Century Services Corp v. LeRoy (2018 BCSC 279)

A: Introduction

This case concerns whether a creditor's non-disclosure of its billing practices will void a guarantee in an action to enforce a guarantee. Specifically, the appeal concerned whether the non-disclosure of such practices constitutes implied misrepresentation that may vitiate a guarantee.

The Court of Appeal decided that the trial judge erred in law in holding that the guarantee, which Ms. LeRoy entered into, was vitiated by misrepresentation.

B: Factual Background

The respondent Rebecca LeRoy guaranteed her husband's company Ted LeRoy Trucking Ltd. ("TLT"). TLT began to experience financial difficulty and was indebted to its creditor the Royal Bank of Canada ("RBC") for approximately $18 million. TLT was unable to repay RBC for the debt and sought relief under the Companies' Creditors Arrangement Act, RSC 1985, c C-35 ("CCAA").

Eager to avoid bankruptcy, TLT entered into a loan agreement for high interest rate bridge financing with Century. Under this agreement, Century paid out RBC for its position as a secured creditor. Ms. LeRoy entered into a limited recourse guarantee for this loan agreement secured by a mortgage on the LeRoy residence. Mr. LeRoy was expected to refinance this mortgage in order to pay the funds to Century in exchange for a discharge of the mortgage. Ms. LeRoy's guarantee secured a maximum of $2 million plus interest and costs. Ms. LeRoy had obtained independent legal advice in relation to the limited recourse guarantee before executing it.

In brief, the parties intended to have Century provide bridge financing to stave off RBC bringing TLT into bankruptcy. In exchange, the LeRoys would have several months to find a new lender to discharge Century's mortgage and one year to secure a new lender for the TLT business.

Due to unexpected business reversals, TLT was unable to make the first payment to Century. TLT soon assigned itself into bankruptcy and authorized the sale of its assets to an auctioneer. The assignment into bankruptcy constituted an event of default under Century's loan agreement and it immediately issued to TLT a demand for payment, and a demand for payment under Ms. LeRoy's guarantee. Century then commenced foreclosure proceedings to realize on its security. Ms. LeRoy argued that the guarantee and the mortgage were unenforceable because Century had impliedly and fraudulently misrepresented to her at the time she entered into the guarantee.

C: Trial Decision

The trial judge dealt with two separate issues: first, the effect of misrepresentation on the validity of a guarantee where the misrepresentation is made at the time the guarantee is entered into. Secondly, the effect of a creditor's subsequent misconduct on the validity of a guarantee. Ms. LeRoy argued that Century had misrepresented to her that it would comply with the terms of the loan agreement contrary to its true intentions to do so.

Ms. LeRoy did not read the documents, but she had obtained independent legal advice. She argued that the misrepresentation arose from Century's implied conduct in proffering her the documents. She alleged that Century initially promised to perform the loan agreement according to its terms and that conversely, it had not intended to comply with the terms at all. Century had a standard practice of charging interest at the contractual rate on a loan balance and on fees and expenses, and capitalizing on employee time charged to a debtor's account.

The trial judge found that Century engaged in misrepresentation as it did not check the language of the loan agreement to confirm that such charges were authorized. Century represented to Ms. LeRoy that it would adhere to the terms of the loan agreement and that it was indifferent as to whether it truly complied. Further, Ms. LeRoy relied on that representation and suffered a loss in becoming liable under the guarantee. However, the trial judge dismissed Ms. LeRoy's argument that Century's subsequent conduct in posting contested charges to TLT's loan account was fraudulent as this did not increase the risk to Ms. LeRoy in being called to account for her guarantee.

D: Appeal Decision

Century appealed the trial decision based an error of law in treating the failure to disclose standard charging practices as a material misrepresentation.

The Court of Appeal affirmed that if a creditor makes express or implied misrepresentations at the time a guarantee is executed a guarantor may be discharged from liability. An implied representation may also be framed as a duty of disclosure. Such a duty may arise where no inquiry was made by the guarantor to the creditor. However, even where the guarantor makes no inquiry of the creditor, the type of information that ought to be disclosed under this duty is information that shows that the relationship between the creditor and principal is materially different from that which the guarantor might naturally expect.

The overall principles applicable to the scope of a creditor's duty to disclose information even where a guarantor does not ask, includes the following:

1. The information is material;

2. "Materiality" is assessed on an objective basis. The query that must be satisfied is whether this information would be "likely to affect the mind of a reasonable guarantor in the position of the prospective guarantor"; and

3. Finally, the information must be in relation to facts connected to the dealings between creditor and debtor or other guarantor who is subject to the guarantee that the surety would expect not to exist.

The Court held that such a narrow scope of disclosure facilitates efficient credit markets since prospective guarantors will be able to make informed decisions based on sufficient information regarding risks they will be assuming and lenders will not have to disclose information that is neither material nor unexpected.

The Court held that the trial judge erred in failing to determine whether the information related to Century's standard charging practices was objectively material in the sense that it would likely affect the mind of a reasonable guarantor occupying Ms. LeRoy's position. The Court determined that Century's standard practices regarding posting charges did not affect the risk that Ms. LeRoy undertook in signing the guarantee. Ms. LeRoy's subjective assertion as to the fact that she would not have undertaken the guarantee had Century disclosed its billing practices did not meet the objective test for material information. A reasonable person in Ms. LeRoy's position at the time of the signing would not have been affected by the knowledge that if the loan went into default, Century would post charges that Ms. LeRoy would not be obligated to pay. Only the terms of the loan agreement and guarantee would govern regardless of Century's billing practices.

Additionally, Century never expressly represented a material fact to Ms. LeRoy. She did not ask Century any questions in relation to the guarantee. Therefore, the analysis related to the scope of Century's duty to disclose material facts as objectively assessed to Ms. LeRoy. The trial judge erred in treating Century's proffering of the loan agreement as an express representation of an intention to abide by its terms. A breach of a promise to perform does not render a contract voidable. In order for Ms. LeRoy to be relieved as a guarantor, any representation that Century made had to be material as objectively determined.

D: Implications to Lenders

This decision makes it clear that non-disclosure of immaterial information will not be sufficient to release a guarantor of his or her liability under a guarantee. What is material information does not depend on what a guarantor subjectively believes is important. Where a guarantor does not ask lender specific questions with respect to the guarantee or loan, a lender's duty to disclose certain information to equip a guarantor to make a reasoned decision to sign a guarantee will be narrow.

A lender's failure to disclose any and all information will be insufficient to release a guarantor from being called to account on that guarantee. The only information that may release a guarantor of his or her liability is information that will affect the mind of a reasonable guarantor and be connected to the relationship of the creditor and the debtor which the guarantor would not be expected to anticipate.

A guarantor's pledge to the principal debt is not to be taken lightly; it is a serious undertaking that will come with drastic consequences even where a creditor does not disclose certain standard practices. Overall, the law expects guarantors to exercise caution before signing on to a guarantee.

Please contact us should you wish to discuss the implications of this decision in more detail.