DebtBeat

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BARRISTERS & SOLICITORS

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DEMAND

When is a demand not a demand? Usually, anytime a guarantor is trying to avoid payment under a guarantee. An example of this is set out in TD Canada Trust v. B&B Enterprises (London) Ltd., a 2008 decision of the Ontario Court of Appeal.

Facts

A corporation ("Corpco") had two shareholders and directors: x and y. Corpco had a $232,000 line of credit with the bank. x and y guaranteed Corpco's obligations under the credit agreement.

Corpco had financial difficulties and defaulted under its payments. The bank became concerned. It reduced the line to $200,000 and wrote to Corpco stating that Corpco had a choice: convert the line of credit to a 4-year term loan or repay the balance of the line within 30 days. Corpco chose the first scenario and managed to reduce the loan to $70,000 before final default.

In the meantime, x had resigned as a director 7 months before the restructuring and knew nothing about it until a few months after it had been concluded. Although x had resigned and x and y had discussed the possibility of having x removed as a guarantor, that never happened. Since x was still a guarantor and since y ultimately assigned into bankruptcy, the bank sued Corpco and x for the amount that remained outstanding on the loan.

Restructure

As a basic rule, a guarantor is not liable under a guarantee if the creditor changes the terms of the debt obligation without the guarantor's agreement. Accordingly, x argued that when the bank restructured the line to a term loan without notice to x, x's obligations under the guarantee ended.

However, financial institutions are not stupid - although this statement is subject to debate in view of the American sub prime loans fiasco. They know the law and draft their credit agreements very broadly so that, by contract, they can override the common law. The bank drafted the credit agreement to allow the bank to unilaterally alter the credit agreement without affecting the validity of the guarantee. x argued that, although the bank could amend the agreement, it still had to give him prior notice of that amendment.

The Court acknowledged the argument - for what it is worth, we feel that the argument is ridiculous - and then indicated that it did not have to deal with it. Rather, the Court looked to another term of the credit agreement, which stated that if default occurred, the bank could demand repayment of the debt, in whole or in part. The Court concluded that this is exactly what the bank did. It demanded repayment, but gave Corpco the alternative to pay the indebtedness over time. It did not need to notify x of the demand or the alternative to full repayment.

Security

x also complained that the bank acted negligently in failing to take steps to preserve the value of the inventory, which, in addition to the guarantees, secured the loan. The credit agreement also dealt with this argument. It stated that the obligations of x were independent of Corpco's obligations and that the bank did not have to protect any security interest or proceed against any security.

The Court therefore rejected x's argument because of the wording of the credit agreement and, further, because the bank had never taken control of Corpco's business and had not appointed a receiver. The bank had no duty to manage or supervise Corpco or its assets.

Result

On the bank's summary judgment motion, the motions judge had held that x's defence raised no genuine issue for trial and, accordingly, the judge granted judgment for the bank. The Court agreed and upheld the judgment.

As an aside, our partner, Ian Latimer, acted for the bank.

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FIDUCIARY (bankruptcy)

A debt does not survive bankruptcy, subject to some exceptions. One exception arises

out of section 178(1)(d) of the Bankruptcy and Insolvency Act. There is no discharge from a debt or liability arising out of fraud while acting in a fiduciary capacity. Fraud is relatively easy to understand, but what is "fiduciary"? This concept was discussed in Ronee v. Machalik, a 2007 decision of the Ontario Superior Court of Justice.

Round & Round

The debtor was playing the system before the system caught up with him. The creditor had sued him for repayment of a $48,000 loan. Four days before trial, the debtor assigned into bankruptcy and the action was stayed.

The creditor subsequently commenced an action claiming civil fraud. That action came on for trial four years later. At the start of trial, the debtor requested an adjournment. It was granted, but the debtor was ordered to pay costs thrown away of $5,100. The debtor did not pay the costs and, accordingly, the debtor's defence was struck. The creditor still had to prove his case and the matter again came on for trial, but without the debtor attending.

Findings

The facts set out in the case are sketchy, but, we gather, the debtor and creditor had a personal relationship. The debtor looked after an Ontario property for the creditor, which engendered some trust between the parties. In addition, as a condition for the creditor lending money to the debtor, the debtor agreed, in writing, that he would not sell his property in Florida without the creditor's permission and would allow the creditor to sell the Florida property if the debtor did not repay the money when due.

Of course, the debtor subsequently sold the Florida property without the creditor's consent and did not repay the loan.

The judge had no problem finding that the debtor's course of conduct was fraudulent. The real question was whether it was fraud in a fiduciary capacity.

Criteria

There are three requirements for a fiduciary relationship:

1. The fiduciary has scope for exercise of some discretion or power.

2. The fiduciary can unilaterally exercise that power to affect the beneficiary's interests.

3. The beneficiary is particularly vulnerable or at the mercy of the fiduciary holding the power.

Put another way, would one party have reasonably expected that the other party would act in the former's best interests regarding the subject matter in issue?

As far as the judge was concerned, the general relationship between the parties, coupled with the debtor's promise not to sell the Florida property, was enough to comprise a fiduciary duty.

We feel that the evidence may have been a little light to substantiate a fiduciary duty. However, judges wish to do justice and justice dictated that the debtor, who had led the creditor on a merry chase, be called to account for his rather unscrupulous behaviour.

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