LAVERY, DE BILLY
BARRISTERS AND SOLICITORS

1 Place Ville Marie
Suite 4000
Montréal (Québec)
H3B 4M4
Tel. : (514) 871-1522
Fax : (514) 871-8977

925 Chemin St-Louis
Suite 500
Québec (Québec)
G1S 1C1
Tel. : 1-800-463-4002
Tel. : (418) 688-5000
Fax : (418) 688-3458

45 O'Connor Street
20th Floor
World Exchange Plaza
Ottawa (Ontario)
Tel. : (613) 594-4936
Fax : (613) 594-8783

Web site: http://laverydebilly.com

Associated Firm:
Blake, Cassels & Graydon
Toronto, Ottawa, Calgary
Vancouver, Londres

REVIEW OF 1995 JUDGMENTS

1. PERFORMANCE BONDS

1.1 SURETY'S OBLIGATIONS

- **The surety must reimburse to the obligee under a performance bond, the sums which the principal failed to pay to its subcontractors and which the obligee had to pay itself.**

At the general contractor's request, the surety had issued a performance bond in favour of the job owner and a labour and material payment bond. At the request of a subcontractor of the general contractor, the same surety had also issued a performance bond in favour of the general contractor.

Petwa, a subcontractor of the said general contractor, obtained a judgment against the surety and the general contractor, which the surety paid. The latter then claimed from the general contractor, under the indemnity agreement signed by it in favour of the surety, the reimbursement of the amount of the judgment. The general contractor alleged in its defense that, under the performance bond issued in its favour, the surety had the obligation to perform all of the bonded subcontractor's obligations, including the obligation to pay Petwa.

The Saskatchewan Court of Appeal maintained the general contractor's position and held that the latter was entitled to set off the amounts which it owed the surety under the indemnity agreement against the amounts owing to it by the surety under the performance bond.

Petwa Canada v. *Logan Stevens*, 19 C.L.R. (2d) 136 (Sask. Q.B.)

1.2 OBLIGEE'S OBLIGATIONS

- **A surety is entitled to refuse to intervene**

SUMMARY

1. **Performance Bonds** 1
2. **Labour and Material Payment Bond** 3
3. **Bid Bond** 4
4. **Surety v. Competing Claimants** 4
5. **Indemnity Agreement** 7
6. **Bond issued under the Highway Safety Code** 8

when requested by the obligee under a performance bond when the obligee prevents the surety from being subrogated in its rights to contract holdbacks.

The obligee had paid to the principal 90% of the holdbacks under the contract, although there remained in excess of $120,000 worth of work to be performed, being approximately 15% of the total value of the contract. Following the principal's bankruptcy, the surety refused to complete the contract, alleging the obligee's default which had prevented the surety from being subrogated in the former's rights to receive the amount of the holdback. Following the surety's refusal to pay a subcontractor which had registered a legal hypothec (lien) in the amount of $118,123.17, the obligee paid the subcontractor and, alleging subrogation in the latter's rights, sued the surety under the labour and material payment bond.

The Court held that the job owner (obligee), had been entitled to pay the holdback to the principal as it did, but that in so acting, it put itself in a position where it could no longer subrogate the surety in its rights regarding the holdback, to which the surety was entitled. The surety was therefore discharged of its obligations vis-à-vis the obligee, under article 1959 of the Civil Code of Lower Canada (now article 2365 of the Civil Code of Quebec).

Ventilation G.R. Inc. v. *Lawson Mardon Emballages Inc.*, Superior Court, Laval, 540-05-000115-950, January 4, 1996, Paul Trudeau J. (appealed)

- **The obligee cannot refuse to pay the balance of contract funds to the contractor, on the ground that it is entitled to compensation for the non-liquidated cost of an eventual correction of deficiencies.**

This is not a suretyship decision but it is nevertheless relevant for sureties facing similar situations.

The owner had refused to pay the balance of contract funds on the ground that the contractor was responsible for deficiencies which had not been corrected nor assessed at the time of the trial on the contractor's action on account. The Court of Appeal decided that the owner could not act as its own judge and therefore had to pay the balance of contract funds.

Chabot v. *Philippe Bertrand Inc.*, J.E. 95-1314 (Court of Appeal)

1.3 PRESCRIPTION (Limitation of actions)

- **The one year delay of prescription from the date of final estimation of the work, stipulated in the performance bond, is not computed from the date of completion of the principal's work.**

The principal had refused to correct the deficiencies in its work, evaluated at an amount between 3 and 3.5 million dollars. The obligee had asked the surety to intervene to correct the principal's defective work. Following the surety's refusal, the obligee had sued the latter.

The surety replied by presenting a motion to dismiss the obligee's suit, alleging prescription of the obligee's recourse under the terms of its performance bond.

Pursuant to a provision of the performance bond, any suit against the surety had to be commenced before the expiration of one year following the date of the final estimation of the work.

The Court rejected the motion to dismiss on the ground that the one year prescription is not calculated from the date of completion of the principal's work, but from the date of the final estimation of the work, being the final acceptance thereof. The

work had never been accepted, so that there could not have been prescription of the suit.

Procureur Général du Québec v. *La Garantie, Compagnie d'Assurance de l'Amérique du Nord*, J.E. 95-1971, (Superior Court), Gérard Turmel J.

2. LABOUR AND MATERIAL PAYMENT BOND

2.1 120 DAY NOTICE

- **The date of the end of the work cannot be delayed on the ground that only a minimal amount of goods and services had not been supplied or rendered.**

The claimant's billing covered the period from November 7, 1986 to February 14, 1987 and the last billing was marked «final balance». In November 1987, the surety retained the services of a third party to complete the claimant's work, without any formal demand to the latter to do so. The trial judge concluded that the work, even if minor and performed by a third party, had the effect of delaying the date of the end of the work.

The Court of Appeal reversed the Superior Court judgment concluding that its interpretation of the bond did not reflect the law. Moreover, the Court of Appeal added that the Supreme Court of Canada decision in *Citadel General Assurance Company* v. *Johns-Manville Canada Inc.* had no bearing on this case. It held that the date of endof the work could not be delayed due to the fact that only minor materials and services were yet to be provided or furnished.

La Garantie, Compagnie d'Assurance de l'Amérique du Nord v. *Construction Luc Coutu Inc.*, J.E. 95-2160 (Court of Appeal)

- **Damages caused by the principal to its subcontractor are not covered under the payment bond but additional work is.**

The Court decided that a labour and material payment bond is a specific bond and is limited to the contractor's obligations for labour, material and services. Damages do not constitute such labour, material or services and therefore cannot be claimed from the surety under the bond.

Notwithstanding the fact that there was no formal purchase order, the amount claimed by the subcontractor for additional work can, however, be claimed from the surety, in this case on the ground that the bond did not specifically refer to the plans and specifications.

The judge agreed to deduct four years of interest and additional indemnity from the claim, on the ground of the claimant's attorney's lack of diligence in bringing the matter to trial.

Monteurs d'Échafaudage Industriels G.G. Ltée v. *The Halifax Insurance Company*, (Superior Court) 500-05-003168-851, October 6, 1995, Jean-Marie Brassard J.

2.2 CLAIMS COVERED

- **The surety does not have to pay the portion of the holdback owed by the principal to its subcontractor which corresponds to the sum due by the latter to its supplier, if the subcontractor is unable to submit a statutory declaration indicating that it has paid its suppliers, as required by the subcontractor's contract with the principal.**

The principal had signed a subcontract with a subcontractor, which had in turn entered into a sub-subcontract with a supplier for the supply of equipment. The subcontractor became bankrupt before being paid the sum of $71,484.34 held back and before having paid the sum of $23,118.91 owed to its supplier. A bank, as assignee of the subcontractor's debts, claimed from the principal and its surety, payment of the sum of $71,484.34, while denying having to pay the sum of $23,118.91 to its client's supplier. The

supplier and the subcontractor both had a valid recourse against the surety for such amounts.

The surety succeeded in its contention that, under the subcontract, the principal had no obligation to pay its subcontractor (and the latter's assignee) the money withheld as long as the latter had not supplied its final statutory declaration indicating that its suppliers had been entirely paid. Since the subcontractor never fulfilled this obligation, the Court concluded that the surety, which had to pay the supplier's claim, could deduct from the sums owed to the bank-assignee, the sums to be paid to the supplier on the ground that an assignee cannot have more rights than its assignor.

Racan Industries Inc. -and- *Banque Canadienne Impériale de Commerce* v. *Les Constructions Sicor* -and- *Compagnie d'Assurance Canadian Surety*, (Superior Court) 500-05-012503-916 and (Superior Court) 500-05-005041-924, February 13, 1995, André Forget J.

3. BID BOND

- **Rejection of a bid submitted with a bid bond which had not been issued by a financial institution recognized in Quebec.**

In a call for tenders for the construction of a building for a university, the lowest bid submitted was rejected on the ground that it was not in order, because it was supported by an invalid bid bond. The call for tender documents provided that the bid had to be submitted with a bid bond issued by a financial institution legally entitled to act as surety. The university had decided that the bond was invalid because it had been issued by a special broker and that the Inspector General of Financial Institutions, through an order, had previously decided that this broker could not issue bonds in Quebec.

The lowest bidder filed a motion for injunction, to prohibit the university from granting the contract to the second lowest bidder.

The Court decided that the bond issued by such special broker was not valid despite later attempts to replace it after the opening of the bids. The motion for provisional injunction was therefore dismissed.

Magil Construction Canada Ltée v. *The Royal Institution for the advancement of learning (Université McGill)*, (Superior Court), Montreal, 500-05-009538-958, September 11, 1995, John Bishop J.

4. SURETY V. COMPETING CLAIMANTS

4.1 FINANCIAL INSTITUTIONS

- **A surety having taken over an obligee's defense after receiving the balance of contract funds, was not successful against a claim for the balance of contract funds by the Caisse populaire (credit union), the assignee of the principal's debts.**

The surety had completed the principal's contract and had collected the balance of contract funds from the obligee, in exchange for an undertaking to hold the obligee harmless from claims by third parties. These facts, however, were not in evidence at trial. The Caisse, as assignee of the principal's debts, claimed the balance of contract funds from the obligee. Pursuant to its contractual undertaking, the surety defended the obligee. The Court held that the obligee had no right in the balance of contract funds which belonged to the Caisse under the assignment of debts.

The Court emphasized the fact that the surety had not intervened in the proceedings to show its rights to the funds. This decision highlights the importance for the surety to intervene in proceedings

instituted against the obligee which it has undertaken to defend, in order to enforce its right to receive the payment of the balance of contract funds.

Caisse populaire Desjardins de la Grande Baie v. *Coopérative d'habitation Nolin Inc.*, (Superior Court), Alma, 160-05-000020-934, May 30, 1995, Benoit Morin J. (appealed)

4.2 DEPARTMENT OF REVENUE

- **The surety completing a contract on behalf of a defaulting principal, has priority over the Department of Revenue for the balance of contract funds withheld by the obligee.**

The principal had abandoned the performance of its work after having completed 25% of its contract. The obligee, which had not yet paid anything to the principal, had put the surety on notice to complete the contract, which the latter had done. Before the surety had completed the performance of the contract, the Department of Revenue had given the obligee a peremptory demand of payment of any sum which could be owed by it to the principal. When the work was completed by the surety, the obligee decided to deposit in Court, the total amount of the contract funds.

Both the surety and the Department of Revenue made motions for permission to withdraw the judicial deposit, and agreed that the latter could withdraw 25% of the value of the contract, representing the value of the work performed by the principal and that the surety could withdraw 50%. The litigation involved the surety's right to the 25% residual amount or the deposit. The Department of Revenue contended that, even if the surety had completed 75% of the work, it only had a right to 50% of the value of the contract, corresponding to the limit of the performance bond. It also contended that the surety should have stopped its work after having disbursed the amount of the performance bond.

The Court rejected the Department of Revenue's argument and decided, on the basis of the decision of *Banque Nationale du Canada* v. *Notre-Dame du Lac (Ville de)* that the surety which completes a contract in the defaulting principal's place, is subrogated in the obligee's right to compensate its completion costs against the balance of contract funds.

Champlain Mécanique Inc. -and- *La Commission Scolaire de St-Eustache*, (Superior Court) 700-05-000317-945, December 6, 1994, Marc Beaudoin J.

- **Preference given to a creditor under an assignment of rents, over the Quebec Minister of Revenue exercising his rights under section 317(3) of the *Excise Tax Act*.**

This decision does not directly involve a surety, but deals with a conflict between the beneficiary of a transfer of debts, similar to an assignee of debts (as sureties are under an indemnity agreement) and the Quebec Minister of Revenue.

This litigation was meant to determine who had priority between the Quebec Minister of Revenue who had sent a notice of payment to tenants of tax due under section 317(3) of the *Excise Tax Act*, and Helmic, the beneficiary of a transfer of rents, as an accessory to a loan contract with the tax debtor. It should be noted that Helmic had served the tenants with a notice of transfer of rents, before the Minister of Revenue sent his order to pay. All of this took place before the coming into force of the new Civil Code.

The Court held that the transfer of rents was equivalent to a clause of assignment of rents and that, under articles 1570 and 1571 C.C.L.C., Helmic became the owner of the leases as well as of any sums owed under such leases, as soon as the notice of transfer of rents was served upon the tenants. From that moment, the tenants no longer owed anything to the tax debtor, but instead to Helmic. The Court concludedthat the Minister of Revenue

was not and could not be considered to be a secured creditor under paragraphs 3 and 4 of section 317 at the time of service of the orders to pay and that accordingly, the Quebec Minister of Revenue was not entitled to such rents.

Placements Helmic Ltée v. *Québec (Sous-ministre du Revenu)*, [1995] R.J.Q. 1381, 200-09-000328-952 (appealed)

- **Priority of a creditor over the Minister of Revenue, as beneficiary of a transfer of rents.**

Even though this decision does not involve a surety, it is of interest as it deals with a conflict between a creditor holding a hypothec on claims (which sureties usually hold under an indemnity agreement) and the Minister of Revenue.

Under the old Code, the creditor had obtained an assignment of leases from its debtor and had served a notice of assignment of rent to the debtor's tenants, before the coming into force of the new Code. The Minister of Revenue alleged that *An Act respecting the Ministère du Revenu* gave priority to the Minister over any security held by a creditor of the tax debtor.

The Court held that the Minister had no right to the rents, because the concept of secured creditor under fiscal laws did not include the owner of rents under the terms of a valid assignment of debts.

Canada (Procureur général) c. *Compagnie Montréal Trust du Canada*, J.E. 95-1523, Robert Banford J., 200-09-000378-957 (appealed)

- **Priority of a creditor as beneficiary of a transfer of rent, over the security in favour of the Quebec Minister of Revenue exercising his rights under section 15 of *An Act respecting the Ministère du Revenu.***

This is another decision dealing with the Quebec Department of Revenue's priority and that of a hypothecary creditor. This case is however subject to the rules of the new *Civil Code of Québec.*

The Department of Revenue was enforcing its rights under section 15 of *An Act respecting the Ministère du Revenu.* It had forwarded a notice to the tenants of a building owned by the tax debtor, giving them instructions to pay the monthly rent to the Minister of Revenue instead of the owner or any holder of a transfer of rent. The Court held that under *An Act respecting the Ministère du Revenu* and the *Civil Code of Québec*, the State holds a prior claim, ranking before a movable or immovable hypothec.

The judge analysed in depth the rights of hypothecary creditors, holders under the old Code, of a transfer of rent, in light of the transitional law and under the new Code. He concluded that the transfer of rent becomes an immovable hypothec and that the hypothecary creditor is the owner of the income generated by the property, from the time the hypothec was created. The rent therefore belonged to the hypothecary creditor as of right. Accordingly, when the Minister sent a notice to the tenants, the latter did not owe the rent to the tax debtor, but to the owner of the rent, the hypothecary creditor. The Court decided that the Minister had no legal right to the rents and his contentions in that regard were dismissed.

Assurances-Vie Desjardins Inc. v. *Ministère du Revenu du Québec*, (Superior Court) 500-05-000047-959, March 10, 1995, Claude Tellier J., (appealed)

- **Priority given to the Quebec Minister of Revenue over a creditor holding a hypothec on a debtor's claims.**

Even though this is not a decision involving a surety, it is still relevant to the suretyship industry because it deals with a conflict involving a creditor holding a hypothec on claims, which is the case of sureties under indemnity agreements.

The creditor held a hypothec on the debtor's rents, created after the coming into force of the new Civil Code. The creditor submitted a motion to have the Court declare that it had priority over the Quebec Minister of Revenue who argued that it had priority over any guarantee held by any creditor of the debtor. The Minister relied on *An Act respecting the Ministère du Revenu*, as amended on December 17, 1993, which grants a priority to the Minister, with respect to any payment to be made to a secured creditor. The creditor holding the hypothec contended that it was not a secured creditor, because the exercise of its hypothecary right on the debtor's debts made him the owner of such debts.

The Court dismissed the creditor's arguments and gave priority to the Minister. The Court distinguished between assignment of debts under the old Code, which the Courts had characterized as a sale of debts having priority over the Minister's rights, and hypothecs on the same debts under the new Code, the provisions of which do not allow the same conclusion.

L'Industrielle-Alliance Compagnie d'Assurance sur la Vie v. *Le sous-ministre du revenu du Québec*, (Superior Court) Quebec City, 200-05-001805-949, September 14, 1995, Danielle Blondin J.

- **This decision of the Supreme Court of Canada gave priority to the federal Crown (for a fiscal debt) over a creditor holding a lien. The Court also refused to declare unconstitutional, a federal law having the effect of invalidating the rights of a creditor holding a lien on property built by such creditor.**

Even though this decision deals with a situation in another province, it is of equal importance in the Province of Quebec, because the Court pronounced itself on the constitutionality of federal fiscal laws affecting rights under a provincial law.

This case involved a dispute between creditors holding liens (now legal hypothecs in Québec) on real property and the federal Crown which served on the job owner, a formal demand of payment under the *Income Tax Act*. The owner held contract funds in trust under the Saskatchewan *Builders' Lien Act*. The Crown claimed that the *Income Tax Act* gave it priority over any secured creditor, including those holding liens. The creditors argued that the *Income Tax Act* was unconstitutional because it affected property and civil rights in a province, a matter within provincial jurisdiction under the Constitution.

In a laconic judgment, delivered orally, the Chief Justice simply declared that the Court was of the opinion that the *Income Tax Act* provision challenged by the creditors, was not unconstitutional.

TransGas Ltd. v. *Mid-Plains Contractors Ltd.*, (1994) 18 C.L.R. (2d) 157 (Supreme Court of Canada)

5. INDEMNITY AGREEMENT

5.1 ILLEGIBLE, INCOMPREHENSIBLE OR ABUSIVE PROVISION

- **A businessman cannot contend that a guarantee document (such as an indemnity agreement) is invalid on the ground that its terms are illegible, incomprehensible or abusive.**

This decision is of interest to surety companies, even though it does not deal directly with an indemnity agreement.

The former officers of a bankrupt company cannot invoke the *Civil Code of Québec* articles dealing with illegible, incomprehensible or abusive provisions, to refuse to pay sums claimed from them under a guarantee document signed by them.

The Court decided that even though the document was complex for the uninitiated, in this particular case, the officers knew its extent when they signed it, being businessmen and since it was not the first time they had signed as sureties.

The Court however concluded that the officers rightly blamed the beneficiary of the bond, for persisting in trying to recover bad debts, despite the officers' demand to abandon them, which caused the beneficiary to incur additional costs which were claimed from them. These costs could not be claimed from the officers.

International Mercantile Factors Ltd. v. *Galler*, J.E. 95-669 (Superior Court), Marc Beaudoin J.

- **A spouse signing a guarantee document with her husband's approval but without having read the document, is liable towards the creditor - Distinction between abusive clause and abusive exercise of a right under a contract of adhesion.**

Even though this decision does not deal with an indemnity agreement, it is still relevant, since indemnitors in indemnity agreements in fact act as sureties for the bonding company.

In this case, the principal's spouse argued that she had not signed the guarantee document under which she was being sued by the creditor and that in any event she had not read the document. The Court decided that the spouse had signed the document (after expert evidence) and that she was bound by it. The Court also decided that a provision in a deed of suretyship, does not necessarily constitute an abuse of rights under the new Civil Code dealing with contracts of adhesion.

Services financiers Commcorp Inc. v. *Contant*, Montreal Superior Court, J.E. 95-308, Jules Beauregard J., 500-09-001941-947 (appealed)

5.2 ERROR WITH RESPECT TO THE PRINCIPAL CONSIDERATION OF THE CONTRACT

- **Economic error or error as to the principal's capacity to generate income, is not a cause of nullity of the deed of suretyship.**

Following weeks of negotiation, the defendant agreed to guarantee, as surety, the reimbursement of a loan in the amount of $100,000 to a company named Havre du Village International. Following the latter's default, the obligee claimed this sum from the defendant as a surety.

The defendant raised a defense of fraud and error with respect to the principal consideration of the contract, being the capacity of the company to generate income.

The Court dismissed this defense, on the ground that economic error or error as to the capacity of the company to generate income was not a cause of nullity of the bond.

Réalisations Solidel Inc. v. *Havre du Village International* and *Louis Bonhomme*, J.E. 95-1229 (Superior Court), Jean-Pierre Sénécal J.

6. BOND ISSUED UNDER THE HIGHWAY SAFETY CODE

6.1 PRESCRIPTION (Limitations of actions)

- **The true owner's recourse against the possessor's vendor is prescribed by 30 years**

This case involved a claim by the real owner of a vehicle against the vendor of the person having possession of the vehicle, to obtain the reimbursement of the price paid upon revendication of the stolen vehicle. The vendor raised against the real owner, a defense of prescription, alleging that the vehicle had to be revendicated within three years from the theft.

The Court held that the three-year acquisitive prescription is one which only a possessor in good faith can raise against a revendication action by the real owner of the vehicle.

Such prescription does not extinguish the real owner's recourse against the possessor's vendor. Such recourse, provided in section 152 of the *Highway Safety Code*, is prescribed by thirty (30) years.

La Prudentielle Compagnie d'Assurance Générale (Canada) v. *Les Automobiles B.A. Inc.*, (Superior Court) 500-05-011748-934, October 5, 1995, Daniel H. Tingley J.

6.2 CLAIMS COVERED

- **The claimant's vehicle must have been sold by the principal in order for the claimant to have a right against the surety.**

The claimant had given his vehicle to the principal, a used car dealer, who had undertaken to sell the vehicle for a set amount. The following day, the principal sold its business to a third party which succeeded in selling the claimant's vehicle within days from the time of the sale of the business. The purchaser of the business never paid the sale price to the claimant and the claimant took proceedings against the principal and the surety, in order to obtain the reimbursement of the sale price agreed upon.

The Court dismissed the suit against the surety, on the ground that the claimant's vehicle had not been sold by the principal.

Richard Blouin v. *Monique Dupré* -and- *Laurentienne Générale, Compagnie d'Assurance Inc.*, (Court of Québec) 500-02-036762-925, January 25, 1995, Gilles Trudel J.

SURETYSHIP LAW GROUP

Claude Baillargeon (514) 877-2929
Jean Bélanger (514) 877-2949
Marie-Claude Cantin (514) 877-3006
Antoine Dore (514) 877-3007
Nicolas Gagnon (514) 877-3046
Richard A. Hinse (514) 877-2902
Claude Larose (Québec) (418) 688-5000
Pamela McGovern (514) 877-2930
Patrice Picard (514) 877-3005
Jerome C. Smyth, C.R. (514) 877-2903
Richard Wagner (514) 877-2922
Lynda Tanguay (paralegal) (514) 877-3042

LAVERY, DE BILLY
BARRISTERS AND SOLICITORS