In The Supreme Court of Bermuda

CIVIL JURISDICTION

(COMMERCIAL COURT)

2012: No. 36

FIFTH STREET FINANCE CORPORATION

Plaintiff

-v-

DAVID DOBBIN

Defendant

JUDGMENT

(in Court)

Date of hearing: June 19, July 10, 2013
Date of Judgment: July 17, 2013

Mr. Alan Dunch, MJM Limited, for the Plaintiff
Mr. Delroy Duncan and Ms. Nicole Tovey, Trott & Duncan Limited, for the Defendant.

Introductory

1. The Plaintiff is a Delaware corporation based in New York State and provides business finance. The Defendant is a businessman resident in Bermuda.

2. By a Generally Indorsed Writ issued on January 24, 2012 (which was filed with a Statement of Claim), the Plaintiff sought US$3,874,441.30 together with, *inter alia*, contractual interest and costs from the Defendant under a Guarantee and Indemnity Agreement dated September 28, 2009 ("the Guarantee"). A Defence was filed on April 16, 2012.

3. The principal debtor whose debts were guaranteed by the Defendant is a Canadian company, Repechage Investments Limited ("RIL"). The primary obligations were owed to the Plaintiff by RIL as assignee of pre-existing liabilities under an April 20, 2007 Credit Agreement owed by two of RIL's subsidiaries, Elephant & Castle Group Inc (a Canadian corporation) and Elephant & Castle Inc. (a Texas corporation).The Elephant & Castle Group operated and franchised British style pub restaurants in the United States and Canada. On or about June 28, 2011, RIL filed a voluntary bankruptcy petition in the United States Bankruptcy court for the District of Massachusetts (Eastern Division) which the Defendant signed as its President and Chief Executive Officer. On the same date similar filings were made in respect of thirteen other members of the Elephant & Castle Group in respect of each of which the Defendant was also President and Chairman of the Board.

4. The Defence alleged that the Guarantee formed part of wider financing arrangements involving GE Canada equipment finance, LP ("GE"), a co-creditor of RIL together with the Plaintiff (paragraph 8). Under an October 16, 2009 agreement ("the Interlender Agreement), GE and the Plaintiff agreed to cooperate and share the liquidation assets of RIL (paragraph 9). The Plaintiff participated in the bankruptcy proceedings commenced by RIL and the Group in June 2011 (paragraph 10). On or about February 3, 2012, an Asset Sale took place by order of the United States Bankruptcy Court under which most of the Group's assets were sold. Pursuant to "the Carve Out", which the Plaintiff failed to object to, junior third party claims were paid ahead of GE's senior debt with the result that the RIL assets available to secure the principal debts were significantly reduced (paragraphs 12-13).

5. The crucial averment in the Defence is that the Plaintiff "*failed to take any or any reasonable care in relation to the principal debts and materially changed, or acquiesced in the change, of the risks undertaken by the Defendant in the Guarantee…The Plaintiff has as a matter of Ontario law thereby lost the right to demand under the Guarantee…and/or its rights to claim are reduced by the amounts by which the Plaintiff's conduct has prejudiced the Defendant as surety*" (paragraph 14).

6. After filing its Reply, the Plaintiff issued a Summons seeking the trial of a preliminary issue on December 19, 2012. Directions were ordered for the hearing of the Summons on January 17, 2013. On January 31, 2013 the Defendant's initial attorneys indicated a conflict had developed and the Defendant's present attorneys became involved. On February 25, 2013, this Court ordered:

> "*The Question of whether the Plaintiff's demand by letter dated 6th January 2012 in the sum of US$3,941,100.72 was lawful as a matter of Canadian Law be determined as a preliminary issue pursuant to Ord. 33 r.3Rules of the Supreme Court 1985.*"

7. Shortly before the present trial, the Defendant issued a Summons returnable for the date of the trial seeking leave to amend his Defence. The application was opposed. I reserved my decision on the application until judgment on the merits of the preliminary issue.

The Guarantee

8. Under the terms of the Guarantee, the Defendant was the "Guarantor", the Plaintiff was "Fifth Street", RIL the "Obligor" and RIL's primary debt obligations to the Plaintiff were defined as "Obligations" arising under the "Finance Instruments". Clause 9.8 ("Governing Law") provides: "*This Guarantee shall be governed by and construed in accordance with the laws of the province of Ontario and the laws of Canada applicable therein*". The main operative clause in the Guarantee was the following:

> "***2.1 Guarantee*** *The Guarantor hereby irrevocably and unconditionally guarantees and covenants with Fifth Street as principal debtor of Fifth Street and not merely as surety, that the Obligor will duly and punctually perform all of the Obligations, and pay or cause to be paid to Fifth Street the principal of and interest on the Finance Instruments evidencing or securing the Obligations (including, in the case of default, interest on the amount in default) as and when the same becomes payable , whether by lapse of time, by extension, or upon a declaration or otherwise according to the terms of the Finance Instruments and all other moneys owing on or under the Finance Instruments or in any way relating thereto including without limitation, all legal fees and expenses, service charges and other costs and expenses. The liability of the Guarantor hereunder for the Obligations shall be unlimited, irrevocable, and shall include interest, fees, costs or expenses (including, without limitation, legal fees and expenses) which may now or hereafter accrue or be incurred with respect to such Obligations and any fees, costs or expenses ((including, without limitation, legal fees and expenses) that may be incurred by Fifth Street by reason of the Guarantor's default under this Guarantee.*"

9. Clause 2.3 ("***Guarantee Absolute***") provides that the Guarantor's liability " *shall not be affected by….c) the bankruptcy, winding-up, liquidation, dissolution or insolvency of the Obligor, Fifth Street or any party to any agreement to which Fifth Street is a party…e) any other law, regulation or other circumstance which might otherwise constitute a defense [sic]available to, or a discharge of , the Obligor in respect of any or all of the Obligations, other than indefeasible payment in full of the Obligations.*"

10. Clause 4.1 ("***No Release***") provides that "*…Fifth Street, without releasing, discharging, limiting or otherwise affecting in whole or in part the Guarantor's liability hereunder, may:…e) apply all money at any time received from the Obligor or from securities upon such part of the Obligations as Fifth may see fit or change any such application in whole or in part from time to time as Fifth Street may see fit;…g) otherwise deal with the Obligor and all other persons and securities as Fifth Street may see fit.*" This clause is supplemented by the following provision:

> "***4.2 No exhaustion of Remedies*** *Fifth Street shall not be bound or obligated to exhaust its recourse against the Obligor or other persons or any securities or collateral it may hold or take any other action (other than make a demand pursuant to Section 6) before being entitled to demand payment from the guarantor hereunder. The obligations of the Guarantor hereunder are joint and several with those of the Obligor and any other guarantor, surety or other person liable in any way for the Obligations. This Guarantee is in addition and not in substitution for any other guarantee, by whomsoever given, at any time held by Fifth Street, and without prejudice to any other security, by whomsoever given, at any time held by Fifth Street, and Fifth Street shall be under no obligation to marshall in favour of the guarantor any such security or any of the funds or assets Fifth Street may be entitled to receive or have a claim upon.*"

11. Section 6 entitles Fifth Street to make demand for payment upon a default by the Obligor and to recover interest at the rate applicable to the Obligations. Section 9 ("***GENERAL***") contains the following relevant provision which reinforces the provisions already reproduced above:

> "*9.1 Waiver of Notice of Acceptance The Guarantor waives notice of acceptance of this agreement and the extension or continuation of the Obligations or any part thereof. The Guarantor further waives presentment, protest, notice, demand or action in respect of the Obligations or any part thereof, including any right to require Fifth Street to sue the Obligor, any other guarantor, or any other person obligated with respect to the Obligations or any part thereof, or otherwise to enforce payment thereof against any collateral securing the Obligations or any part thereof.*"

12. The Guarantee appears on its face to exclude the Guarantor's ability to challenge the enforceability of the Guarantee based on defences otherwise available under the law and/or Fifth Street's failure to pursue other recoveries. The question of construction which arises is whether these exclusion clauses are valid under Ontario law.

Findings: expert evidence of Canadian law (applicable legal principles)

General

13. Mr. Duncan cautioned the Court to distinguish between those portions of the experts' evidence which properly addressed the content of the relevant Canadian/Ontario law rules and those portions of their evidence which applied those principles to the facts. I am not convinced that legal experts cannot properly opine on the construction to be placed on legal documents or steps which might have been taken in the foreign court. Of course, it is ultimately the function of the Court to critically assess the expert's evidence, and to apply the relevant rules of foreign law to the facts of the present case.

14. Both experts filed affidavits and were not required to give oral evidence.

The Plaintiff's expert

15. The Plaintiff's expert witness was Justice James Farley (retired), who was Supervising Judge of the Ontario Commercial List between 1991 and 2006 when he retired. Prior to that he studied law at Oxford and the University of Toronto, was a Commercial Solicitor for 20 years, was appointed Queens Counsel in 1982 and elevated to the Bench in 1989. He is internationally recognised, in particular, for his judicial work in cross-border insolvency cases. In his First Affidavit dated December 13, 2012, he opined that, *inter alia*:

    (1) a guarantor will be released from liability if, to his prejudice and without his consent, the creditor and the principal debtor materially alter the terms of the principal contract: *Manulife Bank of Canada-v-Conlin*[1996] 3 S.C.R.415; *Pax Management Ltd.-v-Canadian Imperial Bank of Commerce* [1992] 2 S.C.R. 998;

    (2) a change which is expressly authorised by the guarantor or contemplated by the contract will not release the guarantor from liability and a guarantor may through clear language be held to have validly contracted out of generally applicable legal protections: *Manulife-v-Conlin* (paragraphs 4-5); *Toronto Dominion Bank-v-Gottbank*, 2000 CarswellOnt2181 (paragraphs 15-16); *Equitable Trust Corp-v- Rose Corp*, 2011 ONSC 4239; K.P. McGuiness, '*The Law of Guarantee*';

    (3) absent a clear agreement to the contrary, if the creditor impairs the value of the security, the guarantor is entitled to be discharged from the guarantee to the extent of the prejudice suffered: *Pax-v- CIBC* (page 1020); *Bauer-v-Bank of Montreal* [1980] 2 S.C.R. 102; *Equitable Trust-v-Rose* (paragraph 92);

(4) the impugned assets sale was made pursuant to the approval of the US Bankruptcy Court and the Canadian Court which take into account the reasonableness of the sale. The Defendant was before the Court and did not object.

The Defendant's expert

16. Edward A. Sellars was the Defendant's expert witness. Called to the Bar of Ontario in 1989, he has been in commercial practice for nearly 25 years and appeared regularly before the Ontario Superior Court of Justice and Court of Appeal. A partner in the prominent firm of Osler, Hoskin & Harcourt LLP, he has also written and taught on, *inter alia*, insolvency and restructuring matters. Mr. Sellars expresses the following key opinions:

(1) the creditor does have a general duty to act in good faith and in a reasonable manner and this obligation cannot be excluded by a clause authorizing the creditor to act towards other persons generally in such manner as the lender deems fit: *Bank of Montreal-v- Korico Enterprises Ltd.* (2000) 50 O.R.(3d) 520 (Ont. C.A.);

(2) the guarantee must be interpreted in the context of the wider transaction as a whole: *Conlin* (pages 428-429); G. Hall, '*Canadian Contractual Interpretation Law*', 2nd ed. (Markham: LexisNexis, Canada 2012) (page 198 et seq), *Dumbrell-v- Regional Group of Companies* (2007) 85 O.R. (3d) 616 (Ont. C.A.) (paragraphs 53-54);

(3) it is "*open to Dobbin to argue that Fifth Street had an obligation to object to the Carve-Out and failed to do so*" (paragraph 37);

(4) without a full enquiry as to the surrounding circumstances of the guarantee, it is premature to decide whether the obligation to act reasonably and in good faith existed at all and, if so, whether it was fulfilled.

17. In his Second Affidavit of April 5, 2013, Justice Farley replied to the various points made in the Sellars Affidavit.

Material alteration of terms of contract of debt

18. I accept the opinion of Justice Farley, which was not challenged by Mr. Sellars, that where the creditor alters the underlying contract of debt to the prejudice of the guarantor without the guarantor's consent, the guarantor is entitled to be discharged

from liability altogether. This finding is supported by the following extracts from the judgment of Cory J (for the Supreme Court of Canada majority[1]) in *Manulife Bank of Canada-v-Conlin* [1996] 3 S.C.R.415:

> "*2 It has long been clear that a guarantor will be released from liability on the guarantee in circumstances where the creditor and the principal debtor agree to a material alteration of the terms of the contract of debt without the consent of the guarantor. The principle was enunciated by Cotton L.J. in Holme v. Brunskill (1878), 3 Q.B.D. 495 (C.A.), at pp. 505-6, in this way:*
>
> > *'The true rule in my opinion is, that if there is any agreement between the principals with reference to the contract guaranteed, the surety ought to be consulted, and that if he has not consented to the alteration, although in cases where it is without inquiry evident that the alteration is unsubstantial, or that it cannot be otherwise than beneficial to the surety, the surety may not be discharged; yet, that if it is not self-evident that the alteration is unsubstantial, or one which cannot be prejudicial to the surety, the Court . . . will hold that in such a case the surety himself must be the sole judge whether or not he will consent to remain liable notwithstanding the alteration, and that if he has not so consented he will be discharged.'*
>
> *This rule has been adopted in a number of Canadian cases. See for example Bank of Montreal v. Wilder, [1986] 2 S.C.R. 551, at p. 562.*
>
> *3 The basis for the rule is that any material alteration of the principal contract will result in a change of the terms upon which the surety was to become liable, which will, in turn, result in a change in the surety's risk. The rationale was set out in The Law of Guarantee (2nd ed. 1996) by Professor K. P. McGuinness in this way, at p. 534:*
>
> > *'The foundation of the rule in equity is certainly consistent with traditional thinking, but it is a fair question whether it is necessary to invoke the aid of equity at all in order to conclude that in a case where the principal contract is varied materially*

[1] Despite the somewhat misleading headnote to the report on this issue, the minority do not appear to have dissented on this issue of broad principle.

without the surety's consent, the surety is not liable for any subsequent default. Essentially, a specific or discrete guarantee (as opposed to an all accounts guarantee) is an undertaking by the surety against the risks arising from a particular contract with the principal. If that contract is varied so as to change the nature or extent of the risks arising under it, then the effect of the variation is not so much to cancel the liability of the surety as to remove the creditor from the scope of the protection that the guarantee affords. When so viewed, the foundation of the surety's defence appears in law rather than equity: it is not that the surety is no longer liable for the original contract as it is that the original contract for which the surety assumed liability has ceased to apply. In varying the principal contract without the consent of the surety, the creditor embarks upon a frolic of his own, and if misfortune occurs it occurs at the sole risk of the creditor. A law based approach to the defence is in certain respects attractive, because it moves the surety's right of defence in the case of material variation from the discretionary and therefore relatively unsettled realm of equity into the more absolute and certain realm of law. In any event, it is clear quite certainly in equity and quite probably in law as well, that the material variation of the principal contract without the surety's consent (unless subsequently ratified by the surety) will result in the discharge of the surety from liability under the guarantee.'

And further at p. 541, he wrote:

Where the risk to which the surety is exposed is changed, the rationale for the complete release of the surety is easily explained. To change the principal contract is to change the basis upon which the surety agreed to become liable. A surety's liability extends only to the contract which he has agreed to guarantee. If the terms of that contract (and consequently the terms of the surety's risk) are varied then the creditor should no longer be entitled to hold the surety to his obligation under the guarantee. To require a surety to maintain a guarantee in such a situation would be to allow the creditor and the principal to impose a guarantee upon the surety in respect of a new transaction. Such a power in the hands of the principal and creditor would amount to a radical departure from the principles of consensus and voluntary assumption of duty that form the basis of the law of contract.""

Lender's duty to act fairly and reasonably

19. I accept the opinion of Mr. Sellars that there is a common law duty on the part of a lender owed to a guarantor to act reasonably and in good faith in selling the secured assets. This, and not any wider general duty to act reasonably, is supported by *Bank of Montreal-v- Korico Enterprises Ltd.* (2000) 50 O.R.(3d) 520 (Ont. C.A.). the Court's judgment made reference to the "*common law duty to obtain a fair and reasonable*

price for the secured assets" (at paragraph [10]). The reference to a duty to act in good faith in the following passage from the same judgment relied upon by Mr. Sellars is also linked to the specific context of selling secured assets:

> "*[18] Admittedly, the language in question could be construed as authorizing the bank to wilfully, recklessly or negligently sell off the secured assets at bargain basement prices that bear no relation to their true market value. In theory, it could even be construed as authorizing the bank to give the securities away or destroy them. On the other hand, it can just as readily be interpreted as imposing a standard of reasonableness and good faith on the bank. Indeed, in our view, of the two possible interpretations, the latter accords with commercial reality and produces a much fairer result than the former. This is especially so when one considers that as against the company, the bank was required under the provisions of Part V of the PPSA to dispose of the secured assets in a commercially reasonable manner.*" [emphasis added]

20. Justice Farley rightly opined that no general duty on a lender to act reasonably exists. This view is supported by K.P. McGuiness, '*The Law of Guarantee*', 2nd edition (Carswell: Ontario, 1996) where the learned author states at paragraph 7.65: "*To say that a person may contract for rights but may only exercise them 'reasonably' would introduce a significant measure of uncertainty into contractual relations.*"

Legal consequences of lender breaching duty to act reasonably in relation to security

21. I find that the Defendant adduced no evidence in any event that under Ontario law the consequence of breaching the creditor's or lender's duty to act reasonably in its dealings with the secured assets is to extinguish liability under the guarantee altogether so as to render any demand based on the guarantee unlawful. Mr. Sellars does not assert that this is so.

22. The authorities placed before the Court suggest that breach of any such duty gives rise to no more than a potential defence (or cross-claim sounding in damages) to the quantum of the creditor's/lender's claim, which might or might not (depending on the degree of prejudice alleged on the facts of any particular case) justify a potential finding at trial that no monies were due under the guarantee. For example in the Korico case, upon which Mr. Sellars relied, the issues before the trial court were summarised in the Ontario Court of Appeal's Judgment as follows:

> "*[8] The company and the guarantors defended the action on the basis that the bank acted improvidently in the sale of the secured assets.*

> *According to the joint statement of defence and counterclaim, as of April 27, 1999, the assets for which the bank received $16,250 had a net book value after depreciation of $128,927. The company and the guarantors, therefore, maintained that the debt owed by the company would have been eliminated or substantially reduced had the bank taken reasonable steps to obtain a fair price for the secured assets.*"

Interpretation of exclusion clauses

23. It was essentially common ground between the experts that any clauses in a guarantee drafted by a lender purporting to exclude generally applicable protections for the guarantor must be clearly expressed with any ambiguities resolved in favour of the guarantor. I accept Mr. Sellars' assertion that the construction of any exclusion clause must be looked at in the light of the agreement and the wider transaction as a whole. As Cory J further opined in the *Manulife-v-Conlin* case:

> "*22.Even if it were thought that the principal debtor clause does not convert the guarantor into a principal debtor, the equitable or common law rules relieving the surety from liability where the contract has been materially altered by the creditor and the principal debtor without notice to the surety would apply, in the absence of an express agreement to the contrary. The question is whether in this case, either as principal debtor or as surety, the guarantor has expressly contracted out of the normal protections accorded to him. This question must be determined as a matter of interpretation of the clauses of the agreement, through consideration of the transaction as a whole, and the application of the appropriate rules of construction.*"

Findings: is the Defendant discharged from liability under the Guarantee because the Plaintiff materially changed or acquiesced in the change of the risks assumed under the Guarantee?

The position on the face of the pleadings

24. The Defendant's only pleaded defence is that the Plaintiff failed to take reasonable care in relation to the Principal Debts and materially altered the risk assumed under

the Guarantee by failing to object to the "Carve-Out" in the US Bankruptcy Court. On its face this plea discloses no reasonable defence under Ontario law because:

(a) I find that Ontario law recognises no general duty to take reasonable care in relation to the principal debts to which the Guarantee relates; and

(b) the Defence fails to allege two essential elements of a claim to discharge liability under a guarantee based on a material alteration of the risk:

(i) an agreement between the guarantor and the principal debtor,
(ii) absence of the guarantor's consent or knowledge;

(c) the Defence appears to conflate two distinct legal concepts:

(i) the discharge of liability altogether under a guarantee if a lender modifies the primary contract of debt with the principal debtor to a material extent by an agreement without the guarantor's knowledge and consent, and
(ii) the guarantor's right to claim in damages if the lender breaches its general duty to act reasonably in realising its security

25. So the Defendant's presently pleaded case does not support a finding that the demand made under the Guarantee was unlawful under Ontario law as I have found it to be based on the expert evidence before this Court. Accordingly, the preliminary issue must be resolved in favour of the Plaintiff on this ground alone. In the context of the Defendant's presently pleaded case, no need to consider the issue of contracting out arises.

The factual merits of the Defence

26. However, even if the formal pleadings are ignored and regard is had to the underlying facts, it is clear that no arguable basis exists for finding either (1) that the demand made under the Guarantee was unlawful, or (2) that the Plaintiff is liable in damages for breaching a general duty to act reasonably in relation to the realisation of the underlying security, based in either case on the Carve-Out, for the following principal reasons:

(a) on the face of the Sale Order, the Carve-Out did not impact on the assets of RIL and (by necessary implication) the Defendant's rights under the Guarantee;

(b) the Sale Order was made on notice to the Defendant while the Plaintiff had no commercial interest in relation to a sale of assets against which it had no security claim;

(c) the Sale Order was approved by the Ontario Court in a hearing the Plaintiff participated in and he raised no objections; and

(d) "*The sale was made pursuant to the approval of the U.S. Bankruptcy Court and Canadian Court, which takes into consideration reasonableness of the sale*" (First Farley, paragraph 48(b)(ii)).

Findings: the Defendant's application for leave to amend his Defence

The proposed amendment

27. The proposed amendment reads as follows:

> "*13A. Further or alternatively, the Plaintiff has further failed to:*
>
> *(i) take any (or any reasonable) steps to participate in the proceeds of sale of the of the Asset Sale as it was entitled to do pursuant to the Interlender agreement pleaded above at paragraph 8 of this Amended Defence, in particular, clause 7 of the Interlender Agreement; and*
>
> (ii) *take any (or any reasonable) steps to realise its security in the other assets of Repechage [RIL], in particular its pledge in respect of the shares held by Repechage other than that of the E & C Group.*"

28. The draft pleading was merely annexed to the Defendant's Summons dated June 14, 2013 with no supporting affidavit deposing to the factual merits of the proposed new allegations. The amendment appeared to me to be a last-ditch attempt to keep the Defendant's defence of the present application alive by raising issues which the experts had no chance to directly address; in circumstances where it was recognised that the pleaded case was hopeless.

29. Based on the findings already made above, the proposed amendment advances no arguable basis for supporting the Defendant's position on the present trial of the preliminary issue. Mr. Duncan orally advanced the argument that, if proven, the proposed new averments would establish a material change in risk, but the draft amendment fails to allege:

(a) an agreement between the Defendant and RIL which materially alters the risk assumed by the Defendant under the Guarantee, and which was;

(b) entered into without the consent and/or knowledge of the Defendant as Guarantor.

30. The failure to make the requisite allegations is unsurprising. The Guarantee was signed by the Defendant in Bermuda on September 28, 2009 and incorporated by reference the Finance Instruments which (including the Interlender Agreement) were signed by the Defendant himself on behalf of RIL on October 16, 2009. Pleas capable of supporting a legally tenable material alteration of risk argument are not advanced because no complaint is or can be made about the prejudicial impact of any 'secret' agreement between the Plaintiff and the principal debtor as the Defendant himself was both Guarantor and the principal of RIL.

31. It is well-settled that any amendment which is <u>not</u> liable to be struck-out on the grounds that, *inter alia*, it discloses no reasonable cause of action or is an abuse of process because it is bound to fail ought ordinarily to be allowed. It remains to consider whether the proposed amendment discloses a legally arguable alternative defence (i.e. a claim for breach of the Plaintiff's alleged general duty to act reasonably in relation to its security). Alternatively, the legal viability of the amendment turns on an analysis of whether the Plaintiff validly contracted out of the relevant duty so that the proposed defence is bound to fail.

<u>Does the draft amendment disclose a reasonable defence?</u>

32. I find that draft paragraph 13A fails to disclose a legally valid defence. There is no basis for finding that a general duty exists under Ontario law for lenders to exhaust their remedies in terms of realising security before enforcing their rights under a guarantee, for the reasons set out above.

33. Carefully construed, the proposed amendment does not allege breach of the recognised general duty to act reasonably <u>when actually realising security</u>. Rather, it alleges a failure to realise RIL's security and to recover other assets that are available pursuant to the Interlender Agreement.

34. I would refuse leave to amend accordingly. However, in case I am wrong in this conclusion I will nevertheless consider whether the Plaintiff validly contracted out of any duty to pursue other available collection remedies by way of security or otherwise.

Has the Plaintiff effectively contracted out of his alleged duty, as Guarantor, to act reasonably in relation to the security under Ontario law?

35. The general principles applicable to construing contracting out clauses were addressed by both legal experts. It is common ground that such clauses must be clear; however, the Plaintiff's expert suggests the relevant clauses are clear while the Defendant's expert suggests that this conclusion cannot safely be reached at this stage.

36. I accept Mr. Duncan's submission that one of the releases found in the Guarantee has substantially similar wording to that found to be ineffective in *Bank of Montreal-v- Korico Enterprises Ltd.* (2000) 50 O.R.(3d) 520. The wording in that case was, most significantly as follows:

> "*…the Bank may…otherwise deal with the Customer and all other persons…and securities, as the Bank may see fit…*"

37. This may conveniently be compared with clause 4.1(g) of the Guarantee: "*…Fifth Street may… g) otherwise deal with the Obligor and all other persons and securities as Fifth Street may see fit.*" It is substantially similar in terms.

38. However, the guarantee in *Korico* did not have an equivalent of clause 4.2 of the Guarantee which concludes with the following words: "*Fifth Street shall be under no obligation to marshall in favour of the guarantor any such security or any of the funds or assets Fifth Street may be entitled to receive or have a claim upon.*" Nor indeed was there in *Korico*, an equivalent of clause 9.1 of the Guarantee which states: *"The Guarantor further waives… any right to require Fifth Street to sue the Obligor, any other guarantor, or any other person obligated with respect to the Obligations or any part thereof, or otherwise to enforce payment thereof against any collateral securing the Obligations or any part thereof.*"

39. This wording is far more germane to draft paragraph 13A because of the nature of the allegation: the Plaintiff has acted unreasonably in failing to pursue alternative collection remedies against collateral securing the principal debt or the proceeds of sale of such collateral. The question of whether or not the Plaintiff has validly contracted out of its duty to act reasonably in relation to the realisation of its security does not arise on the Defendant's draft amended Defence.

40. In my judgment the quoted portions of clause 4.2 and 9.1 of the Guarantee, in the context of the contract as a whole and in light of the wider commercial context in which the Guarantee was concluded, are unambiguous in their terms and effect. The Defendant expressly waived the right to defend any claim brought under the Guarantee on the grounds that the Plaintiff could make a recovery from other funds it was entitled to or from RIL or any security provided by RIL for the principal debt. I

accept the opinion of Justice Farley to this effect: First affidavit, paragraph 17, Second Affidavit, paragraph 14. These clauses in no way abrogate the duty to act reasonably when actually realising security. They are simply designed to underpin the fundamental character of the Guarantee under which the Defendant is jointly liable with RIL, the principal debtor. When a default occurs, the Plaintiff is entitled to elect whom he sues, the Obligor or the Guarantor. And the Plaintiff's ability to enforce the Guarantee is not intended to be thwarted by potentially intractable and highly hypothetical contentions about other remedies which the Plaintiff might have pursued.

41. One of the related agreements which the Defendant himself was party to and which provided for how security recovered by the two lenders (GE and Fifth Street) would be allocated as between them, was the Interlender Agreement. Clause 11 provided in salient part as follows:

> "*GE and RIL and Dobbin hereby agree that Fifth Street and its officers, directors, employees and agents shall not be liable to GE or RIL or Dobbin for any error of judgment or for any action taken or omitted to be taken by them with respect to the exercise of Fifth Street's rights under the Fifth Street Security or any other document and the realization of Fifth Street's security interests in any of the assets or RIL, or Dobbin, including, without limitation, liquidation, sale, release or other disposition of such assets (except for the wilful misconduct or gross negligence of Fifth Street or its officers, directors, employees or agents).*"

42. This clause, found in an agreement executed as part of the wider transaction of which the Guarantee formed part, reinforces the clear intent of the corresponding releases granted by the Defendant under the Guarantee: Second Farley, paragraph 18. Moreover, it demonstrates clearly beyond serious argument that the Defendant agreed, in effect, that he could not advance the defence set out in draft paragraph 13A of the proposed Amended Defence, which seeks to complain about (i) the Plaintiff's alleged failure to participate in proceeds of sale available under the same Interpleader Agreement, and (ii) the Plaintiff's alleged failure to take any or any reasonable steps to realise its security in RIL.

43. So if, contrary to my primary finding that draft clause 13A does not disclose any reasonable defence at all[2], there was a general duty to act reasonably in relation to the lender's security, I would find that the Plaintiff did validly contract out of such duties under the Guarantee as read with the Interlender Agreement.

[2] Because under Ontario law there is no general duty for a guarantor to act reasonably in terms of pursuing alternative enforcement remedies against secured assets of the principal debtor.

Is the draft amendment liable to be struck-out on the grounds that it is bound to fail?

44. It follows that the proposed amendment is liable to be struck out on the alternative ground that even if the pleaded general duty does exist as a matter of Ontario law, the Plaintiff has validly contracted out of the duty and so the proposed new defence is bound to fail.

45. The Court always retains the discretion to allow a dubious amendment on the basis that it is premature to form any reliable judgment about the merits of a proposed plea. Not only is the proposed new defence very obviously either legally flawed or otherwise bound to fail. The proposed amendment had a distinctly hollow and artificial ring about it. There is no evidence before the Court, and the Defendant as RIL's principal would be best-placed to adduce such evidence if it existed, to the effect that RIL's security (or the proceeds of sale thereof) is in actuality available as an alternative source of recovery in any event. So no question of adopting the "wait and see" approach suggested by Mr. Sellars, the Defendant's expert, properly arises.

Conclusion

46. The question ordered to be tried as a preliminary issue of "*whether the Plaintiff's demand by letter dated 6th January 2012 in the sum of US$3,941,100.72 was lawful as a matter of Canadian Law*" is answered in the affirmative. The pleaded Defence to the effect that the Plaintiff materially altered the risk assumed by the Defendant under the Guarantee by not objecting to certain terms of a Sale Order made in consolidated bankruptcy proceedings to which the principal debtor was party and which the Defendant himself participated is both legally and factually flawed. The Defence raises no basis for extinguishing the Guarantor's liability altogether so that the Plaintiff's demand for payment would be unlawful as a matter of Ontario law.

47. The Defendant's application for leave to amend the Defence is refused because the draft amendment discloses no reasonable defence and, alternatively, the Plaintiff validly contracted out of the alleged duty in any event. Under the terms of the Guarantee and the related Interpleader Agreement, the Defendant clearly agreed not to resist enforcement of the Guarantee on the grounds that the Plaintiff ought to have pursued alternative remedies against the secured assets or their proceeds of sale.

48. The Defendant, having personally guaranteed business debts, has clearly decided to defend the present proceedings to the fullest extent possible on technical legal grounds. It is to his credit that he has carefully avoided misleading this Court by personally placing before it evidence which is in any way economical with the truth. And Mr. Dunch rightly submitted, in opening and closing his typically forceful oral arguments, that the lack of merit in the various arguments advanced on the

Defendant's behalf was "pellucidly clear"[3]. I will hear counsel as to costs and the terms of the final Order to be drawn up to give effect to the present Judgment.

Dated this 17th day of July, 2013 _____

IAN R.C. KAWALEY CJ

[3] Mr. Dunch expressly credited this phrase to the late Julian Hall (of the Bermuda Bar). The phrase has more recently attracted attention in England when used by Robert Jay QC (now Mr. Justice Jay) while cross-examining in the course of the Leveson Inquiry: '*Robert Jay delivers another English lesson at the Leveson inquiry*', '*The Guardian*', May 31, 2012.