Blaney McMurtry
BARRISTERS & SOLICITORS LLP

EXPECT THE BEST

Important Advice to Lenders: Beware of the Wording in Your Guarantee

by Diane P.L. Brooks
Originally published in *Blaneys on Business* (June 2013)

Diane Brooks is a partner in Blaney McMurtry's Corporate & Commercial practice group. Her practice centers on commercial finance with a particular emphasis on equipment finance, asset-based lending, and other specialized structured financing products. She is an authority on transportation financing, energy management, retrofit financing and an array of other unique vendor programs. With more than 12 years of industry experience as corporate counsel to a number of financial institutions, Diane brings a unique business perspective to her practice.

Diane may be reached directly at 416.595.3954 or dbrooks@blaney.com.

A recent decision of the Supreme Court of British Columbia contains a critical caution for lenders – know and understand the terms of your contracts and their implications completely, and be sure to comply with those terms strictly.

If you do not, you may discover, the hard and expensive way, through litigation, that what you agreed to was not, in fact, what you intended.

The court decision involves three transportation industry companies – Coast Mountain Aviation, Inc., M. Brooks Enterprises Ltd. and A.K.S. Trucking Ltd. – and an operating loan, guaranteed by A.K.S., that Coast Mountain made to Brooks and on which Brooks defaulted.

In the case [*Coast Mountain Aviation Inc. v. M. Brooks Enterprises Ltd.* (2012 BCSC 1440)], due to an inadvertent error on the part of the lender (Coast Mountain) and its lawyers, the guarantee taken by Coast Mountain to support Brooks's borrowings was held invalid and the guarantor (A.K.S.) was relieved of its obligation to cover the default.

Coast Mountain agreed to lend $1,096,000 to Brooks. As security for the loan, Coast Mountain required a mortgage on land owned by Brooks. Coast Mountain also required a guarantee from A.K.S. (A.K.S. was not related to Brooks but did a substantial amount of business with it) and a mortgage from A.K.S. on a condominium that A.K.S owned.

When signed, the guarantee document contained a proviso that the mortgage was not to be registered against title to the real property unless and until default was made under the loan by Brooks and five days prior written notice to A.K.S. was given. The court held that the giving of the guarantee was conditional upon this proviso and that because the lender registered the mortgage immediately upon receiving it (and before the borrower defaulted and written notice to the guarantor was issued), A.K.S. was relieved of its obligation to pay the lender.

The lender maintained that the insertion of the condition in the guarantee was never the intention of the parties. As evidence of this, it offered that the mortgage to be granted by Brooks was prepared on the same registration document as the mortgage to be granted by A.K.S.

Therefore, the two mortgages had to be registered at the same time. Given that they were contained in one document, there was no way to register the mortgage against the Brooks property without also registering the mortgage against A.K.S.'s property.

As there was no evidence that the Brooks mortgage couldn't be registered right away, the lender argued that the parties could not have intended to condition AKS's guarantee. However, the court found that the lender did not provide sufficient evidence of a different oral agreement between itself and A.K.S. which would negate the condition in the guarantee.

The written decision makes for interesting reading on the history of guarantees and the court reviews much of the case law to distinguish an "accommodation guarantee" from a "compensation guarantee", a distinction not often referred to in the present day.

An accommodation guarantee is one that is given to accommodate a borrower and for which the guarantor receives no compensation. A compensation guarantee is one in which the guarantor receives a fee for giving of the guarantee, as one might see in the construction bonding industry.

The court found that A.K.S was an accommodation guarantor, notwithstanding that it derived some benefit from the borrowings. (Coast Mountain had insisted that part of the loan proceeds to Brooks be paid to satisfy arrears of property tax on A.K.S.'s condominium property and to satisfy a previous judgement against A.K.S. that had clouded title to the property.)

The court determined, however, that the payment of these charges was done primarily to protect the lender's interest and not for the exclusive benefit of A.K.S. as compensation for the company's guarantee. As an accommodation guarantee, the guarantee was held to a higher scrutiny; a breach by the lender of a term of the guarantee would relieve the guarantor from liability.

What may have been in the forefront of the court's mind was the fact that it was the lender's draft of the guarantee that included the condition. The Latin term, *contra proferentem*, means interpretation against the draftsman. In contract law, it is used to interpret contracts that are ambiguous. If a clause in a contract appears to be ambiguous, it is interpreted against the person who drafted the clause. While the condition in this particular guarantee was not ambiguous, the origins of how it got into the guarantee may have swayed the court to find against the lender.

Nonetheless, the lesson for lenders is always to abide by the terms of your written contract, particularly when you have drafted it. ■