

Law of Guaranty: Can-Win Leasing, Contribution and the Rights Between Co-Sureties

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OK, here's the scenario:

You, and a partner, own a business 50 – 50. The business borrows money from a lender.

Both you and your partner guarantee the loan (thereby becoming co-sureties). You start to worry about the business's finances and decide to pay off the loan – absent any demand from the lender and without notifying your partner. You then ask your partner to contribute to the payment of the debt.

Is your partner obliged to pay you? Not necessarily.

The general rule is that where a surety has paid more than its rateable share of a debt, it has an equitable right to recover contribution from its co-sureties if the payment was made in a situation where such surety was legally obliged to pay.

A demand by the lender can certainly trigger the obligation but this is not a prerequisite to the surety's right to pay the lender and seek contribution from the co-surety. So, absent a default by the borrower and demand by the lender, when, then, is a surety who pays the debt entitled to contribution from a co-surety?

Ontario's top court recently considered this issue in *Can-Win Leasing v. Moncayo*. This is a case where a co-surety is exempted from the general rule of contribution, the facts of which are briefly summarized below.

Clifford Irwin and Rafael Moncayo were 50-50 shareholders in Can-Win Truck Sales Inc. ("Can-Win Truck"), which bought and sold used trucks. Mr. Irwin was the sole shareholder of a second

company, Can-Win Leasing (Toronto) Limited (“Can-Win Leasing”). Together, Mr. Irwin, Can-Win Leasing and Mr. Moncayo guaranteed a debt of Can-Win Truck to the Royal Bank of Canada (“RBC”). The guarantee was payable “on demand.”

Can-Win Truck was losing money in 2007 and Mr. Irwin became concerned about the state of the business. Mr. Irwin was getting a lot of pressure from RBC, however, no formal demand was ever made by the bank.

In August 2008, Mr. Irwin commenced payments towards Can-Win Truck’s outstanding debt through Can-Win Leasing. In March 2009, RBC assigned the Can-Win Truck debt to Can-Win Leasing. Both the payment and assignment of the debt took place without any notice to Mr. Moncayo. Consequently, Can-Win Leasing made a demand of contribution against Mr. Moncayo for his share. When Moncayo refused, he was subsequently sued in the Ontario Superior Court of Justice. After losing at trial, Can-Win Leasing appealed.

In dismissing the appeal, the court confirmed that the right to contribution arises when one co-surety has paid more than its fair share of the common obligation. A surety is typically notified by way of demand that there has been a default on the loan by the borrower. Where, as in this case, the guarantee is payable on demand, the demand is a condition precedent to the enforcement of the obligation by the lender.

But, the absence of a demand by the lender does not displace a surety’s right of contribution as between co-sureties and a co-surety will nonetheless be entitled to indemnification by its fellow guarantors if default by the borrower is imminent or a demand can realistically be anticipated.

The court said it appreciates the policy rationale for permitting a co-surety to “stop the bleeding” when failure of the business is inevitable or where there has been a verbal demand on the surety. But it cautions, however, that there is great potential for abuse when this rationale is extended to circumstances where it is not established that default is imminent.

It is important to remember that a guarantee is a secondary and contingent obligation - it is secondary to a primary obligation (i.e. that of the borrower) and it is contingent on the default of the borrower under the primary obligation. By stepping in and paying the obligation, the surety exposes the debtor, and any co-surety, to a liability they may have been able to avoid.

The court, therefore, recommends that, if a surety is intending to pay off the debt, it should give notice of such intentions to its co-sureties and give them an opportunity to participate in the discharge of the obligation. The court says that this “promotes the efficient winding up of the business and the equitable allocation of its outstanding liabilities.” Unilateral action, as occurred in this case, should be discouraged.

The result of this case ultimately turned on the facts. The majority of the court gave deference to the trial judge who found that the business was salvageable and that the threat of default was not imminent. The dissent, however, pointed to the fact that had Mr. Irwin stopped financing the company, then default was not only imminent but also inevitable.

To sum up, if the bank has demanded payment on either the principal debtor or a surety, or if there is evidence that the business is in imminent danger of default, then yes, the co-surety has an obligation. But, unless the evidence of imminent default is crystal clear, a surety may be better off keeping its money in its pocket until the lender comes knocking.

In any event, Ontario courts expect co-guarantors to consult and work together to satisfy the debt they have guaranteed and do not support unilateral settlement without notification. Moreover, in settling the debt on your own, you risk losing your right to contribution from a co-surety, a cost that could be dear.