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This Bulletin deals with various questions which have arisen since the coming into force of the new *Civil Code of Quebec* and with the use of documents resulting therefrom. It also comments upon a draft bill recently tabled in the National Assembly which will have important consequences connected with the registration of indemnity agreements executed prior to January 1st, 1994.

CONDITIONS ATTACHED TO THE EXERCISE OF RIGHTS UNDER NEW INDEMNITY AGREEMENTS

Now that new indemnity and security agreements have been or are being executed and registered in the register of personal and movable real rights, it is useful to recall the conditions attached to the exercise of the surety's rights arising from such agreements upon the default of the principal. For the purposes of the following comments, we will assume that the hypothecs created by the new indemnity and security agreements have been registered in the register of personal and movable real rights.

SUMMARY

1. Notice of withdrawal of the principal's right to collect

The agreement recommended by the Canadian Surety Association stipulates that notwithstanding a hypothec given by a principal on its claims (receivables or book debts), the principal may continue to collect such claims until such time as the surety withdraws the right to do so.

In practice, the surety which desires to collect the claims of a principal must serve upon the principal and the owner, a notice that it will thereafter collect amounts due to the principal.

2. Registration of the notice of withdrawal

The Civil Code of Quebec provides that the notice of withdrawal of the right to collect must be registered in the register of personal and movable real rights.

3. Notice to the principal's debtors

Whether or not the surety has given the principal the right to continue to collect its claims after signature of the hypothec affecting the latter's claims, the surety's hypothec cannot be raised against third parties (generally owners) unless such third parties have acquiesced in it, or have received a copy of an extract or some other proof of the hypothec which can be raised against the principal.

In practice, a notice of hypothec should be served upon the owner. The notice can be given at the same time as the notice of withdrawal of the right to collect mentioned in paragraph 1 above. Contrary to the situation prevailing under the old Code:

a) it is no longer necessary to serve the notice when the third party has not acquiesced in the hypothec, as long as proof can be made that such third party has received a copy thereof or an extract therefrom, and

b) it is no longer necessary to deliver to the third party a copy of the deed of hypothec, an extract of the pertinent provisions thereof being sufficient.

Notwithstanding this, it is prudent, for evidence purposes, to serve the notice.

4. Notice to a bank when required by an assignment of priority

Several forms of assignment of priority (or rank as the Code calls it) of hypothecs on claims held by banks and sureties contain an undertaking by the parties to advise the others of the exercise of their rights under a hypothec. The surety must not therefore neglect to advise the principal's bankers.

When there is no assignment of priority or the assignment document does not require it, the surety holding a hypothec has only to fulfill the formalities set forth in paragraphs 1, 2 and 3 above in order to exercise its rights on the claims, whatever its rank, without obligation to give notice to other hypothecary creditors, including those who rank before it. The surety therefore can collect the claims of the principal until such time as a creditor, ranking ahead of the surety, fulfills the condition attaching to the collection of such claims set forth in paragraphs 1, 2 and 3 above. It should be noted that the registrar will not advise creditors of the inscription of a notice of withdrawal of the right to collect.

5. Notice to the debtor of a claim arising from an insurance policy

There are particular rules which apply to claims arising from an insurance policy, being one category of claims upon which a hypothec is granted by principals in indemnity and security agreements:

a) the hypothec cannot be raised against the insurer until such time as the latter has received notice of it, and

b) when there is more than one hypothec, priority is based on the date upon which the insurer receives notice thereof, contrary to the situation of hypothecs on other claims where priority is determined according to the date of registration. In practice, the creditor who first gives notice remains first ranking, even if another creditor who has first registered its hypothec subsequently serves a notice upon the insurer.

When it is of particular importance that the surety be the beneficiary of an insurance policy held by the principal, consideration could be given to having the surety named in the policy as an additional insured; this could be considered as an acquiescence by the insurer, thereby giving the surety priority on the proceeds of the policy, as its interest appears.

6. Notice to the sureties of sub-contractors

The indemnity and security agreement contains an assignment of the principal's rights under bonds taken out by its sub-contractors.

The Code specifically provides that this assignment cannot be raised against the surety unless the formalities rendering it opposable to the debtor have been fulfilled against the surety itself.

In practice, the surety of the general contractor must fulfill, as regards the surety of the sub-contractor, the formalities set forth in paragraph 3 above.

7. Registration of the assignment of a legal hypothec

Indemnity and security agreements also contain assignments of the rights of the principal in legal hypothecs of persons having taken part in the construction or renovation of an immovable (previously called privileges).

In order for it to be opposable to the owner, the Code provides that:

a) the assignment must be registered in the land register, and

b) a certified statement of the registration must be delivered to the debtor of the claim hypothecated (in practice, the owner of the immovable).

8. Prior notice of exercise of hypothecary right affecting property other than monetary claims

The principal also generally, on bonded contracts, grants a hypothec on its property, other than claims, such as equipment, tools, materials, computers, etc.

The surety must first elect from four possible hypothecary recourses:

a) taking possession of the property to administer it;

b) taking in payment;

c) sale by judicial authority;

d) sale by the surety itself.

The exercise of any of these recourses must be preceded by notice, to the principal which granted the hypothec, within the following delays:

a) 20 days in the case of movables;

b) 60 days in the case of immovables; and

c) 10 days in the case of taking possession of a movable by the creditor of the hypothec (the surety) for purposes of administration.

The starting point for calculating the notice delay is the registration of such notice in the register in which the hypothec is registered. The prior notice cannot be registered until after service thereof upon the principal and upon any other person who has consented to the hypothec.

The prior notice must describe the principal's default, which may be remedied within any delay to which the principal is entitled. It must also set out the amount of the claim in capital and interest, if any, the nature of the hypothecary right which the creditor intends to exercise, a description of the hypothecated property, and call upon the person against whom the right is to be exercised to surrender the property prior to the expiration of the delay specified. It would be wise to send a copy of the notice to the indemnitors.

9. PRIOR NOTICE UNDER THE *BANKRUPTCY AND INSOLVENCY ACT*

As was the case prior to the new Code, the surety must give a prior notice of 10 days of election to exercise its rights under the *Bankruptcy and Insolvency Act*. When it exercises its rights under security affecting the claims of the principal, this prior notice is not required unless such guarantee affects all or substantially all of the principal's claims, which is generally the case in indemnity and security agreements.

It is not clear, however, in the light of the new Code, whether the withdrawal of the right to collect constitutes an exercise of the creditor's rights or simply the lifting of a suspension of a right which previously existed. In the latter event, the creditor would not be required to give the notice required under the *Bankruptcy and Insolvency Act*. The question being undecided, it would be advisable that the notice under the Act be given.

CONDITIONS ATTACHED TO THE EXERCISE OF RIGHTS IN VIRTUE OF INDEMNITY AGREEMENTS SIGNED BEFORE JANUARY 1ST 1994 - ATTENTION: AN IMPORTANT CHANGE TO THE *ACT RESPECTING THE IMPLEMENTATION OF THE REFORM OF THE CIVIL CODE* (THE IMPLEMENTATION ACT) IS ABOUT TO BE ADOPTED

In former indemnity agreements, the only guarantees given by principals were assignments of claims (i.e. receivables and book debts). The law prior to the coming into force of the new Code did not require that such assignments be registered, as is now provided by the new Code for hypothecs on claims. The Implementation Act provides, first of all, that assignments of claims as guarantees of an obligation granted under the provisions of the former Code become hypothecs on such claims.

The reader may perhaps recall that the Implementation Act also provides that when the new law, contrary to the previous law, imposes formalities of registration, the former law dealing with opposability to third parties (owners, trustees in bankruptcy, etc.) remains in force on condition that the right has been registered within twelve months of the publication in the Official Gazette of a notice to the effect that the register is fully operational. This notice has

not yet been published, but it now seems this may be so on October 31, 1995.

This provision may, however, soon be changed, in view of the recent deposit of Bill 67 entitled *An Act to amend the Act respecting the implementation of the reform of the Civil Code* and other legislative provisions as regards security and the publication of rights. By virtue of article 9 of Bill 67, the Implementation Act will be amended to require that movable guarantees which were not required to be registered under the old Code but which have become movable hypothecs under the new Code (which is the case of assignments of claims in former indemnity agreements) must, to conserve their opposability, be registered within 180 days of the coming into force of article 9 of the Act modifying the Implementation Act. It is possible that the Bill will be amended to extend this delay to 12 months.

This means that, contrary to that which has been provided by the Implementation Act to date, registration of assignments of claims contained in indemnity agreements signed prior to January 1, 1994 must be made not within one year of publication of the notice in the Official Gazette that the register is fully operational, but rather within 6 months or perhaps 12 months from the coming into force of article 9 of the Act modifying the Implementation Act.

As of now, Bill 67 modifying the Implementation Act is in third reading and it seems that article 9 will not come into force until at least next September.

In practice, the surety which intends to exercise its rights in virtue of an assignment of claims granted in an indemnity agreement signed prior to January 1, 1994 must:

a) serve upon the owner a notice of the assignment and a copy of the indemnity agreement, and

b) register in the register of personal and movable real rights, the assignment of claims (now a hypothec on claims), within 6 months or perhaps 12 months of the coming into force of article 9.

CONDITIONS ATTACHED TO THE EXERCISE OF RIGHTS ARISING FROM OLD FORMS OF INDEMNITY AGREEMENTS ENTERED INTO AFTER JANUARY 1, 1994

Where an indemnity agreement has been obtained after the coming into force of the new Code using the old form, it is probable that the assignments of claims (now a hypothec on claims) contained in the agreement will be invalid since it is a hypothec on claims in respect of which the new Code imposes the requirement to state the amount of the hypothec.

To the extent that the surety wishes to obtain a hypothec on the principal's claims, it is important that it does not use the old form of indemnity agreement.

NEW TYPES OF CONSTRUCTION BONDS UNDER THE *CIVIL CODE OF QUEBEC*

The new Code foresees certain situations in which security can be furnished in order to permit release of holdbacks that an owner could impose upon a principal. Although it does not specify that such security could be bonds, there is little doubt that bonds will be accepted by the courts as one form of such security.

The three situations are the following:

a) to obtain release of holdbacks imposed by the owner to protect against faulty workmanship; and

b) to obtain release of holdbacks imposed by the owner as a result of notice of sub-contracts or supply con-

tracts from sub-contractors and suppliers, for the purpose of conserving their rights to register the legal hypothec of a person who has taken part in the construction or renovation of an immovable; and

c) to obtain the cancellation of a legal hypothec.

Although, at first glance, these three situations seem to create an interesting opportunity for surety companies to offer new types of bonds, it would be advisable to exercise prudence in view of the fact that such bonds would increase the surety's exposure in the event of the principal's default. Indeed, the contract funds would have been paid to the principal or its bank when otherwise the surety would have had the benefit of these funds to pay the cost of correcting defects or to pay the claims of the principal's sub-trades and suppliers who had registered a legal hypothec.

PRESCRIPTION OF RECOURSES AGAINST INDEMNITORS

The new Code has shortened the prescriptive delay for action by the surety against indemnitors, from 5 to 3 years, commencing from the time when the right of action arises. This point in time is not always easily determinable, but it would be wise not to wait longer than 3 years after any payment before taking action against the indemnitors.

During the period of overlapping of the old and the new Codes, the prescription of 5 years which had not expired by January 1, 1994 is shortened to 3 years from that date unless the delay already expired results in there remaining less time to run from January 1, 1994. In this latter case, it will be the shorter prescriptive delay which will prevail.

THE RIGHT TO REGISTER A HYPOTHEC ON CLAIMS WITHIN 10 DAYS FROM THE DATE THE CREDITOR GIVES VALUE, IN ORDER TO RETAIN PRIORITY BASED ON THAT DATE RATHER THAN THE DATE OF REGISTRATION

The general philosophy of the new Code is to the effect that among creditors their rights rank according to the date of registration of the hypothec in the register. There is, however, an exception. The effective date may be, for a creditor benefitting from a hypothec on claims, earlier than that of registration if the registration is done within 10 days from the date the creditor gives value.

Take an example. Foreseeing the issuance of a bond, a surety obtains on July 1, 1995, the signature by a principal of an indemnity and security agreement containing a hypothec on claims and registers the hypothec on July 10. Let us also assume that the surety agrees to issue a bond and does in fact do so the same day and that the principal agrees to grant another hypothec on claims to its bank, which is registered July 5, 1995. Normally the hypothec in favour of the bank would take priority by reason of its earlier registration. However, in these circumstances, by reason of the exception in the Code, it is the surety's hypothec which will have priority because it is deemed to have been registered on July 1, 1995, since it was registered within 10 days of the surety's giving value (the undertaking to issue and the issue of the bond).

It is not clear when the "giving value" takes place within the meaning of the Code. This might be the moment when the surety undertakes to issue a bond, or the moment when a bond is issued or the moment when the indemnity agreement is signed.

In practice, sureties for which the date of registration is significant will be well advised to:

a) not undertake to issue bonds except on the condition of receipt by the surety of an indemnity and surety agreement duly completed and signed (to delay to the date of receipt, the moment of the surety's giving value);

b) register the hypothecs contained in the agreement within 10 days of giving value; and

c) verify if any other creditor has registered a similar hypothec within such 10 days, since such registration may also have a retroactive effect to the date of the "giving value" by another creditor, and therefore have priority of rank.

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with the collaboration of
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