Financial Services Flash

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Amending Loan Documents: Don't Forget the Guarantor

By Aaron Collins

A recent decision from the Court of Appeal for Ontario (the "**Court of Appeal**") in *Royal Bank of Canada v. Samson Management & Solutions Ltd.* ("**Samson**") highlights enforceability issues that can arise with guarantees when an underlying loan document is altered without a guarantor's consent. The facts in Samson are all too common and should give lenders pause when amending loan documentation. Ultimately, the Court of Appeal did find the subject guarantee was enforceable, but the decision underscores important practices to employ in these circumstances.

In 2005, Royal Bank of Canada ("**RBC**") provided a credit facility in the amount of $150,000 to Samson Management and Solutions Ltd. (the "**Borrower**"). The loan was secured by, among other things, a $150,000 guarantee of all of the Borrower's obligations to RBC from the spouse of the Borrower's principal, Cheryl Cusack ("**Cusack**"), who was not involved in the day-to-day operations of the Borrower. Cusack's guarantee was in RBC's standard form and was bolstered by a certificate of independent legal advice provided by Cusack's lawyer.

In 2006, RBC agreed to increase the loan amount to $250,000. Cusack gave a new $250,000 guarantee in favour of RBC (the "**2006 Guarantee**"), on the same terms as her earlier guarantee. Once again, Cusack received independent legal advice. RBC and Samson then later agreed to increase the loan amount on two separate occasions, first to $500,000, and then to $750,000. At the time of both increases, RBC had no contact with, and did not request a new guarantee from, Cusack. The Borrower's business failed in 2011. RBC made demand on Cusack for the amount of the 2006 Guarantee, and brought a motion for summary judgment. Cusack brought a cross-motion for summary judgment seeking to have the 2006 Guarantee declared unenforceable because the increase of the underlying obligations was a material alteration to which she did not consent.

The Ontario Superior Court of Justice (the "**Superior Court**") found in favour of Cusack, on the basis that the increase of the Borrower's debt carried considerably greater risk to Cusack, she had not consented to such a material change and common law principles dictate that, where a guarantor has not consented to material alterations to a loan document, the guarantor will be released from liability.

The Court of Appeal agreed that the loan increases were a material change to the underlying obligations without Cusack's consent, and that, at common law, the change would have released Cusack from liability under the 2006 Guarantee. However, the Court of Appeal noted that there is a circumstance where the common law release of liability will not operate: if the guarantee contains clear language permitting a debtor and lender to make changes to the underlying loan document without the guarantor's consent. The underlying principle is that a guarantor can contract out of the protection provided by the common law, provided that the language is clear.

It was here that the Court of Appeal found the Superior Court's analysis deficient. When there is a material change in the underlying obligations without a guarantor's consent, the analysis must extend further to examine if, in the language of the guarantee and the context in which it

was given, the guarantor contracted out of the right to the common law release of liability.

In this instance, the 2006 Guarantee contained broad provisions allowing RBC to make alterations to the amount, interest rate and other terms of the Borrower's debt and required that Cusack would pay, on demand, all debts and liabilities of the Borrower to RBC, present or future, subject to the limitations contained therein. In the Court of Appeal's view, the language of the 2006 Guarantee was clear and the fact that Cusack received independent legal advice pointed to a clear and unequivocal waiver of the right to common law protection. As a result, the Court of Appeal reversed the Superior Court decision, found that Cusack had contracted out of her right to be notified of material alterations and granted summary judgment to RBC.

There are a few lessons for lenders to take from Samson. First, always ensure that your forms of guarantee include clear, unequivocal language whereby a guarantor contracts out of the right to consent to future changes to terms in a loan document. Second, where an individual guarantor is not involved in the day-to-day operations of a debtor, it is wise to have that guarantor seek independent legal advice on his/her guarantee. Finally, when amending loan documentation, the best practice, whenever possible, is to have guarantors acknowledge the new terms or provide a new guarantee confirmed by the guarantor.

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