TD V Konga: When Guarantors Are Guaranteed To Pay

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Guarantors beware: the Court of Appeal, in*The Toronto-Dominion Bank v Konga*,1held that the guarantor was required to pay in response to a demand for payment pursuant to a guarantee, even where the debtor corporation had not failed to make a payment under the loan agreement.

Background

The appellant, Raymond Konga ("Konga" or the "Guarantor"), guaranteed a loan made by the respondent, The Toronto-Dominion Bank ("TD"), to Vermatin Inc. (the "Corporation"). TD claimed that the Corporation breached the terms of the loan agreement and demanded repayment of the loan from both the Corporation and Konga. TD moved successfully for summary judgment against Konga for payment pursuant to the guarantee.

Issues and Analysis

The Court of Appeal was tasked with resolving two issues. First, did the motion judge err in finding that TD was entitled to make a demand on the guarantee? Second, did the motion judge err in finding that Konga was not entitled to an equitable discharge of the guarantee?

1. TD was entitled to demand on the guarantee

a. The Corporation was afforded a reasonable amount of time to pay

The case law since*R.E. Lister Limited v Dunlop Canada*2is clear that a debtor is entitled to a reasonable amount of time to pay. The Court clarified that this determination is "fact-specific and dependent upon the conduct of the parties, before and after the demand" and that it "would not be possible, or indeed workable, for the creditor to arbitrarily establish that timeframe for the debtor".3

Applying these principles to the facts of this case, the Court of Appeal held that the Corporation was afforded a reasonable amount of time to pay following the issuance of

the demands. This conclusion was supported by the motion judge's finding that TD did not take steps to enforce the demand for many months after issuing the demand letter.4

b. The demand by TD pursuant to the guarantee was available even where the Corporation had not failed to make a payment under the loan agreement

Konga argued that a demand for payment under the guarantee was only available to TD if the Corporation defaulted on a monetary term of the loan agreement.5In other words, the appellant argued that the Corporation had to be in default of payment under the loan agreement as a precondition of payment on the guarantee.6While breaches of the other covenants in the loan agreement may have triggered TD's right to demand payment from the Corporation, Konga argued that this right did not extend to demand payment from the guarantor.7

The Court of Appeal held that the Corporation repeatedly failed to meet its financial obligations under the loan agreement, and therefore, had defaulted on its monetary terms.8The Corporation was in breach of the loan agreement by (i) being overdrawn on its line of credit, (ii) being in breach of the tangible net worth requirement, and (iii) not providing its accounts receivable listings.9The Court held that the terms of the guarantee were clear. The salient provisions of the loan agreement bound the guarantor to pay the unlimited liability of the corporation and TD was not required to exhaust its recourse against the corporation, or any other security held by the bank in respect of the Corporation's indebtedness, before being entitled to make a demand under the guarantee.10

2. Konga was not entitled to an equitable discharge from the guarantee on the basis of TD's conduct

In order for Konga to obtain a discharge from the guarantee, he had to establish that TD's demand caused the Corporation's default under the loan agreement.11Pursuant to the test set out in*Bank of Montreal v Wilder12*for this equitable relief, the guarantor bears the onus of establishing that the actions of the bank making a demand on the guarantee caused the default of the debtor.13The Court held that TD played no role in causing the Corporation's default. The Corporation was the master of its own demise — the default was the result of its excessive borrowings, breach of the tangible net worth requirement, refusal to submit its accounts receivable reports and continuing failures to cure its defaults despite TD's warnings.14

Conclusion

This case serves as a warning to guarantors that lenders are not necessarily required to exhaust their recourse against the primary debtor prior to looking to the guarantor in an enforcement. Guarantors should be prepared for lenders to call on the guarantee as soon as the debtor is in default.

Lenders should also be mindful that the court will consider whether the lender is a source of the problem. The court will look to whether the lender enforcing on the guarantee has caused the default of the debtor. The conduct of the lender will be determinative of whether an equitable remedy in favour of the guarantor is warranted. Lenders can rest assured, however, that guarantors bear the burden of establishing that a lender has acted improperly.

12016 ONCA 976 ['*TD v Konga*']

2[1982] 1 SCR 726.

3*Supra*note 1 at para 14.

4*Ibid*at para 15.

5*Ibid*at para 19.

6*Ibid*at para 9.

7*Ibid*at para 19.

8*Ibid*at para 20.

9*Ibid*at para 9.

10*Ibid*at para 23.

11*Ibid*at para 27.

12[1986] 2 SCR 551.

13*Supra*note 1 at para 30.

4*Ibid*at para 27.

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