, footnote 24, at pp. 83-9; and footnote 31 with the accompanying text.

<sup>36</sup> Mere default by the debtor is insufficient to crystallizing the charge, as is a demand for payment. In both instances the debtor's authority to manage the business has not been effectively revoked by the creditor, particularly when viewed from the perspective of other creditors; see *Evans v. Rival Granite Quarries Ltd.*, *supra*, footnote 28, and *Re Hubbard and Co. Ltd.* (1898), 68 L.J. Ch. 54. See also Goode, *supra*, footnote 24, at pp. 67-8; and Wegenast, *supra*, footnote 9, at pp. 663-4.

company goes into liquidation, implied) and any events specified in the debenture (the so-called "automatic crystallization" events).<sup>37</sup> For our purposes, it is the first set of events — revocation of authority through appointment of a receiver or taking possession — that are most important.

What are the priorities under the floating charge? In effect, there is no *in rem* right while the charge continues to float: the charge is ineffective against third parties until crystallization. A buyer or encumbrancer, who acquires an interest in the ordinary course of business while the charge floats, takes priority over the charge even if he or she has knowledge of the charge.<sup>38</sup> In general, the only circumstances under which the floating charge will take priority to a later pre-crystallization dealing is where bad faith may be imputed, for example, if the assignee has notice of the restrictions of the floating charge or if the dealings are out of the ordinary course of business. Execution creditors, as we have seen, take free from the floating charge only if execution is completed before crystallization.

In summary, therefore, an English common law floating charge is a present general security which floats over the asset pool of the debtor. It is converted to a fixed charge on crystallization. Crystallization is in effect the removal of the debtor's power of management of the assets of the business. The most frequent event which triggers crystallization is appointment of a receiver. Third party assignees who take in the ordinary course of business while the charge floats (that is, prior to crystallization) take free of the charge. In civilian terms, therefore, while the charge floats there is no *droit de suite*. The major benefits of the floating charge are that, prior to crystallization, the debtor is free to manage the assets of the business without interference from the creditor; yet once crystallization occurs no new act is required by the creditor in order to bring the assets to sale. Once crystallization occurs an *in rem* right in the assets arises. At that moment the floating charge has priority over subsequent charges.

<sup>37</sup> *Evans v. Rival Granite Quarries Ltd.*, *ibid.*; *Hodson v. Tea Co.* (1880), 14 Ch. D. 859; *Wallace v. Universal Automatic Machines Co.*, [1894] 2 Ch. 547 (C.A.). See also, *Wegenast*, *supra*, footnote 9, at pp. 663-4. As to events specified in the debenture, see *Governments Stock and other Securities Investment Co. Ltd. v. Manila Ry. Co. Ltd.*, *supra*, footnote 25; and *Re Brightlife Ltd.*, [1986] 3 All E.R. 673 (Ch. D.). See also *Goode*, *supra*, footnote 24, at pp. 64-74.

<sup>38</sup> See *Re Castell & Brown Ltd.*, [1898] 1 Ch. 315; *English and Scottish Mercantile Investment Co. Ltd. v. Brunton*, [1892] 2 Q.B. 700 (C.A.). See also *Goode*, *supra*, footnote 24, at p. 85.

Both F.W. Wegenast and R.R. Pennington view the concept of a floating charge as unique to the common law, although Pennington acknowledges that a similar concept existed in Roman law.<sup>39</sup> Implicit in the commentary of both authors is the claim that no such concept existed in the civil law. Certainly, the floating charge is unknown to modern civil law.<sup>40</sup> Wegenast substantiates his observation that the floating charge was a common law development by citing art. 170 of the Custom of Paris, claiming that "the Civil Code would recognize no such thing as a chattel mortgage on chattels remaining in the possession of the mortgagor."<sup>41</sup>

In his interpretation of art. 170 Wegenast, however, wrongly assumes that the *droit de suite* is a necessary characteristic of a right of preference; but, as has been explained, even under a common law floating charge no right *in rem* exists prior to crystallization. He is correct in stating that the civil law does not recognize a *chattel mortgage* on chattels remaining in the possession of the debtor; but it does not follow that therefore the civil law does not recognize a *right of preference* in chattels remaining in the possession of the debtor. The law may very well recognize another form of security device, such as an executory hypothec, or the English floating charge, in these instances.

In order to substantiate my claim that the concept of an executory hypothec existed from at least the 16th century onwards in the French civil law, I now turn to examine the various articles under the Custom of Paris and the Custom of Normandy, and shall compare the characteristics of the right of preference outlined there with the characteristics of the floating charge.

#### (a) The Custom of Paris

The Custom of Paris contained a relatively sophisticated concept of a general security interest, not unlike the modern

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<sup>39</sup> See Wegenast, *supra*, footnote 9, at pp. 659 *et seq.*; and Pennington, *supra*, footnote 3, at p. 634. Pennington notes that Roman Law contained a concept of *hypotheca* for moveables, which developed out of the Roman concept of *pignus*. The latter was identical to the modern concept of pledge, only the lender was permitted to redeliver the pledged goods to the borrower, who held them at the lender's pleasure (bailee at will). The *hypotheca* merely took the concept of delivery and redelivery one step further by fictionalizing it.

<sup>40</sup> Article 2022, C.C.L.C.

<sup>41</sup> Article 170 reads: "*Meubles n'ont point de suites par hypothèque, quand ils sont hors la possession du débiteur.*" See Wegenast, *supra*, footnote 9, at p. 656.

English floating charge in personal property. The articles dealing with this concept are located in Title 8 of the Custom of Paris. This title concerns *arrêt*, *exécution*, *et gageries*. The words contained in this heading had various meanings under the Custom of Paris and often one finds the word *saisie* substituted for the word *arrêt*. The verb *saisir* means to “seize”. In the context of the Custom of Paris, it sometimes meant simply the seizing of moveables of the debtor, and sometimes the seizing and execution of the moveables. It also refers to the seizing of proceeds, loosely speaking, accounts receivables in the hands of a third party when such proceeds were due to the debtor (*i.e.*, garnishment): indeed, the word *arrêt* typically referred to this event.<sup>42</sup> The word *exécution* meant the sale of the moveables seized, although it sometimes meant a simple seizing of the moveables of the debtor. The term *gagerie* was a right or privilege by which the moveables in a house were charged, even though not seized to the landlord and certain others.

Article 160 of the Custom of Paris lists three causes for seizing and selling the moveable property of a debtor. The first, and most relevant one for our purposes, stated that one can seize and sell the moveable property of a debtor as a result of an obligation or contract executed before a notary. If the contract is formally signed and sealed in the jurisdiction where it is passed, the goods can be sold without the authority and permission of a judge; conceptually, the seal of a notary had the same effect as a royal seal, in that it had the same force as a sentence or judgment. The obligation contained in a contract of this sort against the moveables and immoveables of the debtor was described as “executory” (*exécutoire*).<sup>43</sup> Unlike the modern concept of hypothec, this is functionally equivalent to the remedies available under modern PPSA regimes.<sup>44</sup>

<sup>42</sup> *Il se prend encore pour la saisie des deniers entre les mains d'un tiers, appartenans ou dus au débiteur de celui qui fait la saisie, et la saisie en ce cas est appelée arrêt, parce qu'elle ne fait qu'arrêter ce qui est dû au débiteur jusqu'à ce que le saisissant ait obtenu par sentence que les deniers saisis lui soient mis entre les mains pour & en déduction de ce que son débiteur lui doit, en sorte qu'en ce cas saisie et arrêt sont synonymes.*

<sup>43</sup> Article 164, Custom of Paris. This is conceptually similar to the notion that the common law floating charge has not attached until crystallization — that is to say, the charge remains executory until the crystallizing event, at which point it becomes executed.

The commentary accompanying the version of the Custom of Paris used by me (C. Ferrière, revised and edited by S. D'Aramon (Paris, Chez les Libraires Associés, 1770)) cites *Arrêts* of October 1550, and December 1, 1552, in support of this proposition. These dates indicate a much earlier usage of this type of security interest than had hitherto been suspected.

<sup>44</sup> The modern hypothec in Quebec requires bringing the charge to judgment unless the



In the absence of a notarized deed, a creditor could seize the moveable property of his or her debtor in much the same way as a modern execution creditor, by requesting and receiving a schedule (*simple cédule*) from a judge, pursuant to art. 173 of the Custom of Paris.<sup>45</sup>

Under art. 177 of the Custom of Paris, the first creditor to seize or to bring the moveable to judicial sale was preferred over other creditors. The rationale listed in the commentary for this preference is that such a rule rewards the diligence of the creditor who watches or ensures that his interests are recompensed, to the detriment of the other creditors who have neglected their affairs.

However, the charge was not effective in an insolvency. The Custom of Paris draws a distinction between what it calls *simple exécution* and *déconfiture* (insolvency). In cases of insolvency, according to art. 179, no creditors are preferred.<sup>46</sup> Rather, they all share rateably, for the reason that no creditors in these situations should find themselves in a better circumstance than the others. In other words, presumably they were all equally negligent in attending to their affairs.

We may therefore conclude that there are at least two similarities between the preferential right under the Custom of Paris and the English floating charge. First, provided the hypothec was signed and sealed before a notary, no new action was necessary for a creditor to bring the moveable property (present and future) of a debtor to sale. This is similar to the situation under a floating charge. Second, the preferred creditor in a competitive situation was the first to seize. Arguably, this is similar to the situation with a floating charge, where the preferred creditor is the one who first causes crystallization, the most frequent form being possession by the receiver. That is, the preferred creditor is often the first seizer.

### (b) The Custom of Normandy

The Custom of Paris was the legal regime in force in Quebec

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debtor voluntarily surrenders the property to the creditor (*dé-laissement*); see generally, L. Sarna and A. Neudorfer, *The Law of Hypothecs in Quebec* (Montreal, Jewel Publications, 1987).

<sup>45</sup> The second cause for which a creditor could seize a debtor's moveable property was a sentence of imprisonment or death. The third cause was a special privilege, such as was contained in arts. 86, 161, 163, 171, 173, and 175, which gave the counterparts to a modern privilege in civil law, or a judicial or statutory lien in common law.

<sup>46</sup> See also, art. 180 of the Custom of Paris. *Simple exécution* appears to be the ancient equivalent to *saisie-exécution mobilière*.

prior to 1866, and it is most likely that the clauses contained in the Quebec instruments created the type of charge described in art. 160 *et seq.* However, this type of executory hypothec was available in other regions of 17th century France. Indeed, it is equally hard to distinguish between the charge found under the Custom of Normandy and the modern English floating charge.

Like the Custom of Paris, the Custom of Normandy did not allow a right to follow moveables alienated by the debtor in the ordinary course of business. However, pursuant to art. 593 of the Custom of Normandy, when the moveables were in the hands of the debtor the order of hypothecs was preserved and the first to seize had only the expenses of his actions, before the preceding secured creditors. Henry Basnage, the author of a 17th century treatise on the law of hypothecs, argued that the latter right under the Custom of Normandy was preferable to the right created by the Custom of Paris. He reasoned that since moveables are susceptible of hypothecation, one must preserve the effect of hypothecation to the fullest extent and should prefer senior creditors over the first to seize.<sup>47</sup>

In contrast to the Custom of Paris, the Custom of Normandy made no distinction between simple execution and *déconfiture*. Merchandise and accounts receivable could be seized when the debtor was insolvent or when they were sold by the debtor in contemplation of insolvency. In either case, all assets fell into the mass or were to be returned to the mass, so that the hypothecated creditors could take in the order their respective charges were created.<sup>48</sup> From the moment the debtor sensed that insolvency was imminent, a presumption of preferential sale arose and the debtor could not dispose of his or her effects in favour of some of the creditors, to the prejudice of others.<sup>49</sup> There were two exceptions to these prejudicial sales. First, a creditor who took goods in payment in good faith before seizure could not be followed by senior creditors. Second, a good faith creditor who was paid by the debtor immediately prior to bankruptcy was not liable to the other creditors.<sup>50</sup>

<sup>47</sup> Henry Basnage, sieur de Franquenay, *Traité des Hypothèques: Divisé en Deux Parties* (Paris, Chez J. Les Febvre, 1694), p. 74.

<sup>48</sup> *Ibid.*, at p. 75.

<sup>49</sup> *Ibid.*, at p. 76.

<sup>50</sup> *Ibid.*, at pp. 75-6. Arguably, this is the same as English common law during this period; see *Ryall v. Rolle* (1749), 1 Atk. 165, 26 E.R. 107. If my reading of *Ryall* is correct, then *Twyne's Case* (1601), 3 Co. Rep. 80b, 76 E.R. 809, has been misread by modern scholars.

The Custom of Normandy, like the Custom of Paris, did not allow the creditor to follow hypothecated moveables sold in the ordinary course of business by the debtor: there was no *droit de suite* in this respect in French law. According to Basnage, the reasons for this were three-fold. First, moveables do not have a “perpetual and certain substance” like immoveables; therefore, their very nature prevents their being hypothecated by virtue of a simple contract. Second, a creditor who did not take possession of the moveable implied to third parties that he or she had not accepted an undertaking with regard to the assets. Third, a right to follow would render commerce inconvenient.<sup>51</sup>

It is interesting to note that the first rationale is the traditional reason given by jurists for the incapacity to hypothecate moveables under the modern civil law; it reinforces the perceived necessity of the conceptual division between moveable and immoveable property in the civil law. However, unlike modern jurists, Basnage does not make the error of conflating the concepts of *droit de suite* and “right of preference”.

Thus, neither Custom created a *droit de suite*, and yet each Custom contained a non-possessory executory hypothec for moveables. Basnage viewed the Roman law rule that gave a right to follow in cases of hypothecation as too severe or harsh. He stated that, given the frequency at which property changed hands, a rule of this sort prevented the debtor from disposing of anything of significant value. Therefore the Custom of Normandy, as with most of the Customs of France, did not retain the right given under Roman law to follow hypothecated moveables into the hands of a third party. This rationale is remarkably similar to the justification given for the non-attachment of a floating charge prior to crystallization: namely, third parties are entitled to assume that the debtor has the creditors’ permission to deal with the assets in the ordinary course of business.

As regards competition amongst competing creditors, the Custom of Normandy retained the right given under Roman law for the senior creditors to rank ahead of a junior creditor, even when the latter was the first to seize.<sup>52</sup> This consequence is similar to the outcome amongst creditors with competing floating charges.

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<sup>51</sup> *Ibid.*, at pp. 83-4.

<sup>52</sup> *Ibid.*, at p. 76. The Custom of Normandy was similar in this regard to the Custom of Anjou, art. 421, and the Custom of Main, art. 436.

What comparisons can then be drawn between the executory hypothec of the Custom of Normandy and the English floating charge? First, like the modern floating charge, the Custom of Normandy did not distinguish between *simple exécution* and *déconfiture* in terms of the application of its right of preference. Second, under the Custom of Normandy, no further act was required to bring the moveables of the debtor to judicial sale, so long as the hypothec was signed and sealed before a notary. Third, prior to a creditor seizing the property of the debtor, the charge floated over the assets, both present and future, and gave the debtor authority to manage his or her affairs in the ordinary course of business. Fourth, the "crystallizing event", the event which converted the charge from an executory to an executed interest, was any action taken by a creditor to seize the assets of the debtor. Fifth, unlike the Custom of Paris but like the modern English floating charge, hypothecated creditors ranked in order of the date of hypothecation. Sixth, transactions *out of* the ordinary course of business and prior to bankruptcy were void.

### (c) Conclusion

It can therefore be plausibly asserted that a right of preference *similar in substance* to a modern floating charge existed under the Custom of Paris and the Custom of Normandy. If this claim is accurate, then it is most likely that the clauses inserted in the Quebec instruments were of French and not English origin. It is equally likely that the Quebec charges were treated according to the rules contained in arts. 160 and following of the Custom of Paris. Although not conclusive, the evidence on a balance of probabilities suggests that the executory hypothec was a well-known, indeed commonly used, concept in Quebec from the earliest moments of the French regime to at least the late 1820s. It may have been used beyond that time. It covered all assets, moveable and immovable, present and future, long before the English judiciary "created" the modern floating charge.

## 4. Some Speculations About the Mysterious Disappearance of Quebec's Floating Charge

If the executory hypothec was so common in the 1820s, why does it not appear in the Civil Code of Lower Canada? At what moment between 1830 and 1866 did it cease to be used, and why? I

have no answers to these questions, but I can offer some speculations.

It seems unlikely that the codifiers were unaware of such a clause. Although the deeds were drafted by notaries (the codifiers were advocates), the codifiers all apprenticed in the 1820s, and in all likelihood were aware of the presence of these clauses. Certainly one of the three codifiers, C.D. Day, was aware of them. Day defended a case on another issue arising from a deed which included these clauses. In that case, he made no objection to the deed on the ground that the executory hypothec was irregular.<sup>53</sup>

It is noteworthy that, as of 1841, all Quebec statutes dealing with hypothecs refer only to immoveables. One should not assume that hypothecs on moveables were thenceforth eliminated in daily practice, but it does suggest that the concept of hypothec was becoming unique to immoveables by that date. Following an 1841 Ordinance, all hypothecs had to be specific rather than general.<sup>54</sup> There is a puzzling comment in the codifier's reports of 1866 that, with the introduction of this requirement of specificity, the German rather than French system of hypothecs was introduced into the province.<sup>55</sup> Nevertheless, one cannot argue that the Ordinance of 1841 eliminated executory hypothecs over moveables merely because it did not mention hypothecs on moveables, although it may well be that the Ordinance had precisely that effect, by negative implication.

One might argue that the development of other forms of security device such as fictitious bills of lading and warehouse receipts made the executory hypothec less popular and less effective. But that argument seems somewhat implausible since, from a creditor's viewpoint, what could be more practical than an executory hypothec, especially in the Quebec of the 1850s-60s. To

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<sup>53</sup> *Hamilton v. Lamoureux* (February 2, 1842, King's Bench, District of Montreal), *per* Pyke, Rolland and Gale JJ.

<sup>54</sup> An Ordinance to prescribe and regulate the Registering of Titles to Lands, Tenements and Hereditaments, Real or Immoveable Estates, and of Charges and Incumbrances on the same; and for the alteration and improvement of the law, in certain particulars in relation to the Alienation and Hypothecation of Real Estates, and the Rights and Interest acquired therein, S.L.C. 1841, c. 30. It was decided in *Corporation du Village de la Pointe Gatineau v. Hanson* (1901), 10 B.R. 346, that one effect of this Ordinance was to eliminate hypothecs of future property.

<sup>55</sup> Quebec, Legislative Assembly, *Civil Code of Lower Canada, Sixth and Seventh Reports and Supplementary Report*, (Quebec, George E. Desbarats, 1865), Title Seventeenth, Commentary accompanying Chapter 3, "Of Hypothecs", at pp. 54-6.

argue that the executory hypothec disappeared because it was more practical not to have one seems to stretch the point somewhat, especially when the traditional common law narrative proclaims "practicality" as the motivating force behind the development of the floating charge.

What plausible explanation, then, is there for the disappearance of the executory hypothec from commercial practice in Quebec?

I suspect the answer is connected to the infant years of the major player on the financial scene during this period: the chartered bank. Its appearance on the Quebec financial scene neatly coincides with the disappearance of these charges. What might have motivated the bank's directorate to abolish such charges?

One could posit a conspiratorial hypothesis. After all, with the advent of fictitious bills of lading and warehouse receipts in the 1840s, and given that the banks had a near-monopoly on pledges of documents of title, these institutions stood to gain the most from outlawing hypothecs on moveables. Accordingly, the bank directors, themselves members of the Legislative Assembly, may have lobbied for legislation that would indirectly prohibit hypothecs on moveables. This would have left them with a near-monopoly on moveable collateral security. Most of the members of the Special Council following the Rebellions, including that of the year 1841, were either directors or shareholders in the banks, and thus were well placed to implement law reform which favoured their own interests.<sup>56</sup> Yet if that were the situation, why did they not do it expressly, rather than through negative implication?

A more likely (and more innocent) explanation for the banks' involvement in abolishing the executory hypothec lies in the banks' charter and the economic crisis of 1825. Before the chartered banks came on the scene, many wealthy Quebecers acted as private merchant bankers. However, the majority of those capable of acting in this capacity became directors of one of the three banks in the 1820s. Under the charter of the banks, directors were prohibited from acting as private bankers.<sup>57</sup> When

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<sup>56</sup> Including for example, Samuel Gerrard, director of the Bank of Montreal and its president from 1820 to 1826. He was a Special Council member from April 2 to June 1, 1838 and from November 2, 1838 to February 10, 1841 (F.G. Halpenny, ed., *Dictionary of Canadian Biography*, Vol. 8, s.v. (Toronto, U.T. Press, 1985)). See, *infra*, text accompanying footnotes 60 to 62.

<sup>57</sup> The bank's royal charter was granted in An Act for incorporating certain Persons therein

forced to assign their loans to the banks in order to assume the directorate, the directors may have merely assigned their interest as mortgagees in the form that they first charged the debtor's assets, namely, an executory hypothec. But the banks themselves were empowered to receive hypothecs on immoveables only as "additional security" (that is, banks could not finance the purchase of real property), and then as a fixed charge only after 1841.<sup>58</sup> By 1821, the only security devices in moveables available to banks was the pledge, either of chattels or securities.<sup>59</sup> Thus, hypothecs on moveables taken by the banks in the infant years, as assignees, would not be renewable upon maturity of the loan.

Therefore, the following hypothesis seems most plausible. Most of the private merchant bankers in Quebec became public bankers with the advent of chartered banking. The chartered banks were restricted in the type of collateral they could take for loans — a fixed charge on existing immoveables and/or a pledge of chattels, securities, or fictitious documents of title. These restraints, imposed on the chartered banks between 1821 and 1841, most likely caused the demise of Quebec's executory hypothec.

Although these restraints existed in the banks' charters from 1821 onwards, little attention was paid to them in the early years of chartered banking. So, for example, the standard form contract of loan used by the Bank of Montreal until 1825 still contained an executory hypothec clause. It does not appear in the bank's contracts after that date. Why did the directorate of the bank conform to the requirements of the charter after that date, and not before? In the absence of any direct evidence of what caused the directors to act so conservatively, I suggest that it may have been connected with the economic crisis of 1826, and the Samuel

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named under the name of "President, Directors and Company of the Bank of Montreal" S.L.C. 1821, c. 25, which is discussed in Chapter 7 of Merrill Denison, *Canada's First Bank, A History of the Bank of Montreal*, Vol. 1 (Toronto, McClelland and Stewart, 1966). The provisions of the Act "were not materially different from those of the Articles of Association" (p. 140) of which the 15th article is the relevant one (p. 411). This corresponds to s. 5 in the Act, which reads in part:

5. ... Provided always that the said Directors shall not, during the period of their services as Directors of the said Bank, act as private Bankers.

See also, An Act for the incorporation of certain persons therein-mentioned, under the name of the "Quebec Bank", S.L.C. 1821, c. 26, s. 3.

<sup>58</sup> See *supra*, footnotes 54 and 57. See too s. 8 of Quebec Bank charter, *supra*, footnote 57.

<sup>59</sup> Given these restrictions with regard to moveable collateral, one can understand why the directorate of the banks were keen to develop pledges of fictitious documents of title.

Gerrard affair, when the Bank of Montreal came perilously close to folding.<sup>60</sup>

Gerrard was born in Ireland to a prosperous Anglo-Irish family in 1767. He moved to Montreal and was established as a merchant in the fur trade as early as 1785. In 1791, he became a partner in the fur trading firm Grant, Campion & Company, which dissolved in 1795. In 1792 he consolidated his wealth by marrying the sister of his partner William Grant, a powerful Quebec merchant.

In November 1795, he formed Parker, Gerrard & Ogilvy, a fur trading firm that competed against the North West Company and expanded its trading in staples such as wheat, flour, timber, and possibly potash. The firm acted as suppliers to the XY Company, which was aborted by the New North West Company in 1804. By 1814, Gerrard's firm held an interest in New North West worth £38,500. His firm dissolved in 1814 and he formed Gerrard, Yeoward, Gillespie & Company. In 1817, he formed a partnership which held three more firms as subsidiaries. These firms exported wheat and timber and imported general merchandise. In December 1821, he sold his share in the firms for £40,000 and shifted his attention to finance.

Gerrard had long been involved in merchant banking — granting credit, extending loans of currency, and discounting bills. In June 1810, he was a prospective stockholder of the Canada Banking Co., an enterprise which was aborted due to legislative passivity. Although he did not sign the articles of association, he was involved with the Bank of Montreal from its beginnings and served as the president from 1820 to 1826.

In August 1826, the bank's directors found Gerrard guilty of granting discounts on his personal responsibility. He also granted loans beyond the permissible £10,000 limit to two prominent mercantile houses, owned by Gerrard's close friends. He was accused of favouritism, especially in the case of potential losses faced through the failure of McTavish, McGillivrays & Company, and McGillivrays, Thom and Co. These two firms were granted loans of £28,500 in late 1825 during a severe economic crisis in Quebec, despite their difficulties in winding up after the 1821 merger between the North West Company and the Hudson's Bay Company.

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<sup>60</sup> The Samuel Gerrard affair is discussed thoroughly in Chapter 9 of Denison, *supra*, footnote 57, and also in the *Dictionary of Canadian Biography*, *supra*, footnote 56.



Evidence suggests that once Gerrard became president of the Bank of Montreal he began assigning to the bank many of the high-risk loans he had granted as a private merchant banker in the preceding years. Some of Gerrard's larger loans were assigned immediately before as well as during the economic crisis.<sup>61</sup> Although no study of the impact of Gerrard's behaviour on the pattern of lending by the Bank of Montreal has apparently been done, it seems reasonable to assume that it influenced the bank's directorate, from August 1826 onwards, to adopt a more conservative policy, in strict conformity with the banks' charter.<sup>62</sup>

It is thus entirely possible that the Gerrard affair and the economic crisis of 1825 forced the major creditor within Quebec society, the Bank of Montreal, to accept from debtors only the type of collateral permitted by its charter. Permissible collateral was limited to pledges of chattels, securities, and documents of title. These events would have been sufficient to cause executory hypothec clauses to disappear from use within Quebec's legal community.

The peculiarity of the story outlined above is that it runs counter to the traditional civilian categories of law and to traditional visions of the development of the law. In terms of categories of law and hypothecation, the division between immoveable and moveable is seen by civilian jurists as fundamental. Yet this division is relatively new, predating Quebec's Civil Code by a few decades at most.

With regard to the development of the law, floating charges and hypothecation of moveables have been traditionally seen as

<sup>61</sup> See, for example, ANQM CN 601-187 #3804, assignment of loan between Samuel Gerrard (creditor) and Austin Cuvillier (merchant, debtor), to the Bank of Montreal; executed before Henry Griffin, notary, May 16, 1825. The agreement covering the original loan, which was for £10,078, was executed before Henry Griffin on July 19, 1821.

As president, Gerrard extended high-risk loans on behalf of the Bank of Montreal to friends during the crisis. According to the bank's charter the directors' liability was limited to losses in excess of triple the paid-up capital of the bank (over and above the reserve.) These loans to friends exceeded the limit, placing the directors of the bank in a position of potential liability; see, for example, ANQM CN 601-187 #5873, contract of loan between the Bank of Montreal (creditor) and Maitland, Garden and Auldjo (merchants, debtors) for £15,700, executed before Henry Griffin, notary, on July 9, 1825.

<sup>62</sup> Gerrard continued as a director after 1826. He was also a major shareholder in the Montreal Savings Bank and the Bank of Canada, both of which were absorbed by the Bank of Montreal. In 1831 he began supervising Canadian affairs for an English insurance company. In addition to holding many civic positions in Montreal, he was a Special Council member from 1838 to 1841. He died in Montreal, March 24, 1857.

necessary elements in the expansion of industrial capital: hence the struggle to develop the concept on the part of the British judiciary and the Quebec legislators, respectively, at the end of the 19th century. Yet, paradoxically, a concept which existed prior to codification disappeared at precisely the time when one would most expect it to be welcomed. This raises questions about the manner in which we construct our traditional narratives of doctrinal development, using less than a handful of cases and statutes as our primary sources in an attempt to understand the factors at work in one of the richest periods in economic history. In turn, we must ask ourselves some very basic questions about the perceived necessity of linking economic growth to particular doctrinal developments in the law. It is entirely possible that economic development has occurred and will continue to occur *independent of* a given strand of legal doctrine.

At a more modest level the foregoing suggests that, despite art. 2022, Quebec jurists need not fear the introduction of executory hypothecs in the Civil Code of Quebec. Rather than being innovative, the reform signals a return to a well-established Quebec tradition.