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A LOOK BACK AT JUDGMENTS IN 1994

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1. PERFORMANCE BONDS

1.1- THE RIGHT OF THE SURETY COMPLETING THE PRINCIPAL'S CONTRACT TO REGISTER A PRIVILEGE

- ***The completing surety under a performance bond has the right to register a privilege, which takes priority over a hypothecary creditor for the undisbursed portion of the latter's loan, even though the principal had granted a cession of priority to such hypothecary creditor.***

The surety had, in virtue of its performance bond, completed the principal's contract. An agreement for this purpose had been entered into by the surety, the owner-obligee and the principal under the terms of which the surety had designated the principal to complete the work. In view of the terms of this agreement, the surety was not acting as a new contractor, but as subrogee in its principal's rights.

The obligee became bankrupt before the completion of the work and the surety, not having been paid for the completion work, registered a privilege (lien) against the building. The hypothecary creditor contested the surety's right to register a privilege on the grounds that only licenced contractors could register and, further, that the principal had granted a priority rank to the hypothecary creditor.

The Superior Court decided, first of all, that under the provisions of the Building Act, R.S.Q., c. B.-1.1, as it then existed, a privilege registered by a person not holding a contractor's licence was null, but that such nullity was only relative and had to be raised in with diligence, which had not been done in this case. In any event, the Court held that the provision of the Act creating the nullity did not exist when the circumstances of this case took place and the new law could not have ret-

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roactive effect. Moreover, the Court also held that the new provision was not applicable since the surety was not to be considered as an independent contractor, but as the subrogee in the rights of its principal which did hold a contractor's licence.

The Court also decided that, in principle, the hypothecary debt took precedence over the builder's privilege in view of the cession of priority granted by the principal, but that such cession had no effect as regards the part of the loan which had not been disbursed by the hypothecary creditor. The surety's action on privilege was therefore maintained for the undisbursed portion of the loan.

Groupe Commerce (Le), Compagnie d'assurance v. **Service Carex Inc., J.E. 94-1354 (S.C.), Judge Tessier, judgment taken to appeal, 500-09-001376-946.**

2. LABOUR AND MATERIAL PAYMENT BONDS

2.1- PRIOR NOTICE OF 60 DAYS AND NOTICE OF 120 DAYS

- ***The Court of Quebec confirmed the validity of the 120-day notice clause in the bond, as well as the requirement that a sub-trade, not having a direct contract with the principal, must give notice of its contract within 60 days from the commencement of its work or deliveries.***

A general contractor bonded by a surety (La Garantie) under an extended form, awarded a contract to a sub-trade bonded by another surety (Alta).

An unpaid supplier of the sub-trade sent a demand for payment to Alta, with a copy to La Garantie. Alta paid 85% of the claim and the supplier sued La Garantie for the balance.

The Court dismissed the claim against La Garantie on the ground that the supplier's notice (by way of a copy of its notice to Alta) did not constitute a sufficient notice to La Garantie. Moreover, the supplier had not given to La Garantie the required 60-day notice.

Équipements Bellemarre Ltée v. **Panpierre Inc. and La Garantie, Compagnie d'Assurance de l'Amérique du Nord, C.Q. 400-02-001284-916, December 20, 1993, Judge Pinard.**

2.2- AMOUNT OF THE CLAIM

- ***An error in the drafting of a sub-contract does not give rise to an additional claim under a labor and material payment bond.***

The Nova Scotia Court of Appeal decided that a claimant could not argue that an error in the drafting of its sub-contract with the principal should be set aside when it claims an additional amount from the surety. In this case, the claimant had submitted a bid to the Nova Scotia Bid Depository and shortly thereafter, increased the bid by $100,000.00 by a written addendum filed before bids were opened.

Eventually a sub-contract was entered into between the principal and the claimant which did not include the additional $100,000.00. The claimant became aware of the oversight after the contract had been signed.

The Nova Scotia Court of Appeal decided that the claimant could not claim this additional amount of $100,000.00 from the surety as no proceedings had been instituted to rectify the contract alleging either mistake, fraud or misrepresentation. The claim against the surety could only be based on the contract entered into between the principal and the claimant, as written.

Comstock Canada v. **Laurentian Shield Insurance Co.**, **(Nova Scotia Court of Appeal), [1994] 21 C.C.L.I. (2d) 2.**

2.3- PAID WHEN PAID

- ***Does a sub-contractor have the right to claim under the terms of a labor and material payment bond when the sub-contract provides that the claimant will only be paid when the owner has paid the principal and the owner has not paid?***

The Nova Scotia Supreme Court said no. After reviewing the relevant jurisprudence, the Court decided that the payment by the owner to the principal was a condition precedent to payment to the sub-contractor. Therefore, as the principal had not been paid by the owner, no payment was due to the claimant. The Court also noted that the claimant had signed many prior contracts with the principal, all containing similar clauses. On at least one occasion the claimant was not paid by the principal as the latter was not paid by the owner.

Arnoldin Construction & Forms Limited v. **Alta Surety Company**, **(Nova Scotia Supreme Court), [1994] 13 C.L.R. (2d) 307.**

2.4- SUPPLIES TO A NON-BONDED PROJECT

- ***A supplier cannot impute to a non-bonded project payments which it receives for materials delivered to a bonded project.***

Aciers Truscon, supplier to a sub-trade of the principal on a bonded project, had given notice of its contract to the general contractor. The general contractor, in connection with another project, not bonded, had given a sub-contract to the same sub-trade which, in turn, gave an order to the same supplier.

The general contractor had agreed with the supplier to issue joint cheques to it and the sub-trade for a total amount of $70,717.78 which covered deliveries to both projects and included an amount of $50,000.00 designated to the bonded contract. The principal paid the amount agreed upon by way of joint cheques. The supplier claimed from the surety a balance, allegedly unpaid, on the bonded project, by means of imputing a greater amount to the non-bonded project. This was done on the ground that the sum of $50,000.00 paid out by the general contractor had not been entirely due at the time of payment.

The Superior Court and the Court of Appeal dismissed the claim, pointing out that the supplier could not, to the surety's prejudice, impute to the non-bonded project amounts that the principal had designated to the bonded project. In effect, it is the debtor who has the right to designate the debt which it intends to pay and it is only in the absence of such designation by the debtor that the creditor is entitled to impute payment.

Aciers Truscon Inc. v. **Groupe Commerce**, **J.E. 94-1044 (C.A.), Justices Chouinard, Brossard and Deschamps.**

2.5- PRESCRIPTION

- ***The delay required to start proceedings under a bond is not a delay of prescription subject to the Civil Code chapter on Prescription but a condition of enforcement of a contractual right.***

The claimant under a labour and material payment bond had instituted proceedings against the principal, within the delay provided for under the bond to institute proceedings against the surety. After that delay had expired, the claimant had amended its proceedings to add the surety as a defendant on the

basis of article 2228 of the Civil Code of Lower Canada which provides that:

> *"A judicial demand brought against the principal debtor ... interrupts prescription as regards the surety."*

On the basis of the decision in 157971 Canada Inc. v. La Compagnie de Cautionnement Alta (also summarized in this Bulletin), the Court concluded that the claimant cannot benefit from article 2228 C.C.L.C because the delay to start proceedings as provided for under the bond, was not a delay of prescription but a contract condition limiting the time within which the surety may be sued.

2753-0732 Québec Inc. v. Castelco Construction Inc. and La Compagnie de Cautionnement Alta, S.C. 500-05-002825-915, February 3, 1994, Judge Blanchet.

2.6- EFFECT OF A PROPOSAL

- ***A debtor may not use Bill C-36 to obtain the suspension of recourses by claimants under a labour and material payment bond.***

A debtor obtained an order of the Superior Court pursuant to the *Companies Creditors Arrangement Act* (R.S.C., c. C-36), a law having similarities with the *Bankruptcy and Insolvency Act* which allows a debtor having granted security by way of a trust deed, to make a proposal to its creditors. The order obtained by the debtor suspended any recourse undertaken by creditors against the debtor's surety under labour and material payment bonds, and proposed a partial settlement of their claims.

Some creditors filed an appeal of this order and the Court of Appeal quashed the provisions of the order which limited the creditors' rights under bonds, on the ground that an arrangement under the Act can only deal with the relationship between the debtor and its creditors, not between the creditors and third parties such as the debtor's surety. The Court added that bonds were meant to protect creditors in the case of a debtor's insolvency.

Toitures P.E. Carrier Inc. and Lacoste Électrique Inc. v. 2603373 Canada Inc. and Boréal Compagnie d'Assurance Inc. C.A. 200-09-000168-945, July 6, 1994, Justices Tyndale, LeBel and Baudouin.

2.7- PROPERTY COVERED

- ***Property lost or stolen is not covered by a labour and material payment bond.***

The Court of Quebec decided that a claim under a labour and material payment bond by a lessor of a generator and an electric cable which were lost or stolen could not be upheld. The Court also held that the lessor's claim for service charges, as well as a claim under a penal clause, were accessories to the principal claim and did not relate exclusively to the works.

A claim against a bond is governed by the conditions set forth in the bond, not by the conditions set out in a contract between the claimant and another party. The Court held that the surety could not be liable for a cost greater than what would normally be current in the construction industry.

Équipement Moore Ltée v. La Compagnie de Cautionnement Alta, C.Q. 500-02-000530-936, January 5, 1994, Judge Beaulac, (transcript of reasons given verbally at trial).

2.8- DELAY OF 120 DAYS FOR NOTICE TO THE SURETY

- ***Institution of legal proceedings by a claimant against the principal or a judgment against it does not interrupt the delay of 120 days to give notice to the surety.***

The claimant completed its work for the principal on July 13, 1990 and instituted action against the latter for payment of the amount due to it on August 13, 1990. The claimant obtained judgment on November 7, 1990, but was still not paid. It wrote to the surety November 30, 1990. The claimant argued that the principal and the surety had a joint and several obligation (now called in the new Civil Code, a solidary obligation) to it and that the institution of legal proceedings against the principal, or the judgment, interrupted the prescriptive delay in the bond or, at least, constituted the notice of claim required by the bond.

The Superior Court held that the principal and the surety did not share a solidary obligation. In fact, solidarity only exists when it relates to one and the same obligation. That of the principal arises from its contract with the obligee, whereas that of the surety arises from the bond. It is not, therefore, the same obligation. Moreover, the judge added:

> *"that the delay of 120 days is not a prescriptive delay susceptible of suspension or interruption, but a contractual condition susceptible of modification only by the mutual agreement of the contracting parties;*
>
> *the claimant was under the obligation to give notice within 120 days to the principal, the surety, and the obligee;*
>
> *the fact that the claimant did not become aware of the existence of the bond until November 15, 1990 does not permit the claimant to push forward the starting point of the 120 day delay. It is upon him to inform himself regarding the bond."* (Office translation).

The claimant's action was dismissed.

157971 Canada Inc. (Les services d'entretien Signature) v. La Compagnie de cautionnement Alta v. Carradino Rivera et al et Castelco Construction Inc., S.C. 500-05-002646-915, January 24, 1994, Judge Deslongchamps.

- ***The delay of 120 days begins to run from the date upon which the sub-trade has completed its work, even though some deficiencies exist which will be corrected at a later date.***

The claimant completed its work on April 28, 1986 and returned to the job site to do some work , part of which involved correction of deficiencies, between May 26th and June 17th. It gave notice of its claim to the surety on September 25, 1986. It must then be determined whether or not the claimant, a sub-trade of the principal, gave notice of its claim to the surety within the delay provided for by the bond.

The Court found that the claimant had, on June 10, 1986, done certain work on the site of the same nature as that of the work called for by its contract with the principal and, therefore, the notice given by it to the surety was within the bond delay. The Court went on to say that if the work done July 10, 1986 had related exclusively to correcting deficiencies and the claimant had used this date to support its contention that notice had been given within the bond delay, it would have held that the notice was outside the 120 day delay. Deficiencies do not hold up the end of the work and, although work has been badly done, it has, nevertheless, been done.

Entreprise de la Construction A.C.F. Inc. v. Arni Construction Inc. et La Compagnie d'Assurance Halifax, S.C. 500-05-008110-866, April 26, 1994, Judge Jolin.

2.9- STARTING POINT OF THE ONE-YEAR PRESCRIPTION

- ***When the principal suspends work for the winter and goes bankrupt the following spring, without recommencing the work, the starting date of the one-year prescription of the right to sue the surety is the date upon which the principal made its voluntary assignment.***

The principal had not been able to complete certain earth work before the arrival of winter and suspended the work on December 17, 1990. In the circumstances, this constitutes the date upon which the last of the work was done on the site. It made a voluntary assignment in bankruptcy April 16, 1991. The surety took over the job and completed it in September 1991. The claimant became aware that the principal would not return to the site on March 28, 1991 and took action against the surety on March 3, 1992.

The surety argued that the starting point of the one-year prescription was December 17, 1990, the date upon which, in fact, the principal did the last of its work. The Court held that on that date the principal had not ceased work on the contract, but had suspended the work for the winter with the intention of continuing the work in the spring of 1991. An interruption of the work for good reason is not a cessation of the execution of the contract; in the circumstances, the starting point of the prescription is the date upon which the principal made a voluntary assignment.

Simard Beaudry Inc. v. **La Compagnie d'Assurance Jevco, S.C. 500-05-003478-920, February 19, 1994, Judge Benoît.**

3. SURETY VS. COMPETING CLAIMANTS

3.1- SEIZING CREDITOR AND TRUSTEE

- ***Conflict between a creditor on a seizure before judgment, a trustee and an assignee of book debts (receivables), decided in favour of the assignee.***

This litigation does not involve a surety but is nevertheless of interest to sureties since it involves a situation frequently encountered by sureties, as assignees of the principal's debts under indemnity agreements.

A creditor had obtained a seizure before judgment of its debtor's property, including two receivables. Subsequently, the debtor assigned the receivables to a third party and then became bankrupt under the *Bankruptcy and Insolvency Act*. The trustee, the creditor and the assignee each contended that it had the bankrupt's rights in the receivables. The Court of Appeal decided in favour of the assignee because, on one hand the trustee could not contend that it had a right to the receivables given that the assignee had perfected its rights under the assignment against third parties (which included the trustee) before the bankruptcy and on the other hand, the bankruptcy had voided the seizure before judgment.

Provi-Grain (1986) Inc. (Trustee of), J.E. 94-1210 (C.A.) Justices Rousseau-Houle, Deschamps and Beauregard.

3.2- REVENUE CANADA

- ***An assignee of book debts or receivables succeeds against Revenue Canada's super-priority.***

Even if this decision does not involve a surety directly, it is nevertheless of interest to sureties in the context of con-

flicts between an assignee of debts or receivables (as sureties often are under indemnity agreements) and Revenue Canada with itssuper-priority created under the *Income Tax Act*.

This case deals with the interpretation of the latest revision of the *Income Tax Act* (sections 224(1.2) and (1.3)), enacted to counter the effect of the decision in LLoyds Bank Canada v. International Warranty Company, (1989) 102 A.R. 240 (SCC), where the Court had given priority to the bank under its assignment of debts. The subsequent amendments to the *Act* attempted to give priority to Revenue Canada, in respect of debts and receivables which were subject to security or guarantees.

The Alberta Court of Appeal again found in favour of the banks, on the ground that the latter are not *"secured creditors"* within the definition of that term in the *Act*, since, under the terms of the assignment of debts or receivables, they become the owner of the receivables and are therefore not creditors secured by such receivables. In case of doubt, the Court preferred adopting an interpretation which would not confiscate a person's property without compensation.

In the Matter of the Bankruptcy of Country Inns Inc., between Province of Alberta Treasury Branches and Her Majesty The Queen in Right of Canada as represented by the Minister of National Revenue et al. (3 appeals), Alberta Court of Appeal no. 14257, January 18, 1994, Justices Hetherington, Irving and Côté.

3.3- BANKS

- ***Dismissal of an action by the surety against the obligee which had paid to a bank holding an assignment of debts from the principal.***

A surety had not been called to perform under its performance bond but had paid various claims by sub-trades and suppliers under its labour and material payment bond. Meanwhile, the obligee under the bond had paid the balance of contract funds to the principal's bank following notice from the bank that it held an assignment of debts from the principal.

The surety sued the obligee on the ground that it was subrogated in the rights of both the principal and the obligee and, therefore, the latter should have paid the balance of funds to the surety.

The Superior Court held that the surety could only be subrogated in the rights of the sub-trades and suppliers which it had paid, and since these had no rights against the obligee (the Crown), the surety could not be subrogated and, therefore, had no such rights itself.

Compagnie de cautionnement Alta v. Québec (Procureur général), J.E. 94-1954 (S.C.), Judge Gervais.

4. INDEMNITY AGREEMENTS

4.1- CHARACTERIZATION OF AGREEMENT

- ***Common law Provinces - Characterization of indemnity agreement and distinction between indemnity and guarantee.***

A surety sued an indemnitor under an indemnity agreement. The indemnitor argued that its undertaking was void on the basis that it constituted a collateral guarantee and, as such, the requirements of the *Guarantees Acknowledgement Act* had not been met. The Alberta Court of Appeal held that the undertaking was valid because it constituted an indemnity since it was a non-collateral undertaking to reim-

burse the surety's losses and that it was therefore not subject to the formalities of the Act raised by the indemnitor.

Western Surety Company v. Helmut Brakup, (Alberta Court of Appeal), [1994] 23 C.C.L.I. (2d) 108.

4.2- PRIOR NOTICE OF INTENT

- ***The importance of giving the notice required by the Bankruptcy and Insolvency Act, before enforcing rights under an assignment of debts.***

Even if this decision does not deal specifically with indemnity agreements, it is relevant to the enforcement by sureties of their rights under assignments of debts or hypothecs contained in indemnity agreements.

In this case, the claimant had given the 10 day prior notice required under section 144 of the *Bankruptcy and Insolvency Act* as a condition precedent to enforcement of its hypothecary rights, but had in fact commenced the enforcement of such rights 7 days later, before the delay had expired. The Court dismissed a motion to dismiss the debtor's defence, which was solely based on the fact that the creditor had not respected the delay in the *Act*. The Court emphasized the fact that this was a serious ground of defence, which should be dealt with on the merits of the case and not on a preliminary motion.

Compagnie Montreal Trust of Canada v. Graus and Lilien, S.C. 500-05-011954-938, March 2, 1994, Judge Guthrie.

4.3- DUTY TO INFORM OF THE EXISTENCE OF A SURETYSHIP IN A CONTRACT.

- ***The decision in North American Trust Co. gives an indication of the attitude that the Courts may adopt within the framework of the new Civil Code dealing with the duty to inform.***

Although this judgment does not deal with a construction bond, the principles commented upon therein could be pertinent in matters of indemnity agreements.

The Defendant, acting as the treasurer of a transport company, entered into an initial leasing contract with Plaintiff, which contract did not include a suretyship. One of the items covered by the lease was a photocopier which had to be replaced. The initial contract was annulled and the lessor presented a new contract to Defendant for signature, this document including a suretyship. Defendant signed this second contract where it was indicated to him by the lessor. Shortly thereafter Defendant left the company, which itself ceased business. The company's assets were transferred to another company which failed to fulfill the obligations under the lease. Plaintiff claimed from the Defendant, as surety, the balance of the contract for the equipment. Defendant contested the proceedings on the ground that he had not signed the document as a surety.

The Court of Quebec held that Plaintiff's representative had a duty to explain to Defendant the terms and nature of the second contract. The Court further held that the Defendant had been given a false illusion of security by the lessor who had had him sign the second contract.

The Court found that article 1400 C.C.Q. was applicable, which article stipulated that error vitiates the consent of a party where it relates to the nature of the contract.

Plaintiff's action was dismissed and the Defendant's suretyship annulled.

North American Trust Co. v. Desjardins, J.E. 94-1010 (C.Q.), Judge Durand.

5. BRIEFLY NOTED

A) UPDATE - A LOOK BACK AT JUDGMENTS IN 1993

1) **Laurentienne Générale, Compagnie d'Assurance Générale** v. **Ville de Candiac**, S.C. 505-05-000198-926, October 19, 1993, Judge Hébert; C.A. 500-09-002045-938, Declaration of Settlement out of Court August 11, 1994.

2) **Roméo Boucher & Fils** v. **Constructions Gosselin and Associés Ltée and Laurentienne Générale Compagnie d'Assurance-Vie Inc.** (sic), Judge Legris, J.E. 93-1924 (S.C.); C.A. 200-09-000660-933, Declaration of Settlement out of Court January 13, 1994.

3) **Excavation St-Pierre Inc.** v. **La Compagnie de Cautionnement Alta**, Judge Toth, J.E. 93-989 (S.C.), (decision appealed): C.A. 500-09-000799-932, Certificate of readiness January 28, 1994, Motion to be placed on the roll by priority rejected July 8, 1994.

4) **Pavage Jéromien Inc.** v. **La Compagnie d'Assurance Jevco Inc. et al**, S.C. 700-05-001807-910, February 16, 1993, Judge Forget, (decision appealed): C.A. 500-09-000580-936 - Certificate of Readiness April 20, 1994.

5) **2323-3208 Québec Inc.** v. **Construction Canadienne T.J. (Québec) Inc. and Laurentienne Générale, Compagnie d'Assurance Inc.**, S.C. 500-05-002937-918, December 22, 1993, Judge Audet, (decision appealed): C.A. 500-09-000163-949, Appelant's Factum August 8, 1994.

6) **Harris Steel Ltd** v. **Alta Surety Co.**, 6 C.L.R. (2d) 55: Leave to Appeal to the Supreme Court of Canada refused August 12, 1993.

7) **Price Waterhouse** v. **PCL Constructors and Western Surety Co.**, (British Columbia Court of Appeal), [1993] 5 C.L.R. (2d) 24: Leave to appeal to the Supreme Court of Canada refused May 6, 1993.

8) **Denis Cimaf** v. **Leblond, Buzetti, Caisse Populaire d'Amos and the Minister of National Revenue**, S.C. 750-11-000129-921, July 8, 1993, Judge Marquis, (judgment appealed by Revenue Canada): C.A. 500-09-001379-932, Appelant's Factum March 24, 1994.

9) **Banque Nationale du Canada** v. **Laurentienne Générale (La), Compagnie d'Assurance Inc.**, Judge Lacoursière, J.E. 93-1932 (S.C.), (decision appealed): C.A. 200-09-000743-937, Declaration of Settlement out of Court July 9, 1994.

10) **Compagnie d'Assurance Générale Dominion du Canada** v. **Suzanne Desaulniers et al**, S.C. 500-05-013239-908, January 15, 1993, Judge Flynn, C.A. 500-09-000263-939, Motion for dismissal of the Appeal granted with costs June 6, 1993.

B) LEGISLATION

Bill 41, An Act to amend the Code of Civil Procedure and the Act respecting municipal courts, assented to January 30, 1995 and came into force March 16, 1995, provides that the threshold for an automatic right of appeal to the Court of Appeal is raised from $15,000.00 to $20,000.00.

The same Bill provides that the jurisdictional amount of the Court of Quebec in civil matters is increased from $15,000.00 to $30,000.00. This provision does not affect cases pending before the Superior Court.

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