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THE COURT OF APPEAL CLARIFIES THE LEGAL NATURE OF A REAL GUARANTEE

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QUEBEC LAW HAS FOR A LONG TIME DISTINGUISHED THE PERSONAL GUARANTOR FROM THE REAL GUARANTOR: A PERSONAL GUARANTOR IS PERSONALLY BOUND TO REPAY A CREDITOR SHOULD THE PRINCIPAL DEBTOR FAIL TO PERFORM ITS OBLIGATIONS; A REAL GUARANTOR DOES NO MORE THAN GIVE SOME OF ITS ASSETS AS COLLATERAL TO A CREDITOR, AND UNLIKE A PERSONAL GUARANTOR, IS NOT PERSONALLY BOUND TO REPAY THE LOAN GRANTED TO THE PRINCIPAL DEBTOR.

ON JULY 16, 2012, THE COURT OF APPEAL OF QUÉBEC UPHELD A JUDGMENT OF THE SUPERIOR COURT TO THE EFFECT THAT REAL GUARANTEES[1] ARE GOVERNED BY THE RULES PERTAINING TO HYPOTHECS AND NOT BY THOSE PERTAINING TO GUARANTEES, WITH THE RESULT THAT UNLIKE PERSONAL GUARANTORS, REAL GUARANTORS ARE NOT ENTITLED TO THE BENEFIT OF DIVISION OR OF DISCUSSION. THAT ISSUE HAD NOT BEEN ADDRESSED BY QUEBEC COURTS SINCE THE COMING INTO FORCE OF THE *CIVIL CODE OF QUÉBEC*.

[1] *Roker c. Prêt relais Capital inc.*, 2012 QCCA 1295.

FACTS

On March 14, 2010, the Respondent, Prêt relais Capital inc. (the **"Lender"**) granted a loan to two persons, Pierre-Denis Carrier and Alimentation Carrier inc. (the **"Borrowers"**). The loan was secured by three separate hypothecs on three separate immovables, being immovables A, B and C. The Borrowers owned immovables A and C. Ms. Roker, the Appellant, owned immovable B and intervened in the loan agreement, in which she is designated as "the hypothecary surety" (*la caution hypothécaire*). However, the loan agreement also stated that the Appellant is not personally liable for repayment of the loan:

> [Translation]
> "For the purposes of interpreting this agreement, although the guarantor, Jean-Noël Jessy Roker (Jessy Roker) is designated as a "borrower" [i.e. collectively with the other borrower], it was agreed that her liability hereunder is limited to the security she furnished pursuant to the aforementioned deed [i.e. the deed of hypothec]. Consequently, the hypothecary surety did not personally guarantee the loan."

On December 9, 2010, the Lender advised the Borrowers that they were in default of paying and registered a prior notice that Lender was exercising its hypothecary recourse of taking in payment against the three immovables. On March 3, 2011, the Lender served the Borrowers with a motion for forced surrender and taking in payment. At the same time, on May 27, 2011, the Caisse Desjardins du Cœur-de-Bellechasse (the **"Caisse"**), also a creditor of the Borrowers, obtained a judgment declaring it the owner of immovable A. Then, on June 23 and June 30, 2011, the Caisse and the Lender signed two deeds of "Discharge for subrogation by the creditor" (*quittance subrogatoire par le créancier*), whereby the Lender became the owner of immovable A in the stead and place of the Caisse.

THE COURT OF APPEAL JUDGMENT

The Court initially reiterated that a personal guarantee is a contract by which a third party undertakes towards a creditor that: (i) it will perform the debtor's obligations should the debtor fail to satisfy its obligations (art. 2333 C.C.Q.) and (ii) all of the guarantor's assets could be used to satisfy the guarantor's obligations under the guarantee. The Court then noted that the same third party could also just hypothecate one or more of its assets to secure performance of the debtor's obligations. This last contract is described in doctrine as a real guarantee and is provided for in article 2681 C.C.Q. In the Court's view, it was clear that Ms. Roker had not personally guaranteed the obligations of the Borrowers, but had granted a hypothec on her immovable as a real guarantee.

The central issue in this case was to determine the rules governing real guarantees and specifically, to decide whether Ms. Roker, as real guarantor, is entitled to the benefit of division and/or discussion to which a guarantor is normally entitled. While a number of authors argue that the specific rules which apply to guarantees should apply to real guarantees, unless such rules are incompatible with the rules governing the security in question, others hold the opposite view, namely that the ordinary rules of guarantees do not apply to real guarantees. The Court puts an end to the scholarly debate by adopting the comments of our colleague Mtre Louis Payette, who subscribes to the second school of thought. In Justice Thibault's own words:

> [Translation:]
> " [34] I lean towards the opposite view, which is that the rules on suretyship in the division titled " *Effects between the creditor and the surety* " (arts. 2343 to 2355 C.C.Q.) do not apply to a hypothec constituted by a third party to secure the debtor's obligation, a transaction referred to as a real guarantee. Therefore, the third party is not entitled to the benefit of discussion. I adopt Mr. Payette's reasoning. His analysis takes into consideration both (i) the difference between the wording of the *Civil Code of Lower Canada* which granted the benefit of discussion to the real guarantor, and the wording of the *Civil Code of Québec* which no longer has that language, and (ii) the general scheme of the rules applicable to contracts."

The Appellant also claims, on the basis of articles 1686 and 2782 C.C.Q., that the Caisse's taking in payment of immovable A extinguished the Borrowers' obligations. Articles 1686 and 2782 C.C.Q. read as follows:

> **1686** A hypothec is extinguished by confusion of the qualities of hypothecary creditor and owner of the hypothecated property.
> However, if the creditor is evicted for a cause which is not attributable to him, the hypothec revives.
>
> **2782.** Taking in payment extinguishes the obligation.
> A creditor who has taken property in payment may not claim what he pays to a prior or hypothecary creditor whose claim is preferred to his. In such a case, he is not entitled to subrogation against his former debtor.

The Court of Appeal applies the solution that it adopted in *Bodeven inc.* c. *Banque de Montréal*[2], and holds that in this case there are three distinct hypothecs and that the Respondent became the owner of the immovable pursuant to the "Discharges for subrogation by the Creditor" rather than pursuant to its motion for a forced surrender and taking in payment:

> [Translation]
> " [47] The Appellant is wrong. First, it is clear that three persons intervened in the "Deed of hypothecation of immovables to secure a loan" and each of them furnished security on an immovable that each owned. Therefore, three valid hypothecs were granted to secure a loan. The fact that those three hypothecs are recorded in a single document does not alter the fact that there are three distinct juridical acts, entered into by three distinct persons, concerning three distinct immovables."

[2] *Bodeven inc. c. Banque de Montréal*, 2005 QCCA 249.

COMMENT

The Court of Appeal rejects the mixed notion of a real guarantee, thereby focusing on the true nature of the structure. The third party, the real guarantor, solely grants its hypothecated property as collateral. The hallmarks of a real guarantee are the absence of an agreement to personally satisfy the obligation of another and the rule that suretyship is not presumed (art. 2335 C.C.Q.).

Real guarantees will now be more predictable. In light of this decision, a real guarantor cannot claim to have the same rights that a personal guarantor has, such as the benefit of discussion (art. 2347 C.C.Q.) or the benefit of division (art. 2349 C.C.Q.). It must be noted that the benefit of discussion obliges the creditor to first exercise its recourse against the principal debtor, and therefore to first discuss the principal debtor's assets. The benefit of division exists where several persons have agreed to guarantee the same debt. It allows the guarantor who is sued to require that the creditor divide his action among all guarantors, thereby reducing his action against any specific guarantor to said guarantor's share of the debt. Lastly, a real guarantor is also not entitled to be provided with information from the creditor (art. 2345 C.C.Q.) or to institute pre-emptive proceedings (art. 2359 C.C.Q.). However, a real guarantor may assert similar rights to those of a person granting a hypothec. Thus, the real guarantor may limit his or her liability to the specific property encumbered and may set up against the creditor all of the rights of the debtor.

This solution is fair, as it allows the parties to negotiate the contract in the manner necessary to obtain the desired effects. Two contracting parties could certainly require the guarantor to sign a personal guarantee and a hypothec. In such a case, the third party guarantor personally guarantees the debtor's indebtedness and also hypothecates property to secure the same obligation. Should the debtor default in its obligations, the creditor could not only seize the hypothecated property, but also institute proceedings against all of the guarantor's other property if the hypothecated property is insufficient to make the creditor whole. Therefore, it is important to always bear in mind the practical advantages of structuring deals with a personal guarantee and a hypothec by the guarantor, which not only protects the creditor, but also has the incidental effect of giving certain additional rights to the guarantor (the creditor's acknowledgment of its obligation to provide information, the unilateral right to terminate a guarantee for an indeterminate period, etc.) which the parties may opt for by clearly stating their intention to do so in the constituting document.

Certain practitioners representing real guarantors may perhaps recommend incorporating certain provisions relating to personal guarantees into deeds of hypothec, such as the benefit of discussion or of division. There is nothing prohibiting the parties from negotiating their contractual relationship in this manner; such provisions do not contravene any rule of public order. However, in our view, it would be more practical to limit the personal guarantee to specific assets as permitted in the second paragraph of article 2645 C.C.Q., and to secure the obligations of the personal guarantor with a similar limited hypothec.

As regards the second issue raised by Ms. Roker, namely whether the deed of hypothecation of an immovable to secure a loan signed by each of the Borrowers and Ms. Roker and constituted as a single document should be considered one and the same hypothec given the indivisible nature of a hypothec, it is our view that the Court correctly held that although the three hypothecs were recorded in a single document, this did not alter the fact that they are three distinct juridical acts, entered into by distinct persons, concerning distinct immovables. It must be borne in mind that the indivisible nature of a hypothec means that the hypothec is attached to the obligation that it secures (art. 2662 C.C.Q.) and as long as part of the obligation subsists, the hypothec remains in effect and charges the entirety of the hypothecated property.

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