

Québec Court of Appeal clarifies rules on guarantors' liability for legal fees

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Introduction

On April 6, 2021, the Québec Court of Appeal (the QCA) rendered a judgment authorizing a lender to recover its reasonable legal fees from a guarantor (or surety), where it is expressly provided for in the guarantee. The QCA granted^[1] an appeal (in part) by the Bank of Nova Scotia (the Bank) from a judgment rendered by the Superior Court on November 26, 2018. The dispute concerned the enforceability of a provision in a personal guarantee that provided, among other things, that the guarantor would be liable for legal costs incurred by the Bank in collecting from the debtor or the guarantor. According to the QCA, such a provision is valid and enforceable, as long as the legal fees and expenses claimed are reasonable.

This QCA decision provides lenders with valuable guidance on the liability of guarantors for legal fees and expenses.

Context

Davidovit was a principal of a company that operated a gym. The company filed for bankruptcy leaving behind a balance owing to its Bank under a line of credit. As Davidovit had personally guaranteed this indebtedness to the Bank, following the bankruptcy of the company, the Bank sought to recover its claim as well as the legal fees it incurred in relation thereto.

The Superior Court ordered Davidovit to pay the outstanding balance of the debt to the Bank and dismissed his counterclaim for damages arising from an alleged wrongful realization by the Bank on the company's assets.

However, relying on article 1437 of the Civil Code of Québec (the Civil Code), the Superior Court found that the provision in the guarantee allowing for the recovery of legal fees was abusive and, consequently, refused to find Davidovit liable for the Bank's legal fees and expenses.

Decision

According to the QCA, the trial judge erred in his application of article 1437 of the Civil Code. The mere fact that a party to a contract is disadvantaged does not in itself lead to the conclusion that the contract or a clause contained therein is abusive. The trial judge failed to take into account article 1617 of the Civil Code, according to which it is possible to provide for damages in a contract in addition to interest, without distinguishing whether this can be included in a contract of adhesion or a contract by mutual agreement. The fact that a contract of suretyship could be characterized as a contract of adhesion was not disputed.

In its decision, the QCA held that clauses that provide for the reimbursement of legal fees, even in contracts of adhesion, are not necessarily abusive, but their enforcement is subject to the overview of the courts to ensure that the right to claim fees is exercised in good faith. Article 1437 of the Civil Code allows the court to review the quantum of legal fees claimed, if appropriate. In doing so, the court must consider all circumstances, including the complexity of the case, the time required and spent on the case, the manner in which the case was handled, and the hourly rates charged based on the lawyer's experience.

In the case of *Davidovit*, the Bank had claimed payment of the amount of \$35,000 for legal fees and expenses, which the QCA reduced to \$12,000, after excluding fees claimed in connection with the exercise of the Bank's hypothecary rights, for which no additional fees can be collected pursuant to article 2762 of the Civil Code, as well as certain other amounts claimed in respect of an expert's report, the usefulness of which the QCA could not determine.

Impact

This decision of the QCA clarifies the existing jurisprudence, which had contradictory strands, and clearly establishes that reasonable legal fees and expenses are recoverable from guarantors, to the extent specifically provided for in the guarantee. The court retains full discretion to review any such fees and expenses to ensure reasonableness and compliance with the law. Lenders should consider reviewing their guarantee templates to ensure that they include a clear and unequivocal undertaking of the guarantor to pay all reasonable fees and expenses incurred by the lender in collecting its claims.

[1] *Banque de Nouvelle-Écosse v. Davidovit*, 2021 QCCA 551