

The Enforceability of Guarantees given by Officers and Directors of Corporate Borrowers and Sophisticated Individuals

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By Shawn English

As a mechanism for safeguarding the enforceability of a guarantee, it is common practice for commercial lenders to require that personal guarantors obtain independent legal advice with respect to the obligations and risks being assumed by the guarantor under his or her guarantee. Independent legal advice precludes the guarantor from alleging that he or she did not fully comprehend such risks and that he or she was unduly influenced or pressured by the borrower to provide the guarantee. Although common practice for many commercial lenders, there have been circumstances in which the Courts have upheld the enforceability of a guarantee notwithstanding the lender's failure to require that the guarantor obtain independent legal advice.

One such case is *Meridian*¹, in which the Ontario Superior Court of Justice confirmed that independent legal advice is not required prior to signing a guarantee if the guarantor is an officer or director of the corporate borrower.² In *Meridian*, the borrower, 2428128 Ontario Limited ("242"), entered into a loan agreement with Meridian Credit Union Limited ("Meridian"). The loan was secured by way of an unlimited personal guarantee given by the director, president and secretary of 242, Kiky Arraf-Bishara ("Kiky"). Upon default by 242 on the loan, Meridian sought recourse against Kiky pursuant to the personal guarantee.

It was conceded that 242 had defaulted on the loan and that Meridian was entitled to the full amount of its damages. However, Kiky submitted that only 25% of the damage amount should be adjudged against her personally on the basis that a Meridian representative had advised that her personal liability under the guarantee was limited to 25% of the original loan amount. Kiky further argued that she had not read any of the loan documents, including the guarantee, and that Meridian had not insisted that she seek independent legal advice with respect to the guarantee.

The Court in *Meridian* found that the guarantee was clear and unambiguous in that it was an unlimited personal guarantee and that there was no evidence to support Kiky's claim that the Meridian representative had misrepresented the scope of the documents or advised her that the guarantee was limited in any manner. The Court held that independent legal advice was not required prior to signing this guarantee, as Kiky was an officer and director of 242. Other factors influencing the Court's decision were that Kiky held a degree in Industrial Engineering and that the word "unlimited" appeared just above where the Guarantor signed her name.

The Court's finding that independent legal advice is not required in the event the guarantor is an officer or director of the corporate borrower is reasonable when one considers the primary rationale for requiring parties to obtain independent legal advice with respect to guarantees – to ensure the guarantor has not been unduly influenced or pressured into providing the guarantee. The parties to a loan agreement are typically the only parties receiving a direct benefit. In many cases, a personal guarantor is often a related party to the borrower, but does not typically share in the direct benefit of the loan. In the circumstance where the guarantor is a director or officer of the borrower, however, the Court has held that the director or officer guaranteeing the loan also shares in the benefit of the loan transaction by virtue of his or her position with the corporate borrower. Any concerns of undue influence or pressure are

mitigated by virtue of the director or officer's senior position with the corporate borrower.

Meridian is one example of a recent trend whereby the Courts have consistently shown that they will not entertain defences from sophisticated and educated guarantors that (i) they did not read or understand the documents they signed, or (ii) they were misled or induced by the lender to provide guarantees broader in scope than the parties intended.

In *Compas*³, the guarantor was a political science professor heading up a pre-eminent public research firm and an officer of the borrower, who was characterized by the Court as a smart and savvy individual. The guarantor was found to have been careless in the execution of the guarantee documents in a brief 5 – 10 minute meeting, which he quickly signed without actually reading their contents. There was no evidence of any material misrepresentation on the part of the lender as to the scope or content of the document presented for signature, and the lender's motion for summary judgment against the guarantor was granted.⁴

Similarly in *Cormier*⁵, the Court rejected the guarantor's bare allegations of undue influence exerted by her step-father where no evidence was ever advanced in support of those claims or as to how the guarantee worked some unfairness against her. Specifically, the Court noted that the guarantor had the education and business experience (as a business manager of an auto dealership) to understand the nature of the documents that were before her, and that she knew the line of credit she guaranteed would benefit the company of which she was an owner and vice president.⁶ Once again, the lender's motion for summary judgment against the guarantor was granted.

Despite the recent trend in *Meridian*, *Compas* and *Cormier* to hold personal guarantors who are sophisticated or officers and directors of the borrower to their bargains, it is always prudent for commercial lenders to confirm with their counsel, in the event there is any uncertainty, as to whether independent legal advice is required for any of the parties to ensure enforceability of a personal guarantee in a specific loan transaction.

¹*Meridian Credit Union Limited v. 2428128 Ontario Limited*, 2017 ONSC 4578[*Meridian*].

²*Meridian* at para 23.

³*BNS v. Compas*, 2018 ONSC 3262 [***Compas***]

⁴*Compas* at paras. 17, 19 and 20.

⁵*Royal Bank of Canada v. 3255177 Nova Scotia Limited and Chantal Cormier*, 2018 NSSC 181 [***Cormier***]

⁶*Cormier* at paras. 65 and 66.

The information and comments herein are for the general information of the reader and are not intended as advice or opinion to be relied upon in relation to any particular circumstances. For particular application of the law to specific situations, the reader should seek professional advice.

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