Bank of Nova Scotia v. Williamson

97 O.R. (3d) 561

Court of Appeal for Ontario,
Feldman, Juriansz and MacFarland JJ.A.
November 2, 2009

Limitations -- Guarantees -- Time for commencing action on demand guarantee not beginning to run until demand is made -- Section 5 of Limitations Act, 2002 not changing date for commencement of limitation period to date when plaintiff knew or ought to have known that principal debtor was not going to pay -- Limitations Act, 2002, S.O. 2002, c. 24, Sch. B, s. 5.

The defendant gave the plaintiff Bank a guarantee of A Inc.'s debts to the plaintiff. A Inc. defaulted on its loans in October 2004, and the plaintiff wrote A Inc. a demand letter. At the same time, the plaintiff sent the defendant a letter stating that if payment was not made by A Inc., it would take steps to recover payment from the defendant. In December 2004, A Inc. was deemed bankrupt. After final assets were realized and the receiver was discharged, A Inc. still owed the plaintiff over $1 million. The plaintiff wrote to the defendant demanding payment from the defendant on the guarantee in June 2007 and, when the defendant did not pay, commenced an action in July 2007. The plaintiff's motion for summary judgment was granted. The defendant appealed, arguing, as he had at trial, that the claim was commenced beyond the two-year limitation period under s. 5 of the Limitations Act, 2002.

Held, the appeal should be dismissed.

A demand guarantee requires a demand before it is enforceable, and the time for commencing an action does not

begin to run until a demand is made. Section 5 of the Limitations Act, 2002 does not change the date for the commencement of the limitation period from the date of demand to the date when the plaintiff knew or ought to have known that the principal debtor was not going to pay. A demand under a demand guarantee must be clear and unequivocal. In this case, it was the second letter from the plaintiff to the defendant that constituted a demand on the guarantor; the first letter was sent merely to advise the defendant that if the principal debtor did not pay the debt, the plaintiff would look to the defendant for payment.

Cases referred to
2015673 Ontario Inc. v. Chorny (2008), 90 O.R. (3d) 207, [2008] O.J. No. 760, 13 P.P.S.A.C. (3d) 168, 165 A.C.W.S. (3d) 247, 44 B.L.R. (4th) 101 (S.C.J.), distd
Other cases referred to
Bank of Nova Scotia v. Mabey, [1979] N.B.J. No. 173, 26 N.B.R. (2d) 536 (S.C.); Bradford Old Bank v. Sutcliffe, [1918] 2 K.B. 833 (C.A.); Brown's Estate (Re), [1893] 2 Ch. 300 (Ch. Div.); Canadian Imperial Bank of Commerce v. Sayani, [1994] B.C.J. No. 1943, 100 B.C.L.R. (2d) 294, 49 A.C.W.S. (3d) 1316 (S.C.); Hare v. Hare (2006), 83 O.R. (3d) 766, [2006] O.J. No. 4955, 277 D.L.R. (4th) 236, 218 O.A.C. 164, 24 B.L.R. (4th) 230, 153 A.C.W.S. (3d) 1243 (C.A.); Mortgage Insurance Co. of Canada v. Grant, [2009] O.J. No. 3769, 2009 ONCA 655, 254 O.A.C. 77, 84 R.P.R. (4th) 1; Royal Bank v. Ruben (1978), 24 N.B.R. (2d) 707 (Q.B.)
Statutes referred to
Limitations Act, 2002, S.0. 2002, c. 24, Sch. B, ss. 4, 5, (3), (4), 15 [page562]
Authorities referred to
McGuinness, Kevin Patrick, The Law of Guarantee, 2nd ed. (Toronto: Carswell, 1996)

APPEAL the from judgment of Trotter J. of the Superior Court of Justice dated November 27, 2008 for the plaintiff in an action on a guarantee.

Eric Kay, for appellant.

John D. Marshall, for respondent.

The judgment of the court was delivered by

FELDMAN J.A.: --

Introduction

[1] The appellant appeals the decision of Trotter J. granting summary judgment to the Bank on a demand guarantee. The only issue on the motion and on the appeal was whether the claim was commenced beyond the two-year limitation period under s. 4 of the Limitations Act, 2002, S.O. 2002, c. 24, Sch. B.

Facts

[2] The appellant, an officer, director and shareholder of Ancon Industries Inc., gave the Bank a written guarantee of Ancon's debts to the Bank up to a limit of $350,000. When Ancon defaulted on its loans in October 2004, the Bank wrote Ancon a demand letter on October 20, 2004 and on the same date sent the appellant a letter which stated:

> According to our records, as of October 20, 2004, the Borrower is obligated to us for direct advances (except letters of credit) in the principal amount of Cdn. $2,770,666.78, for interest in the amount of $15,460.11 and under a letter of credit in the amount of $6,000.
>
> We hold your Guarantee dated December 20, 2002 of payment of the Obligations of the Borrower to the Bank.
>
> We have today demanded payment of the Borrower's obligations to us. A copy of our demand is enclosed. If payment of our demand is not made as required, we will take steps to recover payment from you.

(Emphasis added)

[3] On December 2, 2004, a receiver of Ancon's assets was appointed and on December 10, 2004, Ancon was deemed bankrupt. After the final assets were realized and the receiver was discharged by order dated February 7, 2007, Ancon still owed over $1 million to the Bank. [page563]

[4] The Bank demanded payment from the appellant on the guarantee by a letter from the Bank's counsel, dated June 12, 2007. That letter stated:

> According to the Bank's records, [Ancon] is indebted to the Bank in the amount of $166,201.68.
>
> The Bank holds your guarantee dated 20 December 2002 of payment of the obligations of the Borrower to the Bank, limited to the sum of $350,000. The guarantee is payable on demand and bears interest from the date of demand for payment at the Bank's prime rate applicable at the time of demand plus 2% per annum. The Bank's current prime rate is 6% per annum.
>
> On Behalf of the Bank, we hereby demand payment from you under the said guarantee.

(Emphasis added)

[5] When the appellant did not pay, the Bank commenced this action on July 7, 2007.

[6] The appellant argued that the limitation period under s. 5 of the Limitations Act, 2002 commenced not when demand was made under the guarantee, but when the Bank first discovered that Ancon, the principal debtor, would not be able to pay the full debt. Alternatively, if demand was required for a cause of action to arise and trigger the running of the limitation period, the appellant's position was that the October 20, 2004 letter (the first letter) to the Bank constituted a demand for payment. On either argument, the appellant submits that the two-year limitation period has expired.

[7] The Bank's position was that under a demand guarantee, no cause of action arises until demand has been made on the

guarantor. The first letter was not a demand, but merely a courtesy notice to the guarantor that if the principal debtor did not pay, then the Bank would look to the guarantor for payment. The Bank's lawyer wrote what was clearly a demand letter to the guarantor on June 12, 2007 (the second letter), following the completion of the bankruptcy proceedings of the principal debtor that left the Bank with over $1 million in outstanding debt. The Bank then commenced a timely action.

[8] The motion judge rejected the legal argument made by the appellant that under the Limitations Act, 2002, the limitation period on a demand guarantee commenced not on the date of demand but on the date when the Bank knew that the principal debtor was insolvent and that the debtor would not be paying the Bank. He found that no cause of action arose on the guarantee until the Bank had made demand on the guarantor.

[9] The motion judge also concluded that the first letter did not constitute a demand on the guarantor. He compared the wording of the two letters and found that while the second letter [page564] actually demanded payment from the guarantor, the first was conditional, saying that if the principal debtor did not pay, then the Bank would take steps to collect from the guarantor. The motion judge also referred to the evidence of the Bank representative that the first letter was intended as a courtesy and he noted that there was no evidence from the appellant that he believed the first letter constituted a formal demand on him.

[10] The appellant submits that the motion judge erred in both respects.

Issues

(1) Does a demand guarantee require a demand before it is enforceable?

(2) Does s. 5 of the Limitations Act, 2002 change the date for the commencement of the limitation period from the date of demand to the date when the Bank knew or ought to have known that the principal debtor was not going to pay?

(3) Did the Bank's first letter constitute a demand on the guarantor?

Analysis

Issue 1: Does a demand guarantee require a demand before it is enforceable?

[11] A document that states it is payable "on demand" does not always require a demand before it can be enforced. It depends on the nature of the obligation and the construction of the document.

[12] A promissory note that is payable "on demand" is in fact payable from the moment the money is loaned because the debt is owed from that moment: Hare v. Hare (2006), 83 O.R. (3d) 766, [2006] O.J. No. 4955 (C.A.), at para. 11. Therefore, it has been held that the words "on demand" add nothing to the obligation. The same rule applies to a demand mortgage: Mortgage Insurance Co. of Canada v. Grant, [2009] O.J. No. 3769, 2009 ONCA 655, at para. 19.

[13] However, the courts have long held that this rule does not apply to a collateral obligation such as a guarantee or collateral mortgage given by a third party to secure the debt obligation of the primary debtor. Where the obligation of a third-party guarantor is to pay on demand, then demand is a condition precedent to that obligation. The rationale is that where the guarantee obligation is made on demand, the third-party guarantor is given an opportunity to marshal the funds before the [page565] obligation is due: Brown's Estate (Re), [1893] 2 Ch. 300 (Ch. Div.), at pp. 304-305.

[14] The issue of the need for a demand has traditionally arisen in the context of a claim by a third-party guarantor that an action on the guarantee was statute-barred because the action was commenced more than six years (the former limitation period) after the principal debt was due. However, where a demand is a condition of the guarantee obligation, the time for commencing an action does not begin to run until a demand is made: see Bradford Old Bank v. Sutcliffe, [1918] 2 K.B. 833 (C.A.); Canadian Imperial Bank of Commerce v. Sayani, [1994] B.C.J. No. 1943, 100 B.C.L.R. (2d) 294 (S.C.); K.P. McGuinness, The Law of Guarantee, 2nd ed. (Toronto: Carswell, 1996), at para. 6.26.

[15] The appellant relied both in the motion and in this appeal on the Superior Court decision in 2015673 Ontario Inc. v. Chorny (2008), 90 O.R. (3d) 207, [2008] O.J. No. 760 (S.C.J.), where it was held that the limitation period on a guarantee ran not from the date of demand but from the date of default on the principal debt. However, that case is distinguishable because, although demand was made, there is nothing in the recitation of the facts that indicates that the terms of the guarantees required a demand.

Issue 2: Does s. 5 of the Limitations Act, 2002 change the date for the commencement of the limitation period from the date of demand to the date when the Bank knew or ought to have known that the principal debtor was not going to pay?

[16] In Hare v. Hare, this court held that the Limitations Act, 2002 does not, nor was it intended to change the common law with respect to the operation of demand promissory notes. The same applies to the common law regarding demand guarantees. As discussed above, a demand is required before anything is owed by a guarantor under a third-party guarantee.

[17] The appellant submits, as he did to the motion judge, that by requiring a demand as a condition of the existence of a cause of action and therefore the commencement of the limitation period, the court is promoting indefinite liability. However, as Trotter J. observed, that had always been the accepted effect under the former Limitations Act of obligations that required a demand in order to be enforceable. Furthermore, the appellant could have bargained for a different result. Also, s. 15 of the Limitations Act, 2002 imposes a 15-year ultimate limitation period so that liability will not be indefinite. [page566]

[18] In any event, the Limitations Act, 2002 was amended on November 27, 2008 to add s. 5(3) and (4), which deal specifically with the requirement for the commencement of the limitation period for demand obligations. Those sections provide:

Demand Obligations

5(3) For the purposes of subclause (1)(a)(i), the day on which injury, loss or damage occurs in relation to a demand obligation is the first day on which there is a failure to perform the obligation, once a demand for the performance is made.

Same

(4) Subsection (3) applies in respect of every demand obligation created on or after January 1, 2004.

[19] This amendment demonstrates the intent of the legislature that for all demand obligations, a demand is a condition precedent for the commencement of the limitation period. The legislature may be taken to have recognized that this puts the creditor in the position to extend the limitation period by failing to make a prompt demand. However, it creates more certainty in establishing the commencement date for the limitation period. Although this new section does not affect this case, it affirms the law regarding third-party demand guarantees. [See Note 1 below]

Issue 3: Did the Bank's first letter constitute a demand on the guarantor?

[20] A demand under a demand guarantee must be clear and unequivocal: Bank of Nova Scotia v. Mabey, [1979] N.B.J. No. 173, 26 N.B.R. (2d) 536 (S.C.); Royal Bank v. Ruben (1978), 24 N.B.R. (2d) 707 (Q.B.); McGuinness, The Law of Guarantee, 2nd ed., at para. 6.26.

[21] The motion judge found that it was the second letter from the Bank's solicitor that constituted demand on the guarantor and that the first letter was sent merely to advise the guarantor that if the principal debtor, Ancon, did not pay the debt, then the Bank would look to the guarantor for payment. I agree with the motion judge's finding.

[22] The motion judge founded his conclusion on a comparison

of the letters sent to Ancon and to the appellant on October 20, 2004, [page567] as well as a further comparison with the second letter sent to the appellant. The October 20 letter to Ancon was a clear demand for payment from Ancon, while the October 20 letter sent to the appellant referenced the demand on Ancon and said that if Ancon did not respond to the demand with payment, then the Bank would take steps to collect from the appellant. The second letter to the appellant in 2007 unequivocally demands payment from him under the guarantee.

[23] The motion judge also observed that it was the evidence of the bank representative that the first letter was sent as a courtesy to the appellant and that there was no evidence that the appellant believed the first letter was a demand. The appellant objects to the use of this extrinsic evidence to interpret the letters. In my view, the motion judge made no error by referring to these observations; he was not using this evidence as a makeweight in his interpretation of the letters but merely observing that there was no evidence to the contrary. The evidence of the bank manager was elicited in cross-examination. I infer that the motion judge's references to the evidence and lack of evidence on the point indicate that had there been evidence that the appellant believed the first letter was a demand, the motion judge would have assessed that evidence and that of the bank manager in light of the rules of evidence and dealt with it accordingly.

Conclusion

[24] The appeal is dismissed with costs fixed at $10,000, inclusive of disbursements and GST.

Appeal dismissed.

Notes

Note 1: These new sections now require a demand before the limitation period can commence in the case of demand promissory notes and other debt instruments where, at common law, the debt is owed as soon as the moneys are advanced: see Hare v. Hare, at

para. 11.
