

RBC C. LAVOIE: ARE WE MOVING TOWARDS AN “INCREASED” DUTY TO INFORM IN THE CONTEXT OF UMBRELLA HYPOTHECS?

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The Superior Court decision in *Banque Royale du Canada c. Lavoie*^[1] illustrates the caution that financial institutions must exercise when using umbrella hypothecs. Relying on the concepts of abusive clauses, defect of consent and good faith, the Court concluded that the scope of the hypothec had to be narrowed, without however declaring it abusive or denying its validity.

Background

Mr. Lavoie and Ms. Bernier took out a personal loan from the Royal Bank of Canada (the “**Bank**”), which was fully secured by an umbrella hypothec (the “**Hypothec**”) on their immovable property (the “**Loan**”). The deed specified that the Hypothec secured:

[translation] “ALL ***your*** obligations, present and future, direct or indirect, contingent or not, matured or not, to ***us***, whether you are bound solely or jointly with others, as principal debtor or as guarantor, including ALL amounts ***owing to us*** now or in the future. Such obligations and amounts are hereinafter collectively referred to as the ‘***debt***”.

[Italics and bold in original]

A year later, Mr. Lavoie took out a second loan with the Bank for and on behalf of his corporation (the “**Corporation**”), for which he provided a personal guarantee (the “**Second Loan**”).

The Corporation committed various breaches of its obligations under the Second Loan. In a judgement dated July 6, 2016, the Superior Court ordered the Corporation and Mr. Lavoie to solidarily repay the debt under the Second Loan. Following this judgment, the Bank registered a notice of legal hypothec on the undivided half of the immovable property belonging to Mr. Lavoie. Mr. Lavoie then filed an assignment of his property to protect the immovable property and defeat the legal hypothec.

Over the next two years, the Bank filed four proofs of claim. In September 2016, the Bank filed a first proof of claim in respect of the judgment debt, for which it stated that it held no security and claimed no priority over other creditors. In December 2016, the Bank filed two proofs of claim relating to the Loan for which it claimed

to be a secured creditor. Lastly, the Bank filed an amended proof of claim in February 2018 arguing that the debt resulting from the judgment was also secured by the Hypothec.

In 2018, the debt resulting from the judgment remained unpaid. Alleging that the debt was secured by the Hypothec, the Bank served a prior notice of sale under judicial authority of the entire immovable property. However, the Bank never undertook any proceedings for forced surrender of the property, and it renewed the Loan to Mr. Lavoie and Ms. Bernier.

In 2020, the Bank served a new prior notice of sale under judicial authority and seized the Court. It nonetheless automatically renewed the Loan by mistake in 2022.

Key points of the judgment

Concluding that the Hypothec did not secure Mr. Lavoie's obligations as guarantor of his Corporation, the Superior Court dismissed the Bank's action.

The Court determined that the two loans, the deed of hypothec and the guarantee were all contracts of adhesion given that Mr. Lavoie and Ms. Bernier [translation] "could not negotiate [their] essential stipulations." Importantly, the Court made no mention of any attempt or even intention of either Mr. Lavoie or Ms. Bernier to negotiate the essential stipulations of these contracts.

Relying on the concepts of defect of consent and good faith, the Superior Court then analyzed the manner in which the parties entered into these contracts.

As regards the defect of consent, the Court recalled that it must declare null and void any abusive clause in a contract of adhesion or, at the very least, reduce the resulting correlative obligation. More generally, the Court pointed out that it may render all or part of a contract null and void when the consent of one of the parties is vitiated, in particular by an error which must be excusable. However, the Court did not explicitly address the excessive and unreasonable disadvantage that Mr. Lavoie and Ms. Bernier would have suffered as a result of the hypothecary clause and which would have justified declaring it abusive, nor the excusable nature of their error. Indeed, the Court based its conclusion that the hypothecary clause did not reflect the common will of the parties on the fact that Mr. Lavoie and Ms. Bernier were [translation] "banking and hypothec laypeople."

With respect to the obligation of good faith, the Court stated that the Bank had a duty to inform its co-contractors, and that the latter also had a duty to inform themselves. While the Court recognized that the deed of hypothec was clear as to its scope and that Mr. Lavoie had not asked any questions, the Court was relatively critical of the Bank's attitude. It held that the Bank had an "enhanced" duty to inform and seemed to condemn the fact that it had not advised Mr. Lavoie that the Hypothec granted a few years earlier also secured his obligations arising from the guarantee.

For these different reasons, without specifically identifying which one defeated the Bank's recourse, the Superior Court concluded that it was necessary to reduce the scope of the Hypothec.

Issues and implications

Characterization of contracts

In this decision, the Superior Court appeared to blur the line between contracts of adhesion and contracts containing pre-printed clauses that may nevertheless be subject to negotiation between the parties. However, it is important to emphasize that the characterization of a contract as a contract of adhesion requires that two criteria be met. Firstly, the essential stipulations of the contract must have been drawn up and imposed by one party on the other. Secondly, the other party must have been unable to negotiate the essential stipulations. The second criterion is decisive and requires caution in characterizing the contract as a contract of adhesion.

The simultaneous exercise of various hypothecary recourses

While the ruling was based primarily on the concepts of good faith and defect of consent, it appears that the Bank's strategies in its various recourses had a significant impact on the Court's decision. In particular, the Superior Court questioned the Bank's decision to register a legal hypothec on a debt that was supposedly already secured by a conventional hypothec. In doing so, the Court seemed to overlook the cumulative nature of hypothecary recourses. Although the advantages conferred by such a method are limited, the law does not prevent a hypothecary creditor from simultaneously securing the same debt with both legal and conventional hypothecs.

Best practices

In this decision, the Superior Court took a "broader" view of what can reasonably be considered a defect of consent and imposed an "enhanced" duty to inform on financial institutions. While it is too early to assess the potential implications of this ruling on the validity and scope of hypothec clauses, we can already recommend that hypothecary creditors adopt better practices when it comes to informing borrowers. More specifically, financial institutions that use umbrella hypothecs should ensure that the scope of the hypothec is described in clear and accessible terms and that the grantor is advised of its effects on any future contract.

[1] [Banque Royale du Canada c. Lavoie](#), 2022 QCCS 4876

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A cautionary note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against

making any decisions based on this material alone. Rather, specific legal advice should be obtained.